

# FINAL TRANSCRIPT

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**BWS - Q4 2010 Brown Shoe Company, Inc. Earnings Conference Call**

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*Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

### **Ron Fromm**

*Brown Shoe Company, Inc. - Chairman of the Board and CEO*

### **Diane Sullivan**

*Brown Shoe Company, Inc. - President and COO*

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*BB&T Capital Markets - Analyst*

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## PRESENTATION

### **Operator**

Good morning. My name is Sarah, and I will be your conference operator today. At this time, I would like to welcome everyone to the Brown Shoe fourth quarter and full year 2010 results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions). Thank you. Mr. Mark Hood, Chief Financial Officer, you may begin your conference.

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Thank you, Sarah. Good morning, everyone. Thanks for joining us today for Brown Shoe's fourth quarter 2010 financial results conference call. This call is being made available to the public via webcast.

Our remarks today contain forward-looking statements, which are not historical facts and are subject to a number of risks and uncertainties. Actual results may differ materially. Please refer to today's financial press release and our SEC filings for more information on risk factors and other factors that could impact forward-looking statements. Copies of the Company's reports are available online and from the Company's Investor Relations department. The Company undertakes no obligation to update any information discussed in this call.

Joining me on the call today are Diane Sullivan, President and Chief Operating Officer, and Ron Fromm, Chairman and Chief Executive Officer. I'd now like to turn the call over to Diane.



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**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Good morning, and thank you for joining us. I'll begin with highlights of our fourth quarter and full-year performance, as well as review our priorities as we begin 2011. Mark will then take you through our financials and outlook in more detail, and as always, we'll open the call for questions and answers following our remarks.

2010 marked a solid year for Brown Shoe. We are pleased with our accomplishments and continue to be focused on the opportunities we see ahead. The year included record sales that surpassed \$2.5 billion for the first time, representing a 12% increase versus 2009, and we also delivered adjusted EPS of \$0.97, more than double the prior year, despite challenges faced in the fourth quarter that resulted in a \$0.03 miss at the low end of our expectations. Included in these results were many outstanding accomplishments, a record year at Famous Footwear driven by a 10.5% same store sales increase, 4 consecutive record quarterly sales results, including a 4.9% comp in the fourth quarter, as well as Famous' best ever back-to-school and Black Friday performances.

In fact, Black Friday was our biggest single day and kicked off the biggest weekend ever at Famous Footwear. And we made solid progress on our productivity goals, delivering sales of \$187 per square foot versus \$167 last year. And Famous also doubled its operating profit versus last year with a record \$90.4 million, ending with an operating profit rate of 6.1% versus 3.3% last year. Our e-commerce net sales topped \$120 million during the year, with 21% increases for both the year and the fourth quarter, including record results on Thanksgiving Day, Black Friday, and Cyber Monday. And, we continued to develop new ways to integrate our online and in-store experiences with our consumers to drive greater engagement.

Wholesale sales for the year increased 19.4%, including a 15.1% increase in the fourth quarter, and during the year we saw increases across nearly all of our major brands, Dr. Scholl's, and our contemporary fashion brands generated annual net sales gains over 20%, and Naturalizer delivered a high-teens increase in Wholesale net sales and in doing so, the Naturalizer family of brands ranked third across all channels, according to NPD. Additionally, Naturalizer on an all-in basis had a very good year, with total sales increasing 14.4% for the year and 11.9% in the fourth quarter, including solid comps at retail of 7.2% and 3.8%, respectively. And Naturalizer retail generated an operating profit of \$1 million on the year, something that we haven't been able to say for a while, and we believe that we can continue to drive improved results from the store base as we apply the same portfolio disciplines that we've implemented at Famous Footwear.

We also made great strides in the quality and execution of our marketing. We have discussed all year the increased investment we made at Famous Footwear, and you can see the impact in our traffic levels, conversion rates, which increased over 10% versus last year, and in connecting consumers to our store online and social media experiences. And we also enhanced our portfolio. First, when we completed the Edelman acquisition back in June, solidifying one of our key assets in the contemporary fashion space, and a month ago we announced the acquisition of American Sporting Goods, which will add well-known athletic brands to our portfolio, with Avia, ryka, and AND1.

Clearly, there was much to be pleased with during the year, and we made a lot of progress on several fronts. But we weren't without our challenges. While our retail businesses continued to perform well in the second half of the year, our Wholesale businesses faced a challenging sourcing and supply chain environment. As we worked hard to keep up with the surge in demand for our brands at retail, and as a result of these challenges, we experienced increased delivery costs, and our on-time deliveries decreased, which in turn meant less selling time on the floor and greater markdown, chargeback, and liquidation pressure.

These pressures increased in the fourth quarter with the complexities related to our systems migration to SAP's apparel and footwear solutions, which went live on the first of December. As you know, these large systems implementations are challenging and complex, and they involve significant underlying business process change. It affected everyone and everything across our Wholesale platform, and we applied enormous effort and resources to limit disruption and believe this portion of our implementation went better than most.



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After the cutover, we never stopped shipping product and have continued operating our business without significant interruption since go-live. It took 60 days and 100% of everyone's attention to ship the shoes that got out in the quarter. It was a tremendous effort on everyone's part, of so many people, and not just over the last 60 days, but really for the past year, and we're appreciative of their hard work and perseverance.

So while sales were up 15% in the quarter, this increase fell short of our expectation of a roughly 20% increase. And as you would imagine, the transition impacted the near-term level and quality of fulfillment for some of our customers, resulting in some late shipments and cancelled orders, some visibility and reporting inefficiencies, and diminished productivity due to retraining requiring significant overtime from going to essentially a seven-day operation. All of this led to lower than expected gross margins in our Wholesale business in the second half and in particular in the fourth quarter.

As we speak now in mid-March, we are much closer to our historic pace of shipping efficiency, and we believe the most significant hurdles are behind us and are confident that our upgraded system and supply chain will significantly benefit our business in the longer term. That said, we expected to continue to experience some effects of the systems implementation in the first half of 2011, as we do many tasks for the first time under the new processes. So, as a result, we are forecasting our Wholesale business cautiously, as we work through our systems conversion, and our guidance reflects that thought process.

Now, turning for a moment to 2011. We are pleased with our strategic positioning against many of the most important consumer trends, and our brands continue to resonate strongly with consumers. At Famous Footwear, we have targeted same store sales growth in the low to mid single digits in 2011, following double-digit gains in 2010, with operating income growing faster than sales. Our quarter-to-date comp results are positive, despite the impact of extreme weather across the country earlier in the quarter. And our confidence is supported by the fact that our hot and warm markets are performing at a rate significantly above the Company average for month-to-date.

Toning footwear continues to sell well at Famous as well, though down, and as expected from the pace and average retail levels achieved at its peak in 2010. You know, we've discussed numerous times the opportunity for new lightweight and technical running product to offset this volume. The good news is that our early indications on this are very positive, and we're confident that these categories will not only fill the gap but will provide additional growth. And for the first 6 weeks in the quarter, toning and running combined were equal to the same levels in the same period last year. And importantly, the addition of toning product and now with lightweight and technical running, has both broadened our customer base and also validated that Famous Footwear can be a destination for more premium priced product. At Wholesale, we expect our portfolio to continue to gain market share, built on the enhanced product innovation and trend-right styles, and we're excited about the potential for the opportunities for our newly-acquired brands.

Underscoring our confidence for the enterprise in 2011 is our annual guidance. That includes a low double-digit increase in consolidated sales with low to mid single-digit growth in our legacy business and the addition of ASG, which is expected to contribute more than \$200 million in sales. And, EPS of \$1.25 to \$1.32, inclusive of both the accretion and the costs related to the ASG acquisition.

And now I'd like to turn the call over to Mark for review of our financials in a little more detail.

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Thank you, Diane.

As you can tell from Diane's remarks, we've been busy over the last quarter. Let me help you understand some of the details. I'll begin with a review of the consolidated financials and insights from our segment performance in the quarter.



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Consolidated net sales were \$604.5 million, an increase of 6.8%, compared to \$566 million in the fourth quarter of 2009. The drivers of our sales performance were a 4.9% same store sales increase at Famous Footwear, which follows a 9% increase in the fourth quarter last year. Famous Footwear sales were fueled by low single-digit increases in traffic and AUR and a mid single-digit improvement in our conversion rate. Famous Footwear sales were up across all genders, channels, and geographies. Boots were a key driver across genders, and women's running, casual, and juniors were also key contributors. Importantly, sales of non-toning product was up 3.9% on a same store basis.

During the quarter, we opened 10 new Famous Footwear stores and closed 18 existing locations, ending the year with a total of 1,110 stores versus 1,129 stores last year. For the year, Famous opened 32 stores while closing 51. Diane mentioned the improvements we have made in our store productivity, with sales per square foot of \$187 in 2010. We continue to apply discipline to the management of our store portfolio, opening stores generating \$200 plus per square foot and closing stores at averaging of \$130 or less. We think we can approach \$200 per square foot in 2011 and have set our sights on \$225 over the next few years.

Specialty Retail net sales increased 4% in the quarter, driven by a 3.2% same store sales increase. Our retail numbers were supported by a 21.1% increase across our e-commerce platform, as we focus on engaging her, whether she shops online, in store, or both. These results were driven by a 16% increase in site visits and an 8.5% increase in conversion rate.

At Wholesale, sales increased 15.1%, down approximately 500 basis points from our prior expectations for the quarter. The key drivers were the continued strong growth of our contemporary fashion brands, with sales increasing in the mid-20s during the quarter, and a solid performance from Naturalizer, which had a high single-digit increase in Wholesale sales. Dr. Scholl's sales were down in the mid single digits in the quarter, which follows a 35% increase in last year's fourth quarter. As we have discussed, there's been some unevenness in comparables for this brand during the year, as we transition its business model from a predominantly first-cost business serving the mass channel to a tiering of the brand to serve other channels on a landed basis, much the same we have grown the Naturalizer brand family.

Consolidated gross profit increased by \$2.9 million versus the fourth quarter last year. On a rate basis, our gross profit was 38.9%, compared to 41.1% in the fourth quarter last year. Famous Footwear and Specialty Retail added approximately 30 basis points to the consolidated rate in the quarter, with Famous improving its gross profit rate by 50 basis points. This was the result of strong performance from higher margin categories, including boots, which saw nearly a 17% increase at nearly a 50% gross margin, as well as operating with 33% fewer store BOGO days than in the year-ago period. For the full year, Famous operated with 44% fewer store BOGO days. Specialty Retail also saw an improvement of 30 basis points, with a gross profit rate of 40.6%.

Wholesale had a negative 230 basis point impact to the consolidated rate. The decline in Wholesale gross margins were greater than we had expected based upon our third quarter results and again resulted from shifts in brand and channel mix, higher markdowns and allowances, and increased claims activity. Additionally, we estimate that go-live related issues lowered Wholesale gross margins by approximately 90 basis points.

Mix also had a slightly negative impact on consolidated margins, due to the better than Company average sales increase at Wholesale, with Wholesale sales representing 29% of total sales in the fourth quarter versus approximately 27% in the fourth quarter last year. Selling and administrative expenses increased by \$8.9 million to \$226.9 million, improving by 110 basis points on a rate basis to 37.5% of net sales. This was primarily the result of leverage on fixed retail facilities, which was offset by increased marketing investment of \$3.4 million in the quarter, as well as increased store selling expenses at Famous Footwear.

Throughout the year we have discussed the impact of our investment in marketing, as well as the impact of increased incentive compensation on operating results. For the year, the aggregate increase in marketing and incentive costs totaled \$29 million, down slightly from our previous estimate, due to the lower than expected results in the fourth quarter and its related impact on incentive compensation. As a reminder, we will reset the bar on incentive comp in 2011 and plan to hold our marketing expense to a flat rate of sales compared to 2010.



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To update you on 2010 anomalous costs, we have adjusted our previous number from \$21 million to \$13 million or \$0.19 per share now that we have completed our bottoms-up planning and closed the books on 2010. This consists of \$6 million in incentive compensation, \$2 million of air freight, as we now expect some increase in air freight from historic levels, and \$5 million from other costs. Net restructuring and other special charges were \$2.5 million in the fourth quarter and were related to our IT initiatives, as well as transaction costs related to the acquisition of American Sporting Goods. This compares to net charges of \$5.1 million last year.

Net interest expense in the quarter was \$5.3 million, roughly flat to last year. We had a tax benefit in the quarter of \$2.6 million, which was primarily related to the mix of earnings in the quarter, as well as a reduction in our state tax rate. As a result, net earnings in the fourth quarter were \$3.4 million or \$0.08 per diluted share versus \$5 million or \$0.12 per diluted share in the year-ago period. Adjusted net earnings in the fourth quarter were \$5 million or \$0.11 per diluted share versus adjusted net earnings of \$8.1 million or \$0.19 per diluted share in the fourth quarter last year.

Moving to our balance sheet. We were net borrowed by \$71.5 million at year-end versus a net invested position of \$31.3 million at year-end last year, and we had \$171.6 million in availability on our revolving credit facility. Our borrowed position at year-end relates to working capital investments and the completion of the Edelman Shoe acquisition during the second quarter. Long-term debt outstanding at year-end was \$150 million, same as year-end last year.

In January, we extended our revolver to January 2016 and amended other terms to lower pricing and expand flexibility. Since the end of the fiscal year, we acquired American Sporting Goods for approximately \$150 million and used the designated event accordion feature in our revolver, which increased our borrowing capacity to \$530 million, in order to finance the acquisition. The revolver also maintained an additional accordion feature for an additional \$150 million. We feel good about our financial position and future financing flexibility. We continue to monitor market conditions and anticipate we'll refinance existing senior notes in the first half of 2011.

Total inventory at quarter end increased 14.8% to \$524.3 million. The increase was driven by a 7.8% increase in inventory levels at Famous Footwear. Inventory ex-toning is down 1.9% on a per store basis. In 2011, we are focused on improving inventory turn and expect to operate with less inventory on average. Wholesale division inventory was up 51.6% year-over-year. It's important to note, however, last year inventory levels were down 28%, so on a two-year basis, it's up only about 18.5%, in line with our year-to-date sales increase of 19.4%.

Factors resulting in an increase are the support of our new and growing businesses such as Sam Edelman, Nia, and Vera Wang, accelerated flow of spring inventory to mitigate some of the ongoing sourcing and capacity issues in the supply chain, as well as to manage through our systems transition. The balance relates to the Dr. Scholl's transition from a predominantly first-cost business to a landed business, as well as inventory in support of our backlog for our remaining brands. While inventory is up, aging is consistent with prior years. We expect our Wholesale inventory levels in 2011 to be up mid single digits on average, excluding ASG. Capital expenditures for purchases of property and equipment and capitalized software in the fourth quarter totaled \$13.9 million, with spending primarily on new stores and remodels and our IT initiatives. Full-year CapEx totaled \$54.8 million.

Shifting to our outlook for 2011, as Diane said, we expect net earnings per diluted share in the range of \$1.25 to \$1.32 on a GAAP basis for the full year. This includes \$0.10 to \$0.12 per share in accretion, offset by \$0.12 to \$0.15 in acquisition-related costs, due to inventory related purchase accounting and transaction and integration costs related to our ASG acquisition. The flow of earnings in 2011 will be more weighted to the back half than normal, as we both anniversary a strong first half in 2010 and incur integration costs related to ASG and system startup issues in our legacy Wholesale business.

Additionally, in the first quarter we expect increased marketing costs of approximately \$5 million, an increase of more than 30%, excluding ASG. Consolidated net sales for 2011 are expected to increase in the low double-digit range, which includes an increase in same store sales at Famous Footwear in the low to mid single digits following last year's 10.5% comp. Also included in the outlook is a plan for 5 net new openings, with 45 openings and 40 closings.



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For the first quarter, we expect same store sales to increase in the low single digits, which follows last year's very strong 15.5% comp store increase. We expect Wholesale net sales, excluding the impact of ASG, to grow in the low to mid single-digit range for the year. ASG is expected to contribute more than \$200 million in net sales. For the first quarter, we expect Wholesale net sales to increase by high teens, led by the addition of ASG, as our legacy brands will be flat to down as we anniversary the launch of Dr. Scholl's toning last year.

Consolidated gross margins are expected to be flattish for the year, with retail margins mostly in line with 2010 and a higher mix of Wholesale business offset by improved Wholesale gross margins. Excluding ASG, Wholesale margins in 2011 are expected to expand by 100 to 150 basis points, as we recover from some of the issues we faced in the fall of 2010. We would expect first quarter gross margins below last year, as we transition through certain startup issues from our systems conversion.

ASG brands are expected to add approximately 50 basis points to consolidated margins, excluding the impact of purchase accounting. In addition, our fiscal 2011 -- excuse me. 2011 expectations include an effective tax rate of 33.5% to 34% and net interest expense in the range of \$27 million to \$29 million. This assumes a mid-year refinance of our existing senior notes and that \$50 million of the ASG purchase price is financed by notes. Depreciation and amortization of capitalized software and intangible assets are expected to total \$62 million to \$64 million for the full year. This includes the first full year of amortizing the Wholesale portion of our SAP implementation and our preliminary estimates on the amortization of intangibles associated with the ASG acquisition. Purchases of property and equipment and capitalized software are targeted in the range of \$58 million to \$60 million.

I'd now like to turn the call back to Diane.

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**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Thanks, Mark.

And just before we turn the call over to questions and answers, I did want to summarize and say that we really did make significant progress in 2010, and we fully expect to do so again in 2011. Famous Footwear will continue to benefit from the strategic investments we've made to generate those increases in traffic, conversion rates, brand perception, and new customer acquisitions. And our e-commerce and our dot-com and multi-channel and mobile businesses will continue to gain traction as we allow the customer to shop when and how they'd like to shop. And our Wholesale business will again show market share gains, and we'll improve the gross margin performance while at the same time that we complete the AFS implementation.

You know, the toughest thing in this business is to really get the consumer excited about your products and your brands, and this year we really demonstrated that we could do this. So while it's not going to be easy, and it's hand-to-hand combat and we've got some things to overcome, I have a lot of confidence in our leadership team. And collectively, we are really committed to achieving the targets that we've set out for 2011.

So with that, I'd like to open up the call to questions and answers.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). We'll pause for just a moment to compile the Q&A roster. Your first question comes from the line of Scott Krasik with BB&T.



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**Scott Krasik** - *BB&T Capital Markets - Analyst*

Thanks. Hello, good morning, everybody.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Good morning, Scott.

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Good morning, Scott.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

Diane, just -- I know you haven't given any quarter-to-date comps at Famous, but given the weather issues you had early in the quarter and since Easter comes later than last year, is it safe to say that you're expecting comps to improve throughout the quarter? And is it also correct in my thinking that comps are probably below where you guided the quarter to at this point?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

We definitely expect comps to continue to improve through the quarter. We like the fact that it's a later Easter. We really like the visibility that we have in our hot and our warm zones. We love seeing what's going on with running and toning. So all of the indications so far in the quarter feel very good to us as it relates to Famous Footwear.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

Any comment about how they're running relative to the guidance?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Right now, we are running positive.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

Okay.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

I would say. Positive comps.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

Thanks. That's helpful, actually.

And then in the Wholesale business, a lot of moving parts here.



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**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

The increase in your inventory, though, at year-end, that didn't include ASG.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

No.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

So just maybe -- because it looks like your guidance at least for first quarter Wholesale sales ex-ASG are probably down, so you talk about what this inventory is that you brought in earlier. Is this inventory that you expect to sell not until the fall? Is this inventory that will sell later in the spring? Help us to understand how we add up that 50% increase in Wholesale inventory and likely a down Wholesale plan ex-ASG.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

No problem, Scott. That inventory we definitely expect to sell through the spring season. We brought in goods early due to supply chain issues and to support the growth that we saw in the development of a lot of our new businesses. And as Mark, I believe, mentioned on the call, that when we look at our aging, it's very much in line with where we've been in the past. So while it's certainly a little more than we would like to have, we think that -- we don't see any issue with that as we move through the next quarter or two.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

Okay.

And Mark, just your commentary about some of those anomalous costs, so to speak. Is that the difference between what the guidance of \$1.30 to \$1.50 was versus now trying to parse out on an apples-to-apples basis the new guidance?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Well, again, it's a subset, the anomalous cost rise, I'll call it a reconciler or help to understand how you would grow from the \$0.97 to I'll call it a normalized cost base in 2010, from which you would then grow earnings in 2011. Again, our prior guidance had been that our legacy business would grow from \$1.33 to \$1.44. And so from that you have to take the \$0.12 to \$0.15 of costs relative to the acquisition and add on the \$0.10 to \$0.12 of accretion, so net-net the prior guidance was lowered by \$0.04 to \$0.08 on the range.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

That's coming from your corporate costs, or that's coming from Wholesale?



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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

The anomalous costs?

**Scott Krasik** - *BB&T Capital Markets - Analyst*

Right, those are corporate costs, right?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

They would be across the enterprise. We allocate incentives across the enterprise.

**Scott Krasik** - *BB&T Capital Markets - Analyst*

Okay. So it would be your--Okay, I got it. That's it. Thanks, guys.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Okay, Scott. Thanks.

**Operator**

Your next question comes from the line of Chris Svezia with Susquehanna Financial.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Good morning, everyone.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Good morning. Hi, Chris.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Hi. Just on the -- Diane, the comments you made, Famous Footwear comps this year, low to mid single, you expect operating income to grow faster than sales; correct?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Correct.

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**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

And the comment that you made about toning so far in terms of what you're seeing, toning -- and you threw in a comment about running. Is it fair to say when you look at athletic, it's comping with toning in it, or no? I'm trying to understand where your athletic silo is right now with toning in it. Is it up or down year-over-year?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

With toning in, it's comping slightly up.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay. So with toning, it's comping slightly up. So some of the stuff that you're doing on the running side is helping to mitigate the pressure on toning?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Exactly. As we had mentioned at least in the last 90 days, that was our game plan. We really felt that lightweight running and technical running could help fill that hole in the toning category, and everything that we see up to this point in time only makes us more confident that we've made the right choices around that. So we're feeling good about it, Chris.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay.

And then I guess Mark, just help me out here a little bit on -- I'm trying to understand the puts and takes here, when you guys talk about margin trend first quarter, it seems like overall consolidated is below last year's level. But then you made some comment about ASG adds roughly 50 basis points to consolidated. Is that gross margin or overall margin? I'm trying to figure out the puts and takes in the first quarter.

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Sure, Chris. The 50 basis points would be on an annual basis the impact that ASG has to consolidated margin rates by, I'll call it, raising the average margin of our Wholesale business. And that comment was made excluding, I'll call it, the purchase accounting write-up that will turn out over the first two quarters.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay. So that's 50 basis points to the Wholesale consolidated gross margin for the year, before purchase accounting; correct?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Correct.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay. All right. I got you there.

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Could you -- I'm curious, could you please give us -- I'm trying to reconcile on the Wholesale side of the business, the legacy piece.

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**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes.

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**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

What's the backlog look like at this point, given also the puts and takes and what impact some of the returns and things of that nature have had on that backlog track?

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

It's a good question, Chris. Again, our backlog, we didn't mention it on the call.

I think one of the issues we have in terms of comparability of reporting and the old systems and the new systems is visibility of that number. Our backlog is in support of our guidance of flat comps in the first quarter. But there's been some timing impacts on all of that stuff as we battled the new system.

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**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay. All right. Can you give us any sense as to how we think about growth in each one of those business, contemporary brands, Dr. Scholl's, Naturalizer or -- for the year, I mean if you want to put it in that context, in terms of at least as far out as you can see, do they all grow? Are some down, up?

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Sure. So again, I think we would expect contemporary brands to again lead the way with probably high single-digit increases across contemporary, across that group of contemporary brands. We would expect Naturalizer to be in the mid singles in terms of growth. Dr. Scholl's actually flat to down slightly as we move through the transition in that brand from -- and try to anniversary the toning product from a year ago.

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**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay. All right.

And the last thing I have here at the moment, just go back to the fourth quarter for one second. I guess the one thing that surprised me, I mean, you did miss a little bit on the top line, comps were a little bit below plan, and I guess the Wholesale a little below plan. But the bottom line EPS wasn't too far off, I guess, from what you had thought. But there seems to be a pretty significant tax income benefit. So it seems like the EBIT number was a bit short of what people were looking for. I'm just trying to think about as we move forward, is there anything we should be aware of, whether on the tax rate or tax income benefits, that's embedded into your EPS number that we're not aware of at this point?

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

I don't think there's anything -- I'll speak to the fourth quarter in a second. Again, we guided the tax rate at 33.5% to 34% for 2011. Again, in the fourth quarter you settle out all of your, I'll call it estimates of taxes for the year, settle out in the fourth quarter. Obviously, our annual effective rate came down a bit in the fourth quarter as our full year, I'll call it assumptions, of the mix of earnings realized change as a result of the fourth quarter miss in Wholesale. And then we had some adjustment as a result of the lower state tax rate, which would not be unusual.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay. But as long as we look at 2011, there shouldn't be -- as far as you can see at this point, it's pretty plain vanilla at this point, the tax rate; correct?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

That's correct.

**Chris Svezia** - *Susquehanna Financial Group / SIG - Analyst*

Okay. All right. Thank you very much, and best of luck. Thanks.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Thanks, Chris.

**Operator**

Your next question comes from the line of Jeff Stein with Soleil Securities.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Good morning, everyone.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Hi, Jeff.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Diane, trying to understand a little bit better this -- the supply chain and sourcing issues and separating that from the systems issues. And I'm wondering, where are you in the fix on each of those problems that you experienced in the fourth quarter? And maybe you can give us some sense in terms of what costs that you expect might be incurred to, I guess, get the systems issue corrected. Because I'm wondering if that perhaps might be another anomalous cost that rolls into the new fiscal year that perhaps we might be underestimating.



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**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes. Well, let me try to separate a couple of the questions there, Jeff.

First of all, let me talk a little bit about the sourcing and supply chain question that you had. As you know, it was a tough year for lots of different folks in the industry as demand surged and factory capacity was tight. We experienced those same issues, and when I take a look at our on-time delivery, we historically deliver somewhere in the 96%, 97% rate. And in the third quarter, we had a low of about 83%, and in the fourth quarter of 2010, we were back up to 94%. So we really see that timing and our on-time is moving back in the right direction as we've course corrected and done the appropriate things that we needed to do within our supply chain. So I think that is largely behind us. So that's what I would say on the supply chain.

With respect to the systems implementation, again, we went live on December 1, and we went live across the entire Wholesale platform. We had basically those first 60 days to deliver and ship the 15% increase that we did ship. And as we really look at kind of our current cadence of shipping and where we believe we're at, we think that we're really very much now at the -- sort of the normal natural level of what -- where we have typically shipped and the costs associated, et cetera. So we don't really see any issues there. The big question really comes back to when you ship to one of these -- to these systems, it really comes back to the new processes that you're putting in place across the platform and, I guess you'd say, the learning that all the associates have to go through in order to make sure they understand how to operate the system. So while we won't be complete through that really until the end of this spring season, we do believe we're largely behind any of the shipping and that anomalies we've had up to this point in time.

So, Mark, I don't know about costs, how you might want to comment on that.

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Sure. Again, just back specifically on the margin piece of that, we had mentioned that the Q4 impact of the systems piece was about 90 basis points, and we would expect a comparable amount in the first quarter. But -- and I think in terms of incremental costs, I think that while they had some impact in the fourth quarter, we wouldn't anticipate those incremental costs in terms of warehouse efficiency, et cetera, to stay on-board in the first quarter.

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**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Okay.

And a follow-up. Is the -- does the systems issue in any way complicate the integration of ASG this year?

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**David Meyer** - *Brean Murray, Carret & Co. - Analyst*

No. We will not integrate ASG until we've got the AFS system stabilized, which we believe after the first six months of this year we'll be at a position to be able to do that, towards the back half of the year.

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**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Got it.

Diane, which brands were most impacted by the late delivery issue in the fourth quarter?

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**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Probably, let's see, Sam Edelman was probably one that was impacted in the third and fourth quarter. Franco was certainly impacted a bit during that time period. And actually, even Aigner was impacted. Those would be the biggest ones.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Okay.

And just this final question. Number of BOGO days that you're planning for Famous Footwear in first quarter this year, compared to last?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

No, none.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

So, no more.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

No more.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

And no fewer?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Right.

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Clarify that. We're planning zero BOGO days in the first quarter.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Got it. And last year?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

About five weeks.

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**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Okay. Thanks a lot.

**Operator**

Your next question comes from the line of Jill Caruthers with Johnson Rice.

**Jill Caruthers** - *Johnson Rice & Company - Analyst*

Good morning.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Good morning.

**Jill Caruthers** - *Johnson Rice & Company - Analyst*

Could you talk about Famous Footwear fourth quarter revenues and comps missed plan. I know you had mentioned weather. Was there anything else that was weaker than what your projections were?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

No, I think it would really be that we probably missed by our calculations probably about a point and-a-half of sales relative to weather.

**Jill Caruthers** - *Johnson Rice & Company - Analyst*

Okay. So probably November, December was running on plan and then January, you felt the hit from the weather?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes.

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Right.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes.

**Jill Caruthers** - *Johnson Rice & Company - Analyst*

Okay.

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Could you talk about the seasonality of the ASG revenues per quarter? Would it be easy just to model similar to kind of your core legacy Wholesale business?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Again, I think that -- give me a second to study my sheet here, because I don't have that one memorized quite so much. I'd tell you, it's relatively similar to our legacy business, but I'd just remind you that we -- it will be a short first quarter. So the impact in the first quarter will be a little light from a spread point of view. Because we bought it a couple weeks into the quarter.

**Jill Caruthers** - *Johnson Rice & Company - Analyst*

Okay. Okay.

And then could you just address the kind of -- just reiterate kind of your outlook on product cost inflation in the back half and ways you're looking to mitigate that pressure?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes. We haven't really changed our perspective on that, Jill. We've been talking about 5% to 10% increases in input costs and it, again, depended on what channels of distribution and what price points. We have been doing this, same as we've been discussing, to mitigate those costs. We've been taking prices up in some cases on the brands where we can do that and where we believe we're delivering the right kind of product value. We've been also moving, again, our sourcing to new factories and new locations in order to help with those costs.

And then also, with our new supply chain system, we've also been able to make sure that we're buying leather and other component costs at more favorable prices than where we had in the past, just because we have better visibility to kind of our costs there as well. So it's been a combination of a lot of different things to address the back half of the year.

**Jill Caruthers** - *Johnson Rice & Company - Analyst*

Appreciate it. Thank you.

**Operator**

Your next question comes from the line of Steve Marotta with CL King.

**Steve Marotta** - *CL King & Associates - Analyst*

Good morning.

Very quickly. I missed it. You mentioned that EPS would be more back half weighted for three reasons. And I got strong comparisons, and I missed the other two.

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

One, you would have the, I'll call it the impact of ASG integration and purchase transaction costs, along with the purchase accounting, which will impact the first two quarters, primarily. As well as we said we would have some ongoing impact in the first quarter, in particular, first half of our systems conversion in our legacy Wholesale business.

**Steve Marotta** - *CL King & Associates - Analyst*

Okay.

And lastly, can you talk about toning ASPs and your current toning inventory, where you stand there and how you feel about it going from 1Q to 2Q to 3Q end?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes, we -- again, as I mentioned, we feel very good about our current performance and velocity at retail for toning. Our inventories are at, I believe, 12% right now, and we expect by the end of the first quarter or so to be down at roughly 7%, very in line with the 5% or so percent of total business that we expect it to be in the year.

**Steve Marotta** - *CL King & Associates - Analyst*

Okay.

And how are ASPs trending in the category?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Right now, they're running at about \$60.

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

\$62.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

\$62.

**Steve Marotta** - *CL King & Associates - Analyst*

And that compares to how much a year ago?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

\$90. \$90 and change.

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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Mid-\$90s, yes.

**Steve Marotta** - *CL King & Associates - Analyst*

Okay. Thank you very much.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

No problem, Steve.

**Operator**

Your next question comes from the line of Jeff Stein with Soleil Securities.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Just a quick follow-up, guys.

Wondering, there's been a lot of discussion in the industry about how retailers are going to be planning their inventories for fall. And I'm just kind of curious, as you see your order book shaping up at the moment, are your retail accounts buying in units or dollars or both? And maybe you can talk a little bit about how you kind of see that sensitivity analysis shaking out.

**David Meyer** - *Brean Murray, Carret & Co. - Analyst*

Well, I would say that, generally speaking, people are really trying to balance both their view of units and dollars. It's not either one way or the other. I think it really depends, again, based on channel of distribution brand and category.

But generally speaking, I would say that people are trying to maintain, keep inventories a little bit tighter than we did last year. We were in a market that was really expanding, where there was a tremendous amount of pent-up customer demand for the categories. And as we turn to this year, I think everybody's a little more cautious about that. Who knows where gasoline prices are going, and you name it. So I think everyone's playing it a little bit more cautiously, Jeff.

**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Okay.

And Diane, you guys have indicated that marketing spend is going to be up about \$5 million in the first quarter. Can we then assume for the balance of the year, marketing spend as a percent to sales will probably be down?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Our plan was for the total year for it to be flat to last year at Famous and up in the first quarter and then down a little bit through the rest of the year.

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**Jeff Stein** - *Soleil Securities, Stein Research - Analyst*

Got it. Thank you.

**Operator**

(Operator Instructions). Your next question comes from the line of Sam Poser with Sterne, Agee.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

Good morning, everybody.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Good morning, Sam.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

Can you back up with the guidance from the previous guidance and sort of deconstruct it on an apples-to-apples basis?

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Sure, Sam. It's Mark.

Our prior guidance for 2011, I assume was the question.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

Yes.

**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Okay. So our prior guidance was \$1.33 -- or excuse me, \$1.31 to \$1.43. We have taken that, I'll call it basic guidance, down by \$0.04 on the low end and \$0.08 on the high end, to be a little more cautious on our risks associated with the Wholesale business, and I'll call it macro factors. And then to that, you would add \$0.10 to \$0.12 for accretion from ASG. And subtract from that \$0.12 and \$0.15 for the purchase accounting related to inventory and transaction costs, and that should put you down to the \$1.25 to \$1.32.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

So I guess Xing out the American Sporting Goods part of it, just looking at it as an apples-to-apples basis, what changed in the overall outlook between, I guess it was January and today? What were the major changes that brought the guidance down?



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**Mark Hood** - *Brown Shoe Company, Inc. - SVP and CFO and Principal Accounting Officer*

Okay. So again, I think we gave that guidance in November. So what changed between that and today is I'll call it -- we went live with the systems environment and experienced the fourth quarter.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

And Sam, wanting to make sure we're smart and cautious, given the fact that, that systems implementation is not yet complete. And, again, wanted to make sure that we get that done the way that we needed to complete it.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

And when you're -- I'm sorry.

**Ron Fromm** - *Brown Shoe Company, Inc. - Chairman of the Board and CEO*

Sam, this is Ron.

One of the things I think you have built in that's a little more concrete, if you will, is that built into the original guidance, we had estimated benefits we would receive in 2011 from having those systems in place, up and running, et cetera, okay? And given where we are in the systems implementation, we believe that a more cautious view of when those benefits will arrive, they'll still be there and they'll still come, but they're going to come later.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

Okay. I guess that's the question. Every SAP implementation that I've seen over the years has sort of caused a little bit of interim confusion, to say the least.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Right.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

Where are you -- I mean, like how long -- compared to what you were thinking how long you thought it was going to take in November versus how long you're expecting it to take right now, I mean, to get really rolling, where are we in that changeover?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Yes, I would say it's really through the first -- the spring season. We've got a complete, a full season, not only just of shipping sort of the December, January like we did, but inputting orders, managing the order base, understanding the flow, placing orders overseas. All of those pieces have to happen during this spring season to really come out at the end of June, July and say we understand how the system is operating.

And to Ron's point, Sam, the value realization piece, again with slightly later starts than what we had expected, and the realities of what it really takes to get this system in, and then realizing -- it's one thing to get it in and get it working. It's another thing to get it in and really realize the benefits of it, and that takes a little bit more time for you to do.

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**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

And that could even roll in -- that could even roll into the back half of the year, then?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

I don't -- look, sitting here today, I would tell you it does not feel like that is going to happen, but we think through the first half of the year it's certainly there's some challenges.

**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

Thank you very much. Good luck.

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

Thanks, Sam.

**Operator**

At this time, there are no further questions. Presenters, do you have any closing remarks?

**Diane Sullivan** - *Brown Shoe Company, Inc. - President and COO*

No, I think we're all set and we appreciate you joining us this morning.

**Operator**

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

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