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DTE - Q3 2016 DTE Energy Co Earnings Call

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PRESENTATION

Operator

Good day and welcome to the DTE Energy third-quarter 2016 earnings release conference call. Today's conference is being recorded.

At this time I would like to turn the conference over to Barb Tuckfield. Please go ahead, ma'am.

Barb Tuckfield - *DTE Energy Company - Director of IR*

Thank you, Tanisha, and good morning, everyone. Before we get started I would like to remind you to read the Safe Harbor statement on page 2 of the presentation, including the reference to forward-looking statements.

Our presentation also includes references to operating earnings, which is a non-GAAP financial measure. Please refer to the reconciliation of GAAP net income to operating income provided in the appendix of today's presentation.

Peter Oleksiak, our Senior the Vice President and CFO, will be providing a financial update for the third quarter of 2016 guidance. We also have members of the Management Team here that we can call on during the Q&A session. And now I will turn it over to Peter to start the call.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Thanks, Barb. Good morning to everyone and thanks for joining us today. Of course, no DTE earnings call would be complete without an update on my Tigers, so let me get that over with here. I'm actually disappointed to say that for the second straight season the Tigers did not make the post season. Really the only [sell offs here] is that we were the last American team to be eliminated from contention this year. But do like to congratulate two great Midwestern cities, Cleveland and Chicago, for being the World Series, and as always I'll look forward to a brighter season next year.

Now for an update on DTE. We're keeping today's call focused on the quarter and the current year. As you can see, I'm the only participant here. We have -- I have other members of Management Team here for the Q&A session and I will call on them throughout the Q&A if needed.



I will also be deferring questions on long-term growth and strategy to the EEI Conference, which is only a few weeks away. Gerry Anderson will be providing our normal detailed business update at EEI. There he will discuss our 2017 early outlook and long-term growth plans as well as details about each of the business segments.

So now I would like to start on slide 4. As you know, in September we raised our operating EPS guidance for 2016. At that time increased the guidance midpoint's \$0.17 to a range of \$5.09 to \$5.35 from a range of \$4.91 to \$5.19. The guidance increases were driven by a lot of weather favorability at DTE Electric, favorability across all platforms at the Gas Storage and Pipeline business and a strong year-to-date economic performance at our Trading Company.

In the past we've talked about our reinvestment strategy, holding favorability until we see the summer months play out. Well, this summer was the hottest we've had in the past 60 years and we were able to reinvest a lot of those revenues back into the system, into aging infrastructure to improve customer liability.

We invested a nominal amount this quarter we are stepping up our reinvestment activity for the remainder of the year. Investments will primarily be in our infrastructure with a focus on improving immediate and lasting benefits our customers.

Another area where we're seeing great results this year is in safety. Now we always start every meeting with a discussion on safety and it is our number one priority in the Company. And I'm particularly pleased to announce that the year-to-date -- our employees continue to the best safety record in the Company's history.

Of course, we've had a major announcement in our Gas Storage and Pipeline segment in the third quarter with the acquisition of our gas midstream assets and the heart of the Southwest Marcellus and Dry Utica Basin. The transaction complements our existing midstream business and provides a [plan for] new value creation and significant growth opportunities. And we will be discussing the growth opportunities and their impact on our business at EEI.

Now I would like to go to the third-quarter earning results on slide 5. For the quarter, DTE's operating earnings were \$353 million, or \$1.96 per share. For reference, our reported earnings were \$1.88 per share and you can find a reconciliation for the third quarter reported to operating earnings on slide 17 of the appendix. For the quarter, our gross segments operating earnings were \$343 million, or \$1.91 per share.

Now starting with the segments. With DTE Electric, it was higher by \$71 million. This quarter was, as indicated, one of the warmest on record and drove much of this favorability. DTE Electric also supplemented a rate increase on August 1, as part of the ongoing rate case. This favorability was partially offset by increased expenses associated with the rate base growth.

DTE Gas was higher by \$7 million. This was primarily driven by a gas mainline replacement surcharge and the storage and transport services.

Our Power and Industrial Projects segments were higher by \$3 million, due primarily to higher REF earnings from an additional location that came online in the fourth quarter of last year. These REF earnings were partially offset by lower earnings in our steel-related assets.

Our Corporate and Other segment came in \$8 million favorable versus last year. This variance was mainly due to timing of taxes. Again, overall the gross segment results for the quarter were \$343 million, or \$1.91 per share.

Finally with the Energy Trading segment, they were \$10 million in operating earnings for the quarter and economic net income was \$1 million. Please refer to slide 15 of the appendix which shows our standard view of the Energy Trading reconciliation of both economic and operating performance. Overall DTE had a very strong third quarter.

With that, moving onto slide 6, I would like to provide an update on our 2016 earnings guidance. As I mentioned, we recently raised 2016 guidance and are confident that we will land somewhere between the midpoint and upper end of our guidance this year. Year-to-date results are solid and we are in a good position to finish the year strong.

You could see arrows next to each of the guidance numbers indicating where we think the year may play out for each segment. The green arrows indicate achieving to higher end of guidance, while the red arrows signify the lower end. The positive signaling at DTE Electric is driven by additional weather experienced at the end of September. We had a very warm September.

Our Corporate and Other segment is trending towards the lower end of guidance driven by tax true ups. In the fourth quarter, we expect Energy Trading to have accounting income that covers their expenses, which puts them at the high end of the guidance range.

And moving on to slide 7. In addition to the solid earnings results, our cash flow and balance sheet are strong and continue to support our long-term growth. Based on year-to-date results, we are updating our cash flow and capital expenditure guidance.

Starting with the left side of the page, we are increasing cash from operations by \$200 million due to the strong cash performance year-to-date. CapEx is increasing by \$1.1 billion, which is primarily due to the recent acquisition of our gas midstream assets. We're also increasing our debt financing by \$900 million, which was used in part for our recent acquisition and also for general corporate uses.

Taking a closer look at CapEx on the right side of the page, we show capital expenditure by business unit. We still expect to invest nearly \$1.6 billion at the Electric company and \$430 million at the Gas company.

We have increased the Non-Utility guidance by \$1.1 billion. This change, as I mentioned, captured the purchase of the gas midstream assets. This brings our total capital expenditures to nearly \$3.8 billion for the year.

Now let's move on to slide 8 with a look at our balance sheet metrics. Our balance sheet remains strong. We expect to end the year within our target range for both leverage and FFO-to-debt. Due to the strong year-to-date earnings and cash flow, we will not be issuing equity in 2016. And in early October, DTE issued \$1 billion of senior notes and \$675 million of mandatory convertible securities to support the midstream acquisition.

As a reminder, the \$675 million of mandatory convertible securities will convert to common equity in October 2019. Lastly, we ended the quarter with very healthy liquidity position of \$1.6 billion.

Now wrapping up on slide 9, I'll summarize the quarter and then open the line for questions. We've had another successful quarter and are in a great position to achieve our EPS guidance this year. We're looking to extend our streak to 10 consecutive years of meeting or exceeding our initial EPS guidance.

We are investing heavily in our utilities by upgrading our aging infrastructure and we're executing our growth opportunities at our Non-Utility businesses, most notably the Gas Storage and Pipeline business where we recently added a new platform for future growth. We continue to maintain a strong balance sheet which sets us up nicely for future growth opportunities as we enter a period of significant investment and begin to transform our electric generation fleet.

Before opening the line for questions, once again I'd like to remind everyone that Gerry Anderson will be giving a formal business update presentation at the upcoming EEI conference on November 8. We hope to see many of you at the conference but if you can't make it in person, you can visit our investor relations website to listen in on the webcast.

Now I would like to the open it up for questions. So, Tanisha, please open the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)



Jonathan Arnold, Deutsche Bank.

Jonathan Arnold - *Deutsche Bank - Analyst*

Good morning, Peter. Can you hear me okay?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Yes. Good morning, Jonathan.

Jonathan Arnold - *Deutsche Bank - Analyst*

My question is on Michigan legislation. There was a story in the press talking about some kind of breakthrough and expectation that this would get taken up after the election. But it wasn't clear from that what exactly might have changed in the bill. Can you give any insight as to how you guys see this playing out? And what there might be new to report?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

In terms of playing out there is definitely a strong push to get this legislation done in lame duck. There's a lot of public communication that is happening out there. Senator Nofs has made this a priority for that.

It is going to be a challenge potentially given the timeframe left but I think given the focus and attention on that there is a chance it will happen in the lame-duck session. We've had the public support recently, the Michigan State Chamber came out publicly to support this bill. So I think that's a very positive movement as well.

In terms of what has changed, is that this bill in particular is going to be a bipartisan bill. It is related to the State of Michigan, the energy reliability that is needed in the state of Michigan so both parties need to be supportive, and both parties wanted to get this energy legislation passed. So recently, there is some discussion of the renewable side.

Potentially for that mandate, currently we're at 10% and that could potentially go up to the 15%. That will help get some of the democrats on board as well. And some of the refining, and as I was mentioning even what I've been on the road, that some of it is getting the details right around the retail open access and the capacity requirements related to that.

So there is some finalization around that language. I know there is a new MISO tariff that may be out there as well that is going to help support and complement legislation as well.

Jonathan Arnold - *Deutsche Bank - Analyst*

Thank you. That was it. Thanks a lot.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Thanks Jonathan.



Operator

Michael Weinstein, Credit Suisse.

Michael Weinstein - *Credit Suisse - Analyst*

Good morning, Peter.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Hello, Michael.

Michael Weinstein - *Credit Suisse - Analyst*

With the strong quarter from the weather, just wondering if you could just comment on how that will affect O&M in the fourth quarter and your lean in initiatives?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

With all of this favorability, we are going to be putting some of that back in to the business. We have done this periodically, as you know, and this really helps maintain long-term, really good operations.

And we like to put it into customer centric-type of assets and infrastructure assets. So we are targeting potentially around \$20 million of after-tax invest. The majority of that will happen in fourth quarter. We had a minimal amount that did occur here in the third quarter.

Michael Weinstein - *Credit Suisse - Analyst*

And just a follow-up on NEXUS as we await the draft EIS or the final EIS at this point?,

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Yes, an overall update, I can give you an overall update on NEXUS. We're really at this point in the late stage constructions once again. We are very positive on this project that it is going to be a real strategic part of our portfolio. So late stage construction, the pipe is being fabricated as we speak.

Another great milestone here is that we recently signed our first tap and interconnect agreement in Ohio with an LDC. Now we have [1.75] of tap and interconnect agreements and we expect to term some of those out and that is how we are expecting to help build out the pipe. We are currently at the 2/3 and now we've been at the 2/3 for a little bit here and some of that is with E&P companies taking up pause with their balance sheets, but we're starting to get some express interest with the E&P companies.

But I do expect a good portion of the remaining pipe being filled will be being filled potentially within that Ohio market. We expect to receive the final environmental impact with a final certificate in the first quarter 2017, commence construction, and still targeting the fourth quarter of 2017 in service.

Michael Weinstein - *Credit Suisse - Analyst*

With the improvement in natural gas prices and frac spreads, I'm just wondering if you're seeing an increased amount of interest in the pipeline at all?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

We are. There's always been a lot of interest. A lot of the pause is just with the E&P companies getting -- first getting their balance sheets in order.

The other is coming up with their new capital plans and drilling plans and there's going to be a focus on this region in particular. The Utica and Marcellus.

So a lot of that is just some internal processing that needed to happen with the E&P companies. The other benefit is that we do have, with our new acquisitions, there are some synergies potentially there as well that could help support the NEXUS pipeline.

Michael Weinstein - *Credit Suisse - Analyst*

Great. Thank you very much.

Operator

Julien Dumoulin-Smith, UBS.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Good morning, Julian.

Julien Dumoulin-Smith - *UBS - Analyst*

Hey, good morning. So perhaps just follow up on the last couple of questions. First you kind of alluded to it already, but the deal with the MISO, the PSC and the governor's office as well. You comment a little bit on how that fits within what you are trying to achieve with the legislation.

Is that also one of the reasons why you have been able to get some progress? And can you comment on the fast forward, on the timing and what you expect that to look like ultimately? Or how it complements?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

A couple of comments on that. I think that the movement with the governor and with myself and the MPSC really shows that this issue really is around electric reliability in the State of Michigan. So this was kind of a potential, how do we ensure some reliability and capacity in the State of Michigan. It does help complement legislation.

So that would be one where we will have the requirements for the retail open-access providers, show us your capacity plans with a lot of local clearing requirements, that will have to be in place. Given the fact -- that given the peninsula state that we have, the limited amount of transmission we need have a lot of local generation. So this new tariff, if the ROAA customers cannot get the capacity, they will come to the utilities and we will provide it with a capacity surcharge.

My understanding is MISO will be filing this new tariff with the FERC shortly. Essentially in the next month.

Julien Dumoulin-Smith - UBS - Analyst

Got it. To what extent that achieve goals around ROAA. I suppose in part getting paid for the capacity? I suppose you're moving forward with the new gas line? I suppose that shows some of that confidence in the underlying regulatory construct at present? I don't want to mix issues here too much, though.

Peter Oleksiak - DTE Energy Company - SVP and CFO

No, the goal for the retail open access, was first it is to make sure that they have capacity within the State of Michigan, that we have reliability in the State of Michigan. And that is the number one concern with it for the policy and the regulators and this really does help ensure it, whether they got to get it themselves. If not, now they got to turn to us and we got to make sure that we get it for them.

Julien Dumoulin-Smith - UBS - Analyst

Got it. And the turning back to Mikes question a second ago. Can you comment a little bit about -- obviously there's multiple adjacent products going forward. It seems like you guys obviously are moving forward with your product irrespective.

Is an ability to combine projects and/or are you seeing or having conversations with the off-takers from some of the other projects thus far? I'm just curious if you are seeing some cannibalization here?

Peter Oleksiak - DTE Energy Company - SVP and CFO

I can say that we definitely like our pipe where it's at. We provide a northern path. As E&P companies are looking to get their product to market, they like to diversify where they are putting it.

So putting in North within the markets of Ohio, Michigan and Ontario definitely helps. So we are really, at this point, concentrating on our project. I think a lot of the interest in our project is just because of the multiple markets that it serves. So we are continuing to see a lot of interest in our products, and we're not really worried about other projects in the area.

We are really -- we have a great project. We think we do have the best northern path at this point in time.

Julien Dumoulin-Smith - UBS - Analyst

Got it. But not taking contracts in discussions with the actual operators of the other ones? By any means?

Peter Oleksiak - DTE Energy Company - SVP and CFO

We are in discussions with E&P companies around the NEXUS pipeline and if they want to get their product north, they are in discussions with us.

Julien Dumoulin-Smith - UBS - Analyst

Got it. Thank you.

Peter Oleksiak - DTE Energy Company - SVP and CFO

Thanks.

Operator

(Operator Instructions)

Paul Ridzon, KeyBanc.

Paul Ridzon - *KeyBanc Capital Markets - Analyst*

Good morning.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Good morning, Paul.

Paul Ridzon - *KeyBanc Capital Markets - Analyst*

With the recent acquisition at storage and pipes, are you kind of right sized, or do you think there is potential other opportunities out there?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

At this point in time that is really around new acquisitions. I would say we're not looking for a new acquisitions at this size. We like to develop pipes traditionally, greenfield, that is where you get your most value creation. There is a unique opportunity here.

There is a great pipe in the regions that we want to be in, which is the Utica/Marcellus. 40% of the gas in the country is going to be delivered from this region. It also fit within our footprint and potentially helps support the NEXUS pipeline. So at this point in time we're looking at developing multiple pipe platforms, growth platforms, our NEXUS platform. And we obviously we will be putting a lot of push and development on that.

And then this pipeline in particular, there is a lot of upside potential given the expansion opportunities here, and some new greenfield around the pipe that has yet to be drilled, and put into the pipe. I would say the focus will be on the development of this pipe.

There may be some smaller bolt-ons type of acquisitions, potentially. So we're comfortable right now with the growth platforms that we have in place and the development opportunities around them.

Paul Ridzon - *KeyBanc Capital Markets - Analyst*

Think very much.

Operator

Paul Patterson, Glenrock Associates.

Paul Patterson - *Glenrock Associates - Analyst*

Good morning. With respect to the compromise, it sounded like it was kind of a Senate thing. Is the a House on board with it as well?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

I know Mike Nofs has been working both the Senate but also the House, in particular. So I think that some of the movement you are seeing with the renewable side and the mandate, that is going to help get support within the house.

It is still kind of a wait and see to see if they can get it through the Senate and the House. There would be, post-election, the idea is potentially to get it to the Senate and then after Thanksgiving we work it through the house. So if there's enough support within the Senate and then we get enough of the House Democrats, there is a chance that it can get on this year.

Paul Patterson - *Glenrock Associates - Analyst*

I was told the chamber was on board. Is it [bait] or the schools, are they coming around to it?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Well the state chamber was, for us, was a major supporter. We're very happy with that and that is where a lot of the work has been done over the last few months. We are very happy with their support and that was a key support for us to get.

Paul Patterson - *Glenrock Associates - Analyst*

Okay. And to end the TCN part of it. I didn't understand what that does. The 225 megawatt certificate-of-need requirement. Is there any -- does that mean anything?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

We have a certificate-of-need process right now within the current legislation. It is a great process around getting pre-approval, some prudence around, that was \$1 threshold. They just moved it to a megawatt threshold at this point in time.

Paul Patterson - *Glenrock Associates - Analyst*

Does that mean anything, though, from our perspective? Is that something that we should be thinking about? What does that actually do? Is what I'm wondering.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Probably it may move a little more projects within that process than the old, which we are okay with. Getting a multiple stakeholders involved and getting the MPSC to look at these projects is a good thing before you start putting steel in the ground.

Paul Patterson - *Glenrock Associates - Analyst*

Okay. And in the Ontario transmission line that is being discussed with MISO and what have you, is that something you might be involved in? And do you have any more details other than what I've read here in terms of timing or what is actually being proposed? How many megawatts or anything?

Peter Oleksiak - DTE Energy Company - SVP and CFO

For the Ontario? Some of the TransCanada?

Paul Patterson - Glenrock Associates - Analyst

I'm talking about the Michigan Agency For Energy and the Michigan -- and the Governor Snyder. I'm talking about regional transmission. We talked about connecting more on a transmission with Ontario to examine more interconnections with Ontario.

Peter Oleksiak - DTE Energy Company - SVP and CFO

Yes. That is really not are -- we are not really involved in that issue. Obviously we'll look for the outcomes of that, but we don't have a direct involvement in that.

Paul Patterson - Glenrock Associates - Analyst

Okay. And then just finally, back to the MISO capacity proposal. What I'm wondering is would this be a wholesale transaction that the alternative energy provider would be charged? In other words, would they have to pay you a capacity fee? Or? But that's why I was a little bit confused about it jurisdictionally.

When I read this proposal, it sounded like they could either buy capacity themselves, or they could buy it from you at some set price, by the Michigan PSC. And I'm wondering is -- would that be considered a wholesale transaction?

Peter Oleksiak - DTE Energy Company - SVP and CFO

This really is getting at the issue that we need to have a very high local clearing requirements, which means in state generation. And either they can get generation within the state themselves, if they can't they can procure it from us.

And we need to be compensated for this and it would be a capacity charge put in place. And the Public Service Commission would be over that capacity charge in what the amount would be.

Paul Patterson - Glenrock Associates - Analyst

Would FERC have to be, though, involved in this insofar as it is a wholesale transaction at the alter that the Michigan PSC would be setting the price for. Do you follow what I'm saying?

Peter Oleksiak - DTE Energy Company - SVP and CFO

No, the FERC would not be involved.

Paul Patterson - Glenrock Associates - Analyst

Okay. I appreciate the time. Thank you so much.



Operator

(Operator Instructions)

Gregg Orrill, Barclays.

Gregg Orrill - Barclays Capital - Analyst

Thank you. You talked about, in your release and previously, about building 1,000 megawatts of gas in Michigan for, I think it was 2021. When do you expect to start spending there, and what needs to be done to move forward, [regulatorily] or otherwise?

Peter Oleksiak - DTE Energy Company - SVP and CFO

The high-level timeline on that, Gregg, is in the next year -- probably late next year, we will be providing -- we will be filing a certificate-of-need around that. With the air permitting, everything that we would need to get the projects going, the spending on after will occur at the backend of this five-year plan.

The in-service date that we put within the recent press release is 2021 to 2023 time frames. So the spending will be occurring within a few years. So probably shortly after that certificate-of-need, probably within a year after that there will be some spending occurring. Actually, spending -- a little bit of spending before that just to prepare for the certificate-of-need.

Gregg Orrill - Barclays Capital - Analyst

And do you need to file for approval there?

Peter Oleksiak - DTE Energy Company - SVP and CFO

We would have to file a -- with our certificate-of-need process, with our public service commission.

Gregg Orrill - Barclays Capital - Analyst

Okay. Got it. Thanks.

Operator

(Operator Instructions)

Shahriar Pourreza, Guggenheim Partners.

Shahriar Pourreza - Guggenheim Partners - Analyst

Hey, Peter.

Peter Oleksiak - DTE Energy Company - SVP and CFO

Good morning, Shahriar



Shahriar Pourreza - *Guggenheim Partners - Analyst*

Just one quick question on the synergies that you just mentioned around NEXUS and the GMP system that you purchased. I know you'll obviously disclose more when you get into EEI, but are synergies -- when you highlighted that, is that more of a function of adding additional producers to the pipe?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

It really is a function. We have a clear path -- continuous path with our system that we purchased with the Texas Eastern pipeline. There's a capacity that we have contracted out, NEXUS has, to get it NEXUS.

So it really is around the producers, the drilling plans around those producers. Potentially not signing up new producers but getting into the drilling plans with the existing producers we have on the pipe my and the new assets that we purchased.

Shahriar Pourreza - *Guggenheim Partners - Analyst*

Got it. And then just one lastly on the Michigan policy and the MISO tariff. Is there -- just to confirm, there is no impact to any of your potential future coal retirements, right? If we get passage? You wouldn't -- there is no scenario where you would hold capacity not retired of the coal side?

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

No, there isn't. We have -- it is a combination of age of life of these plants, and there's some new water rules being put in place, that is it is onerous to keep these plants going. So they are retiring.

Shahriar Pourreza - *Guggenheim Partners - Analyst*

Excellent. Thanks. See you soon.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

Thanks, John.

Operator

Thank you. And it does appears we have no further questions at this time. I will now hand it back over to your speakers for any additional or closing remarks.

Peter Oleksiak - *DTE Energy Company - SVP and CFO*

I would like to thank everybody for joining this morning on the call. And once again -- I can't imagine EEI is coming up quickly. How quickly the year goes by but I will be seeing a number of you at the EEI conference coming up next month. Have a great day.

Operator

And that does conclude our program. We like to thank you for your participation. Have a wonderful day and you may disconnect at any time.

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