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Shawn Severson

PRESENTATION

Operator

Good day, and welcome to the Polar Power Second Quarter 2019 Financial Results Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Shawn Severson. Please go ahead.

Shawn Severson

Thank you, and good morning, everyone. I'd like to thank you for taking the time to join us today for Polar Power's second quarter 2019 conference call. Your hosts today are Arthur Sams, Polar Power's Chief Executive Officer; Raj Masina, Chief Operations Officer; and Luis Zavala, Chief Financial Officer. Arthur will begin by providing an overview of the key events in the quarter, this will then be followed by Raj, who will provide an operation update as well as updates on key strategic objectives. Afterwards, Luis will discuss the financial results.

A press release detailing this quarter's results has crossed the wire today at 4:05 Eastern time and is available on the company's website at www.polarpower.com. Following management's prepared comments, we will open the call up for questions.

Before I begin, I'd like to remind everyone that statements made today on the call and webcast, including those regarding future financial results and industry projections are forward-looking and may be subject to a number of risks and uncertainties that could cause actual results to differ materially from those described in the call.

Please refer to the company's SEC filings for a list of associated risks, and we will refer you to the company's website for more supporting industry information.

At this time, I'd like to turn the call over to Arthur Sams, Polar Power CEO.

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

Thank you, Shawn, and welcome, everyone, to Polar Power's Second Quarter 2019 Earnings Conference Call. During today's call, I would briefly discuss our key highlights for the quarter before I'll provide you with an update for each of our core markets. However, before we get started, I would like to discuss the financial highlights for this quarter. Luis will provide greater financial details later during this call.

Financial highlights for the second quarter. Revenues for the second quarter 2019 were \$9.24 million, which is a 59% increase compared to \$5.82 million last year with the majority of the growth driven by sales of our DC power systems to the Tier

(technical difficulty)



Our sales backlog at the end of the second quarter stood at \$7.62 million compared to \$5.83 million last year. The increase over last year was driven primarily by a higher level of sales to our Tier 1 telecommunications customers. I'd also like to note that transition of U.S. telcom markets to 5G and the need to add backup power for improved reliability is shifting infrastructure budgets at Tier 1 telecom companies, and will create some short-term volatility as they prioritize their spending during the second half of this year. This, along with the short lead times, are impacting short-term visibility, but should have no impact on the strong longer-term fundamentals.

Our sales backlog at the end of the second quarter stood at \$7.62 million compared to \$5.3 million last year and \$14.16 million backlog at the end of the first quarter 2019. The increases over last year was primarily driven by higher levels of our sales to Tier 1 telecommunications customers.

Gross profit for the quarter stood at \$2.96 million compared to \$2.06 million last year. Gross margins for the quarter was 32%, a decrease of 3% over last year's 35%. The decrease was due to a mix shift towards more higher volume telecom customers and investments that we made in the business, primarily in production equipment and overseas marketing. During the second quarter, we saw profit of \$0.59 compared to -- excuse me, \$0.59 million compared to \$0.22 million, not cents, but million, for the same quarter last year and \$2.39 million in the first quarter of 2019. On a per share basis, we earned \$0.06 per basic and diluted share as compared to \$0.02 basic and diluted share in the same quarter of last year and \$0.01 in the first quarter. Now I'd like to provide a business update and review.

We're pleased to wrap up another positive quarter with the growing revenue, primarily due to an increase in power system sales to Tier 1 telecommunications customers in the U.S. And now, we have the flexibility to expand further and diversify into new growth areas. I'd like to spend a moment to discuss our backlog and the key dynamics.

As I mentioned previously, we need to bring our backlog into a more manageable range, which I believe is around \$7 million to \$8 million for the telecommunications marketplace. Given our current manufacturing infrastructure having achieved our target backlog, we can now be more responsible to our customers' needs as well as pursue new business that we have in front of us. We're able to accomplish our target backlog by investing in our people and operations over the past year, something we discussed in detail during our last call.

We're excited to be able to facilitate new customers and demand in both our telecommunications and emerging growth segments. During the quarter, we continued to invest in property and equipment in order to continue to expand and meet the increased demand for our DC power systems. Raj will provide in greater detail in his segment on how we are leveraging the investments that we have made, but I'm pleased to say that we are executing successfully on our plan, as can be seen in our margins and profitability this quarter. I would like to address some of the factors impacting the business today.

One is that we've had delays in rollouts of our new products. We're approximately 3 months behind our scheduled releases. Delays are results of engineering resource conflict between new product development, production tooling and the application sales support. We will start interviewing again for electronic programming, application and mechanical engineers coming up very soon. We had prioritized HR and hiring production management and mechanical CAD drafting personnel.

New product delays has affected our overseas efforts. For the most part, overseas clients are waiting for our new embedded webpage software and hardware. We're doing a launch with our new webpage software and controls early this September with the U.S. military in a hybrid power application. Polar has -- from my travels around the world, I can clearly see that Polar has to increase the application support for our overseas and domestic sales staff.

With the launch of our new products and product upgrades, Polar has to build up its PR, its public relations and also, our webpage and information packages to our customers. I would like to remind everyone that we view our business in 2 general silos, one is telecom and two is emerging growth. I believe that we have a better solution with our core DC power systems over incumbent technologies, which is giving us a broad base of new business and growth opportunities. However, I want to spend a few minutes giving you an update on key segments.

Beginning with telecom. We view this segment as having 3 major categories: domestic Tier 1; and domestic last mile; and three, international. Regarding domestic Tier 1, we saw an increase in DC power systems reflected in our backlog and revenue. The demand for our DC generator systems from domestic Tier 1 markets are still driven by key factors, including improving reliability in 5G network.



Also, we see something else coming new on the horizon, and that's edge computing. And the idea is to catch the data at the local cell site so it doesn't have to travel across the country to reach its targeted audience. This saves a lot of traffic and speeds the response time for information. Edge computing, like 5G, requires the site's upgrade in their power requirements.

Moving on to the last mile segment. The Tier 1 customers, at least the domestic Tier 1 customers, have occupied all of our domestic sales resource. But as we're moving forward, we're increasing our resource to be able to handle these last mile carriers. They're the typical ones servicing the small communities, communities generally too small to catch the attention of the major Tier 1s.

The need for power systems in the more rural areas is even greater than the urban areas, so we see significant growth pursuing that market segment. We do have some history with that market segment because they were essentially buying our generators before the Tier 1 suppliers were buying from us in quantity.

In regards to international telecom, I've personally been spending a significant amount of time on the road meeting with potential customers. And as time -- as we spend more time with our overseas customers, we're gaining their confidence to move forward with our products and services. We're very close to closing a number of accounts overseas. So as time goes on, we're clearing those little obstacles out of the way.

Moving on to our emerging growth segment. We have 4 key areas of our focus in emerging growth technology. One is specialty hybrid electric vehicles; two is natural gas and propane-fueled DC generators in a hybrid situation or as a prime power. This is a program that we've been working on for well over a year with Toyota and Bosch on, whereas we'll be introducing these engines overseas within the next month or 2 and possibly 3 or 4 months from now to the U.S. market.

The headwind in the U.S. market, the introduction is the EPA approval, which we see no difficulty in receiving as our current testing shows very low levels of emissions or pollutants.

DC generators for solar and hybrid and renewable energy applications. This will go hand in hand with our gas units, our diesel units, our new lithium ion battery packs and our new support for marketing and selling of solar hybrid systems.

Lastly, I would like to remind everyone that our key strategic objectives are: to increase our market share with top-tier telecom providers; target the last mile carriers and expand our presence in international markets; to diversify our customer and product base by providing more comprehensive services to our telecom customers; and increasing our exposure to other markets, including military, commercial, residential

(technical difficulty)

capacity and efficiency by opening up our second production plant and to facilitate revenue growth; to provide industry-leading technology and power solutions through our R&D and technology road map.

Now I'd like to hand over the call to Raj. He will provide you with an operational update on our 4 strategic objectives.

Rajesh Masina - Polar Power, Inc. - COO

Thank you, Arthur. Let me expand on those 4 key strategic objectives that Arthur just mentioned. The first one is to increase our market share with the Tier 1 U.S. telecom providers. So then, we continue to build on the positive momentum from last quarter. And as what's mentioned earlier, we saw an increase in sales, which is primarily the result of growing demand and sales to the U.S. Tier 1 customers. I want to expand on some of the dynamics happening in the telecom industry.

Our goal continues to reduce lead time for our products to 4 weeks or less, as this is a key competitive driver to get more business and to get approved and qualified with and participate in more and more programs within these Tier 1 telecoms. We're working towards this goal of reducing our lead times, which we believe will give us leverage to increase more market share within these companies. As a reminder, the third quarter of

the calendar year is when the Tier 1 telecoms plan their site buildouts for the following year, so it is critical to our customers we're able to demonstrate our progress in reducing the lead times. This will also enable us to participate in multiple programs across.

The second objective is diversifying our customer and product base by providing more comprehensive services to our telecom customers and increasing our exposure to other markets and applications globally.

International telecom opportunities continues to grow during the first half of 2019. Our recent investments in plant automation and improved supply chain improves our price competitiveness in international markets. We're conducting new business development programs in more than 20 countries, where we believe we have a competitive solution for customers' applications. We are in various stages of the sales cycle. Sometimes these sales cycles can be long, but there are different stages for these opportunities.

As Arthur covered earlier, the opportunities across our emerging growth category continues to expand as we are now building the capacity to cater to more applications. We believe our products and technologies have significant opportunities in the military, Marine, EV charging and renewable energy markets, and we are just at the beginning of becoming a diversified global company. Increased production capacity, along with the strongest sales force globally also allows us to pursue diversified market segments.

Now I'll go to the third strategic objective, expanding capacity. We have made significant investments in the business during the past 3 quarters, which has created a modest tailwind on the contribution margins in the short term.

(technical difficulty)

new markets. We're certainly not done investing in the business and the people, but we believe we reached an inflection point to capitalize on the efficiencies we are currently achieving due to our investments.

The last objective is to provide industry-leading technology and power solutions through our R&D and technology road map. Arthur detailed the technology developments earlier and I'll touch on some of them here.

First one is our new and improved battery storage solutions. In the telecom industry along with the need for increased power and reliability, more compact and lower maintenance types of storage solutions are required. We are developing significant upgrades to our lithium ion storage systems and will be introducing them to the market soon. We have upgraded our battery management electronics and software, along with adding environmental controls for cell temperatures and the ability to manage multiple battery modules in parallel configurations along with improved cell production from overcharge and discharge. Lithium ion batteries that have approximately 1/4 the space and grade of lead acid -- standard lead acid chemistries.

Also in 2012, we've introduced DC power backup systems that integrated our DC generators with super capacitors to eliminate the need for a backup battery in a cell site. The energy that's stored in these super capacitors supplies power for the short-term grid disruptions and the energy supplied in the fuel of the DC generator provides the power needed for the extended power outages. The super capacitors also provided uninterpreted power to the load while the DC generator starts up and takes over the electrical load. This solution is very compact, reliable and has low maintenance.

During the last 3 years, due to the higher usage of super capacitors in EVs and energy storage applications, there has been a significant reduction in the cost of super capacitors. This cost reduction, together with market acceptance of super capacitors as reliable energy storage devices has reintegrated the interest from telecom companies for our compact DC power backup solutions that we've introduced 7 years ago.

In summary, we're starting to see the results of our efforts and investments during the second quarter and as we move into the second half of fiscal 2019. We're ticking all the boxes with regards to production capacity, shortening the lead times, solving our supply chain issues, reducing our product prices, and developing a new configuration of our products, thus increasing the overall value of the company.

I'll now turn the call over to Luis, our CFO, for his financial summary. Luis?



Luis Zavala - Polar Power, Inc. - CFO

Thank you, Raj. Now I'll review the financial performance for the quarter and the 6 months. Net sales for 3 months ended June 30, 2019 totaled \$9.2 million, which is an increase of 59% as compared to \$5.8 million for the 3 months ended June 30, 2018. The increase is primarily a result of more sales to Tier 1 telecom customers. Net sales for the 6 months ended June 30, 2019 were \$17 million, a 59% increase as compared to \$10.7 million in the same period last year.

Our sales backlog totaled \$7.6 million at June 30, 2019 as compared to \$5.8 million at June 30, 2018 and \$14.1 million at March 31, 2019. As Arthur mentioned earlier, we have been able to get our backlog down to a more manageable level of giving better flexibility.

Gross profit during the 3 months ended June 30, 2019 increased 44% to \$3.0 million as compared to \$2.1 million during the same period in 2018. Gross profit as a percentage of net sales was 32% for the quarter ended June 30, 2019 as compared to 35.5% in the same period in 2018. The increase in gross profit margin was attributable to higher sales and throughput and leveraging the investments we made in the business.

Gross profit during the 6 months ended June 30, 2019 increased \$1.8 million to \$5.3 million as compared to \$3.5 million for the same period in 2018. The gross margin during the 6 months ended June 30, 2019 was 31.5% as compared to 33% for the same period in 2018.

Operating expenses were \$2.4 million during Q2 2019 as compared to \$1.8 million for Q2 2018. Operating expenses for the 6 months ended June 30, 2019 were \$4.7 million as compared to \$3.5 million for the same period in 2018. The year-over-year increase in operating expenses is attributable to an increase in sales support activities, added management to support our production ramp-up and the addition of office rent related to our new facility. These initiatives are in part of our ongoing strategy to increase our production capacity and diversify our customer base.

Net income for Q2 2019 totaled \$0.6 million or \$0.06 per basic and diluted share compared to net income of \$0.2 million or \$0.02 per basic and diluted share in Q2 2018. Net income for the 6 months ended June 30, 2019 totaled \$0.6 million or \$0.06 per basic and diluted share compared to a net loss of \$0.1 million or negative \$0.01 per basic and diluted share during the same period in 2018.

The increase in net income is attributable to higher shipments and improved production efficiencies during the second quarter when compared to the same period a year ago. Cash at June 30, 2019 totaled \$5.4 million as compared to \$5.6 million at December 31, 2018. During the 6 months ended June 30, we funded our operations primarily from cash on hand and borrowings under our supplier agreement with Citibank. These funds were also used to make capital expenditure and increase inventory to support a higher level of production. As of June 30, 2019, we had working capital of \$21 million, which had a slight increase of \$217,000 from our total working capital at December 31, 2018.

During Q2 2019, we executed a supplier agreement with the Citibank. Under the terms of the supplier agreement, the company may, from time-to-time, offer to sell Citibank certain of the company's accounts receivables related to invoices, invoice sales made to AT&T and its affiliates. As of June 30, 2019, a total of \$5.2 million of accounts receivable was sold to Citibank by the company. Total discount fees for that transaction were approximately \$23,000.

Now I would like to turn the call back to Arthur. Arthur?

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

Yes. Thank you, Luis, and thank you, Raj. We've been patiently investing in and preparing our business for what we view as a multiyear growth cycle in telecom, and we now have added the additional dimension of emerging growth opportunities. We've been able to accomplish this while keeping tight controls on our cash burn and building a business based on superior product and fundamentals.

I'd like to thank our shareholders for sharing our vision in building a profitable growth company, and I'm looking forward to speaking with you all again next quarter. Now, I'd like to open up this call to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question today from Craig Irwin with Roth Capital Partners.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

So I wanted to ask about the total backlog. Do you have a number that you can share for total backlog today?

Luis Zavala - *Polar Power, Inc. - CFO*

No, we do not.

Rajesh Masina - *Polar Power, Inc. - COO*

Our counsel has advised us not to share the backlog since it is an unaudited number. So at this point of time, Craig, we feel comfortable only releasing backlog as of June 30th.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

There's no such thing as an audited backlog number because there's no gap around backlog. You may want to review that with your counsel. When I'm looking at your bookings in the quarter, I see a grand total of \$2.7 million. This is the lowest number, even below your 3Q '17 number that I have the 3 years of orders that you have. Can you maybe give us some confidence or some flavor about near-term orders that you expect to book? I know you had a healthy revenue quarter but we've got to see both revenue and bookings to see the revenue momentum continue. What can you share with us there?

Rajesh Masina - *Polar Power, Inc. - COO*

Sure. Thanks for the question. So as one of us, I think, Arthur and I mentioned in the script that typically, Q3 is the quarter where the Tier 1 telecoms start planning their rollouts and their construction builds for the next 3 to 4 quarters. And they start building their sites from Q4 or they start their orders typically mid to late Q3 and then it goes into Q4, in Q1 and Q2. So Q2 and Q3, we typically don't see a lot of orders or until mid Q3, we don't see a lot of orders so, which is basically consistent with what has happened for the past 2 years as well.

Now it has not surfaced as such because the backlog, remember, was so high last year, so we had a big problem to deal with. But now that we're fulfilling from their backlog, the numbers are visible -- the lower backlog numbers are being seen right now. So we still have the forecast that these telecom companies share with us, which remains very bullish, very strong for the next 1 year, 2 years. And we will come to a point where we'll be building to the forecast.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Okay. So do you expect any contribution from fast turns business in your September quarter?

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

I didn't get that. That was bleeped.

Craig Edward Irwin - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Do you expect any contribution from book and ship, fast book and ship business, in your September quarter?

Rajesh Masina - Polar Power, Inc. - COO

Yes. Yes, we do.

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

But there's also one other thing I wanted to add to Raj's response to your question, Craig, is that with the 5G rollout, as I mentioned before in my quickly read speech is that there is some competition in budgeting between the power systems, the batteries, the generators versus the radio and the fiber requirements of the 5G rollout. So there's also a little confusion on our parts of our customers as to how much they should be upgrading the size of the generator set. So we do see some delays in orders coming in because of those 2 factors.

One, they're not sure how large of a DC generator set that they will need for their 5G rollout; and two, that we are competing with their other budgets at the moment. But the overall market or need for the generator hasn't gone away, nor the anticipated quantities. Did I answer a little bit better?

Craig Edward Irwin - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Yes. No, that's definitely helpful. So then the total backlog number of \$7.6 million that you disclosed in your press release, how much of that is shippable in the third quarter? And is there a component that maybe lands in the fourth quarter or in your fiscal '20?

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

95%.

Rajesh Masina - Polar Power, Inc. - COO

A majority of that, Craig, will be shipped in this quarter. If I were to throw a number, it would be more than 90%.

Operator

We'll now hear from Robert Marcin with Penn Capital.

Robert Marcin

It looks like you're starting to show some productivity enhancements that the shareholders needed to see and profitability ratios. International business. Over 2 years ago, you had a greater than a \$100 million sales funnel. I still haven't seen the real order yet. So do we need to pay, Arthur, to go sell year-round overseas to get an order? Or do we need to change the salespeople out that we brought on with such fanfare 2.5 years ago?

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

Okay. I'll respond to that since I'm the one that's traveling overseas and meeting these people and customers. I don't know if you real -- I don't know if it's public information but all last week, I was in Sydney and Melbourne, Australia, and I just got back into town Saturday morning. I would say that what we have to do is restructure our support. We've got a great sales crew overseas, but they need more guidance from HQ. And we need to do a little bit more push, reaching out directly to the customers with our engineers so that we can make the overseas customers feel more comfortable about changing their legacy technologies. So I would put the blame more on HQ than our sales directors overseas, okay? And we really need to launch our new products. Some of these features in the new products is where overseas customers are counting on such our embedded webpage.

Rajesh Masina - Polar Power, Inc. - COO

One more thing to add there, Robert. One more thing there to add is also the capacity or the lack of capacity so far, which would not give a lot of confidence to our overseas sales guys to pursue large opportunities. So we're solving that problem, too. We have reached that inflection point, as I said, where we're more comfortable addressing those needs.

Robert Marcin

Okay. So the lack of a significant order is not due to pricing or competitive dynamics and the nature of the industries on a broad basis, it's rather you're making progress but it's slower-than-expected and you need really, support.

A couple of years ago, you guys mentioned that the opportunity was far greater abroad than in the U.S and said within a 2- to 3-year period, you expected a crossover in revenues from abroad. So it is very disquieting to see still no significant revenue from the international markets.

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

I agree with you on that. And I would say that in order to close these sales, we have to do a little bit more at HQ to bring them into fruition. We depended too much on our overseas groups, pioneering the markets with limited support from HQ.

Robert Marcin

Okay, all right, great. You have a lot of new products and then markets you're going after. Is there any chance you're going to try to do so much at the same time with what you have? And that sort of brings me back to the data center business, which seems just have gotten lost in the shuffle with you guys introducing so much new technology into so many new markets. I know it's good for the long term of the business, but we don't -- we're not GE there, not that that's a good thing. But as you've mentioned, you need all kinds of specific skill sets to address these new markets, but you guys aren't worried about being stretched too thin as you continue to grow?

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

Let me answer that question right now, is that in certain areas of our infrastructure, we are currently too thin, and we need to bring on additional staff and management in order to fill in the gaps that we currently have. One of those gaps is in marketing and public relations to help introduce our new products. Public relations is also great for attracting additional engineering resource or talents. And some of the other areas is in training, training our sales groups, training our customers' engineers, documentation. So we still have a little bit of ways to go on that.

But on the bright side, I'm talking to customers and markets, and I'm talking to customers in countries that I think few people have even heard of.



Robert Marcin

All right that's good news. The defense business seems to be a particularly attractive business as far as profitability and they will pay for the feature set that you guys offer with reliability and smaller size. And it just seems perfectly set in the defense electronic area to use the DC power products in the field with all the features that you have. Is there any reason that, that business doesn't become a multiple \$10 million business in the next 2 or 3 years? And do you have anybody pursuing that business from the company for you?

Arthur D. Sams - Polar Power, Inc. - Chairman of the Board, President, CEO & Secretary

Okay. That was on our list for hires on application engineers to be able to handle the current responses for product information we're currently receiving from the various militaries all over the world. In about 4 weeks, September, we're doing the DESI show, which is one of the largest military shows in the world, in London, and we'll be hooking up with some of our guests.

But one of the things about the military is that we have a number of programs going on now. Military programs are hard to discuss because of NDAs in place. Military programs take a long time to reach fruition. And since militaries are also tied to politics, you never know exactly when they're going to happen, when they exactly are going to get funded and stuff like that. But we do see a huge market in the military, and we see progress with our new lithium ion battery set. as I mentioned in our release. We're -- our first customer for a new embedded webpage is not going overseas to our foreign clients, but going domestically to a military contract for a hybrid power system we have -- we currently have.

Operator

(Operator Instructions) And that will conclude today's question-and-answer session. I will now turn the conference over to Mr. Severson for any additional or closing remarks.

Shawn Severson

Great. Thank you, everyone, for joining us today and we'll be looking forward to speaking with you again on the third quarter conference call.

Operator

Thank you. That does conclude today's conference call. Thank you for your participation. You may now disconnect.

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