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ATOM - Q4 2017 Atomera Inc Earnings Call

EVENT DATE/TIME: MARCH 13, 2018 / 9:00PM GMT



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CONFERENCE CALL PARTICIPANTS

Cody Acree *Drexel Hamilton - Analyst*

Robert Sussman *Bentley Capital - Analyst*

PRESENTATION

Operator

Welcome to the Atomera 4th quarter 2017 earnings conference call.

(Operator Instructions)

As a reminder, today's conference is being recorded.

I would now like to turn the call over to Mr. Mike Bishop with the company's investor relations.

Sir, you may begin.

Mike Bishop - Atomera Inc. - Investor Relations

Thank you and good afternoon everyone. I'm Mike Bishop with the company's investor relations and joining me today on today's call is Scott Bibaud, Atomera's President and CEO and Frank Laurencio, Atomera's CFO.

In addition to today's prepared comments we have posted a slide deck to accompany our remarks on the investor relations portion of our website at Atomera.com. After prepared comments by Scott and Frank we will open the call up for your questions.

Before we begin I would like to remind everyone that during today's call we will make forward-looking statements. These forward-looking statements, whether in prepared remarks or during the Q&A session are subject to inherent risks and uncertainties.

These risks and uncertainties are detailed in the risk factors section of our filings with the Securities and Exchange Commission, specifically in our annual report on Form 10-K for the year ended December 31, 2016 filed with the FCC on March 31, 2017.

Except as otherwise required by federal security laws, Atomera disclaims any allegation to update or make revisions to such forward-looking statements contained herein or elsewhere to reflect changes in expectations with regard to those events, conditions and circumstances.

Also, please note that during this call we will be discussing non-GAAP financial measures as defined by FCC regulation G. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures are included in today's press release, which is posted to our website.

Now I would like to turn the call over to our President and CEO, Scott Bibaud. Please go ahead and turn to slide 3. Go ahead, Scott.



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Scott Bibaud - Atomera Inc. - President and CEO

Thank you, Mike. Welcome everyone to Atomera's 4th quarter 2017 business update call. I'd like to start by detailing a number of significant accomplishments since our last call on November 6th and a summary of 2017. Then I'll turn it over to Frank to review our financial results and we'll open the call for questions.

Atomera achieved a major milestone in the quarter by achieving its first ever revenue and more importantly we continue to build and drive our customer pipeline. If you are new to Atomera, we are a materials and intellectual property licensing company with a proprietary transistor enhancement film called Mears Silicon Technology or MST. We are focused on solving one of the biggest problems facing the \$400 billion semiconductor industry today, the slow-down in Moore's Law.

Using Atomera's technology, a manufacturer can make meaningful power performance and cost improvements to their chips. They can use those improvements to avoid the capital investments necessary to build a multi-billion dollar next generation fab, to extend the life of an existing fab or to make an investment in a cutting-edge new fab even more attractive.

In many cases, customers who have exhausted all other opportunities for significant product enhancement look to MST as the only cost-effective solution for getting to the next level. If a customer decides to work with Atomera we will execute a license agreement which grants them the right to manufacture using our technology in exchange for a license fee and royalty payments on shipments of their products.

Slide four - by now, most of you are familiar with our method of representing progress of customers through the phases of engagement shown here. Phase one includes only customers who are actively planning an evaluation of our technology. In phase two we deposit our MST film on customer's wafers for the first time and conduct physical characterization to ensure there's a match between their process steps and our technology.

Phase three is where customers incorporate MST during the production of their wafers and use the test results to justify licensing our technology.

This process can be expensive for both customers and for Atomera. In the fall, we started to discuss charging new customers for MST deposition work. Although the idea initially met some resistance, our efforts have started to bear fruit. In December we recognized our first engineering services revenue. This demonstrates that tier one industry players are willing to invest not only internal RND Resources but also in Atomera to investigate the potential of MST.

At this point in our company's development, engineering services revenue will be largely driven by our evaluation process with customers. So, we are not at the point where we can reliably forecast ongoing engineering services income. Although we are not expecting revenue in Q1, we do anticipate growing engineering services revenue as more customers evaluate our technology.

Slide five - our engagement model was created based on years of working with many different customers. It is intended to represent a typical customer interaction. However, as our list of potential customers grow, we are now starting to see deviations from this linear-phased approach to licensing our technology.

For example, we are now talking to customers about licensing much earlier in the process which will allow us to cement our relationship earlier and will allow them a wider investigation of our technology.

Slide six - other customers are conducting more testing in phase two than in the past. The quick physical characterization techniques used in phase two can be very useful to customers who rely on TCAD to understand our technology, as they can provide good first-level calibration of their TCAD models. Last quarter we spoke about how we were hoping to use TCAD to help our customers minimize the number of integration runs to make an earlier license decision.

In fact, we have made excellent progress on this front. We are working with and delivering TCAD scripts to more and more customers. As a result, you will see some customers who are spending more time in phase two than they have in the past. Overall, this is a very healthy development for all sides since we build credibility with the customer as they use more TCAD and we believe these investments in phase two may shorten the respective customers' time in phase three.



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Other customers however are progressing more rapidly into phase three than we have previously experienced. In the past, as customers move through our phases, they have entered into deep cooperative integration efforts with Atomera. Some of our new ones are more interested in a quick evaluation run and a decision, shortcutting our traditional planning evaluation and testing process.

While we may ultimately develop a deeper relationship with them, it may also result in higher churn than we've experienced in the past. We welcome this new type of customer since although there is a chance they may come and go more quickly, they may also reach a license decision sooner.

Slide 7, during the last quarter, one of our phase three customers began the process of installing Atomera's MST technology in their factory. By doing so, they will gain an ability to run faster integration lots since they will not have to ship in process wafers to Atomera for MST deposition and back to their fab for further processing. We believe this will allow the customer to more quickly understand the optimal way to integrate our technology into their manufacturing process and hopefully accelerate a license decision.

It also will allow them to experiment more easily with other process nodes and relieve Atomera from the costly and resource-intensive task of depositing MST on their wafers. We will continue to encourage more of our customers to install our technology early in the process as we view this as a very positive development in attracting new ideas on how and where to best use Atomera's technology.

Slide 8, during the last quarter we added three customers to our phase two or set-up phase. Two of them remain in the set-up phase today as they continue work on both TCAD and physical characterization of MST on their wafers. As we announced in January, one of the three set-up customers moved ahead to become the sixth customer in phase three.

It is gratifying to see that over the last 12 months we have doubled the number of customers we have in both phase two and phase three. Our reach across the industry has widened to the point where today we are engaged with 50 percent of the world's largest semiconductor companies.

For our customers' engineering teams, RND wafers continue to be an extremely valuable commodity since their fabs are still running at historically high capacity utilization. In 2017 for the first time the semiconductor industry is expected to reach over \$400 billion in sales.

Yet, during the last quarter our customers allocated more wafers to Atomera than ever in the history of our company. Our engineers have been working hard to deliver compelling results to more customers across a wider set of process nodes in market segments.

We have also made good progress in diversifying our customer base to include smaller sized companies reflecting our belief that smaller customers may move faster since their decision process is more streamlined. It is again worth emphasizing that a single customer going at a high-volume production can make Atomera profitable.

Today we are well-engaged with 14 customers and our probability of reaching commercialization increases with each new one. In 2017 Atomera has matured significantly with our technical know-how, our modeling capabilities and our customer engagement processes. With our first revenue we've proven that customers value the integration of our technology into their fabs.

Atomera's RND team has run more than 30 internal wafer runs, giving us insight into a wide variety of ways to improve our film and methods that will help customers successfully integrate it.

Our customer engagements are now keeping us busy around the clock. We have expanded our markets and applications basis and we've filed over 20 new patents this year to solidify our claims. It is our belief that Atomera is a significantly stronger and better positioned company than we were at the beginning of the year.

We look forward to sharing more of our successes with you as we continue to build Atomera into an important and successful technology provider to the semiconductor industry.

I will now turn the call over to Frank for comments on the company's financial results. Frank?

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Frank Laurencio - Atomera Inc. - CFO

Thank you, Scott. At the close of the market today we issued a press release announcing our operating and financial results for the full year and 4th quarter of 2017.

Please turn to slide 9. For the full year of 2017 our GAAP net loss was \$13.1 million, \$1.08 per share, compared to a net loss of \$12.6 million or \$2.22 per share in 2016. The higher net loss was due to increased operating expenses resulting from increased head court and increased outsourced fabrication test expenses offset in part by a decrease in interest expense.

We did not incur any interest expense in 2017 because all of our debt consisted of convertible notes which converted to equity upon the close of our IPO in August, 2016. All interest expense was non-cash and the accrued interest also converted to equity. Net loss per share was lower in 2017 primarily due to an increased in weighted average shares outstanding from 5.7 million for 2016 to 12.1 million in 2017.

Non-GAAP adjusted EBITDA in 2017 was \$9.1 million compared to \$7.5 million in 2016. Our press release in slide nine contain a reconciliation between our GAAP and non-GAAP results. As you can see, the major differences between our GAAP and non-GAAP results are stock compensation and interest, both of which are non-cash expense items.

We believe that non-GAAP adjusted EBITDA, especially when used in connection with GAAP information, provides a better view for investors and it is what we use for our internal planning purposes.

Our GAAP net loss for the 4th quarter of 2017 was \$2.6 million or 22 cents per share compared to a loss of \$3.4 million or 28 cents per share in the fourth quarter of 2016. The main reason for the lower net loss was that our stock compensation expense was \$804,000 lower in Q4 of 2017 than in Q4 of 2016. Non-GAAP adjusted EBITDA loss was 2.1 million in Q4 of 2017, the same as in Q4 of 2016.

Looking now at our results on a sequential quarterly basis, 4th quarter GAAP 2017 net loss was 2.6 million compared to a net loss of 3.3 million in Q3 of 2017. Our GAAP net loss declined primarily due to lower stock compensation expense and the recognition of our first revenue in Q4, 2017.

Non-GAAP adjusted EBITDA loss of 2.1 million in Q4 compares to a loss of 2.4 million in the immediately preceding quarter. The lower loss reflected recognition of engineering services revenue as well as the timing of outsourced engineering expenses.

Turning to the balance sheet, our cash at December 31 was \$17.4 million, a decrease of 2.2 million from 19.6 million at September 30th. Cash used during 2017 totaled \$9.3 million. Consistent with our success in moving more customers into the integration phase, we anticipate that we will incur additional expenses for tool usage, testing and TCAD modeling.

Accordingly, we expect our non-GAAP operating expenses, which closely approximate cash expense, will be closer to \$11 million in 2018. Revenue will offset these expense increases.

Our outstanding share count of approximately 12.2 million shares has not changed materially since last quarter. Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Cody Acree with Drexel Hamilton. Your line is open.



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Cody Acree - *Drexel Hamilton - Analyst*

Thanks for taking my questions and congrats on the progress.

Scott, if we could maybe just go back to your comments around this first installation of MST with your customer, if you could just maybe go back and review that a minute, because you would typically or would have expected on your prior timelines a licensing between that integration and installation. So obviously that licensing had not happened yet.

Is there further evaluation that's needed done? Is there a delay that your customer is needing to go through that installation phase, and could you just walk through again the benefits you see of kind of merging phase three and phase four?

Scott Bibaud - *Atomera Inc. - President and CEO*

Yes. Thanks Cody for the question. OK. So, yes, the customer has started to convert an epitaxial deposition tool in their factory to support our technology. In the past, as I was saying, typically we expect customers won't go through the expense and effort of doing a conversion of a tool like that until they've already reached a licensing decision and then their transitioning to production.

In this case, this customer was interested in doing it earlier so his engineers could start working with the technology and also so he could run more lots much more quickly. To give you an idea, when someone runs a lot today, they process the wafers for a month to a month and a half.

They send it to us for epi deposition and we do that deposition. But, between just shipping the wafers, doing all of the checks for contamination that we need to do when they get shipped and then setting up our tools and processing it and shipping it back, that can take a month or even two months to do. And, then it goes back to them and they probably have a couple more months of processing time, which is why we always say its six to nine months to process a wafer lot.

If they have this installed in their own factory, they literally can process and put our technology on in a few hours. So, they would be saving a month or more of time every time they process a set of wafers. So, that's a big benefit to them and to us. We've never talked about someone doing an installation before they have a license before.

But I will first of all assure you that our legal terms are all in place so that we feel comfortable that we are well-protected with this customer using our technology and if they decided to go production, they would certainly have to still execute a license with us before they could use that technology on their machines for producing saleable material.

Cody Acree - *Drexel Hamilton - Analyst*

And, Scott, thank you for that. Is it fair to say that this is one of the customers that you've been engaged with the longest and would be the most likely to move to that licensed stage first?

Scott Bibaud - *Atomera Inc. - President and CEO*

Yes. I don't think I'll give that level of details on the answer, Cody. But, definitely we've - at this point we've had five customers that we have been in phase three with. The newest one - it isn't him. Obviously, they've just entered into phase three. So, it would be one of the five earlier ones.

Cody Acree - *Drexel Hamilton - Analyst*

And, Scott ...



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Scott Bibaud - Atomera Inc. - President and CEO

And ...

Cody Acree - Drexel Hamilton - Analyst

I'm sorry. Go ahead, please.

Scott Bibaud - Atomera Inc. - President and CEO

No. I was just going to say that I think this is an extremely positive development. You know, it's not something that we encouraged earlier on in our company's history but now we're starting to see enormous benefits on this, not just because it saves us a lot of money and effort.

But also because when the customer puts the effort in to install it in their factory, they've kind of put more skin in the game and more commitment and we believe they'll ultimately be more likely to find a solution faster that will drive them to do the license with us.

Cody Acree - Drexel Hamilton - Analyst

I see. And, Scott, it does look as though you've seen an acceleration of the number of engagements and maybe even an acceleration in the progression through your phases. I guess, is this primarily - I guess can you maybe give me a list of what's driving that? Is it synopsis? Is it just one customer getting engaged? I know there's confidentiality in this, but does one customer or a handful of customers sometimes beget others getting involved as well?

Scott Bibaud - Atomera Inc. - President and CEO

I think there's a couple things that you touched on. Definitely the synopsis TCAD allows people to make a quicker evaluation that they would see real benefits for themselves. I also think we are getting a reputation in the industry where in the earlier days when customers thought they were only one of a few people that was trying this out, it was more risky.

Now that they see, you know, a lot of different players out in the industry are using it, or at least are evaluating our technology, then they are starting to wonder why they aren't evaluating it as well, and that's part of what we're seeing.

Cody Acree - Drexel Hamilton - Analyst

And, lastly, Frank, you mentioned the increased burn rate. You're not expecting engineering fees in Q1. But, are you expecting the balance of about 2 million, if that's the increased burn rate through the remainder of the year and this was 110,000, so that engineering fee - so, is this representative of the kinds of engineering volumes that you might expect?

Frank Laurencio - Atomera Inc. - CFO

It's hard to say, because the engineering service fees that we quote and that we may get paid can be for different things. At times it will be for test wafers. It may involve, you know, work done by us on a project basis. And, so that's why we're not, you know, forecasting what that revenue is going to be and the timing of it, because it's still a fairly new process to us and I just wanted to clarify that, to kind of get to the earlier point and a related one, which is when the increased burn rate would come.

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I made the comment about revenue offsetting increased operating expenses. Obviously to the extent that we have revenue, it will reduce the overall burn, but I wasn't implying that we are going to offset all of the increased burn with revenue.

The second point is, as far as the timing of an increase in the burn, that will be based on us reacting to the number of customers that we have and the demand for deposition on wafers. As Scott said, you know, getting the tool - getting a tool running in a fab helps because the wafers don't fly back and forth and we don't have to incur the cost for that work.

But, as we are working with 14 customers, if they become sort of bottlenecked in the processing, we may need to acquire additional tool capacity and the tool capacity may need to come in different vendor tools or 200 or 300 mm tool variations.

So, as of now we've done a very good job of kind of managing the queue and minimizing that expense, but we could easily see it increasing if we have to have reactors running for multiple different customers.

Cody Acree - *Drexel Hamilton - Analyst*

Well, a good problem to have. So, congratulations on the progress and good luck.

Scott Bibaud - *Atomera Inc. - President and CEO*

Thanks.

Frank Laurencio - *Atomera Inc. - CFO*

Thanks.

Operator

And, our next question comes from the line of Robert Sussman with Bentley Capital. Your line is open.

Robert Sussman - *Bentley Capital - Analyst*

Thank you. In your mentioning that this one customer with the installation has more skin in the game to solve the technical problems, can you give us an idea what the problems are and are the problems that customer is having common to many of the other customers that you have in the pipeline or is each customer experiencing different technical issues?

Scott Bibaud - *Atomera Inc. - President and CEO*

Yes. I mean, at a high level we're trying to - we're always trying to solve the same problem with a customer. We're trying to bring them a big performance improvement while fitting our process improvements into his existing very highly-tuned semiconductor process.

So, typically that just takes a number of integration runs and you know, I don't think it's necessarily correct to call them problems. It's better to call them integration issues, because ultimately with any new process you solve a lot of integration issues before you go to production.

So, that's basically what we're facing. It's not that they're having like some big problem that they can't solve. They just know that they'll take - we'll take a few runs and if they install it inside they'll be able to do those runs faster.

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Robert Sussman - *Bentley Capital - Analyst*

If the technology is so compelling, why don't other companies want to do the installation to accelerate the process, rather than go through months and months of sending wafers back and forth and testing and re-testing? Because, it sounds like a number of the customers don't have enough skin in the game and the investment is on your part and you don't know really how serious that they are?

Scott Bibaud - *Atomera Inc. - President and CEO*

Well, I'm going to give you an idea. A customer who wants to try our technology, in order for them to change their tool, it's a very big impact. These tools cost \$6, 7 million each. To modify them to support our technology would cost another half a million dollars or so and then they have to put engineering resources dedicated to installing it and learning how to run it.

So, in the early stages it's almost always quicker and lower risk for them to just send the wafers to have us - I mean to us and have us deposit it. For some customers, they have a tool available and some free time on it. For them it would be less expensive, but it's still quite expensive to convert the tool and then dedicate the engineering resources to do it.

So, you know, generally I would say any customer who is doing an installation with us, it's a very, very strong statement above their commitment to making this technology work and to ultimately getting to a business agreement with us.

Robert Sussman - *Bentley Capital - Analyst*

Do you see other customers getting to the point where they're willing to do an installation or are they basically laying back to see what will happen with this one installation or see more evidence that the technology will produce the benefits you've indicated?

Scott Bibaud - *Atomera Inc. - President and CEO*

I would say, you know, we're talking to several customers about installation. Many of them are very interested in it early on because they would like to have more control over the development process.

But, there's - you know, we - I would say we generally need to go through one or two runs with them so we develop some kind of mutual trust between the two of us. And, at that point we'd be ready to - I mean, both sides would be ready to go through the process of doing the installation.

Robert Sussman - *Bentley Capital - Analyst*

Well, does the fact that - would the fact that other customers will do an installation - is that an indication that they are more serious and they're willing to put more skin in the game and more likely to actually take a license and pay the royalties and so that if we don't see that, does that indicate these companies are going to move very, very slowly?

Scott Bibaud - *Atomera Inc. - President and CEO*

No. I would say it's definitely a very strong indication if someone does do an installation, but there's many reasons why a customer who is super excited about the technology won't do an installation. So, I don't think that you should make the connection that if they haven't done an installation they aren't serious.

I mean, for - you know, one of the things that is also a big factor is besides just availability of the tool is availability of room on their production floor to put one of these tools. So, if they don't have a tool that's available, it's a very, very high hurdle to kind of buy one and install it.



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Robert Sussman - *Bentley Capital - Analyst*

OK. Because - OK. So, then if you have to go out and buy tools to put on your floor, how capital-intensive is that?

Scott Bibaud - *Atomera Inc. - President and CEO*

Well, it's capital-intensive, no doubt about it, but from a - you know, in the scale of a semiconductor factory, we believe it would be about on the order of \$30 million or so to outfit a factory to run our technology at pretty high volume - at a volume of say 30,000 wafers per month. And, so, you know, the alternative is to modify your fab for hundreds of millions or even billions of dollars, so that's not a very high hurdle.

But, to do an evaluation - you know, to get that - to spend you know, let's say \$6 to 10 million to just do an evaluation of another technology is a pretty high hurdle. And, you know, this option of just flying wafers back and forth to us lowers the barrier to entry for them. So, for many people it's a good option.

Robert Sussman - *Bentley Capital - Analyst*

One last question. Do you think any of these customers are absolutely convinced that they'll get the 20% or more benefit that you're promising and therefore they're willing to keep pushing on this or are you still at a point here where that has to be proven to them?

Scott Bibaud - *Atomera Inc. - President and CEO*

Yes. It's hard to generalize for all of our customers. I think most of our customers understand the science. They've seen the models that say that we can get there. They've seen results from other wafer runs that other customers and - in our internal development that show that it's possible to get there - they haven't seen it themselves. So, if they have, then we'd have a license agreement from them by now.

So, you know, the fact that we've never lost a customer says that I believe they're all - they all believe that it's possible and it's just a matter of continuing to work and make it happen. So, I - you know, ultimately I think it's a matter of time before we get to those results.

Robert Sussman - *Bentley Capital - Analyst*

OK. Thank you very much.

Scott Bibaud - *Atomera Inc. - President and CEO*

Sure.

Operator

(Operator Instructions)

And, I'm showing no further questions at this time. I'm sorry. We do have a follow-up question from the line of Cody Acree with Drexel Hamilton. Your line is open.



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Cody Acree - *Drexel Hamilton - Analyst*

Hey guys. Just one last quick one. So, Scott, you mentioned the - that you could have profitability with one high-volume customer. You've also talked about an engagement that's broadened with different sized chip companies. Would you have to be with one of those larger chip companies to achieve that goal of profitability or would some of your small or medium customers do the same job?

Scott Bibaud - *Atomera Inc. - President and CEO*

A small customer in a high-volume production line - so I talked about - I just talked a minute ago about a 30,000 wafer per month type of production line, which is - I would call that - it's a below-average total production line, but a good size one. I think that is the size that could probably get us to profitability, depending on how fast we penetrated into that total volume. So, small could do it.

Cody Acree - *Drexel Hamilton - Analyst*

Right. Thank you very much.

Operator

Thank you. And, I'm showing no further questions at this time. I would now like to turn the call back to Mr. Bibaud for closing remarks.

Scott Bibaud - *Atomera Inc. - President and CEO*

OK. Thank you. Thank you all for attending today's presentation. This quarter we capped off a great 2017 with a number of very big accomplishments. I want to invite you to please continue to look for our news, articles and blog posts to keep you up to date on our progress. You can sign up for them along with investor alerts on our website, Atomera.com.

Should you have any additional questions, please call our representative Mike Bishop, and we'll be happy to follow-up. We look forward to seeing some of you during our scheduled marketing activities, the next of which is Drexel Hamilton semiconductor week in New York on March 7th and the Roth Capital conference on March 12 and 13 in Dana Point, California.

Thank you for your support and we look forward to our next update call in May. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a great day.



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