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CISG - Q4 2013 CNinsure Inc Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

Arthur Hall *Arthur Hall Insurance - Analyst*

Mike Ryan *MJR Capital - Analyst*

Christy He *Morgan Stanley - Analyst*

PRESENTATION

Operator

Thank you for standing by for CNinsure's fourth quarter and fiscal year 2013 earnings conference call. At this time, all participants are in a listen only mode. All lines have been placed on mute to prevent background noise. After the management's prepared remarks, there will be a question and answer session. Please follow the instructions given at that time if you would like to ask a question.

For your information, this conference call is now being broadcasted live over the internet. Webcast replay will be available within three hours after the conference is finished. Please visit CNinsure's IR website at ir.cninsure.net under the events and webcast section. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the meeting over to your host for today's conference, Ms Oasis Qiu, CNinsure's Investor Relations Officer.

Oasis Qiu - CNinsure Inc - IR Manager

Hi good morning. Welcome to our fourth quarter and fiscal year 2013 earnings conference call. The earnings results were released earlier today and are available on our IR website, as well as on Newswire.

Before we continue, please know that the discussion today will contain forward looking statements made under the safe harbor provisions of the US Private Securities Litigation Reform Act of 1995. The accuracy of those statements 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 risk and uncertainties include but not limited to those outlined in our filings with the Securities and Exchange Commission, 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 is our Chief Executive Officer, Mr. Chunlin Wang, and Chief Financial Officer, Mr. Peng Ge. Mr. Wang will walk you through our financial and operating performance in the fourth quarter and fiscal year 2013, and then Mr. Ge will join him to take your questions after the prepared remarks.

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

Chunlin Wang - CNinsure Inc - CEO

(interpreted) Hello everyone. Thank you for joining us on the call. On today's agenda, our CFO Mr. Peng Ge and I will discuss the operational and financial highlights for the fourth quarter and fiscal year 2013, and share with you our business outlooks. We will take your questions after this.

We wrapped up the year with strong financial performance in the fourth quarter of 2013. Net revenues increased 15.6% from the year-ago-quarter, far exceeding our previous guidance of 5%.

Operating income and net income for the quarter grew 125.1% and 23.2% year-on-year respectively, reflecting our strength and profitability after a 3 year strategic transition.

We are pleased to report strong financial results for fiscal year 2013, with total net revenues up 10.8% year-over-year, beating our previous expectations of 5% to 10%. While operating income and net income attributable to shareholders were down 72.7% and 26.7% respectively from 2012.

We managed to effectively control our operating expense ratio during the fourth quarter of 2013 as a result of the organizational integration, despite continual increase in [scheduled costs].

With successful strategic adjustment over the past 3 years, we maintained stable growth across our 3 existing business segments in 2013, upholding their market position in respective areas.

Meanwhile, we were excited that our new growth drivers started to make meaningful contributions and presented great upside potential, as we rolled out our strategy of strengthening capability and offering comprehensive financial services and bringing high-end technology into operation.

Looking at our existing traditional business segments, P&C insurance agency business grew 17.6% and 14.5% year-over-year for the fourth quarter and fiscal year 2013 respectively, maintaining our strong market position and bargaining power with insurance partners.

Life insurance agency business recorded a drop in sales of new policies, which resulted in 19.5% and 17.7% year-over-year decline in revenue for the fourth quarter and fiscal year 2013 respectively.

Nevertheless, recurring premiums generated by [this] in the fourth quarter grew 8% from the year-ago-quarter, mainly attributable to over 80%, 13 month [consistency] ratio of long term life insurance policies, which is the highest level among our competitors, and was highly recognized by our insurance partners.

We saw frequent occurrence of catastrophic typhoons in 2013. Against this backdrop, our claims adjusting business, renowned for its prestigious professionalism and leading market position, and backed by our strong brand awareness, grew 33.2% year-over-year in net revenues for the fourth quarter, and 20% for year 2013.

Regarding the development of our new growth drivers, let's start with our e-commerce business. After acquiring [e-comm] several years ago, we made a lot of exploration on how to develop this line of business, and decided to make the development of mobile support system our top priority, by continuing to look for opportunities to grow B2C and B2B2C business.

It turned out that that decision was absolutely right. Starting from the second half of 2013, the roll-out massive promotion of CNpad, the workstation of our proprietary mobile support system. By the end of the year, the system had been put into full operation across 20 of our subsidiaries, covering most of our sales network nationwide.

We have also successfully achieved our target of selling 5000 units of CNpad in 2013, which contributed RMB8.8 million to our net revenues, and generated insurance premiums of [RMB216] million.

We were excited to see most of this operating (inaudible) were beyond our expectation. CNpad has been proven to be a powerful sales tool for sales agents. It does not only help them to improve efficiency and lowers down operating costs, but also increase the possibility for them to earn more money more easily, as CNpad increase their professional image, makes them more motivated in marketing, and they are able to present more diversified product offerings to their clients in a more [exciting] way.

And for the Company, it also will enable us to reduce operating costs, improve the [back office] operational efficiency, and support further business expansion without increasing the risk exposure.

Secondly, our brokerage business has become another growth driver. Large project commercial insurance business is a major component of the insurance industry, and there are quite a few leading international brokers, such as Aon, Marsh and Willis that primarily focus on large project commercial insurance business.

We established our brokerage business unit Fanhua Bocheng brokerage company 3 years ago, to explore opportunities in this area. Over 3 years development, our brokerage business has become a new key contributor to our revenue and [product] growth.

In 2013, Bocheng brokerage company generated over [RMB63 million] net revenues. During the fourth quarter of 2013, Bocheng recorded strong growth, with monthly net revenues exceeding RMB10 million, demonstrating a robust sustainable growth momentum.

Certainly in 2013, we continue recommending high quality wealth management products to our clients through our life insurance sales network. As of the end of 2013, we have accumulated a total of 2700 wealth management customers, and the value of wealth management products sold under our recommendation exceeded [RMB890 million] in 2013.

With 2 years efforts, we have established our [lead] reputation and brand recognition among our customers, proving the feasibility of the financial supermarket model.

Looking ahead to 2014, we will continue to execute on our technology and financial supermarket oriented strategy to develop new growth drivers, while strengthening our existing core businesses.

With regards to our existing business, within the P&C insurance and life insurance distribution segments, firstly, we will continue pushing forward the integration of the P&C and life insurance business divisions to facilitate cross-selling which we believe will become a key driver for both volume and profitability growth. And secondly, we will enhance business management, focusing on further improving the persistency ratio of life insurance business and enhancing the co-competitiveness of P&C insurance business by improving customer services. Thirdly, we will enhance headquarter to headquarter cooperation with insurance companies and increase product innovation to enhance profitability.

So within the claims adjusting segment our strategy is to drive future sustainable growth through adoption of mobile internet technology and recruitment of more high caliber professionals. In 2014 we will work on building a mobile platform that enables the function of [onsite] survey, substitute driving, emergency assistance and [equipment] maintenance to strengthen our service capability for auto-related claims adjustment services in a more cost effective and efficient way. In the meantime, for large project commercial insurance related claims adjustment service we are dedicated to attracting more talent to join us in order to further solidify our leadership in the non-auto P&C related claims adjustment business.

Now, turning to the 3 new growth drivers, first of all CNpad. We will focus on further enhancing technology and broadening product portfolios in order to improve user experience, gradually reduce (inaudible) cost and facilitate cross-selling. In the meantime we will accelerate growing [now] the system in more of our subsidiaries and enhance marketing. We expect to sell a total 15,000 units of CNpad by the end of 2014, contributing over RMB1 billion premiums in 2014.

Secondly, for brokers business we will continue active market expansion and focus on developing new channel business while maintaining the existing one to drive volume growth. We expect revenues from brokers business to double in 2014 to over RMB120 million. Thirdly, with regards to the wealth management business, as a result of the organization integration access to wealth management products will expand from life sales agents to include P&C insurance sales agents, which we believe will contribute to a rapid growth of the sales volume of wealth management products to over RMB2 billion in 2014. We are confident that our top line will grow by approximately 15% year-over-year in the first quarter of 2014 and 15% to 20% for 2014. We also anticipate a solid growth in bottom line in 2014.

The growth in our capital expenditure plans since 2010 in phase with the rising social labor costs and the restructuring in the insurance industry our traditional growth model that relies on on-the-ground sales force and network expansion have encountered unprecedented challenges.



Therefore the management decided to transform our business model and rebuild a new CNinsure, a rapidly growing high value-added business by combining our existing resources with mobile internet technology.

In the past three years we have maintained a large cash position in consideration that firstly, a strong capital reserve is the key to the success of our strategy transition and provides solid assurance to the management and employees to execute on our strategy. Secondly, it might take years for the new business model to take effect and before that happens we assumed it would be difficult for the Company to raise additional capital from the capital market if we have urgent capital requirement. Thirdly, we have made attempt to return some of the capital to shareholders through share buyback but we found that share buyback only had a very short term impact on stock price before the new business model actually starts to make contribution.

As the new business model starts to take shape after 3 years' transformation, we now have clear thoughts about how to use our capital to capitalize on the market opportunities. Firstly, by our minority interest of our majority-controlled subsidiaries so as to convert the subsidiaries into branch (inaudible) as part of a commitment to strengthen corporate governance. Secondly, acquire good quality companies in new markets to expand our market% and service capability under the new business model and underlie our historical practice, we will acquire 100% instead of a majority interest. Thirdly, develop mobile internet platform including CNpad and mobile onsite service systems. Fourthly, develop asset management business and service capability to offer diversified financial solutions to high net worth individuals. Fifthly, participate in or initiate establishment of [upstream] financial institutions such as insurance companies and phone companies.

We had expected to spend a maximum of RMB1 billion on minority interest buyout. In the past 3 years we have spent around -- over RMB100 million to acquire minority interests of several subsidiaries. For the remaining companies we expect the total considerations will be approximately RMB800 million. As for the other four areas, there remains uncertainty with regards to the actual amount that may be required, but we will keep the public informed should there be more visibility.

Hereby I would like to extend my heartfelt thanks to all our employees and sales representatives for your hard work and dedication in the past year and to all our shareholders for their continued understanding and support. In phase with the challenges and opportunities in 2014 we will devote all efforts to embrace the change and capitalize on burgeoning opportunities to create more value to our shareholders.

Now our CEO Mr. Wang and CFO Mr. Ge will open the floor for your questions.

QUESTIONS AND ANSWERS

Operator

Thank you ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Your first question comes from the line of Arthur Hall of Hall Co. Please ask your question.

Arthur Hall - Arthur Hall Insurance - Analyst

Yes, thank you. Just had a question on your gross margins, which are the relationship between commission and fees to the revenues. Over the last six quarters the commission and fees have ranged between 71% and 74% of your revenues and you can't seem to break out of that trend. You've talked about improving margins in the future but I wonder can you give us any prospect for getting back to the 60% to 65% range of those expenses so we can improve the profitability? Thank you.

Unidentified Company Representative

Our CFO Mr. Ge would like to take this questions.



Peng Ge - *CNinsure Inc - CFO*

(interpreted) For the traditional business we are afraid that the gross margins may continue at this current level for a while, and even though we expect the commission rate that we receive from insurance companies may still have room for further slight increase but we may continue to see pressure on the commission cost front. And one key driver for the gross margin to come back up will be firstly through the cross-selling as the agents are able to earn more revenues from selling diversified products they may have lower expectation for their commission rate. But for now we are afraid that gross margin may be stabilized at this level for a while, however when the contribution from our e-commerce business and also the contribution from the wealth management products, wealth management business continued to increase to account for a more significant percentage of our total revenues. We expect that will bring our cost down.

Arthur Hall - *Arthur Hall Insurance - Analyst*

Thank you for that, and one further question. It's common for companies to report earnings in both non-GAAP and GAAP measure, and the non-GAAP excludes the shareholder or the share-based compensation expense. In your case the share-based compensation expense is such a large percentage of your earnings that it seems like you would benefit from the press releases if you reported earnings on both bases.

Peng Ge - *CNinsure Inc - CFO*

(interpreted) Hi, Arthur. I think we are already doing that.

Arthur Hall - *Arthur Hall Insurance - Analyst*

You're doing this already?

Peng Ge - *CNinsure Inc - CFO*

(interpreted) Yes. The non-GAAP measure, we report adjusted EBITDA which already excludes the share-based compensation.

Arthur Hall - *Arthur Hall Insurance - Analyst*

Okay, in the adjusted EBITDA but not in the earnings per ADS which I think would be a headline number.

Unidentified Company Representative

Oh I see. I see, thank you.

Arthur Hall - *Arthur Hall Insurance - Analyst*

It just would improve the press release. Thank you.

Unidentified Company Representative

Thanks.



Peng Ge - *CNinsure Inc - CFO*

(interpreted) Your suggestion is right. We agree with your suggestion and right now most of our revenue is still contributed by our traditional business and we believe that most of our shareholders are quite concerned about the actual operating results of our traditional business, so going forward we will exclude those non-operating [factors], especially those non-cash items, so that will give more visibility to our investors to see our actual operating result. For the new business we will also disclose more details about our new business developments going forward.

Arthur Hall - *Arthur Hall Insurance - Analyst*

Thank you.

Operator

(Operator Instructions) There are no further questions. Oh, actually, we have one question that's just come through from the line of Mike Ryan of MJR Capital. Please ask your question.

Mike Ryan - *MJR Capital - Analyst*

Hi, thanks for taking my call. I just had a couple of questions. The first, I fell off the line and so if you've already talked about it I'll apologize, but I wanted to ask about commissions and fees and talk about whether or not you could give us some more detail in terms of what the variability is from your least productive agents to your most productive agents.

As a percentage of commission it's about 72.5% this quarter, and I assume on your more productive agents maybe it's a little higher, on your least productive agents a little lower, maybe it's the reverse, I don't know, but I was just curious if you could talk a little bit about the productivity of the agents and how that impacts commissions and fees revenue. And a follow up to that, or if you could add as part of that, how that impacted with CNPAT.

Unidentified Company Representative

(interpreted) There is not much difference between the most productive agents and the less productive ones in terms of the commission rate that they receive. Actually the commission rates they receive are quite similar.

For CNPAT, we don't really see any direct impacts from CNPAT on our commission rate currently and to be more accurate we actually think that the major positive influence for CNPAT is to reduce the operating cost for our back office platforms in going forward, especially when our technology are further improved and the efficiency for the back office staff will further improve and be able to reduce their workload in a more effective way. That will help reduce our operating costs.

Mike Ryan - *MJR Capital - Analyst*

Thanks. There's two other questions. One was around the share of income from affiliates. You talked briefly about this last quarter right afterwards, additional disclosure, the consumer finance, you said that it made up the majority of that income, where that income was coming from. I was wondering whether you'd given some consideration to providing some more information on that and whether this quarter it is still most of the income.



Unidentified Company Representative

(interpreted) We have about 20% equity interest in this Company and we receive about RMB20 million income from this affiliate. This company is primarily engaged in small loan business and asset management business, and it has been developing quite well and we believe that this business model is quite - has great upside potential, growth potential here in China. But after all it is a private company. We don't really have much details about this company. We can only provide a guidance expectation according to information provided by them.

They expect 50% of growth in 2014 in bottom line and they have official website and we are welcome to log on to their website to look for more information. Their website address is www.cashchina.cn.

Mike Ryan - MJR Capital - Analyst

I understand that they're a separate company, you only have 20%. Just given the magnitude of the earning and the affiliate ownership with Mr. Hu and New China Capital management, I guess I would express to both of them our desire for more disclosure, particularly given we have related party loans to the consumer finance business. I think it's only better that we have a better understanding of what's going on there.

My next question is as it relates to other receivables. I was just wondering if you could tell me what's in that line on the balance sheet.

Unidentified Company Representative

(interpreted) Other receivables mainly consisted of a loan to Puyi which is another affiliate of CNinsure, which we own about 20%.

Mike Ryan - MJR Capital - Analyst

You know, again, I'm just going to express the inter-company loans that are going to these affiliates where we own less than 20%, I guess I'm going to ask another basic question. If we're putting up loans, are those loans, are the other owners putting up equal amounts of loans to their ownership percentage?

Unidentified Company Representative

(interpreted) As far as we know the other shareholders may not have provided the same amount of loan to Puyi. The loan provided to Puyi is actually in line with our business strategy for 2014. As Mr. Wong mentioned, our wealth management business expects to grow very strongly as more of all our sales agents are able to recommend wealth management products to their clients, and the products that we sell are now coming from that company, so we hope to maintain this channel and maintain their ability to design more products.

As far as the loan, we expect to receive a return that benchmark into the market level. We already received approval from the Board to grant this loan to Puyi.

Mike Ryan - MJR Capital - Analyst

I guess as a shareholder and only owning 20% of these minority businesses and wanting to invest capital into these businesses, my guess is they can't go out and get third party loans from banks. So we're providing that financing and we're not getting any additional equity compensation for it. I'm all for investing in these growth opportunities, but we, as shareholders of CNinsure should benefit from those -- that rich capital and not have to pay for it twice in having [devised] the 80% come in at a later date.



Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) First of all, this long tranche was interest income, benchmarking to the market level. Then secondly, from a business point of view, Puyi has a very strong research team that specialize in analyzing financial products in the China market and they have very strong risk management capability and asset management capability. The reason that we're able to sell approximately RMB900 million was the abovementioned products in 2013, is based on the selection of the good quality products provided by Puyi.

Mike Ryan - *MJR Capital - Analyst*

I understand that but we're providing them a loan, so the loans to both Puyi and the consumer finance business are, if you aggregate the two of them, they're almost double the equity we've got invested in them. So I don't know what it is, but it's basically two dollars of debt for every dollar of equity. It seems like to me that they could not get that loan, particularly given their start-ups, from any other bank, so they're not at market level. You're using our cash to invest in these businesses and granted we have other benefits from this in terms of selling their products and getting commission, but I don't see how that justifies providing that sort of debt financing to them. So maybe you could give us an understanding of why you think that justifies the debt financing. Are they giving us above market commission rates?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) First of all, we need to use a certain part of our cash to get some returns and we have a very good chance in Puyi as at procurement capability and risk management capability, so that's why we lend them the loan to earn some investment income. The secondly, we also need good quality wealth management products to give them to our agents to sell. Puyi have been very good in doing that. Also, the loan that we provided to Puyi is only a very small percentage of our total cash and the loan is not very large in the actual amount as well. Right now the total asset under Puyi's management is already RMB1.3 billion.

I would like to emphasize again that the amount of the loan that we grant to Puyi has been approved by our Board.

Mike Ryan - *MJR Capital - Analyst*

Again, as a shareholder, I'm just going to say the following. If Puyi makes up the entire other receivables at \$35 million, the amount due to related parties which is through consumer finance business is \$24 million. Together, that's about \$60 million we're lending to these two businesses, well more than double the equity we have invested, assuming they're the only ones in investment and affiliates of \$31 million. So again, we would rather not have you investing in these companies -- lending money to these companies at low market rates. We'd rather have you take that \$60 million and buy debt back. I mean our stock is trading below cash value.

You say you don't have any cash to return to shareholders and you've generated about \$30 million of cash this year and you've taken that cash and you've lent it out at below rate, at below market rates, to two businesses that we have a minority interest in and the loans we have with them are double the equity investment we have. That, to me, sounds like equity and if we're not getting equity-like returns in terms of the equity of these growing businesses, I don't know how you can justify to shareholders that you're investing our cash wisely.

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) As for cap expenditure, as I explained just now, we have quite a few areas that we want to invest in to capitalize on those opportunities. We have done share buyback before, but we -- the actual results just didn't come out as we expected and we realized that it may not -- the share buyback may not really have a good effect on boosting the stock price until our fundamentals begin to improve significantly.

Then I would like to emphasize again that the loan we grant to Puyi is quite small. It's actually \$20 million. There were many notes -- the other receivables consist of the interest income and then the loan is short term, has a very short term and we also have very strict demands on what areas they need to use the capital. They can only invest in good quality collective trust products. So this is one demand that we have for Puyi.



Mike Ryan - MJR Capital - Analyst

You know, as a shareholder, I don't think anybody is of the view that a share buyback is necessarily intended to increase the stock price. So I think that that is not our goal. Our goal is to use our capital to buy back our stock if it's cheap, so we own more of this great business. If you don't think we have a great business, that's a different story. We don't want you to buy back stock when the stock price is high, we want you to buy back when it's cheap. It does no good to buy it back when it's high. The idea is not to push the stock price up. The idea is to buy back because we're trading at below a dollar. I mean if we have, really, \$378 million of cash and cash equivalents and another \$60 million lent out to two related party businesses, so we have almost \$440 million in cash, we can pretty much -- you know, our trading at below that level -- at about their level.

So I mean it's basically saying the business is worth nothing. If you think it's not worth nothing, you should use that cash and buy it back. It has nothing to do with supporting the stock price. No one wants you to support the stock price. We want you to make good use of our cash, and that's either to invest it and get significant free cash flow in the future, or buy back what appears to be a dollar for less than a dollar.

Unidentified Company Representative

(interpreted) First of all, thank you for suggestions, and we have done share buy backs before and we may continue to discuss whether we want to do another share buy back again, depending on our actual financial requirements and our [operating results].

Mike Ryan - MJR Capital - Analyst

Thanks.

Unidentified Company Representative

Thanks.

Operator

Your next question comes from the line of Christy He of Morgan Stanley. Please ask your question.

Christy He - Morgan Stanley - Analyst

(interpreted) The question is from Christy from Morgan Stanley and she's asking about the development of the CNpad. We've sold 5000 units of CNpad and which is -- which means that 10% of those agents already using -- already have CNpad and then our goal is to sell cumulatively 15,000 units of CNpad by the end of 2014.

Is there any expectation for the contribution from CNpad and how much is the premiums that the CNpad is going to generate? And then what's the margins contributed -- margin of the business contributed by CNpad compared to those business -- compared to those traditional business.

Unidentified Company Representative

(interpreted) We expect CNpad will contribute [RMB] 1 billion to [RMB] 1.5 billion premiums in 2014. And our goal -- our top priority right now is to attract more agents to use CNpad so as to increase their productivity and reduce our operating costs as well as their operational costs.

When the business volume expands, thanks to CNpad, we may have much stronger bargaining power with insurance companies, which means we may receive higher commissions from insurance company.

But our goal is not to [cut] the commission rates that we pay to agents. We want them to benefit more by using CNpad by increasing their efficiency, their productivity, why any more -- why have more sources of revenues, think they are able to do cross-selling to CNpad. So this is the major benefit that we hope that our agents can enjoy as well as ourselves can enjoy.

Christy He - Morgan Stanley - Analyst

(spoken in foreign language)

Chunlin Wang - CNinsure Inc - CEO

(interpreted) With the contribution by CNpad in terms of net revenues, Mr. Wang answered that -- right now we bundled the sales of CNpad -- I mean bundled both the hardware and software in CNpad, but going forward we're going to separate the sales and we may sell software only, and we expect to charge about [RMB] 1000 per unit for the software. And if we are able to sell 10,000 units of CNpad in 2014, that means we will have like [RMB]10 million revenues from CNpad.

Christy He - Morgan Stanley - Analyst

(Spoken in a foreign language).

Operator

Ladies and gentlemen, there are no more questions from the telephone lines and we will now concluded today's conference call. Thank you all for your participation. You may now disconnect.

Editor

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