AVANT

AVANT Corporation

Q2 Financial Results Briefing for the Fiscal Year Ending June 2020

February 27, 2020

Event Summary

[Company Name]	Avant Corporation
[Event Type]	Earnings Announcement
[Event Name]	Q2 Financial Results Briefing for the Fiscal Year Ending June 2020
[Fiscal Period]	FY2019 Q2
[Date]	February 27, 2020
[Number of Pages]	20
[Time]	16:00 – 16:36 (Total: 36 minutes, Presentation: 34 minutes, Q&A: 2 minutes)
[Venue]	Dial-in
[Venue Size]	
[Participants]	
[Number of Speakers]	1 Naoyoshi Kasuga Director, Group CFO

Presentation

Facilitator: Hello, investors. Thank you for participating in the financial results and management briefing conference call for the first half of the fiscal year ending June 30, 2020, of AVANT Corporation.

Today's conference call is attended by Director and Group CFO, Naoyoshi Kasuga.

We will now review the financial results for the period under review, and then we will explain the progress of the medium-term management plan, for about 20 minutes combined. Afterward, we will move on to the question-and-answer session. We expect the entire meeting to last 60 minutes.

The presentation materials are posted on the AVANT website under the Events and Presentations section of the Investor Relations page. Please download the materials from the website.

Before we start the conference call, we would like to make some precautionary notes. This presentation may contain forward-looking statements based on current expectations. However, forward-looking statements are subject to risks and uncertainties. Please note in advance that actual results may differ from forecasts.

We will now begin the presentation.

Kasuga: Thank you for participating in our conference call on our financial results and management briefing. My name is Kasuga, and I am the CFO of AVANT. Today, I would like to provide a review of our business results up to the first half and also explain the progress of the medium-term management plan.

Results Highlights

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Positive growth momentum continued

- Both revenue and profit maintained positive growth momentum even against previous period when each business demonstrated high level of expansion, and overall business progressed in line with full year guidance
- We maintain full year guidance while we observe orders and sales during the second half

(millions of yen)

	FY19/06 Q2<YtD>	FY20/06 Q2<YtD>	Year-on-Year	
			Variance	%CHG
Revenue	6,933	7,734	+ 801	+ 11.6%
Cost of Revenue	3,701	4,355	+ 653	+ 17.7%
SG&A expenses	2,216	2,290	+ 73	+ 3.3%
Operating Income	1,015	1,089	+ 73	+ 7.3%
OP Margin	14.6%	14.1%	-	0.6 point
Ordinary Income	1,014	1,093	+ 79	+ 7.9%
Net Income	641	673	+ 32	+ 5.0%
EBITDA	1,091	1,178	+ 87	+ 8.0%

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First, please look at page three of the material.

Looking at our financial results for the first half of the fiscal year, it appears that the growth rate had slowed somewhat compared to the first quarter when the company achieved double-digit growth in revenue and profits. However, in addition to the extremely high level of revenue and profits of the same period of the previous fiscal year, we are investing in human resources, as well as offices to be used by those human resources in a planned manner in anticipation of future growth. As the whole, I believe we are making steady progress toward our targets.

In the first quarter of the fiscal year under review, we deferred the decision to record an allowance for officer and staff bonuses in the Consolidated Accounting business. In that sense, we believe there might have been some uncertainty about our full-year outlook. However, we have recorded this allowance after completing the first half of the fiscal year. Thus, we believe that the likelihood of meeting the full-year targets has improved.

As for external factors, there were the consumption tax hike and US-China trade negotiations. Also, the effects of the new coronavirus have been attracting attention, and it has prompted us to change today's meeting to a conference call. However, the appetite of customers to invest in IT to increase their corporate value continues to be strong at present. We understand that, at this point, there have been no significant changes in the behavior of customers.

Of course, generally speaking, in the case of our industry and business category, there is a tendency for the effects of customers curbing their IT and other investments to appear with a slight time lag. In light of this, we

understand that orders and sales during the second half must be watched closely. However, at this point, we do not see the need to change our full-year forecast.

Consolidated Accounting Business

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Positive growth against robust results last year

- In addition to the accumulation of new contracts, the company was able to record additional sales from existing large projects. These led to a higher revenue against record-breaking revenue during the same period last year
- Despite increased staffing and increased costs associated with new office and renovation, profit increased through project quality management. Outstanding orders improved to match previous year

(millions of yen)

	FY19/06 Q2<YtD>	FY20/06 Q2<YtD>	Year-on-Year	
			Variance	%CHG
Revenue	4,008	4,165	+ 156	+ 3.9%
Operating income	607	709	+ 102	+ 16.9%
OP Margin	15.1%	17.0%		+1.9point
New Orders	3,501	3,901	+ 399	+ 11.4%
Outstanding Orders	1,927	1,910	17	0.9%

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Please turn to the next page. We operate three core businesses, and I'd like to go over each one.

First, in the Consolidated Accounting business, the main contributions of which come from our operating subsidiary DIVA Corporation, we achieved YoY growth in revenue and double-digit profit growth in the second quarter.

We initially anticipated a harsh business environment compared to the same period of the previous fiscal year as large-scale projects peaked in the same period of the previous fiscal year. However, at the end of the first half of the fiscal year, we were able to record some additional sales from large-scale projects, and we also steadily accumulated new contracts. As a result, revenue exceeded the previous year's level, and we achieved a YoY increase in revenue.

The rate of increase is in the single-digit, just under 4%. But this is mostly due to the extremely strong growth of over 20% in the previous year. I think the fact that we were able to achieve YoY growth in revenue under these circumstances can be viewed positively.

On the expense front, we increased the number of employees, and, in December, we opened a new office in Shinagawa. We rented office space in Konan and also renovated an existing office. These measures have

increased fixed costs. However, we are thoroughly conducting the quality management of our projects, as in the past. As a result, we were able to increase profits more than the increase in revenue.

Business Intelligence Business

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Robust growth thanks to IT investment boom

- Double-digit revenue growth continues as we receive orders including highly difficult projects reflecting clients' expectation for skilled engineers with us
- Prime order ratio continued to rise, leading to a double digit growth in operating income, but margins declined slightly due to enhanced compensation and increased costs associated with opening of a new office

(millions of yen)

	FY19/06 Q2<YtD>	FY20/06 Q2<YtD>	Year-on-Year	
			Variance	%CHG
Revenue	2,430	2,870	+ 440	+ 18.1%
Operating income	313	352	+ 38	+ 12.5%
OP Margin	12.9%	12.3%		0.6point
New Orders	2,459	2,912	+ 452	+ 18.4%
Outstanding Orders	958	1,245	+ 286	+ 29.9%

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Please turn to the next page for the results of the Business Intelligence business.

These results are almost identical to the financial results of our subsidiary, ZEAL Corporation. In this business, we analyze big data to grasp trends in demand, and we visualize these trends to facilitate swift management decisions. The appetite to invest in this service continues to be extremely strong.

Against this backdrop, we were able to achieve double-digit YoY growth in revenue and profits in the second quarter. In terms of expenses, however, we improved compensation, mainly for managers, starting this fiscal year. Manager-class personnel is very difficult to recruit in the current competitive environment, and the headhunting of managers also occurs frequently, so we have raised compensation.

In addition, we have seen an increase in expenses stemming from costs related to the opening of the new office, which started operation in January, as well as another office in Meguro. As a result, even though profits rose, the margins have slightly deteriorated. However, we think these costs can be absorbed by accumulating orders through the second half of the fiscal year. Therefore, as mentioned at the beginning, we do not think the current situation warrants a change in our forecast at this point.

Outsourcing Business

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Revenue growth started to absorb expansion costs

- As governance enhancement and work style reform penetrate into corporations, both outsourcing of consolidated financial results and other sales such as cash management solutions recorded double digit growth
- The operating income margin deteriorated due to an increase in fixed costs due to an increase in office floor space which marginally improved in the second quarter

(millions of yen)

	FY19/06 Q2<YtD>	FY20/06 Q2<YtD>	Year-on-Year	
			Variance	%CHG
Revenue	783	993	+ 210	+ 26.9%
Operating income	202	234	+ 32	+ 16.1%
OP Margin	25.8%	23.6%		2.2point
New Orders	758	1,068	+ 309	+ 40.8%
Outstanding Orders	650	928	+ 277	+ 42.6%

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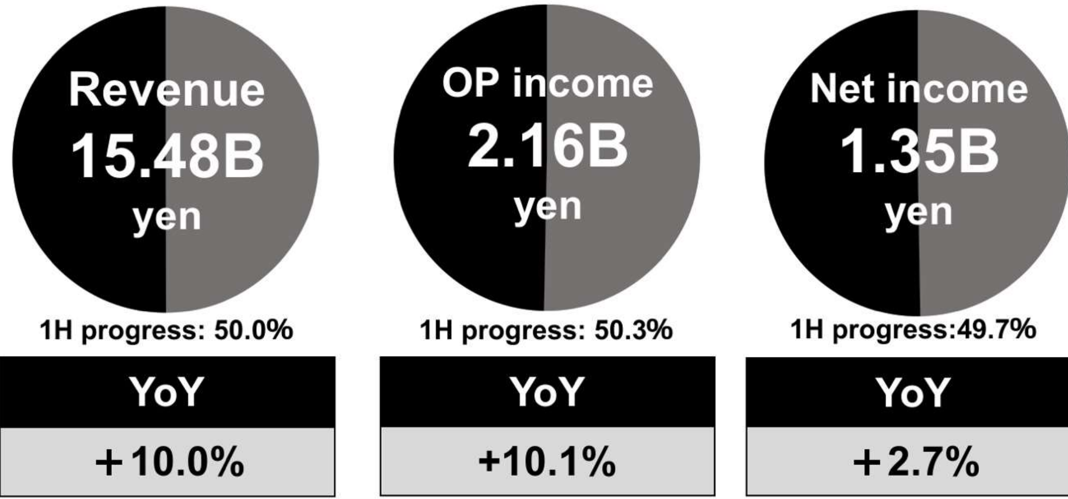
Next, please turn to page six for the results of the Outsourcing business.

Earnings in this segment come from our operating company, FIERTE Corporation, which is mainly engaged in the outsourcing of consolidated accounting and settlement of accounts.

Revenue was supported by demand stemming from external factors such as work-style reforms and the strengthening of governance at overseas subsidiaries. The outsourcing of consolidated financial results and other sales, such as cash management solutions, have shown strong growth, supported by stronger demand at customers for cash management on a global basis. We have maintained a growth rate of around 20% to 25%. Revenue and outstanding orders are also showing strong growth.

On the cost front, this business is also labor-intensive at this point, resulting in increased personnel and the need for more office space. We rented a new office on a different floor of the same building and expanded the office space. We did this at the end of the previous fiscal year, and fixed costs have thus increased. Accordingly, the operating margin has deteriorated somewhat from the previous year. But, if the utilization ratio improves in tandem with increased contracts, we believe the profit margin will recover.



Next, this slide shows our earnings and dividend forecast for the fiscal year ending June 30, 2020.

As we mentioned in the beginning, we haven't changed our earnings forecast at this point. Our forecasts for revenue, operating income, and net income are unchanged from the guidance issued in August 2019. To mention it again, there have been no meaningful changes in segment trends, and no signs are suggesting the need for revising our targets upward or downward, so we have left our forecasts unchanged.

Dividend Forecasts

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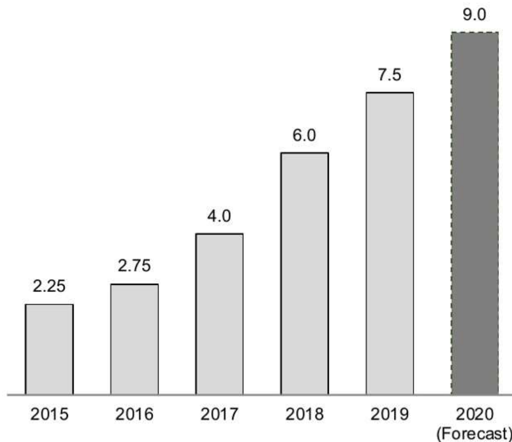
The FY 2020 dividend forecast is 9 yen per share

- In the fiscal year ending June 2020, we plan to increase dividends in line with our policy of continuing stable dividends
- Per share data adjusted for two-for-one stock splits on December 1, 2019



(Adjusted for stock splits)

<AVANT's shareholder return policy>

- Cash dividends are an important part of shareholder return policy
- AVANT plans to maintain sustainable growth in dividends, and rely on dividends on equities (DoE) rather than cash income which could fluctuate and unpredictable
- DoE ratios for AVANT should improve over time and always exceed average of all listed companies of Tokyo Stock Exchange

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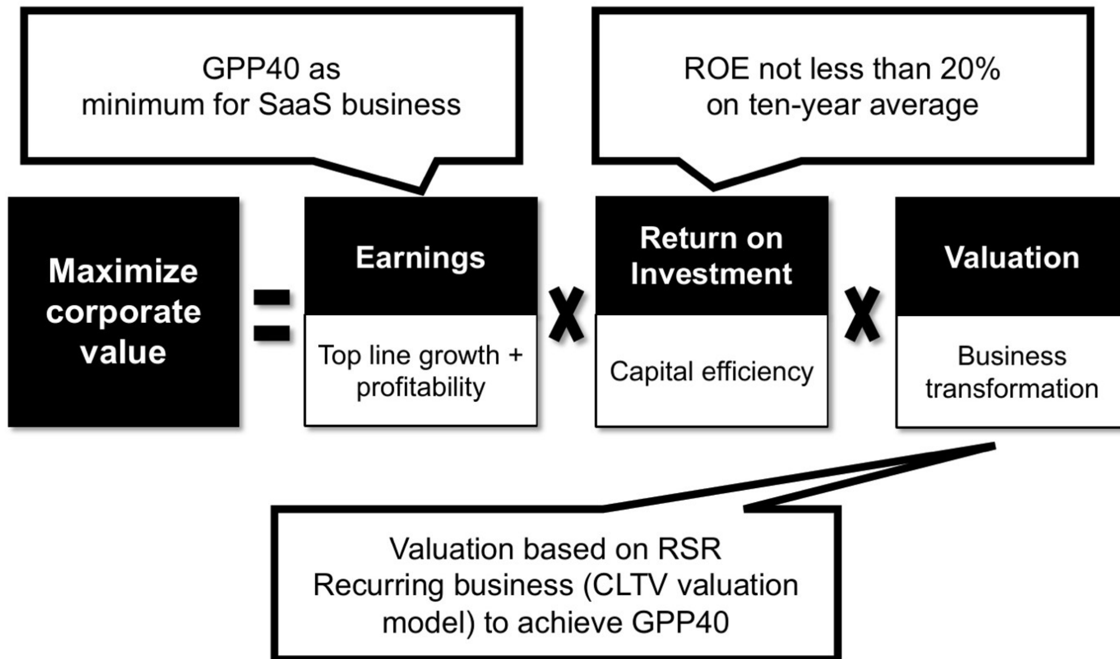
We also left our full-year forecast for dividends unchanged at JPY9 per share.

Our dividend policy is to ensure that the absolute number of dividends does not fall below the level in the previous fiscal year. We hope to gradually raise the dividend on equity ratio, which is currently over 5%. We aim to consistently exceed the average for all companies listed on the Tokyo Stock Exchange. We currently exceed the average, but we will not be complacent with this, and we will continue to raise the dividend on equity ratio, albeit gradually.



Next, I will go over the progress of the medium-term management plan. This is on page 11 of the material.

The figure shows our vision for the medium-term plan, with three factors contributing to the maximization of corporate value.

The first is earnings. Our operating companies are the main contributors to earnings, and our KPI is what we call GPP, or growth and profit point, which is the simple sum of the top-line growth rate and operating profit margin. We currently use this as a benchmark for performance, and we aim to achieve at least 40%.

As many of you know, there is an indicator called Rule of 40, which is frequently used by venture capitalists to gauge the performance of SaaS and other software businesses. Our target of 40% GPP can be likened to this Rule of 40. We eventually aim to become a global SaaS company, so we have set this as our KPI.

When applying this indicator to companies listed on the Tokyo Stock Exchange, it shows that the indicator is effective in gauging the performance of companies in general. Exceeding 40% is only achieved by top-performing companies. Thus, we think this is an indicator that can be applied to operating companies in general, and we have asked our operating companies to set this as their target for the time being.

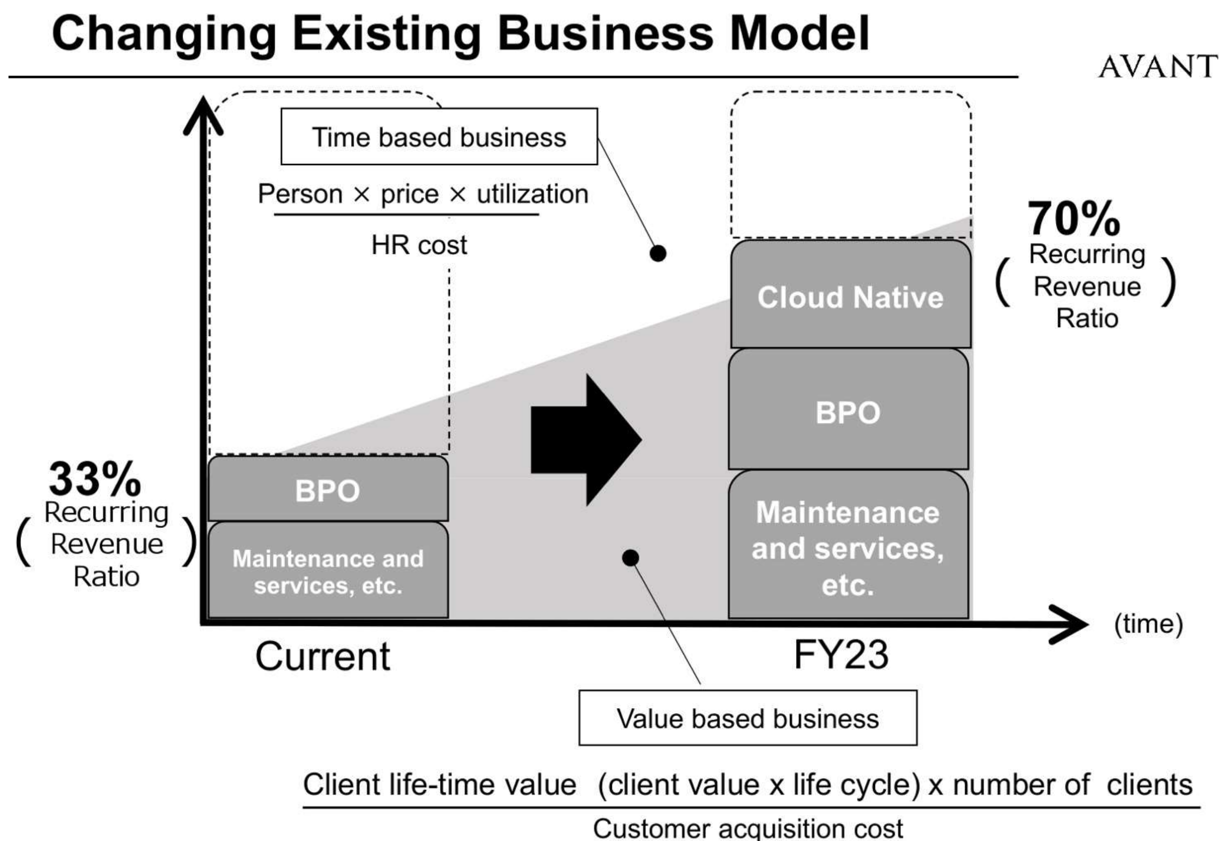
For the return on investment written in the middle, we are gauging performance based on ROE. Back in 2007, we formulated a long-term plan to achieve ROE of at least 20% on a ten-year average, and we envisioned our business along this trajectory. When tracing our performance back to the time we formulated this target, we can see that we have become a company that can achieve ROE of at least 20% on a ten-year average.

When talking about operating companies, the benchmark is ROIC, and we aim to achieve an ROIC of 20% at each of our operating companies by efficiently allocating capital.

The last part is valuation, and this entails a transformation of our business model. The components that go into this valuation are GPP40, or Rule of 40, which I explained earlier, and the recurring revenue ratio, which represents the ratio of recurring revenue. We aim to raise the ratio of recurring revenue to total revenue. Our current target is to raise the ratio up to 70% by 2023.

At present, the recurring revenue ratio is 30%, meaning that the ratio of recurring to non-recurring revenue will reverse once we achieve our target. Currently, the recurring ratio is 30% and the non-recurring ratio is 70%. By flipping this to a recurring ratio of 70% and non-recurring ratio of 30%, we think we would be able to incite a change in the market valuation of our company. If we can transform our business model to this extent, market participants would no longer view us as a traditional software company, albeit this will not only require a shift in the business model but also in our technological capabilities.

By implementing this transformation, I believe market participants will begin to view the company as a SaaS business, or in other words, a business that offers software as a service.



Please refer to the next page.

Based on what I just explained, something I consider to be very difficult to achieve is the business model transformation. I think all of you are probably interested in how we plan to achieve this transformation.

As I just mentioned, our recurring revenue ratio is just over 30% so far. As for how we intend to raise this ratio to 70%, this first consists of expanding maintenance and services, primarily through DivaSystem. We receive a steady stream of revenue from customers by selling DivaSystem offered by DIVA, consisting of maintenance fees for maintenance and services associated with DivaSystem.

We also receive recurring revenue for the outsourcing of consolidated settlement of accounts derived from DIVA, along with additional services. The business process outsourcing fees we collect through these services are the second factor contributing to our current recurring revenue.

In addition to expanding these two sources of recurring revenue, we also intend to develop Cloud-native solutions and software that would further increase recurring revenue. We have already started taking steps toward developing such solutions and software, but we are still in the process of doing so. Thus, we will be making efforts to launch this Cloud-Native business to have three factors contributing to recurring revenue.

The dotted lines indicate the possibility of inorganic growth in recurring revenue on top of our own services.

Change in Recurrent Revenue Ratio

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	FY19		FY20 1H
Consolidated Accounting	38%	→	39%
Business Intelligence	7%	→	8%
Outsourcing	94%	→	88%
Consolidated	32%	→	32%

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Here, we show the progress we have made so far in the first half of the fiscal year, in terms of increasing the recurring revenue ratio in each business segment.

As you can see, there are some businesses in which the recurring revenue ratio has declined from their levels in FY2019. Even though the recurring revenue ratio has increased by 1 percentage points to 39% in the

consolidated accounting business, it has declined somewhat, by 6 percentage points, in the Outsourcing business.

Although on a consolidated basis the recurring revenue ratio was unchanged from the level in FY2019, the hurdle of achieving the target is very high, as explained earlier. I will explain from the next page onward about the measures we will be taking to increase the recurring revenue ratio.

Progress during first six months

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Consolidated Accounting	■ While mega-projects are nearing closing, we are encouraged by favorable new sales ■ Strengthened cloud-based products and services offering centering on management accounting system (SMD)
Business Intelligence	■ Continue to see a strong demand for investments in digital transformation. Posted high growth as we are recognized as Dx specialist and receive complicated projects ■ Prime contracts accounted more than 60% ■ Strong interest in formally released ZEUSCLOUD
Outsourcing	■ Both outsourcing and treasury management solution gained new customer. Increased orders from existing customers ■ Concluded a number of contracts with clients on pipeline
Cloud Native	■ Holding company studied a target company with cloud native products through alliances, mergers or acquisition

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As for the progress during the first six months, as you can see here, in the Consolidated Accounting business, we saw a favorable number of new contracts. In particular, we have strengthened our management accounting system called SMD, along with our offerings of Cloud-based products and services.

In the Business Intelligence business, the recurring revenue ratio is lowest among all of our businesses. As you saw earlier, the ratio is around 7% or 8%. Raising this ratio would be essential for us to achieve the 70% target. We have made gradual internal changes with the aim of transforming the business model.

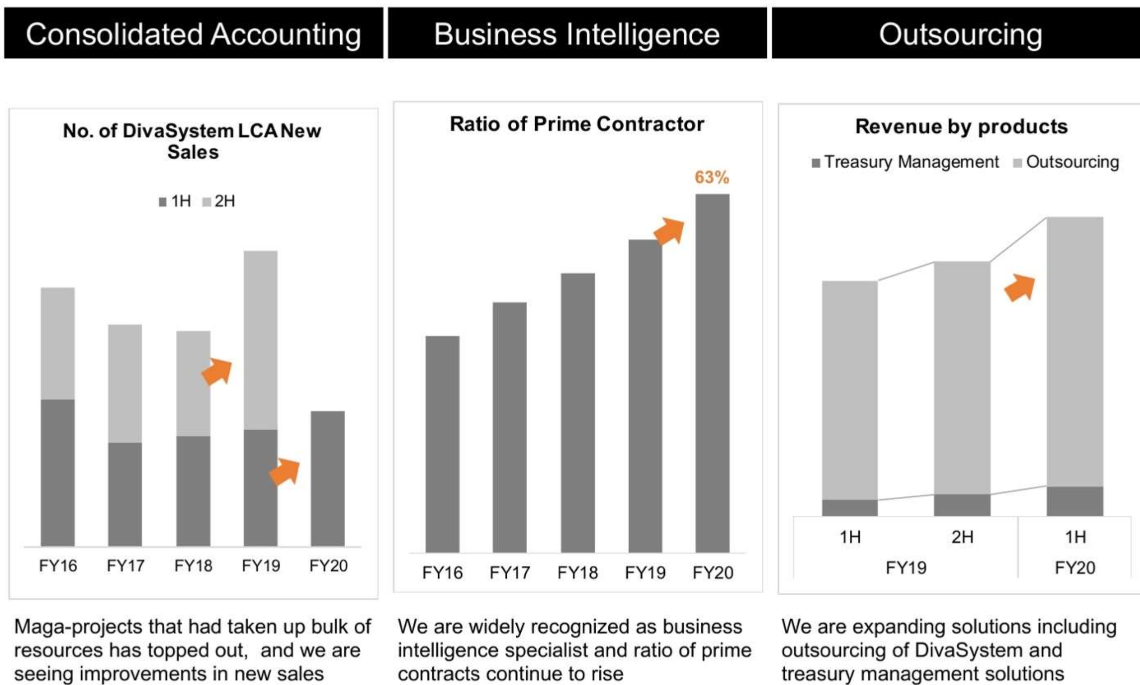
This business was originally a system integration business. Thus, the business model was one in which we did not have our own products. However, as you can see, we leveraged the expertise we accumulated to develop our own solution called ZEUSCLOUD, and we are now offering this product.

Another measure we have been taking in the Business Intelligence business is to offer system integration services based on a subscription model, just like the format of a SaaS business that provides software on a subscription basis. We expect to make efforts in this business domain to raise the recurring revenue ratio,

even if it were to entail a change in contract terms, in order for revenue to be generated continuously rather than on a one-time, lump-sum basis.

In the Outsourcing business, services mainly generate a recurring source of revenue. However, there may be some fluctuations in the ratio depending on demand for one-time projects. Thus, under normal circumstances, the recurring revenue ratio in this business would exceed 90%, as the service contracts are updated every one or two years. By further increasing the weighting of the Outsourcing business in the overall operations of the company while maintaining this recurring revenue ratio, we think the overall recurring revenue ratio will go up in tandem with the rise in revenue in this business.

In the Cloud-Native business, we previously considered partnerships with or acquisitions of companies handling Cloud-native products as a holding company. And, we aimed to generate additional growth from inorganic growth, on top of organic growth in existing businesses, through partnerships and acquisitions.



However, all three businesses, including Consolidated Accounting, Business Intelligence, and Outsourcing, are now demonstrating robust profit margins and reasonable capital efficiency.

Therefore, rather than acquiring a large business from the outside, we think it would be a more beneficial strategy to explore opportunities for business partnerships or acquisitions that would contribute to each business. This isn’t a change in direction per se, but rather an adoption of a two-pronged approach, in which

we would prioritize partnerships and acquisitions that contribute to our operating companies. On top of that, as the holding company, we are moving to explore additional opportunities to drive inorganic growth.

I have just gone over the situation at each company, described on page 14 and 15. On page 15, we have described the progress we have made during the first six months. The topic that I would like to cover here is that we have seen an increase in the number of new license sales in the Consolidated Accounting business.

As you can see in the description under the Business Intelligence section, we have increased the ratio of prime contracts. For those of you who do not know this, ZEAL used to be a subcontractor of system integrators, who are the prime contractors of end clients. We used to be the subcontractor below these so-called SIers.

However, since a few years, especially after becoming a Group company of AVANT, the company has been acquiring contracts with end-users as their prime contractor, and the ratio of these prime contracts has now reached 63% of revenue. Thus, the ratio of prime contracts versus subcontracts has reversed at the company.

By implementing this shift, we have been working to improve the profit margins in the Business Intelligence business through the elimination of intermediary margins that used to go to prime contractors. The results of these efforts are finally starting to bear fruit.

In terms of the Outsourcing business, as you can see, results have been steady. Although only the results for the last three half-years are shown on this slide, a notable change has been the diversification of outsourcing services. In particular, we have started offering an outsourcing service of treasury management solutions using a German software, and the pipeline for this service has finally been established.

As you can see in the figure, the ratio of treasury management solutions is still low on a revenue basis. However, contributions from this service are steadily taking shape.

Challenges during second half

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Consolidated Accounting	■ Studying development of cloud-based DivaSystem ■ Refining SaaS products such as Compass and Planning to compliment SMD, and offer them as comprehensive solutions suite
Business Intelligence	■ Focus on sales of ZEUSCLOUD ■ Develop templates for manufacturers to control integrated process of demand forecasting, production and sales ■ Stay on introducing state-of-the-art Dx products from software vendors
Outsourcing	■ Focus on increasing new customers for outsourcing and treasury management solutions ■ Search opportunities for new business partners to expand outsourcing solutions ■ Launch outsourcing RPA pilot program for actual deployment
Cloud Native	■ Group companies study opportunities for making alliances with, merge with or acquire a company with cloud native products

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Next, I will go over our challenges during the second half of the fiscal year. Please turn to page 16.

In the Consolidated Accounting business, we currently offer DivaSystem to customers as an on-premise solution, meaning that we install the software on the client's server. However, we are currently considering developing a Cloud-based DivaSystem.

In addition, we are currently exploring the possibilities of offering a comprehensive solution by refining our SaaS products such as Compass and Planning and offering them as a comprehensive solution together with our existing product called SMD.

In the Business Intelligence business, we will be focusing on increasing sales of ZEUSCLOUD, which can be called a proprietary product, at ZEAL. In addition, we will be developing and selling templates for manufacturers to control the integrated process of demand forecasting, production, and sales under the concept of a "smart factory."

Furthermore, we have seen an increasing number of development projects to support the so-called digital transformation, or DX, of customers based on state-of-the-art technologies of vendors. Therefore, we will continue to promote measures to meet this fundamental demand.

In the Outsourcing business, we will, of course, continue to grow our existing business, but as I mentioned earlier when talking about offices, this business is still labor-intensive. Thus, we aim to implement our proprietary RPA solutions for the settlement-related outsourcing operations that are especially labor-intensive. We are working on launching a pilot program for the deployment of this RPA solution.

The in-house development of this RPA solution will draw on the expertise that we have accumulated through our own settlement-related operations in the Outsourcing business, rather than adopting the RPA that other business operators are already using. In this sense, the RPA solution will include our proprietary knowledge, and it will only be used in-house.

This solution is not intended for sale to external customers. Thus, we are currently developing the product solely to streamline our services offered to customers. In fact, the profitability of the Outsourcing business already includes the costs associated with this development effort.

In terms of the Cloud-Native business, as I mentioned earlier, we will be looking into opportunities for capital and business tie-ups as well as acquisitions that would contribute to the Group company.

Mid-term Management Plan: KPIs

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	FY18		FY23
Revenue	¥12B	→	¥18 ~ 22B
Recurring revenue ratio	33%	→	70%
Operating income	¥1.6B	→	¥3.1 ~ 3.8B
Revenue growth + OP margins	28.5pt	→	Over 40pt
ROE	24.5%	→	Over 20%
Dividends	¥6	→	Over ¥15

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The results of these efforts are described on page 17. This slide shows how much progress we have made toward the medium-term targets.

In comparison with the medium-term targets in FY2023, we expect revenue to exceed JPY15 billion in FY2019, so we are making steady progress so far in achieving the revenue target. Until last year, we were also on track to achieve our ROE and dividend targets. However, in terms of the other categories, especially the recurring revenue ratio, we are still significantly short of our target, as I have been explaining. The efforts we make from here will be decisive in determining whether we can achieve these targets.

To summarize what I have quickly gone over, our financial results in the first half of the fiscal year was better than we had initially anticipated. As for our full-year forecasts, there are no changes at this point.

As for our mid-term management plan, we still need to raise the recurring revenue ratio, and achieving the target will be challenging, but we have gradually started to take steps toward achieving the target. In the past, we were only in the stage of consideration. But, now, we have already begun to take action, even though our efforts have not translated into numbers yet.

That's all from me.

Question & Answer

Facilitator: We will now move on to the question-and-answer session. Please limit your questions to two per person and state your questions one at a time. Are there any questions?

There seem to be no questions, so we would like to end the briefing meeting. Thank you for your participation.

Kasuga: Thank you.

[END]

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Document Notes

1. *Portions of the document where the audio is unclear are marked as follows: [Inaudible].*
2. *This document has been translated by SCRIPTS Asia.*

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