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VIPS - Q1 2019 Vipshop Holdings Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, good day, everyone, and welcome to the Vipshop Holdings Limited's First Quarter 2019 Earnings Conference Call. At this point, I would like to turn the call to Ms. Jessie Fan, Vipshop's Director of Investor Relations. Please proceed.

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

Thank you, operator. Hello, everyone, and thank you for joining Vipshop's First Quarter 2019 Earnings Conference Call.

Before we begin, I will read the safe harbor statement. During this conference call, we will make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are based on our current expectations, assumptions, estimates and projections about Vipshop Holdings Limited and its industry. All statements, other than statements of historical facts we make during this call, are forward-looking statements. In some cases, these forward-looking statements can be identified by words or phrases such as anticipate, believe, continue, estimate, expect, intend, is or are likely to, may, plan, should, will, aim, potential or other similar expressions. These forward-looking statements speak only as of the date hereof and are subject to change at any time, and we have no obligation to update these forward-looking statements.

Joining us on today's call are Eric Shen, our Co-Founder, Chairman and CEO; and Donghao Yang, our CFO.

At this point, I would like to turn the call over to Mr. Eric Shen.

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

Okay. Good morning, and good evening, everyone. Welcome, and thank you for joining our first quarter 2019 earnings conference call. We delivered robust operational and financial results during the first quarter of 2019. The successful execution of our merchandising strategy is starting to bear fruit.



During the quarter, our total active customers grew by 14% year-over-year, driven by the healthy growth in both the number of repeat customers and the new customers. Our strategic partners also continued to bring us new customers. In the quarter, around 25% of our new customers came from the WeChat mini-program and the JD flagship store. This success are the result of our strategic focus on the discounts apparel segment where we are a dominant player in China.

Our total GMV increased by 11% year-over-year during the quarter. More importantly, apparel-related categories, which are our bread and butter, grew even faster at 16% year-over-year.

In addition, we continued to make good progress on cost reduction. On the logistics side, we began to shift a portion of our orders to third-party delivery companies. So far, we have not seen any notable difference in customer experience as a result of the change. In the coming quarter, we will continue to transfer more packages to our third-party delivery partners in order to reduce fulfillment costs over time.

We are making solid progress in the change of our strategic direction and are pleased to see positive results at early stage. Looking ahead, we will continue to focus on profitability growth coupled with healthy top line growth. We are deeply committed to delivering long-term sustainable shareholders return.

At this point, let me hand over the call to our CFO Donghao Yang so that he may discuss our strategies in more detail and go over our operational and financial results.

Donghao Yang - Vipshop Holdings Limited - CFO

Thanks, Eric, and hello, everyone. We are delighted to have achieved financial results that exceeded our expectations during the first quarter of 2019. Our top line increased by over 7% year-over-year while our net margin improved both sequentially and on a year-over-year basis. These solid operational and financial results give us confidence that we are on the right track with the recent strategic shifts.

The enhanced profitability is the result of our focus on the apparel category in the discount retail segment of which the GMV grew faster than our total GMV during the quarter. We are glad that our more selective assortment is becoming more attractive to our valued customers, as demonstrated by improved year-over-year traffic and conversion rate. Further, our cost reduction efforts also came into play as we streamlined resources invested into certain loss-making businesses.

During the quarter, approximately 5.5 million active customers used our consumer financing service, which accounted for around 22% of GMV. As of March 31, 2019, the total balance of credit outstanding to customers was approximately RMB 4.9 billion and the total balance of credit outstanding to suppliers was approximately RMB 719 million.

We continue to streamline our Internet finance business in order for it to better support our core e-commerce business. We are a leading player in Chinese discount retail channel, and we are uniquely positioned to capture the market opportunities and further expand our market share. We are dedicated to growing profit dollars while maintaining a healthy level of top line growth. Over time, we will generate sustainable value creation and deliver solid return to all our shareholders.

Now moving on to our quarterly financial highlights. Before I get started, I would like to clarify that all financial numbers presented today are in renminbi amounts and all percentage changes refer to year-over-year changes unless otherwise noted.

Total net revenue for the first quarter of 2019 increased by 7.3% to CNY 21.3 billion from CNY 19.9 billion in the prior year period, primarily driven by the growth in the number of total active customers. Gross profit for the first quarter of 2019 increased by 8.7% to CNY 4.4 billion from CNY 4 billion in the prior year period. Gross margin increased to 20.4% from 20.2% in the prior year period.

Fulfillment expenses for the first quarter of 2019 were CNY 1.8 billion as compared with CNY 1.7 billion in the prior year period. As a percentage of total net revenue, fulfillment expenses decreased to 8.3% from 8.7% in the prior year period.



Marketing expenses for the first quarter of 2019 were CNY 781 million as compared with CNY 645 million in the prior year period. As a percentage of total net revenue, marketing expenses were 3.7% as compared with 3.2% in the prior year period.

Technology and content expenses for the first quarter of 2019 decreased to CNY 383 million from CNY 466 million in the prior year period. As a percentage of total net revenue, technology and content expenses decreased to 1.8% from 2.3% in the prior year period.

General and administrative expenses for the first quarter of 2019 were CNY 669 million as compared with CNY 614 million in the prior year period. As a percentage of total net revenue, general and administrative expenses remained stable at 3.1% year-over-year.

Our income from operations for the first quarter of 2019 increased by 30.3% to CNY 863 million from CNY 663 million in the prior year period. Operating margin increased to 4% from 3.3% in the prior year period.

Non-GAAP income from operations, which excludes share-based compensation expenses and amortization of intangible assets resulting from business acquisitions, increased by 18% to CNY 1 billion from CNY 878 million in the prior year period. Non-GAAP operating income margin increased to 4.9% from 4.4% in the prior year period.

Our net income attributable to Vipshop shareholders for the first quarter of 2019 increased by 64.7% to CNY 872 million from CNY 530 million in the prior year period. Net margin attributable to Vipshop shareholders increased to 4.1% from 2.7% in the prior year period. Net income attributable to Vipshop's shareholders per diluted ADS increased to RMB 1.27 from RMB 0.77 in the prior year period.

Non-GAAP net income attributable to Vipshop shareholders, which excludes share-based compensation expenses, amortization of intangible assets resulting from business acquisitions and equity method investments, tax effect of amortization of intangible assets resulting from business acquisitions, gain on disposal or revaluation of investments, tax effect of a gain on disposal or revaluation of investments and share of gain in investment of limited partnership that is accounted for as an equity method investee, increased by 12.2% to CNY 816 million from CNY 728 million in the prior year period.

Non-GAAP net margin attributable to Vipshop shareholders increased to 3.8% from 3.7% in the prior year period. Non-GAAP net income attributable to Vipshop's shareholders per diluted ADS increased to RMB 1.19 from RMB 1.05 in the prior year period.

As of March 31, 2019, the company had cash and cash equivalents and restricted cash of CNY 6.3 billion and short-term investments of CNY 40 million. For the first quarter of 2019, net cash from operating activities was CNY 692 million.

Looking at our business outlook. For the second quarter of 2019, we expect our total net revenue to be between RMB 20.7 billion and RMB 21.7 billion, representing a year-over-year growth rate of approximately 0% to 5%. These forecasts reflect our current and preliminary view on the market and operational conditions, which is subject to change.

With that, I would now like to open the call to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from the line of Joyce Ju of Bank of America.

Joyce Ju - BofA Merrill Lynch, Research Division - VP in Equity Research & Research Analyst

Management, congrats on the solid set of results. I have a question regarding the latest apparels related initiatives. We have seen the company stated have seen initial success in terms of focusing of the apparel categories. May we get more colors like what exactly we have done to help us



to encourage the purchases in this category? And going forward, are we going to have some other strategies to further increase our exposure in the apparel? And how we are going to differentiate from other e-commerce platform in these categories over the long term?

And my second question is related to the competitive landscape because the June promotion season is coming and we'd like to know what we have seen the latest competitive landscape and any big promotion plans from our company?

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] So starting from the third quarter of last year, we started to focus or refocus on to the discount segment, which is what we're beginning our business with. And within that segment, our focus is on the apparel category, which has traditionally been our strongest category and the core reason of why customers come to us. The most important thing is we're beginning to be more selective in terms of the product assortment on our platform and really focusing on good merchandising, high-quality merchandising at low and affordable prices, better brands and better assortment of products. As a result, we did discover that all metrics are starting to improve comparatively and customers like us more.

So going forward, we will continue to invest into the apparel category, and we've already incrementally increased our apparel category investments starting from the third quarter. And in the fourth quarter, we also mentioned on last quarter's earnings call that we shifted a lot of the loss-making or noncore standardized SKUs on 1P to 3P to reduce drag. So going forward, the focus will continue to be on the apparel category, which drives our growth and profitability in the long run.

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] So we are actively planning for our June promotional event, which is a big industry-wide promotional period. Our focus will be on how to best position ourselves in our core businesses, apparel-related categories, to our customer. And we're beginning our promotional event on June 15. So we'll also be doing some standardized categories, but not as much given that the second quarter is also a complement quarter for standardized categories. In the June promotional events, usually the customers are looking to buy those categories as well. In terms of competition, we are seeing intensified competition in the June commercial event as the industry is already in (inaudible).

Operator

Our next question comes from the line of Alicia Yap of Citigroup.



Alicia Yap - Citigroup Inc, Research Division - MD and Head of Pan-Asia Internet Research

My question is related to the retention rate for the new user profile that you acquire through the Tencent channel. So for example, we have seen now probably almost a year now with Tencent channel partnership and JD partnership. So specifically for those that coming from Tencent platform, what is your retention rate and the purchasing behavior? What type of categories that they usually buy and basket size? So for now over the past few quarters, any improvement or change of new user coming from the Tencent platform?

Jessie Fan - Vipshop Holdings Limited - Head Of IR

(foreign language)

Ya Shen - Vipshop Holdings Limited - Co-Founder, Chairman & CEO

(foreign language)

Jessie Fan - Vipshop Holdings Limited - Head Of IR

[Interpreted] So Alicia, there are many program we kicked off in collaboration in March 2018 with Tencent, and in the beginning, conversion rate was quite low. But over the past year, through our collaboration with Tencent, we have more than doubled the conversion rate in the WeChat mini-program. In terms of retention, it's also very similar to the retention we're seeing on our organic platform. Ticket size seems to be slightly smaller on the first quarter but from the second and third quarter on the conversions with this kind of ticket size we see on the organic as well. So overall, we're quite pleased with the customer quality in the WeChat mini-program.

Operator

(Operator Instructions) Your next question comes from the line of Wendy Huang of Macquarie.

Wendy Huang - Macquarie Research - Head of Asian Internet and Media

I have 2 questions. First, can you update us on your thinking behind the logistics strategy? And so what's the mandate to optimize the fulfillment costs in the long run? And secondly, also we think about the GMV contribution from the 3P platform in the long term.

Jessie Fan - Vipshop Holdings Limited - Head Of IR

(foreign language)

Ya Shen - Vipshop Holdings Limited - Co-Founder, Chairman & CEO

(foreign language)

Jessie Fan - Vipshop Holdings Limited - Head Of IR

[Interpreted] So on the logistics side, we begin to try a new method -- a new model called 3-axis in the second quarter of this year. That means we're starting to shift a percentage of single item order from our 1P logistics unit into the third-party partner to fulfill. We are balancing our customer experience as well as the cost. So we pay very close attention to things like delivery time and the overall experience the consumers are giving us



feedback on. And we will continue to look at those metrics very closely in the third and the fourth quarter of this year to see how we can best position the logistics units in terms of the best value between customer experience and cost.

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] On the marketing side, we take a similar position in terms of balancing the customer experience and the cost. So our third-party business contributed to around 2% to 3% of our total GMV before. But in 1Q '19, the contribution was around 6%. So it did increase similar to the 4Q '18 trends. And going forward, we do think it will likely increase likely in terms of contribution, maybe to something like 8%, but it will not be 20%, 30%. So we'll continue to balance the customer experience and the kind of product assortment that we think the customers will buy on our platform.

Operator

Next question is from Hans Chung of KeyBanc Capital Markets.

Mon Han Chung - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

So first question, just can you elaborate more the off-line business? I mean, what's the plan this year for in terms of the store expansion and then what's our differentiated advantage against, like, traditional off-line store? And then what kind of economy so far -- we have some -- we have been running some store, right? And then what kind of economy so far we have seen? And then same question, just follow-up on the logistics. So it seems like the costs are being good and then user experience very good. So why we don't just outsource the bigger portion of the logistics to third-party? And then what's holding us to do more expansion?

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] So Hans, regarding the off-line stores, we have actually 2 types of different store positioning. One is called waiting place and the other is called waiting times. In terms of positioning, waiting time is lower -- slightly lower this year than waiting place. We have some initial data, but we think it's too early to share the specific metrics because we're still in the early trial stage. And because we have stores across different tiers of city in China, we are seeing quite different results. So we are still trying to implement and learn from the off-line business model.

(foreign language)



Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] Regarding the logistics, we have a few million square feet of warehouses, which we use to do quality checks and combine orders from different suppliers currently. So as I mentioned during the previous question, currently, the type of orders that we are attempting to outsource is single item orders. And for multiple item orders, we still need to evaluate the different efficiencies in 1P versus 3P. So if the results are good and we're not seeing customer experience being affected, we may move a little faster, but we will really have to see the results.

Operator

(Operator Instructions) Your next question comes from the line of Jamie Shen of Bank of China International.

Chen Shen - *BOCI Research Limited - Research Analyst*

I have 2 questions. My first one is on the supplier network. I think from an industry perspective, we notice almost all the e-commerce players have started to approach high-quality merchants to offer low-price products that are particularly attractive to customers in low-tier cities. I think management also talk about how to fine-tune the merchandising strategy for the new customers from low-tier cities in WeChat channel. I wonder if you could share with us some updates on that front, in particular for apparel merchants. And I have another very quick question on the technology expenses. If my calculation is right, I think that technology expenses on non-GAAP basis dropped 16% year-on-year. I just wonder if this is a comparable run rate we should be modeling for the rest of 2019?

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] So Jamie, regarding your first question, we did notice that a lot of other e-commerce companies, big and small, are entering the discount retail segment, which we've done for the past decade and we have a lot of expertise in this field. Unlike the other competitors, we are actually very much focused on our merchandising strategy. So our apparel-related categories are also done the first-party model, which is inherently different from a lot of the marketplace models out there. And our merchandisers carefully procure products offered on our platforms giving our customers differentiated high-quality assortment -- affordable assortments.

So in a nutshell, we are trying to be very selective in terms of the products that we display and sell to our customers. And we do have a very close relationship with a lot of our brand partners, and that relationship will be coming closer. So we are really much keenly focused on serving our entire customers and really doing our own business to the best of our ability.



Donghao Yang - *Vipshop Holdings Limited - CFO*

Okay. All right. Let me take your second question about technology and content expenses. You're right that our technology and content expenses have come down quite a bit compared to a year ago as a percent of revenue. We achieved the kind of cost savings by cutting back on our personnel and other investments in the technology and content departments. And I think you would be safe to use this new -- these new numbers in your model just for now. And as we said earlier, we will continue to make efforts to cut more costs. And as we do that, we will keep you guys updated on our progress. And you can use maybe new numbers in your model next time.

Operator

Our next question is from Andre Chang of JPMorgan.

Andre Chang - *JP Morgan Chase & Co, Research Division - Analyst*

(foreign language) Just one quick question from me on the gross margin side. So we notice that after you guys cut the loss-making items shifting to the third-party marketplace, the gross margin indeed rebounded but still at rather low level versus the historical range. So my question is after cutting those loss-making items, the margin is still low. So what can take the gross margin back to the level we saw back in, say, before 2017 or 2016? Does the drag come from the still low utilization of the warehouse or just take and by moving those into the third-party then the situation will improve? Or are there other things we need to consider into this equation?

Donghao Yang - *Vipshop Holdings Limited - CFO*

Thanks for your question. Let me try to answer that. Well, our financial statement, you can see, this Q1 '19, our gross margin was about 0.2 percentage points higher than a year ago. But actually, if you compare apple-to-apple, like-for-like, our Q1 '19 gross margin was about 1 percentage point higher than a year ago. And that was because we reclassified one line item in our fulfillment costs for this delivery services that we performed to client outside of the Vipshop. So last year, Q1 '18 was the first quarter that we reclassified that item, and the net impact on our gross margin was about 1.9%. And this Q1 '19, that reclassification had an impact on our gross margin for about 1.5%. So that was about 1.6 percentage point higher there.

And also we had a new business called OTD. We helped our suppliers, our business partners to buy marketing services from other platforms. And that impact on our gross margin was about 1.2 percentage point. So in total, if you do an apple-to-apple comparison, our year-over-year gross margin improvement was about 1 percentage point. So that said, we will continue to make more efforts to improve on our gross margin and mostly to refocus on our strategy on apparel and discount retail. And we believe that to refocus on apparel and discount retail by sourcing more branded products at lower cost, we will be able to further improve on our gross margin down the road.

Operator

The next question is from Monica Chen of Cr dit Suisse.

Monica Chen - *Cr dit Suisse AG, Research Division - Research Analyst*

I have 2 here. So last quarter, we launched several new flash sale formats like (foreign language), and those results were very encouraging. So just wonder, do we still have any plan to roll out more similar initiatives and to focus on deep discounts for this year? And the second question is how should we think about our marketing spending plan for this year, particularly on branding, user acquisition and promotion?



Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] So Monica, to answer your first question regarding (foreign language), we launched those platforms, which are focused on more deeper discount items than the average level of discount on our platform, and we are seeing them growing quite fast. The GMV contribution in 1Q combined was already higher than 20%, and customer acquisition is quite robust as well. In addition to (foreign language), we also just launched a tab called (foreign language), which is focused on even deeper level of discount. And in the future, our goal is to become a full-cycle inventory management solution provider for our suppliers and really partnering with them to create broader and deeper levels of discount products.

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] In terms of marketing expenses, at this moment, we anticipate the level of marketing expenses this year to be similar to last year. In terms of customer acquisition costs, we're also seeing that comparing to 2018, it remained relatively flat. Therefore, we will continue to plan for this type of expenses for this year.

Operator

Our next question is from Tian Hou of T.H. Capital.

Tianxiao Hou - *T.H. Capital, LLC - Founder, CEO & Senior Analyst*

Yes. Management, congratulations for good results. So I have a question on 2 things. One is regarding the top line guidance. So Q1, you guided 0% to 5% top line growth. And at the end, the growth was actually a lot faster than you thought. So I wonder 2Q guidance, you maintained the same growth outlook with Q1. And what's the prudence behind the guidance? So that's number one. Let me just continue. So Jessie, sure make a note here to translate to Shen-zong.

So the second one will be, we're seeing a lot of individual or smaller, newer merchants emerging. And those merchants most of them are in apparels, cosmetics and some small electronics. And so I wonder if those guys are actually cutting through your territory. If yes, how you fence them off? If no, why it's not? That's the 2 questions.

Donghao Yang - *Vipshop Holdings Limited - CFO*

Well, thank you for your questions. Let me take your first question on our top line guidance. Yes, you're right. For Q1 top line growth, we guided 0% to 5% year-over-year growth and it turned out to be 7.3%. But in our mind, 7.3% is really not a super beat of our guidance. And in Q2, we guided

top line growth between 0% and 5% year-over-year again for a couple of reasons. One, our big promotional campaign, June 16 is yet to come. So we're not very sure about the results that will come out of that promotional campaign. And secondly, in our mind, couple of percentage point difference or beat, it just doesn't really make a big difference in our business. And for now and maybe for the future, we do hope that our investors would focus more on our profitability and healthy top line growth rather than focus too much on top line growth.

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

(foreign language)

Ya Shen - *Vipshop Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Jessie Fan - *Vipshop Holdings Limited - Head Of IR*

[Interpreted] So regarding the question on small competitors and start-ups, we did notice that there are lot more start-ups out there and they are all doing business in different formats. To target 2P, we also have a waiting time for 3PP, which is focused on the 2P business that the majority our biggest focus is on the 2P business. But overall, we think it's important to focus on our own business and our own strategy. So we will continue to do that going forward.

Operator

(Operator Instructions) Ladies and gentlemen, this is the end of our question-and-answer session. Thank you for participating. You now all disconnect.

[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]

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