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FANH - Fanhua Inc 521 Development Plan Call

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CORPORATE PARTICIPANTS

Chunlin Wang *Fanhua Inc. - Chairman & CEO*

Oasis Qiu *Fanhua Inc. - IR Manager*

Peng Ge *Fanhua Inc. - CFO and Executive Director*

CONFERENCE CALL PARTICIPANTS

Dan Tian *China International Capital Corporation Limited, Research Division - Analyst*

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Xue Yuan *China International Capital Corporation Limited, Research Division - Research Analyst*

PRESENTATION

Operator

Thank you for standing by for Fanhua 521 Development Plan Conference Call. (Operator Instructions) For your information, this conference call is now being broadcasted live over the Internet. Webcast replay will be available within 3 hours after the conference is finished. Please visit Fanhua's IR website at ir.fanhua.com, under the Events and Webcasts section.

Today's conference is being recorded. If you have any objections, you may now disconnect at this time. I would now like to turn the meeting over to your host for today's conference, Ms. Oasis Qiu, Fanhua's Investor Relations officer.

Oasis Qiu - Fanhua Inc. - IR Manager

Good morning. Welcome to our Fanhua 521 Development Plan conference call. An announcement about the plan was released last Thursday and is available on our IR website as well as on Newswire.

Before we continue, please note that the discussion today will contain forward-looking statements made under the safe harbor provision of the U.S. Private Securities Reform Act of 1995. The accuracy of that statement may be impacted by a number of business risks and uncertainties that could cause our actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but not limited to, those outlined in our filings with the SEC, including our registration statement on Form 20-F. We do not undertake any obligation to update this forward-looking information except as required under applicable law.

Joining us today are our Chief Executive Officer and Chairman, Mr. Chunlin Wang; and Chief Financial Officer, Mr. Peng Ge; and Board Secretary, [Lily Lee]. Mr. Wang will walk you through major questions we received after release of the Fanhua 521 Development Plan. He and Mr. Ge will then answer your questions after the prepared remarks.

Now I will turn the call over to Mr. Wang.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)



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Oasis Qiu - *Fanhua Inc. - IR Manager*

Thank you for joining us on today's conference call. On June 14, 2018, we announced the Fanhua 521 Development Plan and the achieving the goals of generating RMB 2 billion annual net income and CNY 10 billion annual first year premiums of life insurance business after 5 years. I would like to take this opportunity to provide more details and address some of the key questions that we received from investors.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Firstly, why did the company decide to launch the 521 Plan now, and what are the goals that we would like to achieve?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Firstly, with 2 decades of operation experience and as the largest independent insurance intermediary company in China, we believe that there's no other company has better understanding of the independent insurance that are in China than Fanhua. We believe that China's life insurance market has reached a high base after rapid development in the past few years. 2018 is expected to be a year of many adjustment and consolidation, which is the natural stage in the development of every industry. However, the drivers behind the rapid growth for the life insurance industry remain unchanged. We believe that after the adjustment that we expect in 2018, and as the industry is moving towards protection oriented business, the Chinese life insurance industry will get back on track for development in a more healthy way and resume double-digit growth. As the largest independent insurance intermediary, we expect to be the largest beneficiary of the emerging growth opportunities in the life insurance industry.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

We believe that the best scenario for distribution of life insurance product is one integrating online and off-line platforms, and that sales agents are the best media to which to converge online and off-line. And through the 20-year business operation, Fanhua has built a leading online and off-line platforms.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

In the past 5 years, we have seen an enormous amount of capital brought into the insurance industry. The price for a national operating license for 1 insurance sales company skyrocketed to RMB 20 million to RMB 30 million. This suggests that there is huge interest in the insurance industry

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within the capital markets and also the promising growth prospects of the industry. Amid this backdrop, Fanhua feels that it's important to build a wider moat and higher barrier against any followers by achieving the goals of generating RMB 2 billion annual net income and CNY 10 billion annual first-year premiums of life insurance business after 5 years.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

And the second question, I would like to give some background about the counter-party of the transaction for the purchase of 8.5 million ADS, Master Trend Limited.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Firstly, the seller of the 8.5 million ADS is Master Trend. According to its latest filing on schedule 13G amendment, Master Trend beneficiary owned an equivalent of approximately 10 million ADS of Fanhua, representing 15.46% of our total share capital as of date.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

To our knowledge, Master Trend is a Hong Kong registered investment company set up by Shenzhen [CC] Investment Co. Limited for overseas public equity investment purpose. CC Investment is a PRC-registered and property licensed private equity firm. Mr. Qiuping Lai is the principal general partner of CC Investment.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Mr. Y is one of the earliest founders and former President of Fanhua. After his retirement from Fanhua in March 2016, he has not been engaged in any aspect of our business activities since then, and is no longer an insider of Fanhua. No member of the board and no executive officer of Fanhua has any equity interest or any other economic interest in [CC] Investment. The transaction between Master Trend and the Fanhua Fund participants for the purchase of 8.5 million ADS is made independently and on an arm's-length basis.

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Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

As for why we purchased the share from [CC] Investment, first of all, the scale of the transaction involved in the Fanhua fund is quite large. And there's no other third-party shareholder, either an individual or institution, that has enough shares of the company to meet our requirements in one transaction. If we buy the shares on open market, the purchase prices will be uncontrollable. CC Investment is willing to sell their shares to us because some of the private equity fund products have reached maturity and they need cash to pay the investors. Besides, they would also like to lock in some of the profits.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

And the third question, what percentage of shares do cofounder Mr. Yinan Hu and executive officers own in Fanhua?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Mr. Yinan Hu and executive officers, including our CFO, Mr. Peng Ge and me, collectively own an equivalent of 10.2 million ADS at the time of Fanhua's IPO. We have increased our share ownership in Fanhua since then to 13.4 million ADS as of June 14, 2018. Under the development plan, Mr. Hu and executive officers and the rest of the independent directors also intend to buy an additional 1 million ADS with their personal funds.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

And the fourth question is what is the accounting treatment for this transaction? And will there be any share-based compensation expense as a result of the transaction?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

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Oasis Qiu - *Fanhua Inc. - IR Manager*

As part of the 521 Development Plan, the company will provide most of the financing to the participants of the Fanhua Fund in the form of loan for the purchase of the shares of the company.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Firstly, according to the Accounting Standard Codification 718-10, an entity may offer financing in the form of a recourse note or a non-recourse note in connection with its employees' purchase of shares. A nonrecourse note is a loan that limits the liability of the holder of the stocks being purchased. If, for any reason, the holder defaults on the note, a non-recourse loan would be accounted for a substantive grant of active share options. However, if the loan is collateralized by more than the stock purchased, for example, the entity received recovery of the money by claiming personal assets of the employee, the loan would be considered a recourse loan, and such transactions would be accounted for as a substantive purchase of stock. If the stated interest rate is equal to the market interest rates, the impact of an at-market rate of interest will have no effect on the purchase price, and, therefore, would not result in an increase in compensation cost recognized.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

The company believes that our case fits into the criteria of financing in the form of recourse notes for the purchase of the company stock, as the loans provided by the company to the participants will be collateralized by both the stock purchase and other assets. And the loan borrowers have sufficient financial strength to pay back the loans. In addition, the interest of the loans granted by the company to participants is determined with reference to the market interest rate. Therefore, we believe that no material compensation expense will be incurred as a result of the 521 Development Plan.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Thirdly, we have been discussing the accounting treatment for the transaction with our independent auditor and are still in the process of finalizing the detailed arrangement of this plan and determine relevant accounting impact.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

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Oasis Qiu - *Fanhua Inc. - IR Manager*

And the fifth question is what is the criteria for selecting eligible participants to the Fanhua 521 Development Plan, and how to guarantee that participants have the ability to pay back the loans?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

The eligible participants include qualified entrepreneurial team leaders and key employees. A qualified entrepreneurial team leader is a leader of a team that generates no less than RMB 1.2 million annual new insurance premiums of life insurance products. Key employees, who are eligible to participate in the plan include head of departments at corporate headquarters and general managers and deputies of provincial branches or subsidiaries. The company has established 3 requirements to ensure that participants have the ability to pay back loans: firstly, 10% of the subscription cost of the shares will be contributed by the participants, and shares purchased by the participants will be pledged to the company to secure the loan payment; and secondly, any future dividends derived from the share purchase by the participants will be used to pay back interest of the loans first; and thirdly, the quota of the loans for each participant will be set in proportion to his or her annual income so as to make sure that he or she has the financial strength to pay back the loan.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

And the sixth question, whether the 521 Development Plan will result in an understatement of cost and overstatement of profits.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Firstly, the 521 Development Plan is a company value-sharing program to allow the participants enjoy the growth and the value of the company over the long term.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

The plan doesn't aim at increasing profit margins, rather the goal is to increase market share and further expand our sales network to double the sales volume of our life insurance business. The plans will help us achieve this goal by properly incentivizing some of the most important members of our team and aligning the growth of our company with their interest. It won't have any impact on our gross margin of the life insurance business.



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Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

In conclusion, firstly, we will keep close communications with our auditor and legal counsel to make sure that the accounting treatment for the transaction under the 521 Development Plan strictly follows the requirements of the accounting standards and maintain our business operations in a transparent way that is compliant with all laws and regulations. And secondly, delivery of strong results and sustainable profit speak louder than a thousand words. My team and I firmly believe that for any business, large or small, what matters the most is profit generation and positive cash flow. We also believe that management's value lies in their ability to provide long-term returns to our shareholders, while enabling our employees and sales agents to have a highly respected and fulfilling career that can provide them a strong sense of accomplishment and financial security. And thirdly, the company will still have a strong cash position after the transaction. In addition, we expect stronger cash generation capabilities and continued improvement in ROE and EPS as a result of the 521 Development Plan. Therefore, we remain committed to paying regular cash dividend to shareholders going forward.

Thank you. Now we will open the floor for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of [Kier Cullen].

Unidentified Participant

I have several questions, if that's okay. My first question is, I'm curious with the cash impact of the transaction, what the standard will be. Since you're purchasing about 8.5 million shares, that's about \$250 million. And as of the last release, the company had about \$470 million of cash. So I'm wondering is about 1/2 of the company's cash balance, the current cash balance, about to be transferred as a part of this transaction. Is that correct?

Oasis Qiu - *Fanhua Inc. - IR Manager*

(foreign language)

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

(foreign language) Of the 8.5 million ADS, 7.5 million of the shares will be purchased by the team leaders and key managerial employees and the rest will be purchased by the executive officers and some of the board members. And as we also issued some new shares in amount of 6.5 million ADS, and we would expect to receive some of the cash from the new share issuance, the net cash outflow will be around 1.7 -- sorry, USD 117 million.



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Unidentified Participant

Okay. So I guess my follow-up question is, there is some kind of a cash impact to this transaction. Why not just conserve that cash and issue 8.5 million new shares instead? It's a bit unusual, the use of cash, especially in extent just to fund an incentive plan, right? Typically companies just end up issuing new shares. I'm curious why the company didn't do that instead of having this incentive plan be such a significant use of cash.

Oasis Qiu - Fanhua Inc. - IR Manager

(foreign language)

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Peng Ge - Fanhua Inc. - CFO and Executive Director

(foreign language)

Oasis Qiu - Fanhua Inc. - IR Manager

Our CFO, Mr. Ge, will take this question.

Peng Ge - Fanhua Inc. - CFO and Executive Director

(foreign language)

Oasis Qiu - Fanhua Inc. - IR Manager

The main issue is that management would like to achieve our performance goals, our operational goals without undermining the interest of our existing shareholders. If all of the shares are newly issued by the company, that will cause -- it will be a huge dilution to our existing shareholders. So by this way, by purchasing some of the shares from existing shareholders and combining some new share issuance, it will enable us to provide a better return or better rewards to our shareholders in the future.

Unidentified Participant

Right. Okay. And if I could just ask one last quick question, really appreciate you taking these questions, the clarification is very helpful. Of the 579,000 sales agents that the company disclosed last quarter, should you discuss, again, what percentage were active and sold the policy last quarter, and whether any of those rank and file agents will get to participate in the Fanhua Entrepreneurial Fund? Like will they be able to get shares? Or do they have to sell a certain number of policies every quarter to participate?

Oasis Qiu - Fanhua Inc. - IR Manager

(foreign language)



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Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Of the 570,000 sales agents, 50% of those are active in selling all types of products, including auto, life and all the non-auto P&C insurance products, et cetera. And of the 250,000 active sales agents, 10% of them are active in selling life insurance policies.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

The participants of the program actually just include the entrepreneurial team leaders. Currently, we have about over 800 entrepreneurial team leaders.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

So all of the sales agents are managed in a group, in a unit of a team.

Operator

Your next question comes from the line of Dan Tian.

Dan Tian - *China International Capital Corporation Limited, Research Division - Analyst*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

This is Tian Dan from CICC, and he has 2 questions. The first question is regarding our operation goal to achieve CNY 2 billion net profit after 5 years' time, and how much of the net profit will be contributed by our renewal business. And the second question, if the share price of Fanhua drops by 10% below the subscription cost, will the funds be automatically liquidated? And if we don't have such mechanisms, whether or not the company will recognize any impairment loss.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)



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Oasis Qiu - *Fanhua Inc. - IR Manager*

Okay. So the first question is that while we expect 40% of the net profit at the end of the 5 years will come from renewal business.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Eligible participants to Fanhua Fund, including entrepreneurial team leaders and key employees, are subject to a commitment to fulfilling performance goals within the next 5 years, and the shares will be locked up for 5 years. So we will settle the funds at the end of the 5-year period. So even if the share price drops within the next 5 years, the fund won't be liquidated.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

If the stock price drops below the subscription cost, the company may see recovery of the principal and interest of the loan by implementing a share-based -- sorry, a share buyback program and deducting the portion of the team leaders' renewal commission income to pay back the loans and interest. The share buyback may reduce the common share capital and increase EPS and thus, minimizing shareholders' loss.

Operator

Your next question comes from the line of Howie Xia.

Howie Xia

Just 3 questions from me. I will make them quick. One, out of the RMB 2 billion net profit goal, how much do you anticipate that will be made of investment income? Because currently, the investment income from the cash balance makes up a substantial portion of your net profit. Two, out of -- on this 521 Plan, I'm just wondering when the management team started formulating this plan. Is this something that has been brewing for a long time? Or is it a fairly recent decision? Lastly, on the ramp of the net profit from the current level to RMB 2 billion in 5 years, how do you expect the cadence to be? Would it be in a relatively straight line? Or would it accelerate, say, further around 2020? Will it accelerate right now and then slow down as we get further in time?

Oasis Qiu - *Fanhua Inc. - IR Manager*

(foreign language)

Unidentified Company Representative

(foreign language)



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Oasis Qiu - *Fanhua Inc. - IR Manager*

For the first question, we expect 15% of the net profit will come from investment income.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

We actually have been thinking about this plan for quite a long time taking into consideration both the market situation and our operational situation. So it's not just something that we just developed recently.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

We don't think it will be a straight line. we do expect that the growth rate will be faster in the first few years and then slow down a bit in the following years?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Operator

(Operator Instructions) Your next question comes from the line of [Ken Zhu].

Unidentified Participant

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

The question -- he asked 2 questions. The first question is how is the expectation or how's the feedback from our current sales teams. And if there's a case of under subscriptions, how the company is going to deal with it. And the second question is that this fund is available to existing team leaders and key employees, but as the company's business volume grows, and how -- what kind of incentives the company is going to provide to the newcomers?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)



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Oasis Qiu - *Fanhua Inc. - IR Manager*

Firstly, about the expectation of the team leaders and the employees, well, currently our employees and team leaders have very strong wish to grow together with the company. And we do expect to have a very positive feedback and high enthusiasm in the subscriptions. So we don't think there will be such case of undersubscription.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Well, actually, the Fund A is used to -- is available to the existing 800 team leaders, but the Fund B is used to attract the new talents in the market.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

The participants to the Fund A will fulfill certain performance goals in order to achieve 6.5 billion annual insurance premiums after 5 years. And the participants to Fund B will meet the performance goals to achieve 4 billion new insurance premiums after 5 years. So all together, the participants will achieve about over 10 billion new insurance premiums within the 5 years' time. And based on the current gross margins, we do expect that it will help us to achieve CNY 2 billion net profit after 5 years' time.

Operator

Your next question comes from the line of Yuan Xue.

Xue Yuan - *China International Capital Corporation Limited, Research Division - Research Analyst*

(foreign language)

Oasis Qiu - *Fanhua Inc. - IR Manager*

Xue Yuan has a question about financial impact. Firstly, the plan will use up a lot of our cash and short-term investments. Will there be any impact on our investment income? And then secondly, will that also impact our dividend yield in the future?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Unidentified Company Representative

(foreign language)



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Oasis Qiu - Fanhua Inc. - IR Manager

Well, our board secretary [Lily] will take this question. So basically the loans will bear an interest rate of 8% per annum. So the interest income from the loans will be able to offset the declines in the investment income derived from the short-term investment. And then secondly, we still have adequate cash position. And we expect that our cash generation capabilities will improve as a result of the 521 Development Plan. So we will continue to maintain our regular dividend policy.

Operator

There are no further questions at this time. Presenters, please continue.

Oasis Qiu - Fanhua Inc. - IR Manager

Okay. Thank you for the participation. If you have any further questions, please feel free to contact us. Thank you.

Operator

Ladies and gentlemen, this concludes our conference for today. Thank you for participating. You may now all disconnect. For the speaker, please stay on the line, and I'll be connecting you to the sub room.

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