

FINAL TRANSCRIPT

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SAAS - Q3 2011 Incontact Inc Earnings Conference Call

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PRESENTATION

Operator

Good day, everyone, and welcome to today's inContact Incorporated's third quarter 2011 earnings conference call. At this time, all participants are in a listen-only mode. Later, you will have the opportunity to ask questions during the Q&A session. (Operator Instructions) Please note today's call is being recorded, and I will be standing by should you need any assistance.

It is now my pleasure to turn the conference over to Mr. Paul Jarman, Chief Executive Officer of inContact. Please go ahead, sir.

Paul Jarman - *inContact Inc - CEO*

Good afternoon. This is Paul Jarman, CEO of inContact. Welcome to our third quarter 2011 conference call. Greg Ayers, our CFO, will begin by presenting the Safe Harbor statement followed by our financial results for the quarter. I will then provide some additional information with respect to our third quarter accomplishments including some key customer wins, market trends, and our progress with key partners. Frank Maylett, EVP of sales, will then join Greg and I for Q&A.

Greg Ayers - *inContact Inc - CFO*

Thank you, Paul, and good afternoon, everyone. Let me begin this call with the Safe Harbor statement. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made on the Company's behalf. All statements other than statements of historical facts which address the Company's expectations of sources of capital or which express the Company's expectation for the future with respect to financial performance or operating strategies can be identified as forward-looking statements.

Such statements made by the Company are based on the knowledge of the environment in which it operates but because of the factors previously stated, as well as other facts beyond the control of the Company, actual results may differ materially from the expectations expressed in the forward-looking statements.

During today's call, I will first recap the definitions for our two operating segments, software and telecom. I will then cover our Q3 operating segment and consolidated results as well as other financial highlights. Third quarter financials and comparisons can be found in our press release that went out this afternoon and in our third quarter 10-Q. For access to the news release and other information on inContact, please visit our website at www.incontact.com.



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Our first segment is the software segment, which includes all monthly recurring revenue related to the delivery of our software applications, as well as associated professional services and setup fees. The software segment does not include any telecom revenue. For Q3 2011, I am pleased to report that our software segment revenue increased to \$10 million, which represents a 21% increase or \$1.7 million over the \$8.3 million in Q3 2010. This progress is attributable to three key drivers of our software revenue.

First is existing customer retention. Our software revenue retention for the trailing 12 months remained consistent with previous quarters at a retention rate of approximately 90%.

The second driver of quarterly software revenue growth is a variable utilization of software services by existing customers that fluctuates due to seasonality, customer service activities, and macroeconomic conditions, as well as the revenue generated from the sale of additional services to existing customers. The measurement of this revenue growth is similar in concept to the retail industry's use of the same store sales metric. In other words, it excludes attrition and new customer contract revenue. With these existing customers, we experienced approximately 0.9% increase in Q3 2011 versus the one half of 1% decrease that we experienced in Q2 of this year. This uptick in usage by existing customers is in line with previous Q3 experience.

The third and final driver of our Q3 software revenue growth is revenue from new contracts that are not yet included in the same store sales metric. We closed 67 new contracts in the quarter of which 52 came from new customers and 15 were upsells in existing accounts. We estimate the expected future value of these contracts is approximately 40% higher than the total value of our solid Q3 2010 bookings and represents our best quarter of software bookings.

The Q3 2011 software segment gross margin was 55% on a GAAP basis and 69% with non-cash charges added back compared to Q2's 58% on a GAAP basis and 70% with non-cash charges added back. This decrease in gross margin is principally attributable to higher customer service and professional service costs and depreciation and amortization. Customer service and professional service costs increased approximately 1.8 percentage points as we invested in people and reseller infrastructure ahead of reseller revenue and depreciation and amortization increased approximately 1.3 percentage points as we placed into service and began to amortize larger amounts of previously capitalized software development costs. These investments will be key to our growth in 2012 and we expect that we'll be able to begin leveraging them and improve gross margins in 2012 and beyond.

Our second segment is the telecom segment, which includes all voice and long distance services provided to both our telecom only legacy customers as well as to our software segment customers. Telecom segment revenue for Q3 2011 was \$12.1 million compared to the \$12 million in Q3 2010. Q3 marks the second quarter in a row that quarterly telecom segment revenue has increased year-over-year driven by increases in software related telecom revenue.

The telecom segment gross margin decreased to 25%. This decrease from Q2 is principally attributable to a one-time cost benefit related to telco carrier charges that occurred last quarter. Telecom revenue generated by software customers continues to grow and for the quarter represented approximately 60% of total telecom revenue.

Our consolidated results for Q3 are as follows. Consolidated revenue increased to a record \$22.2 million, a \$1.9 million increase from Q3 2010. This revenue increase was driven almost entirely by our software segment and software related telecom and is the fourth sequential quarter of consolidated revenue growth. Gross margin percentage was 39% in the third quarter compared to 43% for the same period in 2010. This decrease in gross margin is principally attributable to anticipated investments in our strategic international facilities and reseller programs, as well as higher non-cash depreciation and amortization.

These investments included establishing our new European cloud network, as well as building the back office and infrastructure to provide us with additional leverage as we scale up to support Siemens Enterprise Communications and other new partners. These investments are being made ahead of the guaranteed revenue in 2012.

On a cash basis, consolidated gross margin percentage was 46% for the third quarter compared to 48% for the same period in 2010.



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Operating expenses were \$11.7 million, up \$1.6 million from Q3 2010. Approximately \$1.5 million of the increase is attributable to the substantially higher levels of investment in software segment demand generation and direct and channel sales personnel. This investment in sales and marketing has paid off over the past six quarters as we continue to achieve sequentially strong bookings. The value of bookings is measured in terms of the estimated annual value of contracts closed.

The net loss for the quarter was \$3.2 million or \$0.07 per share as compared to a net loss of \$1.3 million or \$0.04 per share for Q3 2010, which reflects our investments mentioned previously.

EBIDTAS, which is a non-GAAP measure, is an important metric of our operating results due to the significant amount of depreciation and amortization resulting primarily from previous acquisitions of software products, customer bases, network technology, amortization of capitalized software development costs, and stock-based compensation.

Q3 2011 EBIDTAS was a negative \$590,000 versus a positive \$564,000 during the same period in 2010. EBIDTAS for the quarter was impacted by the additional investments in our sales and marketing initiatives mentioned earlier and to some extent lower gross profit. Acquisition-related amortization amounted to \$135,000 during the quarter.

As of September 30, we had \$18.1 million in cash and currently have access to an additional \$8.5 million under our line of credit and additional capital equipment financing. As a reminder, during the second quarter, we received approximately \$24 million as a result of the sale of 7.2 million shares of common stock to Siemens Enterprise Communications and reduced the balance on our revolving line of credit to zero.

In summary, during the quarter, we achieved record consolidated and software segment revenues and generated consolidated revenue growth for the fourth consecutive quarter, a trend we expect to continue. We're pleased with the continued positive results that our sales and marketing investments are producing and expect these investments to continue generating increased software bookings, revenues, and software-related telecom revenues through the remainder of 2011 and into 2012.

We made investments ahead of guaranteed revenue, which we will leverage in 2012 and beyond, that will increase gross margins and EBIDTAS.

Paul?

Paul Jarman - *inContact Inc* - CEO

Thank you, Greg. Q3 was a great quarter for inContact. We continued to see strong adoption of our cloud portfolio and achieved record consolidated and software segment revenue as well as record new software segment bookings. During the quarter, as Greg mentioned, we closed 52 new customers and 15 expansion contracts for a record number of 67 contracts in the third quarter. The bookings represented a 40% increase over those in Q3 2010. We now have 24 customers in the global or Fortune 500 and 9 customers that bill \$500,000 or more per year in software revenues.

There are a number of key drivers accelerating our momentum. I'd like to cover four of these with you now. First, as we have expanded our international footprint, we are attracting more multi-national companies with a need to better support their global operations. With our recent international investments, we have expanded our market opportunity to address the full 8 billion worldwide contacts in our market, half of which is in the U.S. and half of which is across the rest of the world. Today, a small portion of that is cloud software so the potential of taking market share from premise-based players is tremendous over the next couple of years.

One of our new multi-national customers is a Global 500 company that selected inContact to create a brand-conscious unified service process for its agents across three global contact centers. The Global 500 company has built a significant international brand and is very careful in choosing solution providers. As a result, when the company decided to centralize its internal help



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desk on a single system, they selected inContact as a reliable redundant secure system that enables Follow-the-Sun routing across its contact centers in the United States, Europe, and Asia. The company also moved to the cloud to support scalability for future growth and expansion without needing to maintain expensive on-premise hardware.

Second, the cloud continues to strengthen in its acceptance and adoption across all segments of the market. Leaders of organizations are requiring that cloud options are considered in the vendor selection process. In fact, in a recently published report, industry analyst firm Gartner reported that by 2014 as more applications are built in a cloud-based model, Software-as-a-Service will emerge as a critical selection factor at all levels of the customer service contact center.

Last week we announced a new retail customer that had been using premise-based hardware and when it came time to update their systems chose to move to the cloud. The company, like most retailers, has significant seasonal shift in their business, primarily during the holidays. By moving to the inContact solution, they will be able to scale to support seasonal shift in staffing while only paying for what they use. inContact's ability to enable at-home agents as well as our built-in redundancy and security were also major factors in their decision.

Our third driver for our continued momentum is the powerful technology partner ecosystem that we are building to compliment the inContact platform. Our partners include CRM companies, work force optimization vendors, hosted phone system providers. Building a strong partner ecosystem has significant benefits. First, it allows us to offer a more complete solution to align with the needs of enterprise level contact centers while allowing us to focus our internal R&D efforts in the areas of our core competencies and greatest return.

Last week we announced we are growing our partner ecosystem by extending our partnership with Verint Systems. Verint is a leading provider of enterprise workforce optimization solutions, which are used by more than 10,000 organizations in over 150 countries, including more than 85% of the Fortune 100. We've offered Verint's workforce management solution in the cloud for the past year, and we are now expanding that successful relationship by creating the first cloud-based workforce optimization or WFO suite in the market. This enables inContact to offer an enterprise class solution and the broadest cloud-based portfolio in the market that can be utilized by contact centers of all sizes in a pay as you go software model.

Finally, we continued to drive additional pipeline growth which results in our Company being invited into more opportunities and ultimately choosing more contracts. Since the beginning of the year, we have continued to execute on our strategic growth plan, which includes acceleration of demand generation marketing, optimization and growth of our existing partner channels, direct sales execution, expanded routes to market through global distribution, and continued products and service innovation.

We continue to be very encouraged by the trend of more enterprise companies switching to the inContact platform from their legacy premise-based solution. For example, we added several new enterprise customers in the past several weeks, including two leading Philippines-based business process outsourcers. Together, these customers will scale to more than 600 agents using the inContact cloud platform.

We also announced that a multi-billion dollar retailer has selected the inContact cloud call routing solution to empower its hundred-agent, inbound contact center functions including customer service sales and employee relations.

As we continue to move upstream in our sales and marketing process and close larger contracts, we are aligning our contract minimums to reflect this shift in focus. This will continue to strengthen our results as we can focus on winning and maintaining the most profitable business.

At our sixth annual inContact Users Conference, ICUC, which we hosted in September, I was able to talk to many customers about why they selected inContact and how inContact has improved the cost and quality of their contact centers. ICUC was attended by over 300 customers, industry experts, prospective customers, and partners, and the feedback has been very positive. In fact, approximately 30 customers recorded very powerful testimonials during the conference about the ways that inContact



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has impacted their business. Those testimonials will be added to the more than 50 current customer videos we feature on our website and YouTube channel.

ICUC not only strengthens our relationship with our customers by delivering additional value to their overall knowledge and processes, it is also a key piece of our strategic marketing efforts. We see significant interest from prospective customers and current customers in new and expansion contracts as a result of the conference, and in ICUC 2011, this was no different. We had a record number of prospective customers at the conference this year and several of the contracts we signed in Q3 were a direct result of ICUC.

I'd now like to give you an update on how we're expanding our already strong referral partner network. During the quarter, we announced Intellisys' selection of inContact as their preferred contact center software solution. Intellisys is the nation's leading master agency distributor of business telecommunication services including voice, data, and internet access. We are very pleased to be selected as the preferred contact center provider for Intellisys and will benefit from their 1,200 referral agents throughout the U.S.

In Q3, we invested in the back office and infrastructure for our new retailer program to provide additional leverage as we scale up to support Siemens and other new partners. During the quarter, we completed key infrastructure enhancements including online channel management portals, provisioning, and retailer order entry systems.

I'd now like to give you an update on the Siemens partnership. As you know, we signed a worldwide retailer agreement with Siemens Enterprise Communications. Siemens made an upfront investment of approximately \$24 million and is guaranteed to pay a minimum of \$15 million of net software revenue to inContact over a two-year timeframe. In accordance with the terms of the investment agreement, we registered these shares last week and included a shelf registration for general purposes. The shelf registration statement is intended to give the Company future flexibility for growth and other strategic initiatives. With the recent Siemens investment and the additional \$8.5 million available under our line of credit, we have no current need for a capital raise.

The partnership between inContact and Siemens is moving forward according to schedule, and we have achieved the following benchmarks during the quarter. First, our product experts are training the sales and service teams at Siemens in Europe and North America to enable them to sell and support the inContact platform. Second, we are now completing the build out of our full European cloud network with two redundant data centers in Germany, a replica of our network in the United States. Third, we had a very successful launch of our partnership to the European contact center industry at the call center expo in London last month. And finally, we continue to work joint opportunities together, and that activity is accelerating in the quarter.

As discussed in previous calls, this is a significant partnership for inContact as it creates new pathways for growth and expansion for our Company, validates us in the market as the leader in cloud contact center solutions, and has also created significant additional industry interest in inContact.

In conclusion, we believe that inContact has never been better positioned to take advantage of the significant opportunities ahead of us. During the quarter, we achieved continued momentum in bookings, pipeline and software revenue growth, expanded our referral program, and ramped our reseller efforts. Additionally, we continue to see increasing adoption of cloud based solutions in the contact center market. These powerful trends cause us to be confident that we will continue to accelerate our year-over-year quarterly software revenue growth rate and deliver strong value for our shareholders in Q4 and beyond.

Greg and Frank and I will now take your questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Mark Schappel with The Benchmark Company. Please go ahead.

Mark Schappel - The Benchmark Group - Analyst

Hi. Good evening and nice job on the software revenue this quarter. Paul, starting with you, in your prepared remarks, I believe you noted that you have nine companies paying you over \$500,000 a year now. I was wondering if you could just give us an idea of what that was about a year ago.

Paul Jarman - inContact Inc - CEO

It was a little lower than that and that, just as a reminder, would be just software revenue, so that number gets bigger as you add any telecom tide to it.

Mark Schappel - The Benchmark Group - Analyst

But you don't have a specific number of companies for a year ago handy?

Paul Jarman - inContact Inc - CEO

Five.

Mark Schappel - The Benchmark Group - Analyst

About five? Okay. Thank you. And then with respect to your partnership and equity investment with Siemens, since that's been announced, have you found your -- let's just say your relationships with prospective customers changing at all? I mean, are they a little bit more at ease doing business with a company with a stronger balance sheet? Are they a little bit more willing to have an audience with you? Maybe if you could just give us some details there.

Paul Jarman - inContact Inc - CEO

You bet. So, first of all, I would say this. As an emerging cloud company and area, it is very helpful for us to have that validation, so -- in two places. Number one with our current customers and two is we prospect and three is we work with different people in Europe. Seeing our European presence as far as the infrastructure and the partnership there has been very helpful.

Mark Schappel - The Benchmark Group - Analyst

Okay, and then with respect to the Siemens partnership again, are costs to maintain that relationship, are they coming in relatively close to your plan or do you think you may need to adjust those another quarter or so?

Paul Jarman - inContact Inc - CEO

You mentioned cost or revenues?

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Mark Schappel - *The Benchmark Group - Analyst*

Well, you're free to comment on the revenues as well, but I was just wondering -- obviously, you have to have some people to help support that relationship and some costs to build out the infrastructure and I was just wondering if you'd just comment on whether those costs are coming in close to what you expected.

Paul Jarman - *inContact Inc - CEO*

Yes, so I would say it's within expectations and steady through fourth quarter then we start ramping leverage against it in first as far as the revenues.

Mark Schappel - *The Benchmark Group - Analyst*

Okay, great. And then final question changing gears here a little bit. Given that your telco revenue seems to be stabilizing and may even start growing here, where do you see the gross margins in this business settling out over the next year or so?

Paul Jarman - *inContact Inc - CEO*

In the telco business alone?

Mark Schappel - *The Benchmark Group - Analyst*

Yes.

Paul Jarman - *inContact Inc - CEO*

Right about where they're at. I would say that that's about the right number.

Mark Schappel - *The Benchmark Group - Analyst*

Great. Thank you. That's all for me.

Operator

Thank you. (Operator Instructions) Our next question comes from Jeff VanRhee with Craig-Hallum. Please go ahead.

Jeff VanRhee - *Craig-Hallum Capital Group - Analyst*

Great. Thank you. Very nice quarter. Couple questions. First, just with the bookings growth re-accelerating again this quarter, what's your comfort level with the 25% to 30% software growth for Q4, and when you're touching on it, what -- if you are still comfortable with that range, what drives high end or low end performance?

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Paul Jarman - *inContact Inc - CEO*

You bet. So first of all, we had a great bookings quarter and we've not changed the guidance. Certainly, the thing that helps us in the quarter is the Christmas seasonality, and as that strengthens, that helps us to push that higher. And so we're still comfortable with the range and the key factor would be just the speed of the turn ups of what we just did combined with a good seasonal holiday process for more calls, more different interactions across these companies.

Jeff VanRhee - *Craig-Hallum Capital Group - Analyst*

Okay, and then you obviously are building some infrastructure to support partners, at this point Siemens but certainly can be reused elsewhere. Talk to me about the timing and progress you've made in discussions with other partners in other geographies.

Paul Jarman - *inContact Inc - CEO*

You bet. So, we've mentioned before a partner we've brought in in the Philippines, one of the carriers there. We are in conversations with the partners, and we think we'll have a lot of success there. So, the infrastructure can be used by many, and it allows us to really have a three-pronged distribution. One is our own marketing with direct sales. Two is our referral program with direct sales, and then three is these larger strategic partnerships that leverage us in the U.S. and leverage us in other parts of the world. And the infrastructure allows us to do the third.

Jeff VanRhee - *Craig-Hallum Capital Group - Analyst*

Is the -- any sense of timing? (Inaudible) better sense of when we might see a tier one brand in the U.S. in terms of expanded distribution?

Paul Jarman - *inContact Inc - CEO*

You know what? I really -- as we finish through what we're doing, I don't want to comment on timing other than that we're making great progress.

Jeff VanRhee - *Craig-Hallum Capital Group - Analyst*

Okay, and then last, on the pipeline, would you just color in a little bit in terms of how it's different now than say three, six months ago in respect to or with respect to coverage, also source of leads, size of addressable customers in that pipeline, whatever notable characteristics along those lines you can call out?

Paul Jarman - *inContact Inc - CEO*

Certainly we're seeing a couple things. Number one is we're seeing larger opportunities, and in the larger opportunities, I'd characterize them as two types. One would be bigger call centers that we would be moving a lot of it over really in a stage one implementation, and also we're seeing more multi-location, multi-national companies where we'll win a first initial piece and then we work with them over time to keep bringing in more countries, more locations, and it gives us some great opportunities. I was with a great company this week who we just turned up about 100 seats and they've got 2,000 seats worldwide and so obviously our goal is to help them through that process.

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Jeff VanRhee - *Craig-Hallum Capital Group - Analyst*

Okay. Great. Thank you. Very nice quarter.

Operator

Thank you. (Operator Instructions) We'll go next to Nathan Schneiderman with ROTH Capital. Please go ahead.

Shawn - *ROTH Capital - Analyst*

Oh, hi. This is [Shawn] for Nathan. A couple questions here. First is about pipeline, so how many Siemens deals do you see in your current pipeline right now, and do you expect the multiple Siemens deals to be closed in Q4?

Paul Jarman - *inContact Inc - CEO*

So, first of all, we do have deals in our pipeline, and we're not at liberty really to go through the numbers of who they are or the amounts or the sizes, but certainly our aspiration is to keep growing that as fast as we can. We've had joint sales opportunities we've done together, and we're building a pipeline today and certainly that would correlate to the minimums they pay next year and hitting those numbers. So, I'd just say that so far so good.

Shawn - *ROTH Capital - Analyst*

Okay. My next question is more about sales reps. So, how many sales reps do you have by the end of this quarter and how many do you expect to be at the end of this year and will you guys continue to -- hiring, like investing in sales reps?

Paul Jarman - *inContact Inc - CEO*

So, we finished the quarter at 32, which is six additional sales people from the beginning of Q3, and we would expect to end the year somewhere between 32 and 35.

Shawn - *ROTH Capital - Analyst*

Okay. That's helpful. And my last question is about operating margin. So, do you expect a better, worse, or flat operating margin in Q4?

Paul Jarman - *inContact Inc - CEO*

So, two things. As Greg mentioned in his prepared statement, we have -- basically we see Q4 being somewhat consistent to this quarter, and then we see a lot of leverage in 2012. So, we'll continue to make some investment in fourth quarter. None of the partnership revenue hits that investment yet, and then in 2012, you get \$5 million that starts to go against it and our own growth that we also have on top. So, basically, consistent through fourth and then nice expansion in '12 in both the operating and gross margin lines.

Shawn - *ROTH Capital - Analyst*

Okay. Thank you very much. Congrats on a great quarter.

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Paul Jarman - *inContact Inc - CEO*

Thank you.

Operator

Thank you. (Operator Instructions) It appears we have no further questions at this time.

Paul Jarman - *inContact Inc - CEO*

Well, we appreciate everybody's interest. We're excited to the progress that we're making and we'd like to thank everybody and have a great day.

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