



**SRG.MI – Q3 2015 Snam spa
Earnings Call
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Corporate Participants

- Carlo Malacarne
Snam SpA - CEO
- Antonio Paccioretti
Snam SpA - CFO

Conference Call Participants

- Mehul Mahatma
Berenberg - Analyst
- Jose Ruiz
Macquarie - Analyst
- Olivier Van Doosselaere
Exane - Analyst
- Cosma Panzacchi
Bernstein - Analyst
- Maurice Choy
RBC - Analyst
- Stefano Gamberini
Equita S.I.M. - Analyst
- Javier Saurez
Mediobanca - Analyst
- Harry Wyburd
Merrill Lynch - Analyst



Presentation

Operator

Good day and welcome to the Snam 2015 Third Quarter Results Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Carlo Malacarne, CEO. Please go ahead, sir

Carlo Malacarne, Snam SpA - CEO [1]

Good afternoon, ladies and gentlemen and welcome to the Snam's 2015 third quarter results presentation. Today's agenda will be structured in two parts. First, I will start by outlining the main highlights of the nine months and the recent developments. Antonio will then focus on the financial results for the first nine months in more detail. At the end of the presentation, we will be happy to answer any questions you may have.

Let me start by outlining the main financial highlights. In the first nine months of 2015, we maintained our strong track record of delivering with a remarkable increase of around 6% in net profit, demonstrating the robustness of our business model. The results of our solid operational activity demonstrated by a constant and sound level of EBITDA were also supported by ongoing debt optimization initiatives, as well as the increasing contribution of our international activities.

Furthermore, our strong operating cash flow generation fully financed overall CapEx and the dividend payment for the full year 2014, ensuring a level of net debt under control. Net debt stood at EUR13.7 billion at the end of September, substantially in line with the level of September 2014. We continue to be strongly committed to maintaining a solid and efficient capital structure.

Let me now provide you with a quick overview of the gas demand in Italy. In the first nine months of 2015, gas consumption totaled 47.7 bcm, up 8.6% versus the same period of last year. The growth was due to the increase accounted both in the residential and tertiary sectors, only partially offset by a lower consumption in the industrial sector.



Gas consumption in the residential sector was up by 10.6%, reaching 19.3 bcm. This was mainly due to the harsh weather condition during the last winter compared to the same period in 2014. In the thermoelectric sector, gas consumption was up by 17%, mainly driven by the significant reduction in hydroelectric production, down 10.6 terawatt hour due to be rain fall coming back to a normal level compared to the unusual heights reached in 2014.

A positive boost also came from the 2.4% increase in the electricity demand. These positive factors were only partially offset by the increase in the electricity production from renewable sources, namely solar and wind, up 2.7 terawatt hour, as well as the increase in the net import of electricity.

Gas demand in the industrial sector decreased by around 2%, 0.2 bcm, as a consequence of the declining trend throughout the period in the chemicals, construction material, and iron metallurgy activities. Finally, gas injected into the network for the first nine months of 2015 was up 5.8%, 2.8 bcm, compared to the same period of last year, since the growth in gas demand was also matched with higher withdrawal from gas storage.

That's all from me. I will now hand you over to Antonio, who will discuss our first nine months consolidated result in more detail.

Antonio Paccioretti, Snam SpA - CFO [2]

Thank you, Carlo. Good afternoon, everyone. We are pleased to report a positive set of results for the first nine months of 2015. Net profit grew by 2.9% to EUR888 million, despite of a slight reduction in EBIT due to the EUR35 million one-off pension fund provision, which I will talk about a bit more later on.

Growth overall was primarily driven by a reduction in net interest expenses and by the positive effect of the cancellation of the Robin Hood Income Tax. Adjusted for the non-recurrent provision, net profit amounted to EUR912 million, an increase of 5.7%, compared to the same period in 2014.

Total revenues amounted to EUR2.748 billion, an increase of EUR100 million compared to 2014. Regulated revenues net of pass-through items rose by EUR68 million, up 2.7%, broken down across the different business lines as follows. Transport revenues increased by EUR22 million, the positive contribution from investment carried out in 2013, equal to EUR57 million and the positive impact of EUR8 million due to the growth of gas injected into the network were partially offset by tariff adjustments of around EUR43 million.



Distribution revenues grew by EUR43 million, thanks to the consolidation of AES Torino starting from July 2014, was EUR32 million and of Acam Gas starting from April 2015 was EUR9 million. On a like-for-like basis, the revenues level confirmed the substantial stability of the distribution business.

Storage revenues increased by EUR4 million, a positive results in the context of the new regulatory framework that allows us to be confident in a level regulated revenues at year-end growth to be stable.

Other revenues increased by EUR8 million, primarily as a consequence of the disposal of non-operating gas inventories in the transport business, EUR22 million. This positive effect was partially impacted by the lack of revenues recorded in 2014 as a result of contracts or agreements between (inaudible) in connection to the Legislative Decree 130.

Moving to operate expenses, total cost amounted to EUR640 million. Net of pass-through items, operating cost totaled EUR522 million, showing an increase of EUR79 million compared to the same period in 2014. Controllable fixed cost increased by EUR26 million, mainly due to the consolidation of AES Torino and Acam for EUR12 million and a decrease in the amount of internal costs allocated to investment activities in the distribution business, EUR27 million.

This increase was partially mitigated by the ongoing cost efficiencies achieved across all businesses over the first nine months. Other costs totaled EUR96 million and that were impacted by a non-recurring pension fund provision of EUR35 million in the distribution business. This provision is connected to a new law approved in August 2015, which requires additional contribution to be paid in the medium to long-term. The EUR520 million growth in the non-regulated activities cost is mainly due to the disposal of gas inventories already mentioned discussing revenues, with a positive impact on margins of around EUR2 million.

EBIT adjusted for EUR35 million, a one-off pension fund provision amounted to EUR1.507 billion, a decrease of EUR21 million, down 1.4% compared to the same period in 2014. This was mainly a result of the EUR68 million increase in regulatory revenues, net of pass-through items, offset by the EUR26 million increase in controllable fixed costs and the EUR53 million increase in depreciation and amortization, higher than the organic depreciation trend due to the changes in the distribution business perimeter, EUR18 million; and the technical life time of some metering assets in the distribution segment, around EUR4 million; and also as a consequence of the important amount of storage assets that entered into operation in 2014.



Adjusted net profit in the first nine months of 2015 was EUR912 million, recording a 5.7% year-on-year growth. In addition to the previously discussed impact on adjusted EBIT, the further optimization in the financial structure resulted in a reduction in the cost of debt to an average of 2.9% causing the decrease in net interest expenses of EUR24 million.

Moreover, the result includes an increased positive contribution from the international activities, up EUR55 million, partially offset by consolidation effects related to AES Torino, down EUR71 million, including EUR51 million of new recurring items accounted last year. The reduction in income taxes of EUR68 million is primarily due to the positive effect of the Robin Hood Tax cancellation.

Turning to the cash flow, cash flow from operation amounted to EUR1.666 billion and includes an increased contribution from international associates that produced a cash inflow of EUR104 million in the first nine months of the year, EUR120 million if we also consider the Italian affiliate.

The significant cash flow from operation fully financed net investment of EUR844 million resulting in a positive free cash flow of EUR822 million. Cash flow from operations benefited from a positive change in working capital of EUR138 million, driven by the structural effects of tax payables in the third quarter.

Cash absorption from net CapEx in Italy amounted to EUR870 million. Net financial investments made a positive contribution of around EUR26 million related to the reduction of stake in TIGF worth EUR84 million, partially offset by the acquisition of Acam Gas worth EUR46 million and TAG price adjustment EUR14 million.

Free cash flow of EUR822 million in the first nine months of the year, financed almost entirely the 2014 full-year dividend payment of EUR875 million, resulting in a net debt at the end of September, staying broadly in line with the December 2014 levels.

Finally, looking at the balance sheet, net invested capital amounted to EUR20.9 billion, essentially in line with 2014 at year-end. Mainly as a consequence of net CapEx realizing internally, partially offset by asset depreciation, the reduction of stake in TIGF, a change in working capital and the one-off pension fund provision.

Thank you very much for your attention. We are now pleased to answer any question you may have.



Questions and Answers

Operator [1]

(Operator Instructions) Cosma Panzacchi, Bernstein.

Cosma Panzacchi - Bernstein - Analyst [2]

I have three questions, the first one is on the evolution of gas distribution tenders. So, we have seen some timid steps towards the start of the gas distribution tenders with municipalities and the government starting to make the initial steps to find an agreement. In this context, when do you realistically think at this point that the process will start? And, do you expect any further delays in the process compared to what you originally had in your strategic plan?

Secondly, looking at your press release this morning, there is a mention of the State Council rulings against the transport tariffs for 2014, 2017. Is there a risk stemming from this ruling for Snam revenue and if yes, what would be your estimate of that and when do you expect that we will have visibility on that?

And finally, regarding your expansion abroad, we have seen your Memorandum of Understanding with SOCAR, you have expressed also your interest for potentially acquiring State Oil's stake in the TAP, could you please update us on the next steps in this disposal process? And what criteria would you use to value these assets, also based on the still uncertain look -- outlook, I would say, for the Azeri gas exports?

Antonio Paccioretti - Snam SpA - CFO [3]

Thank you. From the first question, I can say that despite the current regulations set, the publication of a significant number of tender in 2015, with penalty for local authorities that did not accomplish. Right now, only one area establish a very partial tender with the declared purpose of avoiding Ministerial sanction. I can say that, considering the recent development, we remain confident that by year-end, at the beginning of 2016, we'll see the first call for tender. We still expect that the total length of the process will last four or five years.



So in our business plan, we consider the possibility to take part to 10 tenders in 2016, roughly around 10 tenders in 2016.

For the second question, for the Council of the State or again the leader of the Italian regulator, we understand that their ruling of Council of the State refers to the mechanism to set the tariff, not to revenue. And therefore, took cost allocation methodology among network user. We do not expect impact in our transmission revenue.

For the third question, first of all, an update, we confirm our interest in evaluating our entry in the TAP pipeline, in case -- I repeat, some of common shareholders would be available to sell their stake in the company. Currently there is no public information regarding the potential sale.

It's clear that the development of the South Corridor is a key for the consolidation of the Southern European hub and the TAP is a key project in that respect, sponsored by SOCAR, which a key player in new gas supply reaching EU from the South Corridor. There is -- I can say that, we are in the early stage of the project and we will have more visibility once and if our involvement in the project will evolve.

As regard the MOU signed with SOCAR, signing the MOU, SOCAR is now more focused on sharing their expertise and best practice in the construction and operation of facilities necessary for the transport of natural gas from the Republic of Azerbaijan to Europe. With the aim of farther, let me say, strengthening diversification and security of gas supply to Europe.

We -- signing the MOU, we set the Corporation on the evaluation of initiative for the development of the Southern Gas Corridor as new major route for gas flow to Europe. Our aim is not only to link the Italian network to the new TOP project, but to create all the condition to transfer, [to derive flow] which are in place, starting from 2018, the gas supply to the Central Europe.

Operator [4]

Javier Saurez, Mediobanca.



Javier Saurez - Mediobanca - Analyst [5]

I have also three questions, the first one is on your balance sheet structure. Obviously from the first of January 2016, we should see a reduction in the allowed return on RAB and an increase in the net debt to EBITDA for the Company. So the net debt to EBITDA for the Company now is around 4.9 times. I just question myself if you can give us a latest update on which is level of net debt to EBITDA with which you feel comfortable from 2015 and through the period 2016 and 2017 maybe.

Linked to that, and in light of these likely reductions in the allowed return on RAB, which is your latest view and your fire power to participate in the next auctions for gas distribution on new gas distribution areas in Italy. So, the link between the net debt to EBITDA and then the fire power that the Company may have to play a role on consolidation.

The second question is a follow-up on the TOP project. The Company has been very clear on potentially being interested in joining this project. Can you give us an idea or your thoughts on which could be your cost of capital considerations for entering into this project? Because obviously, this is not a fully regulated asset, it has a component of [load raise], but not fully regulated. So I just question myself how the Company looks at the cost of capital, while eventually putting their money in a project like that.

And the third question is related to TIGF. I have been reading on the Spanish press that the government is very keen to increase the gas inter-connection quite significantly in the period that was up to 2020, while the Fed say, it would require limited investment, what the European Commission and the Spanish government has been mentioning is that they could be significant CapEx for implementing the second phase of the upgrade and that should be passing through also the strengthening of TIGF network in Southern France. Could you give us an update on potentially which could be the opportunity for TIGF there?



Antonio Paccioretti - Snam SpA - CFO [6]

For the first question, in relation to the leverage, I have to say that the, as you know the leverage we used to comment is the debt -- the ratio that's throughout Robin affiliates. It was 52% at the end of last year, it will be the same level at the end of this year. We confirm the expectation to have an level always below 54% in the next four years plan.

And for commenting your consideration, which will be the capacity of the Company to sustain? The participation of Italgas to the next auctions in the distribution sector, we have to reiterate the fact that for two reason, we think that our balance sheet will be well in a position to support this growth. First of all, the investment, we expect are well distributed over the time and therefore there is no any pressure on that.

And the second point, which is very important is that, we are not talking about the Greenfield project. And therefore, we will immediately benefit -- we will have the benefit immediately of the cash flow from the increased perimeter in distribution. So we don't see a problem. We only see opportunities for the participation of our Group to the next proxies for the auctions in the distribution sector.

Carlo Malacarne, Snam SpA - CEO [7]

The second question, as I said, we confirm the interest in evaluating our entry in the TOP. Today, we are not involved and we need more visibility to answer your question. I think we can -- the project will evolve and we can give you more granularity of the project during the strategic presentation next month. Today we don't have all information to give you some data or some information of the project.

For TIGF; TIGF along with GRTgaz and Dana Gas is evaluating the best technical options regarding the realization of the overall infrastructure connected to MEDGAZ, also with the Spanish and French regulators.

With respect to TIGF project, we are at present considering a first step of investment that could be estimated around EUR300 million. The high level group, which is set with the coordination of the European Committee, the high level group supported by Europe Committee or MEDGAZ is ongoing and we expect some realistic result of the activity by the beginning of 2016, with some final decision in the development of the MEDGAZ project.

Operator [8]

Harry Wyburd, Merrill Lynch.



Harry Wyburd - Merrill Lynch - Analyst [9]

I've got three please. Firstly, just coming back to a question that was asked earlier, about your balance sheet capacity to participate in gas distribution. I may have missed it, but better than for you to put a number on it. And I know in the past, you said about EUR1 billion, so, could you confirm whether that's still the case or do you still think you got EUR1 billion on the balance sheet as you are going to spend on cash distribution?

And then second question, when you said a way up whether to invest in gas distribution, which you mentioned has basically a zero time to EBITDA versus the -- a potential investment in TOP pipeline, which may have rather a longer time to EBITDA, how do you compare those two investment opportunities and which one do you think is the most attractive?

And then finally on the new 8 to 10 bids, you mentioned that there are going to be ten, or you expect there to be ten tenders coming up in 2016, should we expect that you will participate in all of those tenders or will you be selective and if you can be selective, roughly how many will you participate in?

Antonio Paccioretti - Snam SpA - CFO [10]

As far as the first question, I confirm that the interest of the Company to increase its market share in the distribution sector up to 40% that has been already discussed in the previous conference call. It is related to an additional investment of around EUR1 billion, EUR1.3 billion. And therefore the comments I tried to give in relation to the capability of the balance sheet to support this growth is related to this level of investment.

As far as the second question, which was related to the -- how we compare different project, different risk and therefore different return, I think that we have already given the capability of the Company to execute M&A transaction also grow the previous TIGF and TAG deals, we will comment the next deal when the next deal -- if the next deals will appear.

Harry Wyburd - Merrill Lynch - Analyst [11]

And then on the final one, which is on the 8 to 10 tenders next year and how may you are going to planning to participate in?



Antonio Paccioretti - Snam SpA - CFO [12]

Yes, we like to consider that in our estimate of 10 tenders, we have to consider that after the publication of the call for tender, there is a time of six months to collect to-date. And the reason why we expect the realistic starting from the TAG process, but not before June 2016. So it will be in the second part of 2016.

Harry Wyburd - Merrill Lynch - Analyst [13]

And would you be able to comment on how many of the 10 you would participate in, just to give a sense of your strategy here, will you be trying to participate in most of the tenders that come up or you are going to be selective?

Antonio Paccioretti - Snam SpA - CFO [14]

Yes, it's clear that our strategy we announced is to take part to the tender, creating the synergy we have today. The reason why it's not so clear today, where the call for tender will be carried out in the beginning of 2016. We will evaluate all, let me say, the tender, which give us the possibility to consolidate the market, maintaining our profitability in the distribution business, we have today with Italgas. So, it's no -- we have analyzed namely and consider the geographical position of the future tender. There is no visibility today. We are waiting the call for tender to understand where there is the best options and where we can consolidate the market without risk in terms of profitability.

Operator [15]

Mehul Mahatma, Berenberg.

Mehul Mahatma - Berenberg – Analyst [16]

I think some of my questions have already been answered. I have one more question. Could you please provide us with an update on the potential LNG project in South of Italy? What is the likelihood of this going ahead and what are your expectations for a remuneration in investment?



Carlo Malacarne - Snam SpA - CEO [17]

Today there is no news in terms of the LNG. We know, today, we have an LNG project in South of Italy, which obtain the preliminary authorization, is the LNG of [Port en Peduclaye], but there is no news in terms of operators who intend to invest in the LNG. I can say that one new LNG project -- one new LNG plant is in energy strategy set by the government, but today, frankly speaking, we don't have visibility when the final investment decision will be taken.

As a regard, you know our LNG plant, which is in Panigaglia, we launched a feasibility study regarding the potential utilization of the terminal for the so-called smaller scale LNG services. And we expect to complete the feasibility starting in the March-April 2016 to evaluate the investment, we have to define to update our terminal improving the small scale LNG services. But today, there is no news in terms of new LNG plant in Italy.

Operator [18]

Jose Ruiz, Macquarie.

Jose Ruiz - Macquarie - Analyst [19]

I just have one question. When you're considering all these Memorandum of Understanding with SOCAR in the Southern Corridor, how and potential involvement in TAP in the future? How do you see all these news flow? Or what do you think about all these news flow regarding the expansion of Nord Stream, Nord Stream 2, considering that they could be adding another 55 bcms in an already over-supplied gas market in Europe?

Carlo Malacarne - Snam SpA - CEO [20]

First of all, we have seen different position in terms of new supply to Europe from Russia, Turkish Stream starting from the South Stream in part of Turkish Stream and Nord Stream. In a way, I think in the medium and long-terms, we need to consolidate in Europe, the two main -- the two important hub, Northern Europe and Southern Europe. The reason why we consider the South Corridor, which is top today, but in the future could implement and could bring gas from other sources. You know, there is some discussion today from Egypt, Israel from Turkmenistan.



The reason why for us in terms of strategic evolution is very important to create the condition of, let me say, hubs exchange, North Europe and South of Europe. If the gas came from Nord Stream, anyway you have to consider that we needed to supply the Center, South of Europe and the Eastern County. So in this case, our position today with TAG, which linked the two hubs, Italy and Baumgarten could be an important evolution in terms of new supply to Eastern County through our pipeline. So, I don't think that the Nord Stream, the only Nord Stream supply could jeopardize the creation of hub in South of Europe.

Operator [21]

Olivier Van Doosselaere, Exane.

Olivier Van Doosselaere - Exane - Analyst [22]

Just a couple of questions on my side. The first one was regarding the pension provision that you had to take in this quarter, I was just wondering that given that you are a regulated activity, if the rules change in terms of pension payments, if that is actually not something that you showed in theory be able to be allowed to recover from the consumer bill. And maybe in the same topic, there has been some indications or there is basically some signs that tax rate might come down in Italy, I was wondering if you expect that to be reflected in new allowed return going forward and then also linked into that one, if you could give us an update on when you expect the next consultation paper on the WACC perimeters is to be published?

Antonio Paccioretti - Snam SpA - CFO [23]

For the second question, the tax rate, it's a matter that we will discuss -- you know the rules from the beginning of the regulation provides for a recovery of changes in the tax rate. But it's something that we'll look here for as at the end of the current regulatory period, which is 2018. As far as the first question, we are considering starting the issue. Today we are not in a position to give you any indication on that.



Olivier Van Doosselaere - Exane - Analyst [24]

Could you just please confirm that the next consultation paper on the WACC is probably -- well, we've heard it is probably going to be published either end of this week or next week? Is that the timeline that you also expect?

Carlo Malacarne - Snam SpA - CEO [25]

Yes. We expect the second consultation document in the coming days.

Operator [26]

Stefano Gamberini, Equita S.I.M.

Stefano Gamberini - Equita S.I.M. - Analyst [27]

Just two questions if I may. First of all, in the last call you underlined that some appeal regarding the (inaudible) to set the redemption value were expected in September for the gas distribution tenders. What was the outcome and do you see further legal obstacles to the kickoff of the tenders, because again their priority is the main item on the table for the spend.

The second, regarding what is your view on the consultation paper issued by the regulator on incentives for investments in the electricity transmission. What I mean is, the regulator wants to cancel the extra turn on work in progress and also want to cancel the -- once you recognize the types when the assets come on stream. So what could be the impact for you if this rule will be applied from 2018 onwards?

Antonio Paccioretti - Snam SpA - CFO [28]

For the first question, there is no legal off the course for starting of the tender process. Frankly speaking, there is some -- there were, frankly speaking, some discussion in postpone the time for some municipality, but today the low is set is the low from July, so there is no delay into this respect. I think the time is only -- the time the municipalities need to carry out the call for tender.

So we have to consider that the new distribution area is a big distribution area with more than one municipality. That is the reason why the collecting process for all the plan to-date and so on is not so, let me say, easy to speed the preparation of the call for tender.



That is the reason why we expect the first call for tender in the first month of 2016 and after we have to wait six months to start with the final ten. That is the reason why -- our feeling is that it will be possible to manage roughly 10 tenders during 2016, starting from the second part of the year.

The second question for the consultation document, the criteria in the consultation document, I can say that the treatment of work in progress, I think, is your question, we've already experienced -- started the season in storage business. So, as far as the gas transfer is concerned, this element I think could be implemented not early than in the regulatory period starting from 2018. If until that time the authority will make such proposal, we will discuss together in order to get the final outcome. I can say that we think that for the transmission business, we will not experience a negative impact in our transport business from such change.

Stefano Gamberini - Equita S.I.M. – Analyst [29]

Just a quick follow up, if I may. If I understand correctly, what you mean is that the work in progress you have are quite limited compare your full --?

Antonio Paccioretti - Snam SpA - CFO [30]

Yes. It's limited only because in the transmission, the construction of the pipeline usually -- in our business plan, we put in operation the construction phase each year. So there is no -- it's different for the plant, the storage -- you know we need more time in the construction phase; for the pipeline, that is not the same situation. That is the reason why I don't think, I'm sure that there is no impact in terms of delay in putting out our investments.

Operator [31]

Maurice Choy, RBC.

Maurice Choy - RBC - Analyst [32]

Just one question if I may. Just back again to your MOU with SOCAR. A few days ago, one of the officials for the Greek Sovereign Fund mentioned that they want to complete the sale of the 66% stake in SOCAR, and after that SOCAR will sell 17% stake of that to preferred



bidder. I'm not sure that if Snam has previously indicated interest in this. But could you just comment a little bit about whether or not you are interested, whether or not you are exploring, and I guess with that, if you are, what the timing is like on this?

Carlo Malacarne - Snam SpA - CEO [33]

In memorandum, I said before, the intention is to share with SOCAR our knowledge, our best practice, our expertise, let me say to, as a consultant, let me say to the SOCAR, in the construction process of TOP and their other connections. Allow me to reiterate that I now choose to comment in press room, but today, I am not analyzing the depth of the project.

Operator [34]

This will conclude today's question-and-answer session. I would now like to turn the call back to speakers for any additional or closing remarks.

Carlo Malacarne - Snam SpA - CEO [35]

If there are no more questions, thank you very much for participating to the conference call and have a good afternoon.

Antonio Paccioretti - Snam SpA - CFO [36]

Thank you, bye.

Operator [37]

This will conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.



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