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BDT.TO - Q3 2019 Bird Construction Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 06, 2019 / 3:00PM GMT

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PRESENTATION

Operator

Welcome, ladies and gentlemen, to the Bird Construction Third Quarter 2019 Financial Results Conference Call. We will begin with Mr. Teri McKibbon's presentation, which will be followed by a question-and-answer session. (Operator Instructions) And the conference is being recorded. (Operator Instructions)

Before commencing the conference call, the company reminds those present that certain statements which are made express management's expectations or estimates of future performance, and thereby constitute forward-looking information. Forward-looking information is necessarily based on a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to significant business, economic and competitive uncertainties and contingencies. Management's formal comments and responses to any questions may -- you might ask may include forward-looking information. Therefore, the company cautions today's participants that such forward-looking information involve known and unknown risks, uncertainties and other factors that may cause the actual financial results, performance or achievements of the company to be materially different from the company's estimated future results, performance or achievements expressed or implied by the forward-looking information. Forward-looking information does not guarantee future performance. The company expressly disclaims any intention or obligation to update or revise any forward-looking information, whether as a result of new information, events or otherwise.

At this time, I'd like to turn the conference over to Mr. Teri McKibbon, President and CEO of Bird Construction. Please go ahead, Mr. McKibbon.

Terrance Lloyd McKibbon *- Bird Construction Inc. - President, CEO & Director*

Thank you. Good morning, and thank you for participating in Bird Construction's Third Quarter 2019 Conference Call. Co-presenting with me today is Wayne Gingrich, our CFO.

In the third quarter of 2019, the company executed a more diverse work program and delivered improved net income, both quarter-over-quarter and year-over-year. To provide a quick update, the company, through its joint venture with ATCO Structures, continues to progress on site construction work for the LNG Canada Cedar Valley Lodge. Construction commenced in the first quarter of 2019 and it's planned to continue through the spring of 2021. Throughout the third quarter, modules were delivered and installed on site, and core buildings continue to be erected and enclosed. The facility is being built to house workers involved in the construction of LNG Canada's natural gas liquefaction and export facility. The project is one of the largest accommodation facilities ever built in Canada.

We are pleased with the continued progress, completing our challenging legacy projects and the impacts of our efforts to diversify our revenue stream across a portfolio of both geographic and balanced risk profiles. We continue to be encouraged by the growth and the amount of awarded but not yet contracted projects, many of which are in preconstruction and in a delivery model that supports a more traditional portfolio risk balance of Bird and our overall work program and our earnings basis begin to reflect this.

While Bird saw some headwinds in the first half of 2019, it has now reached a more steady state in operations for the back half of the year. And on behalf of the company, I want to thank and recognize all of the employees of Bird for their hard work and dedication.

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During the third quarter of 2019, the company announced that it has signed multiple contracts for services for an undisclosed amount at an LNG liquefaction export terminal facility in Northwestern British Columbia. The contracts include a site civil works program and the engineering, procurement and construction of 16 administration and service buildings. The EPC buildings program will consist of a combination of pre-engineered and modular buildings. The contracts will start immediately and commence -- continue into 2022.

Bird also announced that it signed a construction management contract with Westward Construction to build a mixed-use development north of Halifax. Construction over a 3-year period will include 2 high-rise towers and 2 levels of underground parking. The full project value is approximately $140 million, but due to the agency nature of the contract, only the construction management services portion has been added to backlog at September 30, 2019.

The previously discussed Confederation Line extension and the Advanced Nuclear Materials Research Center for Canadian Nuclear Laboratories work programs remain in the amount of awarded in which -- or in which the company was named the primary negotiation proponent that has yet to be contracted. It is over $600 million as of the end of September 30, 2019. At yesterday's Board of Directors Meeting, the Board declared monthly eligible dividends of $0.0325 per common share for November of 2019, December of 2019, January of 2020 and February of 2020.

Wayne will now take us through the financial performance for the quarter and year-to-date compared with prior year.

Wayne R. Gingrich - *Bird Construction Inc. - CFO & Assistant Secretary*

Thank you, Teri. During the third quarter of 2019, the company recorded net income of $6.8 million on construction revenue of $378.6 million compared with net income of $4.4 million on $381.4 million of construction revenue in 2018. Revenue growth has been slowed by a higher volume of pre-construction activity and construction management projects. The extended pre-construction phase, which is longer than originally anticipated on several pending construction management contracts, has served to amplify the impact on shorter-term results due to the allocation of key resources to projects that are not yet generating gross profits.

The company's third quarter gross profit of $23.8 million was $4.4 million or $22.7 million higher than the $19.4 million recorded in 2018. The increase in third quarter 2019 gross profit is primarily due to a higher-margin work program as the mix of revenue shifts from predominantly institutional and commercial projects to an increasing amount of industrial projects in 2019. The company's third quarter 2019 gross profit percentage of 6.3% was 1.2% higher than the gross profit percentage of 5.1% recorded a year ago. On a comparative basis, year-over-year third quarter gross profit and gross profit percentage in 2018 were negatively impacted by lower volumes recognized in the company's higher-margin industrial operations in Western Canada and mining operations in Eastern Canada, a result of project delays and a labor strike at one of the company's primary mining claims.

Income from equity-accounted investments in the third quarter of 2019 was $0.3 million, which is $0.6 million higher than the loss of $0.3 million in the same period of 2018. The income in the third quarter of 2019 was primarily driven by the earnings from non-PPP equity-accounted entities.

In the third quarter of 2019, general and administration expenses of $14.2 million or 3.8% of revenue were $1.5 million higher than the $12.7 million or 3.3% of revenue in the comparable period a year ago. Pursuit costs were $0.7 million compared to a minimal amount recorded in 2018. Also, compensation expense was higher by about $0.8 million year-over-year primarily due to the mark-to-market on the total return swap valuation and variable compensation.

Finance income of $0.7 million in the third quarter of 2019 was $0.4 million higher than the $0.3 million recorded in the same period of 2018 due to higher cash balances. Finance and other costs of $1.2 million was $0.5 million higher than the $0.7 million recorded in the third quarter of 2018. The increase is due to the higher interest costs associated with nonrecourse project financing and right-of-use liabilities.

In the third quarter of 2019, income tax expense was $2.5 million compared to $1.7 million recorded in the third quarter of 2018. 9 months ended September 30 compared with 9 months ended September 30, 2018. During the 9 months of 2019, the company recorded net income of $1.3 million on construction revenue of $955.8 million compared with a net loss of $7.4 million on $995.9 million of construction revenue in 2018. Although volume declined 4% year-over-year, the mix of revenue has changed as the company's higher-margin industrial work program has increased. The

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first 9 months of 2019 were impacted by a PPP project that incurred additional costs due to the -- due to design-related scope growth and acceleration expense to meet the scheduled substantial completion date.

There were substantial changes to the scope of the project requested by the clients that are currently under commercial negotiation. The reduction in revenue in the first 9 months of 2018 was primarily driven by lower volumes due to harsher-than-expected winter conditions experienced in Central Canada in the first quarter and a higher amount of preconstruction activities on construction management projects throughout the first 9 months of 2019. This extended pre-construction phase, which is longer than originally anticipated on several pending construction management contracts, has served to amplify the impact on shorter-term results due to the allocation of key resources to projects that are not yet generating gross profits. However, the company's industrial work programs have begun to increase year-over-year and the more diversified revenue mix helped improve profitability year-to-date.

The company's 2019 gross profit of $44.6 million was $9.7 million or 27.8% better than the $34.9 million recorded a year ago despite lower revenues. The increase in the amount of gross profit in the first 3 quarters of '19 was driven by higher-margin projects as the result of the shift in the mix of revenue from institutional and commercial projects to more industrial projects in 2019.

The company's gross profit percentage in 2019 at 4.7% was 1.2% higher than the gross profit percentage of 3.5% recorded a year ago. Impacting gross profit in the first 9 months of 2018 was the labor strike that has hit in the mining sector.

Income from equity-accounted investments in the 9 months of 2019 was $2 million compared to $0.4 million in the same period of 2018. The income in the 9 months of 2019 was primarily driven by the earnings from non-PPP equity-accounted entities.

In the 9 months of 2019, general and administrative expenses of $42.4 million or 4.4% of revenue were $1.4 million lower than the $43.8 million or 4.4% of revenue in the comparable period a year ago.

During the first 3 quarters of 2019, the company had lower third-party pursuit costs due to an honorarium recognized for a PPP pursuit, where the team has notified it was not the preferred proponent. As a result, pursuit costs were $1.6 million lower than the amount recorded in 2018. Gains on disposable of assets are $0.5 million higher than 2018. Offsetting some of the year-over-year reductions in general and administrative expenses was an increase in compensation expense of $0.6 million primarily due to the company incurring $1.9 million of severance costs.

Finance income of $1.8 million in the 9 months of 2019 was $0.9 million higher than the $0.9 million recorded in the same period of 2018 due to higher average cash balances year-over-year. Finance and other costs of $4 million were $1.4 million higher than the $2.6 million reported in the same period of 2018. The majority of the increase is due to $0.7 million of interest costs recognized upon adoption of IFRS 16 as well as $0.3 million of interest costs associated with nonrecourse project financing. There is also a year-over-year increase of approximately $0.2 million of bank charges and borrowing fees. In the 9 months of 2019, income tax expense was $0.6 million compared to a recovery of $2.9 million in the same period of 2018.

I will now turn the call back over to Teri to comment on the outlook for the company in fiscal 2019.

Terrance Lloyd McKibbon - *Bird Construction Inc. - President, CEO & Director*

Thank you, Wayne. At September 30, 2019, the company was carrying a backlog of $1.44 billion, which is 11.2% higher than that recorded at December 31, 2018. The embedded margin in the backlog continues to improve driven by the positive impact of new contract awards with higher going-in fees, combined with the diminishing influence of selective dilutive contracts that are nearing completion. The $1.1 billion of new contracts and change orders secured to the end of September are across a broad range of markets that will help the company achieve a more diversified work program with a more balanced risk profile.

In addition, the company has greater than $600 million in projects that have been awarded or in which the company was named the primary negotiation proponent that have yet to be contracted as of the end of the third quarter of 2019. Included in this figure are the Advanced Nuclear

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Materials Research Center of Canadian Nuclear Laboratories located in Chalk River, and the Confederation Line extension project in Ottawa, where the company will lead the construction of several light rail transit stations and a maintenance and storage facility.

The validation phase of the Canadian Nuclear Laboratories project is -- which is being delivered under an IPD delivery model, is now expected to extend through the first half of 2020 before converting into backlog; and the Confederation Line extension project is expected to be contracted in the fourth quarter of 2019. In addition, the company is in a preconstruction phase for over $200 million of institutional projects in British Columbia, although only a relatively small fraction of this amount will be included in backlog due to the agency nature of the construction management contract delivery model.

In general, the company has a higher-than-normal level of pre-construction activities for other ongoing but yet to complete into contracts. This extended pre-construction phase, which is longer than originally anticipated on several pending construction management contracts, has served to negatively impact shorter-term results due to the allocation of key resources to projects that are not yet generating gross profits. However, these projects are expected to contribute positively to future earnings of the company once contracted.

The longer-term pipeline remains healthy with respect to a broad range of project opportunities that fall within our risk tolerance expectations. The company will continue to be selective on prospective pursuits, ensuring we balance our available talent with the risk profile of the project and the overall work program. In the near term, opportunities will primarily consist of smaller environmental projects, midsized social infrastructure projects and the range of projects in the LNG sector.

As of September 30, the company's actively bidding a PPP ambulatory care project in Atlantic Canada; 2 design-build projects, 1 located in Ontario and the other in British Columbia; and several work packages in the LNG sector. The company is shortlisted and is awaiting the request for proposals on an environmental project and an administration building for the Federal Government, both located in Ontario. The award of any of these project opportunities will benefit 2020 and beyond.

In terms of active projects, the company is realizing lower margin in selective, dilutive contracts that are scheduled to achieve substantial completion in the near term. One active contract remains subject to ongoing commercial negotiations, and there is a risk that this project could experience additional margin erosion in the fourth quarter if a series of owner-directed changes are not resolved satisfactorily. The company expects to have a work program in the fourth quarter of 2019 that is more balanced and diversified than it has over the past several years, supporting progress towards higher levels of profitability and growth.

Work on the Cedar Valley Lodge is at full production, and management anticipates strong earnings attributable to its higher margin industrial work program throughout the remainder of the year, including contributions for the 2 recently awarded projects at an LNG export terminal facility, work in the nuclear sector in Ontario and from the OPP Modernization Phase 2 project. Management expects pursuit costs in the fourth quarter to increase above the level experienced in the third quarter due to the combination of the timing of bid submissions and the number of active pursuits.

Taking into consideration the company's current backlog, the expected timing for conversion of awarded projects and new contracts and the timing of major project awards, the company expects modest growth of backlog in the fourth quarter. This concludes the prepared remarks section of the conference call.

I'll now turn the call over to the conference call operator who will take your questions in turn. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Michael Tupholme with TD Securities.

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Michael Tupholme - *TD Securities Equity Research - Research Analyst*

You talked about the mix shift in bridge work program toward a higher proportion of industrial work as being a key driver of improved earnings performance. Is there any way to provide some additional details so we can appreciate how the mix has evolved? So what the mix of industrial versus institutional and commercial revenues looks like today versus, say, last year? And then how you expect that to shift further, if at all, as we look -- as we move out to 2020?

Wayne R. Gingrich - *Bird Construction Inc. - CFO & Assistant Secretary*

Michael, it's Wayne. In our year-end filings, we provide the actual mix of revenue split. So we haven't provided it -- that yet for 2019. Suffice to say, the amount of industrial work and the proportion of industrial work is increasing over where it has been in the last several years. We don't expect that to exceed 50%, I don't think, for this year, but we are seeing a really healthy pipeline of industrial-related projects. So we expect that, that favorable work mix to continue through 2020 and beyond.

Michael Tupholme - *TD Securities Equity Research - Research Analyst*

And then do you expect the mix to shift further next year? Or just continue at the same pace that you're -- you've seen in the third quarter and in the back half here?

Wayne R. Gingrich - *Bird Construction Inc. - CFO & Assistant Secretary*

I think we'll continue to see it shift somewhat through next year, maybe not to the same extent that it has shifted this year. But it will continue heading in that direction, I believe.

Michael Tupholme - *TD Securities Equity Research - Research Analyst*

Great. Strong results in the quarter in spite of revenues being flattish on a year-over-year basis. You talked about revenue growth being negatively impacted by higher volume of preconstruction activities on construction management projects. Can you talk a little bit about where you're at with those projects? And any visibility you have on when you'll see some of those projects move out of that preconstruction phase and begin to have a more favorable impact on revenue and driving growth as we look forward here? I mean the backlog is up 17%, so just wondering at what point we start to see that flow through to improved revenue growth trends on a year-over-year basis.

Wayne R. Gingrich - *Bird Construction Inc. - CFO & Assistant Secretary*

I think on the revenue growth, so one thing to keep in mind is, particularly on these construction management projects where we're not necessarily flowing through the full value or the full construction value through our books on that. We're recording the backlog on agency fee for that. And for example, the project that we recorded in Q3 here, while the construction value of the project is $140 million, that's not the value that's going to flow through our backlog or through our revenue. We're just getting that -- the agency fee on that.

So when you look at revenue growth, it is tougher to compare year-over-year on that front with that change of construction management projects because you're not getting the same volume uptick on it, but you are getting the gross profit flowing -- flow through on those projects.

Michael Tupholme - *TD Securities Equity Research - Research Analyst*

Okay. That's helpful. I guess if we do look at it sort of just in terms of the backlog being up 17% year-over-year, at what point should we think about that beginning to favorably impact the year-over-year revenue growth trends? Because that would be separate from the issue you just discussed in terms of the construction management work.

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Terrance Lloyd McKibbon - *Bird Construction Inc. - President, CEO & Director*

Yes, that's true. I'd say it's slightly similar. Backlog growth is multi-year projects, though, so in terms of 2020 or -- if you look at the projects we booked in Q3, including the non-process buildings, that's a 3-year contract. So while we're seeing a lift in our backlog, that may not necessarily drive significant revenue growth in 2020 because that's just giving us some more visibility to 2021 and beyond there as well.

And the same would be with Confederation Line. I mean we expect that to contract in the fourth quarter. But again, that's a project that's going to span 2-plus years.

Michael Tupholme - *TD Securities Equity Research - Research Analyst*

Okay. Just lastly, the higher pursuit -- project pursuit costs that you've talked about in the fourth quarter. Can you provide a little bit more specificity around what you're expecting? It was $0.7 million in the third quarter. How much of an increase are we looking at?

Wayne R. Gingrich - *Bird Construction Inc. - CFO & Assistant Secretary*

It's about $1 million, Michael, in the fourth quarter, approximately, that's $1 million higher.

Michael Tupholme - *TD Securities Equity Research - Research Analyst*

That's right. The term -- - whether that's the increase versus Q3.

Wayne R. Gingrich - *Bird Construction Inc. - CFO & Assistant Secretary*

The increase. That's the increase versus Q3.

Michael Tupholme - *TD Securities Equity Research - Research Analyst*

Okay. And then if we go to next year, I mean, I know these pursuit costs can be lumpy quarter-to-quarter. But on a full year basis for 2020, would you expect that to be much different than 2019 full year?

Terrance Lloyd McKibbon - *Bird Construction Inc. - President, CEO & Director*

At this point, I wouldn't. But again, as you said, there could be new projects evolve, that we get into pursuit by third quarter, fourth quarter, that we don't know about today. But typically, we have a pretty long lead time on these things. But I'd say that it will probably going to be similar based on our focus. We're being very disciplined as we approach projects that have pursuit fees.

Operator

The next question is from Frederic Bastien with Raymond James.

Frederic Bastien - *Raymond James Ltd., Research Division - MD & Equity Research Analyst*

You mentioned in the MD&A that the Cedar Valley Lodge is now at full production. But I was wondering if you could tell us where you're at with the other 2 work packages you've secured for LNG Canada?

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Terrance Lloyd McKibbon - *Bird Construction Inc. - President, CEO & Director*

They're evolving. Essentially early days, but they're evolving. I'd say that 1 is certainly evolving quicker because you've got less design and whatnot. But yes, evolving. So as you typically expect, they typically -- they extend out to 2022, so longer back end to it. So that's going well. And I'm really pleased with the pace of awards (inaudible) just due to the performance we've had and the safety performance and the teams worked very hard. And we're very pleased with those opportunities as they continue to evolve. And as we continue to perform at a high level, we'll continue to see new opportunities.

Frederic Bastien - *Raymond James Ltd., Research Division - MD & Equity Research Analyst*

Are these jobs continuing into Q4? And should we expect them to slow down with weather? Or is this -- are you expecting...

Wayne R. Gingrich - *Bird Construction Inc. - CFO & Assistant Secretary*

Yes, it really depends. This is one that's more site grading oriented that I'd say will slow down a bit with weather. The other, not so much. It's more facilities. So it's got less seasonality and we're in the design phase right now, so.

Frederic Bastien - *Raymond James Ltd., Research Division - MD & Equity Research Analyst*

Okay. We've seen you perform construction management work in the past. So I'm a bit surprised by the emphasis you're putting on the recent contract awards and their impact. Is it because the workload or the implied backlog have seen more -- that much more significant than you've historically seen?

Terrance Lloyd McKibbon - *Bird Construction Inc. - President, CEO & Director*

Yes, I'd say so. And also the scale of some of these opportunities is quite significant as well. Obviously, a project of the scale of our Westwood development is quite significant at that size, that it's in the profile that it's in. We're balancing the risk profile as we've been communicating across a series of contract types, and we're really pleased with the way that's evolved within the past year or more importantly, within the past 2 years, where we were -- we had a much heavier risk profile to the backlog as we opened 2018 compared to how we'll open in 2020. We're really pleased with that. The backlog that we look at and even the awarded but not contracted backlog that we've got on our books, we're really pleased with. And we really like the profile of it and that's considerably different than it was, say, opened in 2018.

Frederic Bastien - *Raymond James Ltd., Research Division - MD & Equity Research Analyst*

Okay. So when we think of margin progression, maybe into 2020, we should expect like a reduced drag from sort of the P3 jobs that you've -- you're completing, sort of a better shift because of -- better mix because of the industrial work and then that CM should also contribute positively to your margin, correct?

Terrance Lloyd McKibbon - *Bird Construction Inc. - President, CEO & Director*

Yes. And I'd say that on the P3 side, we're being very, very selective. We have experienced assignments that, I think, quite honestly, weren't suitable to be P3s, and we felt the pressure of those. So we've got considerable discipline as we approach the various contract types that carry higher risk.

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Operator

This concludes the question-and-answer session. I'll now hand the call back over to Mr. McKibbon for closing remarks.

Terrance Lloyd McKibbon - *Bird Construction Inc. - President, CEO & Director*

Thank you, and thank you again for participating in Bird's 2019 Third Quarter Conference Call. We're very pleased with the performance improvement this quarter and expect a more stable execution of our growing and more diversified backlog. As always, Wayne and I are available if additional information is required, so please do not hesitate to get in touch with us. Have a nice day, everyone. Thank you.

Operator

This concludes today's conference call. You may disconnect your lines. Thank you for participating, and have a pleasant day.

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