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# EDITED TRANSCRIPT

ANEN.O^B14 - Q2 2003 Anaren Inc. Earnings Conference Call

EVENT DATE/TIME: JANUARY 28, 2003 / 10:00PM GMT

## OVERVIEW:

Net sales \$20.9m, up 25% from 2Q02 and up 1% from 1Q03. Net income \$475,000, or \$0.02 per diluted share, up from \$0.01 in 1Q03. Cash, cash equivalents and investments were approximately \$127m at December 31, 2002, up \$2m from June 30, 2003. Q&A focus: Celeritek investment, wireless product group, forward projections.



## CORPORATE PARTICIPANTS

**Lawrence Sala** *Anaren Inc. - Chairman and President and CEO*

**Joseph Porcello** *Anaren Inc. - VP Finance*

## CONFERENCE CALL PARTICIPANTS

**Richard F. Valera** *Needham and Company - Analyst*

**Dale R. Pfau** *CIBC World Markets - Analyst*

**Greg Weaver** *Current Capital - Analyst*

**Howard Horowitz** *Darmel Management - Analyst*

## PRESENTATION

### Operator

Good day, everyone, and welcome to the Anaren second quarter earnings release conference call. Today's call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to Mr. Larry Sala, President and Chief Executive Officer of Anaren, Inc. Please go ahead, sir.

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### Lawrence Sala - Anaren Inc. - Chairman and President and CEO

Thank you. Good afternoon and thank you for participating in the Anaren fiscal 2003 second quarter conference call. I'm Larry Sala, I'm joined today by Joe Porcello, our Vice President of Finance.

I'll provide a brief overview of the results of the second quarter ended December 31st, 2002, after which Joe will review, the financial highlights. We'll then take your questions.

Statements contained in this conference call, which are not historical information, are forward-looking statements. These statements involve risks and uncertainties that could cause actual results to differ materially from those discussed. You are encouraged to review Anaren's second quarter press release, our Anaren Form 10-K for the fiscal year ended June 30th, 2002, and the Anaren Form 10-Q for this current second quarter ended December 31st, 2002, and exhibits to those reports filed with the Securities and Exchange Commission to learn more about the various risks and uncertainties facing Anaren's business and the potential impact on our net sales and earnings.

Net sales for the second quarter were \$20.9m, up 25% from the second quarter of last year and up 1% sequentially from the first quarter of fiscal 2003. Operating earnings for the quarter were \$2000 or approximately break-even compared to a \$1.8m operating loss in the second quarter of last year and a \$455,000 operating loss in the first quarter of fiscal 2003. Net income for the second quarter was \$475,000 or 2 cents per diluted share.

Cash, cash equivalents and marketable debt and securities were approximately \$127m at December 31st. During the first six months of the fiscal year the company generated \$5.6m in positive operating cash flow, in part due to a \$2.1m or 11% reduction in inventory as well as a \$1.6m or 12% reduction in our accounts receivable.

In our wireless group, net sales for the quarter were \$13.1m, up 25% from the second quarter of last year and up 1% sequentially from the first quarter. The wireless market demand remains very weak and visibility remains poor. During the second quarter, demand was driven by network build-outs in China. Wireless group customer concentration for the quarter as a percentage of wireless group net sales was Ericsson at 17%, Motorola at 14%, Powerwave at 12% and Lucent at 11%.



We continued our aggressive wireless new product development activities, as demonstrated by the five new products that were introduced during the quarter. Of particular note are the low-cost mini-Xinger circulator, which is 75% smaller than the initial circulator that we introduced just nine months ago. This product offers excellent performance and is a very cost-effective solution for our amplifier customers.

And the Xinger LNA, which is the latest active Xinger product offering, providing a balance, low-noise amplifier function in a low-cost miniature Xinger module configuration. Two transistors and the associated bias and matching circuitry are embedded in a Xinger package, offering our customers size, cost and performance advantages over the discrete implementations that are typically used. This product provides Anaren the opportunity to gain contact in base station transceiver applications.

Our 802.11 product development and design activity also continues to progress well. During the quarter we continued to expand our 802.11 product offering and aggressively pursue new design wins. For our space and defense group, net sales for the second quarter were \$7.6m. That's up 14% from the second quarter of last year and up 4% sequentially from the first quarter.

Space and defense group new orders for the quarter were \$5.9m and included follow-on orders for our ship-borne jamming subsystems as well as our precision location receivers for airborne applications. Space and defense backlog at December 31st, 2002, was approximately \$29.7m.

During the quarter we took further action to reduce our operating costs in light of the continued weak demand in the wireless market. We've reduced our global work force by more than 10% during the first six months of fiscal 2003 and continue to take steps to streamline our operations and reduce our overall operating expenses.

Joe will now review the financial highlights.

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**Joseph Porcello** - Anaren Inc. - VP Finance

Good afternoon. The financial highlights of the second quarter income statement and the balance sheet at December 31st are as follows.

The gross profit margin for the second quarter of fiscal 2003 was 26.7%. This was a 30 basis point increase from gross margins of 26.4% in the first quarter of fiscal 2003.

Gross margins rose on wireless products and fell slightly on space and defense products in quarter two. Margins rose on wireless products due to the increase in wireless sales and the cost reductions instituted in the first quarter. Space and defense margins fell due to a change in product mix with a higher level of military versus commercial space programs in the second quarter shipment mix.

Going forward at current revenue levels and product shipment mix, we do not expect to see any significant change in gross margins.

Investment in research and development was 7.3% of net sales in the second quarter of 2003, compared to 6.8% in the first quarter. Research and development expenditures have increased from the first quarter due to the application of additional engineering personnel to work on both new wireless land and wireless infrastructure component opportunities.

Income from operations was at break-even in the second quarter of fiscal 2003 compared to a loss from operations of 2.2% of net sales in the first quarter of 2003. Operating margins increased in the second quarter due to the absence of any restructuring charge and the small improvements in second quarter gross margins.

The company is reviewing all opportunities to reduce costs and will continue to implement cost saving measures. We presently do not expect significant improvements in operating income over second quarter 2003 levels without any increase in sales volume.

Net income was 2.3% of net sales for the second quarter of 2003. This compares to .7% for the first quarter of fiscal 2003. On a per-share basis, diluted earnings per share for the second quarter of fiscal 2003 were 2 cents. This compares to 1 cent per diluted share in the first quarter.

The balance sheet highlights include the following. Cash, cash equivalents and investments were approximately \$127m at December 31st, 2002, up \$2m from June 30. We continued to enjoy a positive cash flow from operations in the first half of the year, despite the lower level of net income. Cash generated by operations was approximately \$5.6m in the first six months of fiscal 2003 and came mainly from reductions in inventory and accounts receivable.

Accounts receivable were \$11.5m at December 31st, 2002, down \$1.6m from June 30th. Day's sales outstanding at the end of December were 51 days compared to 56 days at June. We continue to expect days sales outstanding to fluctuate between 50 and 70 days as we go forward, depending on sales levels, customer mix and business conditions.

Inventories at December 31st, 2002, were \$18m, down \$2.1m or 10.7% from \$20m at June 30th, 2002. Capital equipment additions in the first half of fiscal 2003 amounted to approximately \$3.6m. The additions were mainly for automated material handling equipment at Anaren Europe, test equipment at our Chinese operations and production equipment at our East Syracuse facility to support a new military satellite program.

Accounts payable at December 31st, 2002, were \$3.5m, down \$1.5m from June 30th. This reflects the decline in materials purchases, which resulted in the current inventory reduction from the June quarter.

During the first half of 2003, we purchased 71,800 treasury shares in the open market at an average cost of \$8.27. It is anticipated we will continue to make open market purchases of treasury shares under the current board authorization depending on market prices.

Relative to Celeritek, the company's original investment in Celeritek common stock averaged \$8.47 a share and totaled \$6.6m. This investment had a market value at December 31st, 2002, of approximately \$5.2m, a \$1.4m decline. The company considers this to be a temporary decline in market value and it has been recorded as a charge to other comprehensive income in the shareholders equity section of the balance sheet at December 31st. If at a future date this drop in market value is determined to be other than temporary, then the decline in value at that point in time, including the amount previously charged to equity, would at that time be recognized as a loss in the current period income statement.

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**Lawrence Sala** - *Anaren Inc. - Chairman and President and CEO*

Thanks, Joe. Given the continued weak demand and limited visibility in the wireless market, we're projecting third quarter net sales to be in the range of \$19m to \$20m and diluted earnings per share to be in the range of a negative 1-cent to a positive 1 cent.

We'll now take questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. If you would like to ask a question at this time, please signal us by pressing the star key followed by the digit one on your Touch-Tone telephone. If you are using a speakerphone, please ensure that your mute function is turned off to allow your signal to reach our equipment. Once again, please press star-one to ask a question at this time.

We will take our first question from Rich Valera with Needham & Company.

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**Richard F. Valera** - *Needham and Company - Analyst*

Good afternoon, gentlemen.



**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Hi, Rich.

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**Richard F. Valera** - Needham and Company - Analyst

In terms of the stuff you guys are doing to reduce your costs, I understood that you were shifting the manufacturing, I think, of your isolators and circulators over to China. I'm just wondering how that's going and if that could result in some margin improvement as that phases in over the next quarter or so?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Yeah, progress has gone basically to plan. We're in production over there. We are-- you know, we have to go through a process of qualifying with specific customers so we produce product and go through a qualification process.

I'd say by the end of this quarter more than 50% of our ferrite product base production will be at our China operation as opposed to in our other facilities. And there certainly is-- will hopefully be, you know, a financial benefit to that. There certainly would be some head count reduction elsewhere as that product is moved or hopefully some additional production that we can bring in to replace it in these other operations.

So that's progressing well. We really have not seen the benefit of that yet because of the fact that we're not fully qualified with all of our customers. We really have additional costs to date in place because we're producing in the two locations. It really won't be until our fourth quarter that we really start to see the economic benefits of that operation.

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**Richard F. Valera** - Needham and Company - Analyst

Great. Now in terms of the 802.11 stuff, you mentioned you're continuing to pursue design wins. I think you had two last quarter. Is there any update to that or is there any prospects you can sort of highlight for further design wins?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

We have had additional design wins since our last quarter report. We haven't really talked about specific platforms yet and we probably won't until we actually start to see some firm uptake from our customers. So until we start to see more production-volume-oriented orders we'll probably refrain from talking about specific platforms.

So that's gone well to our plan. Really our focus now is trying to expand that product line beyond just the balun function that we had initially introduced to try to, you know, offer higher levels of integration and hopefully more value to our customers and maintain or increase our dollar content. So we've started to beta sample customers with new products and probably before the end of this current quarter we'll be making some more announcements of new 802.11 products that we have in the market place.

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**Richard F. Valera** - Needham and Company - Analyst

Great. And on the guidance of \$19m to \$20m and I think it's a loss to a penny, is there anything changing in-- It seems like the guidance on the bottom line is maybe a little conservative. Is there anything changing in the model, you know, anything that's sort of non-recurring or anything in the model that would cause it potentially to go to the loss there?



**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

No, it's-- I think if you look at it, if we really end up at the low end of our revenue range, in that \$19m range, we'd be down almost \$2m from this quarter and so being down that magnitude, even if we are able to execute on the cost reduction activities, we'd still struggle to do much better than that. So the real question is, where in that revenue range do we fall?

We gave the same revenue guidance last quarter and ended up, you know, closer to \$21m than we did to \$19m, but China was a bit of a surprise to us and it's a very difficult market for us to predict demand for. So we benefited from that and it, you know, it was demonstrated by the strength from Lucent and the strength from Motorola that we saw last quarter, which we had not seen for probably the prior 18 months. And we have difficulty in saying how long and how robust this current China build-out will be. So I think that's really probably one of the bigger factors in where we end up in our revenue guidance.

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**Richard F. Valera** - Needham and Company - Analyst

Sure. On the pricing pressure front, it's obviously been tough. Is there anything you can say about any kind of changes on the margin in the last quarter? Has it sort of stabilized? I mean, I'm assuming it's still pretty tough, but any-- any sort of trends or anything you can talk about on the pricing pressure front?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Not-- no major changes. We're seeing, obviously, continued very aggressive pricing pressure from our customers.

We are exiting some product areas that we just don't see an ability to make profitable contributors for us, so that will affect our revenue to some degree, we don't think significantly, but we have found it to be very challenging, even with moving product to other geographic locations, to be competitive and find it worth our while. So it continues, but it really hasn't changed dramatically or changed our margin forecast for the current quarter.

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**Richard F. Valera** - Needham and Company - Analyst

Great. And just one last one. On Celeritek is there any update there? Have you sort of had any further interaction with them at this point? Or are you just kind of sitting back and seeing what happens here?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

No, there really has been no interaction since we last reported.

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**Richard F. Valera** - Needham and Company - Analyst

OK. Thank you.

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Thanks.

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**Operator**

Once again, please press star-one to ask a question at this time. We'll take our next question from Dale Pfau with CIBC World Markets.



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**Dale R. Pfau** - CIBC World Markets - Analyst

Hi, Larry. Hi, Joe.

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Hey, Dale.

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**Joseph Porcello** - Anaren Inc. - VP Finance

Hey, Dale.

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**Dale R. Pfau** - CIBC World Markets - Analyst

A couple of questions here on what you're seeing and maybe you could help me. When you entered the December quarter -- and I'm going to talk specifically about the wireless group -- what percentage of that quarter did you have in backlog and firm commitments versus how much was in turns and then where are we relative to that position this quarter?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

I would say when we entered the quarter for the coming month-- You know, in any given month, going into the month we may have had something on the order of 40% visibility, I'll call it. It certainly wasn't firm orders, but it was forecasted demand from our customers and we were shipping as much as 50%-plus in a month that we don't have visibility of coming into the month.

That's probably stayed fairly stable, maybe been a little stronger as we got into November, December and January because of the onset of demand out of China. Our customers gave us fairly firm forecasts for a couple of months because that build-out was well defined and they won, you know, solid contracts. Right now, we're kind of working our way through the end of most of that firm visibility and we're either, you know, would expect to see some new forecasted demand or start to see that demand fall off and it's really difficult for us to tell. So far it's hung in relatively well through January and probably the middle of February we have visibility to now, but we don't really have much beyond that, which has pretty much been status quo for the last 12 months.

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**Dale R. Pfau** - CIBC World Markets - Analyst

Did I hear right, you said it's about that same way over the last 12 months?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Yeah. November-December got better for us because of the demand out of China and it hung in there through now and as we look a month out from now, we have relatively good visibility because of the demand out of China.

Prior to November we had, you know, even far more limited visibility than that. So, you know, for us, like I said, over the next six months I think the big driver for the upside will be that demand out of China hanging in there and following through. From what we understand, that build-out should last until, hopefully, the early part of this summer at a minimum.



**Dale R. Pfau** - CIBC World Markets - Analyst

And as a follow-on, what are your customers now telling you? Are they expecting their business to be about the same as it's been for the next 12 months as it filters down to you or are they-- and, excluding China, are they expecting any big, big movements one way or the other?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

No. You know, the November-December time frame is when we sit down with our largest customers and have our annual purchase negotiations where we try to-- they provide their business forecasts and we agree on annual pricing. And from that, the relative expectation appeared to be a very similar year in terms of total demand for the year. So it wasn't significantly up and it was not significantly down. You know, we'll see how it plays out and whether that ends up being reality, but the forecasted demand when we negotiated pricing was demand that was pretty similar to what we saw in 2002.

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**Dale R. Pfau** - CIBC World Markets - Analyst

So would you consider it stabilizing or is it deteriorating any more?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

I'd say it's stabilizing. We've seen-- you know, obviously, we've reported three fairly consistent quarters in our wireless group. So for us to date it's been relatively stable and it's projected to stay this way and so the question will be, do they really meet those forecasts?

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**Dale R. Pfau** - CIBC World Markets - Analyst

And the next question. Where are you seeing the most price pressure? You mentioned that, you know, there is some price pressure and you're exiting certain sub-segments. Certainly you're not exiting your Xingers. Are you seeing it in isolators? Are you-- You know, where specifically is it worse, Larry?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Yeah. Well, you know, it's obviously worse in areas where there's the most-- you know, competitive offerings. The isolator business is a fairly competitive business. The resistive business is a very competitive business and even some of the custom assembly opportunities are fairly competitive these days.

So it's not any-- We're not looking at exiting any product lines, it's just, you know, specific units where there are multiple suppliers on a drawing and the pricing has eroded to the point that we don't see the ability to see any contribution. We're stepping out of those opportunities.

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**Dale R. Pfau** - CIBC World Markets - Analyst

And on a sort of a macro scale, you made kind of a run at Celeritek. You're still holding the shares. Do you have any long-term plans there?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

You know, it was something that, you know, our board is very engaged in and we discuss, you know, very, very regularly. There's obviously a lot going on at Celeritek and we think good reason to continue to wait and see how things resolve themselves. So, you know, it's still our board's desire to continue to maintain our position and interest.



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**Dale R. Pfau** - CIBC World Markets - Analyst

And one last question. You know, given the state of the infrastructure market, has there been anyone-- has anyone approached you about a potential merger, either larger or smaller?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

No. We've really seen very little activity or interest, Dale, to be honest with you, either way. Either people interested in being acquired or people interested in getting into this margin and talking to us. So there just doesn't seem to be a lot of activity right now.

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**Dale R. Pfau** - CIBC World Markets - Analyst

OK. Great, guys. Thanks for the call.

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Thank you.

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**Operator**

Once again, please press star-one on your Touch-Tone telephone to ask a question. We'll move next to Greg Weaver with Current Capital.

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**Greg Weaver** - Current Capital - Analyst

Hey, good quarter, guys.

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Thanks.

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**Greg Weaver** - Current Capital - Analyst

Was Lucent salient on the wireless side? You mentioned Lucent as a top--

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

No, our Lucent business is directly with Lucent.

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**Greg Weaver** - Current Capital - Analyst

What are they doing with your product? Is that back plane?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

We sell many different-- we'll call them custom assemblies or integrated components for various Lucent platforms, mainly cabinet-level power dividers or combiners and those types of products and, obviously, they've had some success in China and we've seen the benefit of that. So we don't reporting Salient as part of Lucent.

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**Greg Weaver** - Current Capital - Analyst

Where did they show up?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

They show up as part of our-- we would report them as sales to Mandarin [ph].

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**Greg Weaver** - Current Capital - Analyst

Right. I meant in terms of percent.

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

They don't show up as a meaningful customer, low percentages. I would venture to say 2%-3%.

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**Greg Weaver** - Current Capital - Analyst

Even though they had a strong P/A quarter? The stuff they're shipping you're not in?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Yeah, our content is just component-level products there. So not-- not a large customer for us in the quarter.

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**Greg Weaver** - Current Capital - Analyst

OK. And on the defense side, you mentioned a new satellite job you were spending some money on to gear up for. Any color on that?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Well, that's-- you know, we announced that we had won a development order about a year ago for our first military satellite program and we have competed aggressively to win the production side and so we've spent some money to try to position ourselves as best we could to be able to capture that production order, which we expect to happen within the next quarter or two. So our development activities have gone quite well and we've felt it was a capability we needed in order to be able to capture the production side of that contract.

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**Greg Weaver** - Current Capital - Analyst

And how large might that be if you won it?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

That's a contract of, I don't know, \$3m to \$5m sort of range.

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**Greg Weaver** - Current Capital - Analyst

And are there any other opportunities on the military satellite side at this point?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Not-- Yeah, there's some that we're pursuing, nothing that's on the near-term booking horizon, but we are-- you know, we are proposing and working with other customers in the military satellite area. So we're seeing activity, but nothing that we would expect to book between now and the end of the fiscal year.

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**Greg Weaver** - Current Capital - Analyst

OK. Thanks.

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**Operator**

And we'll take our next question from Howard Horowitz with Darmel Management.

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**Howard Horowitz** - Darmel Management - Analyst

Hi, just following up on Celeritek, obviously this has been a long process. Have you given any consideration to, essentially, launching a proxy fight or making some shareholder proposals, beginning shareholder solicitation? It seems like the standstill has-- the agreement that they want you to sign has been the sticking point here, so I'm not sure how you get around it other than doing that and this-- you know, given the amount of cash in the company is higher than the market cap today, it would seem like this is a particularly good time to try to do that.

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Yeah, you know, we considered-- we continue to consider, you know, all of the options that we outlined in our 13-D and, you know, are looking at all our options and the appropriate timing of doing anything other than what we've done to date. So I don't really have a lot more to add.

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**Howard Horowitz** - Darmel Management - Analyst

So is there a point in time at which a decision will be made about essentially going hostile?

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**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Can't really say. You know, there's a lot going on in the market place, a lot going on at Celeritek and we're looking at all those factors.

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**Howard Horowitz** - Darmel Management - Analyst

OK. Thank you.



**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

Sure.

**Operator**

And there are no further questions at this time. I will turn the conference back over to Mr. Sala for any additional or closing comments.

**Lawrence Sala** - Anaren Inc. - Chairman and President and CEO

So I just want to say thank you for participating in the call and we look forward to speaking with you again next quarter.

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