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J.G. Wentworth Company

Third Quarter 2015 Earnings Conference Call

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Scott Stevens, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

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David Scharf, *JMP Securities*

Jim Delisle, *Wasatch*

PRESENTATION

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the J.G. Wentworth Company Third Quarter 2015 Earnings Call. During the call, all participants will be in a listen-only mode. After the presentation, we will conduct a question and answer session. At that time, those with questions should lift their phone receiver and press star, followed by the number one on their telephone keypad. To cancel a question, please press the number sign. If at any time during the conference you need to reach an Operator, please press the star, followed by zero. Please note that this call is being recorded today, November 9, at 10 a.m. Eastern Time.

I would now like to turn the meeting over to your host for today's call, Mr. Erik Hartwell. Please go ahead.

Erik Hartwell:

Thank you, Operator. Good morning, everyone, and thank you for joining the J.G. Wentworth Company's Third Quarter 2015 Earnings Conference Call. This morning, we will be hearing from Stewart Stockdale, our Chief Executive Officer, and Scott Stevens, our Chief Financial Officer. After their prepared remarks, we will open the call for questions.

We have included a brief presentation to accompany our remarks and you can find a link to this webcast included the earnings press release. At the conclusion of this call, the slides from today's presentation will be posted on the Investor Section of jgw.com, along with our earnings press release.

Statements in this conference call and in our earnings press release issued this morning, other than historical fact, are forward-looking statements. Actual results may differ materially from those projected in forward-looking statements. Factors that may cause the actual results to differ materially are discussed in our earnings press release. The Company disclaims any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes available, future developments occur or otherwise.

One of the items we will speak about today is adjusted net income, which is a non-GAAP measure. We use adjusted net income as a measure of our overall financial performance. We define adjusted net income as our net income under US GAAP before the amounts related to the consolidation of securitization and permanent financing trusts we use to finance our business, non-cash compensation expenses, provision for or benefit from income taxes and certain other expenses. We use adjusted net income to measure our financial performance because we believe it represents a better measure than the GAAP of our operating results, as the impact of the variable interest entities and other excluded items do not influence our ongoing operations. In addition, the add-backs described above are consistent with adjustments permitted under our term loan agreement. Please refer to our earnings press release for a reconciliation of the GAAP net income to adjusted net income.

Lastly, we will discuss unaudited prior year results of WestStar Mortgage, Inc. for information and comparison purposes only. As these results were achieved prior to the acquisition, they should not be considered part of our audited financial results and are also not indicative of future performance.

Now, I will turn the call over to our Chief Executive Officer, Stewart Stockdale.

Stewart Stockdale:

Thank you, Erik, and good morning, everyone, and thank you for joining the call today.

In third quarter 2015, we achieved a 5% increase in our total adjusted revenues from a year ago. We also delivered positive adjusted net income of $5.2 million. Included in our results are two months of our newly integrated and rebranded J.G. Wentworth Home Lending Division, formerly WestStar Mortgage, Inc. We are now a more diversified consumer financial services company, and are making continued progress against our long-term strategy to transform the Company from a monoline business by leveraging our strong brand that is synonymous with satisfying our customers' needs for cash. In the Quarter, we closed, integrated and rebranded our mortgage acquisition as J.G. Wentworth Home Lending. We also completed our second securitization this year.

In October, Scott Stevens joined as our new CFO, (inaudible) Western Union where he was Treasurer and Chief Risk Officer. He started his (inaudible) Ford Motor Company, where he spent 19 years in different senior finance roles. We have quickly leveraged Scott's strengths and work experience, and have designed an (inaudible) program for the structured settlements business that complements the already existing program (inaudible). Scott will share more details with you later in the call.

J.G. Wentworth Home (inaudible) now has two reportable segments. (Inaudible) at $240 million of total receivables balance (inaudible) in the quarter. For comparison purposes, TRB for Q3 (inaudible) $263 million, but included $6 million in settlements (inaudible). Also, as part of our focus on profitability, we chose to be more selective in our (inaudible) mix, and reduce purchases from third parties that did not meet our metrics, resulting in a difference of $15.5 million in TRB, when comparing to the same quarter last year.

Structured settlements is a mature market and remains an attractive business, in which we have a leading position. The business is changing and it is very competitive. The prolonged low rate interest environment has attracted significant capital, which has increased the number of market participants contributing to pricing pressure. The marketing shift to the web and online has also contributed to increased competition by essentially lowering that barrier to entry by affording a lower cost of customer

acquisition for new and existing competitors. Consequently, as we continue to assess and manage through the segment's changing nature, we are refining our strategy and continue to take out costs as we focus on overall profitability.

We are taking a hard look at our multi-brand strategy to determine how best to position our brands in the marketplace. We see J.G. Wentworth as the umbrella brand for all of our products and the industry-leader brand for structured settlements. We expect this strategy to yield further optimization of our marketing spend. Additionally, we are evaluating opportunities across the Company to lower our cost structure through operational efficiencies and productivity improvements that are consistent with our focus on profitability.

Our structured settlements business is seeing a direct impact related to the increasing nature of the competitive environment. The resulting impact is significant and impacts our TRB and transaction mix, which drives down spread revenue and spread margin. Although we have had success in raising our buy rate on new deals initiated in the quarter, our margins remain under pressure, as we balance the variables of buy rate, deal size, length of deal, and timing of our deal pipeline, along with the timing of securitizations. As we look to combat the competitive pressures, we are reviewing top to bottom our marketing and operational discipline to position us for profitable growth.

The evolution of our digital information and data analytics will allow us to engage in a new level of micromarketing to optimize response and engagement through information-based marketing. We have traditionally focused our marketing efforts on national programming, which has served us well. However, we are exploring a fresh approach with a more targeted strategy to better align the multi-generational shift in consumer media consumption. As consumer viewership patterns change across TV and web, we are responding in kind. We are actively exploring alternative channels, such as digital streaming, Video on Demand and a variety of marketing placement tactics to drive messaging on a one-to-many basis, and more importantly, on a one-to-one basis. Collectively, these micromarketing tactics should drive higher return on marketing investment and provide deeper insights to enhance the customer experience.

Importantly, as we look to implement fundamental operational changes, we will be guided by a customer-centric mindset, so that the actions are focused on driving higher levels of production and yield throughout the lead management funnel. Our goal is to maintain our leadership position in the structure settlement payment purchasing industry, maximize returns on invested capital, and reduce the volatility of our financial performance. We believe over time this strategy can generate returns that can be reinvested in the business or used to fund our various growth initiatives.

Our new segment, J.G. Wentworth Home Lending, has significantly increased our presence in consumer financial services market, and we have the opportunity to gain share in the large mortgage loan origination category. We think we are just scratching the surface of the potential to leverage our highly recognized brand and direct-to-consumer marketing expertise to grow our share in the home lending category. We have completed the major integration milestones, employees and partners are engaged with the transition, and, most recently, the team completed significant industry-wide regulatory compliance changes referred to as TRID, the TILA-RESPA Integrated Disclosure.

Most importantly, reaction to our brand changes have been positive and our execution has been seamless for the customers, so Home Lending is off to a solid start. We have acquired a great platform with leading affiliate relationships and an established distributed retail footprint, but the big opportunity in Home Lending is to expand our market presence by leveraging our strong brand recognition and build out a direct-to-consumer channel. We have positioned Home Lending under the J.G. Wentworth Cash Now umbrella, and we've seen encouraging results of our new Home Lending marketing campaigns across TV and web. We tested our new TV commercials in the San Antonio market, as well as a national paid search campaign. We are optimistic that a direct-to-consumer channel will deliver attractive cost per acquisition economics to the business.

The Home Lending Division has had a solid year of closed origination volumes, with the third quarter increasing 32%, compared to the third quarter of 2014. In the two months operating as the J.G. Wentworth Home Lending brand, closed originations were up 52% year-over-year. Year to date, total closed originations were $1.7 billion, which already exceeds the total closed originations volume of $1.5 billion completed in all of last year. We believe we are positioned well as we enter a seasonably low period in the fourth quarter for the mortgage industry at large.

Although still in incubation, we continue to see prepaid and personal lending as elements of our long-term strategy. On the personal lending front, we continue to test and learn about the dynamics and overall landscape. We have learned a lot about our existing structured settlement customer profile and conversion rates with our existing lending partners. As the brand continues to expand its reach, new customer segments will be exposed to our personal lending offering.

Also in the quarter, we launched our prepaid cards program. We have started offering our prepaid cards to our existing customer base, and are converting our direct mail campaigns to include our prepaid product, replacing checks and third-party incentive card offerings. Our team of prepaid professionals continues to evaluate and selectively pursue opportunities in the incentive and general purpose reloadable categories.

Overall, we continue to make progress against the long-term goals to evolve the Company into a multi-line consumer financial services enterprise. We are focused on stabilizing and adjusting the structured settlement business for profitability. The foundation of the structured settlements division has allowed us to execute on our diversification strategy as demonstrated by the addition of Home Lending and our plans to scale it accordingly.

Now, I would like to introduce our new CFO, Scott Stevens. Scott has made an immediate impact in a short period of time, and we are glad to welcome him to J.G. Wentworth. So let me turn the call over to Scott.

Scott Stevens:

Thanks, Stewart. Good morning, everyone, and I also want to thank you for participating in our call this morning. I'm looking forward to working with all of you. While I've only been with the team here for a little over a month, let me start by saying I believe we have a remarkable organization with a great history and a well-recognized brand in the financial services industry. Furthermore, I believe we have a sound strategy to diversify into adjacent markets, and we are taking actions to address profitability in the structured segments division.

Now turning to our results for the third quarter, on a consolidated basis, adjusted total revenues were up 5% to $65.9 million, with expenses also up compared to a year ago, both due to the addition of Home Lending. Consolidated adjusted net income for the quarter was $5.2 million, down from $7.2 million a year ago. Earnings reflect a reduction in spread margin and a decrease in total receivables purchased—balances purchased, partially offset by an increase in net income from our Home Lending segment.

For the third quarter, structured settlements adjusted spread revenues were $42.6 million, down from $51.2 million in the third quarter last year. Third quarter TRB production was $240.4 million, which is down from recent quarters, as well as down from the Q3 2014 levels of $263.3 million. TRB spread margin for the third quarter was 17.7%, compared to 19.9% a year ago.

Total expenses for structured settlements were down $4.9 million, compared to the same quarter a year ago. Adjusted net income from our structured settlements segment was $3.2 million, down from $7.2 million in the same quarter last year. As you may recall, our last securitization had a prefunding period for several months during the quarter, which locked our cost of funds at the previously securitized rates.

As Stewart noted, we recently established a Home Lending segment. Revenue from Home Lending included in our consolidated results was $11.7 million for the third quarter. Closed originations for the third quarter were $522 million, with $353 million completed in August and September. For the quarter, Home Lending generated a mix of purchases and refinanced originations that included government and conventional mortgages. Closed originations in this quarter are consistent with the business' demonstrated ability to respond to changing market conditions and the corresponding fluctuation in demand for purchase or refinanced loans. Home Lending contributed $2 million to third quarter ANI for the two months it was included in our consolidated results. As of September 30, 2015, Home Lending serviced a portfolio of about 12,000 loans, with an unpaid principal balance of $2.8 billion. The general value of mortgage servicing rights, MSRs, increases when interest rates rise and decreases when interest rates fall due to the anticipated changes in mortgage prepayment rates.

GAAP (inaudible) requires us to consolidate the results of our variable interest entities, or VIEs. (Inaudible) adjusted net income (inaudible) measure of our financial performance to be impacted (inaudible) the VIE entities. ANI takes up (inaudible) securitized assets and liabilities, but includes the impact of changes in rates (inaudible) securitized.

Certain other one-time and non-recurring (inaudible) excluded from ANI. One example is the non-cash impairment charge (inaudible) quarter. This relates to a decrease in the value of the Peachtree and (inaudible) balance sheet.

Prior to the (inaudible), we assessed qualitatively whether the trade name and goodwill resulting from our acquisition of Peachtree was more likely than not to be impaired. As a result, (inaudible) reported loss and the subsequent decline in our stock price, we switched (inaudible) to a quantitative method and determined that the Peachtree trade name (inaudible) was less than its carrying value, and recorded a $29.9 million impairment charge in the third quarter. Although we determined that $85 million (inaudible) resulting from the acquisition was not impaired, it should be noted that the (inaudible) unit's estimated fair value and its carrying value is less than 10%. Consequently, we will need to monitor this closely.

(Inaudible), we are looking to implement a new structured settlements hedging program. This program will complement the hedging program already in place at Home Lending, which, as illustrated on Slide 10, hedges loan originations from the time they are locked to the point at which they are allocated to an investor for securitization. The MSR asset, however, is not hedged.

The goal of the structured settlements hedging program will be to reduce earnings volatility by partially mitigating the effects of changes in the general level of interest rates. While we are not planning to hedge the entire structured settlements pipeline, we do plan to hedge a portion of that risk from the time that deals are funded until sold or securitized. We will monitor and evaluate the effectiveness of this program over time. In addition, as illustrated on Slide 12, we are not hedging the entire interest rate risk, but are planning to hedge the swap component only. There is no cost-effective way to hedge the investor spread.

I also wanted to mention a few other items from the quarter.

At the end of the third quarter, after using $53.2 million of cash for our Home Lending acquisition and completing our most recent securitization, we had cash and cash equivalents of nearly $36 million and structured settlements segment assets ready to be securitized of $23.8 million. In addition, our structured settlements business has $750 million of warehouse facilities. Our structured settlements business regularly accesses the capital markets with securitization transactions, such as the recently completed $158.5 million 2015-2 transaction.

Similarly, our Home Lending segment has its own $210 million of warehouse facilities. Home Lending maintains strong relationships with secondary mortgage market participants, including institutional buyers, as well as government sponsored enterprises, or GSEs.

Let me wrap up with just a few thoughts to keep in mind.

While our new risk management program is designed to reduce some of the volatility in our structured segments business caused by interest rates, it will not completely eliminate this volatility. We intend to begin implementation of this new program as soon as possible. The competitive nature of the structured settlements business will be ongoing and may further impact our spread revenue and spread margin. We are taking actions to position the Company for profitable results as we continue to pursue our diversification agenda.

Finally, the mortgage loan originations industry can be impacted by seasonality and we expect to see that same seasonality in our Home Lending division.

With that, let me turn the call back over to Stewart.

Stewart Stockdale:

Thank you, Scott. Operator, we are now ready to open up the call to questions.

Operator:

At this time, ladies and gentlemen, if you would like to ask a question, please press star, then the number one on your telephone keypad. Again, that's star, one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from David Ho with Deutsche Bank. Please go ahead.

David Ho:

Hi, good morning.

Stewart Stockdale:

Good morning, David. How are you?

David Ho:

Good. I just had a question on the pricing strategy initiative that you've been implementing this quarter. How much do you have left in terms of repricing actions and what is the impact on TRB volumes? Are you finding the nice equilibrium between the demand and the new pricing initiatives?

Stewart Stockdale:

I assume that the new pricing you're referring to is to our buy rate, and with that, if you take a look at what—coming out of the second quarter, obviously we started—as we've discussed, we started raising our buy rate. As we were stating today, it is very competitive out there and there's a lot of access to capital, so there's only so much that we could raise before you start to see that equilibrium where you start to lose deals. We see that because we see that in our wholesale business where people are bidding on some very competitive deals and very competitive pricing.

Also, what we're seeing is that we see pressure as—when we raise—if you think about it, we'll lock a deal and we'll price it when we send out a contract. Remember, it takes 90 days to close—to fund that—on average, 90 days to fund that transaction, so we are also seeing pricing pressure as you go. So one thing is to price upfront, but the other is what do you lock it at, what do you fund it at, so we are seeing

pressure along the way. So, it is an equilibrium and all I could tell you is that it's a very competitive market out there.

David Ho:

Okay, that's helpful. In terms of the hedging strategy, what's the drag incrementally on results?

Scott Stevens:

Yes, so, clearly we spend a lot of time looking at how best to hedge, what part of the pipeline to hedge, and the most cost-effective way to do the hedging. There is a cost, but we believe that the benefit of having, you know, less volatility and more predictability from the point at which deals are funded through which they are securitized outweighs the cost. So there is some cost there, but we think it's a program that's well worth doing from that perspective.

Stewart Stockdale:

David, we did consider and we priced what it would take to hedge the whole pipeline, if you want to think of it that way, and so we're only going to hedge a portion on the back end of the deal, and it's a portion of that, and that'll vary over time, but we want to test and learn and we'll measure the effectiveness of the program. We do think it brings some level of predictability, not complete, but it's something that we've been hearing over the course of the last few months and certainly debating internally as how best to start or to start and so we're starting with a small piece.

David Ho:

Okay, so it sounds like it'll be modest to start. Okay, thank you.

Operator:

Your next question comes from Sanjay Sakhrani with KBW. Please go ahead.

Ty Namaio:

Hi, this is actually Ty Namaio (phon) in for Sanjay. Thanks for taking my questions. I guess my first question is given the market environment for the structured settlements and your focus on profitability, does this imply a lower level of TRB purchases you're going to be targeting on a quarterly basis, and how—is there a certain metric that you guys are targeting in terms of how you're thinking about operational efficiencies?

Stewart Stockdale:

Yes, two parts to that. Obviously, we're looking at how best to utilize our marketing mix and our brand mix, so that's number one. Number two, we're going to look at how do we best operationalize our activities, and so we've got some best practices that we're going to be rolling out on how to make sure that we're more customer-centric, not only as we cut the deal upfront but as we go and manage through the whole pipeline, and we're going to do that along the way.

Yes, as we focus on profitability that's, you know, the TRB levels will vary. We're going to be looking at more profitable deals on an ongoing basis. You know, we continue to be the leader and we expect to continue to be the leader in the category, but it's not going to be so much as the level of TRB but the level of profitability of the TRB along the way.

Ty Namaio:

Okay, thanks. Then is there an update on your current liquidity priorities, such as a share repurchase authorization?

Scott Stevens:

Sure. So, you know, again, when—during the remarks we talked about, you know, really focusing in on the structured side and the improvements that are being made there. We also indicated that we just completed the Home Lending acquisition where we're just integrating and finalizing that as we speak. You know, looking forward, our priorities remain on those two areas for now; that is, you know, improving the profitability on the structured side but also preparing the Home Lending side for additional growth. But from an overall prioritization, you know, we believe that focusing on the growth in the mortgage business, having just completed that acquisition, for now is a good prioritization of how we're thinking about use of capital for now.

Ty Namaio:

Okay, thank you.

Operator:

Your next question comes from John Hecht with Jefferies. Please go ahead.

John Hecht:

Good morning, thanks very much. Maybe my question's been asked. I'm wondering what can you give us in terms of information regarding the breakdown of mortgage originations, you know, what are the key programs you're originating through, are these, you know, like a refi purchase component of it, and maybe give us some information that can help us deconstruct the gain on sale realized versus unrealized.

Scott Stevens:

Yes, let me talk first on—and I think we've mentioned it before, but the business has always had a pretty good split between govies and conventional, and think of them of roughly 50/50, sometimes leaning one way or another. I think the Group does a really good job of shifting one direction versus the other, but think of them roughly split and obviously with a variability quarter-to-quarter on each of those.

Certainly in the last few months, it's been more of an angle towards refinancing versus purchase, and, again, the Group kind of pivots different directions based on where rates are and what the current opportunities are at hand. So, for the last few months it's been heavier in the refi side versus the purchase side, but they do both.

I think over time, as this is the first—we just brought them into the fold and we're beginning the whole rollout of reporting the two segments. Over time, you'll start to see us give more detail and breakout of the mortgage category and the different components that build it up.

Do you want to …

Stewart Stockdale:

No, I think that's right. The key there is the flexibility and that's one of the attractive things about the organization and what they are going to be able to do as market conditions change. So, I think that was very well put.

John Hecht:

Okay, and just in terms of like thinking about the contribution, you mentioned the flexible—that composition migrates to the marketplace and so forth, but what would you think about for the next—just in terms of seasonality and margins and composition, just given your pipeline, what should we be thinking in terms of modeling for the next couple quarters?

Stewart Stockdale:

Yes, well, as you know we don't (inaudible). I would say that we've only had the company for a short period of time, and (inaudible) understand, you know, kind of the seasonality factors and all that for the broader industry, as well. But (inaudible) component there and with the holidays in the fourth quarter, Christmas and Thanksgiving and all those sorts of (inaudible), there's a stronger period, you know, during the spring and summer months, and so on and so forth. So there's no reason (inaudible) our Group will not, you know, look at the whole industry in some part. But (inaudible) the Group in general, if you look at they are a smaller player in a very large (inaudible), we are very optimistic about their prospects going forward, but that seasonality component is there.

Scott Stevens:

The only thing I'll add is if you look at the third quarter results, if you look at the contribution (inaudible) in the two months that we owned them, there are some marketing expenses included in that, so (inaudible) their run rate for the quarter and you look at what we accounted for as ours (inaudible) particularly built after the new campaign that we built out (inaudible).

John Hecht:

Okay. I apologize, you're going in and out; I might have to follow-up with you guys to get some of that answer again. Then the final question is—and I apologize if you gave some of this data out—your intended cost phase, what—I know you mentioned marketing and others, but what line items would we see that in and what timeframe would we see that phased in over?

Stewart Stockdale:

The cost savings are a combination of marketing, operational efficiencies at the business unit level, and corporate expenses, and the team is working on them literally as we speak, so you'll see them throughout 2016.

John Hecht:

Okay, so just you, theoretically, layer them in over the course of the next four quarters kind of thing?

Stewart Stockdale:

That is correct.

John Hecht:

Okay, thanks very much.

Stewart Stockdale:

Right, but they're starting—I mean, we're starting them quickly.

John Hecht:

Okay, great. Thanks.

Operator:

Your next question comes from David Scharf with JMP Securities. Please go ahead.

David Scharf:

Hi, good morning. Thank you. Much of mine has been answered, but I did want to follow-up on I guess the longer-term outlook for the structured settlement business. Obviously, you noted some of the competitive factors. Can you give us some sense for just how much in your assessment the customer acquisition costs in this industry have declined? It seems like more online competition is really at the heart of maybe some secular changes. I'm really trying to get a sense for ultimately whether you think these are just some temporary competitive dynamics or if there's a longer-term structural shift in this business that's going to lead you to de-emphasize it.

Stewart Stockdale:

Well, I can't really forecast what exactly the—the competitive landscape will change over time. I think that the cost of funds and the access to capital has certainly contributed to a lot of people finding capital to enter the category, and, as you point out, the openness of the web has certainly allowed many smaller players to participate. I think we've been in the category in good time and in bad times, and we will continue to do so. I think that what happens with rates and what happens after the capital will be a question that needs to be answered. I think the web is the new reality and that's going to continue to mark a competitive landscape where barriers to entry are smaller or lower. But obviously we have a very competitive position in the marketplace and we continue to look to defend ourselves in that category, but it is competitive and your questions are real.

David Scharf:

Got it, got it. Along those lines, you know, obviously the cost of funding is more attractive now. It's a little surprising so much competition, though, would flood in at a time when the primary market for structure settlements is not that strong. Do you have a sense for whether or not there's any growth on a year-over-year basis in the number of new structured settlements being written and how that might be trending?

Stewart Stockdale:

I don't have access to that, so it's tough to measure. We get a lot of reports that I don't want to comment on. But it's—the data is—we get mixed data, so it's tough to comment on what the year-over-year growth is in the category.

David Scharf:

Got it. Thank you very much.

Operator:

Your next question comes from Jim Delisle with Wasatch. Please go ahead.

Jim Delisle:

Good morning. Could you tell me did you report what your gain on sale margin was from WestStar this quarter?

Stewart Stockdale:

No, we did not.

Jim Delisle:

Do you have that handy or is it something I can calculate myself?

Stewart Stockdale:

Let us look at it and we'll talk to you offline about it, what we can give you and what we can't give you.

Scott Stevens:

Yes.

Jim Delisle:

Wonderful, wonderful, I'll call in a little later. Second of all, can you tell me the total amount of goodwill/intangibles that WestStar is carried for on the balance sheet?

Stewart Stockdale:

We'll get you that number, as well. We don't have it on top of hand.

Jim Delisle:

Okay, great. Thank you very much.

Operator:

There are no further questions at this time. I will now turn the call back over to the presenters.

Stewart Stockdale:

Okay. I want to thank everybody for joining today's call. Thank you very much.

Operator:

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.