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NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

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APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the NQ Mobile, Inc., fourth and fiscal year 2016 conference call. (Operator Instructions) Must advise you that this conference is being recorded today, Friday April 7, 2017.

I would now like to handle the call over to your first speaker today, Mr. Matt Mathison. Thank you. Please go ahead.

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Thanks, Kevin, good evening and good morning in Asia to everyone. We welcome you to NQ Mobile's conference call to discuss the financial results for the fourth quarter and fiscal year of 2016.

On this call tonight is our Chairman, Dr. Vincent Shi; our CEO, Mr. Zemin Xu; President, Mr. Justin Chen; our CFO, Mr. Roland Wu; and I am Matt Mathison.

Before we begin here is our safe harbor disclaimer. Please note that the discussion today will contain certain forward-looking statements made under the safe harbor provision of the US Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations. NQ Mobile does not assume any obligation to update any forward-looking statements except as required under applicable law.

Also, please note that some of the information to be discussed includes non-GAAP financial measures as defined in Reg G. The most direct comparable US GAAP financial measures and the information reconciling those non-GAAP financial measures to NQ Mobile's financial results prepared in accordance with US GAAP are included in our earnings release posted earlier today.

Finally, as a reminder, this conference call is being recorded. We are also offering investors a webcast of today's conference call, which can be found on the investor relations portion of our website at ir.nq.com. With that let's begin.

The call today is going to go as follows. We will first hear from our Chairman, Dr. Shi. Following his remarks, we will here from our CEO, Mr. Zemin Xu. Justin will then provide an update on the recently announced FL Mobile and Showself divestments. I will then provide an update on our businesses and our CFO, Mr. Roland Wu, will then review the financials. We will then open up a call for Q&A.

With that, Vincent, please go ahead.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Vincent Shi - *NQ Mobile, Inc. - Chairman & COO*

Thank you, Matt, and I wish to thank everyone for joining us today. As we complete the divestment of FL Mobile and Showself in the second quarter this year, I felt like it is important for me to describe our vision for the future.

We are a mobile-first, mobile-only company. Our vision is to be the most trusted mobile internet service company. We started out by providing mobile security solutions to smartphone users and expanded our mobile applications and services to consumers and enterprises.

We have worked with many mobile industry partners, including handset makers and carriers all over the world, and gained a unique position in the whole smartphone ecosystem. Now, as we are looking for the future, we will still keep our mission to provide trusted intelligent mobile experience for users. We are just changing our focus from smartphones to smart cars.

We will leverage the expertise and experience as mobile internet pioneers and start to establish strong partnerships in the new smart car industries. We will work with many industry partners throughout the entire smart car ecosystem and become a mobile experience enabler for smart cars.

We have been preparing for this revolution away from smartphones to smart cars for quite some time and today we are now officially making the advancement. This is a future that we believe has very compelling growth potential. As we are a mobile internet enabler for smart car companies, we should be a unique company in the entire smart car industry by not competing with them but by helping them.

I wish to turn over the call to Zemin to discuss more.

Zemin Xu - *NQ Mobile, Inc. - CEO*

Thank you, Vincent. Our future is going to be centered around becoming a mobile experience enabler for smart cars. Let me describe our philosophy around business organization.

Many of the new strategic investors that have participated in recent financial transactions around NQ Mobile, including Zhongzhi and Tsinghua Holdings, have enormous focus and interest in the smart car industry. We look forward to further strategic partnerships with those that we can work together as we build out our future in the smart car industry.

We will leverage these strategic partners and add more partners as well. We will also leverage the important mobile partners that were also involved in our smartphone businesses as well, including chipmakers, technology partners, and others.

Finally, our organization has a strong, talented management team in place focused on smart car opportunities as part of our Link Motion team. As we advanced further in the year we will continue to share more progress and the details. I am pleased to report today that our Link Motion team has successfully signed a commercial contract with a Chinese automaker already.

Now I will turn the call over to Justin.

Justin Chen - *NQ Mobile, Inc. - President & General Counsel*

Thank you, Zemin, and thank you, everyone, for joining us today. I want to provide you with a summary of where we stand with our FL Mobile and Showself divestments.

We are pleased to announce that we have reached a definitive agreement and signed formal share purchase agreements to complete the FL Mobile divestment as well as to sell our Showself live social video business to a fund affiliated with Tsinghua Tongfang Securities.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Let me just summarize each of these divestments for you. Pursuant to the terms of the definitive agreement for the FL Mobile divestment, Tongfang is purchasing 63% equity interest in FL Mobile, which is all of the equity interest that we own, for a total cash consideration of RMB2.52 billion. This values the entire FL Mobile business at RMB4 billion.

As a reminder, we have already sold the other 37% of FL Mobile. Vincent purchased 16.34% and Jinxin Hengrui, Haoyue, Huatong, and Tibet Zhuohua purchased the remaining 20.66%. They have adjusted their purchase price so that all parties are equal at the RMB4 billion valuation.

Pursuant to the terms of the definitive agreements related to the Showself sale, Tongfang is acquiring 65% of equity interest in Showself technology, which is all of the equity interest that we own, for a total cash consideration of RMB800 million. This values the Showself technology business at RMB1.23 billion.

We have already received the RMB150 million earnest money, which is nonrefundable and will be counted towards the remaining payments of the entire purchase price due to us on or before May 31 following customary closing conditions. In addition, Tongfang also has the option to purchase \$100 million worth of Class A common shares of NQ at a price of \$5.25 per ADS within three months after the date of the completion of the FL Mobile divestments.

We also announced that the management purchase of up to \$101 million was of company common shares NQ at a price of \$5.25 per ADS is also expected to take place within three months following consummation of the sale of FL Mobile business. This divestment process took longer than anticipated, but we are pleased to announce this progress and look forward to formally completing this entirely during the second quarter.

Now let me turn the call over back to Matt.

Matt Mathison - NQ Mobile, Inc. - VP, Capital Markets

Thanks, Justin. I am going to spend some time reiterating and providing a bit more background on the vision and future of NQ Mobile as just outlined by our Chairman and CEO.

We have been a mobile-focused company from the very beginning and that will continue. In the previous decade-plus the technology innovation and advancement within the mobile landscape has been centered on the smartphone device. We believe that connected automotive and smart car market will play a more and more important and central role in mobile innovation and technology advancement in the future decade. We have been positioning for this change.

If the smartphone was the dominating technology device of the past decade for mobile applications, we believe the car is the device of the future decade for mobile application innovation and opportunity. Similar to the evolution of the handset and smartphone devices, the initial major disruptions and development came from hardware advancements. However, following a period of hardware revolution, the enabling technology and differentiation came from software.

While on a different evolutionary and revolutionary pace, cars were always defined by engine advancements. However, the major technical revolutions of tomorrow in the automobile space will come from software.

Cars of today consist of over 200 different electrical control units, or ECUs, which all control separate in-car systems. As new functions and features have continued to increase for comfort, convenience, and differentiation, the amount of complexity and inefficiency has followed along. The benefits that proficient software can bring into cars include reduced hardware complexity, security, cost efficiency, added features, and a better overall user experience.

In addition, the need to deliver new features and updates through the lifespan of a car has become an integral part of a connected device and solution. Over the air, or OTA, updates for vehicles have become critical and also drive the need to truly have integrated and connected hardware and software solutions.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Finally, the security of the connected car system lies in all of the elements of the systems including the hardware, the software architecture, all applications, and connectivity features including the OTA updates. This is why it is impossible to add security as a single feature to an existing system.

Among other reasons, this is one of the main reasons why we are so excited and focused on the smart car market going forward. The opportunity for mobile software, security, and platform systems in connected and smart cars is just beginning. The smartcard market is enormous; the market is not just cars. The existing infrastructure and existing companies are old and inflexible and we believe that all new cars will be connected and smart in the not-distant future.

In a sense, this is similar to the desktop PC world and the opportunities that were in front of mobile players before smartphones really took off. We saw this opportunity then when we began NQ Mobile and now again we believe we are seeing a similar dynamic in the car space.

In the summer of 2015, we invested in and took a controlling stake in a Company called LinkMotion. LinkMotion has more than 10 years in automotive software experience and has delivered over 200 projects into various markets on a global scene. LinkMotion's system was designed to address many of the problem factors I mentioned above comprehensively and holistically.

The LinkMotion system was designed with security throughout. The hardware and software have been designed together, creating layers of defenses to protect vehicles from attack at every layer of risk. In addition to the all-important security solution, we also provide a cost efficient, robust, and secure computer for in-vehicle computation needs. The system is a complete platform that is fully customizable by the OEMs and flexible to manage all OTA updates and additional feature plug-ins as needed and desired by the carmakers.

In addition, we have seen market acceptance of this business and recently signed a commercial contract with a Chinese OEM to begin shipping certain lines of their cars with our platform during this year. We have a pipeline of other deals at various stages that the team has been working on and we fully expect 2017 to be a year in which we begin to see the financial progress show up.

One of our main focuses as a company will be centered in the smart car market going forward and we will certainly share more progress and updates on this as we move forward. It is important to also reiterate what our Chairman and CEO said: our biggest strategic investors and partners, those recently involved in transactions including Zhongzhi and Tsinghua Holdings, are very focused on this market and we look forward to leveraging these interests together in the future.

Now on to a different, but no less important, topic. Following the divestments of FL Mobile and Showself, we are committed to following through on our previously-stated plans to use our tremendous balance sheet.

Specifically, we are going to be using the cash and capital for two primary reasons, as we have previously stated. First, we will focus on enhancing shareholder returns through stock buybacks, and second, we will focus our investments and our execution priority in the business on the future of the smartcard industry as we just described.

We recognize that in this short conference call during our financial report it is not the optimal venue or time to detail this future out further. And, as a priority, we must complete and close our FL Mobile and our Showself divestments. We must use the cash to buy back stock and then we must begin to execute a clear business plan.

The chapter of the past is about to close and we are all looking forward to turning the page and beginning our new chapter. Given that and how providing an update on the FL Mobile business and Showself business operations in the past are no longer relevant to our future, we are just going to turn the call over to Mr. Wu, who will then discuss our financial results at this time for 2016.

Roland, go ahead.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Roland Wu - NQ Mobile, Inc. - CFO

Thanks, Matt. Now let us turn our attention to the financials. I wish to walk through some of the highlights and provide you with additional details behind the results.

It is important to mention that I will be using figures excluding the NationSky business for all the numbers in the comparable period in order to better compare the nature of the business as we have previous done. Now, let's start with a discussion of our revenues in the fourth quarter and fiscal year 2016.

We generated USD94.7 million in net revenues for the fourth quarter of 2016, which was an increase of 4% compared with last quarter. For the fiscal year, we generated net revenue of USD343.1 million, which is an increase of 19.7% compared with last year. As you know, most of our revenues are generated in RMB and, as the currency has depreciated almost 7% during that year, this translation impact offset some our reported growth in US dollars.

Revenues from our MVAS segment decreased 2.3% QoQ in the fourth quarter. This was mostly due to the security business continuing to decrease because we continue to transition from a premium subscription-based model to advertising model. FL Mobile's revenue slightly decreased due to the timing of the game launches.

Domestic and international business remains healthy. The Showself business performed great and reached a record level and constitutes about 60% our total MVAS segment in the fourth quarter. And compared to last fiscal year, revenues from MVAS segment increased 43.1% to USD199.8 million for the fiscal year 2016. This strength was primarily attributable to the revenue growth in live mobile social video platform business and mobile gaming business.

Our advertising revenues decreased 0.8% QoQ. This was inline with our expectations. Compared to the last fiscal year, overall advertising business revenue increased 44% as we continued to see expansion of our advertising networks and the consolidation of Launcher.

Revenues derived from our enterprise mobility businesses increased 60.1% when compared with last quarter, due to Q4 being the strongest season quarter as well as the timing of new smartphone launch. Our enterprise revenue for the fiscal year decreased 44% year over year as we continue to focus less on the hardware procurement opportunities overall.

Next, let's spend a few minutes discussing our gross margin and walk you through some of the elements within our cost of sales. Our gross margin in this quarter was 16% compared to 22.9% last quarter; also, our gross profit decreased 27.1% QoQ. The decrease in gross margin was mostly due to higher performance of our enterprise hardware business compared to last quarter, as Q4 is always the seasonally strongest quarter for enterprise and hardware procurement as well as fluctuations in our consumer business.

Gross margin for the fiscal year 2016 was 23.9%, which was relatively flat from last year excluding NationSky. Let me now walk you through our operating expenses.

I also need to highlight the impairment of goodwill and intangible assets which account -- according to GAAP standard is include as an operating expenses. There was impairment of goodwill and intangible assets of USD98.9 million in the fourth quarter and fiscal year. This came from USD8.1 million in impairment from the enterprise mobility reporting unit and USD90.8 million from the security and others unit, which consists of mobility, security, live mobile social video platforms, and internet traffic-related business.

Since this is a one-time non-cash expense, I will be referring to figures excluding the non-cash expenses associated with the impairment of goodwill and intangible assets in my discussion on operating expenses.

In the fourth quarter, total operating expenses was USD24.5 million and increased 1.4% from last quarter, which includes the share-based compensation and amortization of intangible assets rising from acquisitions. This increase was mainly due to slightly higher R&D expenses.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

As a percentage of revenues, our operating cost was normal and decreased to 25.9% of revenue from 26.5% compared with last quarter. For the fiscal year, total operating expenses was USD94.9 million, we significantly reduced our operating expenses for the year some 33.9% from USD121.2 million last year. This was one of our objectives this year as we will continue to stay focused on this going forward.

Total SBC expenses was USD0.1 million in the fourth quarter and USD12.6 million for the full year. This was also significantly below last year's total SBC expenses of USD16.6 million. Net loss attributable to NQ Mobile was USD124.5 million in the fourth quarter compared with net loss of USD9 million in the last quarter.

Net loss attributable to NQ Mobile was USD140.8 million for the fiscal year 2016, compared with a net loss of USD1.3 million in 2015. Non-GAAP standard net loss attributable to NQ Mobile was USD3.4 million in the fourth quarter and non-GAAP net income attributable to NQ Mobile was USD8.5 million for the fiscal year 2016, or \$0.09 per fully-diluted ADS for the year.

Finally, let me conclude my review of the financial performance for the fourth quarter and full fiscal year of 2016 by highlighting a few other things.

Our balance sheet. We ended this quarter with USD318.2 million for cash and cash equivalents, term deposits, and restricted cash, as we are in the process of divesting FL Mobile and Showself, our two largest components of our financials, we will not be providing guidance for 2017 at this time. However, we will find opportunities to present more details about the progress of our LinkMotion and smart car focus, as previously described, and will provide more information as we move forward through the year. Thank you.

Matt Mathison - NQ Mobile, Inc. - VP, Capital Markets

Thanks, Roland. That concludes our prepared remarks at this time, so, Kevin, why don't you go ahead and prepare the participants for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jun Zhang, Rosenblatt.

Jun Zhang - Rosenblatt Securities - Analyst

I have a couple of questions. One question be could you give us more color about this deal with Tongfang -- Tsinghua Tongfang? What is the difference between this deal with Tsinghua Tongfang versus a deal with other potential buyers in the past? And what is the timeline for that? Thanks.

Matt Mathison - NQ Mobile, Inc. - VP, Capital Markets

Yes, thanks, Jun. So on the question about -- I think you asked two parts of that. One was: What is the difference between this deal with Tongfang Securities and the other deals with other potential buyers?

I think the answer to that I think the main difference was in the previous transaction there was a contingency around the successful listing of the Chinese securities and the required regulatory approvals associated with that. This deal doesn't have that. I mean, we've signed the definitive agreement and regular customary closing conditions associated with it. So that is that.

On the part about the timeframe, I will just reiterate what Justin said. We have received the earnest money of RMB150 million already and, per the closing conditions, we are to receive the balance of the total monies due on or before May 31. And so that is the timeframe.



 APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. And then my second question is after the divesting of the asset, what other assets you have -- are going to remain with NQ? And also how do you use the cash after this deal close? Thanks.

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Sure. Let me answer the second part of the question first. We have been very clear with what we are going to do with the cash. We are going to do two things that we've stated.

The first thing we are going to do is focus on returning capital to shareholders through stock buybacks. And the second thing that we are going to do with the capital and the cash in the business is make sure that we invest and have a really strong future in the business that we just described. We are going to be focused on the smart car business.

In terms of the first part of your question, you said: What remains? Is that --? Can you repeat the first part of your question, Jun?

Jun Zhang - *Rosenblatt Securities - Analyst*

So after divesting the [video] and Showself what other assets you remain with the NQ listing -- listed part?

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Sure. As you know, we have a number of other subsidiaries and investments outside of the FL Mobile group and the Showself live video social video business that will be sold. And I think it is clear, based on the conference call today and the vision and direction of the Chairman and CEO, that we are going to be focused on the smart car business. The remaining other subsidiaries investments that we have we will have to see what happens with those as we go forward. But we are going to be focused primarily on the smart car business going forward.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Are you going to also still divesting other assets; still focusing on the LinkMotion business in the future?

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

I think the standard answer: obviously, we look at opportunities, right? So if there is an opportunity to divest or sell a business, we always consider it. We will do what's -- at the time is what we believe is the best thing for value. So we will look -- we take all opportunities and we will look at it case by case.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. And also the -- about LinkMotion, what kind of addressable markets you think of in the next one or two years and how big LinkMotion could grow in the next couple years? Thanks.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Yes, I think that is a really important question. Obviously, Jun, we are going to have the opportunity over the coming months and quarters to provide more specific information about the specific business model and opportunity.

We will look to have management non-deal roadshows, investor meetings, conference attendance as all part of that process of educating both about our LinkMotion business as well as about the opportunity that is in front of it. I will reiterate what Zemin said, we have signed a commercial contract already with a Chinese carmaker and we are working on implementing that during this year. And we have others in the pipeline so we do expect to start to see financial performance begin this year.

In terms of your overall market size question, I think the best way to describe the opportunity is to really look at the total number of vehicles sold annually and then determine what percentage of those sold are smart cars. And you will notice that as you do your work on that it's a fairly small percentage right now. Then you have to make a projection on what percent of those cars sold annually are going to be smart cars in the future and we believe that is going to be a very big portion and a big percentage of that.

So, look, we believe the market size is enormous. Obviously, the -- it is a global marketplace. LinkMotion is headquartered in Europe with also offices in China and so there is a global opportunity. Again, as we move forward through this year and start to see some performance, I think it will be a more appropriate time for us to give more specific financial projections and guidance at that time.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay, thanks. And my last question is also about buyback. Do you have -- by the time of buying back stock do you have enough US dollar to do that or you needed to continue to exchange from RMB to US dollar?

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Sure. Obviously, the currency controls associated with the RMB are a factor. We do have some currency that is outside that is RMB and we expect to have more with some of the other investments, management investments and things like that. That is a factor, but it is a factor that we are preparing for and planning for as we move forward.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay, thanks. That is all my questions.

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Thank you.

Operator

Dave Foertsch, BTIG.

Dave Foertsch - *BTIG - Analyst*

Congrats on moving forward on the divestment transactions and your initial commercial smart car contract. It sounds pretty exciting.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Could you provide maybe just a few more thoughts around maybe milestone we should be thinking about as you move down the new path of this strategy? Obviously you indicated you will provide more details, but should we think about -- I guess initially as we are looking at this is it commercial contracts that we should focus on and as those ramp and then the velocity of those ramping?

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Yes, absolutely. I think the important milestones are a couple. I think, obviously, commercial contracts with automakers are very important milestones. But then, after you get the commercial contract in place, obviously implementing and getting your system and your platforms actually into the cars themselves and sold out into the market are another important milestone.

And then after that then the milestones to look for will be, okay, what is the total market size, what is our competitive position, what percent of that market can we get; and then, on a per-car basis, what is the ASP and the revenue potential per car. I think we look at it those ways. We have got to first get the commercial contracts in place, of which we have got one, but that is not enough; we need more.

Second, we need to get those commercial contracts actually implemented and into the marketplace. And then, lastly, it will start to help obviously at that point to understand kind of the ASP per car and the revenue projections going forward. So those are the milestones we would point to.

Dave Foertsch - *BTIG - Analyst*

Okay, those are helpful from a broad brush standpoint.

And then secondly, obviously very encouraging that you are going to put the balance sheet to work with the buyback that you announced. Could you provide maybe some sense of the investment needed to penetrate this market and build out the broad-based solution that you have outlined for the connected car? Or does LinkMotion, is it fully developed -- is it a fully-developed platform at this point where it can support your new strategy?

Just any thoughts around that as a platform and the investment needed to make it a broad-based platform to go forward with your new strategy. Thanks.

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Yes, great question. The answer is LinkMotion, we have been working on building this now -- again, we took a consolidated position in it back in the summer of 2015 so we are going to approach two years on it. It is currently a fully-developed platform that is able to sign commercial contracts and be implemented as is.

Obviously, just like any industry in the mobile world, the need to continue to invest remains, but the business itself is fully developed. It is commercially ready. And as we move forward we will obviously continue to look at important investments or add-ons or technologies as we move forward, just like we have always done.

Dave Foertsch - *BTIG - Analyst*

Excellent, that is all of my questions, thanks. Thanks for taking them, appreciate it.

Operator

There are no more further questions at this time. I would like to hand the call back to the speakers for any closing remarks. Please continue.



APRIL 07, 2017 / 12:00AM, NQ - Q4 and Fiscal Year 2016 NQ Mobile Inc Earnings Call

Matt Mathison - *NQ Mobile, Inc. - VP, Capital Markets*

Thank you. Again, thanks, everyone, for joining us on this call. We hope you have a wonderful day and we will talk to you soon, thank you.

Operator

Ladies and gentlemen, that does conclude our conference call for today. Thank you for all participating. You may all disconnect. Goodbye.

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