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EDITED TRANSCRIPT

YHOO - Q2 2014 Yahoo! Inc Earnings Call

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OVERVIEW:

YHOO reported 2Q14 GAAP revenues of \$1.084b and revenues ex-TAC of \$1.04b. Expects 3Q14 GAAP revenues to be \$1.06-1.10b and revenues ex-TAC to be \$1.02-1.06b.



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PRESENTATION

Operator

Good afternoon, and welcome to Yahoo's second quarter 2014 earnings video webcast.

(Operator Instructions)

As a reminder, this conference call is being recorded. The webcast today will be moderated by our business reporter from Yahoo Finance, Mike Santoli.

Before getting started, I would like to remind you that today's presentation will contain forward-looking statements about our expected financial and operational performance, including business and financial strategies, revenue growth, products and ad sales. Actual results might differ materially from our projections. Potential risk factors that could cause these differences are described in our Form 10-Q filed with the SEC on May 8, 2014. All information in this video is as of today, July 15, 2014, and we undertake no duty to update it for subsequent events.

Today's discussion will include non-GAAP financial measures. Reconciliations of our non-GAAP results to the GAAP results we consider most comparable can be found in our earnings slides, which also contain full versions of the financial charts and graphs you will see in today's video. We encourage you to review the complete earnings slides in our Investor Relations website at investor.yahoo.com under the earnings tab. And with that, let me turn the program over to Mike. (Music).

Mike Santoli - *Yahoo! Inc - Business Reporter, Yahoo Finance*

Welcome to Yahoo's second quarter 2014 earnings video webcast. I am Mike Santoli, and I will be moderating today's earnings event. Here with me are Marissa Mayer, Yahoo's Chief Executive Officer, and Ken Goldman, Yahoo's Chief Financial Officer. Today we bring you prepared remarks from both Marissa and Ken around Yahoo's second quarter performance. Later they will be answering your questions submitted by e-mail. Institutional investors were encouraged to submit questions, and we have selected a few questions that were representative of the group. I would now like to turn it over to Marissa to discuss Yahoo's second quarter business update. Marissa?



Marissa Mayer - Yahoo! Inc - CEO

Thanks, Mike, and good afternoon, everyone. Thank you for joining our Q2 earnings live stream. I want to begin today's call with some perspective on where we stand, in the overall transformation of our business. We have transformed our culture by focusing on our strategy on speed and execution. We have transformed our products, divesting in those that are not strategic, and investing in those that can drive long-term growth. Along the way, we have reinvented every single major consumer product at Yahoo.

And now we are transforming the ways in which we generate revenue, countering declines with investments in new products, platforms and businesses. What we know is this, transformation is not a singular event. It is a series of events and quarters, some more challenging than others, and some more successful than others, and it will take time. And in the case of Yahoo, I have stated in the past that we believe a transformation of this size and scale will take multiple years. And we continue to believe that is the case today.

Even so, given our top priority of long-term sustainable growth, we are not satisfied with our results this past quarter. In Q2, we delivered \$1.04 billion in revenue ex-TAC, which is down approximately 3% year-over-year. Looking at the core of our business, search hit \$428 million in revenue ex-TAC, representing 6% growth year-over-year. On the display side, we saw some specific challenges with \$394 million in revenue ex-TAC, a roughly 7% decline year-over-year. I will return to the specific revenue analysis around the challenges, after our quarterly product update.

In the past, we have consistently talked about our product in terms of four areas, search, communications, digital magazines and video. All powered by two tremendous platforms, Flickr and Tumblr. We have also discussed our strategy of speed, quick decisions, quick execution, quick implementation. And I want to walk through our progress in Q2, and help connect this strategy to real-time progress in our business.

Let's start with search. Last quarter, we acquired Aviate, as part of our efforts to accelerate mobile search. As a contextual personal home screen product for Android users, we are excited about the opportunity to deliver the right information and applications at the very moment of relevance. In late June, we brought Aviate out of beta, receiving an incredible response, and rapidly growing users 2.5 times over in the first week alone, and we are seeing our users interact with the new Yahoo Aviate an average of 50 times a day, making it a truly daily habit.

In terms of search monetization, we continue to make great strides with our Gemini marketplace, the very first unified mobile search and native buying platform in the industry. We are incredibly excited that for the very first time since 2010, we are serving our own mobile search ads in the United States, and we continue to see the power of consolidating all mobile advertising into one marketplace. Gemini now represents 50% of Yahoo's mobile display revenue in the United States. I am also excited to report that our mobile display and our mobile search revenue, each grew more than 100% year-over-year. In Q2, we continue to iterate on our search experience, servicing relevant information like event invitations, upcoming flights, package tracking data and more into the search experience. This sort of integration not only improves the user experience, but it also brings a unique value proposition to millions of Yahoo Mail users, leveraging our scale and long-standing market position.

Now let's turn to communications. In Q2, we launched a re-imagined mail app, integrating search, news and content into the ultimate daily habit, communicating with friends and family. What is notable here, is that we are bringing the best that Yahoo has to offer into one experience. So now when you are checking your e-mail, you can catch up on the latest headlines, check the weather, see how your favorite sports team is doing, or check in on your stock portfolio, all in the same application.

The result has been a more immersive, engaging experience that users are responding to positively. On the iOS app, we have added one minute of time spent per user per day, and page views have increased over 70% compared to the previous mail app. And on Android, we have seen time spent per user increase by 65%. Developed in under six weeks, our latest mail app is yet another testament to the abilities of our teams to be mobile first, move fast, and launch products our users love.

Next, I want to turn to our digital magazines. Digital magazines are fundamentally reinventing the way users experience digital content, making it more modern and immersive, complete with distinct editorial voices, and beautiful native advertisements. This past quarter, we launched three digital magazines, Yahoo Movies led by Josh Wolk, previously an editor for Vulture and Entertainment Weekly, Yahoo Travel, led by Paula Froelich, formerly of the New York Post, and Yahoo Beauty, led by industry maven Bobbi Brown. And the launches continue, just earlier today we launched Yahoo Health, the latest edition to our line of digital magazines.

The response to our digital magazines continues to be strong. I want to note something I mentioned on previous calls, content sharing. We are seeing share rates on these magazines at a higher rates than on our other verticals, speaking both to the quality of the content, and the opportunity to connect with users beyond the Yahoo network. This continues to be an area of investment and opportunity for us. More importantly, digital magazines are one of the driving forces behind growing our display business, especially our native ad inventory.

Our digital magazines magazine verticals are increasingly becoming attractive placements for brand advertisers eager to see themselves next to premium content. We also made some exciting progress this quarter, with the integration of Tumblr into our digital magazines. When we acquired Tumblr just over a year ago, we saw what many of you saw, a tremendous platform for creators and curators to share. We also saw something else, an incredible canvas to bring brands to life, unconstrained by cookie-cutter pages or character limits.

And in Q2, we began to make more meaningful steps forward in the monetization of Tumblr, with native Tumblr-sponsored posts. This announcement effectively combines the creativity of Tumblr with the scale of Yahoo, allowing advertisers to seamlessly promote their content and their brands across the Yahoo network. We are very excited about this move forward, as it truly marks one of the most meaningful integration opportunities we see between Tumblr and Yahoo. As the industry shifts to more and more digital advertising, the need for high-quality engaging brand content will continue to grow exponentially, and we are proud of that 65 of the Ad Age top 100 brands are already leveraging the Tumblr platform to create and share content.

And finally, I would like to turn to video and Yahoo Screen. In the past, I have talked about building our video library in order to engage and grow our video audience. Q2 was no different. We have continued our focus on video, with investments in unique premium content. Fundamentally, premium content draws premium advertisers, and we have had early success bringing these opportunities to market.

In April, we announced that two original series, Other Space and Sin City Saints would be debuting on Yahoo screen. Both led by teams of Emmy-nominated directors and producers, we are confident audiences are going to love these two new shows. And in June, we announced that we will host the 6th season of the TV show, Community exclusively on Yahoo screen with 13 new episodes. We are thrilled by the positive response from the Community's passionate following, and we are excited to welcome those fans to Yahoo.

We also made an exciting partnership announcement with Live Nation in April. Yahoo will be broadcasting one live concert on Yahoo Screen every day for a year. That is 365 concerts, over 365 days, and coincidentally it all starts tonight with the Dave Matthews Band, and their debut of their new acoustical format. Tune in at 7:20 Eastern Time at Yahoo.com/live.

As I said earlier, we are building our content library, bringing new audiences and younger viewers to Yahoo. While the reinvention of our video business is still in its early days, I am heartened by the user growth metrics we are seeing both in the broader market and internally. For example in Q2, we saw a 22% increase quarter-over-quarter in daily active users on Yahoo Screen. And we saw a 29% increase in daily active page views, which represents a 67% increase year-over-year. Again, our video business is still early, but these initial strides are building the foundation for more meaningful user and advertiser growth in the future.

Moving from products to revenue, I want to discuss a bit of what we saw this quarter. In Q2, we saw two key issues specific in our -- specific to our business, both were in traditional PC display. While traditional PC display is an area that is in decline across the industry, the two issues that we saw were unrelated to this trend. We believe they will be short-lasting, and can be corrected in the next one to two quarters.

The first issue concerned our delayed execution of our audience transition to Yahoo Ad Manager Plus. We took extra time to ensure the product was delivering for our advertisers. During that period, buying on Genome, our existing audience platform slowed, and we were left with a revenue shortfall.

Fundamentally, Yahoo Ad Manager Plus is an important driver in growing our display business long-term, especially as programmatic buying continues to evolve and grow. While it is still early, Yahoo Ad Manager Plus has already been well-received. Throughout Q2, I met in small group settings with approximately 500 advertisers and agencies representing more than 350 brands, and we have been hearing consistent excitement and interest in the opportunities we are unlocking with Yahoo Ad Manager Plus.

Stepping back for a moment, I want to underscore that this is a completely new way to buy advertising on Yahoo. I am tremendously impressed with the speed with which we have built and scaled a buying solution at parity with the market. A transition of this magnitude will take time, and we now understand it will take a little longer than we originally forecasted. It is early, and we still have much to work to do, in bringing current and new advertisers onto the platform, but this is a tremendous growth lever that we are putting in place.

The second issue we saw in Q2, was a lower than expected contribution from premium advertising, resulting in an unfavorable mix shift. Premium exclusive high-quality content is best monetized through premium direct sales. Premium offers great opportunities to advertisers, and it also captures more favorable pricing. As such, we recognized that premium is an important part of our business that merits investment, especially in content.

This is why we have been investing in editorial to increase the quality of our media offering, improving engagement across our verticals, and ensure we have premium inventory to attract advertiser demand. Across premium, we will also continue to experiment with new ad units, better targeting and tools, to improve the performance and contribution from this segment. Moving to search revenue, Q2 represents our 10th consecutive quarter of search revenue growth ex-TAC, especially notable due to the Q1 expiration of the Microsoft RPS guarantee in North America. With global PPC up 15% year-over-year in Q2, and clicks up 3% through continued innovation in our science, our user experience and our partnerships, we continue to drive a sustained increase in our large search business.

Finally before I pass it over to Ken, I want to come back to the idea of transformation that I discussed at the beginning. While it is clear we have work to do on our display business, I want to be clear that the progress we saw this quarter, especially around the new ad technology that we rolled out towards the end of the quarter will have a long-term measurable impact on our ability to transform Yahoo. After Ken walks through our financial performance this quarter, I want to outline some of the key areas of growth that we see on the horizon, and our broader strategy around display advertising. Ken, over to you.

Ken Goldman - Yahoo! Inc - CFO

Thanks, Marissa, and thanks to all of you for joining us. Before we jump into the numbers, let me quickly touch on where I think we are today. Over the past two years, we have invested in people to develop engaging products, and position the Company for long-term sustainable growth. In Q2, some of the trends in display accelerated faster than expected, including pricing softness and programmatic adoption, which impacted our business.

While we are not pleased with the financial results we delivered this past quarter, we are in fact making good progress on a number of our important growth initiatives. What this quarter undoubtedly points out, is that we need to move even faster to improve our execution, and selling the right ads at the right price in our PC display business, and we need to execute faster on our new ad technology offerings across all of our four growth initiatives. Our industry and digital advertising landscape are both rapidly changing, and we remain committed and confident in our long-term vision for Yahoo.

Revenue growth remains our first priority. We are encouraged that search and mobile continue to show strong year-over-year growth. And as Marissa mentioned, we have identified areas of focus, and are actively working to deliver better results faster over time. And on the expense side, we are very mindful of our cost structure, and our results demonstrate our commitment to prudently manage expenses in light of our lower revenue and required investment initiatives. We believe that the current cost levels are approximately appropriate, and we would expect future revenue growth to provide operating leverage, and ultimately flow to the bottom line. We are constantly looking for ways to improve our cost base for efficiencies, including the \$62 million contra expense benefit from patent sales that we successfully monetized in Q2.

And our third financial priority, capital efficiency, we continue to follow through on our commit to shareholders as we repurchased 21 million shares at an average cost of \$34.94 per share, for a total of \$719 million during the quarter. We continue to see value in repurchasing our shares, and as equity holders ourselves, we believe this is a prudent use of capital at this time. Our share repurchase total of the past two years now exceeds \$6 billion.

We continuously to see long-term value in equity holdings, and today I am pleased to announce that we have reduced the maximum number of shares to be sold in the Alibaba IPO to 140 million from the previous 208 million. We are aware that there has been much discussion around the

allocation of the Alibaba proceeds during the IPO. On this initial tranche, we expect the proceeds will be fully taxed, and we are committed to returning at least half of the after-tax IPO proceeds to shareholders.

Regarding tax efficient structures on the remaining equity holdings, we approach all transactions with the goal of maximizing long-term value for our shareholders. These transactions are complicated, can take multiple years, involve multiple jurisdictions, and generally are not disclosed before completion. Please do not mistake our silence, as a lack of awareness or effort on this issue.

With that, let's go through our second quarter financial results, and later I will close with our forward-looking guidance. Once again, I will focus most of the discussion around non-GAAP results, which excludes stock-based compensation expense of \$102 million, and restructuring charges of \$53 million, primarily related to data center consolidation. As a reminder, you can find complete reconciliations between GAAP and non-GAAP results in our earnings slides on our Investor Relations website.

Now starting with the financial highlights for Q2, as seen on slide 5, so I am going to go through some of highlights now. Q2 GAAP revenue was \$1.084 billion, and revenue ex-TAC was \$1.04 billion. And as Marissa mentioned, search revenue ex-TAC continues to show strength, as it grew 6% year-over-year despite not having the benefit of the RPS guarantee this past quarter. Display revenue ex-TAC was down 7%, as we saw a shift toward lower price inventory in our ad mix. Looking at our search and display businesses, the combined core revenues was roughly flat versus the prior year. And other revenue was down 10%, as we saw weakness in some leads and fees-driven businesses.

Adjusted EBITDA, I should say was \$340 million in the quarter, which was above our guidance range as we were able to offset costs of \$62 million through our patent sales. Non-GAAP operating income was \$194 million, non-GAAP net income was \$382 million, or roughly flat versus the prior year. Earnings and equity interest of \$256 million contributed meaningfully, as it grew 14% year-over-year driven by the Alibaba Group. Non-GAAP EPS was \$0.37, up 5% versus the prior period, as our fully diluted share count decreased year-over-year by 7% to 1.015 billion shares for Q2, it was down more than 16 million from Q1. Lastly, free cash flow was \$186 million for the quarter, up 41% versus prior year as we improve working capital efficiencies.

Now let's take a couple minutes to go through the financial results in a bit more detail. I will begin with search. GAAP search revenue grew 2% and revenue ex-TAC grew 6%, marking another quarter of growth in the business. Once again, GAAP revenue growth was lower than revenue ex-TAC growth, due to the Microsoft transition in Asia Pacific. Similar with the last quarter, much of search strength can be attributed to click yield improvements as Price-per-Click grew 15% year-over-year, accelerating the growth trend from Q1.

This was a result of favorable traffic mix, as we saw a greater contribution of clicks from higher monetizing segments, specifically from the Americas region, and also on Yahoo-owned properties. Paid clicks were up 3% year-over-year, as traffic from Yahoo properties increased in each of the three regions. The growth was a slight deceleration from the prior quarter, as we were compared to a strong Q2 of 2013 that had 21% year-over-year click growth. These underlying operating metrics delivered a 19% year-over-year increase in search click revenue, once again strong double-digit growth, and the strongest growth during the 2.5 years we have been tracking this metric.

Now moving to display, gap display revenue declined 8% and revenue ex-TAC declined 7%, as pricing was down year-over-year resulting from a mix shift to a lower priced ad units sold. Growth in the number of ads sold accelerated in Q2 to 24%, as we continue to grow engagement in ad inventory, but the PPA decline of 24% offset the volume increases. Looking closer at Q2 display, our native stream ads continue to be a driver of ads sold as it more than doubled versus Q1, and now contributes 40% of total units. The contribution of premium ad units as a percent of total decline versus prior year, lead to an unfavorable mix shift. I will reiterate what Marissa said earlier. We believe we have a good strategy to monetize premium display across our several properties and platforms.

More positively, mobile display more than doubled year-over-year. Other revenue which includes the listings, leads and fees businesses was down 10% on an ex-TAC basis. In Q2, we also entered into patent license agreement that will result in approximately \$20 million per quarter of fee revenue over four years, and a smaller amount for the fifth year, which will start in Q3 of this year. For a revenue detail of our original region, please refer to slide 12. Revenue ex-TAC was down 2% versus prior year for the Americas region, in America, I am sorry, the EMEA revenue ex-TAC grew 2% year-over-year. And turning to APAC, revenue ex-TAC was down 8% as foreign exchange was negative \$6 million revenue impact in the quarter.



Now briefly moving to expenses, traffic acquisition costs were down 32% compared to prior year. As a reminder, we substantially completed our migration of the Microsoft search monetization platform for AsiaPac in Q4, contributing to the year-over-year declines in TAC. Non-GAAP total operating expenses were down 2%, as we saw lower depreciation costs related to reduced capital spending, and realized cost benefits from the patent sales. Product development costs were higher than prior year, as we continue to invest in our technical capabilities, and incorporated the acquisitions from 2013. Most of the increase in operating expense was workforce-related, as we continue hiring in key areas of product and engineering. Our total headcount increased 5% versus the prior year, as we ended the quarter with approximately 12,300 employees.

Reviewing GAAP total operating expenses, stock-based compensation expense was higher on a year-over-year basis due to the higher underlying stock price, as well as new equity grants issued. Depreciation was down due to lower capital spending, while amortization of intangibles increased as a result of the acquisitions. EBITDA was \$340 million in Q2 as our margin remained relatively flat at 33% on a revenue ex-TAC basis, which includes the \$62 million benefit from patent sales. Non-GAAP operating income was \$194 million for the quarter, resulting in a margin of 19% on a revenue ex-TAC basis.

And now rounding out the income statement, other expense includes imputed interest on the convertible debt, our non-GAAP tax rate was 28% as we realized some discrete tax benefits in the quarter. Earnings and equity interest grew 14% year-over-year to \$256 million, reflecting growth in Alibaba Group offset, by a decline in Yahoo Japan. Non-GAAP EPS increased \$0.02 per share year-over-year to \$0.37 in Q2, as we reduced our diluted share count by 7%.

Turning to the balance sheet, at the end of Q2 we had \$4.3 billion in cash and marketable securities, which was down \$300 million quarter-over-quarter. The change in cash balance was primarily driven by share repurchase activity of \$719 million, strong cash flow of \$186 million, proceeds from sale of foreign exchange contracts of \$170 million, dividends received from Yahoo Japan of \$84 million, and net proceeds from employee equity of \$50 million.

Now, let me turn to guidance. As we look to the second half of the year and going forward, we are committed to sustainably and predictably growing our business. Growth is absolutely a function of success and our new investment businesses, and clearly we need to operate with an even greater sense of urgency. Given the trends from this past quarter, we have elected to reset our expectations.

Our guidance assumes that the declines we saw in Q2 do not reverse in Q3, and as a result, we expect Q3 results to be comparable to Q2. Our Q2 guide -- our Q3 guidance has the following assumptions. Given the Alibaba IPO, we have assumed the normal quarterly Alibaba TIPLA amount and pro rata recognition of the royalty. Equity earnings from Alibaba will cease in quarters following their IPO.

For revenue, we are expecting growth in initiatives we have discussed, mobile, social and video through narrative -- through native I am sorry, but we also mindful of seasonality in our business in Q3. Short-term expenses are expected to be approximately \$800 million, a modest sequential increase when adjusted for the patent sales in Q 2. For Q3 guidance, we expect the following GAAP revenue -- effective following I should say, GAAP revenue range of \$1.06 billion to \$1.1 billion, revenue ex-TAC in the range of \$1.02 billion to \$1.06 billion, EBITDA in the range of \$220 million to \$260 million, and non-GAAP operating income in the range of \$70 million to \$110 million. Thanks again for your time. Let me now turn it back to Marissa.

Marissa Mayer - Yahoo! Inc - CEO

Thanks, Ken. I started today's call talking about the transformation of our business. I want to spend some time now talking about what that transformation actually looks like. In the past, I have said that achieving long-term sustainable revenue growth would take multiple years. This is especially true, given that Yahoo had experienced approximately five years of prior revenue declines. Stabilizing the business and reversing that historical trend takes time.

If you step back, and look at where we were two years ago and where we are today, and more importantly how quickly we got here, I am very impressed with our achievements. Two years ago, Yahoo lagged lacked a clear vision for the future, and some of the key fundamentals to build a vibrant growth business. Today our ability to focus and execute has led to some dramatic and critical changes. In Q2 2012, our mobile user base

was hovering just above 200 million monthly active users. Today I am happy to report that Yahoo saw 450 million monthly active users for the very first time in Q2 2014, representing more than 100% growth in just two years.

In addition to driving user growth, mobile has also delivered step changes in engagement, with time spent on mobile growing 79% in the last year alone. This growth in traffic has been the direct result of two things, great people and great products. We have been particularly focused on recruiting great technical talent. Since Q2 of 2012, our technical workforce has grown more than 11%, and this will continue to be a point of focus and investment.

And this influx of talent has had a very real impact on our products. Two years ago, our products were noticeably scattershot. They were lacking in quality, and fundamentally lacked a clear consistent user value proposition. To help deliver focus, we have sunset more than 60 products and services over the past two years, and redirected these resources towards products that are fundamental to our vision for growth. Today our products have evolved into a contiguous suite, anchored by Yahoo's four core strengths, search, communications, digital magazines, and video.

Just take a look at where our homepage was two years ago, and where it is today, or where Yahoo Mail was two years ago and where it is today. Or our new digital magazines like Yahoo Beauty, or our lineup of new line up of new coherently branded and designed mobile applications, almost all of which are entirely new in the past two years. In fact, our mobile applications have won the Apple Design Award two years in row. Our win with Yahoo Weather last year, was followed up with a back-to-back win by Yahoo News Digest this year, and Yahoo Finance, the platform for today's earnings call, and our industry-leading financial and business new news property, and finally our ad business.

Two years ago, Yahoo operated a primarily hands sold premium business that was quickly losing relevance amidst broader industry shifts to be mobile first, and programmatic buying platforms. As I spoke about earlier, we have invested tremendously to overhaul our ad technology, to streamline our advertiser offerings across the Yahoo network, and to strengthen the opportunities for programmatic buying. Getting here required speed. Sometimes when you move fast, you misstep, but speed as a strategy has worked for us. We have proven that. Through the tremendous increase in our focus and quality of our core products, and speed will continue to guide our efforts to grow Yahoo's business.

More than almost anywhere else, speed is an important part of our strategy to grow our display business. And I want to spend some time here, as this is of utmost importance to us. Looking back this time last year, our display offerings had fallen behind the industry. But today as we look at where we stand, we believe we are at parity with the market, and we are also leading the charge with some very innovative new technologies and ad formats, including programmatic buying, audience targeting, viewability and disruptive ad units.

Starting with programmatic, the maturity of real-time bidding platforms has opened up a growing market, where programmatic is a key component of any advertiser's buying strategy. Every day we see and hear, the industry shift to programmatic, that it is happening even faster than everyone expected. To that end, we expect that more than 80% of all digital display advertising in the US will be bought programmatically by 2017. As I noted earlier, Yahoo Ad Manager Plus is a critical play here, to help us capture that programmatic buying opportunity. Moving to audience targeting, marketers are increasingly relying on data to better understand audiences, and serve the right ad, to the right user at the right moment. Yahoo audience solutions leverages our data, first-party data and third-party data to reach highly relevant audiences across Yahoo premium inventory and across the web.

Next viewability. In June, we launched Yahoo Prime View, a new ad product that provides brands the ability to run display campaigns at a 100% viewability rate on Yahoo. While Yahoo Prime View is currently only available for display in ads in the United States, we plan to take the offering across the Yahoo global network. We are excited about this product, and see it as an important step towards creating a simple, transparent advertising ecosystem, that will allow brands to understand the real and best impact of their media investments.

And finally disruptive ad formats. Over the last few months, we made a concerted effort to shift our focus and inventory toward native, to empower enhanced brand storytelling. And as I mentioned earlier, we also launched three additional digital magazines, boosting native inventory on the Yahoo network. But our focus here has not just been limited to increasing available inventory. We have also been hard at work developing new ad formats. Splash ads, our largest display ads, are complete with autoplay video and dynamic sizing, so they fit organically into the digital magazine's experience.



Another new ad format is our Tumblr sponsored posts, which I spoke about earlier. These are just a few of the efforts that we have focused on stabilizing and growing our display business, particularly in traditional PC display. In the past, we have talked about our four growth businesses, both for Yahoo and for our industry, mobile, social, native and video. And while still small relative to Yahoo's broader business, we continue to see accelerating growth here, and thus continue to invest. This quarter I am happy to report that we collectively saw these businesses grow at nearly 90% year-over-year, a growth rate that we believe continues to outpace the industry at large.

I would like to provide further updates in these areas. Let's start with our first investment business, mobile. Yahoo today is a mobile first company. This is something we are very proud of, and this is a tremendous change from where we were less than two years ago. Increasingly, smartphone users are spending more time on mobile apps versus mobile web. In fact, the average user now spends 86% of their time on smartphones in apps.

As one of the biggest app development houses, if not the biggest in the industry, this trend is favorable to Yahoo and our business. At present, we have more than 400 Yahoos working exclusively on building iOS and Android apps. This investment is paying off. As I mentioned a few moments ago, this quarter we surpassed more than 450 million mobile monthly active users, a 36% increase year-over-year. With regard to mobile search, we really believe that the mobile search experience should be completely different than that of traditional desktop search. There is a clear opportunity here, and we are continuing to look at ways to deliver more innovative, more intuitive search experiences on mobile phones. From an overall mobile monetization standpoint, we have invested in building one of the most dynamic and comprehensive suites of mobile apps that can cater to a user's daily behavior. This growth combined with the launch of Gemini, our mobile search and native marketplace, has positioned us to monetize our mobile traffic in a smart sustainable way that supports long-term growth.

Turning to social, we made some exciting progress this quarter. We really see Tumblr as the best platform for brands on the internet, and as I mentioned earlier, 65 of the Ad Age top 100 brands have a presence on Tumblr, and the majority of those are spending on the platform. With the launch of Tumblr sponsored posts across the Yahoo network, including stream, digital magazines and mobile, we are just beginning to unlock new and unique opportunities for brands to leverage the creative canvas that is Tumblr.

Moving onto native, fundamentally we believe that premium advertising requires premium content. And so, as we have focused on transitioning more and more of our inventory to native, we have really been investing in editorial excellence. Mobile native ad revenue has grown 3.5 times over since the start of Q2. Stream ads have been a particular point of strength here, and they continue to deliver for advertisers.

For example, we worked with Wells Fargo to help launch their new small business platform this quarter. And according to them, Yahoo was one of the most effective media partners at generating qualified contest entries for Wells Fargo Works, with Yahoo stream ads, as a top performing tactic. And as of Q2, with more than 40% of our advertising units now native, we are extremely well-positioned to deliver some of the best, most effective advertising on the web. As the demand for stream ads and the accuracy with which we target them grows, so will our pricing.

Now to our last investment business, video. As I have talked about before, our focus on video has been building our library to bring new audiences to Yahoo. Yahoo has always been an incredibly strong place for brands to reach their audience, and brand advertisers have and will continue to migrate to digital video. Late last week, we announced the acquisition of RayV, a company with an exciting approach to online video streaming in the rapidly evolving mobile space. RayV has built a full end-to-end solution that enables improved high-quality streaming for online and mobile content partners, and will be a key asset in boosting our underlying technology in the video space. Video really is the next generation of display. So what we see here is the opportunity in video to evolve it as the next generation of our display business.

Finally, I would like to revisit some of the comments I made on my first earnings call. When I spoke with you in October of 2012, I stated that I came to Yahoo to grow, and to help redefine one of the internet's most beloved companies. During that same call I stated that we believe that Yahoo's best days lie ahead. I also stated that we intend to do great things, and we intend to win. Despite a short-term setback in our pursuit of growth, all those statements have never been more true than they are today, and I have never been more confident or committed to the future of Yahoo. With that, Ken and I would like to take your questions.



QUESTIONS AND ANSWERS

Mike Santoli - *Yahoo! Inc - Business Reporter, Yahoo Finance*

Thank you, Marissa. That brings us to the Q&A portion of our live earnings event.

(Operator Instructions)

We have also been taking questions via e-mail that were submitted before the call. We will get to some of those too. The first question will come from Eric Sheridan of UBS.

Eric Sheridan - *UBS - Analyst*

I have a question, so I guess, two questions. One, on the display advertising side, wanted to understand -- you said not fixable over the next one to two quarters. But just wanted to understand the pricing dynamic you are seeing in the business today, the mix shift, and how much we might see sort of weakness continued in pricing going forward, as opposed to sort of improvement sort of over that one to two quarters, so sort of the unit price dynamic as you work through that mix shift? And then Ken, quick question on the Alibaba announcement. Was any consideration paid by Yahoo, or how exactly -- maybe you can give us a little bit of the story of how you got to the reduction in shares for the IPO transaction? Thanks.

Ken Goldman - *Yahoo! Inc - CFO*

Somehow I thought that you might ask me that question. (Laughter).

Marissa Mayer - *Yahoo! Inc - CEO*

Sure. On display ads, we really are very happy with the overall traffic increases we have seen, the increase in engagement, and the increase of inventory, and that 24% increase in ads sold really reflects that. On the pricing side, there is a few ways that we can address it. One is, we can have more of our advertising sold at a premium, which is why we are making investments in editorial that we have made to date. The other is, that we will work to make our tools and targeting and processes more efficient, in showing the right ad, to the right user.

For example, our stream ads which now make up 40% of our overall display volume are sold on a CPC basis, but then priced into this metric on a CPM basis. Which means, for example, if I have an advertiser who is willing to pay say, \$10 per click, and I show them 1,000 times, that prices in at \$0.01. However, if I find the exact right user who clicks, and show that ad exactly one time, that price prices in as a \$10 ad. So with improvements in terms of how we target, and when we show which stream ads, we think we can get good price accretion over the coming quarters.

Ken Goldman - *Yahoo! Inc - CFO*

I will take this one. (Multiple Speakers).

Marissa Mayer - *Yahoo! Inc - CEO*

And actually I will jump in on Alibaba, before I turn it over to Ken. Because I just want to take a moment, because this is likely the last earnings call before the IPO, take a moment and offer a word of thanks. Thanks to both our Founder, Jerry Yang, who identified Alibaba as an investment opportunity and really championed it here at Yahoo. And I also want to thank Jack Ma and Joe Tsai for having us participate through the journey that has been Alibaba as shareholders. We really have appreciated our relationship with the company, and the value that they have delivered to us. And the relationship between the company continues to get better and better, which is one of the results of which is what you saw in the share sale reduction that you saw today, and I will let Ken expound on it further.



Ken Goldman - *Yahoo! Inc - CFO*

Yes, I guess, we would all like to pass out comments, because they have done so well. But there is nothing specific that we have done. We have continued to work very strongly with Alibaba, in terms of helping them with their thinking about their IPO, and working with them. So we are great partners with them. We absolutely intend to be great partners with them going forward, and there isn't anything specific that we did relative to this. By the way, I would add that I think when we started about a 1.5 year ago, we were going to sell 262 million shares at the IPO, and through now two different times, we reduced that to 208, now to 140 million. And again, it just gives us -- gives -- should give all of you a sense that we are very, very strong believers in Alibaba over time.

Mike Santoli - *Yahoo! Inc - Business Reporter, Yahoo Finance*

Next question comes from Brian Pitz of Jefferies.

Sachin Khattar - *Jefferies - Analyst*

This is [Sachin] sitting in for Brian. Question is, you have spoken about the approximately 450 million unique visitors to Yahoo on mobile. On that, what properties are you primarily talking about? And then, I think you might have given this on the script, but what percentage of Yahoo revenue comes from mobile, and is that primarily search or display? Thanks.

Ken Goldman - *Yahoo! Inc - CFO*

I could just -- on the mobile, we have not given the exact percentage. I would say it is meaningful, and search is somewhat larger than display. But we do expect over time that we will be providing more specific metrics there, but as of now, we have not, other than to say it is meaningful. We talked about the growth year-over-year, and the fact that search is somewhat greater as a percentage than display.

Marissa Mayer - *Yahoo! Inc - CEO*

And for the 450 million monthly active users, we see their participation really all across the portfolio, as many of our apps fill those digital daily habits. I would say that the largest ones are the same ones you would see and expect, both on desktop and when you have a phone as the device, which is mail, search and our homepage also relating to news.

Sachin Khattar - *Jefferies - Analyst*

Great. Thanks a lot.

Mike Santoli - *Yahoo! Inc - Business Reporter, Yahoo Finance*

Next, we are going to take an emailed question. How does Yahoo plan to reinvent itself, in light of heavy exposure to desktop e-mail, which is the core to usage of other services across the Yahoo network?

Marissa Mayer - *Yahoo! Inc - CEO*

Well, as I just alluded to one of our strongest offerings on mobile is around mobile mail. And so, what we see here is the opportunity for communications from the phone, because as a communication device, as in many ways even stronger than it is in desktop. And so, while we seek



many different forms of communication developing on the mobile platform, we feel that we are well-positioned, because we have always been part of our users daily habits in terms of how they communicate.

Ken Goldman - *Yahoo! Inc - CFO*

I think, I would just add, we clearly continue to believe content is very, very important, which is content that we provide. We also think, and you have seen in some of the engagement we have, video is certainly extremely important today and in the future, and I suggest all of you who watch the music later today. And social, and some of that is Tumblr, there will be others. So the ability to wrap that all up is very, very important, as we see Yahoo going forward, balance of this year and certainly in 2015 and beyond.

Marissa Mayer - *Yahoo! Inc - CEO*

And I would also say, in terms of the reinvention of e-mail as we moved to mobile, we made a really important stride forward this past quarter with the unified app. So now in Yahoo mail, you actually get our news, search, weather, sports score, all right in the mail application on your phone. So we have really brought our network approach into that application of e-mail. And we think that that's one important reinvention, where we can bring some of our strengths from desktop on to mobile.

Mike Santoli - *Yahoo! Inc - Business Reporter, Yahoo Finance*

Next we will take a question from Carlos Kirjner of Sanford Bernstein.

Carlos Kirjner - *Sanford C. Bernstein & Co. - Analyst*

Thank you, I have two questions. Marissa, do you think Yahoo's business and performance are in good enough shape to assure that a material acquisition -- for example, buy a company with several thousand employees, would have a good chance of creating value? In other words, would it make sense for a business that is not performing well, when undergoing a transformation to make a large acquisition that could increase executional complexity? And for you Ken, in the past you had said that the net cash you had already was, what you thought the Company needed to run the business. Yet today, you left open the possibility of holding on to 50% of the Alibaba IPO proceedings, which are several million dollars. Can you tell us what changed the Company's mind? And how you justify not returning the majority of the proceedings to shareholders, given that two years in and after a lot of investment, we have not seen any sustainable growth? Thank you.

Marissa Mayer - *Yahoo! Inc - CEO*

On the first question, I am going to actually take it in two parts, taking the acquisition parts separate from the executional complexity part. I think that when you look overall at Yahoo's business, we have made great strides forward. One of the things that Ken and I really value, and we have been working with the entire management team on, is reducing complexity here at Yahoo. And I think that we have made important strides forward. We have actually seen a lot of areas of growth, particularly in search, in mobile, social, native, video. And all the growing areas in our industry, we are growing at the pace of the industry if not faster. This past quarter, we did have a setback in PC display. We know that this will happen in transformations of this size and scale. But overall, I feel good about the internal operations of Yahoo, and our ability to use this as a foundation for growth.

Separately moving to the M&A performance and how we might approach that, we have generally looked at things -- what we have done is we have taken a look at three different types, talent acquisitions, small tuck-in acquisitions that help us immediately start to rebuild some of our products. Building blocks, like Summly or Xobni, where we have something really fundamental like contacts or the summarization of content, where we need to get stronger quickly. And large strategic acquisitions, of which we have really done one to date, which was Tumblr.



And the number of ways that Tumblr fit in with, and actually helped further simplify our business and strengthen us, I think it has been made obvious to everyone over the past year. But from everywhere, in terms of providing a platform for brands to interact, and put their content online and get that content onto Yahoo, to actually being a publishing platform for our editors, to bringing a social aspect to both Yahoo, as well as providing that on Tumblr. There is any number of ways in which Tumblr was a really critical acquisition, that was strategic in that it really helped us build up our core competencies in a meaningful way.

Ken Goldman - Yahoo! Inc - CFO

Carlos, I am going to try to turn your comment or question a little bit more positively. First of all, I think it is very important to say and restate, that we are very committed to the success of Yahoo, Yahoo's core business. So I want you all to think, we spend all of our waking hours focused on that. Two, we are absolutely in line with our Board as to how we think about capital allocation, how we utilize capital.

And I would remind all of you, that we went way beyond what we said relative to the first time we provided proceeds back from Alibaba. And that over the last two years, we have returned over \$6 billion of cash to our shareholders through buybacks, repurchase of stock, and we have done that -- we, through the \$719 million in this past quarter. So we have clearly to me, demonstrated succinctly that we are doing everything we think makes sense to provide cash back to shareholders. On the other hand, we do want to have the ability to have strong balance sheet. And I have said, and Marissa used some examples that we have acquired some companies in the past, and to the extent that we think that makes sense in the future, and we think that would positive for shareholders, we want to have the ability to do that.

Mike Santoli - Yahoo! Inc - Business Reporter, Yahoo Finance

Next question is from Ron Josey of JMP Securities.

Ron Josey - JMP Securities - Analyst

Marissa, [until] your comments on Ad Manager Plus, and the lower contribution from premium ads. On the Ad Manager Plus, I just want to know what gives you the confidence that perhaps the changes would take one to two quarters to launch, given I think you -- this was originally announced maybe back in January? And on the premium mix shift, I wonder if you can go further into the detail that you saw in the quarter, that perhaps what -- perhaps led to some of the comments as to why you may think you need more premium formats? Or maybe why splash ads are still new, and could do that? So thank you very much.

Marissa Mayer - Yahoo! Inc - CEO

Sure. On those two areas, so on YAM Plus, in particular which is the acronym we used to refer to Yahoo Ad Manager Plus, it was announced in January we anticipated the migration would occur at the beginning Q2. That said, the migration is proceeding now. And so, we anticipate that we will be able to complete the movement of the North American market, probably likely in the first half of this quarter, and we will be migrating other markets across the globe in the second part of this quarter. But we now have good experience with the platform. We know that it performs. And so, we are moving ahead with the migration full steam. So while there was a slight delay, we feel confident that we can get back to where we wanted to be in the next quarter or two.

On the premium piece, what we really saw there is, and one of the reasons we think it will improve in the next one to two quarters, is we have got great premium content coming online. When you look at things like our partnership with Live Nation that kicks off tonight, fantasy football coming next quarter, the investments that we have been making in our digital magazines, these are all great opportunities for premium advertising. And we have seen advertisers really respond to that. Our Live Nation partnerships sold out within 10 days of us announcing them, and we have had really tremendous growth and response to some of the premium content we have brought to the market.



In particular, on the new formats issue, one of the areas of weakness that we saw in premium advertising this quarter was around a unit that we call the FPAD, which is a small square unit that appears on the front page. We actually continue to see in some of our new and more innovative formats like our Billboard that we run on the homepage and our splash ads, tremendous value delivered to advertisers and tremendous response. But in particular, we, on the FPAD, we think that we need a new approach both in terms of format overall as well as the pricing. And to -- in order to deliver better value to our advertisers.

Ron Josey - *JMP Securities - Analyst*

Great. Thank you very much. Very helpful.

Mike Santoli - *Yahoo! Inc - Business Reporter, Yahoo Finance*

Next question is from Justin Post of Merrill Lynch.

Justin Post - *BofA Merrill Lynch - Analyst*

Thanks. Again, a lot of questions on EBITDA. If you -- should we back out the patent sale when we think about the run rate for 2Q? And then, 3Q the guidance is 23% margins at the midpoint, and that is down quite a bit from last year. Can you talk about the forces driving that, and where that could bottom? And then second for Ken, is there any chance of holding the Alibaba proceeds overseas to avoid taxes? Can you give us any update on that? Thank you.

Ken Goldman - *Yahoo! Inc - CFO*

Well, I think I have given the comments that I want to give. We were very specific on the comments, relative to tax and so forth, and I think I am going to leave it -- I am going to have to leave that there. I think you can read what I -- what I exactly said.

On, we really looked at a very simple is -- our expenses -- if you back out the patents around \$800 million of short-term expenses, and if you look at long-term, which is primarily depreciation and amortization, that is about \$150 million. And so, to get to the EBITDA is a very straightforward, relative from the revenue numbers I gave. And so, I think what will drive increase in EBITDA going forward, is clearly going to be revenue growth which I talked about, and our ability over time to bring growth in revenue, and bring a good portion of that down to profits. But the \$800 million is up a bit from Q2, when you take out the patent sales, and again some of those areas, again it would be in the workforce area.

Marissa Mayer - *Yahoo! Inc - CEO*

I mean, I would just also add that we have come off of years of chronic under-investment in the core products. And so, this is really an area where we need to invest. And we have been honest all along that we are investing in order to drive top line growth.

Ken Goldman - *Yahoo! Inc - CFO*

Which why the by the way, does not mean -- I think I said in my comments, but does not mean that in a variety of areas that we can't focus on efficiency and effectiveness, which we are. And so, we will continue to do that. And again, we are going to make sure that we do provide the ability to invest in the areas we noted. And not by increasing expenses necessarily, but also by basically reallocating and remixing expenses.

Mike Santoli - *Yahoo! Inc - Business Reporter, Yahoo Finance*

Peter Stabler from Wells Fargo Securities is next.



Peter Stabler - Wells Fargo Securities - Analyst

Thanks very much. Good afternoon. Marissa, you mentioned your comments that you have spent a significant amount of time meeting with agencies, meeting with advertisers. We are guessing, that this is probably the result of Enrique moving on, and you not filling that position. So wondering if you could give us a bit more color about these conversations. Has this been more of kind of a sales initiative, has this been a listening tour? What kind of feedback are you getting from the major marketers? We continue to believe you guys have a relationship with every meaningful marketer in the -- across the globe almost, or at least certainly in the US. Just wondering what you can tell us about the tenor of those conversations that gives you optimism going forward? Thank you very much.

Marissa Mayer - Yahoo! Inc - CEO

Sure. And as I have mentioned, I have had a lot of conversations even in Q2, meeting with more than 500 people in small groups. Actually if you count things like keynotes, it was more like 4,000. But in small groups, I met with about 500 different people, representing about 350 different brands. And it has been a bit of listening, it has been a bit of also talking about how our products are different, both on the consumer side and on the advertiser side.

And I think that what we have generally heard is one, a lot of respect for how quickly we have moved the consumer perception, the way our products are -- advertisers always want to advertise on beautiful products. And the fact that we have done a lot, to improve the usability, the beauty, and the value proposition to our end-users is something that they really respect. On the advertiser platforms, they can see that Yahoo Ad Manager is something that is a big step forward in terms of modernizing our ad platform.

Prior to this, we didn't have our things like real-time bidding. We didn't have cost per engagement, cost per install. We didn't have the ability sometimes to seamlessly mix first-party data and third-party data into your buy, creating custom segments more easily. All of these things, are things that advertisers really want.

And so, we have been focused on that. It is how we designed Yahoo Ad Manager Plus to basically bring in these more modern aspects, and ultimately make them available to the market. But it wasn't just about getting the parity. It is also about bringing new things to bear. And so, one of the things that -- there is two basic initiatives there. One is that we have really talked a lot, and gotten a lot of feedback -- good feedback from advertisers around our unified approach to advertising.

Because Yahoo can differentiate itself, because we are the one place where you can buy search, display, native, mobile, video, all in one place, audiencing also. So basically, all six predominant ways of digitally advertising can all be bought here. And that unified approach is something that allows for us to have all kinds of interesting insights. So, for example, if you advertise on search, and then you reinforce it with a display ad, how does that user ultimately respond, and how does that translate into real sales?

The second initiative that we have launched, which has gotten great response from advertisers is, something that happened through an asset that I think very few people appreciated here at Yahoo, which was Yahoo Smart TV, formerly Yahoo connected TV. But today, we actually have our software running on millions of screens in North America. And through a technology that was part of an acquisition, prior to my time, a technology called SoundPrint built by a team called IntoNow. We basically in those screens can see when users see commercials. And it doesn't even have to be in real time, because it is sound-printing off of the sound of the commercial.

So for brand advertisers, they can literally for the first time ever, tie together their digital ad spend to their television ad spend. And they can see what happens when they change the mix of their spend from TV to digital, how do the two reinforce each other? How do they interplay? And we are also working on closed loop solutions that help tie this to in-store purchases.

So it is something that is incredibly exciting. We spend a lot of time talking about what we are doing. And basically understanding the assets that we have, and how we can bring them to bear on the unique problems that advertisers bring to us. So we are really excited about where we are



today. There is still a lot more to do. But when you look at where we are today, even versus six months ago or a year ago, I think we have much more relevant, modern advertising solutions than we have ever had.

Peter Stabler - Wells Fargo Securities - Analyst

Thanks for the color.

Mike Santoli - Yahoo! Inc - Business Reporter, Yahoo Finance

We will take our final question today from Youssef Squali of Cantor Fitzgerald.

Youssef Squali - Cantor Fitzgerald - Analyst

Ken, starting with you, we noticed there was a little bit of a discrepancy between the numbers that Alibaba reported in their F1 filing, and the numbers you reported. I was wondering if you could maybe help just us understand, just what the reason for that is? Is it just FX assumptions, or is there something else? And then, on the Alibaba shares that you will hold after this sale of 140 million which by our estimates is about \$384 million, what are the terms of the sale of those last tranches? Do you have to sell it -- to sell them by a certain date, and will be assumption there be also that they will be fully taxed? Thank you.

Ken Goldman - Yahoo! Inc - CFO

Yes, this is Ken. I don't -- I am not aware of any discrepancy. We will go back and check. The number should have come directly from their numbers. So I will go back and check, and we can -- I or Joon, can talk to you about that. In terms of what we will do in the second tranche, I mean, we will be under a lockup like others, we will be under a lockup and that will be for one year. Beyond that, I don't want to give you any timing, and we will take it from there as we -- makes the most sense. And again, I think the most important part is, both management and the Board will review what makes sense for us, and how what we think at the time and so forth. So, and we have a long time to think through that. And again, I will lead back to the comments I already made in my formal remarks, as to how we think about maximizing the proceeds, that we would over time provide to our shareholders, and creating value for Yahoo.

Youssef Squali - Cantor Fitzgerald - Analyst

Thank you.

Mike Santoli - Yahoo! Inc - Business Reporter, Yahoo Finance

Thank you all for your questions. That concludes the Q&A portion of our call. Before we go, I will hand it back over to Marissa for her final remarks.

Marissa Mayer - Yahoo! Inc - CEO

To recap the key points from today's call, this quarter we saw more than 450 million monthly active users on mobile, up 36% year-over-year. We also saw our 10th consecutive quarter of search revenue growth ex-TAC year-over-year. Yahoo Aviate on launch saw 2.5x user growth in the first week. We saw our display revenue fall 7% year-over-year. Mobile, social, native and video grew at almost 90% year-over-year. You have heard our commitment to plan -- to return 50% of the Alibaba IPO proceeds to our shareholders. We announced the hosting of Community, Other Space, and Sin City Saints on Yahoo. And with that, we will see you next quarter.



Ken Goldman - *Yahoo! Inc - CFO*

Thank you.

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