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Q4 2019 NKT A/S Earnings Call

EVENT DATE/TIME: FEBRUARY 26, 2020 / 9:00AM GMT



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## PRESENTATION

### Operator

Ladies and gentlemen, thank you all for standing by, and welcome to today's annual report 2019. (Operator Instructions) I must advise you all that this conference is being recorded today, Wednesday, the 26th of February 2020.

So without any further delay, I would like to hand the conference over to your first speaker for today, Mr. Alexander Kara. Please go ahead.

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### Alexander Kara *NKT A/S - CEO*

Yes. Good morning, everybody, on the call. I would like to present today the NKT annual report 2019 and Q4 result, together with my colleagues. My name is Alexander Kara, CEO of NKT. Here with me in the room, I have Roland Andersen, CFO of NKT; and Basil Garabet, CEO of NKT Photonics. And it will be a pleasure to present the results.

First, NKT and what I will present. And afterwards, Basil will present the NKT Photonics results and the highlights. And Roland will cover the financial highlights of NKT A/S before we go to the question-and-answer session.

Looking at 2019 and the fourth quarter. In my opinion, we have delivered as guided. In the fourth quarter, we have returned back to revenue growth, increased earnings. And we delivered in the fourth quarter EUR 262 million on revenues. Important in 2019 was for NKT that we have secured several orders. One of it was Dogger Bank in U.K. but also several other orders. And our order backlog is all-time high at EUR 1.37 billion. This is very important as this gives us the basis for delivering a stronger 2020 and beyond.

We have also strengthened further in 2019 our technology competence. We acquired the technical -- a technology consultancy of ABB in Västerås. And with those, we can further develop our cable -- new generation of high-voltage cables. Also, we're successful and very proud of that, that we qualified the 525 kV for the corridor projects as we have already delivered in 525 at first and that Cigre announced the 525.

Now going to the individual business lines. Looking at Solutions, in the fourth quarter, as just mentioned, we have increased significant revenues and earnings, which is very positive. Further, we have also -- now all our high-voltage factories are running on green electricity. This is in addition to the NKT Victoria, which is very fuel-efficient and (inaudible) we have a power (inaudible) also, where we can feed with renewable energy. We have, as mentioned, the qualified for the 520 kV German corridor project, which is an important part of the German Energiewende, very important to bring this to power, which is generated in the North Sea from the generation to the south to the load center to Bavaria and so on. That is critical for Germany and the further development.

And looking now to one specific order in Solutions, where I'm extremely proud, is the first HVDC offshore wind farm connection in U.K., which we got awarded last year. This is a total 2.4 gigawatts, which is 40% out of the CfD auction. And once in service, it will be able the wind farm to feed with green energy approximately 3 million households. This underlines our capability to deliver high-end DC XLPE cables. And we have a strong back record on all projects, what we have already delivered in the past. We'll use also the -- our state-of-the-art Victoria to install these cables and make sure that this will be a success.

Looking at the high-voltage market in 2019. We received more than EUR 700 million orders out of EUR 3 billion, which is roughly 1/4 out



of this, which is positive. And if you look for 2020, we see a similar number of orders in the range of around EUR 3 billion. On top of this, we will have the German corridor projects, which will significantly increase the tenders which will be awarded, looking backward to the last years. So this is a positive outlook for the entire cable industry.

Looking at the backlog. Important is if you look at the Slide #9 with EUR 1.3 billion that we execute these orders what we have in hand, flawless, without any issues. And we have projects in all segments, offshore, interconnector, oil and gas. And we're also tendering projects in all these fields. So we see positive momentum on the market and execute as it is expected from our customers.

This concludes the Solutions part. And now looking to Applications. Applications' performance in Q4 and for the full year is not satisfactory. And revenues, particularly in Scandinavia and France, were below what we expected. And it's clear we need here to improve our efficiency and output of the factory. It's not where we want to be. And we will work on that. And I come a little bit later back to that.

Last, let me say some words to Service & Accessories. We delivered satisfactory financial results in Q4. We have no offshore repair, which has an impact on the profitability in Q4. And we could secure the first order where we gave a granted vessel mobilization time of 10 days. We received this order from EirGrid. And obviously, it's very important to have the downtime of the cable minimized. And with 10 days' mobilization time, we can ensure that, which is an important for our customers. We have also grown our accessories business in medium voltage and offshore.

And with this, it sums up the performance in 2019. And now we'll talk briefly about the key actions in 2020 and 2021 in order that we improve the profitability. And that is the key for us in cable for 2021 to improve the profitability.

If you look at Slide #12, we have on Solutions, it's important that we fill our factories. We have secured already some orders successful in 2019 with the right composition, means between DC/AC a right mix to maximize the utilization of the assets. Further, we need to execute the project with the quality which is expected from our customer. And this will be one of the priorities and -- yes.

On Applications, we need to increase the output of our factories, make them more efficient, getting more out of the factories and reducing, as an example, yes, also our maintenance cost in the factories. In service, we have a nice service offerings. As I mentioned, the order with EirGrid with a 10-day mobilization. We need to increase here our offerings and our service footprint, what we are doing in U.K. and in the Middle East, so that we have a larger coverage of the market.

With that, I would like to conclude on the 2019 year. As mentioned, we delivered as guided. And it is clear that we worked hard to improve the near time -- near-term sustainable performance of the company.

With this, I would like to hand over to Basil, and he can guide you through the Photonics highlights.

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**Basil Garabet NKT A/S - CEO & President of NKT Photonics**

Thank you, Alex, and good morning. We are on Slide 14 now, going through the key highlights for the fourth quarter 2019.

In the quarter, our revenue came in at EUR 25.5 million. That is up from EUR 22.5 million in the same quarter in 2018 and is the highest revenue quarter in the company's history. It comes with a growth of 15%. This growth has -- it is an improvement to the growth -- organic growth from previous quarters and is in line with the guidance of the financial outlook that we gave. EBITDA came in at EUR 7.2 million. That is down from EUR 8 million of EBITDA in the same quarter in '18, driven mainly because of the investments that we put into the company to enable growth, growth in the year and growth in future years.

In the same quarter, our order intake increased by 50% compared to the same quarter in '18. And it is driven by a number of large OEMs. And that has been the way that we've been moving forward is concentrating on more and more OEMs to enable the growth that we are forecasting. The performance in the quarter is in line with expectations. And as the same in previous quarters or previous years, Q4 is always our largest quarter. And that's because of the seasonality of our business.

In October of 2019, we opened our new manufacturing facility in Boston, Massachusetts in the U.S. It's very important for us that Boston



facility will service the market in the U.S., especially on our medical and our aerospace and defense markets. We've also opened a new industrial application center in the U.K. to deliver our customer-focused services, looking at our ultrafast lasers and laser micromachining applications, helping our customers and ensuring that we get more business through that center. As I said earlier, we are preparing for future growth. And in the quarter, we hired more than 20 employees, bringing the total at the end of the year to just over 400 people.

We move to the next slide, Slide 15. One thing that we are doing, especially moving forward and especially for 2020, we are updating the market segmentation that we are servicing. So we're moving from a product-focused market segmentation to a market-focused segmentation. And that really shows the growth in the company, especially the maturity in the company.

So previously, we had reported on segments which were Imaging & Metrology, Sensing & Energy and Material Processing. The new market segments -- actually, they're not new, they're more sort of prominent in what we do is Medical & Life Sciences as one segment, Industrial as another segment and Aerospace & Defence as the third segment. And we'll continue reporting on that throughout 2020. These market segments are generally in line with the reporting in the global photonics industry and allow people to compare like-with-like and compare us to our peers going forward, also to look at the size of the market and look at the performance of NKT Photonics within those clearly defined markets. This will provide a very good overview of our commercial focus on the years ahead.

These 3 markets are basically moved forward by a number of mega trends. The first one is a mega trend where there is a growing and aging population and an additional need for more health screening, additional need for sensing and monitoring, the additional need for less expensive medical instrumentation for mass screening, less expensive medical instrumentation for diagnostics, et cetera, that helps our medical market segment.

For our technology market, the mega trend is mainly in newer technology. As technology becomes more complex, becoming more complex, the material processing part of that is becoming more and more important, especially for newer technologies. And that's where we play, especially with our ultrafast business. And finally, on the mega trend within our Aerospace & Defence segment is with a big focus on security. Where we play is mainly in directed energy, in areas such as drone detection and protection, et cetera, focusing on security both on the aerospace and civil side.

We move to Page 17. The growth in 2019 came mainly from Aerospace & Defence. That's the market segment that grew tremendously in the year for us and we see that growing in 2020 as well. The other segment -- actually the fastest-growing rather than size, but the fastest-growing segment was our Medical & Life Sciences. There, we play in bio-imaging, we're in medical devices and very importantly, we are in ophthalmology. Especially for cataract operations, we supply lasers for cataract operation, supply lasers going into and being designed into for other applications such as LASIK.

The Industrial side is the side that has -- is our largest at the moment. It is moving forward as well but not the same levels or speed as medical or aerospace. That's driven mainly in remote sensing and semiconductors. And finally, again on the aerospace side, where we play is in directed infrared countermeasures, DIRCM, in directed energy and in remote sensing.

And with that, I end my segment of the report and I pass on to Roland.

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#### **Roland Munkerod Andersen NKT A/S - CFO**

Thank you, Basil. Let's just jump to Slide 19 and have a look at the group's revenue development since the same quarter in 2018. And if we adjust for metal price impact, the SP revenues in 2018 was EUR 254.6 million. And we have had small currency impacts, primarily from Sweden and we also had a divestment of our rail business that has impacted the Q. And if we adjust for that, then NKT has posted organic growth of EUR 36.7 million and Photonics has posted organic growth of EUR 3.2 million, so the revenue figure being primarily driven by organic growth in both companies.

If we jump to Slide 20 and have a glance at the group's consolidated income statements. Operational EBITDA for Q4 '19 was up, primarily driven by NKT. Improved earnings in Solutions drove that pickup and admittedly compared to an unsatisfactory Q4 from 2018. And Photonics has continued to invest in initiatives to drive further growth going forward. In these numbers, implementation of IFRS 16



increased operational EBITDA by EUR 1.7 million, of which EUR 1.2 million stems from NKT and EUR 0.5 million stems from NKT Photonics.

We have posted one-off items of EUR 6.2 million in Q4 2019 and that's only related to NKT. It's primarily finalization of our strategic initiatives and reducing headcount on the program we announced at the beginning of 2019 and also a few strategic initiatives we have on improving our production efficiency. As expected, our FTE number is lower now coming out of '19 as we have been driving our cost program almost to an end and also because of the divestment of our railway activities back in February 2019.

So if we jump to Slide 21. Our operational EBITDA has been declining, as we know, over 2019. However, the LTM margin is picking up a little bit in Q4 2019. Our operational EBITDA margin LTM was 0.8 points lower in Q4 '19 compared to Q3 '19. The pickup in the profitability from '15 to '17 was primarily driven by the acquisition of the ABB HV Cables activities but also the divestment of the Chinese operations in NKT back in '16.

If we come to 22 and have a quick glance on the balance sheet. Clearly, our working capital improved in Q4 '19. It improved exceptionally and is not most likely a new normal, we come back to that on the next slide, whereas NKT Photonics was largely flattish at the end of Q4. The improved working capital also drove down capital employed, yet we still have negative RoCE from the NKT business. On this balance sheet, the IFRS impact have added lease liabilities of EUR 38 million, of which EUR 28 million is from NKT and EUR 10 million is from NKT Photonics.

So if we move to Slide 23 and have a bit look on the working capital. It is clear that the reduction in working capital was very positive for Q4. It was driven by development in phasing of milestone payments from the Solutions business primarily. However, also the Applications have worked increasingly with trimming the inventories and also improve the steerings of their receivables and has contributed with a meaningful amount. And in this respect, the Service & Accessories was more stable compared to the end of Q3 '19. Now working capital is expected to normalize at a higher level during 2020. And we all recall that working capital will primarily depend on timing of payments in Solutions, which will cause quarterly fluctuations.

If we turn to Slide 24, obviously the working capital improvement led to a positive free cash flow for Q4, primarily driven by NKT. CapEx was mainly driven by NKT investing in the upgrade of equipment in Solutions but also an increased investment level in NKT Photonics. NKT in Q4 strengthened our R&D capabilities with the acquisition of a technology consulting unit of Västerås in Sweden from ABB, effectively adding further competencies to our -- especially our high-voltage DC development efforts.

If we jump to Slide 25, our net debt was reduced to EUR 205 million by the end of the year, excluding IFRS 16. And that is down from a comparable level of EUR 248 million by the end of 2018. With the implementation of IFRS 16, however, we all recall that we are adding EUR 38 million to that level. Now the debt level of net interest bank debt consists of EUR 166 million from mortgage debt and EUR 46 million drawn on our revolving credit facility, under which we have availability up to EUR 300 million, and cash at bank and in hand was about EUR 7 million by the end of the year. Only the revolving credit facility is subject to financial covenants. These include agreed remedies in the form of security over NKT Photonics and the vessel NKT Victoria. NKT A/S has sufficient financial headroom to manage the level of activity expected in 2020.

If we move to Slide 26. NKT's financial outlook for 2020 now includes a revenue guidance of between EUR 1.0 billion and EUR 1.1 billion in standard metal prices. And we expect an operational EBITDA of between EUR 40 million to EUR 60 million. With regards to our medium-term guidance, NKT anticipates an increasing demand for powertrain solutions and services in the years ahead. And as a technology-leading provider, NKT expects to be a significant beneficiary of this development.

The growth of the high-voltage market is, however, subject to various factors, including the timing of political decision-making, which makes the rollout of specific projects challenging to predict. Back in 2017, NKT provided medium-term financial targets, which targeted an operational EBITDA of approximately EUR 200 million to EUR 225 million and return on capital employed to more than 13%. However, due to the aforementioned timing uncertainties, in particular future awards of high-voltage projects, NKT has decided to only provide financial outlook within the current financial year.

If we move on to Slide 27, now the outlook for 2020 for NKT Photonics is an organic growth of between 5% to 15% and an EBITDA margin of 15% to 18%. Now medium-term targets for Photonics is an annual organic growth of 10%, about 10%, an EBITDA margin of about 25% and a corresponding return on capital employed of about 20%.

And with those words, I will give it over to the operator for questions and answers.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) So our first question comes from the line of Akash Gupta.

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### Akash Gupta *JP Morgan Chase & Co, Research Division - Research Analyst*

I have three questions, please. My first question is on working capital, where you say you expect it to normalize at a higher level. Can you quantify what you mean by that? Do you still expect it to remain negative? Or can it go positive? So that's question number one.

The second question I have is on Photonics business, where you are in process of strategic -- exploring all the options. Can you talk us through where we are in the process and by when we should expect to hear some update? And also, I'm surprised that despite having 50% order growth in Q4, you are targeting 5% to 15% organic sales growth for 2020. So maybe if you can elaborate how the order growth was for the full year in that business?

And my final one is on Applications. I mean the performance of business was a disaster in 2019. Can you talk about how much improvement you can expect or -- and then steps you are targeting there? And also, I mean in that business, there has been some deterioration in performance in Q4. Was it only driven by top line? Or was there anything else that we should be aware of?

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### Roland Munkerod Andersen *NKT A/S - CFO*

Thank you, Akash. Maybe I should start also. On net working capital, as you know, I think we have improved the level in Applications substantially. So I think on Applications, there's probably a more permanent improvement compared to the average you've seen over the past 4 to 6 quarters. On Solutions, it's more volatile. It really depends on which orders we get in, how fast we get them in and also the timing of milestone payments over the period of execution of the project. So we're not going to quantify that so much more than that. With regards to the strategic review on Photonics, I think we're happy that Photonics delivered on their guidance from November and the strategic review is moving on as per plan. And for now, we don't have further information on that process than that. Basil, I think there was a question maybe on the growth rates?

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### Basil Garabet *NKT A/S - CEO & President of NKT Photonics*

Yes. So usually, as I said earlier, the fourth quarter is our largest quarter and we have a seasonality in the business, but in this particular case, gave us a 15% growth. The actual growth we calculated for the full 2019 is 10%. We are guiding 5% to 15%, so we're not really changing the growth process and the trajectory that we're on. It's very similar to '19. We -- as reported earlier, there are headwinds in our industry. Other companies in our field have been reporting double-digit down organic growth. We have a little bit more of a balanced portfolio, so we are seeing a little bit more for growth than they are. And I think that's a healthy growth. And it's also conservative, looking at 5% to 15%.

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### Alexander Kara *NKT A/S - CEO*

Yes. Maybe to your questions with Applications, what you called a disaster, I would go not that far. But it's not -- definitely not where we want to be. And we went down in revenues in the fourth quarter from EUR 97 million to EUR 92 million, which has, of course, an impact on the profitability and considering also the contribution. So what we need to do is to increase the output of the factory, increase the productivity, make sure that we optimize changeover times and so on, so the output must be increased. And with this output, we also increase the revenues. Further, we need to look at maintenance costs, where we can come down. So we will improve that in 2020. But it will be not a step function. So currently, we'll go up, but we don't guide on the individual Applications line.



**Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst**

Yes. And maybe a follow-up on Applications. So how long do you think it will take to normalize margins in that business to, let's say, mid-single-digit level?

**Alexander Kara NKT A/S - CEO**

We will work hard on 2020 and work on the actions which we have defined to improve the output on the factories, on all the factories in the Nordics, in Czech and in Denmark. And then we'll give you an update at a later stage when we move towards the end of the year.

**Operator**

The next question comes from the line of Claus Almer.

**Claus Almer Nielsen Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT**

Yes, I also have a few questions from my side. The first question goes to the Solutions division. You are labeling the tender activity as continued tender activity, which seems a bit less positive than your market outlook that including SuedLink could more than double compared to both '18 and '19. Is there a message you want to share by this way of characterizing the tender activity? That will be the first question.

**Alexander Kara NKT A/S - CEO**

Yes. Tender activities, we are active in all segments of interconnector, offshore wind and oil and gas. And as I mentioned, before, we believe it will be around EUR 3 billion. And then we have the corridor projects, where we expect it to be awarded in Q4. And this will have a significant increase on the volume in the market. And on that, we believe we get our share.

**Claus Almer Nielsen Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT**

Okay. I just thought -- I would have thought you have talked about the tender activity to be busy, but -- and then did you mention that the project in Germany will be awarded in Q4 2020? Was that...

**Alexander Kara NKT A/S - CEO**

In Q2. Sorry, in Q2, maybe (inaudible). This is what we hear from the TSO that, that award will take place in Q2. And obviously, we are busy with all projects in all the tenders interconnector, land and sea, oil and gas and offshore wind farms.

**Claus Almer Nielsen Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT**

Right. Okay. Then coming back to the working capital, if the market will play out, including the SuedLink, will you still be having a higher net working capital by the end of the year? Or what's the assumption behind normalizing net working capital?

**Roland Munkerod Andersen NKT A/S - CFO**

So we are not quantifying that, Claus. And especially with regard to SuedLink, it's closed now. So we won't be too quantifiable on that. But what we're saying is that as and when we get orders in, and we got orders in '18 and also in '19, then we will maintain negative working capital in that business line. And that is expected to continue. So you can expect negative working capital to be even more negative when we get awarded projects compared to if we are not awarded projects. Now by the end of Q4, by end of Q4 '19, it was a little bit of, in a good way, the perfect storm. That's why we're saying that is not the new normal. It will bounce back to Q1, Q2.

**Claus Almer Nielsen Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT**

Okay. That makes sense. Then given the projects that have been awarded in the market and the outlook for awards in 2020, how do you see utilization among the main cable manufacturers? Are you starting to see -- sorry?

**Alexander Kara NKT A/S - CEO**

Yes, go ahead. Please go ahead, yes.

**Claus Almer Nielsen Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT**

No. Are you starting to see a more -- a tight supply-demand balance?

**Alexander Kara NKT A/S - CEO**

Yes. I mean if you look at 2019 on the awards, so we have achieved more than EUR 750 million from EUR 3 billion, but all other cable manufacturers got also their share. So the utilization is going in the industry, which is good for the entire cable industry. And we are looking towards a more balanced demand-supply situation.

**Claus Almer Nielsen Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT**

Okay. And then just a final question regarding your mid-term targets, yes, I understand you didn't give some new mid-term targets for the cable division. But if you remove this uncertainty about timing, do you still think it is possible to achieve the EUR 200 million to EUR 225 million EBITDA for the cable division?

**Roland Munkerod Andersen NKT A/S - CFO**

Yes. So Claus, thanks for the question. I'll answer it this way. So compared to when we issued this guidance in 2017, there's basically no change in our view on the market and the market potential. And there's no view -- or no change in our view on our own capabilities, our own technological edge or capabilities. What has changed is that we have learned, especially in the large end of the interconnectors, the large projects that are driven by political decisions, allocations on the government's spending budgets, legal provision rights to land and so on, there's a lot of uncertainty with regards to timing. That has changed. And that's why we are articulating in this way instead of what we did in '17.

**Operator**

Our next question comes from the line of Andrea Scatozza.

**Andrea Scatozza Goldman Sachs Group Inc., Research Division - Research Analyst**

One is on the net debt. Could you please comment on how you see your financial leverage going into 2020, considering also your comments on the working capital evolution?

**Roland Munkerod Andersen NKT A/S - CFO**

So I was a little -- what is it on? What is the question on?

**Andrea Scatozza Goldman Sachs Group Inc., Research Division - Research Analyst**

On your net debt and financial leverage in 2020, how do you think of it going forward, given also the working capital evolution?

**Roland Munkerod Andersen NKT A/S - CFO**

Yes. I think -- so there's a close correlation, right, to net working capital and to our guidance on EBITDA and thereby, our net interest-bearing debt. So assuming, as we say, that net working capital to a certain extent will bounce back, our net debt will also somewhat bounce back up.

**Andrea Scatozza Goldman Sachs Group Inc., Research Division - Research Analyst**

And my second one is on high-voltage market. Given the positive outlook in 2020, how do you see pricing trends over the year?

**Alexander Kara NKT A/S - CEO**

I mean, as I said, the utilization of the cable manufacturer is increasing. That would lead to a better supply-demand, let's say, outlook. And based on economy, that should have its impact on (inaudible).

**Operator**

Sir, Akash Gupta would like to ask a question again.

**Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst**

My first follow-up is on progression on EBITDA in 2020. Like how should we expect first half versus second half and if there is anything unusual in terms of phasing of backlog that we should aware of? And the second, if there is anything latest -- is there anything latest on SuedLink award? And maybe if you can talk us -- if you can talk about when do you expect this project to be awarded.





**Roland Munkerod Andersen NKT A/S - CFO**

Thank you, Akash. So with regards to our guidance, I think that you should think of it as being back-end loaded, right? So the second half will be better than first half. So that's one thing. And then regards to the SuedLink, I think as Alex said, we expect in line with the customers' communication that there will be awards before summer.

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**Operator**

No further questions at this time. Sir, please continue.

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**Alexander Kara NKT A/S - CEO**

Okay. I think if there's no further questions, then I would like to thank you that you took the time to call in and for your good questions. And I wish everybody a good day and talk to you soon. Bye-bye.

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**Operator**

Thank you. And that concludes our conference for today. Thank you all for participating. You may all disconnect. Speakers, please stand by.

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