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FANH - Q2 2017 Fanhua Inc Earnings Call

EVENT DATE/TIME: AUGUST 22, 2017 / 1:00AM GMT



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CORPORATE PARTICIPANTS

Chunlin Wang *Fanhua Inc. - CEO and Executive Director*

Oasis Qiu

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

Yinan Hu *Fanhua Inc. - Co-Founder and Chairman*

CONFERENCE CALL PARTICIPANTS

Arthur Hall

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Fanhua Inc. Second Quarter and First Half 2017 Earnings Conference Call.

(Operator Instructions) I must advise you that this conference is being recorded today, Tuesday, the 22nd of August 2017.

I would now like to hand the conference over to your first speaker today, Ms. Oasis Qiu. Thank you. Please go ahead.

Oasis Qiu

Good morning. Welcome to our Second Quarter and First Half 2017 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 note that the discussion today will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. The accuracy of these 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 risks and uncertainties include but are 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 these forward-looking information, except as required under applicable law.

Joining us today are our Chief Executive Officer, Mr. Chunlin Wang; our Board Chairman, Mr. Hu Yinan; Chief Financial Officer, Mr. Peng Ge. Mr. Wang will walk you through our financial results in the second quarter of 2017. And then he and Mr. Hu, Mr. Ge will take your questions after the prepared remarks.

Now we turn the call over to Mr. Wang.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language) Thank you for joining us on today's conference call. Here with me, we have our Chairman of the Board, Mr. Yinan Hu; our Chief Financial Officer, Mr. Peng Ge. We will begin today's call with a review of our second quarter 2017 financial and operational performance, followed by a brief discussion of our business outlook. Then we will have a Q&A session after the report. (foreign language)



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Yinan Hu - *Fanhua Inc. - Co-Founder and Chairman*

(foreign language) Hello, everyone. I am Hu Yinan.

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

(foreign language) Hello, everyone. I am Peng Ge. Welcome to join us on the call.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language) First of all, looking at the industry landscape, since last year, China has been tightening its control over the financial market. A series of new regulations have been issued by the Central Bank and the CIRC, CBRC and CSRC, aiming at fixing the financial system and guarding against financial risk. New rules rolled out by the CIRC in the past year cover a wide range of issues, from risk inspection, rectifying market orders, cracking down on irregularities, protection of consumer interest, to realigning product mix of insurance companies, showcasing the regulator's commitment to tightening supervision and steering the insurance industry back to its focus on protection-oriented insurance products.

(foreign language) Among other things, the #76 notice issued by the CIRC in September 2016 specified that insurance companies must make adjustments to its current product design before April 1, 2017, including decreasing valuation interest rate of universal life insurance products, liability reserve and improving the risk protection from proportion of personal life insurance products.

(foreign language) As these new regulations and rules took effect, especially the implementation of the #76 notice, a bulk of popular insurance products were forced to be off the shelves on April 1, 2017, across the industry. As a result, total insurance premiums in the Chinese insurance industry only grew 6.4% year-on-year in the second quarter of 2017, among which the P&C insurance premiums grew 14.1% year-on-year, while life insurance premiums only grew 2.9% year-on-year, the lowest level in the past few years.

(foreign language) In the meantime, we can also see that the CIRC's emphasis on protection-oriented insurance business has yielded positive results as follows. Firstly, acceleration of business structure adjustments. Long-term protection-type traditional life insurance business accounted for 52.9% of the total life insurance premiums, up 16.7 percentage points from year-end of 2016. Regular term life insurance products also accounted for higher proportion of the total new insurance policy sales. And secondly, professional insurance intermediary companies have become an increasingly important channel for small-, medium-sized companies, with fair strategic value getting more and more appreciated.

(foreign language) Now let's turn to the financial performance in the second quarter of first -- and first half 2017 for Fanhua.

Against the industry backdrop in the second quarter of 2017, we recorded RMB 1 billion in total net revenues, a decrease of 5% year-on-year, among which revenues from life insurance business achieved RMB 590 million, up 187.9% year-on-year. And revenues from P&C insurance business decreased [55%] (corrected by company after the call) year-on-year to RMB 350 million. Operating income registered RMB 71.2 million, beating expectations. Net income attributable to the company shareholders achieved RMB 140 million, up 352.7% on a year-on-year basis.

As for the first half of 2017, we recorded RMB 2.5 billion in total net revenues, up 25.7%, among which revenues from life insurance business achieved RMB 1.2 billion, up 229.8% from a year ago. And revenues from P&C insurance business decreased [22%] (corrected by company after the call) year-on-year to RMB 1.1 billion. Operating income registered RMB 130 million. Net income attributable to the company shareholders recorded RMB 210 million, up 317.2% on a year-on-year basis.

(foreign language) Now let's look at the performance of each of our 3 business segments.

First of all, life insurance business segment. As we mentioned just now, in the second quarter of 2017, a bout of popular insurance products were taken off shelves, while the approval process of new products by the regulator was delayed. It also took time to prepare for putting new products back on shelves and provide training to sales agents. As a result, we have suffered from lack of supply of our major life insurance products for nearly a month. Despite that, our new term life insurance product sales still grew 143.7% year-on-year to RMB 390 million in terms of standard insurance



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premiums. Persistency ratio continued to improve, with 13-month persistency ratio of term life insurance products rising to 93.3% from 89% a year ago, while 25-month persistency ratio of the term life insurance products hit a 85% record high, showcasing the high recognition our customers place on our products and service quality.

By the continued rapid growth of new insurance business, life insurance business has become a major source of revenues for us, as we expected, with its contribution to our total net revenues increasing to 58.2% from 19.2% a year ago.

(foreign language) And secondly, the P&C insurance segment. The fierce competition in the P&C insurance market brought great damage to the commission's spread-based profit model of P&C insurance intermediaries. The financial performance of our P&C insurance business in the first quarter of 2017 might be revealing. In the first quarter, our P&C insurance business only recorded 7.4% in gross margin, whereas operating cost was over 7%, which means that our operating income was close to 0. As the CIRC continue to push ahead a second round of auto insurance pricing reform, competition will become more and more intense, which may make P&C insurance business for insurance intermediaries more susceptible to losses. In view of this trend, the management decided to relinquish all of our noncore and low-margin P&C channel business, which previously accounted for nearly 50% of our overall P&C insurance business. And we only retained the retail P&C insurance business, which we believe will be conducive to the development of life insurance business. As a result of this decision as well as the suspension of cooperation with PICC P&C, revenues from P&C insurance business dropped 55% year-on-year, and its contribution to total net revenues also decreased to 34.6% during the quarter.

(foreign language) And thirdly, the claim adjusting business segment. Despite the impact of the suspended business cooperation with PICC P&C, revenues generated by the claims adjusting business in the second quarter only decreased 10% year-on-year. The half 1 resales were largely attributable to our [term-adjusting team's maturity and also the competitiveness of its brand.

(foreign language) Next I will share with you some updates on our business operations in the second quarter of 2017.

Last October, we announced a fundamental business guideline whereby the company will continue to actively pursue opportunities to grow our life insurance business through expanding and strengthening our sales force. In the meantime, we are dedicated to enhancing our market competence by offering a wide spectrum of financial products and services and best-in-class technology, which we believe is the key to fulfilling our mission to help sales agents and team leaders become the top income earners in the Chinese insurance industry and achieving our goal to become a market leader that can generate hundreds of billion insurance premiums each year. Following this guideline, we continue to press ahead with our various key initiatives and are happy to see continued progress.

(foreign language) Firstly, our sales force continued to expand. Over the past year, we have seen a rapid growth in the number of sales agents and sales outlets. As of June 30, 2017, we recorded 856 sales outlets, representing a year-on-year increase of 73.3%. And the number of registered agents reached 328,000, up 116.6% year-on-year. We have seen increasing contribution from newly joined sales agents as well. Take life insurance business as example. Over 20% of the new life insurance premiums during the second quarter was contributed by new sales agents. (foreign language) Secondly, we've been working on further diversifying our product suppliers. In the first half of 2017, our top 2 product suppliers were Tianan Life and Huaxia Insurance, which respectively contributed 38.4% and 36.4% of our total life insurance business in terms of standard annualized life insurance premiums. In the second quarter of 2017, we commenced strategic cooperation with ICBC AXA life and Evergrande Life, which have yielded positive results. In June -- and ICBC AXA life and Evergrande Life Insurance contributed 7.7% and 2.8%, respectively, to our total life insurance business in terms of standard life insurance premiums, while the combined contribution with Tianan Life and Huaxia Life Insurance in June decreased 6.8% compared with that of May, implying a more diversified product supply structure.

(foreign language) And thirdly, we are pleased to see continued rapid development across our various online platforms.

And firstly, CNpad, as of June 30, 2017, 294,000 copies of CNpad App were downloaded and activated, up 114% year-on-year. Transaction volume reached RMB 920 million in terms of insurance premiums, up 23.1% year-over-year. And more than 60% of our auto and life insurance policies were transacted through CNpad App. We aim to put all of our key auto insurance business online by the end of 2017. (foreign language) And secondly, Baoxian.com, the online marketplace for health insurance and accidental insurance as well as travel insurance. In the second quarter, Baoxian.com



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recorded RMB 44.7 million in insurance premiums, up 131.8% year-on-year. The number of accumulated users reached 1 million, up 189.3% year-on-year. Baoxian.com was already making profits in the first half 2017.

(foreign language) And thirdly, eHuzhu, the online mutual aid community. As of June 30, 2017, the number of accumulated registered members of eHuzhu exceeded 1.8 million, more than 4x larger than that of a year ago. Since March this year, we have endeavored to raise the number of active users through marketing campaigns and product adjustments, and we are glad to see a net increase of around 10,000 active members each month.

(foreign language) And looking ahead to the next quarter, our major focus will be to further reform our P&C insurance business model, namely to transform it towards a platform-based and digitalized operating model. (foreign language) As evidenced by the financial performance of our P&C insurance business in the first half 2016 and 2017, the original profit model of earnings profits from commission spread has come to an end. The future competition in the P&C insurance business market must be the competition of cost and efficiency. A radical reform is inevitable. In view of that, with the approval from the Board of Directors, management decided that the company will abandon the original profit model and transform to a new model of earning profits through platform management fee and technology service fee. The major features of this platform are as follows.

(foreign language) Firstly, after 5 years of development, our CNpad App is mature in technology and operation. It has become the best trading tool and platform in the industry. And secondly, we decide to give the industry full access to CNpad App, through which the demand side and supply side of the P&C insurance business can complete a transaction on this platform at their discretion. And thirdly, Fanhua will serve as a matchmaker between the demand side and supply side instead of the previous role of a broker in its relationship with P&C insurance companies, clients, other insurance intermediary companies and third-party Internet insurance platforms. From now on, the company will no longer charge insurance companies commissions or pay commissions to sales agents or other distribution channels for the P&C insurance business. Instead, we will charge both the demand side and supply side platform management fee and technology service fees based on the actual amount of premiums transacted over CNpad App. Fanhua will be committed to creating a business model like Taobao of the insurance industry. And fourthly, with this model in place, we expect to see a major decline in top line, but the impact on our gross margin and operating margin will be positive. From a long-term perspective, we expect that the move to substantially reduce -- the move will be -- substantially reduce our operating costs and elevate our overall profitability. We are convinced that this model represents the future direction for operating P&C insurance business in the Chinese insurance market.

(foreign language) The explosive growth of China's life insurance market and wealth management market has just begun, and we believe a well-organized sales network will become the most valuable market resources in the future. With the accelerating trend of sales agent migration and life insurance companies shifting focus to protection-oriented life insurance business, our decision to further develop our life insurance business through expanding and strengthening our sales force is a timely one. Rapidly growing our life insurance business will require a robust, well-organized and disciplined sales force. To that end, we will channel more resources to building out our platform and operating capability. We will focus on the key areas of regional expansion, office set-up, staff recruitment, assembling our sales team, sales agent management system development as well as marketing and training. We believe these initiatives are necessary to enhance the company's competitiveness and ensure sustainable development over the longer term.

Given that, we expect that the operating income in the third quarter of 2017 will be no less than RMB 50 million.

(foreign language) Thank you. Now the management will open the floor for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of [Hsieh Yen] from CICC.



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Unidentified Analyst

(foreign language)

Oasis Qiu

The first question is from Xue Yuan from CICC. And first of all, he congratulates Fanhua on our results, and he has two questions. The first question is regarding our selling expenses. Our selling expenses dropped about 60% in the second quarter. And he understand that it was mainly due to cancellation of a subsidy provided to sales agents in the quarter. Will that impact the growth of our sales in the next few quarters? And the second question is regarding our investment income. The investment income increased by over 120%, and he's wondering what kind of -- and the investment income mainly related to the short-term investments. He is wondering what kind of products we invested for this short-term investment.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

And Mr. Wang would like to answer the first question. Actually, the reason for the decline in our selling expenses was because the sales subsidy has become a, kind of, regular payment. We have actually accounted it as a commission cost. We don't really think that this will impact our sales growth.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

And the second question regarding our investment income, the reason for the rapid increase in our investment income was mainly because these kind of products have a term of roughly one year, and a lot of these products mature in the second quarter. And as we only recognize the investment income when received, so we have a higher investment income during the second quarter. And most of this short investment are invested in interbank savings deposit, kind of, products.

Operator

(Operator Instructions) Your next question comes from the line of Arthur Hall of Hallco Incorporated.

Arthur Hall

Could you explain the reason for the large increase in the amounts due from related parties? It seemed like it was an unusual amount of increase. And also, do you have a target for the number of sales agents at year-end?

Oasis Qiu

(foreign language)



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Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

Please -- may Mr. Ge answer the first question?

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

(foreign language)

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

(foreign language)

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

(foreign language)

Oasis Qiu

The receivable from related parties is mainly related to the revolving loans that we provided to CFSG, the company that we invested, in which we hold about 20%. And the loan -- the amount of the loans was about RMB 370 million with annualized interest rate of 7.3%. And basically, this is a short-term bridge loan that CFSG needs to cover their needs for their loan issuance business, and we expect them to pay back the loans by the end of next quarter.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

And our target to -- our target for the number of sales agents is 400,000 by the end of this year.

Operator

Next question comes from the line of (inaudible) Of [Open Door].



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Unidentified Analyst

(foreign language)

Oasis Qiu

(inaudible) has 2 questions. The first question is regarding our reform] on the P&C insurance operating model. As we say, we are going to transform our profit model from the commissions spread-based to platform based, under which we will charge platform management fee and technology service fee instead of commissions. And when are we going to start this platform-based model? And right now, P&C business still accounted for 34.6% of the total net revenues so under the new model, will this revenues totally disappear? Or will it be offset by the platform management fee and the technology service fee? And how much can it be offset? And then the second question is regarding our investment income. We have recorded about RMB 100 million investment income in the second quarter. And is this investment income related to the investment in Puyi as well as CFSG? As for Puyi, as we understand, currently we own about 15%, and CFSG we own about 20%. So is it related to these 2 companies? Is the investment income related to these 2 companies? And what's our plan for these 2 companies?

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

Mr. Wang will take the first question, and Mr. Ge will answer the second question.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

For -- as for the first question, actually, we have been doing a lot of research on this platform-based model for quite a long time, and we have been basically trying to adapt this model according to the market trends, according to the changes in the market. And right now, we have submitted the proposal to the board, and we already got their approval. We expect to complete the transition to the platform-based model by the end of September. And under this new business model, our -- the way to look at our P&C business or the main metrics to benchmark our P&C business will be the transaction volume as well as the platform management fee and the technology service fee, which will be basically the net gross profit for us. And as a result of this change, our top line may decline significantly. But in the longer period, we hope that by 2018, our P&C insurance business revenue will be flattish in terms of revenues. And in 2019, our top line will continue to grow significantly, and we will return back to profitability on our P&C business. Thank you.

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

(foreign language)

Oasis Qiu

So Mr. Ge's answer basically said, in the second quarter, we had about RMB 100 million investment income, and that's mainly yields from the short-term investments, as we mentioned just now, mainly related to the interbank deposit products. And another [RMB 12 million] (corrected by company after the call) are actually share of income from affiliates, and that's mainly the share of profit that we got from CFSG, in which we currently



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own about 20%. As for the future plan for these 2 companies, business wise, we will definitely continue to support the growth of their business, as financial products and services is a key part of our overall strategy, so we'll continue to support their growth. But as for whether or not we're going to take a further step equity wise, that will depend on how the financial market environment evolves over time, as currently the financial market is under a strict control by the Central Bank as well as the regulators, amidst the financial regulations at this stage. And then, as Mr. Ge emphasized again, on business wise, we'll continue to support their development because there are still quite strong demand for these type of products in the market.

Operator

Your next question comes from the line of Mr. [Jessie Guo] of [Taiping Asset Management].

Unidentified Analyst

Sorry, it's (inaudible) from (inaudible) International.

(foreign language)

Oasis Qiu

The question is from [Jessie] from (inaudible) International. she's wondering whether we have any plan to introduce new customers in the second half. And as for Tianan Life and Huaxia Life, which are currently our top product supplies, how their contribution will change in the second half?

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

As I mentioned just now, the insurance intermediary channel has become a more important channel for the small and medium-sized companies, and our strategic value is better appreciated by them. And we have been seeing a lot of small, medium-sized company actively pursuing cooperation with Fanhua, and we expect to have more strategic contracts with some insurance companies in the third quarter and the fourth quarter. But we will be more selective in terms of our considerations that we need to find the best company that can enhance our product portfolio competitiveness in the market as well as can provide better brand recognition for the customers. And then as for the revenue contribution from Tianan and Huaxia we do expect that the contribution to come down a little bit more so that we don't have so much concentrated product supply.

Unidentified Analyst

(foreign language)

Oasis Qiu

And what about (inaudible) introduced new product suppliers? So normally, are we happy to introduce 1 or 2 new product suppliers each quarter? Or that actually depends on how much new cooperation that we've been discussing with new insurance companies? And we don't have any specific number?



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Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

Unlike P&C insurance business, for the life insurance contracts, it's not the more the better. And we tend to be relatively concentrate on the cooperation with a certain number of life insurance companies. So we will basically control the pace of introducing new product suppliers. We don't really have a specific target to achieve. And when we choose the product suppliers, we will basically analyze their own position as well as our market needs to decide who to cooperate with.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

So right now Fanhua basically has a much more stronger bargaining power or has much more larger say over who to cooperate with and what type of products we can sell.

Operator

(Operator Instructions) Next question again is for (inaudible) of [Open Door].

Unidentified Analyst

(foreign language)

Oasis Qiu

The question is from (inaudible) and he's asking, by the end of June, our cash and cash equivalents was about RMB 700 million. Does it include the short-term investments? And if including the short-term investments, what's the net cash amount at the end of the second quarter?

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

(foreign language)

Unidentified Company Representative

(foreign language)

Oasis Qiu

And our financial manager, [Li Lee], will take this question. And she says that by the end of second quarter, we had about RMB 620 million cash and cash equivalents and RMB 2.3 billion short investments. So that means that our net cash position was about RMB 3 billion.



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Unidentified Analyst

(foreign language)

Oasis Qiu

How are you going to spend it?

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

Let's give a chance for our Chairman to answer the question.

Yinan Hu - *Fanhua Inc. - Co-Founder and Chairman*

(foreign language)

Oasis Qiu

The management and the board are in active discussion of several options on how we can better give returns to shareholders. And basically, we have been listed for over 10 years -- for almost 10 years, and he's happy to see that Fanhua has achieved a sustainable profitability, and he's also happy that over 20 years of development, since our inception, Fanhua has found the right business model that can generate sustainable growth and sustainable profitability. So right now, the board has been thinking, what is the right way to to enhance our shareholder value.

Operator

There are no further questions at this time. I would now like to hand the conference back to today's presenter. Go ahead. Please continue.

Chunlin Wang - *Fanhua Inc. - CEO and Executive Director*

(foreign language)

Oasis Qiu

Thank you for joining us on today's conference call. If you have any further questions, please contact us. Thank you.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may now all disconnect.



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