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XIN - Q1 2018 Xinyuan Real Estate Co Ltd Earnings Call

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## CORPORATE PARTICIPANTS

**William Zima** *ICR, LLC - Head of Asia Practice*

**Lizhou Zhang** *Xinyuan Real Estate Co., Ltd. - CEO & Executive Director*

**Yuan Zhang** *Xinyuan Real Estate Co., Ltd. - CFO*

## CONFERENCE CALL PARTICIPANTS

**George Guo**

**Matthew Larson**

**Franklin Morton**

**John Sheehy**

## PRESENTATION

### Operator

Good day, everyone, and welcome to the first quarter 2018 earnings conference call. Please note that today's call is being recorded. I would now like to turn the conference over to Mr. Bill Zima of ICR. Please go ahead.

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**William Zima** - *ICR, LLC - Head of Asia Practice*

Hello, everyone, and welcome to Xinyuan's First Quarter 2018 Earnings Conference Call. The company's first quarter earnings results were released earlier today and are available on the company's IR website as well as on newswire services.

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. Forward-looking statements involve inherent risks and uncertainties. As such, our results may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is included in our registration statement and on our Form 20-F and other documents filed with the U.S. Securities and Exchange Commission. Xinyuan does not assume any obligation to update any forward-looking statements, except as required under applicable law.

Today, you will hear from Mr. Lizhou Zhang, the company's Chief Executive Officer, who will comment on our operating results. He will be followed by Ms. Helen Zhang, Chief Financial Officer, who will provide some additional color on Xinyuan's performance, review the company's financial results and discuss the financial outlook. Following management's prepared remarks, we will open up the call to questions.

With that said, I would now like to turn the call over to Xinyuan's CEO, Mr. Zhang. Please go ahead.

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**Lizhou Zhang** - *Xinyuan Real Estate Co., Ltd. - CEO & Executive Director*

Thank you, Bill. Good morning, and thank you all for joining our first quarter 2018 earning conference call. We are pleased to report that the first quarter 2018 financial results were in line with our expectations despite the impact of the seasonal trends on our active projects and the ongoing government policies restricting China's housing market.



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We begin 2018 with strong contract sales grew in the first quarter and improved ASPs. Compared to first quarter 2017, contract sales in China grew by 55.9%, representing strong demand from our customers for our active projects despite the current market environment. Overseas, our project in New York continued to progress as expected.

Our Hudson Garden project completed foundation work this quarter, and we began transferring and protecting crucial parts of the landmark theater at our Flushing [project] (corrected by company after the call). We also sold 2 units at our Oosten project in Brooklyn. In addition, we are pleased to continue our overseas [expansion] (corrected by company after the call) to London, where we made an equity investment in the Madison Project.

The Madison Project is a residential community project in the Canary Wharf neighborhood with is expected completion in 2020. In January and April, we purchased 2 parcels of land with a total GFA of 1 million square meters, which helped us enlarge our land bank and broaden our pipeline that support our long-term growth. We are also pleased to continue our dividend payment for this quarter.

Now please allow me to turn the call to -- over to our CFO, Ms. Helen Zhang. Helen, please go ahead.

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**Yuan Zhang - Xinyuan Real Estate Co., Ltd. - CFO**

Thank you, Mr. Zhang. Hello, everyone, and welcome to Xinyuan's First Quarter 2018 Earnings Conference Call. Allow me to take you through the financial results for this quarter, further discuss our latest operations and initiatives and conclude by updating you on our financial outlook for the rest of the year.

First, we want to inform you that on January 1, 2018, we adopted ASC 606: revenue from contracts with customers, which was issued by the Financial Accounting Standards Board. We adopted ASC 606 on an over-time basis via the cost input method and applied the standard only to contracts not completed as of the date of adoption, and made a cumulative effect adjustment to retained earnings recognized as of the date of adoption. Therefore, our first quarter results reflect the adoption of ASC 606, especially with regards to revenues and net income, and may not be directly comparable to prior periods.

First quarter contract sales increased 24.7% to about \$381 million from about \$305 million in the first quarter of 2017. In renminbi terms, contract sales were CNY 2.4 billion for the quarter. Total GFA sales in China were about 150,000 square meters in the first quarter, increased from about 140,000 square meters in the same quarter last year and declined from about 444,000 last quarter.

Total revenue decreased 38% to about \$174 million from about \$281 million in the first quarter of 2017. The decrease was mainly due to the adoption of ASC 606. The average selling price per square meter sold in China was around CNY 16,000 in the first quarter of 2018 compared to about CNY 12,000 in last quarter, and about CNY 12,000 in the first quarter of 2017.

SG&A expenses as a percentage of total revenue increased to 22.9% from 12.6% in the first quarter of 2017 and increased from 10.8% in last quarter. The increase was due to costs associated with company expansion and a decrease of revenue due to the adoption of ASC 606. Interest expense this quarter was about \$30 million compared to about \$25 million last quarter, and \$9.3 million in the same quarter last year. The increase was mainly due to increase of debt.

As a result of decreasing revenues and the increase in SG&A and interest expenses, net loss for the first quarter of 2018 was \$12.7 million compared to \$7.4 million net earnings for the first quarter of 2017. Diluted net loss per ADS attributable to shareholders was \$0.16 compared to \$0.11 net earnings per ADS in the first quarter of 2017. The company did not make a share repurchase in the first quarter of 2018.

Balance sheet. As of March 31, 2018, the company's cash and cash equivalents, including restricted cash, decreased to \$1.2 billion from \$1.5 billion as of December 31, 2017, mainly due to the payment of land acquisition. Total debt outstanding was \$3.8 billion, which reflected an increase of \$502 million compared to \$3.3 billion at the end of fourth quarter of 2017.



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The balance of the company's real estate properties under development at the end of the first quarter of 2018 increased to about \$3.5 billion compared to \$2 billion at the end of the fourth quarter of 2017. The increase was mainly due to the adoption of ASC 606, resulting in deferred revenue recognition as well as from the land acquisition.

Equity at the end of the first quarter of 2018 was about \$705 million compared to about \$1 billion at the end of the fourth quarter of 2017. The decrease was mainly due to the adoption of ASC 606.

In summary, with the adoption of the ASC 606, first, revenue will be recognized at the completion of GFA sold [for projects] (corrected by company after the call) launched before January 1, 2018, which is later than previously estimated under the percentage of completion method; and second, deliveries of different projects in different periods tend to fluctuate depending on the master plan and the progress of the project.

We provided 2017 financial results adjusted for ASC 606 adoption in today's earnings release, where you can see the comparison before and after the adoption and the mismatch between the revenue recognition and when sales occur. And lastly, the accrual method of SG&A and interest expense remain unchanged.

Now let's come to our project updates. As of May 20, we have in total of 23 active projects and 16 projects under planning, including 2 projects acquired in January and April this year, with total GFA of around 1 million square meters. The new projects are mainly located in our existing markets with solid track records, and we believe they will drive our long-term growth. As of May 20, our total unsold land bank is around 6 million square meters, which lays a strong foundation for our development in future years.

U.S. project updates. As of March 31, our Oosten project in Brooklyn, New York has recognized a total revenue of about \$256 million from the sales of 174 units out of 216 total units, representing approximately 81% of the total units sold. Revenue from this project in the first quarter of 2018 was \$5.2 million. We expect total projected revenue of around \$120 million for the remainder of this year and into 2019.

Our Hudson Garden project in Manhattan, New York, completed foundation work in the first quarter. After optimizing the internal layout of the building, we now expect 92 units to be available for sale, an increase from the original 82 units.

We continue to execute on planning, governmental approvals and predevelopments of our ground-up development projects in Flushing, New York. The Landmark Protection Committee has approved our landmark protection plan and awarded us a Certificate of Appropriateness. We began transferring and protecting crucial parts of the existing theater as scheduled.

Malaysia project updates. Xinyuan owns the development right for a total area of 170 acres in Melaka, with the development of surrounding reclamation projects such as Impression City Melaka and Melaka Gateway. We noticed that the price of the reclaimed land in Malacca rose by 40% compared to when we acquired the project. We have conducted the environmental impact assessment, and secured related approvals from the local government and are currently in the process of finalizing the reclamation contractor. We plan to launch the reclamation in June-July period of this year.

U.K. project update. We acquired 50% equity sharing of Madison Project London in the Canary Wharf neighborhood in March. In the first quarter, all below-ground work, including the [formation] (corrected by company after the call) of the extensive basement and all piling work have been completed. The structural core of the building has been constructed up to 12th floor out of a total of 53 floors. Central mechanical and electrical installations also began during the quarter. Construction remains on track for completion in 2020. At the end of the first quarter, 40% of available market sale units have been presold.

And now come to construction management service business. In the third quarter of 2017, we introduced our new construction management service business when we obtained our first construction management service project in Guangzhou. During this quarter, we had 6 active projects in our pipeline. We charge a service fee on the construction management service we provide and may receive additional revenue [through] (corrected by company after the call) our expansion into financing services and the minority holdings in projects. This asset-like business model will supplement our core traditional project development business and aid our future growth.



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Dividend. We announced a cash dividend for the first quarter of 2018 of \$0.10 per ADS, which will be paid before June 22 to shareholders of record as of June 11, 2018.

Now I would like to share with you our understanding of the current market situation. A more restrictive policy implemented by the government began around October 2016. It has been well over the year, and we expect the government's restricted policies to remain unchanged in 2018. High down payments for second home purchases, qualification of homebuyers in the local market and ceiling price guidance are still in place.

Despite the restrictions, overall underlying home-buying demand remained favorable in our local markets as demonstrated by our first quarter sales and ASP increases. We believe the goal of the government's restriction policy is to maintain healthy and stable development of the market by cooling down irrationally escalating prices in certain cities, which we support the long-term sustainable growth of our business.

We believe overall long-term housing demand trends are strongly backed by China's stable economic growth and urbanization process, in which a large population is migrating to Tier 1 and Tier 2 cities. We remain fully confident in our business growth, particularly as most of our available units are for first homebuyers or buyers who upgrade their living standards and not the luxury markets.

And finally, on to our full year 2018 financial forecast. Our guidance reflects the adoption of ASC 606 and may not be comparable to prior year periods. Our contract sales, which are better indicator for business development with the adoption of ASC 606, are expected to continue to grow sequentially in the remaining 3 quarters of the year. Second quarter contract sales is expected to be around \$530 million.

For the full year 2018, the company expects an increase in contract sales of about 10%, and an increase in consolidated net income of 15% to 20% over 2017. The majority of the company's net income is expected to occur in the fourth quarter of 2018. This is because under the adoption of ASC 606, our newly purchased land before 2018 need a cycle to turn into revenue.

This concludes my prepared remarks for today's call. And operator, we're now ready to take questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We will now take a question from George Guo of (inaudible).

### George Guo

My understanding of the accounting rule change is that the revenue will be the same, it just shifted. Is that correct?

### Yuan Zhang - Xinyuan Real Estate Co., Ltd. - CFO

Yes and no. Yes is because the revenue for specific project actually is fixed as we expected. No is because it will be shifted to a later period and might not be accrued in this year.

### George Guo

Okay. Also, I noticed that you paid less tax this quarter -- last quarter. Will the accounting change be (inaudible) because your profit will be less?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

I'm sorry. Would you please repeat your question? There's been -- there's disconnection of the line just now.

**George Guo**

I noticed you paid less tax on the last quarter earning report. Because of accounting change, will that reduce a tax limit because of the change on that...

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Right. The decrease of the tax for Q1 is because we had a lot. But generally speaking, due to the change of the accounting policy, tax were comparatively lower compared to the one when we're using the old accounting method.

**George Guo**

Okay. Last question is I noticed a big -- a large change in the sales per square meter, in average selling price per square meter. Can you give me more color on that, why large change in the sales price?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

The ASP for Q1 is around CNY 15,000 per square meter, it's mainly because 48% of our sales in Q1 are coming from commercial products. Looking into the remainder of this year, we believe that both the ASP for commercial and residential will hold up for the project of our company in the local market where we have presence.

**George Guo**

Okay. Just to clarify, you said 10% to 20% increase in profits over 2017. Is that based on the \$80 million base or based on the new accounting rule?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Last we have stated, we have taken consideration of the adoption of the new accounting policy. So the annual net income guidance that was given to you guys is between 15% to 20% increase over 2017 number.

**George Guo**

So what would be that number, because there's a little bit of confusion, what number was that...

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

The number -- sorry?

**George Guo**

I'm just -- is that okay to give an actual number because of the confusion about the last year's base?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Okay. In renminbi term, the net income for 2017, for the full year 2017, was approximately CNY 530 million.

**George Guo**

Okay. I see. So 10% to 20% over that.

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

15% to 20%.

**Operator**

We will now take a question from Matthew Larson of Wells Fargo.

**Matthew Larson**

A couple of questions, 2 or 3 of them. You didn't -- no buybacks this quarter? I mean, usually, you do even a small amount because you trade well below book value and it's a good use of your funds and you can retire stock that you pay high dividend on. What was the reason for that, for not buying back stock?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Two. We didn't buy any stock in Q1 because the board would authorize a ceiling price internally. So if the stock price didn't reach the ceiling price, then we're not going to repurchase. That's the general rule.

**Matthew Larson**

Even at \$5? All right. Okay. And you didn't mention much of your technology or blockchain initiative that you've highlighted last quarter with, I guess -- you work with IBM on a blockchain platform and then most recently with Tencent. I mean, these are things that clearly could give you a higher stock price. If what I read is accurate, one author penned a piece saying that you've got a lot more patents than, say, Tencent in the area. And that your platform could be adopted by certain governmental agencies to help facilitate transactions. Can you give us an update on how your technology advancement is going?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Yes. We are investing, in the past 2 years, in the blockchain or related technology. Although we had obtained some patents, a number of patents, and had some cooperation with companies such as Tencent, it's still in the very early stage. So we don't think if we don't have any material change or development with regard to that business sector, it's not appropriate for us to give a lot of exposure or disclose with regard to that sector to our investors because our core business is still real estate developer. Blockchain centers...

**Matthew Larson**

What value -- I'm sorry. Go ahead.



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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

The blockchain technology would be value-added service related to our property management sector.

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**Matthew Larson**

Right. What value would you place on that business at this point, that through investments you've made and the sort of valuation to marketplaces on that sort of asset?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

I think it's too early to talk about it. We'll give update to the public once we have material development.

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**Matthew Larson**

Got you. Okay. And a couple of other questions. The Oosten project in Brooklyn, which I visited, it's very nice. You have 41 units left as of end of the quarter. You said you had 100 and -- I don't know, 225, you've done 170 or something. I live in New York and the market remains pretty strong, particularly Brooklyn. Are you getting full value for those units? Are you just holding them off the market until you get the price you want? Is that why it's taking this long to close out that project?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

The problem is not the pricing of the units. The 40 units left that you are talking about actually are most of larger size, with comparatively higher total amount of unit. So naturally, by nature, it will sell in slower pace compared to smaller-sized units.

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**Matthew Larson**

I see. So you -- this is a normal pace to close out the project. Okay.

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Yes.

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**Matthew Larson**

And I mean, I guess, the longer you wait -- I mean, prices have remained pretty strong in New York, so I assume you're getting good value on the units when you do sell them. Let's see, back to the blockchain question I had. Previously, you announced that you were working on a blockchain initiative, not only with Tencent, I guess with IBM also, some sort of platform. And then you work with, I guess, a local company, Ruizhuoxitou -- I don't know how to pronounce it. But you had announced that there's 5 companies that had earned the national high-technology enterprise certification. And that one blogger or writer talking about your company said that your platform actually could be the benchmark that is used for real estate transactions, the blockchain. Is that a reasonable assessment?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

As we have talked about, it's too early to give more comments of that business sector. But I think if that business developed has not generated any material sales or productivity, we should wait to a later time to have further discussion.

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**Operator**

Our next question today comes from Franklin Morton.

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**Franklin Morton**

I would like to just step back a second and try to understand why the need for the accounting change. Is this is something that you all lead or is this something you were told to do? And why and where did it come from?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

As we were talk about it, actually, it's required by the U.S., both SEC and the Financial Accounting Standards Board, and the effective date is January 1, 2018. So this is required, it's not our choice.

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**Franklin Morton**

Okay. Okay. And just second question. You sound very enthusiastic about the Canary Wharf project, but I think a lot of the press out there says that Brexit is going to hurt the London real estate market. And I'm wondering how -- why you are also confident given what is likely to happen to the business economy in London?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

The project actually has started in year 2015, so it's been almost 3 years already. And after the due diligence that's been finished, according to our estimation, we believe this project has done nice gross margin, which is about 26% to 27%. And our ROE or, say, the return on our investment is around 16%, 17% on an annual base. So taking consideration of the economy, we think it might be a good investment opportunity. On the other hand, we've known the partner, the local partner, for a while. So there's kind of a trust between us. It's not kind of a cooperation that we've done with strangers on the street.

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**Franklin Morton**

But if the market deteriorates and prices go down, are you saying that you bought it so cheaply that even with lower prices, you're able to get these kinds of returns?

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**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

When we're doing the due diligence and also the financial estimation, we've given a kind of buffer both in the cost and the expenses side. So the numbers we just discussed actually is kind of conservative.

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**Operator**

Our next question comes from [John Sheehy].

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**John Sheehy**

Ms. Zhang, you gave some interviews with Chinese media describing details of the company's technology-driven business strategy. Can you share some of the same information with international investors?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Okay. The company believes that the next few years will witness an increasing serious competition in the traditional real estate market. So it is [important] (corrected by company after the call) for property companies to identify and grasp some new opportunities for development while managing our core business. So in -- I believe for the near future, Xinyuan will play emphasize -- will place emphasis not only at adding core business development, but also supporting business. We actually categorized it into 5. Let me try to explain or briefing the investors one by one. One is we talked about it as the industrial property development. Actually, it's a combination of residential, commercial and industrial property development platform. In that regard, by joining hands with Cambridge and Oxford University, we had conducted an in-depth cooperation in the field such as [biotech], AI and new-generation of IT, new materials and other fields. And also in March this year, the Central China maker towns, which is invested by this subsidiary of Xinyuan, was listed as the first debenture from municipally featured town by Zhengzhou, which is the capital city of Henan province. And with a focus on AI and IT and the town has brought in Fortune 500 companies, such as IBM, Oracle and Lenovo. So this is the early stage of the development with that regard, and we're continuing to have cooperation in local government. This is what is the industrial property development. And another one is the construction service that we have just talked about in our prepared remarks. And then our property management arm, that's the third one. We've been talked about it before. And this property management business has been ranked #14 in China. Another, two, one of them, is the cloud platform for property management that will help to reduce business cost, increase efficiency and promote coordination among offices. It not only provides our in-house IT support and also can sell different ERP modules to small- and medium-sized business in other sectors as well. This is the number four. And the number 5, the last one, is -- we call it business management company, a subsidiary, which aims to provide commercial services to neighborhoods and communities. So that's the one core business and the 5 supporting business that have been talked about in our earnings release.

**John Sheehy**

That's great. Also you provided guidance that first quarter contract sales would be unchanged from 2017, and actual sales were up 25%. So can you explain the better-than-expected result?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

We are trying to be conservative when we give our guidance last quarter because Q1, as you know, is a low season and with the restrictive policies in place in local markets. But as we can see that the increase of contract sales and the ASP actually give us confidence. And talking about the whole year, it's extremely back-end loaded. As we've talked about, that the majority of the net income will come in the first quarter of this year. So we're confident of our guidance. And this is why we stick to the guidance that was given to the public last quarter.

**John Sheehy**

And which projects will make the biggest contribution to second quarter contract sales?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

I believe that would be Zhengzhou area, because with respect to the contract sales contribution, also land bank of sellable resources, Zhengzhou area account for more than 50%.



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**John Sheehy**

Okay. And what is the status of the Tongzhou project in Beijing?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

As you know, the central government -- some functions of the central government are moving to Tongzhou area. So the master planning has been delayed -- I mean, the approval procedure has been delayed because of this policy change. We have submitted related documents to the local government, and we're waiting for the approval. I don't think there would be any sales and revenue contribution from this project this year.

**John Sheehy**

So that's probably in 2019?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Yes.

**John Sheehy**

Okay. And what is the strategy for selling the real estate property development completed, which had a total value of \$813 million at the end of March?

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

I think we're going to develop it into a larger size. It's not more, but it's not large enough. So we do have -- we do need to have some more time to nurture that business.

**Operator**

That's all the time we have for our question-and-answer session. At this point, I'd like to turn the call back over to management for any closing remarks.

**Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

We thank you for joining us on today's call, and we appreciate your ongoing support. We look forward to updating you on our progress in the weeks and months ahead. So thank you very much.

**Operator**

This concludes today's call. Thank you for your participation. You may now disconnect.



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