

# FINAL TRANSCRIPT

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## **HW.TO - Q3 2011 Harry Winston Diamond Corporation Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Robert Gannicott**

*Harry Winston Diamond Corporation - Chairman, CEO & Director*

**Alan Mayne**

*Harry Winston Diamond Corporation - CFO*

**Frederic de Narp**

*Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.*

## CONFERENCE CALL PARTICIPANTS

**Des Kilalea**

*Royal Bank of Canada - Analyst*

**Edward Sterck**

*BMO - Analyst*

**Brian MacArthur**

*UBS - Analyst*

**Irene Nattel**

*RBC - Analyst*

**David Christie**

*Scotia Capital - Analyst*

**John Hughes**

*Desjardins - Analyst*

**Paul Jamcogian**

*- Private Investor*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Harry Winston Diamond Corporation fiscal year 2010 third-quarter conference call. My name is Laura and I will be your conference coordinator for today. At this time all participants are in a listen-only mode and we will conduct a question-and-answer session towards the end of today's conference.

As a reminder, this conference is being recorded for replay purposes. Please note that we will be making some forward-looking comments today. Various factors and assumptions were applied and deriving these comments and actual results could differ materially. The principle factors and assumptions that were applied, and risks that could cause our results to differ materially from our current expectations, are detailed in our OSC and SEC filings.

I would now like to turn the representation over to your host for today's conference, your Chairman and CEO, Mr. Robert Gannicott. Please proceed.

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**Robert Gannicott** - *Harry Winston Diamond Corporation - Chairman, CEO & Director*

Thank you. Good morning, everyone, and welcome to the Harry Winston earnings call for the third quarter of our financial year 2011. I'm Bob Gannicott, Chairman and Chief Executive Officer, and I'm joined on the call by Frederic de Narp, the Chief Executive of our luxury brand, and Alan Mayne, the Group Chief Financial Officer.

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Although measured against a quarter last year that reflected temporary rough diamond production suspension and stalled retail sales, especially in the US, this third quarter reflects robust recovery in both jewelry demand and the rough diamond demand that is inevitably linked to it. The engine of this recovery is being fueled by the Far East as Chinese citizens become consumers, not only at home, but also in the luxury shopping districts of the developed world.

I'm now going to turn the call over to Alan who will discuss the financial results in some detail and he'll then be followed by Frederic who will present our luxury brand business. I'm then going to return to discuss the mind Diavik mine and our rough diamond business before closing our part of the call and inviting your questions.

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**Alan Mayne** - *Harry Winston Diamond Corporation - CFO*

Thank you, Bob, and good morning. As Bob mentioned in his opening remarks, the Company's consolidated results for the third quarter reflected the continuing impact of the recovery in the global economy. Consolidated sales increased almost 90% from the comparable quarter last year and the Company recorded earnings from operations of \$13.7 million compared to a loss from operations of \$4.9 million.

Our foreign currency exposure has a material influence on our reported earnings. During the third quarter ended October 31, 2010, the Canadian dollar strengthened against the US dollar; this resulted in a net \$3 million foreign exchange loss in the quarter compared to a net \$1.6 million foreign exchange gain in the same period last year.

Taking into account this foreign-exchange loss, our interest expenses, other income and tax expense, we recorded net income attributable to shareholders of \$3.9 million or \$0.05 a share compared to a net loss attributable to shareholders of \$200,000 or zero earnings per share in the third quarter last year.

Now let me spend a few minutes on the financial review of our business segments. As highlighted in our results released yesterday, rough diamond sales for the quarter increased considerably from the same period last year resulting primarily from the substantial increase in the volume of carats sold.

You may recall that the volume of carats sold in the third quarter last year was unusually low as a result of the summer production shutdown. This increase in sales resulted in a significant improvement in gross margin and earnings from operations.

Revenue at Harry Winston Inc. increased to \$80.2 million from \$54 million in the comparable quarter of the prior year. This 48% increase in revenue led to earnings from operations of \$5.4 million compared with a loss from operations of \$0.5 million in the third quarter last year.

During the financial crisis management significantly reduced the discretionary SG&A expenses at Harry Winston. In line with the improvement in the global economy and the financial results of the business, management will be increasing the amount of advertising, marketing and promotional investment in the Harry Winston brand. This reinvestment in the brand, as well as higher variable expenses resulting from higher sales, were significant components of the increase in SG&A expenses in the quarter.

I would now like to turn the call over to Frederic to discuss the luxury brand business in more detail.

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**Frederic de Narp** - *Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.*

Thank you, Alan, and good morning, everyone. The retail segment maintained its positive momentum from the first half of the year with sales of \$18 million during the third quarter. This represents an increase of 48% over the prior year comparable quarter. We experienced increases in sales across all geographic regions. Demand for heritage brands like Harry Winston continues to



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strengthen globally. Chinese consumers traveling abroad have been an important factor [shooting] the demand for luxury retail products.

In the US market the Company recorded sales of \$23 million during the quarter which was 76% above the comparable quarter of the prior year. The US market has shown a considerable improvement as consumers are showing an increasing willingness to spend on luxury products and we are also seeing watch wholesale accounts begin to replenish their inventory.

Sales in Asia were \$25 million, 23% above the prior year. Growing economic activity in emerging markets continues to see both rising demand for luxury retail products. We see that the Japanese market continues to be a consistently strong performer for the Company and our Asian business has become a significant source of sales growth for our Company and is a major focus of our future growth plan.

Our business in Europe generated sales of \$33 million which was 56% above the prior year period. Although business conditions in Europe remain uncertain, strong energy prices have translated into rising sales to Middle Eastern and Russian clients. In addition, Asian tourists have become an important source of sales for our European business.

Gross margin during the quarter was 50.4%, a decrease of 350 basis points compared to the prior year period. The decrease in margin was primarily due to the sale of the several significant items in Europe at a lower than average margin.

Harry Winston is well positioned moving into the holiday season. Consumer demand for timeless luxury products continues to increase globally. Consumers are responding positively to the exclusive designs, fine materials and quality craftsmanship of the Harry Winston products offering along with an exceptional sales experience. Luxury consumers are traveling in ever greater numbers further driving consumer demand.

Harry Winston is having many exciting sales events. We recently celebrated the 50th anniversary of Harry Winston's donation of the Hope diamond to the Smithsonian Institute of Washington, DC with the Court of Jewels. The Court of Jewels is a major selling exhibition of rare gemstones and jewelry which took place in November in New York. We expect to generate significant sales of high-value items from these events that are generally at a lower gross margin.

In October we launched a new worldwide advertising campaign further supporting the development of the brand. In addition, we have completed the refurbishment of our flagship New York salon and are planning the opening of a new Las Vegas location which is scheduled to open the middle of this month.

Although the cost associated with these initiatives will impact operating margin in the fourth quarter, we do anticipate the retail segment will generate an operating profit for the quarter. We expect the rate of sales growth for the retail segment for the fiscal year to be in the range of 35% to 40%. So now let me turn it back to over to Bob.

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**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Thanks, Frederic. So turning now to our mining operations and -- production for this last quarter has been mostly from the A-418 open pit supplemented by relatively small amounts of ore from underground delivered from development headings driven to prepare large areas for production scale mining.

A modest amount of ore also came from a few underground production areas as we're still testing the suitability of various mining techniques and the ongoing efforts to define lower cost mining methods that are consistent with workplace safety.

The upper parts of the 418 pipe are lower grade than the ore reserve average and contain [lenses fair] mud derived from the lake bottom through which the kimberlite pipe punched its way to the surface. Not only is the grade lower but the diamond size distribution is finer implying a lower average price.



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Fortunately an improving diamond market has compensated for this so that our average realized price for the quarter was actually modestly higher than that of the equivalent quarter of the prior year. The mud lenses have given us some production challenges in the processing plant as well by taxing the ability to thicken and dispose of the increased amount of fine particles.

This issue restricted ore processing velocity while modifications of the plant were undertaken to reduce the amount of ore that can be processed this year. However, the modifications are now complete and the plant will be back up to capacity for the coming year.

Research and experience (inaudible) tonnage from an underground portion of the A-154 South pipe to be mined without the use of any cemented backfill. Rio Tinto, the operator, are currently evaluating the use of this method going forward which would represent a significant cost saving and may well be applicable to most of the underground tonnage of both A-154 South and A-418.

Work continues on designing and permitting an efficient mining method for the A-21 pipe while efforts and operating cost reduction generally are ongoing. Diamond demand in the Far East continues to propel rough diamond prices as the Diavik mine transitions to underground production.

We continue to expand our marketing efforts and store openings, but are successfully burnishing the Harry Winston brand to capture the luxury appetites of the emerging wealth of the newly developing parts of the world as well as the reawakening traditional markets, especially America. So thanks for listening to us and we're now happy to take your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Des Kilalea, Royal Bank of Canada.

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### Des Kilalea - Royal Bank of Canada - Analyst

Hi, Bob, hi, everybody. Bob, I wonder if you can just talk about the production guidance. It's come down from 7.8 carats to 6.9 carats for this year and next, and you explained about the mud lenses. Can you explain -- throw more light on more 2000 -- the following year or if you can. I don't know if you are able to.

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### Robert Gannicott - Harry Winston Diamond Corporation - Chairman, CEO & Director

The year beyond next year?

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### Des Kilalea - Royal Bank of Canada - Analyst

Yes. I mean are we going to start seeing a recovery?

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### Robert Gannicott - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, well what's happening -- let's just go through what's actually happening. So this coming year we are largely mining the A-418 pit and a geological unit in there called the [B-ore] and this is the finer grained ore. The processing plant is also set up to be able to do that at a good velocity now. But inevitably it is lower grade.

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So we now come into a phase of this, whereas up until now we've really had a pretty simple basis of ore in the sense that A-154 South had a certain size distribution, a certain value per carat and a defined grade. We now get a mixture of ore types. So A-418B is lower grade, the diamonds are finer grade and, of course, that means that the diamond price is lower going against that; working the other way is that diamond prices have risen.

But in the coming year we should be -- the plan shows about 75% of the ore coming from A-418. I would caution, however, that there is a lot of work going on to make ore from A-154 South accessible earlier than had been planned and at a higher velocity. And this is to do with being able to mine it with actually an open sky surface rather than actually having to backfill areas as they are mined. And this is a long way along to being officially permanent.

So that may well bring in more 154 South ore into the ore mix for this coming year than is shown in the plan. Going beyond that then we then get through basically -- at least we get a mixture coming out of A-418 for the -- but almost the last year of the pipe's production, which is not as heavily dominated by the B-ore. The [A-ore] being much more similar to what we were used to [renovate] 154 South.

Going along with that then we get increasing amounts coming from A-154 North where although the grade is lower the diamond price is actually substantially higher. And if you want a comparative there -- the diamond price per carat as it is at the moment out of A-154 North is almost double to the diamond price that we are currently getting out of the A-418 B-ore.

So we really -- these mixtures are now no longer just minor adjustments, they're quite big -- they're quite big changes so that any changes in the mine plan into the coming year -- through the coming year are likely to have quite a big impact on both the number of carats that are produced and on the actual sales price of those carats.

And really the change should only be to the upside in the next year because we've got a plan that is based really almost entirely on mining 418 and so the upside would be whether more of these ore types get added into the mix.

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**Des Kilalea** - Royal Bank of Canada - Analyst

Thanks, Bob. And just if I can add a rider there -- and you still intend to have a similar kind of sales cycle around 10 sales for the year?

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**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Absolutely.

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**Des Kilalea** - Royal Bank of Canada - Analyst

Yes, okay. Thank you.

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**Operator**

Edward Sterck, BMO.

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**Edward Sterck** - BMO - Analyst

Good morning, gentlemen. So, I'm going to focus on the production from Diavik as well. Just the first question is on the stockpile, the 200,000 tonnes stockpile to be processed next year. Is that from A-418 open pit?

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**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Mostly; yes, mostly. Not entirely, but mostly.

**Edward Sterck** - BMO - Analyst

Okay, then the second question is, just looking at the guidance for production for next year, and Des touched on this as well, but the underground guidance is for 600,000 tonnes of ore split evenly between the two pipes that you currently have underground access.

I'm just curious, that seems quite a low figure compared to the production that was achieved during the third quarter of this year, the one just reported. When you annualize that, that comes out at being over 800,000 tonnes. I'm just wondering why there's a bit of a discrepancy there. Of course I appreciate that plans might be in flux at the moment as well.

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Well, it's really to do with a mix of development work plus -- the mix of development work and production headings. In other words more of the ore delivery will be coming from development work as they adapt to these new mining methods.

**Edward Sterck** - BMO - Analyst

Okay.

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Does that make sense?

**Edward Sterck** - BMO - Analyst

And just -- yes, I guess so. So I mean when you did mention -- or a minute ago you said that the new mining method has progressed some way towards permitting. Does that mean there's actually been a decision to use it and it's now just a question of the regulatory authorities agreeing to that?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

No. It has got through its first engineering review and it should not be problematic to continue to that to formal adoption of it. But it's not yet formally adopted. It is for one of the pipes, it is for A-418, this type of mining does require a backfill (inaudible) with an open hole. That has been fully approved for A-418. And it's sort of like three-quarters of the way along for A-154 South.

**Edward Sterck** - BMO - Analyst

All right, then. So just a last question, just on A-154 North -- which obviously, according to the guidance, is a bit of a focus for the fourth quarter in terms of underground operations. Just to confirm then, would we be expecting lower grades overall as a consequence but higher realized diamond prices?

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**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, these are rough numbers because I'm not good at remembering all the things after the decimal points. But A-154 North is basically about 2 carats per tonne. But it's about a double in diamond price. So it's equivalent to mining 4 carats a tonne out of A-418 (inaudible) in terms of dollar revenues.

**Edward Sterck** - BMO - Analyst

Thanks very much.

**Operator**

Brian MacArthur, UBS.

**Brian MacArthur** - UBS - Analyst

Good morning, I'm also going to focus on Diavik. Can we just -- for 418, obviously there's more than one phase, but there's just A and B to keep it simple right now. You have a reserve grade on the open pit of about 3.2 carats per tonne and the underground of 4 carats per tonne and obviously we're doing the B, it's obviously lower than 3.2. How many tonnes roughly of B versus A are there? And just roughly what's the delta in the grades that leads to that average of 3.2? Are we talking like 2.6 versus 3.8, are we talking --?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

I think you said -- Brian, we should get back to you with some proper numbers. But off the top of my head it's about 2.8 versus 3.2.

**Brian MacArthur** - UBS - Analyst

Okay. So because again, if we're 2.8 versus 3.2 now, you're quite a bit below; you're going to make that up at some stage. I presume there's no sterilization of the ore here or anything. I.e., it's --.

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

No, no, no, it's not that. There is one other issue. I mentioned there are these mud lenses, right? The mud lenses are unconsolidated, so when one drills a large diameter hole through them you don't actually recover that material in the drill core, it gets washed away.

So if you could sort of picture that, say, well -- so then what happens is over a 20 -- say over a 10 meter increment drill core you've actually got a higher weight of rock in there than you actually do in the ground because the lighter rock, the mud has been washed away.

Does that make -- do you know what I mean? So that changes just slightly, probably slightly overstate the grade in that B unit. But I mean it's only slight, it's like a 10% perhaps effect.



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**Brian MacArthur** - UBS - Analyst

Okay, and is the B unit only in -- you've got open pit and underground reserves; where exactly is the B unit as it goes through both --?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Almost all in the open pit, but there is a bit of it going down the side of the underground pit, but it's not large amounts.

**Brian MacArthur** - UBS - Analyst

So when we go to the underground, which has a higher grade, 4 carats versus 3.2, if we back-end load this you should get more production in the later years -- is that still the way you see (multiple speakers)?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Not only that, they are -- those carats are sort of almost at 154 South price, as opposed to 418B carats which are significantly below 154 South price.

**Brian MacArthur** - UBS - Analyst

Okay, because that was going to be my next question. Because when I looked at the original samples we had of valuing the carats which -- publicly the only stuff we have is a number of years ago. Again, that was all a weighted average too I assume. So we're taking the lower grade stuff now, lower value stuff, we should get the higher stuff later on, that's still true?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

That's right. And as I say, it's not just lower grade, it's lower value, so you've got a double whammy. But of course it goes the other way when we go back again.

**Brian MacArthur** - UBS - Analyst

Now there's another issue about we're trying all these methods to get the cost structure down going forward, which again I guess I could say you're taking pain up front, mining lower stuff to save the MP value of the higher stuff later on which you're going to get at a lower cost, which sort of sounds to me what like Rio is trying to do.

How much cost savings are we talking? Are we talking 10% a tonne? 20% a tonne? I mean, is it -- when you say 'significant', what sort of percentages roughly are we talking about?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

They're targeting it -- so they're targeting it sort of 20% -- 20%, 30%. Whether they can actually achieve it is yet to be seen.

**Brian MacArthur** - UBS - Analyst

Right. Okay, and just switching to one other issue. I just want to be clear, if you look at -- and it's in the notes. We're talked about your obligations for next year, there's obviously -- there's the long-term debt which was \$81 million of which I believe a portion

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of that is the Kinross which sort of says you can satisfy with the needs of shares if you want. Can you just go through what conditions you can do that for?

And the second issue, there's \$80 million of environmental and participation agreements, incremental commitments, I mean how -- I know you've got a note in here saying the risk is -- the partner does it and I don't have to worry about it. But can you just go through what the risks are there? Because obviously if you're going to have lower production, lower prices next year and you do actually have to do with these commitments of \$180 million it's not an ideal situation.

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**Alan Mayne** - Harry Winston Diamond Corporation - CFO

I'll take you through that, Brian. Hi, it's Alan. Let's deal with the Kinross note which is \$70 million and I'll tell you that our expectation right now is that we will be able to satisfy that in cash. So what we -- when we structured the transaction we built in a provision to be able to satisfy it in shares. Right now, based on our outlook for next year, we expect to satisfy that in cash.

As it relates to the commitment, those commitments are the same commitments that have been in place from day one and they really relate to the asset retirement obligation. The obligation is secured by a letter of credit which has been put up by a parent company of the operator, So effectively a Rio Tinto company.

And so obviously we need to highlight that should those arrangements change, which we do not expect them to change because they haven't changed since inception, and it was never required that we would have to take our share of the obligation, that's why the note is in there. But to be absolutely clear, the arrangement securing those commitments has been in place since inception and we do not expect that to change.

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**Brian MacArthur** - UBS - Analyst

And it didn't change in the crisis anyway, so you wouldn't think it would change right now, right?

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**Alan Mayne** - Harry Winston Diamond Corporation - CFO

No, no, I mean there's a -- we don't expect it to change, there's a variety of very good reasons related to the overall comfort level of the various government entities that provide permitting. It's very advantageous for the government to have this structure because they're dealing with one counterparty rather than at least two if not more. And we do not expect that to change.

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**Brian MacArthur** - UBS - Analyst

Right. And just to be clear, [sir], my real issue was the \$70 million, that is still -- I mean, I know you expect to use cash, but if you need to it's your option to use shares. I mean, you do have that option?

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**Alan Mayne** - Harry Winston Diamond Corporation - CFO

Yes, yes we do.

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**Brian MacArthur** - UBS - Analyst

Okay. Great, thank you very much, that's very helpful.

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**Operator**

Irene Nattel, RBC Capital Markets.

**Irene Nattel** - RBC - Analyst

Thanks and good morning, everyone. I of course am going to switch gears to the retail business. I was very interested to look at the mix of sales in the quarter that was really weighted toward important pieces and the commentary that we should expect more of the same in Q4. And I'm just wondering if this is just timing or if this is part of a deliberate strategy to really reestablish the heritage of Harry Winston in those important pieces?

**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

Yes. Indeed, Irene, I mean what the part of the this strategy this year was to celebrate the association between Harry Winston and the most important gems in the world, especially based on the celebration of the gift of the Hope Diamond -- you know, the largest and the rarest gem on earth that was given by Harry Winston 50 years ago to the Smithsonian Museum.

So that was a good opportunity, a really amazing opportunity to celebrate with the Smithsonian, re-creating what Winston did 50 years ago, Court of Jewels. And Court of Jewels where -- basically major exhibition, selling exhibition with large stones and large gems and fine jewelry. And it's a little bit also what we've done at the (inaudible) in September reaffirming Harry Winston's association with the largest stones in the world.

And so that in a very positive environment generates very significant sales of big precious stones at the center of some creations. So of course these are big significant sales, we expect more to come and these are sales with a lower margin ratio but very important sales.

**Irene Nattel** - RBC - Analyst

Absolutely, and we like the gross margin dollars. Could you talk a little bit about the evolution of your customer base at this point? Because again, one of the strategies was to expand a little bit beyond the historical customer base. How is that coming along?

**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

It's extremely -- we are, I would say, ahead of our plans in the way that on one side is really, as I told you, Harry Winston, the king of diamonds, king of precious stones, and then -- and it means flying the clients to Winston or flying a special assortment of gems and fine jewelry to the clients and generating extremely important sales and many of them are special orders.

On the other side is building a predictable business, which is as well extremely positive. If I just tell you that the bridal business, which is absolutely crucial for us, is growing at a pace of 70%, we are 70% ahead of last year in sales of bridal and the bridal is typically what I call a predictable business. Knowing the fact that we have just, just, just, just launched the new advertising campaign.

So the mix of our clientele is development at the extreme high-end of the pyramid, the clients who love us, but many more of these clients, many more of these high jewelry sales people joining the Company to serve these extremely important clients. And on the other side contributing and developing a broader audience of clients through the development of bridal activities, watch development and I'm extremely confident of the two watch lines we're going to present in (inaudible) this year which will be more (inaudible) than before, more profitable than before and enlarging the audience of the clientele.



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**Irene Nattel** - RBC - Analyst

That's great, thank you. And as far as the salon design goes, you had mentioned almost creating a new layout where you would have three more distinct sections in the salon. And I apologize because I haven't been to the New York salon yet. Is that -- is the New York salon reformatted in that way?

**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

New York salon is -- it's this institutional environment that we didn't want to change. We did create some more separated areas, but it's not as distinct as the salon of Las Vegas which really the new concept store by Bill Sofield, one of the most important architects in New York, was viewed as an -- the kind of new look of Harry Winston for the future.

I will go there on the 20th of December to see the new look of our new salon by Bill Sofield. And this new salon very much will have a watch corner, a bridal corner and a jewelry corner. And yet this is the directions where we want to go to have a more welcoming, warmer environment for clients and to have people feel comfortable.

**Irene Nattel** - RBC - Analyst

That's great. And then finally the last question, on bridal where do you stand at this point in terms of really moving ahead with a fuller bridal strategy, target advertising and the like?

**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

We're perfectly good. We are done with that. We are now launching -- it's a matter of putting the marketing dollars behind it, which we expect to do next year. We have -- the ad campaign is fully complete, I have hired Baron & Baron, the persons who have been the architect of the revamp of the Burberry brand 10 years ago. And we've taken the -- and Patrick Demarchelier, who is probably the most important French photographer, to shoot our ad campaign.

It's ready, it's absolutely nice, it's very well perceived and it's to be rolled out worldwide from now on. So we are fully -- and from the catalog to the bridal concepts part of the store development and all the [CRM] activity, everything is online and already done. So it's a matter of rolling it out now.

**Irene Nattel** - RBC - Analyst

That's great. Thank you very much.

**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

Thank you, Irene.

**Operator**

David Christie, Scotia Capital.

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**David Christie** - Scotia Capital - Analyst

Good morning, guys, just a couple of quick questions. First at the mine, as -- you said in your note there that you think it's going to go out and they're going to try to fill the mill basically as they go forward here. Just sort of wondering if this is your thinking -- A-21 happens for sure and if so it might happen? And is that the only big CapEx requirement remaining at the mine?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, well I think A-21 does happen for sure. It's simply too valuable a resource. And of course becoming increasingly valuable as diamond prices go up. It's a (inaudible) A-154 South style diamond price and, as you know, a decent grade. So it will happen.

The debate is -- well, how do you -- to make the most money off it what's the cheapest way to do it? Can we do this without a fully hydraulic dike, without a dike where we remove the water from behind it? Can we do it with just a berm that allows us to float a barge on it and do some form of hydraulic mining.

So that stuff is all being dealt with. And once the plan has been landed we've then got to get the appropriate permits for it. But, yes, it's definitely going to happen. What was the other part of the question again, Dave? I'm sorry.

**David Christie** - Scotia Capital - Analyst

And then I guess is this your main plan to be able to keep filling the mills and having A-21 go --?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, that's -- I mean, keeping the mill full is going to be basically done -- as opposed to the initial mine plan, it's going to be done by being able to take higher velocity out of underground through these open sky mining techniques. Which are the same techniques, by the way, that were used by BHP at Ekati, are the same people doing it actually.

So I'd say you're not allowed to get tonnage out from underground faster, so that kind of keeps the mill full in the interim until A-21 is there to add its increment as well.

**David Christie** - Scotia Capital - Analyst

Could you explain the open sky concept?

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, it's -- so if you sort of picture this thing is sort of sitting like it's got a carat in the ground, as you know the kimberlite pipe, spiral ramp development in the ground and around the outside of it that spirals you down to the bottom.

And all you do is you simply take a -- put droll point drifts, in other words, you just put tunnels in off the spiral ramp that go into the kimberlite pipe, you drill up-holes, blast and so now you've got a big mud pile sitting in front of you and you muck it out, just leave the open hole above you. Then you go down another lift and do the same thing again.

One of the key aspects of being able to do this is having scoop trends that are remotely controlled because obviously you can't -- you don't want to expose -- you can't put men exposed to the kind of rock fall that could possibly happen or (multiple speakers) steep vertical walls going up a long way.



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So, these scoops are up there, they're being used now using the 154 South, everything is going fine. So, that's just fine and you go all the way down to the bottom of the pipe. Because the rock mechanics are sound enough up there, go all the way down without experiencing a failure of the hole, the walls of the hole, (inaudible) get all the ore in and not require any backfield with any cement.

Where -- that's already deemed to be doable at 418. It's well along the way to being achievable at 154 South. It's not the kind of thing that you can do at A-154 North. A-154 North is too close to the dike wall to be able to risk any sudden rock mechanics failure that would allow a slumping of the top of the dike to occur.

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**David Christie** - Scotia Capital - Analyst

So there you just keep doing the same method you're already using?

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**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Well, there are some modifications allowed that we use, it's not no cement but a lot less cement. They're being seriously looked at now. But that's further back along the way. The first one done was 418, now it's 154 South and A-154 North will be the last one that gets modified mining method treatment if you like.

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**David Christie** - Scotia Capital - Analyst

Okay, that's great.

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**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, it is (multiple speakers).

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**David Christie** - Scotia Capital - Analyst

No, no, it's good. And just on the retail side then, in China you mentioned a lot of high net worth. Could you just give me a example of the kinds of goods that are being sold? Like what's the big ticket item that tends to be the big demand there?

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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

Well, there is a demand -- I mean, there is a demand for big diamonds, of course. And Harry Winston being the king of diamonds [is by sense] and really having a major editorial corporate around the world of what we're doing and who we are, especially this year of celebration, it attracts clients to us ask Winston for the important diamonds.

I would tell you diamonds are -- many, many diamonds are over 5 carats, quite a few requests of diamonds over 20 carats. I can even tell you about requests of diamonds over 100 carats. So we're talking about the unique (inaudible) and this is exciting.

And there's also a new development for the brand that I wanted to bring is the -- historically Winston was also not only the king of diamonds but of precious stones -- all sort of precious stones with the Court of Jewels 50 years ago which we reproduced. So we bring an amazing array of very, very rare colored stones like peridot, tourmalines, mandarin garnet, [spenard] and sapphires, of course rubies and emeralds.

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So all in all, there is an appetite for big stones, especially coming from Middle East and China. In China they only want the best and they don't hesitate. So we have this great opening and this is, of course, the development and the strategy to develop in a major way the presence of Harry Winston in China -- also to answer this big request for big stones and gems.

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**David Christie** - Scotia Capital - Analyst

Now, these big stones, are they in settings or are they just asking for big stones?

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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

No these are big stones that are -- they're asking for special orders, so we set these big stones, we do sketches and rings and everything back-and-forth with the clients and we end up with beautiful layout of -- and most of times these are necklaces, they could be also rings -- very important.

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**David Christie** - Scotia Capital - Analyst

So you actually build a necklace and put the stone in?

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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

(multiple speakers) our jewels, yes, absolutely.

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**David Christie** - Scotia Capital - Analyst

Perfect. And I recently went to the Hope Diamond display at the Smithsonian, it's quite an amazing display, so --.

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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

It is, thank you.

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**Operator**

Edward Sterck, BMO.

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**Edward Sterck** - BMO - Analyst

Hi again. I just wanted to come back and ask some questions on the retail segment and really to focus on the strategy for the way the salons are going to look in the -- or how the salons are planned for the future. At the moment looking very crudely at the revenue distribution between the three regions of the US, Europe and Asia. I mean it looks as though on a per salon basis the two salons in Europe are contributing relatively more to revenue. Is that the same in terms of gross margin or is it a little bit more varied than that?

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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

Well, in gross margin, the gross margin is -- the number one is surely Japan. Japan we are accruing very importantly and constantly in Japan which is the market with the highest gross margin which is extremely good and we are continuing to grow and we are very confident in this market, Japan.

Asia is high too, but in Asia, as I told you before, we are experiencing the sales of very important fine jewelry and gemstones, so this is a place where we have lower margins. And Europe, it's also -- we experienced a huge concentration of a few sales to Middle Easterns, Russians and now even Chinese from London and Paris store. And this is where some of the largest deals happen at this very moment.

So it is a (inaudible) base where the margin ratio would be the lowest at this very moment. America all in all is extremely positive, America is back. Harry Winston is (inaudible) American, is the only exclusive American jewelry brand, actually, and is back and is extremely profitable. And of course (multiple speakers) development of watches will bring additional margin as it is an extraordinary profitable activity, the watch activity.

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**Edward Sterck** - BMO - Analyst

Okay, thank you. And it just looking to the future then, I know you talked about this back in June, but can you give us a little bit more indication of the way you're thinking about how you want the salon networks to develop through 2011 and 2012?

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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

Yes. We really want to focus in two areas. The first area is develop and create a subsidiary in China and we will open two to three stores within the next 10 months in China, major locations, two already identified, a third to come very, very soon. So we will very, very soon come to four salons in China internally run.

So 100% of the development of new openings of new salons will be in China for the next 12 months. And also we will restore the flagship store, New York, Paris to come very soon and Ginza as well. So this is the development we want; we don't want large expansions, we want to increase the profitability of the existing salons which is exactly what we're doing today, plus expansions of new salons in premium places in China.

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**Edward Sterck** - BMO - Analyst

Okay, thank you. Just one final question on this then. Earlier you said that in terms of the marketing of the Harry Winston retail brand, you were talking about either flying customers to the salons or flying the items to the customer. I mean, the question I just want to ask is does Harry Winston need so many salons? Would it perhaps be better just to focus on a few key salons in sort of some of the true world cities and then perhaps close the salons in more minor locations?

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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

No. We need salons -- the first experience with the (inaudible) clients is 99% of the time it is starting in a salon, if you don't have the salon to start with you don't have the connection with the client. So you need salons.

But you're right, we need the minimum amount of salons, quantities of salons and we won't go -- we will do a maximum of 40 to 50 salons around the world while other jewelers think of 400, 500 salons around the world. So we are absolutely -- you're absolutely right. Clients, because a Harry Winston purchase is kind of an investment that you do for generations to come and then clients fly to Harry Winston and this is why we want to concentrate a very limited network but a network.

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And also I didn't tell you what -- I told you the development of China will be internally run salons, but of course we expressed the desire to develop the partner salons, new channel of distribution, we get started with this year and we will open Moscow, Dubai and maybe Abu Dhabi with new partners right now.

So we're working on this project on the side. So that's also -- we re-create and re-create the big strong awareness of Harry Winston in this continent where we are very small and quite unknown.

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**Edward Sterck** - *BMO - Analyst*

Okay, thank you. I'm sorry, I'm going to ask a final final question. Where's the sweet spot for Harry Winston retail brands between exclusivity and profitability?

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**Frederic de Narp** - *Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.*

Well, the sweet spot -- this is -- I mean Harry Winston, the first thing is to really position and to keep our positioning of the most exclusive jeweler and watch maker in the world. In this category we have no competitors and this is where we want to affirm our presence. Also (inaudible) in the fact that in parallel we target the ultra-high net worth people with \$30 million liquid assets, you have more than 100,000 people -- of these people around the world plus the high net worth, it's about 10 million people with \$1 million liquid assets.

And this is all the categories we are targeting and with our positioning we want to be in the category where nobody plays at this moment, and this is where we are. The sweet spot between balance and profitability, you know sometimes if you accept to sell an item for \$10 million or \$20 million you accept to have a lower margin ratio and you're happy to have the absolute value and the absolute -- the margin but not the ratio, the ratio won't be good but the margin is good.

And of course it's a balance between that and the watch activity, of collection activity which are collections we are growing and developing very rapidly to show our clients. Because the same clients are spending millions of dollars in diamonds and the diamond ring love to have jewelry from Winston from every day. So, this is what we're developing and these are our collections which are much higher margin ratio as you can imagine.

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**Alan Mayne** - *Harry Winston Diamond Corporation - CFO*

Perhaps I could just add one thing. I mean, for very good reasons we obviously talk a lot about the brand in the context of jewelry. But I don't think we should lose sight of the watch business. This watch business has grown tremendously as a very young brand and it's -- I mean if we think the jewelry business is underrepresented globally, the watch business is even more so underrepresented.

So, for very good reason we talk about the brand in the context of jewelry, but the other part of the strategy for Frederic and the team is to significantly grow the watch business. And we've got the factory in Geneva to do that and we've got the design team focused on how to alter the profile of the watch line to make it more accessible and to make it more profitable. That is going to be key. And we don't require a lot more bricks and mortar to execute that part of the strategy.

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**Frederic de Narp** - *Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.*

Today watches represent about one-third of our sales and we would love to take the watch activity to half of our business very soon.

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**Edward Sterck** - BMO - Analyst

Okay, thank you very much.

**Operator**

Des Kilalea, Royal Bank of Canada.

**Des Kilalea** - Royal Bank of Canada - Analyst

Thank you. Bob, could you talk about that resource extension you've got in A-418 and 154 North? You do say it's not in the reserves yet, but can you give any kind of color as to what it might do to life -- maybe a most optimistic and a kind of -- or -- and a pessimistic kind of view of what it might do? And then maybe you could just talk with a bit more granularity on the diamond markets, where the improvement is, the segments that are doing better, if you don't mind.

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, okay. I think if you -- you're right that these extensions will add to life because we've got to keep the development heading down there to get them out. They add to life rather than near-term velocity. One is (inaudible) it could -- there is somewhere -- perhaps a year or two in there. Yes, more like two than one I guess.

The diamond market -- yes, the diamond market -- well, we -- from the polish side and the experience of buying polished for the Harry Winston jewelry business we saw struggles -- struggles to try to push up the prices of polished on many items and were often successfully resisted by the retailers. In other words, the polisher would try to increase the price.

But if you sort of held their feet to the fire and wanted to buy enough you could probably get the -- you could probably still buy at the price you were paying the previous month. That's really changed now. Prices have been raised, there's nobody willing to sell at the old prices there were. Which presumably does reflect the fact that rough has been sold at pretty good prices for quite a while.

So that's going -- that higher price will obviously come through the system, the publisher just insists on getting his margin. And the marketplace is strong enough that he can do that. So polished prices have definitely gone up, some items by 2%, probably some items by more than 5% may be an average for the kind of things that we buy. No, I think for the average for the market might be in the 3% or 4% area -- that sort of happened in the last month.

Rough prices, of course, are still rising because of that. As you know, there's a complexity in the diamond market that not everything goes up together. So some items are in stronger demand than others, but we've been able to continue to put our prices up a bit. So, and obviously with polished prices moving I don't expect that trend to reverse. Is that sort of what you (multiple speakers)?

**Des Kilalea** - Royal Bank of Canada - Analyst

Yes, that's great. Thanks, Bob. And then just finally on the exploration, a couple of quarters ago I think you mentioned that Rio was kind of looking a bit outside the Diavik mine itself for new ore bodies.

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

Yes, they are.



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**Des Kilalea** - *Royal Bank of Canada - Analyst*

(multiple speakers) progress?

**Robert Gannicott** - *Harry Winston Diamond Corporation - Chairman, CEO & Director*

Yes. There are principally two I guess pretty good looking target areas. But I will caution, this is not sort of kimberlite pipes that are under investigation for diamond content, these are a combination of geophysical and geochemical anomalies that are still under investigation for a source pipe.

But I mean they are good-looking things. As you know, good mineral chemistry does have the implication and you can sort of imply whether or not you're going to have a decent diamond content in the rock from that -- in the kimberlite from that. And these things do look pretty interesting.

**Des Kilalea** - *Royal Bank of Canada - Analyst*

Thank you very much (multiple speakers).

**Robert Gannicott** - *Harry Winston Diamond Corporation - Chairman, CEO & Director*

But there's nothing further to report at this stage of it. Obviously all the kind of the steps of working up there on exploration are very much seasonal, so there's a winter drill program -- drill campaign planned, but that begins by taking equipment up the winter road and then gets underway when the sun gets a little higher in the sky, so right about March.

**Des Kilalea** - *Royal Bank of Canada - Analyst*

Thanks, Bob.

**Operator**

(Operator Instructions). John Hughes, Desjardins.

**John Hughes** - *Desjardins - Analyst*

Thank you, operator. Thanks, Bob, for the script around the mine front, that definitely helps. I just have one question left on the retail business. Quite a nice trend in terms of the earnings from operations over the last several quarters. And I just was running quickly some numbers with regards, again, to the retail for the fourth quarter with regards to your sales growth guidance for the year of 35% to 40%.

In using the midpoint of that I'm coming up with potential revenue numbers in the fourth quarter of \$95 million to \$100 million in the quarter. And I'm just wondering if I went with that number, how should I be adjusting my gross margin, or should I, given some of the disclosure with regards to the Hope Diamond (technical difficulty) Smithsonian as well as the new advertising campaign?

So if you add those two sort of more I guess higher cost side, but you have strong growth on the top line, are we looking somewhere \$10 million to \$15 million in terms of earnings from operations for the fourth quarter?



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**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

Yes, what I can tell you is that actually we are constantly and at this very moment [breeding] the rock solid base of the global international luxury brand. And that requires to invest in marketing. So marketing, I told you about the advertising campaign, these PR events were huge in terms of cost effectively for us with extremely great selling success as well.

And image wise I've really -- I've had to really reposition the brand. But in the fourth quarter we expect, yes, very important sales at the lower margin, plus a major investment in marketing to build the rock solid base of the brand and to focus the brand towards a bright future. Alan?

**Alan Mayne** - Harry Winston Diamond Corporation - CFO

John, I think the number that you indicated is much higher than a range of what we would be looking at.

**John Hughes** - Desjardins - Analyst

Okay.

**Alan Mayne** - Harry Winston Diamond Corporation - CFO

For earnings from operations.

**John Hughes** - Desjardins - Analyst

All right, that's good. So we can manage -- you've guided us on the sales front and we can manage the margin based on those several items that are occurring in the fourth quarter that may temper that margin as experienced in the third quarter?

**Alan Mayne** - Harry Winston Diamond Corporation - CFO

Yes, I think -- as Frederic said, the mix of business is obviously an important component. But I think we've tried to be I think strong on the guidance that it's not -- it's not a quarter where you could -- and I wouldn't disagree with your top-line derivation of revenue. But an extrapolation of a significant amount of this revenue increase dropping to the earnings from operations line would be wrong.

**Robert Gannicott** - Harry Winston Diamond Corporation - Chairman, CEO & Director

The fourth quarter is always the quarter when we have the predominance of marketing expenses because of the holiday season and so on, so --.

**John Hughes** - Desjardins - Analyst

Okay, that's -- thank you very much indeed for the guidance.

**Frederic de Narp** - Harry Winston Diamond Corporation - CEO & President, Harry Winston Inc.

Thank you.

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**Operator**

[Paul Jamcogian], private investor.

**Paul Jamcogian** - - *Private Investor*

Yes, I had read in your published report yesterday about an indefinite liability on taxes. And I wish, if I had missed that earlier in the call, if you could elaborate what we were talking there. I did not see a dollar figure.

**Alan Mayne** - *Harry Winston Diamond Corporation - CFO*

Well, I don't believe we ever used the term an indefinite liability on taxes. Taxes are generally either current or deferred. So we do have a significant future income tax liability, which is largely in our mining business and that relates to differences at the rate of which we take deductions for capital cost allowance and other matters for tax purposes compared to what we deduct for depreciation and amortization for accounting purposes.

This is not unusual, as you're probably aware. The tax codes in most countries provide for different methods of capital cost deductions. So, there's no indefinite liability, there is a future income tax liability that will reverse over the course of the mine life depending on the source of production by pipe and from open pit and underground.

**Paul Jamcogian** - - *Private Investor*

Is there basically an aggregate dollar value that is going to be amortized?

**Alan Mayne** - *Harry Winston Diamond Corporation - CFO*

Well, if you look at the balance sheet the future income tax liability is \$343 million. However, I would caution you that a significant amount of that is related to transaction accounting going back to when we bought the Harry Winston retail business.

Without going into all the details, when you make an acquisition like that and there is goodwill there is an implied capital gains tax liability that you have to record on the books on the basis that if you sell this business in the future what would the implied capital gains tax be and that's the future income tax liability.

So, the amount that we would be recognizing is much lower than the \$343 million that's on the balance sheet. The timing of what we will recognize on an annual basis, as I say, varies depending on the source of production at the mine.

**Paul Jamcogian** - - *Private Investor*

Thank you, thank you very much.

**Operator**

Sir, there are no further questions at this time.

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**Robert Gannicott** - *Harry Winston Diamond Corporation - Chairman, CEO & Director*

Okay, well thank you very much, all of you, for joining us. It's a pleasure to report a quarter like this and we look forward to talking to you again for the year-end figures. Thank you.

**Operator**

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect.

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