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HNI Corp. (HNI)

Q4 2015 Earnings Call

CORPORATE PARTICIPANTS

Kurt A. Tjaden

Vice President and Chief Financial Officer

Stanley A. Askren

Chairman, President & Chief Executive Officer

OTHER PARTICIPANTS

Bobby K. Griffin

Raymond James & Associates, Inc.

Steven Ramsey

Thompson Research Group LLC

Matthew Scott McCall

BB&T Capital Markets

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Laurel and I will be your conference operator today. At this time, I'd like to welcome everyone to the HNI Corporation Fourth Quarter and Year End 2015 Fiscal 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] As a reminder, today's conference call is being recorded. Thank you.

Mr. Tjaden, you may begin your conference.

Kurt A. Tjaden

Vice President and Chief Financial Officer

Good morning. Thank you for joining us to discuss our fourth quarter and year-end fiscal 2015 results. Joining me is Stan Askren, Chairman, President and CEO. Copies of our financial news release, earnings presentation and non-GAAP reconciliations are posted on our website.

Statements made during this call that are not strictly historical facts are forward-looking statements which are subject to known and unknown risk. Actual results could differ materially. The earnings presentation posted on our website includes additional factors that could affect actual results. The corporation assumes no obligation to update any forward-looking statements made during this call.

I'm pleased to turn the call over to Stan.

Stanley A. Askren

Chairman, President & Chief Executive Officer

Good morning, everyone. As typical, we'll share a brief assessment of our 2015 results and then provide some thoughts on our outlook for 2016 and then we'll conclude it with an open call for questions.

First, let me start with the year. 2015 was another strong year. Non-GAAP earnings per share increased 31% on modest sales growth. We again generated solid cash flow to support our long-term business investments and increased our already strong dividend. We executed well on our core strategies which, I'll remind you, include focusing on the core [ph] splitting focus with (0:02:04) leverage and then, finally, our rapid continuous improvement which is driven by the strength of our member/owner culture which is very unique and very powerful.

Our businesses performed well against the competition in a challenging slow growth economic environment. Office furniture markets were negatively impacted in the second half by muted CEO and small business confidence and economic turmoil in the PRC. In our hearth markets, single family housing starts continued to improve modestly, while warm weather and dramatically lower oil prices severely impacted the biomass market.

Our hearth business achieved another record year of profits, delivering \$80 million of non-GAAP operating profits on sales of \$527 million. Sales results across that business were mixed. Solid growth in new construction and retail gas were more than offset by a significant decline in the biomass business due to low oil prices and very warm weather.

We continue to invest and strengthen our industry leading brands, products and distribution and we are the preferred choice for builders and homeowners. Our office furniture business non-GAAP operating profit increased 25% on modest sales growth. Strong operational performance, consistent flawless execution for our customers, and benefits from our operational investments were key drivers for those increased earnings.

North America sales increased approximately 2%, led by 5% growth in our contract business. Our supplies business sales were basically flat, impacted by muted small business confidence. Sales in our international businesses were up 3% despite a significant drag from the economic upheaval in China, mainly the PRC.

We continued our investment commitment to our Business Systems Transformation initiative. We made strong progress simplifying and transforming our business processes to deliver more value to our customers and reduce non-value added cost. BST remains a significant focus for our organization and a strategic investment for HNI.

We believe our unique member/owner culture is a competitive advantage that stands the test of time and we remain committed to our core beliefs and values.

And let me now comment on the fourth quarter. We finished the year strong. Non-GAAP earnings per share increased 40% despite a slowing economy [ph] and 8% (0:04:44) lower sales. Office furniture non-GAAP operating profits increased 23% on a 5% sales decline.

In our hearth business, non-GAAP operating profit margin improved 170 basis points on a 14% sales decline. Overall, I'm very pleased how our businesses are performing and our position for the future. And I'd like to thank our customers, members and suppliers for their outstanding contributions to our success. Kurt?

Kurt A. Tjaden

Vice President and Chief Financial Officer

So let me comment on the fourth quarter of 2015. Consolidated net sales decreased 7.7%. Office furniture sales decreased 5.3%. Sales in our supplies driven business were down 7%, while sales in our other office furniture businesses were down 3%.

Sales in our hearth business decreased 14%, new construction sales increased 4%, and sales of our biomass products decreased 38% due to dramatically lower oil prices and unseasonably warm weather.

Non-GAAP consolidated gross margins improved 220 basis points versus the prior year to 37.9%. Strong operational performance, structural cost reductions, favorable material costs and price realization were partially offset by lower volumes. As a percent of sales, non-GAAP selling and administrative expenses decreased 50 basis points, primarily due to cost reductions and lower incentive-based compensation, partially offset by investments.

During the quarter, we reported \$12.7 million of restructuring and impairment charges and transition costs. These expenses included goodwill and intangible impairment charges of \$11.2 million related to our small office furniture business and \$1.5 million of restructuring and transition costs in connection with previously announced closures, acquisition integration and structural realignment.

For the year, we generated \$61 million of free cash flow and our year ending debt-to-EBITDA leverage ratio was less than 1x.

Stan?

Stanley A. Askren

Chairman, President & Chief Executive Officer

Okay. Thank you, Kurt. As we look to 2016, we expect the weak economic environment to continue impacting our competitive markets. Our exposure to short cycle business provides us early visibility into market shifts. We are navigating the near-term, while remaining focused on long-term value creation. I'm confident we can deliver strong profit performance in any market environment. Our seasoned and experienced team has effectively managed through multiple business cycles in the past.

Consistent with our long track record – and listen to this, please – consistent with our long track record of driving significant structural cost reductions, we are working several large restructuring initiatives. The estimated impact of these initiatives will result in \$50 million to \$60 million of restructuring charges over the next three years.

Once completed, we expect to realize \$35 million to \$40 million of annual savings. While these initiatives are not yet final, I have confidence in the opportunity and the magnitudes that I've just indicated. The initiatives are broad based, including corporate functions, office furniture and hearth businesses and both domestic and international businesses.

These actions were not developed just in response to the slower economy. These initiatives have been in process for some time in varying levels of readiness. We will not provide additional detail on specific initiatives at this time, so as to allow flexibility for planning, communication and execution. We will disclose the economic impact of each of these initiatives at the appropriate time, consistent with our past practice and regulatory requirements.

I continue to believe we are well positioned to create long-term shareholder value. We have the right strategies, the right products and the right people to continue to outperform the market.

Kurt?

Kurt A. Tjaden

Vice President and Chief Financial Officer

So our financial outlook for the first quarter of 2016, we anticipate overall sales to be down 3% to 7%. Office furniture sales are expected to be down 4% to 8%. Supplies driven office furniture sales are projected to be down 6% to 10%. Sales in our remaining office furniture businesses are forecasted to be down 3% to 7%. In our hearth business, overall sales are expected to be up 1% to down 3%. New construction channel sales are forecasted to be up 4% to 8% and we expect remodel retrofit channel sales to be down 3% to 7% driven by lower biomass sales.

Non-GAAP gross profit margin is expected to improve modestly from the first quarter 2015 levels of [ph] 39.5% (0:09:46). Non-GAAP SG&A as a percentage of sales is expected to be modestly higher than the first quarter 2015 results of 32.2%. Our estimated non-GAAP earnings per diluted share for the first quarter is in the range of \$0.16 to \$0.21 per share.

So our full year 2016 outlook, we expect consolidated sales to be down low to mid single-digits. We are forecasting office furniture sales to be down 4% to 7%. And sales in our hearth business are expected to be down slightly to up slightly. The effective tax rate for the year is projected to be approximately 35% and we expect capital expenditures to be in the range of \$105 million to \$110 million.

Consistent with Stan's earlier comments about the weak economic environment and high degree of uncertainty, we are expanding the range of our full year earnings per share guidance. Our current best estimate of non-GAAP earnings per diluted share for the full year 2016 is now in the range of \$2.20 to \$2.60 per share.

Stan?

Stanley A. Askren

Chairman, President & Chief Executive Officer

Okay. Let me wrap this up and summarize. I'm confident in our ability to deliver long-term shareholder value in any market environment. Our businesses are strong, agile, and well positioned for the future. Our brands are competing well in their markets. Our strategies are working and our investments continue to deliver strong financial returns. So with those comments from Kurt and myself complete, we'll now open it up to questions.

Operator, are you there, please?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]. Our first question comes from the line of Budd Bugatch with Raymond James. Your line is open.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

Good morning, guys. This is Bobby actually filling in for Budd. Thank you for taking my questions. First up for me is just a little bit more around biomass and the comparisons. How should we think about those comparisons throughout 2016? When will the comps from the lower fuel start to ease, I guess, is part of my question or the main bit of my question?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yeah. It should, Bobby, work through and we should reach the bottom in 2016. Likely to step down another 10% to 15%, down to sort of historic lows and then level out in 2016.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

Would the historic lows probably hit sometime in mid-summer, would that be a rough guess?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

It's very seasonal, Bobby. So using mid-summer is not really representative [indiscernible] (0:12:45) heating appliances purchase seasonal. And so you'd say not till the end of the year – not till we get through the burn season at the end of the year are you really going to be through it.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

Okay. And then on the office segment, inside the office segment, was there any big shifts in products that you're seeing pressure on, a shift from the consumer to a different style product maybe?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

No.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

And the weakness is pretty broad based across all your product categories?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yes, sir.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

And price points as well?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yes, sir.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

Okay. And then lastly, when you look at supplies – the supplies channel business, and you referenced the other non-supplies channel business, that's mostly North America contract, correct?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

It includes international as well. It's mostly North America contract, yes.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

All right. I was just trying to get a parse of what North America contract did for the quarter. Are you guys disclosing that?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

For which quarter, Bobby?

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

For the fourth quarter that we just had.

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

So fourth quarter, we would have seen North America contract down slightly, in line with our expectations.

Bobby K. Griffin

Raymond James & Associates, Inc.

Q

All right. Thank you. I appreciate you guys answering my questions and best of luck in 2016.

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

Yes.

Operator: Your next question comes from the line of Matt McCall with BB&T Capital Markets. Please go ahead.

Matthew Scott McCall

BB&T Capital Markets

Q

Thank you. Morning, everybody.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Morning, Matt.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay. So maybe I'll follow up from the last question. North American contract down a little bit; did you talk about the specific expectations from North American contract in 2016?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

We did not on that, Matt. We talked general office furniture as we talked about 2016, down – overall down [indiscernible] (0:14:41).

Matthew Scott McCall

BB&T Capital Markets

Q

Okay. So any comments on underperformance, out-performance for your different segments?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Well, Matt, I think if you look at what's transpired over time, we've outperformed. Certainly, in the contract side, we have – if you look at all the last 24 months – so I'll remind you, our perspective is if you use any quarter or even a year to compare, you really run the risk of distorting your picture. So it's more likely to use a 24-month period. So we would say HNI North America contract in the last two years is up, I think, 6.7% on average, difference of 4.6%. 2015, I think we indicated for the year, North America contract of HNI was flat to BIFMA, so about the same. Supplies has basically been flat to up modestly. We think based on what we look at with our largest customers in the market which we view were tracking slightly ahead of that. So we would expect regardless of what the economy gives us that we would continue to outperform. So the numbers we're giving you here are more reflective of what we think the economy is going to do rather than us indicating that we think we're going to lose some position.

I think we said a lot in these conferences, we said it at least four times, we expect to continue to outperform the market in the long-term. Watch the short-term stuff because in this industry you get all screwed up.

Matthew Scott McCall

BB&T Capital Markets

Q

Got it. Got it. Okay. So you talked about your several large restructuring initiatives. And I know you don't want to give specifics. I understand that. But you said you've been working on these for a long time. So maybe outside of just the cyclical softness, and I know that didn't drive the decision, can you just talk about maybe the strategic nature of what you are trying to accomplish here because it sounds like it's been kind of – on the drawing board for a while? What changes are you trying to make?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yeah. First of all, let me comment on the drawing board for a long while. If you go back and you look at our history, Matt, certainly since I've been the CEO, we always have major productivity, structural cost take-out initiatives underway. It's part of our lean RCI sort of environment and culture.

The second part is, the industry is always changing, we're always changing, we're always responding, we are getting smarter. There is new sort of ways of thinking about things. We do acquisitions, on and on it goes. And so, these are simply things that impact logistics costs, impact operational costs, impact sort of overall facility costs. These are investments in productivity, new technology. These are investments that deal with the shifting mix of products, et cetera. So it is extremely broad based. And I said, corporate, office furniture businesses, hearth businesses, international, domestic, and it just goes on and on. So the objective is to continuously drive more, better, faster with less for our customers to create value for our shareholders, deliver return on these investments, and so it's just more of the same.

The point is, is these things were underway before the slowdown. We simply are – I guess I am quite pleased that we're in a spot that these things have been worked, they've been vetted. We've done our due diligence. We've done our homework that's actually underway and we're beginning to roll those things out over the next two to three years.

And we are simply saying, hey, ladies and gentlemen, this is a slower economy, but we are going to do well to do that. We're not going to waste this crisis. We're going to use this as an opportunity to do what we do well, which is continue to invest for growth, but also adjust our cost structure so that we're more competitive, driving better returns for our shareholders.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay, okay. That's helpful. And then, so you quantified that the total benefit, I think, is \$35 million when everything's done. Can you talk about maybe what is assumed, what kind of benefit is assumed in the guidance for 2016 – your outlook for 2016? I don't know if you gave margin – a margin outlook for 2016. If either of you have that, that would be helpful.

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

Yeah. If you think about this, Matt, it's – assuming we proceed with these, it really becomes a – it's a total of \$35 million to \$40 million of benefit and it's over a three-year period. And assuming we proceed with these, you would start to see nominal benefit in the fourth quarter of 2016. I'd call it 5% to 10% of that at rates that Stan talked, ramping up to kind of a half to two-thirds run rate in 2017 and by 2018 we would expect to be on plane with that number that Stan talked. Again, all subject to timing, but that's kind of how I think about the ramp. So not a big impact on our guidance for this year.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

And then, Matt, the other thing is, right behind these, we'll be working and developing the next sort of initiatives to continue to drive productivity and structural cost as well. So we're simply stating over this next period, this is what we have teed up, but behind that we'll be looking for more.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay. I have two more quick ones, well, two more quick questions. We'll see about the answers. But the deflationary environment, maybe talk about it in two ways. The impact on your customers, I know – I think Bobby asked about where you're seeing weakness. We've heard there's more weakness in energy and industrial than there is elsewhere. It sounds like you're seeing it across the board. So is there any negative impact from deflation in some of your customer groups? And then talk about the deflationary benefit on your price cost situation.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yeah. Let me comment on Bobby's question. The way I took Bobby's question, is there anything that we're seeing in our business that's inconsistent with the overall economy? I think anybody in business these days is seeing the energy section slow down.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

We're participating fully on that. [ph] There are signs (0:21:19) across the board. I think my answer is, look, ladies and gentlemen, look at the overall economy, we're tracking the overall economy; look at the overall sectors, we're tracking the overall sectors; look at the overall price points, we're tracking the overall price points. So I don't want to imply to you that energy is, we're just seeing along and everything is good and we're not doing as well in some of these other areas. I simply was commenting, we are tracking the overall economy.

Your deflationary question is a good one, Matt. Certainly that is a benefit to us as it relates to materials. We are seeing inflation, though, in people cost, so pay rates, healthcare, et cetera, continues to go up and that's a significant cost as part of our business. The opportunity in this lower material inflation environment to get price is less. So it kind of offsets when we kind of look at it. We benefited in the past from a decent ability – opportunity to get price. That's going to be harder going forward. The other side, material cost should get better as things go forward and we should benefit from that.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay. All right, perfect. And last one, I'm sure you've been asked this, but the current situation, you compare it to previous periods. The most recent we had that it could compare to are kind of 2011, 2008, right? So if you think about what you're feeling today, what you're hearing from customers, what you're sensing in your business, does this compare more to what happened in 2008, 2011 or does it feel totally different than those two periods?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yeah. Again, this is a question everybody is trying to answer regardless of what your business is. And the question is, if I could restate it Matt, is this a soft patch or is this a recession?

Matthew Scott McCall
BB&T Capital Markets

Q

Right.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

I don't know. I don't know. I think it's more likely to be somewhere in the middle, a soft patch. You see what we're calling. Again, I think we're calling not just our performance. We're calling the overall view of the economy, which is, it's going to be down. We've gone back and looked at all this data. It's not the same as the Wall Street mortgage crisis. It's not. There's not that big of a shock. I think this is more of an asset – global asset re-pricing, sort of the quantitative easing coming off, global slowdown. And I think it's more likely to be a soft spot, soft patch or a mild recession, if you ask me.

And look, my opinion is not worth much on this. There's all sorts of people that are smarter than we are looking at this and feeling this. This is simply our response to, I think, an overall slowdown, an overall, I think, souring or slowing of CEO confidence. I think most of the indicators you're seeing are lagging would be what I would say. And small business confidence has been shaken. And the question is, how long does that go and how fast do they shake that off and then begin investing in our very important, but non-revenue and non-income producing asset, called office furniture.

Matthew Scott McCall
BB&T Capital Markets

Q

Very helpful. Thanks, Stan. Good luck.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

All right, Matt.

Operator: Your next question comes from the line of Kathryn Thompson with Thompson Research Group. Your line is open.

Steven Ramsey

Thompson Research Group LLC

Q

Hi. This is Steven Ramsey filling in for Kathryn. My first question on non-GAAP operating margins, the improvement in Q4, in reference to the structural costs you are taking out in the office business so far, how much of this is permanent versus costs being only reduced in the low volume environment?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

Well, I think the way I'd answer that, Steven, is that is ongoing structural cost take-out. It's not a temporary adjustment, if you will. We've been making – if you think about actions we took in the third quarter around structural costs, we had plants come offline last year that we've seen benefits flow through this. So I would say, the majority of that structural cost takeout, I would expect to be repeating and continue. And it's part of why you see – if you look at our 2016 outlook and kind of take the midpoint of guidance, a very favorable de-leverage and continue to expect returns on those investments that will [indiscernible] (0:26:09).

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Let me take another shot at this, Steven. The volume is good for us on costs. So when volume comes off, there aren't things we can just sort of stop spending and make our financials look better, number one. Number two, we're actually investing – continue to invest for the long-term. We have a long-term view of the business. We get paid to deliver results. We get paid to deliver long-term value creation for shareholders and for customers. And so, we don't do anything that's going to be sort of a short-term thing that will impact the long-term. As Kurt says, what we take out is longer-term structural cost and we would expect to do that going forward. So I'm not sure I totally understood the question, but I think we're hopefully answering that for you.

Steven Ramsey

Thompson Research Group LLC

Q

Right. No, that's helpful. I appreciate that. My next two questions are on the hearth side of the business. New construction has made up about 40% of the sales there in the past – the recent past with the recent declines on the R&R side. Do you expect this 40/60 composition to shift in 2016 where new construction would make up more sales? And if so, does that change the margin profile of the business at all?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

The answer is yes. Obviously, based on how the numbers just work out, hearth sales will be made up more largely of new construction than recent. And the margins will remain generally the same. The mix doesn't impact the margins is another way of saying that more clearly.

Steven Ramsey

Thompson Research Group LLC

Q

Great. And then last question on hearth. Excluding biomass, how was your core R&R business performing? The R&R market as a whole seems to be strong based on our survey work and recent reports from large publicly traded companies, so wanted to get your take on that.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yeah. Excluding the biomass, our R&R hearth business would be tracking at or above the R&R indices. So it's doing well. We're in a great market – we have a great market position. We have great products and that business is doing very fine.

Steven Ramsey

Thompson Research Group LLC

Q

Excellent. Appreciate it. Thanks.

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

Okay. You bet, Steven.

Operator: Ladies and gentlemen, there are no further questions. I turn the call back to the presenters for closing remarks.

Stanley A. Askren

Chairman, President & Chief Executive Officer

All right. Well, thank you so much for your interest in HNI and for tuning in. And we look forward to talking to you in the future. Have a great day.

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

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