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CNK - Q2 2017 Cinemark Holdings Inc Earnings Call

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PRESENTATION

Operator

Good day. My name is Carmen, and I will be your conference operator today. At this time, I would like to welcome everyone to the Cinemark's Second Quarter Earnings Call. (Operator Instructions)

I would now like to turn the conference over to Chanda Brashears, Vice President of Investor Relations. Please go ahead.

Chanda E. Brashears - *Cinemark Holdings, Inc. - VP of IR*

Thank you, Carmen, and good morning, everyone. At this time, I would like to welcome you to Cinemark Holdings, Inc.'s Second Quarter 2017 Earnings Release Conference Call, hosted by Mark Zoradi, Chief Executive Officer; and Sean Gamble, Chief Financial Officer.

I would like to remind our listeners that certain matters that are discussed by members of the management during this conference call may constitute forward-looking statements within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause Cinemark's actual results to differ materially from the expectations indicated or implied by such statements. Such risk factors are set forth and expressly qualified in their entirety in the company's filings with the SEC, including the most recently filed annual report on Form 10-K. The company undertakes no obligation to publicly update or revise any forward-looking statements.

Today's call and webcast may include certain non-GAAP financial measures. A reconciliation of these non-GAAP measures to the most directly comparable financial measures calculated and presented in accordance with GAAP can be found in today's press release within the company's most recently filed quarterly report on Form 10-Q and on the company's website, investors.cinemark.com.



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I would now like to turn the call over to Mark Zoradi.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Thank you, Chanda, and good morning, everyone. We appreciate you joining us for our 2017 second quarter results call. The key takeaway I would like to convey to you today is the consistency of our global financial performance, which is again demonstrated in our second quarter results. I'm pleased to report that our worldwide operations delivered an increase in the second quarter total revenue of approximately 1%, achieved a record in food and beverage per caps, and grew adjusted EBITDA by 1.4%. Year-to-date, our adjusted EBITDA has grown a robust 8.4%, with 60 basis points in margin expansion on top of last year's record results.

In the U.S., we notched another quarter of box office outperformance relative to the North American industry. During 2Q, our year-over-year admission revenue results surpassed the industry by 50 basis points, and we've now exceeded the industry for 30 of the past 34 quarters, and we're able to achieve this outperformance despite 153 temporary screen closures during the quarter that are undergoing for [client] conversions.

In Latin America, our international operations delivered box office growth of 3.7%. This growth came in spite of a 4% attendance decline that was driven by a significantly challenging comparison to the second quarter of last year, which included a much stronger slate of local films, a more favorable blockbuster release timing, and the film *Conjuring 2*, which was the 3rd largest film in Latin America during 2Q '16, while there were no meaningful releases in the horror genre this year. As a reminder, history has shown that the exhibition business is more closely tied to the strength of film content than economic cycles, both domestically and in Latin America, and we believe the second quarter box office continues to be a reflection of that trend. In terms of the overall global industry box office environment, fluctuations in film release patterns and strength of content may impact quarterly results, but we believe it's important to take a long view of box office trends. While the North American industry box office declined approximately 3.5% in the second quarter, the first half of 2017 was record setting, up nearly 1% from 2016 all-time high. And over the past 5 years, we've witnessed 4 new box office records with attendance that has been fairly stable at slightly over 1.3 billion admissions.

As for the remainder of 2017, while we may see fluctuations over the course of the second half, we remain optimistic about the upcoming film content, including *Dark Tower*, *It*, *Kingsman*, *LEGO Ninjago*, all still to come in the third quarter, and a very strong fourth quarter line up that includes *Blade Runner 2049*, *Thor*, *Justice League*, *Coco*, *Pitch Perfect 3*, *The Great Showman*, *Jumanji*, and of course, *Star Wars: The Last Jedi*.

We continue to capitalize on the box office environment through the execution of our strategic initiatives, which have been key drivers of our consistent results. As outlined on previous earnings calls, these initiatives include Luxury Lounger recliner seats, enhanced food and beverage tactics, premium offering expansions, such as our XD auditoriums and D-BOX motion seats, as well as continued development of our Connections loyalty program. Our overarching objectives with regard to all these initiatives are to deliver the highest quality guest experience by providing a wide variety of amenities and outstanding customer service, which will drive attendance, box office and total revenue, while continuing to consistently deliver industry-leading adjusted EBITDA margins. We are excited about the progress we're making on our strategic initiatives, and I'd like to provide a few updates for you today.

Regarding Luxury Loungers. We remain aggressive in our conversion initiative and grew our recliner footprint by 263 auditoriums in the second quarter to a total of 1,472 screens that represents 32% of our domestic circuit. By the end of the year, we anticipate that approximately 40% of our domestic circuit will feature this amenity. We continue to focus on our Luxury Lounger rollout plan, as conversions to date are sustaining very strong financial results, driven by significant attendance uplift, ticket pricing power and food and beverage per cap growth well in excess of a traditional theater. These recliner results continue to significantly exceed our 20% return threshold, and guest feedback remains extremely positive.

In regard to our food and beverage initiatives, as discussed last quarter, we're focused on 4 key components to drive concession revenue: one, core product category growth; two, new concept innovation; three, operational execution; and four, strategic pricing. Last quarter, we discussed our core product growth. Today, I'll provide some input into our new concept innovation tactics.

As consumers tastes and expectations are continuously changing, we're focused on evolving what we offer and how we sell concessions to our guests. By expanding food and beverage offerings, including seasonal and multicultural fair, increasing creative promotional tie-ins with film content, as well as introducing alternative designs and layouts that improve guest convenience, reduce transaction time and grow purchase



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incidents. Within these efforts to meet consumer demand, we're on target to deliver 60% of our domestic theaters with expanded food and beverage categories, and 35% offering alcohol by the end of the year. From a financial perspective, our food and beverage initiatives delivered yet another per cap record and contributed to our industry-leading trend of 42 consecutive quarters of per cap growth.

Shifting to XD. We remain committed to our XD strategy, with 231 XD auditoriums throughout our circuit, and maintain our position as the #1 private label premium large format in the world. As part of our XD initiatives, we're focused on differentiating our PLF environment from other offerings, including the installation of our Luxury Lounger recliner seats in XD auditoriums. Currently, 45% of our domestic XD screens feature recliners. Our guest response to the immersive screen with captivating sound, in addition to the oversized plush reclined seating, has been tremendous. We also initiated a significant marketing campaign earlier this year to help promote the upgraded XD experience to a wider range of our customers both inside and outside of our theaters. The results of this campaign have been excellent. And combined with our other XD initiatives, our global XD admissions revenue increased 16% year-over-year in the second quarter. Our worldwide XD screens, which comprise only 3.9% of our circuit, generated 9% of our admission revenue during 2Q, which was up 130 basis points from this time last year. We will continue to actively pursue our XD strategy, considering the favorable economics, flexibility and control of our private label, PLF.

And finally, an update on our Connections loyalty program. We have been vigorous in our marketing effort, and it has certainly paid out -- paid off. After only 15 months, we have 6 million members worldwide for which we were able to monitor, track and segment consumer behavior. This is paving the way for a more personalized Cinemark experience for our guests. We're thrilled with our progress to date, and are beginning to utilize the data to create relevant messaging and offers for our loyalty members. From the data we have gathered in the first year of this program, we have confirmed that loyalty members' annual spend and visit frequency rates are substantially higher than our general moviegoing population. Our ultimate goal with our loyalty program efforts are to continue to expand our membership base, further enrich our guest experience, increase moviegoing frequency and spend, as well as support our studio and concession partners with target-marketing actions.

In closing, we are pleased with our consistent financial results that are supported by strong operational foundation we have built, as well as the execution of our strategic initiatives. I'd like to commend our worldwide team, including our 529 theaters and corporate support centers that span 16 countries for their dedication and outstanding performance to drive our results.

That concludes my prepared remarks. I'll now turn the call over to Sean to address a more detailed discussion of our financial performance. Sean?

Sean Gamble - Cinemark Holdings, Inc. - CFO

Thank you, Mark, and good morning, everyone. During the second quarter, our global company generated \$751.2 million in total revenues that were up approximately 1% versus 2016. Worldwide adjusted EBITDA grew 1.4% to \$170.7 million, and our adjusted EBITDA margin improved 10 basis points to 22.7%. In the U.S., attendance declined 5.5% to 43 million patrons, as a result of film content that had weaker consumer appeal compared to the second quarter of 2016. That said, our attendance results continue to outpace the North American industry.

Our average ticket price increased 2.6% to \$7.79, due primarily to the impact of recliner conversion opportunities and other strategic pricing actions. The combined impact of price and attendance variances resulted in domestic admission revenues of \$335 million. The food and beverage initiatives that Mark discussed earlier continue to yield strong results in the second quarter, and delivered U.S. concessions per patron growth of 7.7% to a record \$4.59. This per cap increase lifted our total domestic concessions revenues 1.8% to \$197.3 million. Domestic other revenues also increased by 6.8%, and are back to a more normalized run rate now that we have fully lapped the non-repeating promotional benefits we realized from 3Q '15 through 1Q '16, as discussed during the past several quarters. Overall, our U.S. operations delivered total revenues of \$551.2 million, with an increase in adjusted EBITDA of 1.2% to \$129.4 million, and a 50 basis point growth in our adjusted EBITDA margin to 23.5%. Internationally, attendance declined 4% from the prior year to 26.4 million patrons, driven by film release timing and a tough local film content comparison relative to 2Q '16, as Mark previously explained. International admissions revenues were \$114.9 million, which grew 3.7% versus last year, as reported, and were up 0.9% in constant currency. Our reported average ticket price of \$4.35 translated to a constant-currency increase of 5% that was primarily driven by inflationary price increases, and partially offset by ticket type mix.

International concessions revenues were \$65 million, which grew 8.7% as reported, and 6.5% in constant currency. Our reported concessions per patron was \$2.46, which translated to an 11.1% increase in constant currency. Overall, total international revenues grew 6.6% to \$200 million, as



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reported. Adjusted EBITDA was \$41.3 million, with an adjusted EBITDA margin of 20.6%. While foreign currency has created significant translation headwinds on our reported financials over the past few years, these headwinds turned around in the first half of 2017, and delivered an approximate 3% tailwind for the second quarter. While future currency fluctuations are obviously difficult to predict, if current rates continue to hold, we would anticipate a modest tailwind for the full year of 2017.

As a reminder, the vast majority of our international operating expenses are transacted in local currency, including film rental and facility lease expenses, so the impact of currency exchange is predominantly translation-based and not transaction oriented. Furthermore, our operations throughout South and Central America are largely self-sustaining, with regard to both operational cash requirements and organic growth needs.

Shifting back to our worldwide consolidated results. Second quarter film rental and advertising costs, as a percentage of admissions revenues, declined by 10 basis points year-over-year to 54.8%. This favorable variance was the result of a reduced concentration of blockbuster films this quarter that was partially offset by lessened international local film content mix, as well as incremental spend on global advertising and promotional campaigns.

Conversely, concession costs, as a percentage of total concession revenues, increased by 40 basis points in comparison to the prior year. This increase was primarily due to the impact of expanded food and beverage offerings across our global circuit that carries slightly higher costs. And while these expanded offerings can create a slight drag on our concessions margin rate, they continue to drive incremental purchase incidents and sizable growth in overall concessions revenues and incomes previously discussed.

Salaries and wages were 12% of total revenue, and increased 70 basis points compared to the second quarter of 2016. This growth was driven by labor cost increases associated with minimum wage hikes and general inflation, as well as the impact of our recliner conversion ramp up and food and beverage initiatives and the effect of actual attendance results that were somewhat less than our expectations. Facility lease expenses and utilities and other costs as a percentage of total revenue both increased slightly by 20 basis points and 10 basis points, respectively. These increases were largely driven by net theater additions to our global circuit. Similarly, G&A for the quarter also increased by 20 basis points as a percentage of total revenue. Collectively, second quarter pretax income was \$81.3 million. Our effective tax rate for the quarter was 36.2%, and net income attributable to Cinemark Holdings, Inc. was \$51.2 million or \$0.44 per diluted share.

With respect to our balance sheet, we ended the quarter with a cash balance of \$504 million and a net debt position of \$1.5 billion. We remain dedicated to prudent capital planning, and for the 4th time in the past 18 months, the consistent strength of our balance sheet enabled us to take advantage of favorability in the debt markets during the second quarter to yet again reprice our senior secured credit facility, and reduce our loans coupon by an additional 25 basis points. This reduction will produce an incremental \$1.7 million in annual cash interest savings. We now expect our annualized interest expense to be approximately \$105 million.

Shifting attention to our U.S. footprint. We operated 337 theaters and 4,544 screens in 41 states and 102 DMAs at quarter end. During the quarter, we added 1 theater with 12 screens, and closed 1 theater with 9 screens. We assigned commitments to open 4 theaters and 38 screens during the remainder of 2017, and 8 theaters representing 86 screens subsequent to 2017. We expect to spend approximately \$87 million in CapEx for these 124 screens. We also anticipate closing around 10 to 20 screens during the remainder of 2017. Internationally, our Latin America circuit grew to 192 theaters and 1,382 screens across 15 countries. During the quarter, we expanded by 4 theaters and 29 screens. As of quarter end, we have signed commitments to open 1 theater and 10 screens during the remainder of 2017 and 6 theaters representing 28 screens subsequent to 2017. We anticipate spending approximately \$16 million in CapEx for these 38 screens.

Consistent with our prior comments, we continue to view Latin America as a long-term growth opportunity. Considering the challenging political and economic environments within certain countries in which we operate, we are experiencing modest near-term impact on our organic growth efforts. That said, we continue to anticipate adding between 50 to 75 international screens during 2017, and we believe that long-term growth prospects across Latin America remain intact even if they slow slightly in the short run.

Regarding overall CapEx, we spent \$91.6 million in the second quarter, including \$14.3 million on new builds and \$77.3 million on existing theaters with a concentration on recliner conversions. We continue to anticipate spending between \$325 million to \$350 million of CapEx during full year 2017, of which \$70 million is designated for new builds, both domestically and internationally; \$80 million is for core maintenance of existing



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screens and in line with our historical run rate; approximately \$15 million is associated with the continued renovation of our headquarters building; and the residual \$160 million to \$185 million is for cash flow-generating projects that includes our Luxury Lounger theater conversions and varied food and beverage initiatives. We continue to expect that our annual depreciation and amortization will increase to approximately \$230 million to \$240 million in 2017 as a result of this CapEx spend.

In closing, I would like to echo Mark's commentary regarding the consistency of our financial results that are driven by the strength of our company's financial and operational foundation. With this foundation intact and our continued execution of our strategic initiatives, we believe Cinemark is well positioned to capitalize on future growth opportunities.

Carmen, that concludes our prepared remarks, and we would now like to open up the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Julia Yue with JPMorgan.

Yang Yue - JP Morgan Chase & Co, Research Division - Analyst

International attendance this quarter is a little softer than we expected, and you mentioned the fiscal comparison against film content last year. But can you elaborate a bit more on -- if you saw any particular regions that were weak during the quarter? And also, it would be great to get your outlook honestly, and the general health of Latin America movie going to the second half of the year? It seems like it's a more favorable slate, but just wondering if you're also seeing any local language films that could swing either way?

Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

Julie. Thank you for your question. Yes, let us add just a little bit more color to that. The largest reason for Latin America attendance off was there was significant local content reduction from previous year. To be specific, it was like 38% off over across the region, and specifically, Argentina was off dramatically in terms of their local content production. It was off 70% in that specific country. In addition to that, there were 2 important U.S. releases that were shifted outside of the quarter; Cars 3 and Transformer both shifted outside of the quarter. So we'll see positive elements of that next quarter. And then also, I mentioned in my prepared comments that Conjuring 2, which was a very important title for Latin America in 2016, there was no such horror genre. That was a very, very popular title for '16 that we didn't have. And then finally, Wonder Woman, which was a big success in Brazil, did not resonate as well throughout the rest of Latin America. So I think when you add all of those things up, that really is the cause for some of the attendance decline during the -- in Latin America during the second quarter.

Yang Yue - JP Morgan Chase & Co, Research Division - Analyst

Got it. And do you have any sense right now of the local language film coming up in the second half of the year?

Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

What that is there is we typically have somewhere between 10% and 15%, and we do have some sight into what's coming. We have a whole list of titles. But what you don't have is you don't have the titles going on tracking like you do in the U.S. to be able to say, "This one is going to be the big, big hit." But there is a good skew of local titles that are coming. And then in addition for some things that -- there are a few titles in the U.S. that are going to be actually shifted into 2018, like Coco is going to shift in Brazil and Argentina to 2018. Jumanji is going to shift into 2018, and Ferdinand is going to shift into 2018. So most of this is shifting titles from one quarter to the next.



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Yang Yue - *JP Morgan Chase & Co, Research Division - Analyst*

Okay, got it. And just a question on domestic concession per cap. You really had good growth in the quarter. I was wondering if these are initiatives that you talked about earlier, such as a standing e-bill, multicultural food, more tie-ins with film content, the alternative designs and layout. How much of that was implemented in the quarter or across the circuit, and what is the expected ramp of those initiatives?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

We're constantly doing that. I mean that's something that's just happening literally every single week here because what our concession people are doing is they are out in the field doing the local research to find out what is working in, let's say, Southern Texas versus what's happening in the Northeast or Southern California. So that's not something that's really a onetime version. It's something that we're constantly looking at in terms of adapting to local tastes, new local foods and beverages that we might choose to offer. So that's something that, I would say, is not specific to a quarter. It's rather an ongoing strategy that we have.

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

And I would attribute about half of the growth to those initiatives that Mark indicated, which will be ongoing, and the remainder is really a combination of some of the new builds that we've opened coming onboard, as well as the modest price increases.

Operator

Your next question comes from the line of Eric Handler with MKM Partners.

Eric Owen Handler - *MKM Partners LLC, Research Division - MD, Sector Head, & Senior Analyst*

First, Sean, it's very rare in the industry that when attendance is down, you can see margin expansion like you did in the U.S. with the U.S. circuit. Anything you can attribute to how you are able to achieve that, and just exactly how much flexibility do you have or levers can you pull to ratchet back cost when you see your tenants are soft and maybe ratchet up when things are good? And then secondly, when I look at how well your XD screens are doing, just curious in some of your better theaters, have you thought about maybe doing a second XD screen or maybe like an XD light type of screen?

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

Sure, thanks, Eric. Yes, I mean, we've got a big driver of our EBITDA margin on the favorable side is certainly coming from the food and beverage initiative and per cap growth that we talked about, as well as the impact of our recliner efforts and new builds. We did also get a timing benefit from the MCM tax dividend distribution, which last year happened in the first quarter and this year happened in the second quarter. So that piece is also boosting our results a bit. So I'd say a combination of the operational benefits from food and beverage as well as our recliners, supplemented with MCM.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Eric, in regards to your XD question, yes, we are very pleased with the results in the second quarter too. To over-perform like that in a quarter, which box office is down and XD up, we were extremely pleased about. And we are taking some initiatives to add in second XD screens, where appropriate. We would only do that in a theater that has at least 14, 16 screens because you want to be able to offer the consumer a wide variety, but we already have 4 of those theaters, and we'll be looking to do some additional ones as well.



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Eric Owen Handler - MKM Partners LLC, Research Division - MD, Sector Head, & Senior Analyst

Great. And just as a quick follow up, with your loyalty program, I know it's still early, but I wonder if there's some early data you can provide us into how many more movies the average rewards member, how many times they go to the movies versus the overall company average or spending level versus the overall company average?

Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

Let me give you some color on that, and I think it will help. When we look at frequency visit and spend uplift, what we're seeing with Connection members is about a 1.5x to 2x the regular moviegoing population for frequency visit and also for spend uplift. So I think that will -- that gives you little bit of a flavor for how significant the Connections members spend is, as well as their frequency visit.

Operator

Your next question comes from the line of Leo Kulp with RBC Capital Markets.

Leo J. Kulp - RBC Capital Markets, LLC, Research Division - Associate

Just one on the international screen outlook. I think it's in the backlog there was a 10. With the 24 you've opened year-to-date, what kind of -- where do you get the confidence that you can hit that 50 to 75 for the rest of the year?

Sean Gamble - Cinemark Holdings, Inc. - CFO

We have a variety of theaters in our pipeline. I think one of the challenges in terms of the visibility with international is a lot of the signed and committing activity happens really at the very last minute. It's a much, much shorter lead time than what you see in the U.S. That said, we don't usually spend cash on constructions until the contract is fully complete. But it's not out of the norm that you could have a signing and committing a theater days before it actually opens. So I'd say when you look at the pipeline that we have, the experience we have, the long-term relationships with these developers and experience, I think we have kind of confidence when you wrap all that together and being able to get to those numbers.

Leo J. Kulp - RBC Capital Markets, LLC, Research Division - Associate

Okay, got it. And then any initial thoughts on how we should think about 2018, given some of the economic situations down in Latin America?

Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

Leo, let me take that one. We're confident that 2018 looks like in the same category, somewhere in the 50 to 75 range in regards to additional screens for Latin American, and we can start to see that in the pipeline in some of the countries beyond Argentina and Brazil. So it looks like a pretty consistent growth there. Again, 50 to 75.

Leo J. Kulp - RBC Capital Markets, LLC, Research Division - Associate

Got it. Thank you, Mark. And then just one last question. One of the large European circuits recently said they were considering a sale. Can you update us on your thoughts with regards to expanding into new geographies?



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Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Leo, we look at every potential deal that's put to the marketplace and we look at it in a careful and diligent way. At this stage, we really can't make any comment about any potential future acquisitions. I have said in the past that a priority for Cinemark is to go deeper into the 16 countries in which we already operate. That doesn't mean that we wouldn't go outside of that if a particularly good opportunity presented itself.

Operator

Your next question comes from the line of David Miller with Loop Capital Market.

David Walter Miller - *Loop Capital Markets LLC, Research Division - MD*

Sean, I've seen you guys, I followed the guys for years, seen you guys outperformed the general U.S. market. You're always just very consistent. But this was pretty notable. I mean, you guys pretty much blew away the U.S. Index, which was down 3.5% in the second quarter. So if you could flush that out for me, I'd appreciate it. I mean, what was going on in the quarter? Did you guys -- was there any dynamic pricing going on or did you guys just take share from local competition? Just so you could flush that out, that would be great, and then I have a follow-up.

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

Sure. We like to believe that it's the combination of the philosophy we've discussed for a while on focusing and prioritizing attendance as a way to maximize box office, and that comes into our pricing strategies, the level of investment that we devote to our core circuit beyond everything we're even doing with our initiatives, but then our initiatives as well. So it's hard to point in any one particular thing that does that. But when we kind of look at the ability that we've had to outperform for 30 of the last 34 quarters, I think it's all those things that consistently have enabled us to do that.

David Walter Miller - *Loop Capital Markets LLC, Research Division - MD*

Okay, great, and then, Mark, this PVOD cloud just continues to kind of hang over the subsector, yet there's just no consensus -- or seemingly no consensus amongst the major studios on when the window would start, which studios would be involved, which films would be involved and no consensus on what the pricing structure would look like. So other than Disney, which you said that it's not going to participate, in your discussions with your studio partners, had there been any other major studio in your view that has said to you, "We're out. We're not going to do this?" Any other conversations that you've had that can shed light on dispelling this PVOD cloud?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

David, thanks for the question. Relative to PVOD, we have had a pretty consistent position on this that we've been clear about for well over a year now, and that position has been that we're very, very cautious about it, and we would not proceed down any road here, unless we were very confident that it was going to be a positive financial terms for our shareholders. So we've held that position. We've made it clear. Relative to discussions -- specific discussions with individual studios, I'm sure you can recognize that that's not something that we can discuss in any kind of a public forum. I would just say that we do have ongoing active discussions with all of our studio partners, but I would not categorize those as any form of negotiation, and so -- and we remain very consistent with our position relative to PVOD.

Operator

Your next question comes from the line of Robert Fishman with MoffettNathanson.



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Robert S. Fishman - *MoffettNathanson LLC - Senior Research Associate*

I have one for either Mark or Sean. Can you just remind us of how many of the 337 U.S. theaters are located in the malls across America? And how do you think about the balance of renewing those long-term leases in those mall locations on more favorable terms versus the risk of attendance decreasing in malls where large retailers shut down?

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

Sure, we have about -- it's about 25% of our domestic circuit is in what you would think of as a traditional mall-type environment. I think over the years, we've been particular about what locations we go into. So where you might read about kind of strain on malls and pressure on malls and issues there, we like to think -- and what we've seen is the majority of our theaters are not in those particular types of malls. The malls we're in are performing well. In the -- interestingly enough, in the few malls that we have been in that have kind of suffered some challenges, we've seen examples where our theater continues to perform and grow. So it's kind of a varied landscape. But I'd say, as it pertains to lease renewals in those malls, I mean, just like any other lease renewal we do, we'll take a look at the demographics, what's going on in the market place, how the theater's performing, what's the competitive landscape and all that will bear into the decisions we make as far as the renewals.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

I think, one last thing, Robert, that I might add to that as well is theaters in today's world, actually, are very important traffic builders for malls. And where there might be some softness in traditional retail, mall developers are very anxious, and want to keep us in their mall or put us into new malls, and we're expanding quite dramatically into, what I would call, lifestyle malls as opposed to traditional malls because theaters drive traffic and mall developers like that traffic.

Operator

Our next question comes from the line of Chad Beynon with Macquarie.

Chad C. Beynon - *Macquarie Research - Head of US Consumer, SVP, and Senior Analyst*

My question, Mark, Shawn, just kind of a broad one here on the overall industry, given that as we've talked about it, it really can't get out of the way of a lot of negative headlines. As you talked to your friends back in Hollywood about the weakness that we've seen in the second quarter bleeding into the third quarter, has their view of the industry of the content, the number of films, has that changed at all? Or do you think this is something, as you've talked about, is just cyclical and we're kind of in a patch on the downside?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Chad, thanks for the question. We tried to deal a little bit of that in some of the prepared remarks. I mean, Sean spent a significant amount of his career in Hollywood. I spent the majority of my career there, and it was always on the film side. And if there's one thing that was true for those 30 years that I was at Disney, and that it continues to be true today, is that motion pictures -- it's very difficult to look at this business on a quarter-by-quarter basis because you move one title out of a specific quarter and put it into the next quarter, and it changes the entire way you would look at that quarter. And so I don't think there's anything that is epidemic relative to a problem in terms of product, because as I highlighted, there's still several titles -- strong potential titles for the third quarter. And most importantly, what I would consider a very strong fourth quarter to come. And so when the whole year is said and done, I think the year is actually going to be in pretty decent shape, and you have to evaluate it -- at the very least on an annualized basis, because making a movie and getting that movie ready for distribution is not a simple process for the studios and other content providers. Things shift one quarter to the next, and then our business shifts one quarter to the next. So if Sean and I have a consistent comment that we like to make to you and others is please look at this business on a little longer term perspective, instead of just on this quarter-by-quarter basis.



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Chad C. Beynon - *Macquarie Research - Head of US Consumer, SVP, and Senior Analyst*

Great. That's super helpful. And then just on capital allocation. You talked about kind of projected CapEx for the number of screens in LatAm for 2018 and your leverage is kind of near historical lows. If there aren't M&A opportunities, and you kind of know the CapEx for the Luxury Loungers, what's the right level of leverage to flex up? And what's kind of your order of capital allocation outside of everything that's already earmarked?

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

Sure. We're obviously still putting together our plans for 2018, so it's early to get into that, although we do -- we are optimistic about the ongoing opportunities that exist for developing and growing our company. Our leverage has kind of hovered around the slightly over 2x level for the past few years. Say we're not uncomfortable with that level. We don't have a defined target or stated target, per se, but we have been pretty consistent in that result. The orders of priority, which we've stated in the past, we clearly focused on prioritizing investments in ROI generating growth opportunities for the company, while returning cash to shareholders through our dividends that -- currently carry about a 3% yield, and while maintaining a strong balance sheet that gives us the financial flexibility to act quickly on opportunities when they present themselves. So I think we're going to continue to focus on that balance. In terms of any shift or any change, that'll kind of come through as we look at what our CapEx demands are for 2018 and where we think our overall cash flow will wind up as a result of that.

Operator

Your next question comes from the line of Eric Wold with B. Riley.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

Couple of questions. I guess, one, first, Mark, so let me get clarification. When you talked about Latin America and the slate down there and titles "shifting", that's not shifting for release date or changing released dates -- they were always scheduled to be in separate quarters, that's correct?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

That's correct.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

Okay.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

And the reason for that is really very simple. It's usually related to school holidays. And so the countries are not on the same exact school holidays as us domestically, and therefore, they like to take advantage of that.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

No, I hear you. I just want to clarify, make sure it wasn't actual thing shifting to the dates. So considering on Latin America, I guess, how do you think about the growth goals for the company overall? Do you keep U.S. and Latin America completely segmented and kind of think about growth plans for each separately? Or if there is, continued uncertainty in Latin America and development plans remain slow, does that want you to kind of accelerate growth in the U.S. to the extent you can, either organically or through M&A?



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Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Eric, we clearly look at each country individually because each country has their own growth opportunities and their own challenges. Without question, Latin America, because of the penetration of theaters and screens, is so much less on a population basis than it is in the U.S. We have a greater ongoing and consistent growth opportunity in Latin America. So -- and the good thing about Latin America is it's not all one country. So if Brazil is hopefully at or near bottoming out in their political and economic problems, you have central America and Chile and Peru, which are doing much better. So it's -- the growth prospects are different even within that region, and so we look at it with what are the opportunities for that specific country and what are the opportunities to put in new theaters and continue to grow our business.

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

The other thing I would add is just one of the other benefits that the strength of our balance sheet gives us is we are -- we can go after growth in both areas simultaneously. We're not forced to have to make trade-offs one between the other. The right kind of prudent investment is there in the U.S., as well as international. We can do both and we do, do both.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

And then last question on kind of going back to XP -- sorry XD, and the success you've had there. I know you did the trials and got people to kind of trade up and try it. As you've been able to track through the loyalty program, what have you seen in terms of -- I know you talked about just overall spending and visitation in general for loyalty versus non, but what about XD specifically in terms of the propensity for loyalty members to use that now as a more consistent choice for them? And then remind us the price differential here and in Latin America on XD versus basic pricing.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Generally, in the U.S., it's about 3 -- it's a \$3 upcharge in the U.S. generally. It could be \$2.50 to \$3.50. Generally, \$3. In Latin America, it's more like \$1.50 to \$2 for the up charge. And the thing that was most encouraging for us relative to our XD performance in the second quarter is that in a quarter in which box office was down, we specifically saw our XD revenue go up by 16%. So that's significant, and we think that it's a reflection of a lot of our initiatives. One was the marketing campaign, and the second is just the initiatives that we've done within the theaters themselves. We've reclined 45% of our XD auditoriums. We put a big promotional push on it. We've -- obviously, have the best technology available in those screens, and we went out and promoted it pretty effectively in this last quarter of both to our connection members and to the general movie going population, and that's why we saw the 16% increase.

Operator

Your next question comes from Michael Ng with Goldman Sachs.

Michael Ng - *Goldman Sachs Group Inc., Research Division - Research Analyst*

I just have a few follow up questions on the U.S. You said that Cinemark outperformed the industry box by 50 basis points, but average screens declined by 60 basis points. So excluding that, I think Cinemark would have outperformed by 110 basis points, and that's assuming industry screens are flat. First, is that a fair way to think about that? And what do you think U.S. industry screens actually grew in the quarter? And second, could you just provide the order of magnitude by which recliners, XD and tax on top contributed to the outperformance?



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Sean Gamble - *Cinemark Holdings, Inc. - CFO*

Well, let me start with the first part. So yes, I think the short answer is yes. I think you can look at it that way. Our per screen -- our domestic admissions revenues was down about 2.4% on a per screen basis, the industry being down about 3.5%. If you assume about a 1% screen growth in the industry, you might be looking at around a 4.5% decline on a per screen basis for the industry. I think that's how we tend to approximate per screen for the industry. So the comparison there would be about 2.4% down for us compared to 4.5% for the industry. And then, I'm sorry, your second question again was?

Michael Ng - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Can you provide the order of magnitude by which the recliners and XD and tax on top contributed to that, I guess, 210 basis points of outperformance?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

I don't have that specific breakout for those individual units. But just knowing how important recliners were, I would put it clearly at the top. Tax on top only affected about 60% of our overall theaters because some states didn't have any sales tax in which to put tax on top with. And even when we took the benefit of tax on top, we were typically only taking maybe half or even 40% of it. So if, for example, in Texas, the box office -- the sales tax is just over 8%, and we were not taking all 8%. We're taking maybe 3% or 4% of that. So in terms of magnitude, I put recliners as #1, and then tax on top, what was the third one that you asked about?

Chanda E. Brashears - *Cinemark Holdings, Inc. - VP of IR*

XD.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

In XD, I'd probably put on top and then XD.

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

Yes, I was going to say -- just to round that out, when you look at kind of overall price, you take tax on top out, just for our overall price, we were fairly in line with industry growth at about 2.6% versus 2.5%. So the pricing component was somewhat in line. Recliners, for us, as we've looked at this in the past, has definitely been an uptick. So you might attribute about half of that to it. But the other thing we see is our core circuit when you try to strip out the impact in the industry of these other factors of recliners and what not, we've seen that over index, which comes back to a comment I made earlier about the investment we make in all of our non-reclining screens just to keep those things up to shape, so it's really an amalgamation of everything.

Michael Ng - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Great, that's really helpful. And said you had 153 screens temporarily closed in the quarter. I think, last quarter, you originally guided to about 100. So are you being more aggressive on the recliner renovations or is this timing-related? And can you provide your updated outlook for temporary screen closures for the rest of the year?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Are we being more aggressive? We're being consistently aggressive. Since the beginning of this year, we said that we were going to reach the goal of 40% by the end of this year in terms of our domestic screen count reclined. We're well on our way to getting there. And we're going to continue



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to probably have somewhere north of 100 screens closed during the year. I don't have an exact number of what that will be, but there's -- we won't be anymore aggressive in the remainder of Q3 and Q4 because we're online to get to that 40% by the end of the year.

Michael Ng - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. And maybe just a quick one on international. Could you just provide us an updated outlook on how do you think about the second half in terms of local language content versus the second half a year ago?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

We think that the content during the second half of the year will likely, when we're all said and done, end up somewhere between 10% and 15% of overall box office in those local industries. Likely because second quarter was low, it will probably be closer to the 10% than the 15%, and that's relative to attendance as opposed to box office as well.

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

And I think what Mark indicated earlier to the bigger challenge you have with the local content is it's harder to predict where the big winners are going to be because a lot of them, you don't have a big line of sight. They're not these hugely expensive productions that you can kind of anticipate being big blockbusters. A lot of times, they're just local things that connect and do significant business. So there is a big lineup of titles coming. It's just, again, it's harder to anticipate which ones are going to be the breakouts and which ones are -- and that tends to ebb and flow quarter-to-quarter, year-to-year.

Operator

Your next question comes from the line of Ben Swinburne with Morgan Stanley.

Benjamin Daniel Swinburne - *Morgan Stanley, Research Division - MD*

Can you guys talk about the returns you're getting on upgrades, both recliners, and also the food and beverage investments today versus, say, last year? And on the 60% that you haven't upgraded the circuits, how are you thinking about the timing there and the opportunity? Is that something you could accelerate in '18 and beyond? What's sort of the remaining opportunity in the circuits since you're obviously getting good returns today? And then I know you're probably loath to predict any single title, but Star Wars is a pretty big driver of strength in fourth quarter. Any initial read on that film and expectations around how that might compare to previous Star Wars releases, like Rogue One last year?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Ben, I'm going to take part of the question. I'm going to ask Sean to do the other. First, I'll do the Star Wars question. We expect Star Wars to be a very, very successful film. But at this stage of the game, given that we've not seen the movie, and the only thing we've seen is the trailer and some early footage, it's really difficult to predict. So we expect it to be the biggest driver in the fourth quarter, but I can't put a box office number attached to it. Relative to your question on recliners, we have not announced a specific plan for 2018. And we choose not to do that because it's not that we haven't thought about it, in fact, we've thought about it a lot, and plans are in place. But we don't come out with any suggestion of what that number is going to be until we see the ongoing results. The ongoing results of all of our recliner effort has continued to be very substantial, as I mentioned, well above our threshold of 20%. And I will say this, we expect that 2018, we will continue aggressively in the recliner effort. And in one of the future quarters, we will come forward, and give you an estimate of what we think 2018 will be. But at this stage, we want to see results, and we do it simply because we want to be due diligent financial analysis before we commit to a number.



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Operator

Your next question comes from the line of Jim Goss with Barrington Research.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

I was wondering about reserved seating. A couple of things. What is your share of total attendance that is accounted for by that? And in terms of monetization, is it having a favorable impact on concessions in that people don't have to be worry about getting to the seats? Or is it having any effect on the timing of arrival in terms of pre-roll advertising and that sort of thing as well?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Jim, in terms of reserved seating, it's about 30%, and it can go up a little more than that. What we see is that it does have a positive effect on our food and beverage. Typically, we'll see growth somewhere in the 1.5x to 2x of growth rate in reserved seating, and the reason for that is a very logical. People walk into the theater, they know they have their seat, they don't have to rush to their seat -- rush to the auditorium to get their seat, therefore, they're more open to be able to go to the concession line and pick up what they would like. So it's positive relative to the -- that concession. It's positive relative to our ability to push price, and it's positive relative -- in terms of reclining relative to attendance and that's what's driving the ROI on these reclined seats.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Okay, and I was wondering about whether you've had any interest in virtual reality? And I know you've also pushed a certain amount of alternative content. Is there any update on those?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Virtual reality, it's -- that is a great category that we are very interested in, that we're very involved in researching. We have met with just about every virtual reality hardware company and software company. And in the coming quarters, I am certain that we will be testing some various opportunities and virtual reality either in our lobbies or potentially in a small auditorium. Nothing to announce as we sit here today, but there are some great opportunities out there. And again, we're going to take our time and pick what we think have the highest potential in regards to providing consumer demand. So we are going to do it. We're looking at it and stay tuned.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Okay. And finally, M&A topic has come up a couple of times. I was wondering, it doesn't seem like the recliner trend has had a significant impact in boosting the attendancy or maybe you tell me otherwise. And within the international markets, are you more likely to try to increase your penetration in larger markets like Brazil and Argentina? Or would you rather be looking at other markets to expand your footprint?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

In terms of M&A activity internationally, we would be interested in all 15 of our international markets. Clearly, there's -- the larger the country sometimes, the more the opportunities are there, and we already have such a large market share in Argentina and a very significant market share in Brazil, sometimes it's a little more difficult when you're reaching 30% or even 35% market share to continue to grow because you ran into a level where you can't continue to acquire theaters. But it doesn't mean that we aren't opportunistic there. And -- but I'd say, in all of our international territories. And I'm not sure what your question was relative to recliners, you mentioned?



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James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Well, I was thinking the -- in an earlier stage when the screens were going digital, there was a suspicion that perhaps some of the smaller owners might want to sell out. I didn't know if there would be a similar motivation given maybe a need to upgrade, and maybe the better path would be to sell to a Cinemark or whatever.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

It's maybe a little surprising that we haven't seen more potential opportunities in that area. But we're just very cautious and diligent acquirers of theaters. And it doesn't mean that we're not interested, we are. But we just want to make sure that whatever we would acquire is going to have a positive, accretive effect to our shareholders. So we will look to do it, but we're going to look to do it only where we feel like it's going to be very accretive to our shareholders.

Operator

(Operator Instructions) Your next question comes from the line of Matthew Harrigan with Buckingham.

Matthew Harrigan

Two questions. First, could you talk a little bit CinemaCon about your access to rich data, particularly, if you have been in the loyalty program it could probably help your studio partners and (inaudible) sell through at some point. You're clearly looking for some correlations. And what movies people go to and all that could be very interesting, both to you and the studios. I know it's still early, but would you have any additional comments on that? And then secondly, the other anomaly have been for movies underperforming this year has been 2 of the top studios have really been on their back for quite a while now, Paramount and maybe Sony to a lesser extent. As those studios come back, I mean do you think it's somewhat of a zero-sum game or do you think that people sometimes are ignoring a little bit that you got 2 studios that have been dysfunctional and could be pretty additive if they got their games back together?

Sean Gamble - *Cinemark Holdings, Inc. - CFO*

Yes I'll start with the first question. I would say given that our program has been active for a little over a year, we're still kind of ramping up -- we have gotten into some of that utilizing our data to kind of personalize. We've beefed up our data analytics capabilities. We've added members to our team, as well as third-party resources. So I think we're very excited about the prospects. It's probably a little bit early just to report too much on that because we really just beginning to implement many of those capabilities and opportunities. But we are excited about how that can just enrich the overall experience that our consumers have, as well as create greater opportunities with our studio partners and create incremental monetization opportunities.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

In regards to studios, we are so pleased and so happy that Sony had the giant hit in Spiderman. So I think Sony is clearly on an upswing. And they also had Baby Driver, which was a movie that way overperformed what people thought it was going to be. So we're very pleased. In with regards to Paramount, Jim Gianopulos taking the helm there. It's an incredible positive thing for us. We think Jim is the -- is one of the most creative and driving executives at Hollywood. So we're very much looking forward to what Jim would be able to do with Paramount.

Matthew Harrigan

Congrats on the quarter, as always.



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Operator

There are no other questions at this time. I'd like to turn the call back over to management for closing remarks.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Thank you all for joining us today. We really look forward to speaking to you again following our third quarter. Goodbye.

Operator

Thank you again for participating in today's conference call. This does conclude today's call. You may now disconnect.

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