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Conference Call Transcript

TPP - Q3 2007 TEPPCO Partners, L.P. Earnings Conference Call

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Dan Duncan

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Darren Horowitz

Raymond James - Analyst

Yves Siegel

Wachovia Securities - Analyst

Ross Payne

Wachovia Securities - Analyst

Sam Arnold

Credit Suisse - Analyst

PRESENTATION

Operator

Good day. Welcome to the TEPPCO Partners, L.P. third quarter 2007 earnings conference call. Today's call is being recorded. At this time, I would like to turn the conference over to TEPPCO's Treasurer and Director of Investor Relations Mark Stockard. Please go ahead, sir.

Mark Stockard - TEPPCO Partners - Treasurer and Director of Investor Relations

Thank you. Good morning, everyone. Thank you for joining us today for TEPPCO's 2007 third quarter earnings conference call. Jerry Thompson our President and Chief Executive Officer will lead the call. Jerry's comments will be followed by Bill Manias our Chief Financial Officer. During the call, we will address recent partnership developments and review our third quarter financial results including key factors impacting the results. We will also address our business environment as well as our outlook for the remainder of 2007.

Before we begin, I would like to remind everyone that the matters discussed on this call, will contain forward-looking statements and expectations regarding future results, increases in distributable cash flow or expenditures which are subject to many factors, risks and uncertainties that are described in TEPPCO's filings with the Securities and Exchange Commission. If any of these risks and uncertainties materialize or should underlying assumptions prove incorrect, actual results or outcomes may vary materially from these are expected. We undertake no obligation to update any forward looking statements. Our discussion will also include certain non-GAAP financial measures as defined under SEC rules. To comply with these rules we have provided a reconciliation of these non-GAAP measures on our website, www.teppco.com. At this time I will turn the call over to Jerry Thompson for introductory comments. Jerry?

Jerry Thompson - TEPPCO Partners – President and CEO

Thank you, Mark. For the fifth consecutive quarter I'm pleased to report that TEPPCO has delivered record quarterly results. For the third quarter 2007, each of our business segments reported improved result over the 2006 third quarter. I'll briefly cover a few of the quarterly highlights and then I'll turn the call over to Bill to review the segment performance in greater detail. Compared to the third quarter, 2006, net income increased 16% to \$47.6 million for the third quarter of 2007.

On a per unit basis, net income was \$0.44 per unit for the third quarter compared to \$0.39 per unit for the same quarter in 2006. EBITDA increased 13% to a record of \$114.4 million for the 2007 third quarter. As I mentioned, every segment had increased EBITDA performance with the Downstream segment leading the way with a 22% increase over the prior year quarter. Our Midstream segment also posted impressive results with a 13% increase. Our Upstream segment, which is our smallest segment in terms of EBITDA at 25% of the overall amount, reported a 2% increase in EBITDA for the third quarter but that's 2% over an outstanding third quarter for 2006. So we are very pleased to see continuing excellent performance in our Upstream segment.

With respect to volumes transported on our pipelines, refined product volumes on our main line system increased 14%, which benefited from lower competing local refinery production in our Midwest market areas. Centennial Pipeline, in which we own a 50% interest, also benefited with volumes averaging 181,000 barrels per day. This is a record since the joint venture began operations. In the Midstream segment, natural gas gathering volumes are on Jonah system increase 28% from the third quarter of 2006 to 1.65 billion cubic feet per day in the third quarter of 2007 reflecting the continued active drilling in both the Jonah and Pinedale fields in Wyoming.

Also in the Midwest segment, the Chaparral and Panola NGL pipelines systems operated near capacity throughout the quarter. Our 100% owned crude oil pipelines in our Upstream segment posted a 7% increase in volumes.

As you are aware, earlier this month, we announced an increase in our quarterly distribution rate to 69.5 cents per unit, our second distribution increase for 2007. The increase brings our current annualized rate to \$2.78 cents per unit and represents a 3% increase over the quarterly distribution rate from a year ago. The completion of a number of organic growth projects has increased TEPPCO's ability to serve our customers and provide incremental distributable cash flow to our unit holders. I'll now turn the call over to Bill to update you on specifics around the quarter results, after which I will wrap up with the review of a few of our ongoing projects.

William Manias - TEPPCO Partners – Vice President and CFO

Thanks, Jerry. I would like to review the highlights of each of the business segments and I'll start with Downstream. Downstream EBITDA from continuing operations increased 22% to \$39.8 million. That's up from \$32.7 million for the same period in 2006. Total transportation revenues increased \$5.9 million or 10% due to increased refined product transportation volumes to the Midwest market areas along the upper Texas Gulf Coast attributable in part to the Genco integration project completed during the first half of 2007. Both refined products and LPG transportation revenues also benefited from tariff rate increases that took effect in 2007. Storage revenues also increased as a result of new leased capacity available from the Genco assets that were acquired in 2005.

Now moving on to our equity investment in Centennial Pipeline. We were very pleased with the record throughput of 181,000 barrels per day that Jerry mentioned. Third quarter EBITDA from Centennial totaled \$1.7 million compared to a loss of \$400,000 for the same period in 2006.

Now let me move on to Midstream. Midstream EBITDA from continuing operations increased 13% to \$45.8 million from \$40.7 million for the third quarter of 2006. Our ownership interest in Jonah was the largest contributor to this increase in EBITDA which totaled \$28.1 million during the third quarter of 2007 and that's compared to \$15.6 million for the same period in 2006. The increase was primarily due to a 28% increase in natural gas gathering volumes which averaged 1.65 billion cubic feet per day compared with 1.29 BCF per day in the third quarter of 2006. As many of you know, Jonah is governed under a joint venture agreement with an affiliate Enterprise, which provides in part that Enterprise will earn an increasing percentage on the earnings of Jonah as the Phase V expansion is completed. During the third quarter, the first portion of the Bridger compressor station was completed and that triggered a larger sharing ratio for Enterprise. TEPPCO received approximately 84% of the EBITDA from Jonah during the third quarter of 2007 compared with 100% for the third quarter of 2006 and going forward TEPPCO should receive approximately 80% of the earnings of Jonah.

Our NGL systems operated near capacity throughout the quarter. Transportation revenues increased 9% on a 2.5% volume increase and 6.6% increase in the average tariff rate per barrel. Gathering revenue on the Val Verde system totaled \$15.4 million in the third quarter of 2007 as compared with \$16.3 million in the third quarter of 2006.

Now let me move on to Upstream. Third quarter EBITDA from continuing operations for the Upstream segment was \$28.8 million compared with \$28.2 million for the third quarter of 2006. The segment reported increased marketing, transportation and terminaling volumes and revenues partially due to the completion of several capital projects during the quarter. These projects included a new pipeline connection supplying a New Mexico refinery and 900,000 barrels of leased storage capacity at Cushing. Our prorata share of EBITDA from Seaway pipeline for the quarter was \$3 million compared with the \$4.8 million for the third quarter of 2006. These lower equity earnings were primarily due to lower long haul transportation volumes on the system as well as a reduction of our financial interest from 47% to 40% as stipulated by the Seaway partnership agreement. Our future sharing ratio will remain at 40%. Long haul transportation volumes on Seaway averaged 104,000 barrels per day in the third quarter of 2007 compared with 239,000 barrels per day in the third quarter of 2006. One of the primary drivers for the decreased volumes was the temporary shutdown of several refineries for maintenance purposes that reduced volumes in both the second and the third quarters. And now that these refineries are back on line and with the completion of capital projects that facilitate movements on Seaway, we're seeing pickups in the volumes in October so we're optimistic about improved volumes for the fourth quarter of 2007. That concludes the review of the segments.

Let me touch briefly on our financial position. At September 30, 2007, TEPPCO had total debt outstanding of approximately \$1.8 billion with remaining liquidity of approximately \$300 million under the partnership \$700 million revolving credit facility. For the latest 12 months, our debt to EBITDA ratio was 3.6 times. Now that excludes discontinued operations and gains on asset sales, but includes the 50% equity content of our junior subordinated notes. As you may recall earlier this year, we issued \$300 million of 7% junior subordinated notes due in 2067. Because of the long dated maturity and other characteristics of these notes, Moody's and Standard and Poor's each assigned 50% equity content to the notes. The partnership currently anticipates the total capital expenditures for 2007 will be approximately \$280 million, which includes about \$230 million for organic growth projects and system upgrades and \$50 million for maintenance capital. In addition we expect to invest about \$180 million in 2007 for capital contributions to Jonah, which will be primarily used to fund the Phase V expansion and well connections. Now that adds up to about \$460 million in capital spending and investments for the year and these levels are consistent with our previous ranges that we provided to you in our July conference call. With that, I'll turn it back over to Jerry.

Jerry Thompson - TEPPCO Partners - President and CEO

Thanks, Bill. Again, I'm pleased with the excellent performance of each of our segments during the third quarter. Our employees did an excellent job of maintaining the high utilization of our assets throughout the quarter. I'm also pleased with the recently completed projects which provided incremental distributable cash flow during the quarter. We continue to make good progress on the Phase V expansion on Jonah and we continue to expect full completion by the end of the first quarter of 2008 on that project. We have already benefited from the partial completion of Phase V increasing the capacity from \$1.5 billion cubic feet per day to the current capacity of 2.0 billion cubic feet per day. Compared to the fourth quarter of 2006, volumes have increased 13% to \$1.65 billion cubic feet per day during the third quarter of '07. Looking ahead to the fourth quarter of this year, volumes on Jonah will likely stay in the current range until some of the local demand catches up with the supply. This typically occurs during the shoulder period with mild weather between summer and winter. Longer term, the additional takeaway capacity from projects like the Rockies Express pipeline is expected to return the growth pattern that we have seen earlier this year.

As you've probably read, Motiva received board approval for their Port Arthur refinery expansion. Work is continuing on pace on our refined products terminal to support their expansion. We received our air permit last week, two weeks ahead of schedule and we can now begin construction of the foundations for the new tanks. We expect to complete this project on time and on budget with the total project cost of approximately \$240 million and a completion date by year-end 2009. With that, we are ready to take any questions you may have.

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS) And our first question we'll hear from Darren Horowitz with Raymond James.

Darren Horowitz - Raymond James - Analyst

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Good morning, guys, thank you. My first question is in the Downstream segment as you have mentioned in the press release and also highlighted again on the call here, you did see a lot of the upside due to the higher transportation revenues and it looks like as you pointed out that was as a result of the reduced Midwest refinery production. I'm curious as to the current situation there, specifically when you look, you know, the 49 million barrels being up about 9% sequentially have those refineries I assume come back online and what's the expectation for volume there in the fourth quarter?

Jerry Thompson - TEPPCO Partners - President and CEO

Let me turn that question over to Sam Brown who heads our Downstream segment.

Samuel Brown - TEPPCO Partners - Vice President of Commercial Downstream

We expect the trend to continue through the fourth quarter. The biggest disruption of supply in the Midwest has been the BP refinery in Chicago and Whiting and they're anticipating full capacity sometime later in 2008. We're expecting some refinery turnarounds in our markets in the fourth quarter. So we expect all three of our pipelines, the two we own and operate and the Centennial Pipeline to be full through the end of this year and then probably continue into the first quarter of next year.

Darren Horowitz - Raymond James - Analyst

Okay. Switching over to the LPG's, it looks like that was up slightly sequentially to about 7.1 million barrels. Can you give us some color on your expectations for the seasonality in that business? I know it jumps up very, very dramatically in the fourth quarter. Do you think that from what you're seeing right now, you could see a doubling in those volumes?

Samuel Brown - TEPPCO Partners - Vice President of Commercial Downstream

No, I think what we're going to see on our LPG side is driven mainly by mother nature and the weather. It's been a little sluggish in the third quarter. We're hoping that will pick up in the fourth quarter and our numbers, if you look at them year-over-year they're a little bit distorted because of the forced sale we had by the FTC of assets that was effective March 1st of this year where we sold a pipeline that was a high volume, low tariff pipeline so our volumes are a little bit distorted. That won't clear up until after the first quarter of '08 but year-over-year on our existing assets we're actually showing higher volumes for LPG's in addition to the higher volumes you've seen on our refined products lines.

Darren Horowitz - Raymond James - Analyst

Then two quick questions for you on the Midstream side of the business. When we're looking at the Midstream segment and the average fee for MMBTU it was down sequentially, albeit slightly but it was down on face of volume increases. How should we look at your average fee for MMBTU as you exit the year '07?

William (Bill) Ordemann - Executive Vice President

I think what you're seeing as we continue to complete Phase V before those assets were put into service we may have seen some higher pressures and our fees are somewhat based on our pressures up in the Jonah system. So now that we've brought those pressures back down with the implementation of that compression, I think you should see those average fees for MBTU go up a little bit.

Darren Horowitz - Raymond James - Analyst

Okay, and then final question on also on the Midstream side on the condensate sales, you know, the volumes were down, I know that obviously that business is very, very seasonal as well but are you guys expecting a similar type of sequential rebound here in the fourth quarter as to what you experienced last year?

William (Bill) Ordemann - Executive Vice President

Yes, on the condensate sales particularly up around the Jonah system are seasonal. We do get the quite a bit more condensate in the winter months from the pipelines running at cooler temperatures, so I think we will see that cycle of nature stay in place.

Jerry Thompson - TEPPCO Partners - President and CEO

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Let me add just a little more color to your question on LPGs. We did complete minor debottle necking project in our system to move more LPG into the East Coast markets, so we anticipate that pipeline capacity will pull volume away from rail so we should see an increase year-over-year in our propane movement.

Darren Horowitz - Raymond James - Analyst

Okay, thank you.

Operator

And next we'll move onto Yves Siegel with Wachovia.

Yves Siegel - Wachovia Securities - Analyst

Just staying on the LPG for a second. Are you under the impression that some of your customers might be short propane going into the winter so that perhaps that could stimulate incremental demand?

Samuel Brown - TEPPCO Partners - Vice President of Commercial Downstream

Mainly, the buying patterns have been sluggish in the third quarter just due to the mild temperatures back in the Northeast. We've got plenty of inventory positions up system for our customers. So if we do have a cold snap, we're well positioned to deliver to them when they're ready and able to take it.

Dan Duncan - EPCO, Inc. - Chairman

What we're seeing, if you look at the Enterprise system I think we feel the same way over on the TEPPCO system, most of your dealers is probably not filling up their storages in the third quarter because of prices. They think that prices is probably the high side and if you would stay at the same level or they may come back down. We feel that the secondary storage in the fields and I think this is true of everywhere in the market is not being filled up by now, so in theory you will have an uptake in demand in the fourth quarter.

Yves Siegel - Wachovia Securities - Analyst

Okay. Yes, and then just to stay on the pipeline. Do you guys benefit at all from a PPI adjustment on the tariffs?

Samuel Brown - TEPPCO Partners - Vice President of Commercial Downstream

Yes, that's reflected. We adjust both our refined projects and LPG tariffs. Weighted average it was about almost 4.5% increase that went into effect in the second and third quarters of this year.

Yves Siegel - Wachovia Securities - Analyst

Okay, great. And then following up on just the growth CapEx question. Jerry, I'm just -- in terms of the long range growth that you're trying to push for, any update on what you think might spend in '08 and are there any large projects may be looming on the horizon?

Jerry Thompson - TEPPCO Partners - President and CEO

Your question on '08, we're in the process of finalizing the capital budget for 2008 and we'll have that information available later in the year. As far as large projects on the horizon, we're still working on a couple very large projects that we hope to push across the finish line very shortly and we'll be able to announce in the not too distant future.

Yves Siegel - Wachovia Securities - Analyst

Can I push it Jerry in term of the nature those projects?

Jerry Thompson - TEPPCO Partners - President and CEO

Well, they have to do with crude and refined products.

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Yves Siegel - Wachovia Securities - Analyst

Okay. So it sounds like it could be a pipeline?

Jerry Thompson - TEPPCO Partners – President and CEO

Could be.

Yves Siegel - Wachovia Securities - Analyst

Okay. I'll let it go with that, thank you.

Operator

And as a reminder, if you would like to ask a question, please press star followed by the digit 1 and next we'll move onto Ross Payne with Wachovia capital.

Ross Payne - Wachovia Securities - Analyst

First question is what is the ownership you have in Meeker right now and does that change if I'm correct on that.

Jerry Thompson - TEPPCO Partners – President and CEO

TEPPCO has zero ownership in Meeker.

Ross Payne - Wachovia Securities - Analyst

Okay, for some reason I thought they had 20% or so of that and so the answer to that is nothing on that. Okay.

Dan Duncan –EPCO, Inc. - Chairman

Maybe you're talking about Jonah. The Jonah deal that's where Enterprise and TEPPCO has the joint venture. So, I think you're talking about Jonah, but TEPPCO has never been involved with Meeker. That's down in Colorado. TEPPCO has always involved in the Jonah Pinedale area there.

Ross Payne - Wachovia Securities - Analyst

And Enterprise will get approximately 20% of that. Of Jonah.

Jerry Thompson - TEPPCO Partners – President and CEO

After completion of Phase V, that's right, Ross.

Ross Payne - Wachovia Securities - Analyst

Thanks for that clarification. Also, Jerry, did you say you expected Centennial to be operating in close capacity through Q1 and Q2 of next year?

Jerry Thompson - TEPPCO Partners – President and CEO

Well, certainly through Q1. We see it operating at capacity.

Ross Payne - Wachovia Securities - Analyst

Okay and can you give us -- you gave us the through put in this quarter, what capacity utilization or what was the through put sequentially one or two quarters prior, just so we can kind of see the improvement there?

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Jerry Thompson - TEPPCO Partners – President and CEO

Third quarter of '07 was 181,000 barrels a day and as I recall third quarter of '06 was in the 130,000 barrels a day range, so it's 45,000 to 50,000 barrels a day increased.

Ross Payne - Wachovia Securities - Analyst

That's very nice and substantial. Is anything -- a lot of the refineries were out during the quarter. What is driving -- do see a notable increase in through put on this pipeline once those get back up and running and if so, what's driving that?

Jerry Thompson - TEPPCO Partners – President and CEO

Again, we will see an uplift just to the overall increase in demand for refined products in that region of the country but the big bump that we've seen is due to some refinery outages and as Sam said earlier, typically refineries will have turnarounds in the fourth quarter and first quarter. So we see a lot of that Midwest refining capacity being offline for major maintenance.

Samuel Brown - TEPPCO Partners – Vice President of Commercial Downstream

And also we've done some organic projects around our heritage TEPPCO system, mainly for deliveries into the Memphis market that we previously haven't had in the past and as our propane business grows to the northeast, what you see is our TEPPCO lines can typically stay full and the incremental increases rolls over to Centennial. So a lot of the organic projects that we've been able to execute the last couple of years have resulted in increased volumes in Centennial. We're also recommending to our partner that we spend some minimal capital to expand the capacity around Centennial going forward.

Ross Payne - Wachovia Securities - Analyst

And I guess finally, this kind of (inaudible) into what Yves had mentioned earlier. You guys had kind of talked about a large green fill project initially to help get Canadian crude south. With ENB and Exxon expanding their pipes significantly, how does that play into your thinking down that strategy?

Jerry Thompson - TEPPCO Partners – President and CEO

Well, the whole picture of Canadian crude production has gotten a little more complex over the last two to three weeks with the announcement by the Canadian government that they're looking at changing the royalty structure around that heavy crude production and that has all of the producers looking at their own card to see if they want to increase their production as rapidly as they initially forecast. So we're still assessing the situation, Ross, and certainly the Enbridge and Exxon Mobil announcement has us thinking about timing of when additional capacity would be required and again that's a function of how quickly the Canadian producers ramp up their production. So, it's still something that we're evaluating. And as of yet we're not ready to announce a position one way or the other.

Ross Payne - Wachovia Securities - Analyst

Hopefully, we'll hear it from Alberta in the next couple of weeks.

Jerry Thompson - TEPPCO Partners – President and CEO

Yes, hopefully that will clarify the issue.

Ross Payne - Wachovia Securities - Analyst

Very good, guys, thank you very much.

Operator

And next we'll move onto Sam Arnold with Credit Suisse.

Sam Arnold - Credit Suisse - Analyst

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Hi, guys a couple of quick questions for you primarily on the Midstream. If you could just talk a little bit how the Jonah drilling is going and what you expect for ramp up of volumes? And then also just some comment on the activity in Val Verde.

William (Bill) Ordemann - Executive Vice President

The Jonah drilling is still going very strong typically up in the Pinedale area. We've seen a little bit of drop off in rigs this year and I think what we're going to do is to see that pickup again when Rockies Express West is done here in January and prices have been pretty depressed up there at the moment, but the last count there were still 33 rigs drilling in either of the Jonah or Pinedale fields with our dedicated acreage is still robust growth. There is some production right now that's being shut in due to those prices but we expect that to come on pretty quick as demand on the front range picks up. So I think today we're running in the 1.7, 1.75BCF a day range at Jonah. When that gas comes back on, I think we'll continue to ramp up well north of 1.8 and maybe level out there for a little while until the drawn activity picks up after the first of the year but certainly somewhere in the 1.8 to 1.9 ranges where I predict would be at the end of the year.

John Goodpasture – TEPPCO Partners – Vice President of Corporate Development

On the Val Verde asset which preliminary serves the coal bed methane play and Fruitland Coal, that reservoir is pretty much on maintenance. We see some drilling but fewer than 10 wells probably this year-to-date. So it's a mature basin and it's more on a maintained -- it is not a high growth, high drilling area, at least in the coal bed methane. We do have, as I think you probably know, we do have existing relationships with the Colorado Gathering system where we're bringing in some additional volumes from Colorado. The drilling in Colorado is a little more active because that area is more recently developed, and we're discussing with Colorado producers and to gather additional increases to bring additional volume down into our system to utilize existing treating capacity. Nothing to announce at this point but we're working on that. That's probably an area where we can at least preserve our current situation and maybe even grow it but the indigenous drilling in the coal bed methane in the southern San Juan Basin in New Mexico is pretty much on maintenance at this point.

William (Bill) Ordemann - Executive Vice President

One more comment on Jonah as we brought on the initial compression associated with Phase V, I think the response we've seen from the field in the way of higher production rates has exceeded all of our expectations, both the producers and ours certainly, we've really seen dramatic increases in production to Jonah field as a result of the lower pressures and we're probably only a little over halfway to where we're headed with those pressures. We will bring additional compression on like in February of next year. We hope to see continued improvement in those production rates but we've really seen a dramatic increase in the rates of Jonah associated with lower pressures.

Sam Arnold - Credit Suisse - Analyst

Thank you.

Operator

And as a reminder, please press star one to ask your question. We'll pause for just a moment. It appears there are no questions at this time. And if you would like to listen to the replay of this call, you may dial in 888-203-1112 using confirmation code 9452025. That replay will be available from 2:30 p.m. central time today, October 25th and will end on November 1, 2007 at 2:30 p.m. central time that number again was 888-203-1112. Confirmation code 9452025 and I will turn the call back over to the speakers for any additional or closing remarks.

Mark Stockard – Treasurer and Director of Investor Relations

At this time we don't have any more comments. Again, we appreciate everybody's participation today and we will disconnect now. Thank you.

Operator

And that will conclude today's call. We thank you for your participation.

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