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SRG.MI - Q1 2018 Snam SpA Earnings Call EVENT DATE/TIME: MAY 08, 2018 / 2:30PM GMT

Corporate Participants

- Alessandra Pasini Snam S.p.A. - CFO and Chairman of Snam Rete Gas

Conference Call Participants

- Antonella Bianchessi Citigroup Inc, Research Division - Director and Head of European Utilities Equity Research
- Enrico Bartoli MainFirst Bank AG, Research Division - MD
- Harry Peter Wyburd BofA Merrill Lynch, Research Division - VP and Junior Analyst
- Javier Suarez Hernandez Mediobanca - Banca di credito finanziario S.p.A., Research Division - Research Analyst
- Maurice Choy RBC Capital Markets, LLC, Research Division - Analyst
- Rui Dias UBS Investment Bank, Research Division - Associate Director and Equity Research Analyst
- Stefano Gamberini Equita SIM S.p.A., Research Division - Analyst



Presentation

Operator

Good day, and welcome to Snam 2018 First Quarter Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Alessandra Pasini, CFO. Please go ahead.

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

Thank you, good afternoon, ladies and gentlemen, and welcome to Snam 2018 1st quarter results presentation. In the quarter, Italian gas demand was up 1.3% due to harsher weather conditions with increases in the industrial sector. Mainly, glass & ceramics sectors but also steel and chemicals. While term electric consumption was lower than in the first quarter of last year, which benefited from the French nuclear outage and lower wind production. Demand grew in Europe as well, with the 6 main consumer markets up 3% and in particular U.K., up 11%. This is largely due to the residential sector. Meanwhile the strategic value of the flexibility and interconnection offer by our European assets is becoming increasingly apparent. In February, Italy made its first step towards becoming a gas hub, when price dynamics made it more convenient to supply Switzerland from Italy rather than from northern market. Reverse flow is expected to be fully operational in October 2018, when we will be in a position to export up to 40 million cubic meter per day to Passo Gries and 18 from Tarvisio.

Turning now to the U.K. market. There's been particularly great strong interest from traders and shippers on interconnect to U.K., in which Snam has recently increased its stake to 23.7% all of following -- also following the closure of the rough storage field. Indeed, products sold in the new capacity allocation mechanism launched in mid-April, in addition to the scheduled auctions on the PRISMA platform was well received and in some cases, the maximum capacity offered to the market was sold. These products were related to the capacity sold on a seasonal and quarterly basis for 2018 and 2019 with highest demand being from seasonal capacity for summer 2019 and quarterly capacity for the first quarter of 2019. In France, 100% of TIGF's storage capacity for the thermal year 2018, 2019 has been booked. Let's now look at the headlines figures for the first 3 months of 2018, which we will comment further later. EBITDA was up EUR 8 million, mainly thanks to the higher regulated revenues. Net profit was EUR 254 million, in line with the same period of 2017. CapEx was EUR 156 million, in line with our budget. The strong cash flow generation over the quarter covered investments and the payments of the interim dividend as well as the continuation of 2017 approved share buyback, leading to a net debt at the end of March of EUR 11.4 billion.

On the strategic side the consortium made up of Snam with a 60% stake, Enagás and Fluxys with a 20% stake each has been selected as the preferred bidder for the 66% stake of DESFA. The Hellenic Republic will have the remaining 34%. EBIT in Q1 was EUR 355 million, up EUR 2 million over the same period of the previous year. This number reflect increase in regulated revenues for



EUR 23 million, mainly due to the increase in tariff RAB, inclusion of ITG and a gradual ramp-up in regulated services. Increase in fixed controllable cost for EUR 4 million mainly due to labor cost inflation, the release during of the first quarter of 2017 of a noncash provision accrued in 2016 on labor cost, and the inclusion of ITG cost that we expect to fully absorb by 2020. Depreciation was up EUR 6 million. Other components include mainly: extraordinary nonregulated revenues in 2017 as an insurance refund for about EUR 1 million and sales of materials for about another EUR 1 million; EUR 1 million related to new business development and EUR 3 million to net provisions. In the first quarter, we continue to focus on our efficiency plan in line with our target. Efficiency in the first quarter were compensated by a different saving in existing corporate cost compared to the first quarter of 2017 and ramp up of the merger synergies. Net profit for the first quarter of 2017 was EUR 254 million, up with -- in line with last year. This was driven by the positive performance of our operations, just commented, lower net interest expenses of EUR 3 million, thanks to last year liability management; refunding activities completed last year, and treasury optimization carried out during the quarter. Slightly lower contribution from associates, mainly due to transmission regulatory review in France from April 2017 onwards and its trailing effect impact. Higher taxes due to higher EBT and lower ACE benefit, due to the lower recognized statutory percentage from 2.5% to 1.5%. The tax rate for the period was around 25.3% on EBT including [associates] versus 26.9% in full year 2017. Cash from operations was EUR 775 million, thanks to the solid net profit and the positive working capital. Due to the effect of [carriage] related item, net tax payable accrued in the period and net trade payables. Balancing activities' impacted on working capital was EUR 43 million, lower than in first quarter 2017, due to the lower temperatures registered this year that had led to higher purchases of gas to balance the system. These effects will reverse in the next quarter.

The strong cash flow generation of our CapEx, financial investment, mainly cash calls from TAP, the payment of the interest dividend and the buyback leading to a net debt at the end of the quarter of EUR 11.4 billion. Let me now give you an update on Snam's debt structure.

In the first quarter, Snam tapped again the bond market, exploiting favorable market conditions and in particular strong market appetite for floating rate notes, issuing a EUR 350 million 2 years floating note that's Snam swapped to fix at a negative yield of [34 basis points]. The issuance of this instrument, which is different in terms of tenor and size from standard non-benchmark issues at fixed rate can be considered as part of our treasury management optimization strategy. As for other funding needs please remind that a 3.875%, EUR 850 million bond recently expired in March and has been already financed by the pre-funding actions executed in 2017 with an average coupon of around 1%. Overall, the average cost of our debt in the first quarter was slightly below our full year guidance set at 1.8%. As regards to that debt breakdown, at the end of the first quarter, the fixed rate portion is 74%, in line with our 3 quarter of fixed flow in the 2018 guidance, which we confirm. Maturity profile is well spread over time and liquidity profile remains strong. With reference to the share buyback program in April, Snam launched an amount



of treasury shares equal -- reached an amount of treasury shares equal to 3.5% of the share capital, corresponding to the limit set by the previous shareholder meeting held April 2017. Since the start of the program and including the purchases made after the end of the quarter, Snam acquired 121 million shares for an aggregate of EUR 455 million at an average price of circa EUR 3.7 per share. Corresponding to 4.5% discount from [Deva] of the period and to an average premium throughout in the mid-single-digit area. On the 24 of April, the extraordinary shareholder meeting of Snam, approved the cancellation of 31.6 million treasury shares held by the company without share capital reduction and the ordinary shareholder meeting outlines new the share buyback for maximum amount of EUR 500 million and up to a maximum of 135 million shares. Without exceeding 6.5% of the share capital for the period -- maximum period of 18 months. In April we also completed TAG refinancing, raising a total commitment of EUR 430 million of which EUR [2060 million] under a shoe shine (inaudible) instrument under German law mainly devoted to local investors, with an average tenor higher than 7 years and the remaining part, banking facility with a 5 tenor -- year tenure. The new structure implies a significant increase in debt maturity and fixed rate portion together with a good reduction in interest rate risk.

Let me now turn the acquisition of DESFA. The consortium led by Snam has been selected as the preferred bidder for 66% of the Greek transmission operator. DESFA has a very good fit with our strategic and financial acquisition criteria. Strategically, it is particularly interesting because of its potential role in the development of southern route. The DESFA network is placed where a new route for gas coming from the Mediterranean Sea and Middle East toward Europe will likely target. Moreover as Greece become transit country for new sources for gas supply, it may have additional interesting opportunities to interconnect with East and Central Europe. According to the privatization procedure and the legislation, some steps are necessary for the completion of the transaction that we expect to happen by the end of this year. From a financial standpoint, the acquisition values DESFA enterprise value at around 6x the average EBITDA for 2016 and '17. DESFA results have been on an improving trend as the Greek macroeconomic and gas demand environment continue to recover. We are currently finalizing a no-recourse acquisition financing at BidCo level. The debt portion of the overall acquisition price is expected to be in line with similar transactions. Depending on the final structure, the size of Snam's investment be somewhere in the region of EUR 110 million to EUR 130 million and we target returns on this investment, which are coherent with our criteria of risk-adjusted returns higher or equal to the returns available on Italian CapEx and grow in line with our existing international portfolio. DESFA's solid CapEx plan for the next year is self-funded and is driving a stable RAB in the medium term. This, together with a net financial position close to 0 gives the company potential space to optimize the capital structure. Snam has 60% of the right in the Bidco, which will express 5 out of 9 board members and the CEO. This concludes our presentation. We're now pleased to answer your questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Javier Suarez from Mediobanca.

Javier Suarez Hernandez - Mediobanca - Banca di credito finanziario S.p.A., Research Division - Research Analyst

The first one is on the acquisition of DESFA. If you can give us some more details on the financial criteria, the profitability that you are expecting from this acquisition. I think that you said that the total equity investment should be -- is likely north of EUR 100 million, you can confirm that? And the EPS impact that you are expecting from I guess 2019? And also when you are evaluating the company, which is your assumption regarding the allowed return on (inaudible) from the 1st of January, 2019. That is the first question. In the second question is on TAP, there's continuous inflow -- news flow, possible delays in the program, particularly, when it comes to the connections with the Italian system, you can please update us on the completion of the TAP pipeline and if that may have any delay in your view? And the third question is on the recent news flow that if Snam could be interested in some privatization process in Brazil, if you can give us some light on that?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

So on the first on Greece. I think what we meant is when we say that the returns that we are targeting, that were implied on our offer are consistent with that our international associates. I think I've been fairly precise in the type of returns that we have embedded in our offer for DESFA. As you know what sort of equity or cash return we're making on our international associate portfolio today. So that's a good proxy of where we expect DESFA to be depending on how we will finalize the acquisition financing that we are discussing, which is why -- the reason why I'm giving a range and it's also the reason why I'm not going too specific as we are close to finalizing final terms with banks, but until that has been done and signing takes place, it's a little bit premature for us to be specific on absolute equity contribution and moreover on EPS impact for next year, also taking into account that as you can imagine we will be having dialogue with regulator as it relates to the renewal of the tariff for the coming years. As it comes to TAP, nothing changes on the timeline, so as we've been saying on March, we still expect TAP to come into operations in 2020. So nothing is really changing since what we said a couple of months ago. When it comes to the rumors that you're referring to, as you know, we don't comment any on any M&A rumor in general. I think what matters is really is just to confirm our commitment to the investment criteria that we state one year ago and that we confirm last March. We want to maintain our rating and metric -- credit metric service profile. First, the investment needs to generate accretive returns, on the risk-adjusted returns for the investment. Again that needs to be equal or better on an adjusted basis that one we make on our CapEx. We're keen on investment that, [amends] the value of our existing infrastructure or that allow us to develop and leverage our industrial capabilities and unlock additional growth or -- optionality.



Operator

Our next question comes from Harry Wyburd from Bank of America.

Harry Peter Wyburd - BofA Merrill Lynch, Research Division - VP and Junior Analyst

Just a couple of small ones to follow up. Eventually on DESFA. There was a good economic and gas demand scenario in Greece. Is there -- Can you quantify the volume exposure or GDP exposure of that business, is it the same as what you have in Italy in terms of the volume exposure, is it tucked and collared within a very small range or is there a wider range in Greece? And then secondly just returning to Slide 4, just on the costs. So EUR 15 million of extra costs in the quarter, you mentioned the demerger synergies - dis-synergies. Can you just remind us how much of that EUR 15 million increase in costs came from, sort of rightsizing things post the Italgas de-merger. And whether there's any further demerger cost impacts that we should expect for the rest of the year?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

The first is easy, there is no volume risk because it's a capacity regulation structure so I think the - there is any -- positive implication on volumes, that is more related to past revenue from DESFA rather than anything that relates the (inaudible) regime that is currently in place. As it comes the cost, I think the demerger -- dis-synergies that we quoted in June 2016, now, were targeted EUR 10 million for first year and EUR 15 million in the second year. So when I made reference to the fact that there is a ramp-up in the merger dis-synergies, I'm simply reminding that the timeline that was required to have the full impact from the demerger was more than one year. Overall, we were at EUR 19 million efficiency by the end of 2017. By the first end of the first quarter, we have reached almost EUR 20 million but costs are not all linear. So that's not something that needs to be kept in mind. And I think it's also very important when looking at the evolution of cost, and even in the first quarter -- is just remind that in the first quarter 2017, the phasing of the costs was likely unusual. The costs were relatively lower in the first quarter than in the rest of the year. And that's something we need to keep in consideration when comparing quarter-on-quarter.

Operator

Our next question comes from Rui Dias from UBS.

Rui Dias - UBS Investment Bank, Research Division - Associate Director and Equity Research Analyst

The first one, Alessandra, just to confirm on your guidance, you're not including any impact from the acquisition of DESFA, right? So this will be the first question. And second question is also very -- a bit broad regarding balance sheet. Are you able to tell us what would be Snam's balance



sheet capacity for further acquisitions after the acquisition of DESFA without any significant impact on your credit ratings?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

Thank you. I guess for the first question, it was related to net debt guidance correct? That's what you meant?

Rui Dias - UBS Investment Bank, Research Division - Associate Director and Equity Research Analyst

Yes, correct.

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

So of course the full year guidance that we gave, did not include DESFA because at the time we were in a competitive auction. So aside from the DESFA equity contribution, we have no reason to make any further -- not to confirm our guidance for the year. When it comes to financial flexibility, I think that as you know, we do have the most stringent parameter that we have is the net debt to RAB at 60%. So we ended 2017 with 52%. You know that rating agencies look at our metrics, looking at the pro rata contribution also of the RAB of our acquired participations. So I think that you can roughly work it out from next year because the closing is expected by year end. The type of financial flexibility that Snam still have. But as I said, we expect the equity contribution to be in the EUR 110 million, EUR 130 million. So not really moving the needle in terms of our financial flexibility.

Operator

Our next question comes from Enrico Bartoli from MainFirst.

Enrico Bartoli - MainFirst Bank AG, Research Division - MD

First of all, I'd like to go back to the slide. If you can give us the rough value of the company at the moment and actually on the [brands], there were indication of potential additional CapEx very significantly related to that to the company. If you expect that -- actually the company would provide the possibility to significantly grow the rough value over the next years? And second question in general on your comment on this dry speculation about your interest in Brazil and the fact that, if I understand well, that you're looking for opportunity that will provide an interesting return on capital? This implies that actually now you are interested also in looking at M&A opportunities outside Europe because I guess that so far probably your interest was focused on Continental Europe and if you can comment also on the [blast]. There was reported some contact with gas more recently. Is this a part of this -- your new strategy or new (inaudible) in terms of M&A. The third one is related to the buyback. Particularly you canceled some shares during the period. This is something that, first of all, can you elaborate on the rationale on this? And if we are going to see this process to continue also in the future over the next quarters?



Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

Okay, so going in order. DESFA. The 2016 RAB was approximately EUR 800 million. That's the latest publically available number that you can take as a good proxy. In the national development plan for 2017-2023, DESFA and this a public, indicated EUR 330 million of CapEx including the connection with the LNG plant of Revithoussa. This is DESFA plan. I am not saying this will be our plan but I think we do expect some good contribution in terms of investment to further develop the RAB and I think more importantly also see on top of the strategic connotation that I described earlier, the opportunity to explore the introduction of CNG as well maybe bio-methane for the Greek market, which offer us additional scope for maybe leveraging on a good existing platform. It's also important to remember that DESFA 2017 year end numbers closed with a EUR 5 million net cash provision, so it's a company that effective has sufficient flexibility to fund its own CapEx and I would even say that it has scope to optimize its capital structure. On the question, Europe versus non-Europe. I think we were relatively clear when we deliver our strategy presentation in March. I think what lies our investment criteria, which clearly says that to the extent that are investments that have announced the value of our existing infrastructure, we like. So that's clearly something that speaks for things that are closed or existing presence. But that's not -- does not exclude that for a good investment, that is consistent with our criteria we may not look at it if it is outside of Europe. So would actually put it other way around. As it comes to Gazprom, I think again, it's public knowledge that as part of the (inaudible) procedure, we've been asked as well as DESFA, for its own portion to evaluate -- carry out the feasibility study on a possible new route bringing gas into Italy. So it's our own duty to have this type of dialogue with the upstreams or shippers that are keen to explore new route for gas but nothing more than that. So I wouldn't read too much into the that meeting. As it comes to the cancellation of treasury share, well I think we've been asked many, many times since we started our share buyback what sort of utilization we had in mind for those bought back shares. I think we always said, with the exception of those that are there to serve our convertible bond that was done in the context of treasury -- capital structure optimization, it was viewed by us as a way to further announce -- the return for our investors, which clearly can be crystallized by further by also the cancellation of treasury shares. When it comes to the new share buyback, which has just been approved, our criteria will not change. So we've been mainly driven by value consideration, and the pace at we have which carried out, which is confirmed by the implied share price at which we have bought back our shares as well as the average premium RAB that we reported. i.e. -- until we think that there's a lot of unexpressed value for our own stock, one of the best way, place for to invest our capital and our financial flexibility is clearly our own RAB. So that's the logic behind it. I just want to remind, net debt guidance, there was no assumption of further buyback executed during the year because as I said it will be more a value-driven consideration that we will follow.

Operator

Our next question comes from Stefano Gamberini from Equita.



Stefano Gamberini - Equita SIM S.p.A., Research Division - Analyst

Just a few quick questions. First regarding the buyback, is it correct that you already have 4.5% of treasury shares and you can reach at maximum 6.5%, so even if you now you have EUR 500 million approval of buyback from the shareholder meeting, you can just buy a 2%, an additional 2% right now? Am I wrong or not? And the second, if you can repeat what is the guidance of net debt full year -- I joined the conference a little bit later? And if this guidance includes or not the acquisition of DESFA? Third question if I may do you have a guidance of OpEx for the full year considering this different phase of OpEx in first and second part of the year compared to last year?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

So on the buyback I think the additional number of shares that can be bought back is 131 million overall. So I think this maybe helps you aside from the percentage. So yes, we've reached 3.5% but then part of it has been canceled. So maybe it is easier to read it as 131 million shares is what we can buy further from now. On the net debt guidance as I said it did not include DESFA cost. Because at the time we gave the guidance, of course DESFA was not something we were certain to win. Depending on how we will finalize the acquisition financing package and the for -- the ultimate acquisition cost for our stake, we will of course reflect that in the guidance. When it comes to OpEx, I don't think that it makes much sense to be that accurate. And I just wanted to give you a sense that first quarter 2017 was relatively low in terms of cost and that was as we said already on the call last year, unusual for a number of reasons, which effectively led to a normalization during the rest of the year. It's not something that is due to a one off or something specific that I can explain, it's just simply a different phrasing of costs that we had last year.

Operator

(Operator Instructions) Our next question comes from Maurice Choy from Royal Bank of Canada.

Maurice Choy - RBC Capital Markets, LLC, Research Division - Analyst

Just one question from me and this goes back into the geographies in which you would consider to invest in. Based on what you're telling us, the investment criteria allows for you to look into many geographies, which will meet your investment criteria but I suppose we wouldn't want necessarily for Snam to go all across the world into every single market that meet this criteria specifically if some regions are more unsafe than your domestic ones or in Europe. So maybe instead of asking you whether you're interested in Brazil, would you rule out maybe top 2 or 3 geographies where you wouldn't invest in?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

Again, I think the way -- I wouldn't go down that path because I don't want this discussion to become a cherry-picking of things that we come to that we think are or are not interesting. We think what is important is we are not interested in opportunistic standalone companies. We are



focused on assets that, assuming that they are consistent with our investment criteria, allow us to further deploy capital. And that means that we may be interested in geographies where there is an underlying material and sustainable long-term need and growth for gas infrastructure.

Maurice Choy - RBC Capital Markets, LLC, Research Division - Analyst

Just a follow-up on that, so if for example there is an opportunity, say, in Russia or even India and that meets your criteria are you then -- would you also be considering that as well?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

I don't think that neither Russia or India frankly meet our investment criteria, first. The second that they are in long-term -- in special need of long-term sustainable gas infrastructure. So I don't think they don't fit our criteria for a number of reasons. Let's also remind us that the first and one of the most important is our credit rating matrix and risk profile which already means quite -- many few things. Because one of the ways we adjust our returns is looking also at the underlying risks of the regulation, the country risk -- counter party risk. So all of these things are things that are -- that are taken into due consideration. Moreover, we look at things that have either a regulated nature or long-term contractual nature. So we don't look at things that have commodity risk. So I think we've been already fairly explicit in our investment criteria in a number of occasions and we are not going to move from this, and be very disciplined from a financial standpoint on this.

Operator

Our next question comes from Antonella Bianchessi from Citi.

Antonella Bianchessi - Citigroup Inc, Research Division - Director and Head of European Utilities Equity Research

Just a very quick question on the Ukraine Gazprom transaction deal. Do you have any update on that and do you think we will know if the contract for the transport of Russian gas via the Ukrainian pipeline is going to be in -- by the end of this year or is a decision that you think is going to be taken maybe further -- in 2019 or 2020? And which could be the role of Snam in this type of decision?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

I think as we said in the past, for us Ukraine may only be relevant from a services standpoint so not from an investment or a capital commitment standpoint. That's the only background to the MOU that was signed one year ago. I think we are going to monitor what happens and to extent that there is the need for a TSO to provide its competence via services to facilitate whatever the Ukrainian and the Russians and the European committee will decide in terms of the ongoing



discussion on Ukrainian route. We may be there to consider. But there is nothing more in which we are involved frankly.

Antonella Bianchessi - Citigroup Inc, Research Division - Director and Head of European Utilities Equity Research

And in terms of timing you think it's going to be a 2018 or more a 2019 decision?

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

I'm afraid that's not something that we have particular view because it's not something that depends on us. As I said, to the extent that there will be the need and a solution that require a TSOs provider competence, we will be there. It seems to us that not much has happened since the MOU one year ago. So very hard to comment on what sort of timeline those discussion will have. As I said we're not the main actor there frankly. We will we only be participating via services to the extent there is any reasonable scope for competence to be provided from a TSO like Snam.

Operator

There are no further questions from the phone.

(Operator Instructions) As there are no further questions, I'll now turn the call back to your host for any additional or closing remarks.

Alessandra Pasini - Snam S.p.A. - CFO and Chairman of Snam Rete Gas

I thank you very much all for your time and patience on this call and look forward to speaking on the next one.

Operator

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



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