

FINAL TRANSCRIPT

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ATAI - Q4 2010 ATA Inc. Earnings Conference Call

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Jun. 07. 2010 / 12:00PM, ATAI - Q4 2010 ATA Inc. Earnings Conference Call

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Christensen - IR

Kevin Ma

ATAI Inc. - Chairman and CEO

Walter Wang

ATAI Inc. - President and Director

Benson Tsang

ATA Inc. - CFO

CONFERENCE CALL PARTICIPANTS

Mark Marostica

Piper Jaffray - Analyst

Ella Ji

Oppenheimer & Co. - Analyst

Adele Mao

OLP Global LLC - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the fourth quarter 2010 ATA Inc. earnings conference call. My name is Deanna, and I'll be your operator for today.

At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session. (Operator Instructions). As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the conference over to your host for today, Mr. Thomas Myers with Christensen. Please proceed.

Thomas Myers - Christensen - IR

Thank you, Deanna. Our team today includes Kevin Ma, Chairman and CEO; Walter Wang, Director and President; and Benson Tsang, Chief Financial Officer and Chief Accounting Officer.

One of my duties today is to remind you about forward-looking information. Our conference call may include forward-looking statements made under the Safe Harbor provisions of the Private Securities Litigation Reform Act. Although we believe that the expectations reflected in our forward-looking statements are reasonable as of today, those statements are subject to risks and uncertainties that could cause the actual results to differ dramatically from those projected.

There can be no assurance that those expectations will prove to be correct. Information about the risks associated with investing in ATA is included in our filings with the Securities and Exchange Commission, which we encourage you to review before making an investment decision.

The Company does not assume any obligation to update any forward-looking statements as a result of new information, future events, changes in market conditions, or otherwise, except as required by law.



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ATA issued its earnings release for the fiscal year 2010 after the market closed on Friday, June 4. The Company will cover the main points of the release, then go to your questions; first, Mr. Ma, Chairman and CEO. Kevin?

Kevin Ma - *ATAI Inc. - Chairman and CEO*

Thank you, Tom. Hello from ATA in Beijing. I'm very happy to be with you today.

We are pleased with our preliminary results for year 2010. We are especially pleased with the strong results in our testing services, where revenues increased about 37% during the fiscal year.

Total tests taken in fiscal year 2010 were up about 14% to 5.8 million tests. Our average revenue per test increased 20% to RMB32.5 in 2010 from last year, mainly due to the high value per test, especially for the English language qualification tests and the HR Select tests. Our strategy and actions remain on track.

Clearly, 2010 was a year of transition. First, we increased our testing business nicely in all categories; in testing for the securities and the banking industries; testing of English for International Communications or TOEIC; and the testing in the HR Select product helps to find the most qualified candidates for both the hiring and internal promotions.

Aligned with that expansion have been our more aggressive marketing and business promotions, as well as other investments in our new business, including enriching the content of our HR Select testing service.

The higher expenses did temporarily pressure our results in 2010, but our actions this year were designed to help encourage and support additional revenues, not only for 2010, but also in the years ahead.

HR Select is a very good example of that long term potential. More than 60,000 companies and organizations have been introduced and received fundamental training on that new testing product.

It does take a while for such innovative new methods to be adopted. So far, more than 50 companies and organizations have become paying customers for HR Select, so we are only in the beginning of what we believe will be a long term growth curve for the Human Resources Testing and Evaluation business.

On the other hand, the Chinese Government has delayed implementing the National Teachers' Testing Program or NTET.

The delay resulted in our taking over expense provision in fiscal year 2010 for the related long term tutorial software accounts receivable, since we don't know when the Government will enforce and resume the funding for this testing program.

In the long term, we believe our strategy is very sound, and we are on track for delivering very good operating performances in the years ahead. Those attractive results should create a substantial value for our shareholders.

Before I introduce Walter to provide an update on our operations, I would like to update the progress on two business leads. Internet cafe testing and licensing under the Ministry of Culture and the security card certification under the Ministry of Public Security.

As you we mentioned in our previous conference call, the Chinese Government has been trying to develop a test to qualify and license Internet cafes owners and administrators to be sure they will be provide a high quality service to consumers.

That testing program has been delayed since 2008. We have kept the dialog open with the Government and have been informed that the licensing program may be resumed this year. We will continue to follow this business lead, but so far we don't expect any financial contribution from this program in our fiscal year 2011.

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[Relative] we have been awarded the contract by the Ministry of Public Security to develop the question bank for the security guard licensing test and we have completed that services. We are currently arranging a trial test for this certification program in about 10 cities, which is to be held on June 12. Although we are yet to win the commercial contract, we are excited about the progress.

Now Walter will update our operations for you; then Benson will cover the financials. Walter, please.

Walter Wang - ATAI Inc. - President and Director

Thank you, Kevin. I'm very pleased with the performance of our employees and operations this past quarter and year. They are making very good progress as we expand our services and start new businesses. We believe those will provide attractive future growth and higher returns for ATA.

Looking at our fiscal year 2010, in Testing Services, we delivered 5.8 million tests this year, up 13.8% from 2009. Average revenue per test was up 20% to RMB32.5 in the year, mainly due to the higher value per test, especially in TOEIC for English language and the HR Select tests.

We expanded our testing network, adding 63 authorized test centers for a total of 1,988 centers available throughout China as of March 31.

Without question, we have the greatest proven ability to deliver large scale tests across China. Our locations are convenient for the candidates, and we safeguard all aspects of each exam's integrity and security.

Our new HR Select platform helped our clients deliver almost 199,000 exams for employee recruiting and internal assessment during fiscal year 2010.

HR Select is expanding dramatically, and we have been working hard to make that happen. So far, we have registered more than 60,000 companies who are the potential customers for this human resources testing service, and so far, converted more than 50 companies into paying customers for HR Select.

We have invested aggressively in 2010 by adding employees, and by higher marketing and promotion, plus per customer training for HR Select, because we believe it is becoming a growth driver for us in the years ahead. So far, Testing Services are doing well, and its outlook is very encouraging.

We are also optimistic about growth and returns from our Test Preparation and Training Solutions. In this business, we focus mainly on professional training requirements, both for first training, and for continuing education for professionals in the financial security industry.

This is a very attractive business; very good in both expected financial performance and long life. We have built first class sales team for HRS of about 30 so far to capture what we think are very large opportunities in China's private sector.

Our aggressive marketing and sales efforts temporarily pressured margins, since we have been paying the upfront costs that should help enable the revenues to be achieved.

This is especially important for innovative new testing products. We add value by providing the secure resources for the testing to order, but that happens only after our potential test sponsors learn about the tests in all ways.

And after they've learned about them, they then adopt the tests in their own test programs for licensing, knowledge, validation, employee recruiting and advancement, and professional education.

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We are happy and satisfied by the progress on the development of these new services, especially when we look forward to what we believe we can achieve in the next few years.

We will continue our test based education service as it is, and we are focusing our resources on expanding our success in our higher margin business. These are Testing Services and Test Preparation and Training Solutions. We expect those two businesses will eventually account for most of our revenues and net income.

Now Benson will cover the financials. Benson.

Benson Tsang - ATA Inc. - CFO

Thank you, Walter. Good morning to those in the States, and good evening to those in Asia.

We announced our results last Friday. I believe you have had a chance to read the release, and I will cover the key points here.

Our fiscal fourth quarter 2010 guidance for net revenues, was RMB30 million to RMB34 million. We reported RMB47.2 million. We exceeded the guidance by about 39%, mainly on the strength of our testing services which were up 98%, fourth quarter 2010 over the same quarter last year.

Of that fourth quarter increase, the number of tests we delivered was up about 99%, and average price per test was even. So we're up in volume and even in price, fourth-quarter-to-fourth-quarter.

Our increase in Testing Services in the fourth quarter reflected the continuing extension of our business mix towards higher value tests, especially for the financial security industry and corporate customers.

In the fourth quarter, we have had a thorough review of our business and have made two decisions. First, we wrote off the prepaid royalty fees of RMB5.5 million for an educational program we attempted to offer in conjunction with a few universities since 2008. Due to the rapid changing computer and IT environment, the program became outdated. We have decided to discontinue this business lead. This write-off affected our cost of revenues.

Second, we have made a provision of RMB22.3 million for the long term [AT&T] accounts receivables, given that we are uncertain as to when the Government will enforce and resume the funding for this program. We have provided for the full amount as doubtful debt. The provision is included in our general and administrative expenses.

Also in the fourth quarter, we have an additional non-recurring share based compensation charge of RMB2.5 million for two members of our senior management. The majority of this charge is related to personal shares granted by a shareholder to a senior management member. According to US GAAP, this transaction is required to be recorded in the Company financials, even though the Company is not a party of this transaction. This charge is also included in our general administrative expenses.

After adjusting for these three non-recurring items, our operating results in the fourth quarter were, net revenue RMB47.2 million remains unchanged; gross profit RMB22.8 million instead of RMB17.3 million; gross margin becomes RMB48.2 million instead of RMB36.6 million, as compared to 43% last year. Loss from operations becomes RMB7.7 million, as compared to loss of [RMB13] million last year. Net loss becomes RMB7.7 million as compared to net loss of RMB12 million last year.

Financial results for the year, by adjusting the same three non-recurring items I just mentioned, our operating results for the year were, net revenue remained unchanged at RMB245 million; gross profit RMB121 million instead of RMB115.5 million; gross margin becomes 49.4% instead of 47%; results from operations become about break-even. Net loss becomes RMB5 million.

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Now moving to capital expenditures, we spent about RMB52 million to purchase our 2,100 square meter Beijing office and spent about RMB7 million on maintaining OpEx. We have also used about RMB12 million to buy back shares in the fourth quarter. The shares we purchased have been cancelled.

As of March 31 2010, ATA had cash of about [RMB214] million equivalent to about \$31 million, and we had no debt. ATA has substantial financial flexibility for expansion, new property developments, product marketing and promotion, and contingents.

Now our guidance. We expect net revenues for our fiscal year 2011 to range between RMB280 million to RMB300 million, represent a growth of 14% to 22% from last year. For fiscal first quarter of 2011, net revenues are expected to range between RMB78 million to RMB82 million.

Net revenues for Q1 last year was [RMB80] million. During the later part of fiscal year 2010, the average selling price for banking exam was adjusted from RMB64 to RMB49.5. Included in the RMB80 million Q1 last year net revenue, about RMB7 million was the impact of such price adjustment, had the price change been effected in Q1 2010.

[Factor in this]; net revenues of Q1 last year was about RMB73 million. Our guidance of RMB78 million to RMB82 million represent a growth of [6.8%] to 12% from this adjusted RMB73 million last year Q1 figure.

Now it is your turn. I am sure you have questions. Operator, please poll for questions, then we are happy to start our answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). And the first question will come from the line of Mark Marostica, Piper Jaffray.

Mark Marostica - Piper Jaffray - Analyst

Yes, thank you. My first question is related to HR Select. I wanted to get a sense of your average size of the 50 customers that you currently have. Can you give us an idea of how much revenue the average customer is actually generating today?

Benson Tsang - ATA Inc. - CFO

Hi, Mark; I'll take the question. The revenue generated from HR Select in fiscal year 2010 was about RMB11 million. And, as we mentioned earlier, we have about 50 customers in HR Select. Now the strategy the Company has is really develop core or seed client for HR Select. The three biggest users for HR Select account for close to RMB10 million, and the remaining 40 somewhat customers will make up the difference.

Mark Marostica - Piper Jaffray - Analyst

Okay, great. And then can you talk about your pipeline? I know you have 60,000-some odd customers that have had the training. As you look into your guidance for the upcoming fiscal year, how many of those do you expect to convert to customers in terms of your assumptions and your guidance?

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Benson Tsang - ATA Inc. - CFO

I'll take this question as well, Mark. So our HR Select, in the past year, the Company fully understands it's a brand new product we need to put the effort to introduce to the market. We're mainly focused in increasing our brand awareness, and we also put a lot of effort in direct marketing to our clients, and also, as I mentioned, we want to create the seed customers. And we expect the growth for next year, we expect at least about 50% in terms of revenue.

Mark Marostica - Piper Jaffray - Analyst

Thank you. And also I'm interested to learn more about the security guard exam that you talked about. It sounds like you've been awarded the exam; congratulations on that. Can you give us a sense of revenue contribution tied to the trial test in the sense that is that a meaningful contributor or not? And then talk about the next steps beyond that; assuming the trial goes well, what will be the next steps that will occur? And when will that be a meaningful contributor to revenue?

Benson Tsang - ATA Inc. - CFO

Well, first of all, thank you very much. The management here are very excited about the progress as well in the security guard certification program. At the moment, our CEO just mentioned, we are happy we got awarded the contract with [Zhejiang] Bank, and we're moving into the trial test. That will happen on June 12.

For this trial test, it's basically part of the sales pitch process. The financial contribution from this trial test will not be meaningful.

Going forward, if the trial test is successful, we will start the commercial contract negotiation with the Government.

It's a bit too early for us to say the financial contribution coming in what year, but what I can share with you instead is some tests about security guards. Right now the security guard numbers about 5 million in China right now and the average turnover rate is about 30% per year. So if the certification program goes, we expect it will probably take a couple of years just for us to complete the first initial certification tests, so hopefully, this will give you some idea about the potential financial contribution from this program.

Mark Marostica - Piper Jaffray - Analyst

So you have a sense how that might be priced?

Benson Tsang - ATA Inc. - CFO

Sorry?

Mark Marostica - Piper Jaffray - Analyst

Do you have sense as to how you might price that exam?

Benson Tsang - ATA Inc. - CFO

Yes. We believe the pricing will be similar as the current contract we have with the Government, so probably within the range of RMB40 to RMB50 per test.

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Mark Marostica - Piper Jaffray - Analyst

Okay, great. And then one last question and I'll turn it over. I'm just curious, should we expect any additional charges to hit the P&L in the current quarter, or are all those charges washed out in the fourth quarter?

Benson Tsang - ATA Inc. - CFO

Currently, we do not expect any non-recurring charges in our Q1 2011.

Mark Marostica - Piper Jaffray - Analyst

Okay, great. Thank you.

Benson Tsang - ATA Inc. - CFO

Thank you.

Operator

(Operator Instructions). Please keep in mind you will be limited to two questions. (Operator Instructions). The next question will come from the line of Ella Ji, Oppenheimer.

Ella Ji - Oppenheimer & Co. - Analyst

Good evening, Kevin, Walter and Benson. I want to follow up with the prior question. You mentioned the three biggest clients in HR Select accounted for RMB10 million of your revenue. That's almost 99% of your total revenue in the year. So within your pipeline, how many clients, potential clients, are of the similar size of the three biggest clients you have right now?

Benson Tsang - ATA Inc. - CFO

I'll take this question as well, Ella. Yes, for fiscal year 2010, the three biggest clients in HR Select account for the bulk of the revenue. First of all, it's because of those three clients are very big corporations, and each client will use up 20,000 to 30,000, or even more tests. In our pipeline, we do have customers of that scale but, as I mentioned earlier, it will take time and a lot of effort from the management to win the contract.

As I mentioned also earlier, we are confident that we will be able to grow the HR Select revenue by about 50% in fiscal year 2011, and the growth for that revenue will come from a mix of big customer and smaller customers.

Ella Ji - Oppenheimer & Co. - Analyst

Thank you. And also, you mentioned this year is the year of transition, and you invested heavily in the three private sector tests. Could you talk about what would be your focus for fiscal year '11 for HR Select TOEIC, and also for Cambridge Young Program?

Thanks.



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Benson Tsang - *ATA Inc. - CFO*

This is Benson, I'll take the question, and then maybe Walter can add some comments later on. I'll first start with the Cambridge Program. Cambridge Program, last quarter [we share] -- we already signed a contract, or signed up a potential relationship with about 200 schools, covering about 200,000 students.

The focus of the Company right now is to build a relationship with these Cambridge schools, and then we want them to adopt this DVD concept to help the students practice. And so far, the strategy is working. I'm happy to share with you we've got some successes in Q1 of fiscal year 2011.

And for HR Select, our strategy remains the same. We strongly believe increased brand awareness, direct marketing, educate the clients, and also create the seed customers are our focus. And we are continuing to build up the team where necessary to approach our customers and to achieve the three objectives I just mentioned.

Walter, anything to add?

Walter Wang - *ATAI Inc. - President and Director*

For the TOEIC, we are currently doing the road show in about 27 famous universities across China and build the market awareness for TOEIC. And in terms of revenue for TOEIC, we are hoping that we can increase 50% in revenue.

And for HR Select, we are not only developing the new clients, but also we are helping our current clients to expand the test numbers in our current clients. For example, for the ABC and BOC, they are already our current clients, but they have branch offices across China, and they have -- they both have more than 300,000 employees across China. So there are a lot of potentials for us to develop new businesses from our current clients. That's for the HRS.

Thank you.

Ella Ji - *Oppenheimer & Co. - Analyst*

Thank you. So it appears that you've achieved a lot of progress, but you still need to continue to invest in both content and sales and marketing for the three new businesses. So in terms of the total investment and the impact on your margins, could you do a brief comparison? Do you expect to spend more in fiscal year '11 versus fiscal year '10 or less? And then what's the impact on the margins?

Thanks.

Benson Tsang - *ATA Inc. - CFO*

Sure, for fiscal year 2010, for these three projects, we spent about RMB20 million in total for sales and marketing and R&D.

For fiscal year 2011, we expect to spend at least the same as fiscal year 2010, and as we move on, we will make the decision whether we will spend more, and the range we are thinking about RMB30 million to RMB40 million. But as I mentioned, the actual spending of the money will be depending on the progress of the three business units.

Ella Ji - *Oppenheimer & Co. - Analyst*

Thanks for the color; one last question. You mentioned you cancelled your share repurchase program. Could you give us some more color why you made the decision?

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Thank you.

Benson Tsang - *ATA Inc. - CFO*

Okay, let me clarify. The comment we just make is we did repurchase some shares in Q2 2010. The total amount we spent was RMB12 million. And the shares we repurchased, we cancelled those shares. We did not cancel the share buyback program.

Ella Ji - *Oppenheimer & Co. - Analyst*

Oh, that's good; that's good for clarification. Thank you very much.

Walter Wang - *ATAI Inc. - President and Director*

Thank you.

Operator

The next question will come from Adele Mao, OLP Global.

Adele Mao - *OLP Global LLC - Analyst*

Hi, guys; just a quick question. Given the business mix change that has happened over the past year, could you elaborate on the revenue seasonality for fiscal year 2011?

Benson Tsang - *ATA Inc. - CFO*

Yes, for the traditional business, the seasonality will be more or less the same, so I will focus and comment on these three new businesses.

For the Cambridge business, we expect that it's pretty stable throughout the year. The reason we expect that is it is not a traditional school, it's more like an add-on to help the students to learn English, so we expect seasonality on that will be less.

And as for our HR Select, we predict that the high season will probably be in Q3. During that time maybe a lot of recruitment will happen during that period, and also for a lot of companies, they will go through some annual review as well during that period.

And finally for TOEIC, currently, we predict for this year that peak season, the high season, will be in Q3 as well. The reason for that is the Company is currently working hard to build a brand name, announce it, introduce it to many different schools.

Adele Mao - *OLP Global LLC - Analyst*

Thank you.

Benson Tsang - *ATA Inc. - CFO*

Hopefully, this will (technical difficulty) seasonality.

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Adele Mao - OLP Global LLC - Analyst

Right, that's very helpful. Now, Benson, I think you touched upon this a little bit earlier. I just want to get your further thoughts on this.

After adjusting for the one-time recurring items, fiscal year 2010 is about break-even, and I would expect some kind of gross margin expansion into fiscal year '11. And what's your comfort level in terms of going on -- growing -- getting the gross margin beyond the adjusted level of 49% in fiscal year 2011, and if there's more operating leverage to actually be extracted from your expense base?

I do understand that you guys are looking at evaluating your business progress and potentially be spending more on I think -- I'm trying to an idea in terms of the profitability level that we could be expecting for fiscal year 2011.

Operator

Ladies and gentlemen, please stand by. (Technical difficulty). The conference will resume in a moment.

Benson Tsang - ATA Inc. - CFO

Hello?

Operator

You may proceed.

Benson Tsang - ATA Inc. - CFO

Hello, this is ATA again. Okay, let me just repeat the question. So the question basically was to have more color on the gross margin going forward, so let me comment on that.

My comfort level on the margin is I feel comfortable the Company will have the ability to improve the margin. After the adjustment this year, the margin is around 48% to 49%. We predict the overall margin for fiscal year 2011 will improve to about 50% to 52%.

The reason for the improvement on the margin is, first of all, we will achieve decent growth basically across all the business units. For the traditional Testing business, we expect 15% to 20% growth. For HRS and TOEIC, we mentioned already, we expect about 50% growth. For the Cambridge, we expect we'll see a financial contribution for Cambridge. So overall, we are quite comfortable that the revenue figure, the net revenue figure will be improved.

And in terms of [COS], we do expect some of the fixed costs that we invest in fiscal year 2010 we will start seeing some efficiency in fiscal year 2011.

And for the overall, when we look at the SG&A, the Company will definitely watch out the revenue growth and the gross margin, and will spend the SG&A accordingly.

Next question, please.

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Operator

(Operator Instructions).

There are no more questions at this time. I'd like to turn the call back to Benson for any closing remarks.

Benson Tsang - ATA Inc. - CFO

Okay, thank you. I will now pass the -- pass to Kevin to do the closing remarks.

Kevin Ma - ATAI Inc. - Chairman and CEO

As we begin the summer vacation period in North America and in Europe, I want you to know that we will continue to be vigilant every day in every prudent way possible to achieve additional success and to grow our revenues and the net income during our fiscal year 2011.

By prudent, I mean wise in our long term and short term decisions, never choosing short term benefits that could damage our long term success.

We thank you for your interest and your investment in our Company. Both continue to be vital to our success.

Like a bond between good friends, we expect to deliver the attractive returns that you expect from us.

Until we meet again, wish you good health, success and happiness. From ATA in Beijing, goodbye for now. Thank you.

Benson Tsang - ATA Inc. - CFO

Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may now disconnect, and have a great day.

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