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## CORPORATE PARTICIPANTS

**Kelly Hsu** *HTC Corporation - IR*

**Chialin Chang** *HTC Corporation - CFO & President of Global Sales*

**Edward Wang** *HTC Corporation - VP, Finance*

## CONFERENCE CALL PARTICIPANTS

**Jean-Louis Lafayeedney** *Haitong Securities - Analyst*

**Brett Simpson** *Arete Research - Analyst*

**Anne Lee** *Nomura - Analyst*

## PRESENTATION

### Operator

Welcome everyone to HTC's 2015 first quarter results conference call and webcast in English. Today with us we have CFO and President of Global Sales, Mr. Chialin Chang; VP of Finance, Mr. Edward Wang and the Investor Relations, Miss Kelly Hsu and Miss Sally Kuo. (Operator Instructions).

Now I would like to introduce Miss Kelly Hsu from Investor Relations. Miss Hsu, please begin.

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### Kelly Hsu - HTC Corporation - IR

Thank you. Good morning, good afternoon and good evening, ladies and gentlemen. Welcome to HTC's 2015 first quarter analysts call. This is Kelly Hsu, Investor Relations at HTC. The event is now being broadcast live via HTC's website at [www.htc.com](http://www.htc.com). If you are joining us through the dial-in lines, your call is now being placed on mute. As this call is now being broadcast for investors around the world, we will conduct this call in English only.

The format for today's call will be as follows. First, I'll help to summarize our operations for the first quarter 2015 followed by our guidance for the second quarter. Afterwards, our CFO and President of Global Sales, Chialin Chang and VP of Finance, Edward Wang will lead the Q&A session.

Before we begin, I'd like to draw your attention to the disclaimer statement on page 2 of the slides. Please note that this presentation contains forward-looking statements. These statements are based on our current expectations. Actual results may differ materially from our expectations and the Company undertakes no obligation to update these forward-looking statements going forward. If you have no questions, I will begin to give the overview of the first quarter 2015.

Please turn to page 3. Page 3, first quarter financial highlights. Revenue for the first quarter was TWD41.5b with gross margin of 19.7% and operating margin of 0.05% (corrected by company after the call). Net profit after tax was TWD0.36b or an EPS of TWD0.43 per share.

First quarter overview.

HTC turned in another profitable quarter for the first three months of 2015 with revenue up 25% year on year, boosted by tailored portfolios for individual markets and targeted marketing efforts. The US saw the strongest growth since 2011, while markets in Europe and the Middle East showed continued momentum for both flagship HTC One and HTC Desire families. In Asia, Taiwan continued to gain market share in mid-end on top of the sustained momentum in high-end and also in India, within the targeted segment.

The flagship HTC One M9 was unveiled at Mobile World Congress to wide acclaim and distributor support, while the HTC One M9 Plus with a larger screen was introduced into specific emerging markets in early April.



MWC was also the venue for HTC to launch its first foray into the health and fitness market with the HTC Grip high performance fitness tracker. This is the first part of our partnership with Under Armour, a leading sports brand aimed at empowering athletes and promoting a healthy lifestyle.

In addition, HTC announced a partnership with Valve in the development of the most advanced and immersive virtual reality platform, HTC Vive which received an overwhelming response at the show and earned many award honors.

Grip and Vive represent the next steps in HTC's diversification into the connected lifestyle space, a strategy that will leverage HTC's key strengths in premium design and technology integration to further extend our consumer reach into new product areas and revenue stream.

In recognition of the strategic importance of connected smart devices to HTC's future, the HTC Board of Directors agreed a change of corporate governance towards the end of the first quarter, appointing Cher Wang, Chairwoman and Co-Founder of HTC as Chief Executive Officer. Peter Chou was appointed as Head of the HTC Future Labs, a move that will enable him to focus on the new product areas that will help drive new revenue streams and broader brand penetration for HTC going forward.

Page 5, HTC garnered numerous awards in the first quarter and especially during the Mobile World Congress, with all three announced products finding favor among media and consumers alike.

The HTC One M9 received editor's choice and top rating stamp awards from numerous publications around the world and was ranked among the best products or smartphones at MWC 2015 by Yahoo Tech, PC Mag, Engadget and Pocket Lint. The HTC Grip earned Best Fitness Wearable by both Chip Chick and TechnoBuffalo while HTC Vive attracted many best in show awards including from TechRadar, Gizmodo, Digital Trends, Mashable, Tom's Guide and Ubergizmo.

Page 6. This page gives an overview on revenue and operating profit.

Revenue for the first quarter came in at TWD41.5b and operating profit at TWD0.02b.

Page 7. Page 7 gives an overview on gross margin and operating margin. Gross margin for the first quarter was 19.7% and operating margin for the first quarter was 0.05%.

Page 8 and 9 with financial overview for the income statement and balance sheet.

Page 10, guidance for the second quarter 2015. Revenue is expected to be in the range of TWD46b to TWD51b. Gross margin is expected to be around 23% to 23.5%. EPS is expected to be TWD0.06 to TWD0.34 per share.

This wraps up the content of our presentation. And now I'd like to turn the podium to HTC's CFO and President of Global Sales, Mr. Chialin Chang. Moderator, please start the Q&A session.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Jean-Louis, Haitong.

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### Jean-Louis Lafayeedney - Haitong Securities - Analyst

Hi, good afternoon. Thank you for taking my questions. I have two. The first question is just for the guidance for the revenues, TWD46b to TWD51b. Perhaps you could just provide what the makeup of that is and how that perhaps relates to the gross profit margin which is expected to be 23%



to 23.5%. So that's a good bounce Q-on-Q. So could you just provide the makeup of the revenue in context to the fact that it's down year over year, but nevertheless gross profit margin, a good bounce from Q1 is expected. Thank you.

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**Chialin Chang** - *HTC Corporation - CFO & President of Global Sales*

Thank you for your questions. First of all, what we try to do in the second quarter is and this is what we aim to do for 2015 is to maintain hopefully a Q-over-Q growth. That's number one.

Number two, I can hear my echo, so, operator -- something. On the year-over-year, primarily is due to the two reasons. One, we try to do differently here is to maintain a healthy [M9] channel inventory that instead of massively deployment there. Also coupled with the fact that in certain countries and regions, that we have M9 and then we are going to introduce the M9 Plus and some other new models.

And this is the first place, the first time we introduce the dual flagship. So there's uncertainty around it, we certainly want to push for it. So both of them actually feed into what we intend to guide for second quarter.

And in terms of your question about gross margin, I don't know exactly the question there. But this to me, it's just pretty normal course of the business, the product mix and the gross margin. So if there's anything specific, you can ask again.

Operator, can you fix that echo?

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**Operator**

(Operator Instructions).

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**Jean-Louis Lafayeedney** - *Haitong Securities - Analyst*

Okay, so I'll carry on. But just to let you know there's -- we can't hear an echo from our side when you're talking. You sound fine. So really the question is -- okay, on the gross margin specifically it's a pretty good bounce. I think Q-over-Q to get up to 23% to 23.5% from the bounce is quite strong. So if you could just break it down a little bit in terms of the kind product that you're talking about within that revenue, how much is high end versus mid end and how much is non-smartphone.

So for example, the new products you've introduced, wearables, the camera for example, anything that's non-smartphone as well. Just a little bit more color in terms of the breakdown of your product mix for the second quarter and how that relates to --

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**Chialin Chang** - *HTC Corporation - CFO & President of Global Sales*

You can assume -- I think we still have the echo. Maybe you want to mute on your side as well. You can -- I can tell you in the second quarter, primarily is smartphone and non-smartphone devices as I said, we're trying to be more meaningful into 2016. We'll start getting some traction in 2015 second half.

And the gross margin is entirely due to the product mix in there. And the -- what we do differently here is that the -- in general it's not just applying to HTC, I think it's applying to pretty much the smartphone industry. If they're operating in a normal mode, in the high priced tier, it tends to have a higher margin. Not always the case, but typically it's the case. And the -- on the lower price tier, you tend to have lower margin of the phone.

And the -- we don't intend to, as we said in the past, we don't intend to sell smartphone below cost. That's not the intention there. Obviously if there's in the end there's a lifecycle channel inventory issue that's a different issue. But we don't intend to sell, position the smartphone at a loss. So we'll try to maintain a margin we feel very comfortable but it's purely because of product mix.



Operator, you do need to fix the echo issue. I don't think we have in the past.

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**Operator**

Okay, one moment please.

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**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

Did you hear what I said in terms of responding to your question or are you still hearing an echo?

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**Jean-Louis Lafayeedney** - Haitong Securities - Analyst

No, it's fine. I certainly heard what you said and from my side, there is absolutely no echo coming from what you're saying. This is a bit of feedback from my side. Thank you very much for that. I'll get back in line.

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**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

Okay.

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**Operator**

(Operator Instructions). Brett Simpson, Arete Research.

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**Brett Simpson** - Arete Research - Analyst

Yes, thanks very much. It's Brett Simpson here for Richard Kramer. If I look at your second quarter revenues, going back through the last couple of years, typically we've seen a much bigger spike in the quarter-on-quarter revenue line Q2 versus Q1. Can you maybe just talk a little bit about what's happening with this here? Is the seasonality really shifting in your business? Is there something in currencies that perhaps isn't giving you the confidence in Q2 revenue spike?

And just in terms of your gross margins, is there anything you think we can see this year that would structurally raises up gross margins to higher levels to what some of your peers in premium segments would be delivering. I noticed you've started to use MediaTek, for example, for the first time, for example with the M9 Plus. I don't if that's -- can you elaborate why you might start to see structurally better gross margins or is there something in the [brand] you think we might see this year from HTC?

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**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

Thank you. I think as I talk about it and I'll take this opportunity to talk a little bit how we see in 2015, obviously this is a very competitive environment so how we are -- on things what I said. On the second quarter, basically as I said earlier, our intention for 2015 is having a good sequential growth, so that means we're also for sequential growth Q-over-Q into the third quarter. Again that's our intention so I see to caveat that.

What we did differently compared to year over year is first of all, we decide the -- typically in a flagship product we draw a lot of big partners in there and that depends on the final sell-through which is still early because the products just launched about two weeks, start selling on the shelf about two weeks.

So this year, we'll do it differently. We'll try to maintain a leaner channel size, obviously leaner or more it all depends on final sell-through.

The second thing we did differently this year here, this is the first time we launched a dual flagship in certain markets that both flagship will co-exist. In certain markets, the M9 Plus eventually is going to take over the M9. But obviously, it's very important the initial M9 sales, it's a good thermometer in terms of how much more we're going to sell into the M9 Plus.

In terms of the -- in terms of gross margin, it's very hard. As I said early on, on the high end you typically have a higher gross margin and in the mid tier and lower you tend to have lower. So the lower price, it tends to have a lower -- that's a more general rule for the industry but it depends how aggressive a product vendor would like to do.

And I won't be able to comment more. Obviously we'd like to have higher gross margin because we don't intend to sell product at a loss unless some of the vendors there they have their own reasons. We don't intend to do that.

And you know we try to use a different chipset solution. The purpose is the following. What we want to present HTC is a HTC that people know the brand and the phone, they don't really care what's inside the phone and that's the representation for HTC. They only need to know this phone is the highest grade, performance grade, user experience grade. They don't need to want to know what's inside there from a brand HTC vendor perspective there.

We're choosing different multiple chipsets is for multiple reasons because in various countries and regions, there are different degree of wireless infrastructure development. To put it more specifically, in some of the countries, there's not even a, in industry jargon, a carrier aggregation. Then you're having a chipset that you would need to, asking consumers to pay something that they don't even have on the wireless support probably doesn't make a lot of sense. So that's how we decide how we play around different things in there. But at the end, it's the ultimate HTC product that we care.

And I'll take this moment to talk about what we're going to do slightly different this year as well that admittedly in the holiday season in the last few years, we have not been able to figure out something that we're able to introduce a hero product. Sometimes it's a small migration of what we have introduced earlier in the year.

So what we try to do in the year we are introducing a, I would say, a holiday hero in the second half, so hopefully we can maintain some momentum. So I just wanted to comment on this. So we have a hero product and then just continue the momentum and introduce a holiday hero in certain regions. And obviously different markets they have different needs.

And lastly, I would say the non-smartphone for primarily in the fitness as we talked about we have a joint venture with Under Armour. We're going to introduce the product for the holidays. And the HTC Vive as I said it's our intention to introduce this by the end of the year as we said publicly. The final timing is yet to be determined in terms of the HTC Vive for the virtual reality because this is not just introducing the product, this is introducing product and at the same time, fostering an entire ecosystem. So I'd just take this opportunity to post the people on the call about the general status of HTC. Thank you.

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**Brett Simpson** - *Arete Research - Analyst*

That's very helpful. If I could just ask a follow-up on the non-smartphone part of the business and you mentioned Vive and the Under Armour partnership and you've got cameras ramping up here. Can you maybe share with us, if you look long term, not so much this year, but over the next two, three, four years, what are the key targets that you're setting for this part of the business? And how do you take these products to market given much of what you've done as a company thus far has been engaging with carrier-centric products. Thank you.

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**Chialin Chang** - *HTC Corporation - CFO & President of Global Sales*

I think the -- you asked a very good question and that is also involving the HTC future, how are we going to -- not just the product, not just a market strategy business model, involving all the sales, a different structure involving there.



So the more measurable stick as we said in the past is it's our intention to see the non-smartphone products accounting for a meaningful defined as 10% of HTC revenue in 2016. Obviously it's all forward-looking so I need to put some caveat in there. But certainly it's our internal intention in that.

Second thing there, you can see what HTC try to do here is not just being known as a smartphone brand. We want to be seen as a lifestyle technology brand. And in a connected world, as our Chairperson who is now the CEO has articulated in the past, there is occasions there. We want to be seen, we want to have -- draw a very strong brand appeal in the connected world.

So a RE camera is one example. Some of you may not know actually the RE camera is gradually -- the good thing about RE camera in my personal view here is the shelf life is actually much better than the smartphone in this environment. And just to give you an example, RE camera is actually the number one best selling camera in Hong Kong. We introduce country after country, gradually increase the awareness.

Our traditional is actually in the electronics chain, in carrier channel, electronics channel, on the RE product actually we started shifting, even though it's a major pace into a lifestyle channel. And gradually, say for example, in the US in the coming months you're going to see that in a very different lifestyle channel that we'll see..

And then if we talk about the -- working with Under Armour on the HTC fitness area, partnering with Under Armour and also leveraging the strength of both sides, so we're able to cater -- with a stronger proposition cater to consumers. That would also shape up in a very different channel as compared to the HTC traditional channels.

On the HTC Vive, in terms of virtual reality, it's not only -- as I said, it's not only about the hardware, it's not only about the user experience. It's about fostering the entire ecosystem. So that's where we think we have -- we're well positioned and we think we have good opportunities.

So by introducing that, frankly speaking, it's not so much about exact timing, it's about the maturity of the ecosystem that consumer will feel it's great. Even though for the initial one it will be for early adopters maybe primarily on gaming side and not some other type of early adopters. But that will require an entirely different ecosystem and entirely different channel how we do that.

So that involves the Company in a -- beyond smartphones, if you want to position yourself as a lifestyle brand you've got to have the -- be able to articulate your right strategy in the respective area. The right business model and whole sales structure need to be [realized] accordingly as well. So with that our Chairperson also, she's driving the whole internal, optimizing the organizational structure to better position us for the future.

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**Brett Simpson** - Arete Research - Analyst

Thank you.

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**Operator**

Mr. Simpson, do you still have any questions for our speakers today?

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**Brett Simpson** - Arete Research - Analyst

Maybe just a final follow-up, I was keen to get a better response for the direct consumer online business at HTC. Can you perhaps talk about developments here, maybe what portion of overall sales would be selling direct online. Certainly I've seen it's been building with some of your competitors. Apple is quite successful online. I think the Chinese, some of the Chinese brands have made a big push in the last couple of years and done quite well. How about HTC? How do you see the online channel as a growth driver for the business?



**Chialin Chang** - *HTC Corporation - CFO & President of Global Sales*

We think online channel is definitely a very important tool. Not just a channel and not just a tool, it's a very strategic important part of HTC business. Not just for the smartphone, eventually for all HTC sales.

And I won't be able to break down currently our online business. We're actually rolling out to various countries and we started with China and we just turned on Taiwan. We're very careful in doing that because especially in countries that we have a good presence, for example like Taiwan, we're very carefully doing that to make sure the retail channel feels like it's a good complement, it's not a competition to what they're doing.

And to us the e-commerce, not just the -- eventually obviously it's delivering the sales for e-commerce, and combining the community and combining the service, combining the marketing and aggregating our consumer behavior, these are all linked altogether and in the end that will deliver the sales.

We are going to roll out in multiple key countries throughout the rest of the year including India, including Hong Kong, certain parts of Asia and China -- not China, China's already done -- in the US, major part of European countries as well.

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**Brett Simpson** - *Arete Research - Analyst*

Thank you.

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**Chialin Chang** - *HTC Corporation - CFO & President of Global Sales*

Thank you.

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**Operator**

Anne Lee, Nomura.

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**Anne Lee** - *Nomura - Analyst*

Hi. Thank you for taking my question. I have two housekeeping questions first. One is could you give us the breakdown for the first quarter, the non-op. I see there are some gains there, but I don't know what are the details.

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**Chialin Chang** - *HTC Corporation - CFO & President of Global Sales*

Okay, so you want the answer. Edward will answer it's relating to hedging so --

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**Edward Wang** - *HTC Corporation - VP, Finance*

Primarily of the non-operating income was from the currency hedging and the remaining is from the interest that we earned. So it's broadly 70% from currency hedging and 30% from the interest income.

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**Anne Lee** - *Nomura - Analyst*

Okay. And the other housekeeping question is I see your R&D expenses actually meaningfully expanded year over year for the same period. So is that a trend we are going to see for the rest of the year?



**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

The -- I think -- this is what we'll do. The R&D I can tell you for sure that the R&D expenses for non-smartphone will continue to increase and obviously we'll look at the ROI very carefully. For the Company's future, R&D for the non-smartphone will continue to increase.

In terms of the R&D for the smartphone, I don't think it will increase materially because the majority of the R&D is actually related to (inaudible) and the product SKU not necessarily for the headcount. Given that we try to allocate and balance that resource, I don't envisage the R&D for the smartphone to increase in that regard because we believe we have pretty core base of the best engineering in the world in my view. So I don't think we need to increase that much for the smartphone part of it.

**Anne Lee** - Nomura - Analyst

Okay. And my key question is actually I see your second quarter guidance and actually it's very below historical pattern. And I calculated I think the issue seems not only related to the high-end you keep in inventory strategy. Could you give us an update on the mid to low end situation, because if the mid to low end continues to grow healthily it shouldn't be that number.

**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

I think the mid to -- in the mid to entry level here, there is a -- I think you can -- I'll answer you in a more [open] way because in the mid to entry level here, starting from the second half of last year, there's a cycle that actually ended in second quarter, because on the new products, because the chipset selection issue here won't come up until July. So you'll see a wave, another mid to entry level that's coming out in waves in the second half starting third quarter and probably will culminate in Q4. And then that will extend into -- that will extend into Q1 and then you'll see a similar pattern repeated in Q2 for the -- some of the mid to entry level products.

**Anne Lee** - Nomura - Analyst

Okay. And then for the high-end side, because I recall last year, actually your Company also mentioned that you remain very strict way to cautiously watch the inventory. So now it seems like you've become more cautious. So is there any environment change or procurement strategy change from your clients or channels or it's because of your implementation of the dual flagship models so you are afraid of fighting with each other? Could you give us more color compared with last year's cycle because I remember your Company has been always very cautious on inventory control?

**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

Well, I wouldn't say we have always been very cautious on inventory. We started to be more conscious in making sure that the whole supply chain from the planning side down to the channel, sales channel side is actually streamlined. So I can tell you I personally watch that very carefully myself. That's number one.

Number two here is as I said, this is the first time we introduced a dual flagship. We want to manage it carefully and if it works out well, then this is something we think we have better comfort for how we think about our product positioning in the future.

So what I would say here is that to me, looking into 2015, in 2015 HTC I can tell you if I say it with all the caveat forward-looking statement there, it's our internal goal to continue to grow volume year over year versus 2014.

And the second thing here is that we want to have -- we want to avoid a pattern about having a peak in second quarter and start going down in the third quarter and Q4 and then really bottom in Q1 the following year and having another peak. So we were hoping to see -- again, this is all forward-looking statements with a caveat in there -- we're looking to see a sequential strength in that as I said earlier.



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**Anne Lee** - Nomura - Analyst

Okay. And my last question will be related to VR. I think it's a very interesting product and with great potential in the future. But could you give us some guidance on what's in your mind how to quantify the potential market for that? Because I understand your Company put a lot of resources in that product, but I also personally struggle how to quantify that potential market. Could you give us some hint how you think in your mind?

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**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

I won't be able to give hint because the more I say I'm going to reveal more our internal thinking. For sensitivity in terms of competitive reasons I won't be able say too much about it.

What I would comment is the following. First of all, we actually think, in our view we believe the market size is tremendous and the -- if we all think about all the big guys in the industry, without naming names, their efforts there. So it seems they also agree otherwise they wouldn't have put that kind of resources in because that's actually to us it's at least one of the top very few big areas in the next decade. So the potential is actually huge.

My personal view is it's much, much bigger than the so-called broadly defined wearables space. I may be proven wrong, but that's how I think -- that is my thinking, and our internal thinking as well.

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**Anne Lee** - Nomura - Analyst

Okay. And right now because VR you developed with Valve right now. And may we understand if it's an exclusive partnership or is there any timeframe after that they can open the technology to other participants?

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**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

I think I won't be able to disclose because the -- it's not about -- I guess you probably think about that HTC is producing hardware only. I think that is -- I wouldn't think that's the right observation. I think you should think about both sides join hands actually potentially with the other industry players to really enlarge this ecosystem.

So HTC will not -- in this space, I can tell you it's certainly not HTC's intention to be a hardware provider only. We are going to be a -- we aim to be -- we aspire to be an important player in this entire ecosystem.

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**Anne Lee** - Nomura - Analyst

Because I watch on a technology website and they called -- there is a technology called Lighthouse, it's owned by Valve. So I understand HTC may provide some software solutions to make the hardware work. But the key technology is it the Lighthouse controlled by Valve or HTC also have some assets on the technology?

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**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

Again I won't be -- I would not be able to comment on the specifics because it's involving a lot of the confidentiality, other sensitivity and future competition so I won't disclose too much because then that's going to get into very detail in that. I hope you can understand.

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**Anne Lee** - Nomura - Analyst

Yes, yes, sure.



**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

The second thing I would say here is that I want you to think about -- again it's a -- if you think about, if you had time to explore and then the way we see the VR space will be very different. And once you see the VR space to be very different then you would probably think about there's various segmentation and there's various devices that are going to fit that segmentation. I'll just pause here without elaborating further.

But my comment at the end is I think the market is huge and we aim to be a big player in that ecosystem.

**Anne Lee** - Nomura - Analyst

Thank you. Thank you, I have no questions.

**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

Okay.

**Operator**

Okay, there is currently no questions in line. We thank you for all your questions. I'm going to pass the call back to the CFO and President of Global Sales, Mr. Chialin Chang for closing remarks. Mr. Chang, please proceed.

**Chialin Chang** - HTC Corporation - CFO & President of Global Sales

Thank you very much for getting on our call. Thank you.

**Operator**

Thank you for your participation in HTC's conference. There will be a webcast replay within an hour. Please visit [www.htc.com](http://www.htc.com) under the Investors section. You may now disconnect. Goodbye.

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