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EDITED TRANSCRIPT

EQB.TO - Q1 2018 Equitable Group Inc Earnings Call

EVENT DATE/TIME: MAY 11, 2018 / 12:30PM GMT

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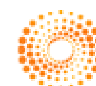

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PRESENTATION

Operator

Good morning, ladies and gentlemen. I'd like to welcome shareholders and analysts to Equitable's First Quarter 2018 Conference Call and Webcast. (Operator Instructions)

Before we begin, and on behalf of our speakers today, I will refer webcast viewers to Slide 2 of the presentation and our callers to the following information, which contains the company's caution regarding forward-looking statements.

We remind you that certain forward-looking statements will be made today, including statements regarding possible future business and growth prospects of the company. You are cautioned that forward-looking statements involve risks and uncertainties detailed in the company's periodic filings with Canadian regulatory authorities.

Certain material factors or assumptions were applied in making these forward-looking statements and many factors could cause actual results or performance to differ materially from those conclusions, forecasts or projections expressed by such forward-looking statements.

Equitable does not undertake to update any forward-looking statements made by itself or on its behalf, except in accordance with applicable securities laws.

Additional information on items of note, the company's reported results and factors and assumptions related to forward-looking statements are available in Equitable's Q1 2018 MD&A and earnings news release. This call is being recorded for replay purposes on May 11, 2018.

It is now my pleasure to turn the call over to Andrew Moor, President and CEO of Equitable Bank. Please proceed, Mr. Moor.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Thank you, Dan. Good morning, everyone, and welcome. I'm joined by Tim Wilson, Senior Vice President and Chief Financial Officer of the bank.

Equitable produced solid first quarter performance, increased the dividend for the second time this year and continued to expand its role as Canada's Challenger Bank, with the introduction of new deposit and lending services. In our single-family business, we did experience some headwinds in the market, as consumers and lenders began to adjust to new B-20 guidelines.

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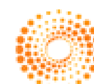

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During today's call, we will update you on our strategic progress and our outlook. We will start with a recap of the quarter's results, beginning with asset growth.

At quarter end, mortgages under management stood at an all-time record of $23.8 billion, up 9% year-over-year and 2% from December 31, 2017, on growth in our single-family, commercial lending and securitization, financing portfolios.

As mortgage assets are the source of the most of the bank's earnings, this is a positive performance and reflective of Equitable's diversified lending platform, which provides us with the opportunity to allocate capital to different business lines, so that we can achieve the best returns for our shareholders.

And we did exactly that in Q1, we began to deploy more capital to our commercial lending businesses, in light of the slowing conditions in single-family. And looking at the components of portfolio growth, single-family mortgage principal was up 16% from a year ago and 2% from Q4. While our single-family book continue to grow in the quarter, new originations flowed on a year-over-year basis.

We had expected slowing as a result of changes towards B-20 guidelines. I think it's probably fair to say that we did not adapt to these changes as well as we might have done, but have made the appropriate adjustments and expect originations to climb by around 40% to 45% in Q2 from these lower levels in Q1.

Having said that, the period of market adjustments to B-20 is still playing out. With the business visibility that we do have, we continue to believe that our single-family portfolio will grow 4% to 6% this year, in line with prior guidance.

Helping single-family portfolio growth was higher mortgage retention. As you may recall, our hypothesis going into the new B-20 era was that mortgage retention would be higher than in the past, and our teams are working hard to sell our customers to ensure this continues to be the case. This was certainly true in the first quarter as we see our -- saw our retention rates increase.

During the quarter, we also introduced new digital technology that allow single-family borrowers to view their account status in real time. This should add another reason for customers to stay with our bank.

Given opportunity levels in single-family, we chose to begin allocating more capital to commercial lending business, and with good results. Origination volumes were at quarterly record, as the bank funded high-quality opportunities, generated from our large and expanding network of customers and business partners.

Compared to the first quarter last year, when we funded one particularly large commercial loan, this year's originations were broad-based by asset type, loan size and partner. As a result, commercial mortgage principal was up 4% or $122 million year-over-year, and up 6% or $180 million in the quarter alone.

As you know, Equitable has been a commercial lender for its entire existence, so this growth seems very natural to us. We certainly like our prospects in this market.

Commercial lending had a different risk return profile than single-family, but one with which we are very comfortable as we continue to grow this part of the bank.

Securitization financing mortgages under management increased by about $640 million or 6.6 -- or 6% over year-over-year. And this performance reflected higher multifamily volumes. Multiunit residential originations grew, as we continue to take good advantage of an increase in the bank's Canada mortgage bond capacity. This portfolio provides a solid and reliable stream of activity and earnings.

While growing assets, the bank had another consecutive quarter of great credit performance, reflecting the higher quality of the mortgage portfolio and our success with workout activities. Once again, Equitable's provision for credit losses, as a percentage of total loans, was in the low single-digit basis points, just as it's been for more than 5 years now.

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In the first quarter, our PCL was 2 basis points, unchanged from a year ago and up 1 basis point from Q4 2017.

Looking at credit metrics. There's little noise this quarter because of the bank's adoption of IFRS 9 on January 1, 2018. That noise reflects our historically conservative allowance calculation methodology and reinforces the fact that the book is solid and that the bank is well reserved.

You will note that ECLs under IFRS 9 were $8.5 million less than general provisions that we had reserved under IAS 39. Even when this change, our allowance still sits at 13 basis points of mortgage principal and covers 92% of our impaired loans. That compares well to our 10-year average loss rate of 4 basis points. The impact of the IFRS 9 implementation is to increase book value per share by $0.42.

Compared to Q1 last year, impaired loans decreased by -- in both dollar terms and as a percentage of the total portfolio. The majority of the decrease was in alternative single-family and almost 2/3 of it was related to Alberta and Saskatchewan, with the remainder due to the discharge of 2 large commercial loans that were impaired at the end of Q1 2017.

These factors were partly offset by the addition of $4.6 million of insured mortgages that were between 90 and 365 days past due. This amount moved to the impaired loan category in Q1 as a result of the adoption of IFRS 9, and the prior accounting treatment did not recognize them as impaired. We do not anticipate any losses on this group of loans.

Looking forward, Equitable continues to benefit from rigorous and effective risk management practices. As a result, we expect our arrears and rates and credit loss provisions to be low for the remainder of 2018, assuming the Canadian economic conditions stay within the range of broad market expectations.

We take comfort from the fact that we lend in a prudent risk-aware manner, and this should allow us to effectively manage through any downturn in market conditions. In particular, Equitable's low LTVs on uninsured mortgages are designed to protect the bank in the event of a softening in the economic environment.

Our savings businesses also performed well in the quarter. Total deposits increased 19% year-over-year to $11.9 billion, just above the core rate of our core lending -- just above the growth rate of our core lending portfolio. Deposits also grew by $856 million or just over 8% since December 31.

Equitable continues to attract a diverse stream of deposits, both through EQ Bank and from our broker partners. EQ Bank deposits grew 42% or $515 million year-over-year to $1.7 billion, and its customer base surpassed 50,000 people.

Part of our deposit growth came from the launch of EQ Bank GICs. As you may recall, we readied the platform late last year to offer GICs as a complement to the EQ Savings Plus demand account. And after introducing the product in March, with very little marketing, EQ attracted GIC volumes that were above our own expectations.

EQ Bank GICs are easily purchased through our digital banking app, a convenient advantage over traditional bank offerings and feature attractive interest rates of varying terms.

This offering is the latest manifestation of Equitable's Challenger Bank status in that it leverages our position as a regulated institution and trusted store of value, as well as our technology infrastructure that was built to expand, to accommodate new and better ways of serving customers.

We certainly believe the EQ Bank platform, combined with our low-cost business model, gives us a competitive edge in responding to the needs of Canadian savers. And it's been interesting recently to see investment journalists promote the merits of GICs more frequently.

For individual investors, the yield pick-up on the GIC, compared to the equivalent risk of a mutual fund that owns Government of Canada Bond, is material. As interest rates generally tick up, we are seeing stronger fund flows through the GIC boards.

Just last weekend, we added to the functionality within the EQ Bank platform for GICs, and you should expect to see us broadcasting that message in print through out-of-home advertising in digital media and on television.

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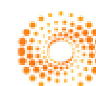

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Overall, we have created a strong digital platform and we plan to continue adding innovative features and functionality this year to expand EQ's position as a leading provider of banking services in Canada.

Offering GICs also improves our liquidity risk profile by extending the average term for deposits. Growth in EQ deposits were complemented in the quarter by a 23% or $1.7 billion year-over-year increase in brokerage GICs placed by deposit agents, investment dealers and financial planners on behalf of Canadian savers. Based on these numbers, the evidence suggests the funding market is normalized after last spring's disruptions.

Looking at the bottom line, diluted EPS was 2.3 -- $2.34, down 8% from the first quarter of 2017, as a result of costs related to the secured funding backstop facility that we added in Q2 of last year. Without those costs, the bank's first quarter earnings would have been at record levels.

In spite of the compression caused by the presence of the backstop, ROE for the quarter was 14.5%, which is in line with the broader Canadian banking industry and a good performance when compared to both small and large banks around the world, and reflective of Equitable's ability to allocate capital effectively.

On this strong earnings performance, book value per common share was up 16% year-over-year and 4% during the quarter itself. As you saw from last evening's earnings release, the board opted to increase the common share dividend to $0.27 per quarter, a 17% increase in dividends to -- over the dividends declared in December -- in May of 2017; and 4% above the dividend declared in February, which was the last time we raised the rate.

This latest increase reflects the board's belief that the bank's capital position is more than sufficient to support future asset growth and to award shareholders for their confidence in Equitable with a continuing pattern of a steady increase in dividends and our goal of increasing them by more than 10% a year over the longer term.

In -- while increasing our dividend, we finished the first quarter with CET1 ratio of 14.7%, far above the minimum regulatory requirement. I'll have more to say about our capital position, in my closing comments.

Now I'll turn the call over to Tim for his report.

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Thanks, Andrew, and good morning, everyone. As you heard, first quarter earnings and ROE were solid, but below last year even though we achieved strong growth in mortgage assets and continued to benefit from a very efficient, non-branch business model.

The recent results were held back is, as Andrew had mentioned, the costs associated with the liquidity measures taken in Q2 of last year. In the first quarter, those actions, net of associated funding cost benefits, reduced EPS by $0.27 per share and compressed ROE by 1.6 percentage points. There were no such costs incurred in Q1 last year.

Compared to the fourth quarter, the cost of the funding backstop dissipated by $0.05 per share. Even so, earnings were lower on a sequential basis by $0.02 due to a variety of factors, including lower prepayment income, declining maple revenue, increased compensation costs and a slightly higher PCL.

Looking forward, the liquidity actions, mainly the secured backstop facility, will cost us a little more than $5 million per quarter for the remainder of 2018.

Over the course of the next year and prior to the termination of the current backstop in June 2019, we will review the bank's needs for any future backstop facility. The goal will be to maintain a high level of prudence in our liquidity model, but hopefully at a reduced cost.

What is a highlight in our financial results is that even with these liquidity event costs, our Q1 net interest income was an all-time quarterly record of $81.3 million, up 4% from a year ago.

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Solid 9% growth in average asset balances was offset by an 8-basis-point year-over-year decline in NIM. That decrease in total NIM was driven by core lending. Securitization financing NIM was flat. NIM in core lending was 24 basis points lower than a year ago for a few reasons, all of which are detailed in our MD&A.

The most significant factor, again, was the cost of our liquidity actions, which accounted for 24 basis points of the year-over-year decline. Lower prepayment income also had a 4 basis point unfavorable impact. These factors were partially offset by a 7 basis point increase from higher spreads within both our single-family and our commercial lending portfolios.

Those spreads widened, mainly due to the pricing changes introduced in May of last year. We do not expect that same trend to continue, as spreads on new business have moderated in single-family. For 2018, our outlook for net interest income is for more growth, at year-over-year rates in the 8% to 10% range, as assets grow at approximately that same rate.

Our current thinking on NIM is that total NIM will be in the range of 1.55% to 1.6% in each of the remaining quarters of the year. Although we may see some quarterly fluctuation due to mortgage prepayment income and other factors such as seasonal variation in our liquidity holdings. You can review the assumptions made in arriving at this outlook in our MD&A.

Growth in our existing businesses as well as investments in our Challenger Bank strategy led to a year-over-year increase in noninterest expenses of 13% in Q1. 7% growth in FTE and other factors that caused compensation and benefit cost to increase were the major drivers this quarter. As well, we spent more on the EQ Bank platform.

Regulatory, legal and professional fees also increased, mainly because of an increase in CDIC's standard premium rates as well as higher deposit balances and overall business growth.

Despite cost growth, Equitable's productive workforce and our branchless business model, produced an efficiency ratio of 37.7%. This performance is consistent with the expectations that we set for 2018. For the remainder of the year, we plan to continue investing in the bank's franchise, adding more features and functionality to the EQ Bank platform and reinforcing our high level of customer service.

With that, noninterest expenses should increase at year-over-year rates slightly higher than the growth rate of our overall business. Of course, as actual growth in our lending markets is different than anticipated, we will manage our expense levels accordingly so that Equitable remains one of Canada's most efficient banks.

Now back to Andrew.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Thanks, Tim. Our key financial and operating metrics point to the strength of our diversified business and the credit quality of our assets. We believe that our strategy of serving Canadians as the country's Challenger Bank is proving itself out.

I'm hoping you'll have a chance to our attend our Annual Meeting of Shareholders next Tuesday, as I plan to use that opportunity to talk more about our take on the future evolution of the banking industry and where our positioning may take Equitable in the future.

In terms of growth initiatives, I talked about PATH Home Plan on our last call. And since then, we've had a positive reception to this reverse mortgage product as we embarked on the time-consuming but vitally important process of building the awareness and describe the merits of our approach that will ultimately fuel growth in assets.

Now that we've actually launched the product, we are climbing a steep learning curve as the reality of the market test the assumptions that we made in putting together our business plan. I certainly have more confidence in the future of this business than I did at the time of the launch in January.

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While we're pursuing exciting new Challenger Bank opportunities to deploy capital with higher ROEs like this, and we do expect mortgages under management to grow 6% to 8% in 2018, the prospect for slower single-family asset growth may continue to leave the bank with excess capital.

If this happens, we will evaluate the options for adjusting our equity base in response. We'll determine the best course of action once the longer-term impact of regulatory changes in our markets becomes clearer and the prospects for our growth initiatives and the impact on capital becomes better understood.

Whatever we choose to do, that choice will be informed by thorough evaluation of all organic and inorganic growth avenues open to us. So you can be confident that it will be in the best interest of all shareholders because our board and management team measure ourselves on being good custodians of our owner's capital.

Also on the agenda this year, as Tim said, is reviewing the future place of a backstop facility, if any. In the meantime, as Canada's Challenger Bank, we remain squarely focused on making banking better for Canadians across all of our business lines.

On the funding front, I'm pleased to note we launched a deposit account in partnership with Wealthsimple in the first quarter. Wealthsimple is a Canadian fintech and Canada's leading robo-adviser that selects appropriate portfolios for its clients based on their objective risk tolerance. Wealthsimple selected Equitable because of our like-minded approach and strong technology foundation.

I do believe that Wealthsimple is a great example of how elegant fintech solutions can bring value to people's lives. And our team admires the execution that they have brought to the table and how this translates in the customer experience beyond the core idea.

This collaboration is consistent with our strategy to partner with fintech leaders to provide value to Canadians savers, further diversifies ours funding sources and underscores our ability to embrace the changes likely coming to the Canadian banking industry with the advent of open banking that was announced in the budget presented by the Minister of Finance earlier this year.

To summarize, first quarter asset growth and profitably was solid. Our board increased the common share dividend for the second time this year. We continue to solidify our position as Canada's Challenger Bank in the marketplace, with the launch of EQ Bank GICs and the PATH Home Plan.

Although significant uncertainty remains, we believe that mortgages under management and balance sheet assets will continue to grow in 2018, providing the fuel for good earnings performance.

That concludes our prepared remarks. And now we'd like to invite your questions. Dan, can you please open the lines to analysts that have questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Nik Priebe with BMO Capital.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Analyst*

Recognize that it's still very early days on this front, but I was wondering if you could give us just a little color on the early rollouts of the PATH Home product? Andrew, I know you've kind of alluded to it in your comment, but just whether you've seen decent uptick on that product or what feedback you're hearing. Anything on that front would be helpful.

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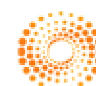

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Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. We've closed, let's say, a handful of loans. We've had a quite large number of applications. And I think we've realized we missed on a couple of elements of the product that we're currently making some adjustments to make it fit the market a little bit better. So yes, feeling really good about. And our teams have done a bang-up job in getting it across the country. Just a reminder, that we're only in British Columbia or Alberta and Ontario as we speak, so we're certainly gearing up to go into other provinces, and that's actually a fair bit. So once we've -- since we launched, we've had a chance to talk to reverse mortgage companies around the world and it's a really interesting product. If you're looking to sort of have more flavor on how these markets are evolving in other parts of the world, I recommend you look at Heartland Bank in Australia and New Zealand and the works of both legal and general and -- they have been doing in the U.K. market, where they've been growing this asset class quite fast.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Analyst*

Okay. Yes, that's helpful color. So would we see any volumes from that lending activity reflected in the total for the core single-family origination going forward?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Yes, going forward, we'd likely put those volumes in with the core single-family business. That's right, Nik.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Analyst*

Okay. And then just one last one from me. You did mention in your commentary that you made a few adjustments to pricing structure in our core single-family segment. That should help capture some incremental market share there in the second quarter. Have you done work to look at what the NIM impact of that might be on the broader portfolio? Just based on guidance, it looks like there isn't really a material change expected relative to the first quarter.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

I think that's a fair conclusion. Tim...

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Yes, I think that's right, Nik. We've modeled that at the current pricing environment just over the course of the past few weeks, and we're maintaining our NIM guidance. While we do see a little bit of competitive pressure in the alternative single-family origination, we are getting some offsets in other places. So for example, we're able to -- I think we're sharpening our pricing on renewals of single-family mortgages, given that environment which is providing a bit of an offset going forward, probably expect our liquidity portfolio to be slightly below at seasonal high at the end of March. And then we're seeing -- we're going to see more of an asset mix shift towards commercial, which as you're aware, is a higher spread business. So when you flush all those through our models, we're maintaining the guidance that's in the MD&A.

Operator

Your next question comes from the line of Marco Giurleo with CIBC.

Marco Giurleo - *CIBC Capital Markets, Research Division - Associate*

My first question is for Andrew. Just on your opening remarks, when you mentioned that you did not adapt the B-20 changes as fast or as well as you would have liked, what did you mean by that? Could you elaborate?

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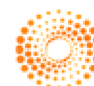

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Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. It's a little hard for me to describe it. But I think -- so I'll try to give you some sort of color of and be quantitative about it. But as you know, we're a bank that's very concerned about being on the right side of regulatory risk. And so we manage regulatory risk like credit risk very tightly. So I think towards the back end of last year, the changes coming out of B-20 -- or the B-20 modifications were quite significant. And we were very serious about approaching those and putting them through our teams and making sure that all our procedures and so on adapted so that we could be squeaky clean with the regulators come January. I'd say -- but our business is one of hustle and one where you've got to be on a firm lining it up for the brokers. And I think we probably took our eye a little bit off the ball of that side of our business. It's hard to have priorities on 2 or 3 things all at the same time. And I think to be fair to our team, they did a great job in adapting to a fair bit of regulatory change. But I think we did just lose a bit of edge in the marketplace and were less focused on that for a period of time, probably in the November, December period. Combine that with perhaps being a little bit off the market on price seeing one of the major competitors wanting to build market share at the expense of margin, I think left us a little blunter in the marketplace in kind of December through to sort of mid-February. Our teams are the best in the industry, frankly, in terms of kind of hustling and figuring out how to turn that situation around. And everybody is right on their game now, so not only are we able to comply with B-20, we've got a team that's engaged in the market talking to our customers and understanding it. So I'm pretty comfortable. It was a temporary thing, but it was something that we experienced and went through.

Marco Giurleo - *CIBC Capital Markets, Research Division - Associate*

All right. That's a good segue into my next question. Just you mentioned pricing and competition. Can you talk a bit about the level of competition you're seeing in the market, both on the residential and commercial side? And can you tie that into the firm's discipline on pricing loans and ROE?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. I mean, I'll start with commercial because I don't think it's -- partly because there's less happening there in terms of any sort of change in competition. As you probably are aware, all of our originators have on their desktop an ROE calculator that attributes capital to the loans they're making and allows us to sort of drive a bottom line. We have hurdles that they try to meet. Sometimes it's a bit more of art than a science, but there is a lot of quantitative analysis around that. And I will say that Darren and his team in commercial have done a good job in actually improving the ROEs on that metric over the last 6, 9, 12 months. So the spreads look very good. And in that business, one of the challenges is loans. Some loans are lower risk than others and they demand a higher price. So pricing for risk is really critical, and we -- our team is very experienced in that. In the single-family space, it's been a bit more of a concern that we've got perhaps one of the larger players in the market wanting to build market share at the expense of margin. Now we're not obviously about to kind of give away our franchise just because somebody wants to build a bit of market share for a period of time. So we've chosen to be fairly strategic in a few spots in the market where we want to give competitive offerings and we don't think it's going to have a longer-term impact on margins. But the next few quarters might be not what we would really -- we maybe not be pricing where we'd really desire or believe logically the market should be priced. But I think we're not seeing quite the same discipline out of one of the major players that we would have typically seen over the years.

Marco Giurleo - *CIBC Capital Markets, Research Division - Associate*

All right. Great. And if I could just sneak one last one in on capital. Capital position was strong this quarter and your book value grew 4% sequentially. Given where the stock is trading, are you -- how do you -- how are you thinking about an NCIB right now?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Well, we -- certainly, I don't think we've talked on the last call about thinking about it. We've advanced our thinking on what it would take to do it. We're also updating our capital -- our asset projections to make sure that whatever we do, we continue to be able to face the opportunity in the market. And I think probably by the time we get to the August call, we'll have more meaningful just more meaningful to say about it. I don't know that we look particularly at where the stock price is changing -- is trading at any point in time, it's more so much about making sure that we're

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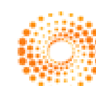

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funded efficiently so that the -- our shareholders are getting appropriate returns in the capital they entrust to us. So certainly thinking through that.

Operator

Your next question comes from the line of Geoff Kwan with RBC Capital Markets.

Geoffrey Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Just following up the questions on the competition in the nonprime space. Is it just really home that's been the competitive friction? Or has it been other players, like Optimum and some of the other smaller players? Or is it maybe the banks that have been coming down are willing to do more in that space than they have before?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

I think certainly to the last point, if anything, I would say that the banks in general, the big banks, are upgrading their credit criteria, and say that the views of some of the banks is their stock is not doing well because they've been -- seen to be exposed to Canadian mortgages. That's not always true, but I think that at a broad picture, that's probably the case. I'd say that, at the end of the day, the pricings are broadly set by us and Home, that we're the 2 players in the market. Frankly, there are other players that are significant. But my sense is that Optimum is running a nice good business and would sort of take the price that the market would offer. So there are a couple of smaller guys around, but I don't think they really drive the prices at all. So...

Geoffrey Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. And then, just so within that context though, I mean, historically in the industry, Home was -- would have been bigger than Equitable. And arguably, they were the ones that kind of set the pricing and you guys would try to maybe compete more on service to get that business. But given what happened last year and you guys are much closer in size, and if your growth rates kind of, let's say, move reasonably in tandem, do you think about like what that means from a pricing dynamic that you don't have a clear leader that may be the one that arguably kind of sets the price? And does that create a bit -- a little bit more volatility around where the originations go as well as the NIM yields?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

I think that's to be determined. Certainly, we're trying to show more responsibility in the industry around prices. And I think, as I mentioned, we had to -- we thought we had adjust to that -- adjust our thinking a little better on that. I mean, it sets more fine-tuning on thinking. But clearly, we believe that to run sustainable, well-capitalized banks that produce the right returns and reward shareholders and appropriately price risks is extremely important to price with discipline. So we'll continue to -- and that's the DNA that we work with, and we'll continue to sort of work with that DNA. And I can't believe that anybody that doesn't take that sort of view will thrive long term. So we just need to be careful about that, and think about how we play our cards in that.

Geoffrey Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. And just one last question I had is on the reverse mortgage product. The other competitor in the market has been doing this for decades and arguably has a big kind of database or experience on the consumer behavior patterns. I wonder if -- how should we think about how you guys are kind of rolling out in the stretch? Obviously, you're just starting here. But would it be fair to maybe describe it as being maybe erring on the side of conservatism on the underwriting side until you get a little bit more of the experience in terms of how these borrowers -- or is there something

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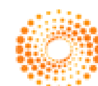

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that you did before the launch that you're able to get more comfort, more information around how potential borrowers in Canada behave with respect to this type of product?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Well, I think if you look at in -- if you line up our underwriting grids with the other competitor in the marketplace, you'll see that we're actually operating in a more conservative manner than them, so working within the risk umbrella. So I'm pretty comfortable that we're not taking risks that we shouldn't be, and we spent a lot of time working on that. And we think about the dynamics in other markets, you can look at sort of LTVs. The way this product is underwritten is primarily around the age of the borrower or borrowers, the quality of the real estate and then the loan-to-value assessment against that. So the metrics that apply in other markets probably should be similar to what apply in Canada. The math is relatively complicated, but the underlying dynamic is pretty similar. So we're actually lending at relatively low loan-to-values, and we feel pretty comfortable we've got the risk pretty well battened down.

Operator

Your next question comes from the line of Jaeme Gloyn with National Bank Financial.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

First question is just going back to the, I guess, the Q1 experience and the conversation around implementing B-20 versus price competitiveness. Can you allocate a weight to both of those, is it 50-50? Or would you say price was the biggest driver of market share being ceded?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

It's really hard for me, you know that Jaeme, that's why I tried to give you color rather than trying to be quantitative, frankly. I think even within Equitable, we might have different views on that. It's really hard to be quantitative on it. Certainly, I do feel that we were pretty focused on what it took to adapt to B-20 and that was -- whether it was 50-50 or 40-60 or whatever, I know that, that was a considerable distraction. The need to actually upgrade our systems to calculate the new structures, GDS, TDS is the need to make sure that no second mortgages are put in place behind. Some -- those were -- those are a couple of highlight ones, but there are number of other pieces in that document that are quite (inaudible), but are thinking through. So our leadership team in the single-family was definitely fully engaged. And I don't know -- on a fairly short timeline, frankly, from the time they said these are the final rules until we got to have these things in place by December 1. It was a heavy lift for the team to make it happen. And I'd say -- and I think it's very hard for us to kind of really quantify it, but I think they did a great job in keeping on the right side of the rules, which is job 1 in a bank. And so I'm not providing any criticism to our team. I think our team did the right thing. But probably others maybe have done a better job of keeping fully engaged in the market while going through that journey.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And you made a comment, also just in terms of the relative competitiveness, about the underwriting criteria and perhaps that maybe competitors are underwriting a -- perhaps a lower-quality book. Can you describe maybe some specifics of what you're seeing in terms of that credit scorecard, where Equitable is relative to competitors? And how much of a driver is that to mortgage growth in recent periods?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

So I'm -- it's not clear that I made any relative -- sorry, I can't recall making any relative credit statements. I'm not aware that I'm -- made any relative issues there.

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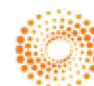

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Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Maybe we'll follow up on that after. Just getting -- still on pricing. I asked this to a competitor as well. I'm just -- I'm curious to know, what is the net interest spread of new mortgages being underwritten today versus mortgages that would be rolling off of the portfolio? Is that something that you have at hand that you'd be able to disclose?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Yes. We do have it in hand, Jaeme, but it's not something that we disclose publicly. I think we'd just point you to the movements in the aggregate NIM in our portfolio. What I would say is, broadly speaking, within the commercial and single-family portfolios, the NIM on what we're adding today is roughly equivalent to the NIM of the mortgages that are rolling off the book.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. So what are -- I'm sorry if I missed this, if this was already discussed in the commentary. But what are the offsets? If we're looking at net interest spreads today versus net interest spreads a year ago, it's significantly lower just looking at this on the surface. So what are some of the offsets that would support a stable NIM in that environment on specifically just the mortgage itself?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Well, the huge one -- the huge change in NIM is just the cost of backstop facility that gets amortized through that line.

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

If you're looking at -- I mean, if you're looking at market available pricing data for single-family and market available GIC data, that is probably what you're seeing, agreed in more recent months. But again, what I'd say is that the market data you have isn't necessarily reflective of what's happening in the inside, point one. Point two, what you're not seeing is retention. So as we mentioned, B-20 makes our book generally a little bit stickier and offers the opportunity for us to price more selectively, so we can make up some of the margin that we're losing in originations in the retention. And then, broadly speaking, with our commercial -- sorry, with our core lending book, we also get the benefit of -- this year, of a mixed shift towards the higher spread commercial business.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Fair enough. So shifting gears then, just in terms of the capital deployment through the remainder of the year, we've had dividend hikes here in the last -- each of the last 3 quarters. How do you -- how are you, I guess, measuring dividend hikes versus NCIB or an SIB? Is it something that you would consider perhaps normalizing that payout ratio with other Canadian financial institutions? Are you able to provide any initial insights based on some of your conversations?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. I think what you're asking is highly relevant to our thinking. Generally, as Canada's Challenger Bank and thinking about new opportunities that are going to open up, while we may, over the next few months, have a lower growth profile that we've had over the last decade, which has been I think very consistently kind of CAGRs in high teens, that may well resume as we find other opportunities. So we don't want to lock ourselves into a position where -- we're in a very high payout ratio business, where we're unable to take advantage of organic opportunities. So I think that leaves us to the logic that at least over the next 2 to 3 years, to the extent that we're returning additional amounts of capital, probably be through an NCIB or some other mechanism that allows us just to do -- to make sort of deliberate decisions to move capital ratios if they're overly high down to levels

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that are more appropriate. In terms of the regular dividend, I think we've been quite consistent over the last few years saying that we want to grow it in double-digit, at a double-digit rate year-over-year. The position to -- or the plan to raise the dividend by $0.01 in this quarter was probably something I could have told you 2 years ago. So this is not something that would really change any dramatic view or really reflects underlying operating performance, it's more around our commitment to making sure that investors who stay with us do see the benefit of dividend growth. And as you mentioned, we're apparently one of lowest payout ratio banks in Canada and we have lots of opportunity to continue to grow the dividend.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Fair enough. And last one from me, just around the reverse mortgage business. There were some favorable comments, let's say, from the CEO of CMHC. Do you have any sense or feeling or indication that might allow you to pursue more aggressive growth on -- in that channel given a favorable regulatory position?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Well, I think it's encouraging to see that policymakers at the highest levels are thinking about reverse mortgages that -- and putting them in a favorable context. I don't know that we would then suddenly translate that into faster growth. As we mentioned at the launch, the first thing is to make sure that we don't -- that there are a number of issues around this product, one of which there is risk that it could be sold in a way that we wouldn't feel comfortable with. So we -- and I think we don't -- that's one of the things I'm encouraged about over the first few months, frankly, is we've seen the process we put in place to make sure that these are being used in the right use cases and actually -- that has you panning out as far as I'm concerned. So we'll wait and see on that, but it is encouraging. I think there is a really strong public purpose behind these types of mortgages. With an aging population, they've got lots of equity locked up in their homes, maybe not the same cash flow from pensions that they might have expected. But wanting to continue to live in their homes and their communities as they age, that this product makes a lot of sense. So it's -- so I'm encouraged by it. I think it probably has got tailwinds behind it for a number of reasons, but I don't think we're about to change our guidance on how fast it might grow.

Operator

Your next question comes from the line of Graham Ryding with TD Securities.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Just to follow-up on that, have you provided any guidance as to what you think a reasonable target is for growing your reverse mortgage book this year or next year?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

No, we haven't yet. I think once we get a sort of (inaudible) a couple of quarters in, we'll start to do that. I mean, we've always promoted this as kind of like this is a year of wait and see. And I wouldn't expect to be -- wouldn't expect to get $50 million this year in assets. But beyond that, it'll start to grow faster we hope.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Okay. Fair enough. You're talking about market conditions, competition, B-20 now slowing the growth of your single-family business and then looking to sort of adjust your use of capital, if that's the case. Is there any appetite on your part just given the market that we're in, very highly indebted Canadians, rising rate environment, there seems to be some volatility in the GTA market, that's a key market for you, of just deliberately

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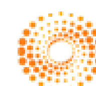

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reining in growth and being a little bit more stingy with how you're underwriting or the credit that you're willing to lend to. Is there any appetite to offer it like that going forward?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

I think we're pretty comfortable with the credit mix. I mean, as you know, we always, over the years, we adjust various loan to values, different things to reflect where we see the risk. I think we've always been prudent. We've never been that expansive either, and I don't know that we -- expansive or stingy, we just think that we're prudent. We faced the market consistently and I expect that they will continue to do that.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Okay. The allowance for credit loss reduction under IFRS 9, can you just walk us through that? Is that basically a reflection that you were fairly conservative under your previous provisioning pre-IFRS 9 and that's what caused the allowance to be released?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

I think that's absolutely right, Graham. I think as we develop more sophisticated risk models, as -- on our forward journey towards AIRB and for the implementation of IFRS 9, we always believed our models were conservative. But the extensive and more sophisticated modeling we've done for those programs confirm that. If you looked at our allowances relative to our uninsured book prior to the implementation, they were running north of 30 basis points as compared to our average 10-year loss rate of 4 basis points, which, again, reinforces the notion that we have been very conservative. And hence, the reduction in our allowances on January 1.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

By the way, this has been a major effort, a major lift from our team to actually do these models. It's many thousands of hours of analysis, so we're pretty comfortable we've got it right.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Got it. Shifting to your -- the GTA market has seen some price declines sort of over the last year. Is that factored in when you sort of -- when we look at your overall loan to value on your portfolio, not on your originations but on your overall portfolio? Is that price decline been factored in there? Is that -- does that get captured by an HPI index or what not?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Yes, it has. The LTVs that we disclosed were flagged in the most recent HPI numbers.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Got it. And then my last question, the Wealthsimple partnership, is this a savings account on the Wealthsimple platform or is this GICs as well? And what sort of funding costs -- how does that look relative to your other existing channels?

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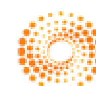

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Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. It's a savings account that's controlled by the underlying investments. So it's a corporate relationship, but it's the underlying investor that makes the decision, the underlying individual user. And the funding costs are higher than brokerage GICs but lower than our EQ Bank platform by somewhat, sort of halfway between those 2. So we see these as kind of relationship accounts. These are relationship accounts.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Okay. Got it. But this will be an on-demand savings account?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

It's on-demand, at least at this point.

Operator

Your next question comes from the line of Stephen Boland with GMP Securities.

Stephen Boland - *GMP Securities L.P., Research Division - MD & Equity Research Analyst*

Just -- I just want to make sure I understand the guidance for Q2, and maybe you've answered this indirectly. But on the single-family, you've guided a 40% increase quarter-over-quarter, or roughly I think that's the number. Is that -- again, is that due to higher retention from your existing book? Or is that factoring in a big wash of new business that's coming in?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

That's all new originations. We don't include -- that stack doesn't relate to retentions or renewals, it's simply new customers coming through the front door.

Stephen Boland - *GMP Securities L.P., Research Division - MD & Equity Research Analyst*

And again -- and then from what you said, that's just due -- you're winning that business back is just from pricing? Or is it just from service or a combination?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

It's from a more proactive stance to the market, I would say. As I tried to describe earlier on, we were very focused on making the changes to accommodate B-20, and now our teams are much more active in placing the market.

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

And then that origination performance, Steve, combined with the improvements we've seen in our customer retention, have led us to increase our view on portfolio growth for single-family to the 4% to 6% range, which is up by a couple of percentage points from last quarter.

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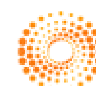

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Stephen Boland - *GMP Securities L.P., Research Division - MD & Equity Research Analyst*

Okay. And second question, just on the credit facility. I know it's a year away. I mean, do you envision being able to get rid of that facility in total? Or, I mean, do you believe that you're always going to have to have maybe not $2 billion but $1 billion or $0.5 billion standby facility with -- just with the change of the landscape, but the view on demand deposits?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Well, I have a view. My view is that we would stand alone without a standby loan because this is very much something where I won't take the feedback from the board, other people or the market participants' view, the views of, frankly, the people that provide the standby facility. I think, in general, we should take the view that banks stand alone through their funding mechanisms and shouldn't be sitting there. I take the view that banks should be standing alone there with their other funding mechanisms and wouldn't have standby drawable credit facilities. But the experience of last year, certainly, we need to consider that before we make that decision. That's going to be the decision we make over the next 12 months or so.

Stephen Boland - *GMP Securities L.P., Research Division - MD & Equity Research Analyst*

Okay. And Andrew, when you say that, how do you balance having -- it seems to me that you -- in the words and then also on the MD&A, that you believe that there is some excess capital. How do you talk about getting rid of a facility and balancing that with carrying excess capital? Are the 2 separate or you do look at them together?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

I really think of them separate. Capital is to CET1, to fund your credit losses and other things. It's the capital reserve you hold in reserve, you hope you never need it, but it's sitting there to provide that lifeboat in the event of a severe economic downturn. Funding is supported by the backstop facility. The ability to access deposits is essentially being funded by -- is what supports the backstop. So I think as we advance our ability to gather deposits, then the need for the backstop becomes less evident.

Operator

Your next question comes from the line of Phil Hardie with Scotiabank.

Phil Hardie - *Scotiabank Global Banking and Markets, Research Division - Director, Diversified Financials and Analyst*

Just one quick question, most of my questions have been answered. But just looking at the shifting landscape, with impacting volumes and retention rates. Can you maybe just talk about maybe what the implications are on the broker side of the business? And whether that's changing concentration of that broker business or impacts the volume incentives and commission structures?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes, I haven't seen much in the way change there, frankly. That's -- it's pretty much -- we've come up -- we have the same programs that we had last year, and I think, broadly speaking, they pay the same. So our programs are to provide more compensation for those brokers that are more loyal to us and provides the more volumes. It's called the (inaudible) program, it's been in place for a number of years. And works -- we're always tinkering with it a little bit, but it's not -- it's essentially the same program we always had.

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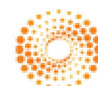

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Phil Hardie - *Scotiabank Global Banking and Markets, Research Division - Director, Diversified Financials and Analyst*

Okay. So similar concentration of the similar players and same volume incentive on loyalties?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

That's right, yes.

Operator

(Operator Instructions) Your next question comes from the line of Jaeme Gloyn with National Bank Financial.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Asked and answered. Thank you.

Operator

And we have no further questions in the queue at this time. I would like to turn the call back over to Andrew Moor for closing remarks.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Well, to conclude, we look forward to delivering our next quarterly report in August. And look forward to seeing you at the Annual General -- Annual Shareholders Meeting next Tuesday, May 15 at Equitable Bank Tower at Midtown Toronto, starting at 10:00 a.m. Eastern. Thank you for listening.

Operator

Thank you to everyone for attending today. This will conclude today's call, and you may now disconnect.

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