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SSNC - Q2 2014 SS&C Technologies Holdings Inc Earnings Call

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CORPORATE PARTICIPANTS

Justine Stone *SS&C Technologies Holdings Inc - IR Coordinator*

Bill Stone *SS&C Technologies Holdings Inc - Chairman & CEO*

Norm Boulanger *SS&C Technologies Holdings Inc - President & COO*

Rahul Kanwar *SS&C Technologies Holdings Inc - SVP & Managing Director of Alternative Assets*

Patrick Pedonti *SS&C Technologies Holdings Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Ashish Sabadra *Deutsche Bank - Analyst*

Darren June *JPMorgan - Analyst*

Elizabeth Colley *Needham & Company - Analyst*

Peter Heckmann *Avondale Partners - Analyst*

PRESENTATION

Operator

Good afternoon. My name is Jamie, and I'll be your conference operator today. I'd like to welcome everyone to the SS&C Technologies second-quarter 2014 conference call.

(Operator Instructions)

Please note that this conference is being recorded and will be made available on SS&C's website, www.SSCTech.com. I'd now like to turn the call over to Justine Stone, Investor Relations Coordinator. Ms. Stone, you may begin your conference.

Justine Stone *- SS&C Technologies Holdings Inc - IR Coordinator*

Hi, everybody. Welcome, and thank you for joining us for our Q2 2014 earnings call. I am Justine Stone, the Investor Relations Coordinator for SS&C. With me today is Bill Stone, Chairman and Chief Executive Officer; Norm Boulanger, President and Chief Operating Officer; Rahul Kanwar, Senior Vice President and Managing Director of Alternative Assets; and Patrick Pedonti, Chief Financial Officer.

Before we get started, we need to review the Safe Harbor statement. Please note that various remarks we make today about future expectations, plans and prospects, including the financial outlook we provide, constitute forward-looking statements for the purposes of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995.

Actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors, including those discussed in the Risk Factors section of our most recent annual report on Form 10-K, which is on file at the SEC, and can also be assessed on our website. These forward-looking statements represent our expectations only as of today, July 31, 2014. While the Company may elect to update these forward-looking statements, it specifically disclaims any obligation to do so.

During today's call, we will be referring to certain non-GAAP financial measures. A reconciliation of these non-GAAP financial measures to comparable GAAP financial measures is included in today's earnings release, which is located in the Investor Relations section of our website at www.SSCTech.com. I will now turn the call over to Bill.

Bill Stone *- SS&C Technologies Holdings Inc - Chairman & CEO*

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Thanks, Justine. I'll start with a brief overview of the quarter, and then turn it over to Norm, who will take you through some operational highlights. And then Rahul, who will take us through our alternatives business. And Patrick will run through some details on the numbers.

First, I would like to thank everybody who attended our Analyst Day in June, whether you were in person or on the webcast. We appreciated the opportunity to share with you our outlook for the Company and the industry at large. And we particularly were thankful for the great response we had.

Now to Q2 performance. We delivered revenue of $188.7 million in the second quarter of 2014, up from $177.5 million in the same period of 2013. And our adjusted diluted EPS was $0.57 per share, an increase of 18.8%. Our sales pipeline continues to grow, and we are gaining some traction. The deal sizes are also growing, and we believe we are very well-positioned.

M&A activity is also robust, and we continue to methodically go through our opportunities. As we stated at our recent Analyst Day, we continue to execute on our strategy through selling into our core markets with world-class technology, using the cloud and our overall expertise. With that, I'll turn it over to Norm.

Norm Boulanger *- SS&C Technologies Holdings Inc - President & COO*

Thanks, Bill. We saw solid performance in the business in Q2. Regarding the state of the business, we are capitalizing on demand across our software and services, and continue to invest in sales and service expertise to support our opportunity.

The first half of year we signed a number of large, complex customers. Organizations such as Ares Management, service investment partners and REIT customers require deep expertise to sell and support. We're well-positioned to deliver quality technology, services and expertise to support their complex requirements.

At the same time, we are leveraging these wins to create new opportunities. In Q2, we realigned our institutional asset management and SS&C PORTIA divisions into one single organization, led by Christy Bremner and Tim Reilly. We believe the new organization will perform at a high level, servicing our customers from both license and outsourcing perspectives.

In Q2 we hosted our annual Investment Intelligence Summit. One of the most notable things about the event was the sheer amount of solutions we showcased. This is a reflection of the investment we have made across our business for our customers. As announced at the Summit, we launched new investment intelligence capabilities that transform how our customers can access their data through the cloud.

In Q2 we signed a number of deals across the business. One of the world's leading banks selected our managed service for performance attribution through client reporting for approximately 900 institutional clients. A UK-based $4 billion wealth manager selected Global Wealth Platform that supports 1,000 high network customers. Two existing customers expanded the use of SS&C PORTIA.

A privately owned Canadian investment firm selected our client reporting solution. We licensed the use of our Benefits XML technology and IP rights to a prior licensee of our Benefits XML product. A large law firm with wealth management services selected our performance and client reporting solution.

A mortgage REIT selected our reconciliation solution. And a wealth management firm selected global wealth platform for its full front-to-back-office requirements. Now I'll turn it over to Rahul to go through the alternative asset management business.

Rahul Kanwar *- SS&C Technologies Holdings Inc - SVP & Managing Director of Alternative Assets*

Thanks, Norm. As reflected in this quarter's results, we continue to see strong demand for our product and services. Revenue for alternative assets grew 7.5% over Q2 in 2013. And the pipeline of opportunities remains robust, several of which we converted into customers during the quarter.

We continue to see demand from investment managers situated across complex asset classes, and require scale and risk mitigation in their internal operations. Some focus areas include front office support and middle office functions. Offering solutions in these areas, combined with funded administration and our cloud-based technology, enabled us to win several deals this quarter. In one example, a $4 billion private equity and hedge fund manager expanded our current relationship to include middle office and private equity servicing.

Many of the prospects we are currently speaking to are interested in similar service offerings. Over the past several quarters, we have been enhancing our services for alternative investors, like consulting organizations, state pension plans, sovereign funds and endowments and other large investors. Our demonstrated expertise helps

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these organizations execute investment decisions, manage relationships, monitor the underlying investment funds and the funds' performance and analytics, including looking through to exposures and risk parameters. All exposed via the web or on mobile devices.

We won a well-recognized name in the asset allocation business in Q2, and view this as a growth area for the future. Regulation continues to drive the sale of new services, as well as create an entry point in organizations that aren't already customers. For example, we signed several customers to our FATCA, NX4 and depositary lite offerings, and continue to work on additional regulatory products we can offer. I will now turn it over to Patrick.

Patrick Pedonti - ***SS&C Technologies Holdings Inc - CFO***

Thanks, Rahul. We reported for the quarter revenue of $188.7 million. GAAP net income was $27.2 million and GAAP diluted EPS was $0.31. Revenue increased $11.3 million or 6.3% over Q2 2013. Strong license revenue and year-over-year 5.4% growth in our software enabled services business drove the growth in the quarter. Foreign-exchange had a negative impact on revenue of about $100,000 in the quarter.

Adjusted operating income for the second quarter was $74 million, an increase of $5.2 million or 7.6% from the second quarter of 2013. Operating margins increased to 39.2% from 38.7% in Q2 2013. We continue to make significant progress on implementing the GlobeOp and PORTIA acquisition cost synergies, and currently expect to generate approximately $23 million in savings for the full-year 2014. In addition, operating margins significantly improved in our fund administration business in the quarter.

Adjusted consolidated EBITDA was $77.7 million, with 41.2% of revenue. This is an improvement of 7.1% compared to Q2 2013. Net interest expense for the quarter was $6.6 million, and includes $1.4 million of non-cash amortized financing costs and OID. Interest expense decreased due to the $244 million of debt pay-down we've made since the second quarter of 2013 and the 2013 credit facility repricing that reduced our weighted average interest costs from 4.2% in the second quarter of 2013 to 3% in this quarter.

We reported a GAAP tax provision in the quarter of $11.5 million, or 30% of pretax. In the first quarter, we recorded a non-cash charge of $2.5 million to adjust our differed tax liabilities for tax changes that were enacted in New York State. Excluding this one-time item, our year intake tax rate was 28%.

Adjusted net income was $49.6 million, and adjusted diluted EPS was $0.57. The adjusted net income excludes $21.3 million of amortization of intangible assets, $2.8 million of stock-based compensation, $1.4 million of non-cash debt issuance costs, and $4.6 million of unusual expenses. Including $2.4 million related to legal expenses for an IP infringement lawsuit we settled in the second quarter, and $1.9 million for two facility's consolidations. The effective tax rate we used for adjusted income was the same 28%.

On the Balance sheet and cash flow for the quarter as of June 30th we had $73.5 million of cash and $675.0 million of gross debt for a net debt position of $601.5 million. We had strong operating cash flow for the first six months. Operating cash flow was $92.8 million, a $22.8 million increase or 33% over Q2 2013. Cash flow was driven by improved earnings, improved working capital management, and lower accounts receivable DSO.

For the six months, we've paid out $107 million of debt. That brings the total to $482 million of debt pay-downs since the GlobeOp acquisition in June 2012. We purchased 186,000 shares of SS&C stock for a total of $7.4 million for the six-month period. And we used $11.2 million for capital expenditures and capitalized software, 3% of revenue. We paid $15.3 million of cash taxes compared to $15 million in 2013. The accounts receivable DSO as of June was 43 days compared to 45 days in December 2013.

In financing activities, we recorded the proceeds from option exercise of $12.3 million, and a tax benefit related to those option exercise of $8.2 million. - LTM consolidated EBITDA was $304.7 million as of June, and based on our net debt position, our leverage ratio was 1.97 times.

For outlook for Q3 and the year -- for Q3, our current expectation is revenue in the range of $190 million to $194 million, adjusted net income of $50.5 million to $52.2 million and diluted shares in the range of 87.4 to 87.7 million. For the full year, our current expectation is revenue in the range of $757 million to $770 million, which represents a growth of 6.2% to 8% over 2013. Adjusted net income in the range of $198.5 million to $206 million, and diluted shares increasing approximately 2.4% compared to 2013, to a range of 87.5 to 87.8 million.

And we expect the effective tax rate to continue for the full year to be 28%. And then, for the full year, we expect cash from operating activities to be in the range of $225 million to $235 million, and capital expenditures to the range of 2.3% to 2.8% of revenues. We'll use all excess cash flow this year to fund potential acquisition, buy back shares on the open market, and pay down debt. Now I'll turn it over to Bill for final comments.

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Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

Thanks, Patrick. We had a good first half, and we have momentum going into the second half of the year. We expect acceleration in our business, and we are confident in our strategies, our people, our products and our [prophecy]. Patrick said for the full year we expect revenue between $757 million and $770 million. And I'll now open up for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Ashish Sabadra from Deutsche Bank.

Ashish Sabadra - ***Deutsche Bank - Analyst***

Hi, thanks for taking my question. License revenues are pretty strong in the quarter. I was wondering if you could provide some more color around the demand environment there, what's driving the demand for licensed software. Thanks

Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

Yes, I'll take that first, then maybe Norm can comment. We have spent a lot of time building out our sales force, and we had a good license quarter. We had one particularly large license that came in, in the quarter, and that helped buoy those results. We do have a strong pipeline on licenses, and we're looking forward to a strong Q3 in licenses, as well. Norm?

Norm Boulanger - ***SS&C Technologies Holdings Inc - President & COO***

Yes, Bill, there's a couple things from my perspective is, we have been working very hard to improve our license sales and we're doing that across the business. And some of the new organizations like the PORTIA organization broaden our opportunities. So what we are seeing is, on a given quarter, I think we have a bigger opportunity to close a good license.

We have a good license quarter. But in the license business, it comes down to execution and execution on time. So I feel really good that over the next couple of quarters, if we execute well, we could have some good license contributions.

Ashish Sabadra - ***Deutsche Bank - Analyst***

That's great. Just a follow-up question on the sales force ramping up. I believe your plan to ramp up your sales force from 110 to 150 by the end of the year. I'm just wondering if you could provide some color on how that's going, and then comment on the sales productivity, as well.

Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

Yes, I think that we continue to interview sales candidates around the country and around the world, and we are continuing to hire. I do think it is aspirational to get to 150 by the end of the year, so I would not be surprised if we come in at 130 or 135.

That doesn't mean that we wouldn't go to 150 if we could find the candidates. But it is something where we are being very selective. We really have a very robust pipeline, and bringing that pipeline home takes a lot of effort, and sometimes that effort conflicts with all the interviewing and hiring of additional sales people.

Ashish Sabadra - ***Deutsche Bank - Analyst***

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Yes, that makes sense. Just quickly on the software-enabled services. We usually see a sequential improvement from 1Q to 2Q. Relatively flat this time. The growth was slightly slower. But I was just wondering if there is anything -- any particular call-out there. And how should we think about the growth for software-enabled services through the rest of the year?

Norm Boulanger *- SS&C Technologies Holdings Inc - President & COO*

Bill, I can take that if you want.

Bill Stone *- SS&C Technologies Holdings Inc - Chairman & CEO*

Yes, go ahead.

Norm Boulanger *- SS&C Technologies Holdings Inc - President & COO*

There are two things I think that's worth mentioning is, one is there's always been seasonality in the first couple quarters for tax and regulatory services. And as that business has grown, it's shifted a little bit into Q1 versus Q2. And the other thing is, we are signing lots of large outsourcing opportunities that the timing of that revenue has impacted us a little bit. So from my perspective, those are the primary factors in the sequential -- lack of sequential growth. In going forward, I think you'll see a bounce-back.

Ashish Sabadra *- Deutsche Bank - Analyst*

That's great; that's good to hear. One quickly on the acquisition pipeline. I was wondering if, as you continue to look at your M&A pipeline, if there's anything you can comment on, on the pipeline itself or asset valuations?

Bill Stone *- SS&C Technologies Holdings Inc - Chairman & CEO*

Yes, I think as you guys could probably tell on the call, that we're pretty proud that our leverage ratio is at 1.97 times. What that does is give us a lot of flexibility, and we're constantly in search mode for the right kinds of acquisitions, and we think that there's opportunity out there. And hopefully, we'll be able to get some execution. So we think it's robust.

Asset valuations are high because interest rates are low. But as I have talked with some of the investors, it is a little bit of a springtime for acquisitions in 2014, 2013 with -- I think our overall interest rate is 3%. So if we can be disciplined and buy good properties that fit in with our strategy, acquisitions are a very attractive thing for us.

Ashish Sabadra *- Deutsche Bank - Analyst*

That's great. Thanks for that color.

Operator

Sterling Auty from JPMorgan.

Darren June *- JPMorgan - Analyst*

Hi, it's Darren June from JPMorgan on for Sterling. Thanks for taking my question. I'm just was wondering, given that the high-end of the full-year guide for revenue is coming down slightly. And given that you've mentioned the pipeline is pretty healthy, I'm just wondering if there is any impact that you're seeing from a higher churn rate? Or what the reason would be for the high-end of the range coming down a little bit?

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Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

Yes, as we have gone from being a 40%, 50% licensed business on a quarterly basis to being -- I think we did almost $10 million out of $188 million, so about 5% from license business. What we are is a recurring revenue business. So if we sign a $4 million deal in recurring revenue in September, we're really -- if we can get them to start in October, we get three months worth of revenue. And there's a good chance if we sign them in September, we get them to start in November, so we get two months worth of revenue. So two 12s, so $4 million is -- 1/6 of $4 million means that we get $800,000 or something in -- not quite, maybe $700,000 that we get in the year.

So there's just a little bit of a lag factor with these great big deals, getting them closed, and then also getting the date for them to get started so that the revenue engine starts to kick in. That's why you see the top end being flipped a little bit.

Darren June - ***JPMorgan - Analyst***

Okay, understood. And then just another one. I think in the past, you've talked about -- or you were expecting a couple of large accounts to ramp in the second quarter. I'm just wondering if that happened. I know you mentioned a number of large signings, a couple of deals that got expanded. I wasn't sure if those pertained to the couple of large deals that we were thinking of.

Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

Yes, one of them is Virtus, which we announced last quarter, and that's in process.

Darren June - ***JPMorgan - Analyst***

Okay.

Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

That we're converting. And then another one that we have is a very large REIT that we're also in process of implementing. And again, we have -- like I said, we have a very full pipeline. These are large, sophisticated organizations with very bright people. And they are the best in the world at what they do, which means they also can afford anything that they want. So when we win, we have to execute, and there's a big competition to win that business.

But we're excited about where we stand, and we think that revenue will accelerate from here. But could I tell you it's going to be in Q3 or it's going to be in Q4? I'm not that crystal ball-ish. But I'm pretty confident that revenue is going to accelerate, and it's not going to be years.

Darren June - ***JPMorgan - Analyst***

Okay, thanks for taking my questions.

Operator

(Operator Instructions)

Elizabeth [Cooley] from Needham.

Elizabeth Cooley - ***Needham & Company - Analyst***

Hi. Can you give us any additional color on increased regulation and compliance driving new business? And I'm also curious if you guys are seeing the impact more with new customers or with the expansion of existing customers?

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Rahul Kanwar - ***SS&C Technologies Holdings Inc - SVP & Managing Director of Alternative Assets***

I'll take that. I think we see regulation doing a couple of things. One, it helps us provide more value to current customers. So there is expansion in current customers, and you can see that whether -- you see it with PF -- Form PF two years ago, or with FATCA that everybody's trying to comply with right about now. And some of the things that are happening in Europe with AIFMD. So that's one opportunity.

The other opportunity is, it is an entry point for us, as I said in my remarks, into new organizations. Because even if they are using somebody else or some of our core services, they generally have a need related to these regulatory offerings. And to our knowledge, there's not that many administrators that have built cloud-based platforms and a team of experts that can provide these services. And a lot of times when we're in those organizations, we can expand and branch off into other areas. So both of those are positive drivers for us.

Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

And recently, we just -- in Q3, we picked up a client in Europe that's using our AIFMD NX4 processing, and it's over $0.5 trillion in asset managers. It's an entry point, and we think it gives us a lot of opportunity to burrow deeper into those large organizations.

Elizabeth Colley - ***Needham & Company - Analyst***

Okay, thank you. And I just have one additional question. Can you guys give any updates on margin trends for the rest of the year? And also just remind us the levers to get us to the high-end of the margin, or the long-term range you guys give for EBITDA, 40% to 42%?

Patrick Pedonti - ***SS&C Technologies Holdings Inc - CFO***

This is Patrick. If you look at the -- and I'll just talk about operating income margins first. But if you look at the range that we provided for the year of $757 million to $770 million, I think initially during the year we thought our margins would be up about 50 bps compared to 2013. Now we think in that range they'll be up anywhere between 40 and 100 bps, on that range of revenue. And we'll see similar expansion in the EBITDA margin over 2013.

And really, at this point, the focus is continuing to implement the synergies with the GlobeOp and PORTIA acquisitions we did in 2012, continue to improve productivity in our software-enabled services business, and then take advantage of low-cost areas like India and then our Indiana operation. And I think one other thing, as you saw in the quarter, we did take a charge for some facilities consolidation, and we're continuing to look at that to reduce our long-term facilities costs.

Elizabeth Colley - ***Needham & Company - Analyst***

Okay. Appreciate your answering my questions.

Operator

(Operator Instructions)

Peter Heckmann from Avondale.

Peter Heckmann - ***Avondale Partners - Analyst***

Good afternoon, everyone. Patrick, I wanted to ask a question as regards exposure to trading volumes. I know this is not a big item, maybe 4% or 5% of total revenue. But I wanted to see if the decline in equity trading volumes in May and June and the declines that we've seen on the fixed income side are contributing any noticeable drag to revenue growth within software-enabled services.

Patrick Pedonti - ***SS&C Technologies Holdings Inc - CFO***

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I'm just looking quickly at those product lines, and I don't think -- we didn't see them going up, but they're pretty flat year to year.

Peter Heckmann - ***Avondale Partners - Analyst***

Okay. And then, I would've expected a little bit more benefit on the currency line. Is there something I'm not totally taking into account, given some of the strength of the pound, is there maybe some (multiple speakers)

Patrick Pedonti - ***SS&C Technologies Holdings Inc - CFO***

I think what's hurting -- yes, what's hurting us is the Canadian dollar.

Peter Heckmann - ***Avondale Partners - Analyst***

The Canadian dollar, okay.

Patrick Pedonti - ***SS&C Technologies Holdings Inc - CFO***

We've got more exposure in the Canadian dollar on the revenue side than we do in the British pound.

Peter Heckmann - ***Avondale Partners - Analyst***

Got it. All right, thank you.

Operator

At this time, I am showing no further questions. I would now like to turn the call back over to Bill for closing remarks.

Bill Stone - ***SS&C Technologies Holdings Inc - Chairman & CEO***

Again, thanks, everybody, for dialing in. We appreciate during your summer season that you're able to take an hour out to be with us. And we look forward to talking to you at the end of next quarter. Thanks.

Operator

Ladies and gentlemen, that does conclude the conference for today. Again, thank you for your participation. You may all disconnect. Have a good day.

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