

ORANGE POLSKA Q3 2014 RESULTS CONFERENCE CALL
October 23, 2014, 11:00 AM CET
Chairperson: Leszek Iwaszko

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Orange Polska third quarter 2014 results conference call on October 23. (Operator Instructions).

I will now hand over the conference to Mr. Leszek Iwaszko. Please go ahead, sir.

Leszek Iwaszko - Orange Polska SA - Head, IR

Good morning, everyone. Welcome to Orange Polska's results conference for the third quarter of 2014. My name is Leszek Iwaszko. I'm the Head of Investor Relations. Today we are joined by management of Orange Polska starting with Bruno Duthoit, Chief Executive Officer; Maciej Nowohoński, CFO; Mariusz Gaca who is responsible for the Business Market; Michał Paschalis-Jakubowicz who is responsible for the Mass Market; Piotr Muszyński, Chief Operation Officer and Jacek Kowalski who is responsible for HR.

Please note that our results have been published yesterday afternoon. They are available on our IR website www.orange-ir.pl. Now I hand over the floor to Bruno Duthoit to start the presentation.

Bruno Duthoit - Orange Polska SA - CEO

Thank you, Leszek. Good morning, ladies and gentlemen. The agenda for today is as follows. I will begin with some highlights of the third quarter and also address the recent regulation and network modernization. I will then ask Mariusz Gaca to talk about our new initiative Orange Finanse and our progress in conversion offers. Maciej Nowohoński will follow with the financial review. Finally, I will conclude the presentation with a few takeaways before opening the Q&A session.

Let's start with Q3 highlights on slide 5. Q3 was a very busy period for us. We have completed the preparation of two new important commercial initiatives, Orange Finanse, and a pilot for Orange Energia. We have also enhanced our broadband offer following deregulation.

In Q3 we maintained a high level of commercial activity. Our mobile customer base continued to grow by more than 3% year on year and we broke another record for quarterly net addition of dedicated mobile broadband customers, MBB.

We see sustained strong demand for convergence and high speed fixed broadband. Our mobile number portability balance in Q3 was below the previous two quarters, but we are still ahead of the two other mobile incumbents.

Our financial results were marked by slower revenue decline due to much lower regulatory impact. As we said a quarter ago, market rivalry is not getting any easier and this is reflected in our mobile ARPU evolution.

Nonetheless, we have achieved satisfactory EBITDA margin due to cost savings and efficient commercial spending. We confirm our full year guidance for organic cash flow.

We are pleased to see 800 megahertz frequency spectrum auction process being re-launched after a period of uncertainty. We confirm our interest to take part in the auction.

In Q3 the Polish regulator approved partial deregulation of the fixed broadband market. Let's review this on the next slide.

First, we are very happy with this decision. It will definitely contribute to the development of the internet market in Poland and to the objective of the digital agenda.

This means to us much higher pricing flexibility on the retail market. We have immediately reacted to this new market condition by launching last week a new more attractive offer on the deregulated areas.

However, the regulation alone is not enough to structurally improve the broadband market share which we lost over the previous years. Quality upgrade of our network is a must. Deregulation constitutes a trigger for us to consider investing in fixed broadband area based on fiber technology.

We are currently analyzing the business case. Before we announce our plans we want to make sure it will strictly meet our investment criteria, and that we are able to monetize it. The result of Warsaw pilot are promising and prove our ability to win back customers.

As for the wholesale market we intend to continue to make our infrastructure available to alternative operators now on commercial terms.

On the next slide I would like to summarize our mobile network modernization project. As you know, in July 2011 we announced a network sharing agreement with T-Mobile. After a period of preparation, network modernization kicked off in Q2 2012. The project was just completed after around two and half years.

On the slide you can see the scale of improvement in terms of 3G coverage which has reached now almost 100%, but also the jump in data usage overall and per customer. Our LTE network construction started in September of last year, and today after a little more than one year it is reaching close to 60% of population.

Let's now look at our new commercial initiative Orange Finanse and how we are progressing in our convergence strategy. I would like to ask Mariusz to present it.

Mariusz Gaca - Orange Polska SA - VP, Business Market

Thank you, Bruno. Morning, everyone. In just around six months we managed to launch what we believe is the best and the most innovative retail mobile banking platform in Poland. It combines the unique assets of Orange Polska and the banking expertise of mBank, which is the fourth Polish largest bank which has set the trends in mobile electronic banking.

Now why do we do that and what kind of value will it bring to us? For quite some time we've been looking for new opportunities to offer more services to our customers that would be complimentary same time to our telco services.

Today, with the smartphone becoming management center for a large group of our customers, customers overall, and with a growing number of people buying online via a mobile device, financial services look like a natural extension of our service portfolio.

Bundling telco and financial products should result in increased customer retention. The revenue impact would depend on the scale and pace of service adoption. What is quite important, Orange Polska does not bear any risk of managing banking products. We provide our brand, our marketing, customer acquisition, distribution and bundling strategy. Using the agency model, we are remunerated in for client on-boarding and for product sales.

We encourage all of you to test and to use Orange Finanse. This is very easy to set up an account. This is very flexible. And probably and the most importantly, this is very beneficial from the economic point of view of our personal finance.

On the next slide we will review performance of Orange Open. As you can see. by the end of Q3 we had 480,000 customers of Orange Open. Net quarterly acquisitions was maintained at above 60,000 customers, and more than 20% of our fixed broadband clients are now in Open.

All Orange Open customers use almost 2 million services which implies, that on average every one of them uses more than four services. And this figure has been sustainable. Our upsell statistics keep on improving. The share of those customers who bought additional services when entering Orange was at 61% as of Q3, up from 57% as of Q1.

Thank you very much. Now I will pass the floor to Maciej Nowohonski for financial review.

Maciej Nowohoński - Orange Polska SA - CFO

Thank you very much, Mariusz. Good morning, everyone. Let's begin the financial review on slide 11. As Bruno mentioned, the market environment remained challenging in Q3 but we managed to achieve satisfactory results.

The top-line dynamics improved as we no longer saw the impact of the MTR reductions from mid-2013. Cost savings and effective management of commercial expenses allowed us to generate resilient EBITDA margin.

The scheduled increase in payments for the UMTS license and revenue pressure drove the cash flow generation slightly down year on year in Q3. Nonetheless, our cash flow is on track with the guidance for the full year. As a reminder our objective is that it will be at least stable versus 2013, above PLN1.1bn excluding one-offs.

Let's review our results in more detail, starting from the revenue. As expected, our revenue decline materially slowed down in Q3 due to a much lower regulatory burden. Excluding regulatory impact, revenue decreased by less than 3% or PLN87m versus Q3 of last year. Dynamics were affected by lower than expected ICT. We see also stronger push of our B2B customers towards more affordable solutions. This trend on B2B mobile seems to be rather sustainable in the coming quarters.

Let's now look at mobile in more detail. Mobile revenue, excluding regulatory impact, was up 1.5% year on year. Key growth drivers include the launch of installment offers, which impacted mainly equipment revenue, and the expansion of our customer base which continues to grow above the level of 3% year on year.

Our retail ARPU erosion further deteriorated. There are two main reasons for that. First of all, price competition continues. Secondly, higher popularity of SIM-only offers as well as installment offers have a negative influence on ARPU. However, the value that we generate from a customer remains comparable to traditional subsidized offers.

We work on ARPU defense to slowdown the deterioration. Additional services like insurance or incremental data bundles, careful retention process in which we try to limit ARPU erosion, new motivation schemes for sales and distribution. These are some examples in that field.

Let's now turn to broadband. Fixed broadband is a key strategy element for a convergent player. That is why we would like to use opportunities coming from the deregulation to invest in high-speed technology to make our network more competitive, as mentioned earlier by Bruno. We still see robust demand for high-speed internet.

Our fast broadband customer base is up 160% year on year. Our total customer base is falling, however, only due to the CDMA legacy products. ARPU is stable at around PLN60. On one hand, it is supported by stronger triple-play bundles and VDSL offer sales. On the other hand, it is negatively affected by the re-pricing of old contracts both on consumer and business markets.

Let's now take a look at the fixed voice. Fixed voice revenue evolution saw further improvement. In Q3 this revenue category contracted by 12% year on year versus 13% in Q2 and 16% a year ago. The improvement is driven both by better subscriber trends and the lower ARPU erosion proving our efficient bundling strategy. The number of fixed voice clients went down by 54,000 in Q3 versus 78,000 a year ago.

This concludes the review of our top line, and we are moving right now to EBITDA. Q3 restated EBITDA amounted to almost PLN1.07bn. It stood at 35.1% margin. Compared to the previous year, decline was by PLN90m.

It was affected by revenue down PLN87m and interconnect costs, which excluding regulatory impact, went up by PLN49m in line with the traffic growth and finally, other OpEx which increased mostly due to broadband infrastructure projects realized with local communities.

On the positive side, EBITDA was supported by our cost optimization program which added another PLN80m in Q3 and lower direct commercial costs, despite higher number of acquisition and retention acts.

On the next slide we will take a closer look at our cost savings. In Q3 we maintained the pace of cost savings from the previous quarter. We are proving that our efficiency gains reach far beyond workforce optimizations. We are reviewing every possibility to save costs and reduce our resource consumption. Our workforce optimization progresses as scheduled. Year on year our employment is lower by more than 1,500 people.

Let's now turn to net income. Net income amounted to PLN140m in Q3 versus PLN239m a year before. This decrease was mainly driven by lower reported EBITDA. That was partly offset by lower depreciation and lower net financial expenses as a consequence of debt refinancing executed in May this year.

Let's now review how all of this translated into cash generation. Organic cash flow amounted to PLN369m in Q3 and was in line with our expectations. As I already mentioned, starting from this year we pay higher annual UMTS obligations. In Q3 we paid close to PLN120m which is around PLN50m more than last year. Such level of payment will continue until the year of 2021.

Decreasing revenue no doubt puts additional pressure on our cash flow generation. On the other hand, we are helped by our selectivity on costs, CapEx and we benefit from lower cost of debt. We constantly improve our working capital management. We have in our pipeline right now an attractive supply chain financing program for our suppliers. On top of that we look into possibilities of cashing the receivables coming from installment offers.

Concluding my part, I want to reiterate that we are comfortable with full-year guidance. The Company is well prepared to fight for cash generation coming from business as usual. We also have secured financial means to cope with significant standalone events, spectrum auction being an example here.

Ladies and gentlemen, thank you for your attention. And I hand the floor back to Bruno for conclusion.

Bruno Duthoit - Orange Polska SA - CEO

Thank you, Maciej. In a challenging market environment that persisted in Q3, we managed to achieve relatively good commercial and financial results. The market rivalry remains high. At the moment we are even more concerned by the situation in the business client segment where we see increasing competition and erosion of the value chain. We are working on an action plan to address this issue.

As we move into the fourth quarter, traditionally our peak season, we will remain proactive on the commercial front. At the same time, we'll keep on rigorous cost control. Our ambition is to deliver significant savings in the quarters to come.

As I mentioned earlier, we are analyzing various possible options to invest in fiber technology in urban areas following deregulation. We will communicate our decision as soon as we are sure the business case is well prepared and we can achieve desired return on these investments. Therefore, I would like to ask you for your understanding if we are not yet in a position to answer all of your questions on that topic today.

Thank you very much for your attention. This concludes the presentation and we are now ready for your questions. Thank you.

Q&A

Leszek Iwaszko - Orange Polska SA - Head, IR

I suggest we, as we usually do, start with the questions from the floor if there are any.

Pawel Szpigiel - mBank Securities - Analyst

Pawel Szpigiel, mBank Securities. In the presentation you concluded that the market remains very competitive. Could you please refine that slightly? In particular, could you comment on B2B mobile market and broadband market?

Bruno Duthoit - Orange Polska SA - CEO

Mariusz, do you want to take this?

Mariusz Gaca - Orange Polska SA - VP, Business Market

I will comment B2B market with maybe three points that I believe are the most important. First is that what we see now in the B2B market is similar to what we've experienced a couple of years ago in the B2C market where the price competitiveness is increasing and in fact it's benchmarking very much on the B2C segment. That's the first point.

Now the second point is that we observe that there is a clear tendency for companies going SIM-only, which by the way, we should keep in mind it's not necessarily bad for the profitability but definitely touches the top line. So the SIM-O shift is clearly visible in all categories both mobile, voice and mobile broadband.

And third last point, I think it's quite similar to B2C, but this is a market that is becoming a market of abundant offers, so unlimited offers. So we clearly see that a portion of revenue and ARPU in particular coming from additional minutes in the past off net and earlier from on net even are now disappearing from our P&L as all of those is already included in the unlimited tariff plan. So these are three of the most important points from the B2B market.

Bruno Duthoit - Orange Polska SA - CEO

Thank you. Maybe on broadband, Michał, some word?

Michał Paschalis- Jakubowicz - Orange Polska SA - Head, Mass Market

On broadband we see the continuing competitive pressure from cable TVs that increase the speeds of internet in their offering. We also see the low cost introduced by one of our competitors based on the traditional DSL technology. And as well as we see the attempts to infiltrate a fixed broadband market with LTE.

The comment that I want to make at this opportunity is also that ourselves we do not see the increasing churn of our DSL in that respect. However, this is due to many efforts we make including the convergent offerings to protect the base in this context.

Leszek Iwaszko - Orange Polska SA - Head, IR

Any more questions from the floor? I don't see any, so let's turn it over to the conference listeners.

Operator

(Operator Instructions). Herve Drouet, HSBC.

Herve Drouet - HSBC - Analyst

Yes, good morning. It's two questions, the first one is regarding the change of the regulatory environment in Poland in the fixed line business, especially in the cities. I understand that you don't want yet maybe to fully disclose yet the plans and maybe that's still work in progress, but what I was wondering can you give us some directions where you think from your perspective how that will evolve, especially in terms of fiber rollout, in terms of potentially as well CapEx spending in the coming years.

And what do you think you would still need from the regulatory to make you warmer in provisioning much more, let's say, fiber to the building services in Poland. That's the first question.

The second question is regarding the margins and especially the interconnect costs, which has risen quite significantly. So I understand from your presentation that part of it is coming from the tariff plan with unlimited options which are increasing in your subscriber base. I was wondering looking forwards in the coming quarters do you think this trend of interconnect cost increasing is going to continue? Thank you.

Bruno Duthoit - Orange Polska SA - CEO

I will take the first question then give the floor then to Maciej. Concerning the regulation impact, there is already an action plan which is public because two things. Immediately after the deregulation it mean end of last week we launched a new offer, additional ADSL offer, more in fact a bit cheaper which was not possible before in order to be more able, let's say, to compete with cable TV operator and to win back the customer.

And the second part of this action plan is that we announced officially that we continue naturally to provide a wholesale service even in deregulated area we are interested. It is an important and good business for us but this time based on commercial, let's say, conditions without increasing price.

Concerning future investment it is clear that thanks to deregulation we may have much better payback business case than in the regulated area for investment in fiber to the home. As I explained, unfortunately today, exactly today we are not in a situation to discuss figure but we are working hard and we can say we are almost ready to go. We need naturally to go through our internal governance system which is very normal.

What I can say that deregulated area it's approximately 9m, 10m inhabitants and it represents, if you look at the potential for very high broadband, more than 30% of the total Polish market. And we believe that we are as well, because we are infrastructure company we have team, we have partners. We can invest relatively quickly and we are ready to invest it's not something which needs, let's say, a year or a semester to be ready.

Then after, it's a question of sizing and business case. And we are -- we should be in situation during the next weeks to finalise to present significant investment, but we are very reasonable and we want to keep reasonable ratio for the company, reasonable EBITDA. We don't want to increase our debt on EBITDA ratio to too high. It's only what I can tell you today.

Concerning termination I will give the floor to Maciej.

Herve Drouet - HSBC - Analyst

Thank you.

Maciej Nowohoński - Orange Polska SA - CFO

Thank you for the question on the interconnect costs. Here in this category we need to recall that there are three elements which are driving those costs. So first there is fixed traffic, so the customer base on the fixed which is generating the traffic and then we pay for that. Then the second category is the mobile traffic. And the third category is our wholesale activity mainly international.

So from those three categories the trends are as follows. The traffic which is generated by the fixed voice customer base, this is decreasing. The traffic which is coming from the mobile customer base is increasing. And the third category, the international activity, is a little bit less possible to predict what will be the activity level in the future because it is not explicitly driven by some market trends.

So globally we can conclude that today, until today, this mobile traffic is prevailing and the growth is visible there. And it's difficult to expect that the growth will be cooling down in the future. That's a long-term trend.

Herve Drouet - HSBC - Analyst

Okay, thank you for your answers.

Operator

Dalibor Vavruska, Citigroup.

Dalibor Vavruska - Citigroup - Analyst

Hello, good morning. I have two questions if I may. One is just on the Orange Finance and the energy business. I just wanted to see your view beyond what you've said in the press release as to how important is this for the overall business case of Orange Polska? And how should -- how would you advise investors to look at it in terms of the relative ability to move the needle or create some value of substance at this particular stage.

And my second question is about market consolidation. To what extent when you're making your business plans, to what extent can you assume or do you assume that there may be some market consolidation in either mobile or fixed or both. I understand there are some discussions about the way, how LTE should be awarded. And there were some views that they should be -- the number of the entities that will run LTE will be -- should be limited.

I'm just wondering how you look at this and whether if no consolidation happens and the market remains as fragmented as it is now whether this is going to be a problem or whether this current fragmentation is sustainable. Thank you.

Bruno Duthoit - Orange Polska SA - CEO

I will take the question. Concerning the first we -- Orange Finance, Orange Energia are business with significant EBITDA. Orange Finance it's a dealer model, we expect to have an EBITDA, incremental EBITDA significant. For Energia naturally it links to a wholesaler partner thus our margins are lower.

But altogether we expect that in a few years it could represent, I cannot disclose precise figure because it could represent several percent, most probably more than 5% let's say within three, four years of the total turnover of the company with naturally significant incremental EBITDA. Okay for the first point. We are really very convinced that it will support our business because it's a very coherent with the convergent approach we are implementing now.

Concerning your second question I just want to tell you one point. We are not, as Orange Polska, today involved in any negotiation to consolidate with another company on the Polish market. But we can say that everything can happen. It is clear that on fixed or even mobile market something can happen. It will most probably not be as an initiative Orange Polska but we are looking very cautiously about what could happen, particularly within fixed market because you know there are many, many actors on cable TV and high-speed side. We will see. I cannot say more at this stage.

And concerning LTE, number of possible actors in LTE, today there are four. The regulator a few days ago announced a launch, a re-launch of auction for 800 megahertz frequency spectrum. We will see after this action if there are still four but most probably yes.

Dalibor Vavruska - Citigroup - Analyst

Okay, thank you.

Operator

Ondrej Cabejsek, Wood & Company.

Ondrej Cabejsek - Wood & Company - Analyst

Hi, thanks for taking the question. I have -- I wanted to ask about the one-off impact of these broadband infrastructure projects on EBITDA, whether this is something that is likely to happen again in the future and what this was exactly.

Also I would like to ask whether there is any -- were there any hints on unlimited fixed voice offers in the market which would probably further increase interconnection costs.

And perhaps third question, whether there are any 4G coverage targets, and what upgrades are need on your current infrastructure to achieve a higher population coverage. Thank you.

Maciej Nowohoński - Orange Polska SA - CFO

Okay, so I will take the first question. I'm not sure I understood the other two questions. But let's hope that it will become more clear. So regarding the infrastructure projects and the cost which are visible in our P&L in Q3, first of all, these are not only costs because we have revenue in Q3 on those elements. We have satisfied -- a satisfactory margin on these services. And in fact, we can expect that coming quarters will also bring some additional new revenue from this category and additional cost respectively.

Could you please repeat your second question and the third question, because I'm not sure I got it.

Ondrej Cabejsek - Wood & Company - Analyst

Sure. The second question was whether there is any -- whether there are any unlimited fixed voice offers in the making on the market whether be it from your side or from the competitors' side, because I assume that these would further increase the interconnection costs that were up quite a bit this quarter.

And the third question was what sort of upgrades there are necessary if any on your current infrastructure for increasing the 4G population coverage.

Michał Paschalis-Jakubowicz - Orange Polska SA – Head, Mass Market

So I will take the second question regarding the unlimited offers in fixed. So first thing is, yes, there is growing popularity of unlimited in fixed. But I also need to make a point that this is mostly in our voice over IP proposition being a part of our flagship Fun Pack.

In general, the unlimited offers in fixed do not have such a contribution to the increase of the interconnect costs, because most of unlimited is used within the fixed line area. So from that perspective compared to the impact that unlimited in mobile are having on the termination costs this is not material.

Bruno Duthoit - Orange Polska SA - CEO

Of the 4G coverage plan, Piotr.

Piotr Muszyński - Orange Polska SA - VP, Operations

The 4G coverage plan is fully deployed. And we expect that we will finish end of this year with 61% population covered by 4G on 1800 megahertz. And of course the next step is the auction and eventually possibility to roll out further more DLT on 1800 which is typical coverage spectrum. So we assume that being successful in the auction we will continue roll out and we'll increase the coverage but on another spectrum.

Ondrej Cabejsek - Wood & Company - Analyst

Okay, thank you.

Operator

David Kaplan, Barclays.

David Kaplan - Barclays - Analyst

Hi, everyone. I just have a question both in mobile and in fixed. You made a point of talking about the B2B business and the pressure that's been putting on revenues both -- in both of those businesses. Can you talk us through a little bit of what that back book looks like? What percentage of your B2B customers have contracts that are rolling off in the near-term? Are you more than halfway through that or less than halfway through that? Just any guidance on that it would give us a little bit more of a sense of how long that pressure is going to be on the business. Thanks.

Bruno Duthoit - Orange Polska SA - CEO

Mariusz?

Mariusz Gaca - Orange Polska SA - VP, Business Market

When it comes to the postpaid base, I can quote one-third of the base being already equipped with unlimited tariff plans. So that gives you, I think, a pretty precise number. Clearly, touching on market trends, it's clear that the trend is that probably one day a vast majority of customers will go into that kind of offers since this is now in the portfolio of all the market players. So we are one-third of the way I would say.

David Kaplan - Barclays - Analyst

Of combined mobile and fixed, is that what you mean by that?

Mariusz Gaca - Orange Polska SA - VP, Business Market

When it goes to fixed, situation is a bit more different. What is under the pressure today and the heaviest pressure I would say these are managed networks. This is due to the fact that there is a huge wave of large tenders that are supposed to be renewed next year or were renewed this year.

Actually, I would say that majority of those contracts are already behind with the full impact that will be definitely visible 2015 because these are usually at least two years if not four-year contracts. And that's I would say the re-price factor.

When it goes to other factors I would quote another one which is the fact that customers are more and more searching for hybrid solutions. And with hybrid solutions from time to time they are ready to compromise quality with the price. As the quality of the network is becoming better the hybrid solutions from the low-end of the market are naturally giving better possibilities.

And since all the companies are very much oriented on savings with maybe exception to security services, they are trying to make a choice between the quality and the price. And what we see massively today what is favorable or more in favor of those customers is rather pricing.

David Kaplan - Barclays - Analyst

Okay, great. Thanks very much.

Operator

That was our last question.

Leszek Iwaszko - Orange Polska SA - Head, IR

Maybe we have any more questions on the floor. Yes.

Pawel Puchalski - BZ WBK - Analyst

Pawel Puchalski, BZ WBK. You made a point that 2014 was a year of heavy investments into mobile infrastructure. May we expect that as of 2015 your core CapEx will be materially lower year on year?

Maciej Nowohoński - Orange Polska SA - CFO

Thank you for the question. We are right now in the preparation of the plans, commercial plans and financial plans for 2015. And we will come back with the precise information on the next quarterly meeting. So that will be a good opportunity in February 2015 to discuss this point, to discuss probably the dividend point and the potential very-high broadband plan that we could have.

Leszek Iwaszko - Orange Polska SA - Head, IR

Any more questions from the call, teleconference, operator?

Operator

We have no further questions at this time, sir.

Leszek Iwaszko - Orange Polska SA - Head, IR

Okay. If we have no more questions, then thank you very much. We will be reporting Q4 results mid-February. Thank you.

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