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MRAM - Q2 2018 Everspin Technologies Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, and welcome to Everspin Technologies Second Quarter 2018 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded today, August 8, 2018. I would like to turn the call over to Leanne Sievers, President of Shelton Group Investor Relations. Leanne, please go ahead.

Leanne K. Sievers - Shelton Group - EVP IR

Good afternoon, and welcome to Everspin Technologies Second Quarter 2018 Earnings Conference Call. I'm Leanne Sievers, President of Shelton Group, Everspin's Investor Relations firm. Joining me today are Kevin Conley, Everspin's President and CEO; and Jeff Winzeler, Chief Financial Officer.

Before we begin the call, I want to remind you that this conference call contains forward-looking statements regarding future events, including but not limited to our expectations for Everspin's future business, financial performance and goals, customer and industry adoption of MRAM technology, successfully bringing to market and manufacturing products in Everspin's design pipeline and executing on its business plan.

These forward-looking statements are based on estimates, judgments, current trends and market conditions involves risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements. We would encourage you to review our SEC filings, including the 2017 Form 10-K filed with the SEC on March 15, 2018, and other SEC filings made from time to time in which we may discuss risk factors associated with investing in Everspin. All forward-looking statements are made as of the date of this call, and except as required by law, we do not intend to update this information.

This conference call will be available for audio replay for at least 90 days in the Investor Relations section of Everspin's website at www.everspin.com.

And now, I'd like to turn the call over to Everspin's President and CEO, Kevin Conley. Kevin, please go ahead.

Kevin Conley - Everspin Technologies, Inc. - CEO, President & Director

Thank you, Leanne, and good afternoon, everyone. I'm pleased to announce the results for our second quarter. This is our first full quarter of STT-MRAM production shipment in which the qualification of our 256-megabit STT-MRAM was completed by a leading enterprise storage provider. In previous earnings calls, we have focused on this significant milestone as key to driving our market adoption for this innovative new MRAM technology. It's an achievement that has been our objective for several years, and we are extremely pleased to see our vision of STT-MRAM in a mainstream storage appliance becoming a reality. I'll speak more of this later on the call.



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With regard to our financial performance during the second quarter compared to the same quarter a year ago, our revenue increased over 20%. Total product revenue grew over 30%, and the product revenue from our core focus MRAM products experienced 40% growth. Second quarter loss per share also improved compared to the year-ago quarter and was slightly better than our forecasted guidance range.

Revenue for the quarter ended slightly below our guidance range due to higher-than-anticipated operational variances. The primary factor behind this was increased demand for industrial and automotive-grade Toggle products, which put us behind the yield recovery target discussed last quarter. Nevertheless, our pursuit of stronger Toggle production metrics presses on. Our efforts to improve the performance of our back-end fab have achieved progress, as measured by early indicators of the line. We expect to realize gradual improvements in productivity and yields at our Chandler facility throughout the second half of this year.

In conjunction with this progress, I also want to highlight that our facility lease with NXP has been extended into 2021.

Turning to market developments. This week, we had 2 significant industry events. The inaugural MRAM Developer Day and Flash Memory Summit. MRAM Developer Day was added by the organizers of the Flash Memory Summit in recognition of the increased attention this technology has received from the storage developer community. As the leading manufacturer of MRAM products, we were honored to have the opportunity to present the leadoff keynote address. In that keynote, I reflected on the progress we have made in our technology and why we believe that MRAM is moving from the emerging technology class toward mainstream adoption. Our partner, GLOBALFOUNDRIES, also presented at the event, promoting the importance of 22-nanometer FDX embedded MRAM development and the progress on customer engagements in consumer and industrial applications. They also reiterated their projection for embedded MRAM mass production in 2019. It was a great platform for our partnership to demonstrate how far we've come in leveraging our MRAM IP towards our joint goal of producing MRAM solutions in both discrete and embedded form, aimed at a broad assortment of market applications.

This was significant not just as an opportunity to market our technology but also to announce that IBM has qualified our 256-megabit STT-MRAM component in a recently launched all-flash array. This milestone carries significance force in 2 ways: First, it demonstrates the value proposition of persistence, performance and endurance in enterprise storage application, which has been our strategic focus; and second, it shows that our new STT-MRAM product is able to pass the robust qualification process of a top-tier storage customer like IBM. Our technology is now gaining interest with storage companies with a valuation starting in applications that need the differentiating benefits our STT-MRAM technology provides.

We are also seeing interest in applications outside enterprise storage where similar needs have low latency data persistence exist such as medical imaging devices. In addition to this major news, we jointly promoted the nvNITRO storage accelerator with SMART Modular. This product started mass production earlier in the quarter and is starting evaluation with customers in key markets, including the FinTech segment. SMART also showcased a new U.2 form factor for the product line, opening up new use cases in storage arrays for this ultra-low latency storage accelerator. This product also enabled us to demonstrate MRAM's performance benefits in NVMe over fabric deployments. One common theme in both of these applications has been our success in qualifying MRAM and FPGA-based storage application.

At the Flash Memory Summit, we also highlighted our Xilinx-based design inside our SMS booth as this relationship has become increasingly important path to market adoption for our STT-MRAM products. By partnering with Xilinx, we're able to decrease the time-to-market for applications utilizing MRAM to complement our work with partners and customers in the storage ecosystem. In addition to this exciting progress on our 256-megabit product, we have continued on track with our 1-gigabit STT-MRAM, which we target for selective customer sampling at the end of this year.

With that, I'd now like to turn the call over to Jeff Winzeler, our CFO, who will review the details of our second quarter results as well as provide our third quarter 2018 guidance.

Jeffrey G. Winzeler - Everspin Technologies, Inc. - CFO & Secretary

Thank you, Kevin, and good afternoon, everyone. I'll start by reviewing the second quarter 2018 income statement. Revenue in the quarter was up 21% year-over-year to \$10.8 million from \$8.9 million in the second quarter of 2017, but was down sequentially from the \$14.9 million in the first quarter of 2018, which included over \$5 million licensing, royalty and other revenue.

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Product sales represented 88% of total revenue or \$9.4 million, which was up from \$7.2 million during the same quarter last year and comparable with the previous quarter. Licensing, royalties and other revenue contributed approximately \$1.3 million in the quarter compared to \$1.7 million in the second quarter of 2017, and \$5.5 million in the previous quarter, largely due to our sensor technology licensing agreement with Alps Electric.

For MRAM products, which include Toggle and STT-MRAM, revenue in the second quarter was \$9.1 million, a 40% increase from the \$6.5 million in the second quarter of 2017, and a 2% increase from the \$8.9 million in the previous quarter.

During the quarter, we experienced lower manufacturing yields on Toggle MRAM products, which constrained our output and limited our revenue on the quarter. Our backlog for Toggle remains strong, and the demand will carry over into the third quarter.

Gross profit for Q2 2018 was \$5.3 million compared to \$5.8 million in the same period a year ago and \$10 million in the first quarter of 2018. The sequential decline in gross profit was primarily attributable to the decrease in licensing, royalty and other revenue in the quarter. As we stated on previous calls, this part of our revenue is variable from quarter-to-quarter and is based on size and the terms of each transaction, and as such, can affect gross profit and margins materially.

The resulting gross margin for Q2 2018 was 49%, a decrease both from the 65% in the second quarter of 2017 and from 67% in the first quarter of 2018. As Kevin mentioned, we saw measured improvement in the performance of our back-end fab and expect to realize gradual improvement and productivity in yields at our Chandler facility throughout the second half of this year. This should have a positive effect on both capacity and margins.

Operating expenses for the second quarter 2018 were \$11.8 million compared to \$10.6 million in the second quarter 2017, and \$11.1 million in the first quarter of 2018.

Breaking down our operational spending for the second quarter. Research and development expenses were \$6.8 million compared to \$6.4 million in the same quarter a year ago and \$6.5 million in the first quarter of 2018. SG&A spending was \$5 million in the second quarter compared to \$4.2 million in the second quarter of 2017, and \$4.6 million in the first quarter of 2018.

Interest expense for Q2 2018 was \$222,000 compared to \$176,000 in the second quarter of 2017, and \$211,000 in the first quarter of 2018.

Other income was \$132,000 in the second quarter of 2018 versus \$24,000 in the second quarter of 2017, and \$44,000 of income in the first quarter of 2018.

GAAP net loss for Q2 2018 was \$6.6 million or a \$0.40 loss per share based on 16.6 million weighted average shares outstanding. This compares with a GAAP net loss of \$5.2 million or \$0.42 loss per share during the same quarter a year ago and a GAAP net loss of \$1.3 million or \$0.09 loss per share in the prior quarter. \$0.30 of the change from the prior quarter was directly due to the reduction in licensing revenue from the last quarter.

Now turning to the balance sheet. Cash and cash equivalents were \$32.7 million at the end of the second quarter of 2018 compared to \$33.9 million at the first quarter of 2018. The change in cash results reflected the collection of cash licensing payment from the Alps agreement signed in Q1, offset by cash used in operations.

Total assets at the end of the second quarter were \$52.3 million compared to \$57.1 million at the end of the first quarter. Total liabilities were \$20.6 million as compared to \$20.5 million in the first quarter of 2018.

Stockholders equity was \$31.8 million compared to \$36.7 million in the first quarter of 2018.

Looking ahead to the third quarter of 2018, we expect revenue to range between \$10.6 million and \$11 million. This revenue range reflects our expectations for MRAM revenue to grow approximately 8% sequentially, offsetting an anticipated decline in legacy product sales. Note that this decline in legacy product sales opens up production capacity for our core MRAM products. We expect the result in gap loss per share will range between \$0.34 loss per share and \$0.30 loss per share based on an average weighted share count of 16.9 million shares outstanding.



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Now I'd like to turn the call back over to Kevin for some closing remarks.

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

Thanks, Jeff. We're pleased with the growth in revenue from our entire family of MRAM products. Even with this progress, there's clearly more opportunity for improvement from an operational perspective, especially on our Toggle MRAM products. This is a key area our team will continue to pour effort into improving our results.

Our IBM design win represents the culmination of a long and successful engagement with a major player in the enterprise space. We believe this is an important step in gaining broader adoption. We will continue to focus on the promotion of our STT-MRAM into storage and other applications where data persistence and speed is critical and could be rapidly integrated. We are developing a product road map to expand the market opportunities for this technology and continue to focus on long-range technology investments that will propel us into the future.

Now operator, we'll open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Rajvindra Gill with Needham & Company.

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst of Microcontrollers, Analog & Mixed Signal; Consumer IC & Multi-Market*

Great job on the IBM qualification. That's very good. Question, Jeff, on the margins. So you mentioned that you're capacity constrained and you experienced lower utilization yield on the Toggle product. I wonder if you could maybe elaborate a little bit further on what occurred during the quarter, and kind of what are the utilization rates now and where do you think they can go in the second half?

Jeffrey G. Winzeler - *Everspin Technologies, Inc. - CFO & Secretary*

Yes, so Raji, the utilization rate of capacity was high. The issue is that our product mix over the last couple of quarters has shifted a lot toward automotive and industrial products, which require higher temperature testing and have different tolerances than typical commercial-grade Toggle product. And so that has resulted in less output from the factory. Our yields are less, which has constrained our output or our ability to deliver on the revenue in the second quarter. So that's where we were constrained. We had demand, but we weren't able to completely supply that demand because of the yield output in the 200-millimeter Toggle factory. And that yield output, unfortunately, is at the very end of the line. So that product gets all the way through the manufacturing cycle, and that's where we're seeing the yield hit, which very much constrains our ability to supply.

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst of Microcontrollers, Analog & Mixed Signal; Consumer IC & Multi-Market*

Okay. Got it. And so what are the steps that you're taking? And you talked a bit about this on the script of the call about to increase capacity to meet this kind of change in demand and the change in the demand profile.



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Jeffrey G. Winzeler - Everspin Technologies, Inc. - CFO & Secretary

Yes, there's 2 things that are happening. One is we've addressed the issues that have caused lower yields in the factories. So we've identified root causes of those yield variances, and we have active programs in place to go fix those. So that will help. Although, as I mentioned, a lot of this yield fallout is at the end of the line. So we'll continue to see somewhat depressed yield, but it should start getting better in the second half of the year. The other issue that we talked about in terms of capacity is that our legacy products, which are primarily the sensor and the back-end foundry services that have been part of our revenue for the last couple of years, those are starting to decline. And the bad news is it somewhat mutes the growth that we're seeing in our core Toggle MRAM products, the good news is by running less wafers devoted to sensor and other products, we're able to run more Toggle wafers.

Kevin Conley - Everspin Technologies, Inc. - CEO, President & Director

If I could add just a little color to that with regard to your question of what things are we doing. There's really 2 primary things. One is we're making investments in better management of the yield data and be able to tie that to specific processes within the manufacturing flow that will result in better yields. And then, the second part is, as Jeff said, taking some of those issues, which, today and in the past, have been more end-of-line issues and moving those earlier in the line to lessen their impact on the overall results.

Rajvindra S. Gill - Needham & Company, LLC, Research Division - Senior Analyst of Microcontrollers, Analog & Mixed Signal; Consumer IC & Multi-Market

Yes, that's very helpful. And the 1 gig product that's targeting samples at the end of the year, can you talk a little bit about any updates there since the last quarter, and when do we think we should start to see some revenue or what the customer profile could look like as we go into maybe next year?

Kevin Conley - Everspin Technologies, Inc. - CEO, President & Director

So adoption of any new product, of course, takes time. We're reiterating our plan to sample, which means that the design will be meeting our customers' requirements and meeting its operational specs, and that will be within the parameters of performance and reliability. So our indicators, as we track this, week-to-week, month-to-month, are on track, indicating that we're still on our plan to meet that milestone in December. Looking at typical technology ramps, that would mean that our main production would be ramping around the middle of 2019. And then, of course, we'll go through the customer adoption cycles from the point of sampling through their qualifications eventually ending up in volume production with those customers.

Rajvindra S. Gill - Needham & Company, LLC, Research Division - Senior Analyst of Microcontrollers, Analog & Mixed Signal; Consumer IC & Multi-Market

And last question for me. So you had mentioned that the MRAM business is going to grow 8% sequentially, offsetting the decline in legacy, the sensor and the back-end foundry. Any way to kind of quantify what that impact is? What is it going from X to Y? Yes, because last year, it was pretty significant. If I recall, I think it was a couple million, like \$2 million last year, if I remember, on the sensor revenue, which dropped off around that range. I think foundry was \$3 million, and correct me if I'm...

Jeffrey G. Winzeler - Everspin Technologies, Inc. - CFO & Secretary

You have a good memory. It was about \$2 million, \$2.5 million last year. So that business is something that we've anticipated would go away. As you know, we're moving to a licensing and royalty model with regard to the sensor business specifically, and it's just that volumes lasted a lot longer than we thought it would. It's definitely in 2018, we're seeing the business start to go away. We expect that at some point in time, it will reach 0. We're devoting that factory line directly to Toggle MRAM production, and so we're getting a lot closer to that point.

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Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

And I would probably back that up, Raji, by highlighting that in our strategy, we've taken more of a licensing approach to the sensor business and successfully completing our second license of this technology. And that will be our continued focus in terms of sensor.

Operator

And our next question comes from the line of Richard Shannon with Craig Hallum.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

I'll add my congratulations on the IBM design win as well. Kevin, maybe -- I know this is kind of early, you've announced this probably just over 48 hours ago, but have you got any initial reaction from other engagements who have been looking at the technology and seen the IBM announcement and had any reaction that you can share with us?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

I'd say, the reaction from the other storage manufacturers and even from other Xilinx-based designers has been very strong at the Flash Memory Summit, in line with what we expected. We did think having a lighthouse customer like IBM was going to attract a lot of attention. So we saw a great deal of interest and discussion about how MRAM could bring benefits into a variety of customers' application. I will also say, with the specs now published in what the product actually is and the level of performance and density that it delivers in a very compact footprint, there's a lot of excitement about the product itself and what that will mean for Everspin MRAM sales.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. Perfect. Thinking a little bit more tactically near-term with IBM, I was at the event on Monday when IBM announced the product. And if I heard them correctly, they said the product would be available by the end of August. Did I hear that correctly, Kevin?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

I think that's what he said. Yes.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. So presumably, your revenues for the third quarter will include some kind of initial inventory build from IBM. Is that fair to say?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

Yes, that's fair to say. As we said, our Q2 revenue included a full quarter of production shipment. And by that, I meant we're going into production and preproduction builds with a variety of customers. So the revenue that we're shipping today to them is going into units that will be in product shipments.



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Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. Any way that you can characterize, in any way, the visibility and or forecast that IBM is giving you regarding this product? I know it's very new and early stage, but anything you can share to help us think about this would be helpful.

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

Yes. I'm not in liberty to share their projected forecast with that, I'm afraid.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. I thought I'd give that a try. Last question for me. Just talking about overall product gross margins, you talked about the back-end line issue for the Toggle. If I caught your comments correctly, it sounds like you're expecting the problem to be improved over the second half of the year. So should we get kind of to a normal gross margin with the Toggle product exiting this year, or could be faster, slower? Any way you can characterize and be more specific on timing expectations there?

Jeffrey G. Winzeler - *Everspin Technologies, Inc. - CFO & Secretary*

Yes. As I said in the prepared remarks, we really expect this to start getting better in the second half of this year. I think, with the lag of material that's already in the line and the fixes that we put in place, we would really expect to see the yield impact to gross margins probably more in the Q4 time frame than the Q3 time frame, but definitely on the uptrend, and we think that will be healthy by the time we exit the year.

Operator

And our next question comes from the line of Kevin Cassidy with Stifel.

Kevin Edward Cassidy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

I'll also add congratulations for the IBM win. With the STT product, is that at mature yields now or is there still room for yields to improve on 256?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

So we're still ramping the production, Kevin. And as most technology, memory technologies go through, there's continual improvement in the yields until these technologies hit the top. And that takes a pretty good amount of time. As to specifics of where we are, I hope you can appreciate that's competitive information that we don't make public.

Kevin Edward Cassidy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

Sure. Just getting an idea directionally if there's still good improvement ahead. And then, also, IBM made it clear in their presentation on Monday that they engaged with Everspin 2 years ago. So it was a long product cycle. I know we had to get the STT product qualified into production like GLOBALFOUNDRIES. But your next engagements, would you -- what do you expect the design cycle time would be from the time engagement with the customer to maybe being able to announce a win?



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Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

So we'll maybe bring back what we said on previous calls that qualification with enterprise storage customers could take anywhere from 9 to 12 months. In terms of how well we've done with 256 at this point, you'll recall my early commentary on changing strategy and reengaging with customers on the 256-megabit. And so, I think, we actually, working very closely with our customer, we're able to get it qualified and into preproduction builds in pretty record time. So it will be the focus of our team to stay at a high pace of driving those customer engagements and hopefully perform at equally high level.

Kevin Edward Cassidy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

Okay. Great. Just on the R&D, as you're introducing the 1 gigabit device, should we expect R&D expenses to move up or it's mostly R&D completed on the 1 gig?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

So R&D activities will continue until we hit production and even as we begin to ramp and work on the early yields. So as we've said on previous calls, and Jeff and I are focused with the team on keeping our operating expenses more or less in line with historical averages.

Kevin Edward Cassidy - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

Okay. I see. And just one other question about the GLOBALFOUNDRIES. I think they had announced having some wins on their 22 FDX process. For next year, would that be -- would eMRAM be a significant revenue? Or is it still something that would have to be in the much higher volume?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

What their statements mean in terms of next year revenue is hard for me to comment on. I think they did talk about significant design wins and a good portion of those were going to be MRAM-dependent. The timing of those, I don't have much visibility to other than pointing to the reiteration of restarts at the end of this year and mass production next year, I think, of embedded MRAM.

Operator

And our next question comes from the line of [Lauren Hirschman] with [AIDH]. All right, I'm showing no further questions at this time, and I would like to turn the conference back over to Mr. Kevin Conley for any further remarks.

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

Thank you. In closing, I'd like to highlight that Everspin will be attending multiple upcoming investor events, including the Jefferies conference on August 28 in Chicago. Please contact your Jefferies sales representative or the Shelton Group if you would like to schedule a meeting. Thank you for your participation on today's call. We look forward to reporting our progress next quarter. I want to again thank the Everspin team for the strong work across the board that delivered these results and look forward to the future progress. Operator, you may now disconnect the call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone, have a great day.



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