

# FINAL TRANSCRIPT

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## **BPO.TO - Q3 2011 Brookfield Office Properties Inc Earnings Conference Call**

**Event Date/Time: Nov. 04. 2011 / 3:00PM GMT**



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## PRESENTATION

**Operator**

Good day, ladies and gentlemen. Welcome to the Brookfield Office Properties Incorporated third-quarter 2011 conference call. (Operator Instructions) Today's call is being recorded. It is now my pleasure to turn the call over to Ms. Melissa Coley, Vice President of Investor Relations and Communications. Please go ahead, Ms. Coley.

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**Melissa Coley** - Brookfield Office Properties Inc - VP of IR and Communications

Thank you. Good morning, and welcome Brookfield Office Properties third-quarter 2011 conference call. Before we begin our presentation, let me caution you that our comments and discussion will include forward-looking statements and information, and there are risks that actual results, performance, or achievements could differ materially from anticipated future results, performance, or achievements expressed or implied by such forward-looking statements and information.

Certain material factors and assumptions were applied in drawing the conclusions and making the forecasts and projections in the forward-looking statements and information. You may find additional information about such material factors and assumptions and the material factors that could cause our actual results, performance, or achievements to differ materially set forth in our news release issued this morning. I would now like to turn the call over to Chief Executive Officer, Ric Clark.

**Ric Clark** - Brookfield Office Properties Inc - CEO

Thank you, Melissa. Good morning, everyone. Thanks for joining our call. I wanted to also thank those of you who were able to join our Investor Day on September 26. So, thanks for that.

With us today on the call as usual are Bryan Davis, our CFO, as well as Dennis Friedrich, and Mitch Rudin. Tom Farley, who is usually on the call is in transit back home from our Board meeting. In his place is Jan Sucharda, the CEO of our Canadian operations, who most of you, I believe, know. So, Jan is with us in Tom's absence.

I started the call by saying we are pleased with the results for the third quarter and our operating performance for the year. With a couple of additional transactions that closed just after the quarter, this performance has continued into Q4. We have achieved the principal priorities that we set for ourselves for this year with 2 months left to go. So far this year, including the couple of things that closed after the quarter-end, we've completed the recapitalization of our US office fund, we financed or refinanced \$3.1 billion of debt at incredible terms, including \$1.3 billion during the third quarter.

We've sold \$1 billion on a gross valuation of properties. We have reinvested the equity from those sales into \$2.5 billion in assets on what will be a more accretive basis and we think will be great for shareholders over the long-haul. Many of these acquisitions were done on an off-market basis where we picked up additional interest in properties that we were already invested in, and on what we believe were favorable terms.

We have leased, so far this year, 8.2 million square feet, including 767,000 square feet to Bank of America Merrill Lynch in lower Manhattan, which was announced earlier this week, in fact, on Monday. This volume of leasing virtually matches our best full-year production ever, ensuring the 2011 will replace 2007 as the new leasing high watermark for Brookfield. As I mentioned, we have 2 months to go; have more we want to get done for the year. So, we're looking forward to the rest of the fourth quarter.

To give context on the operating environment for the fourth quarter and heading into the next year, I'll make a couple of high level comments -- just sort of going around the horn here. In the US, we continue to see signs of modest economic improvement, Q3 GDP was 2.5%. Not stellar, but better than many expected. Corporate earnings have come in stronger than expected by most companies reporting so far. Consumer spending has continued to improve. Bank loans are increasing. Obviously, all of these things are good signs.

On the flip side, the housing markets are no better. In fact, in some cases -- some people believe that they might be a little worse. Federal, state, and local government deficits remain unresolved. This will ultimately result in cuts, which long-term will help, but short-term won't do anything to help stimulate the economy. The political environment is toxic, which again, doesn't help. Doesn't solve problems.

Most relevant for companies like ours that push space for a living, the employment picture remains stagnant with a 9% unemployment rate. Which has dropped, we just learned this morning from 9.1% modest improvement. But still, not in a great



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place. Overall, market vacancy in the US with 17% as of the third quarter, but considerably better in the markets in which we are invested at 10.8% on a weighted average basis.

The bright spots for us are clearly Canada and Australia. Both countries have strong banks, strong financial fundamentals, moderate fiscal liabilities, and meaningful resource base helping to fuel the economy and drive it forward. And political systems that are working relatively well. The employment pictures in these countries are also meaningfully better than the US. Canadian unemployment stands at about 7%; Australia is just about 5%. Overall vacancy at the end of the third quarter for Canada was 7.3%; Australia was effectively the same. Both considerably better than the US.

Who knows where the global economic situation is going? We don't at all pretend to be economists or make plans based on our predictions. Conditions could improve soon or get a little worse before they get better. Those of you who have spent time with us know that as an organization, from top to bottom, we have a healthy respect for the cyclical nature of real estate and financial markets. As a result, we've set a strategy that is respectful of this. Our goal is to be positioned to perform well, notwithstanding the general economic direction.

We have worked hard -- I'm sure you have noticed -- over the last couple of years to diversify away from a pure reliance on financial services-dominated markets into markets driven by other high-growth businesses. And from the US into other strong, stable, and growing economies. To that end, I would say that 34% of our asset base is invested into properties [in the most dynamic] cities in the strong economies of Canada and Australia. These markets are all experiencing low vacancies; about 3% in Perth to 8% in Sydney. High rents, tightening concessions that are not threatened by looming unmanageable new supply. Our combined vacancy in these markets is just 2.9%.

When you add Canada and Australia -- when you add in to Canada and Australia our holdings in New York City, Houston, and Washington DC, the top and most solid-performing US markets, our combined holdings in these best-performing local or international economies goes to 81% of our asset base. So, bottom line is, we are very happy to have this great diversification, which is a unique position within our industry.

Moving to a couple of comments on performance for Q3 and the year, I would make a few brief points before Bryan gives his report on results. We continue to execute well on the leasing front. This is one thing that we probably do better than anything else. Completing 3 million square feet of leasing for Q3. As you'll see on slide 23 of our supplemental, 1.4 million square feet of this was completed in Canada; effectively, the same amount was completed in the US. The balance of the leasing comes from Australia in our portfolio which as I mentioned before is almost fully leased.

Rents captured on Q3 leasing reflected a 36% uplift versus expiring rents. Subsequent to quarter end, as I mentioned, we completed a lease renewal with Bank of America Merrill Lynch at 2 and 4 World Financial Center, bringing our year-to-date leasing to 8.2 million square feet. This essentially matches our best year ever, which was 2007, and ensures that this year will be the new high watermark.

On prior calls, I mentioned the amount of leasing discussions that we view are at a serious level, a level where we believe there's a high likelihood of converting them to signed contracts. That number continues to remain high. We haven't seen any change in that. We haven't really lost any meaningful momentum. The number stands just shy of 6 million square feet. At this point, we feel it is prudent to predict that a good portion of this will roll over into next year; possibly the majority of it, which positions us for a solid 2012 as well.

We currently expect to capture about a 16% uplift on these leases, should we be able to get them done. And, obviously, it's far from a guaranteed, but we feel pretty good about that leasing in the pipeline at the moment.

During the third quarter and including transactions announced subsequent to quarter end, we acquired Bank of America Merrill Lynch's 49% interest in 4 World Financial Center for \$264 million, or roughly \$283 a foot. With the great momentum in lower Manhattan and our plans for repositioning this property, we're happy to have consolidated our ownership into 100% interest



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in 4 World Financial Center. We have also expanded our presence in Bethesda, Maryland, by acquiring 3 Bethesda Metro Center for \$150 million.

1 quick anecdote about what we have been trying to do recycling capital. I would use as an example the sale of Newport Plaza which also recently happened. That property, which is located in Jersey City, traded for \$344 a foot. The way we look at it, we just recycle that capital into 4 World Financial Center at \$283 a foot. Some leasing capital is required at 4 World. But, when it's all said and done, we expect to base this on a per square foot basis to be pretty comparable that we've upgraded from Jersey City to a Manhattan asset in a great location.

During Q3, we also completed the recapitalization of our US Office Fund and conveyed that 18 non-managed assets in this fund to our partner, together with any associated debt, pursuant to the terms of our put-call agreement. As a result, our consortium consolidated its ownership into 100% interest in the 38 assets that have been managed by Brookfield.

So, with those brief comments, and our accomplishments so far this year, as well as the results we expect to achieve in the fourth quarter. I would say that we are projecting our FFO for the year in the range of \$1.12 to \$1.14 per share, which is above the high end of our guidance range. Bryan will give you a bit more color on that. Actually, right now, as I turn the call over to Bryan.

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**Bryan Davis - Brookfield Office Properties Inc - SVP and CFO**

Thank you very much, Ric, and good morning, everyone. As noted in our press release, we reported funds from operations totaling \$168 million for the third quarter of 2011. This compares to funds from operations of \$169 million for the same period in 2010, and \$166 million in the prior period. On a per share basis, the current quarter funds from operations was \$0.30 per diluted share. This compares to \$0.32 per share in the prior year and \$0.30 per share in the prior quarter.

Now, before getting into the numbers, to explain the performance and variances for the quarter, I did want to spend a few minutes on the US Office Fund as Ric had alluded to. As we press released earlier in August, Blackstone exercised their right to call the non-managed assets that were part of the US Office Fund joint venture. Their assets located in LA and Midtown Manhattan.

The significance of this transaction from a reporting perspective was the requirement post-exercise of the call option for us to begin consolidation of our managed assets within the US Office Fund in our IFRS financial statements, with the exception of 4 properties that were owned in joint venture structures at the asset level which we continue to equity account.

The active consolidation did not have any impact on our bottom line, but rather grosses up balances in our financial statements to reflect 100% of the assets that we manage and corresponding net operating income and 100% of the debt associated with those assets and corresponding interest expense. With the portion not owned by us getting reflected through non-controlling interests.

We recognize that this will make things confusing when looking at our IFRS results on a period-over-period basis. And, as a result, you'll recall we began presenting our proportionate financial statements back in 2010 in anticipation of this. These results present our interest in the US Office Fund and other non-consolidated joint ventures on a basis that is proportionate with our ownership. And as a result, not impacted by the exercise of this call option. Of course, with one exception.

We will now recognize our proportionate share of the earnings associated with only our managed assets as opposed to our share of both the managed and non-managed assets. Something that we had anticipated and began providing guidance to you in our supplemental disclosure back in 2010. With that as background, I will take you through our proportionate results and focus on variances from Q2 2011 as I think those give you a more meaningful description of what happened during the quarter.



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So, in reference to page 7 of our supplemental, net operating income for the quarter increased to \$343 million, from \$319 million in the same quarter -- in this last quarter. And, that is as a result of a few items. First, being same-store growth of 1.4%, or \$4 million, as we continue to make progress on lease-up of our space.

We had the acquisition of Southern Cross West in Melbourne; Bank West Tower in Perth; 450 W. 33rd Street on the west side of Manhattan; and Bethesda Metro Center in Bethesda, which contributed \$11 million of NOI in the quarter. We also had the acquisition of an additional 20% interest in the US Office Fund from a fund partner, which contributed approximately \$12 million in net operating income for the quarter.

Also included in the quarter was a termination gain in Houston of \$3 million. And, all of this was offset by a slight depreciation of the Canadian and Australian dollar average exchange rate during the quarter which reduced NOI by approximately \$2 million and also reduced by the sale of 1400 Smith Street, which took place during the end of last quarter and that contributed to a decline of \$3 million on an NOI basis.

Interest and other income of \$36 million for the quarter included interest that we earned on the residential note we hold from part of the sale of that asset. That contributes about \$8 million on a quarterly basis. We had \$13 million of interest and discount amortization on the US Fund debt that we had acquired back in 2010. Note that with the recapitalization of the mezzanine debt within the US Office Fund and repayment of that mezzanine debt, we will fully amortize the discount and collect our last of the interest associated with that asset that we carried on our balance sheet.

In addition this quarter, we earned a 1-time settlement on a partial investment that we had in 200 Broadway. This is a property that was condemned to facilitate the redevelopment of the Fulton transit station. This settlement, which was included in interest and other income, amounted to \$11 million, and it was awarded and collected in the quarter.

A number of you have asked what is a reasonable run rate for our interest and other income on a go-forward basis? To answer that question, I would offer that it is anywhere between \$12 million and \$15 million. That represents the interest we will earn on our residential note plus other interest income that we earn on a fairly regular basis. Interest and other income did decrease from the prior quarter. This was largely a result of including only a partial interest of -- a partial quarter of interest and gain in amortization on the US Fund debt as that was repaid during the quarter.

On the expense side, interest expense on our commercial property debt increased from \$146 million in Q2 to \$160 million in Q3. This increase was largely due to additional interest expense on the debt associated with the acquisition of Southern Cross West in Melbourne, Bank West Tower in Perth, 450 W. 33rd Street, and of course, Bethesda Metro Center. In aggregate, that accounted for about \$7 million of that increase.

We had additional interest expense associated with the acquisition of the incremental 20% interest in the US Office Fund, including financing provided to us to fund part of the equity requirement. That amounted to about \$11 million for the quarter. These 2 items were offset by a reduction in interest expense on the sale of 1400 Smith Street, the repurchase of 75 State Street debt in Q2, and a reduction in the overall interest in the US Office Fund as a result of the repayment and recapitalization of the mezzanine debt.

Our net income for the quarter was \$415 million, or \$0.72 per share. This compares with \$631 million, or \$1.11 per share last quarter. Net income in the current period did include revaluation gains of \$168 million. The revaluation gains in the current period were primarily due to the impact of leasing activity. And also included market improvements which were evidenced by the values we were able to transact at or expect to be able to transact at on assets that are part of the disposition process.

Offsetting these revaluation gains, in equity, we had losses attributed to foreign exchange, which were far more exaggerated than the impact to earnings as a result of a sudden depreciation in both the Canadian dollar and Australian dollar at the end of the quarter. The good news is that both of these currencies have regained some of that loss since then.

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Also, included in net income was a gain of \$150 million, which was associated with the recognition of a deferred gain that represented the value of the put-call option that had previously sat on our balance sheet within our Accounts Payable and other liabilities. Upon Blackstone's exercise of this option, we are able to recognize this gain through earnings.

Before I pass the call back over to Ric, I just want to make a couple of comments on our revised expectations for 2011 FFO. The increase from our previous midpoint of \$1.08 per share to our new midpoint of \$1.13 per share is largely attributed to 2 things. The first is the benefit of some 1-time items that were not otherwise reflected in our original guidance.

This includes a joint venture settlement of \$5 million that we recorded in the second quarter. It includes the gain on the repurchase of the 75 State Street debt in the second quarter. The aggregate of those 2 things were \$10 million. In addition to that, the settlement that we received on the investment in this third quarter was \$5 million higher than we had originally expected. In aggregate, that [\$15] million represents about a \$0.03 per share difference from our original guidance.

Over and above that, we had the benefit of stronger currencies through the first 9 months of the year, particularly over the parity that we used when we set out our guidance. These stronger currencies contributed approximately \$10 million to our earnings, or \$0.02 per share.

Although we have been very active in acquiring assets during the year, the impact of which has been largely offset by dispositions. Increased corporate interest expense to fund some of the equity. And also due to the delay of the close of the residential transaction. And some slightly higher G&A reflecting some transaction cost activity. All told, these acquisitions, although they didn't contribute much to our 2011 performance, will serve us well in future periods, as Ric had mentioned. So, on that, I'll pass the call back over to you, Ric.

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**Ric Clark** - Brookfield Office Properties Inc - CEO

Thanks, Bryan. I had 3 things to mention before we turn to questions. And, the first is, we [have just commenced] the redevelopment of the retail and common areas of the World Financial Center. In conjunction with this, we are also fully engaged in our marketing efforts to re-let the retail section of the complex. I'm happy to say that interest has matched -- possibly even exceeded our expectations. And, we are advancing discussions with several notable top tier retailers and restaurateurs and hope to have more to report on that in the upcoming quarters. But, bottom line is, our view on the positive things that are happening to lower Manhattan are shared by many.

Many of these retailers are not currently in lower Manhattan. This is all fantastic news for us. We're also having a similar experience with our Fig at 7th retail renovation that was launched in the first quarter of this year, which is in LA, and hope to have more to report on this project shortly as well.

We look forward to seeing many of you who have signed up for our Houston Investor Day on Monday, November 14, which is the day prior to the start of NAREIT in Dallas. If you are interested in attending and haven't yet had an opportunity to sign up, please get in touch with Melissa Coley. And, we'd look forward to seeing you if you can join us. So, with that as background remarks, Operator, we are pleased to answer questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions)

We'll take our first question from Michael Bilerman with Citi. Please go ahead.



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**Josh Attie** - Citigroup - Analyst

Good morning, thanks. It's Josh Attie with Michael. Other companies have talked about leasing velocity in Midtown Manhattan slowing, particularly with respect to deals that would be done 2 years to 4 years out. Have you seen any change in the tone of your discussions with tenants for pre-leasing your west side project?

**Ric Clark** - Brookfield Office Properties Inc - CEO

No, in general, Josh, I would say -- and Mitch is on the call, maybe he can chime in, in a second. But for sure, the smaller tenants, which really isn't our business, their advisers are saying to them -- look, there's no downside to waiting. If you have the luxury of waiting to make a decision, by all means you should do it. And if I was in their shoes I might feel the same way. But the larger groups that we deal with, both on our Manhattan West project and in many of our properties in Manhattan, they are moving for other reasons. Either they rent large amounts of space, it takes a long time to mobilize, they're trying to be more efficient, cut costs, consolidate several locations. And we haven't seen that abate at all. And in fact, I mentioned our close to 6 million square foot pipeline of leases in serious discussion. That really hasn't changed, and that is made up with the big guys.

So, Mitch, I don't know if you have anything to add to that?

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

I would add to that, there's always this sense that it, the slowdown is greater than it is because the first half of the year in Manhattan was so extraordinary. I believe the second quarter might have been the largest quarter in a decade, so while it has in this year is a little more front ended than a typical year, still an expectation that it will end one of the strongest leasing years in quite some time. And as Ric said, as it relates to the tenants for Manhattan West that you alluded to, their timetables are 2015 to 2016, 2017 and 2018 lease expirations. And we have seen, if anything actually, an increase in interest as the project starts to move closer.

**Josh Attie** - Citigroup - Analyst

Thanks. That's helpful. And if I could ask one more question. Could you talk about the fundamentals in Australia, the market fundamentals? Has there been any change in -- directionally over the last 3 months or 6 months in the market?

**Ric Clark** - Brookfield Office Properties Inc - CEO

That is kind of a Tale of Two Markets. A good part of the country is fueled by mining minerals and resource businesses, and that is still growing very solidly forward. And there's good growth in those businesses. The rest of the country may have slowed down a little bit, but not really materially. The unemployment has crept up just modestly, it is still just barely over 5%. Vacancy might have crept up again modestly. But we've got a pretty fully-leased portfolio, but we do have some rolls over the next couple of years, and those tenants are engaged in discussions. So, and we are not really seeing a major economic difference there. We have been quite pleased with that investment.

**Josh Attie** - Citigroup - Analyst

Okay, thank you very much.

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**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

Okay. Thanks.

**Operator**

We'll go next to Jay Habermann with Goldman Sachs.

**Jay Habermann** - Goldman Sachs - Analyst

Good morning, everyone. Just a question I guess in terms of the outlook. And I know you're not giving guidance on 2012 at this point. But, Ric, you've been a net acquirer this year and I'm just curious -- you mentioned some of the uncertainty in the capital markets. How do you think about dispositions over the next 12 months in some of that asset recycling you mentioned earlier?

And then I guess, just separately, can you comment on the Bank of America lease extension? What potential impact that might have in terms of NOI going forward? And perhaps other deals that are in the works downtown?

**Ric Clark** - Brookfield Office Properties Inc - CEO

Sure. So, first of all, as far as the investment landscape. On our dispositions, we have done well versus what we expected to achieve in the properties that we have been marketing. And we found in every instance that there were several interested parties at good pricing, which matched or exceeded our expectations. So, that has kind of worked out well.

We have been recycling that capital into mostly properties that need some work. They have vacancies. So, there might be an initial, just based on these transactions from the set of assets that we sold to the set of assets that we bought. There might be an initial drop in NOI because the properties aren't fully leased, and the properties that we're selling effectively are, but long term over the next couple of years, once the things that we've bought are stabilized, we expect to see a meaningful increase in NOI and FFO as a result of it. And that is why we are doing it.

On the Bank of America Merrill Lynch lease parameters, Bryan, maybe I defer to you on that?

**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

Yes. I guess the only comment I would say is that the rate that we secured that lease at, are consistent with the rates that we disclosed as kind of market rates in lower Manhattan in our supplemental. And we don't expect on that specific space to have any meaningful roll downs in NOI when we ultimately reflect the impact of the new lease come September 2013.

**Ric Clark** - Brookfield Office Properties Inc - CEO

I think with the lower Manhattan leasing, we are pretty flat. We expected some of the deals would be less than the lease, the [Merrill] lease rolling off, and some will be better, but net-net we expect to be around relatively flat.

And just to, Jay, make another comment on the acquisition environment, I would say now is an excellent time to buy real estate. In every cycle there is a period of time where you kind of hit the bottom. You bounce along the bottom. The environment is improving modestly, but there are still owners that need to kind of sell and sell quickly, or lenders that find themselves with loans that isn't effectively collateralized. So, we have been staying away from chasing the kind of core properties in New York City, because those things are pretty fully priced. But the assets that we are buying, we expect, based on the price that we are paying, and once a sustained recovery kicks in, given that there's no new supply coming on and et cetera, that there will be



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very meaningful growth as prices move their way back towards replacement cost pricing. And so, you know, we think this recycling that we have been working on will have a great benefit for shareholders.

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**Jay Habermann** - *Goldman Sachs - Analyst*

Okay. And my second question -- I guess, just based on the current stock price still trading below NAV, can you give us some sense on perhaps further share repurchases in the near term?

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**Ric Clark** - *Brookfield Office Properties Inc - CEO*

You know, we have been active buying shares. Bryan, I don't want to talk about any. We will still do some of that, but every time we go to do that, we do evaluate it versus some things that are acquisition opportunities.

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**Jay Habermann** - *Goldman Sachs - Analyst*

Yes.

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**Ric Clark** - *Brookfield Office Properties Inc - CEO*

And I think we continue to do both. But, Bryan, anything to add?

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**Bryan Davis** - *Brookfield Office Properties Inc - SVP and CFO*

Yes, I'd say that is exactly right. I mean, we have bought back I think a little over 800,000 shares, spent about \$14 million in the process. As Ric said, we evaluate it relative to acquisition opportunities. Probably number 1 priority I think for us is to continue to grow our business, and to grow our asset base and our platform for the future. But to the extent that we trade at a meaningful discount to net asset value, which we have during periods in the last quarter in particular, that's provided an attractive opportunity for us to invest some excess liquidity.

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**Jay Habermann** - *Goldman Sachs - Analyst*

Thank you.

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**Operator**

We'll go next to Alex Avery with CIBC.

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**Alex Avery** - *CIBC World Markets - Analyst*

Thank you. I was just hoping you could run through I guess the 4.6 million square feet of Bank of America Merrill Lynch leasing just in terms of the status? How much of that is leased and how much is not?

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**Bryan Davis** - *Brookfield Office Properties Inc - SVP and CFO*

Yes, this is Bryan. Ric, if you want me to just kind of go through that? 4.6 million square feet in the first half of the year, we had 2 leases, 1 with Commerz and 1 with Oppenheimer, which aggregated to about 500,000 square feet. So, bring that 4.6 million

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square feet down to 4.1 million square feet. And with the most recent transaction announced, we're down to about 3.4 million square feet, which is sort of the balance that is left remaining to lease between now and September of 2013.

**Alex Avery** - CIBC World Markets - Analyst

And of the, I guess the leasing activity that you said might get pushed out into next year, how much of that would relate to the World Financial Center?

**Ric Clark** - Brookfield Office Properties Inc - CEO

I don't have that scorecard in front of me. I would say maybe on the serious scales, we're maybe 0.5 million feet. But behind those transactions, and not considered at the serious level yet, we're in discussions with multiple tenants, a couple in the 1 million square foot range. So, I think things in lower Manhattan just keep getting clearer and clearer to potential tenants. And as time goes on, we expect to do better and better.

**Alex Avery** - CIBC World Markets - Analyst

Okay. And then, Ric, I think you highlighted the price per square foot benefit of selling Newport and buying Four World Financial. From an NOI perspective, what would the -- I guess, what would the impact of that be on the Company?

**Ric Clark** - Brookfield Office Properties Inc - CEO

Bryan, would you be able to respond to that?

**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

Yes, sure. So, just trying to remember my numbers on Newport. Newport is approximately, say, \$5 million a quarter in NOI, a little over \$20 million a year. The one thing that you will note in our acquisition of the interest in Four World Financial Center, for a period of time up until the expiry of the original Merrill Lynch lease, we have been receiving a preferred return. That preferred return has been illustrated in our supplemental, in our joint venture slide, which means that we acquired that 49% interest with effectively a \$12 million NOI on an annualized basis until that point in time, after which that 49% interest will be commensurate with 49% of the underlying NOI. And if you were just to assume the NOI stays similar to what we have existing in that property, that 49% interest would equate to about \$30 million to \$32 million of NOI on an annual basis.

**Alex Avery** - CIBC World Markets - Analyst

And in Four World Financial, is the 767,000, or sorry, the proportion of the 767,000 square feet, is that the only leasing that is completed in Four World Financial for 2013?

**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

Correct.

**Alex Avery** - CIBC World Markets - Analyst

Okay. That's great, thanks.

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**Operator**

We'll go next to Mario Saric with Scotia Capital.

**Mario Saric** - Scotia Capital - Analyst

Hi, good morning. Just coming back to World Financial Center. The world has really changed in the last 2 or 3 months, especially with respect to the finance industry announcing further job cuts. In relation to the vacated BofA space at [Two and Four World Financial Center] effective October 2013, do you right now envision, or do you think there is enough demand outside of the finance industry to lease up that space over the next 12 months to 18 months?

**Ric Clark** - Brookfield Office Properties Inc - CEO

Yes, and --.

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

Ric, would you like me to jump in on that?

**Ric Clark** - Brookfield Office Properties Inc - CEO

Yes, sure. Yes, Mitch, go ahead.

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

I mean, one of the most material things that has changed in the last actually 3 months was the signing of the Conde Nast lease at the World Trade Center for 1 million square feet, which continues a trend that started about 5 years ago, and takes from 7 million square feet to 8 million square feet, the number of tenants that have moved from midtown to downtown.

So, what has happened is it has greatly broadened the universe of tenants that are available for this space where, in a prior generation, it might have been limited to the fire sector. And I think as Ric alluded to in his earlier response, those tenants that we are in active, albeit not serious discussions with, have -- fall into that non-fire category.

**Ric Clark** - Brookfield Office Properties Inc - CEO

So -- and we are in discussions with some financial services firms as well.

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

Yes.

**Ric Clark** - Brookfield Office Properties Inc - CEO

But I'd say the World Financial Center, notwithstanding some of the banks that are cutting jobs -- and others aren't, by the way. So, not everybody is. There still is a need to basically become more efficient and cut costs. And so the nature of those discussions



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are all about people coming from multiple locations into more efficient and modern space. So, I think we'll be doing deals with both inside and outside the industry.

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**Mario Saric** - Scotia Capital - Analyst

Okay, great. Thank you.

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**Operator**

We'll go next to Michael Knott with Green Street Advisors.

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**Michael Knott** - Green Street Advisors - Analyst

Hi, guys. Curious if you can comment on -- we had seen a recent trade rag saying that, that some part of the Brookfield organization had bought a building in Denver, and just curious if you can comment on whether it's Brookfield Asset Management, or potentially yourselves? And if it is Brookfield Asset Management, just curious how investors should think about the conflicts there of them having a vacant building when you have a leased building in that market?

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**Ric Clark** - Brookfield Office Properties Inc - CEO

Yes, so, Michael on that, no Brookfield entity is, at this point, acquired a building in Denver. So, reports were premature. But I would say, if any Brookfield entity buys a downtown Denver asset, it will be Brookfield Office Properties, and it wouldn't be Brookfield Asset Management. As for Denver as a market, and Mitch, feel free to jump in here, but we have seen lots of positive things happening there. And I think the shale -- the emergence of shale as an affordable means of fuel, it sort of helps fuel that local economy.

We are not adverse to looking at acquiring assets in markets like this. I'd use what we did in Houston about a year ago as an example. When we bought Heritage -- the Heritage building down there, in the almost 12-month period since we bought it, Houston has added 60,000 jobs. So, we think it is much better for us to be focused on situations like that, possibly even Denver, versus getting into a gun-slinging contest for an asset in New York City. Probably more than you wanted.

Mitch, I don't know if you have anything to add on Denver?

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**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

I would only add quickly that from a report I saw yesterday, that market is outperforming the rest of the country. They have had 9 consecutive quarters of positive net absorption. It is also one of the few markets in the country that continues to attract major users from outside the market -- Arrow Electronics being the most recent consolidating from New York and California. And third, it is exhibiting that some of those traits that we see in lower Manhattan, becoming a 24-hour city in the last decade. The residential population downtown has increased by 61%. And that is at both ends of the spectrum -- both kids out of college and empty-nesters. So, it is a good feel from that city.

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**Michael Knott** - Green Street Advisors - Analyst

Okay, thanks for that. And then if I can just ask, are you guys willing to share maybe what the lease economics were on the Merrill Lynch deal? Or maybe just more broadly, how you thought about underwriting that investment at Four World? And kind



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of how the 285 a foot might ultimately end up, at maybe 300, 350, 400, whatever the number might be? Just curious how you thought about that?

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**Dennis Friedrich** - Brookfield Office Properties Inc - President and Chief Investment Officer

Hi, Ric, do you want me to answer that, it's Dennis.

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**Ric Clark** - Brookfield Office Properties Inc - CEO

Yes, sure, Dennis, go ahead.

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**Dennis Friedrich** - Brookfield Office Properties Inc - President and Chief Investment Officer

Hi, Michael. The way we looked at Four World is we are assuming that we are going to achieve stabilized NOI yields in excess of 8%. Our sort of stabilized cost will probably be in the 370-ish range or so, baking in leasing costs and some improvements. We tend not to like to discuss specifics of leases, but I can say the Merrill lease, most recent lease is in the sort of 30-ish net range. And that would be actually Four, and that building in particular, the lowest level floors, which always tend to have to be discounted somewhat. And actually also the deal was lighter on concessions than what you would typically find in a new deal. So, I think we are on our way, and I think we are feeling that we can generate Four World versus -- Newport for instance is probably 300 basis point-plus spread in NOI yield.

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**Michael Knott** - Green Street Advisors - Analyst

Okay, thanks, that's really helpful. It must be nice to have that monkey off your back, and be able to move forward with the rest of that complex there. Thanks.

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**Dennis Friedrich** - Brookfield Office Properties Inc - President and Chief Investment Officer

It definitely feels good. Thanks.

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**Ric Clark** - Brookfield Office Properties Inc - CEO

Thanks, Michael.

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**Operator**

We'll go next to Nicholas [Ulyko] with Macquarie.

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**Unidentified Participant** - - Analyst

Oh, hi. Good morning, everyone. I imagine you guys are actively talking to some of the larger pension funds and global institutional investors out there as you guys think about maybe doing a future fund. Can you just tell us a little bit about how they are thinking about the world these days? And which markets they might like better? And whether they have an appetite more for, still for just stable core versus development opportunities?



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**Ric Clark** - Brookfield Office Properties Inc - CEO

Sure. So, it is interesting, I would say the group is -- not everybody is in the same place. But what we are seeing from many of them, they're definitely interested in distress. There is an appetite for development, particularly high-quality office development. We have seen a number of pension funds participate in Manhattan, in Sydney, in London, all over the world. So, development isn't of concern to them.

And also from our perspective, it makes us feel good about what we have been working to do within our development portfolio. These are smart savvy investors, and if they are backing development, it's because there has been so little for so long, and there is a belief that once the economies start to grow again, development will absolutely be needed. So, they are interested in development, but looking for value added and distressed kind of returns mainly. Some are looking for core, but I would say at least the ones we are talking to are looking for the other.

**Unidentified Participant** -- Analyst

Okay. And then just turning to New York. Just 2 questions there. One on 450 W. 33rd, could you just talk about the level of interest on the 2 big blocks of space there? And then on the SocGen lease, the additional space they took at 245 Park. And was that, were those sort of economics already fixed a year ago when they took the space? Or was there actually a possibility to sign at a higher rent today? Thanks.

**Ric Clark** - Brookfield Office Properties Inc - CEO

Mitch, do you want to talk to SocGen? Or, I don't know, I'm not sure if that was done by Dennis since he did the original SocGen deal?

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

That was an extension. And although it happened before I arrived, I believe it was an extension --.

**Dennis Friedrich** - Brookfield Office Properties Inc - President and Chief Investment Officer

It was an expansion within the last --.

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

Within the last --.

**Dennis Friedrich** - Brookfield Office Properties Inc - President and Chief Investment Officer

They weren't completely fixed, but it was, the economics were cast in the original lease. It was a 2-floor extension.

**Ric Clark** - Brookfield Office Properties Inc - CEO

Certainly a good sign given what is going on in Europe.

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**Dennis Friedrich** - Brookfield Office Properties Inc - President and Chief Investment Officer

Yes.

**Ric Clark** - Brookfield Office Properties Inc - CEO

So, we are pretty pleased with that. On 450, this -- Mitch, do want to talk about leasing there?

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

Yes, we are currently formulating our plan for that building. We continue to see tenants on a fairly regular basis. But it will -- activity will pick up once we have a more concrete plan to discuss with the world.

**Unidentified Participant** - - Analyst

Okay, thanks.

**Operator**

We'll go next to Sam Damiani with TD Securities.

**Sam Damiani** - TD Newcrest/Waterhouse Securities - Analyst

Thanks. Good morning. Just back to the World Financial space there -- 3.5 million feet to lease, come 2013. Are any of the remaining sub-tenants likely to extend directly with you guys? I think you have done a couple, but I haven't heard you talk a lot more about that opportunity.

**Mitch Rudin** - Brookfield Office Properties Inc - President & CEO - US Commercial Operations

Probably not going to happen. There may be some small ones, but not in material. We are really looking for new tenancies for that.

**Sam Damiani** - TD Newcrest/Waterhouse Securities - Analyst

Okay. And just a big picture, back to acquisitions, development, and dispositions. How do you view your balance sheet today? And given your plans over the next year, do you see capital coming in sort of matching going out? Or do you see the ability to expand your capital deployment on a net basis?

**Ric Clark** - Brookfield Office Properties Inc - CEO

On a net basis, I think it is capital in, matching capital out. And if your question is -- are we expecting to raise equity, we are not. But I would say -- now is an incredible time to borrow money. With government's concerns over the economy and et cetera, they've been keeping rates down. It's kind of happening all around the globe. And it's been a fantastic time for borrowers like us to tap into the debt market. So, we're not afraid to push leverage to the high end of investment grade levels when we do make acquisitions. And so we have been able to sell things and deploy money into a larger gross asset base, just by selling underlevered properties and putting proper leverage on the things that we acquire.

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I'm not sure if that answers your question.

**Sam Damiani** - TD Newcrest/Waterhouse Securities - Analyst

Yes, that's great. And just finally on the Canadian REIT. Any thoughts on furthering your strategy of reducing ownership there? Any thoughts you might be able to share given where it is trading?

**Ric Clark** - Brookfield Office Properties Inc - CEO

Sam, I don't think at this point we have anything new to say. It still is our goal to sell down our interest there. Our only issue is sort of timing. We just believe that those assets are worth far more than where they are trading, where the stock is trading. But at some point, hopefully soon, we will be able to make more progress on selling down our interest.

**Sam Damiani** - TD Newcrest/Waterhouse Securities - Analyst

But you are in no rush?

**Ric Clark** - Brookfield Office Properties Inc - CEO

We don't feel any urgency.

**Sam Damiani** - TD Newcrest/Waterhouse Securities - Analyst

Great, thank you.

**Operator**

We'll next take Karine MacIndoe with BMO Capital Markets.

**Karine MacIndoe** - BMO Capital Markets - Analyst

Oh, thank you. The mark-to-market gap for the Canadian properties went down in the quarter compared to the prior quarter. Was that mostly FX related combined with recent leasing activity? Or can you shed any light there?

**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

I would probably offer that it could ultimately be FX rated. I'm just trying to remember what we were prior quarter. Current quarter we have a 13% mark-to-market.

**Karine MacIndoe** - BMO Capital Markets - Analyst

Yes, you had a 12% last quarter that went to about a 6%. And it -- the in-place rents didn't move a ton, but the market rents are down somewhat. So, it's just a matter of the in-place not moving as much, maybe due to the recent leasing activity? Or is this a different view on market rents across the country?

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**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

Okay. I would say it's not a different view on market rents across the country. Just to -- now that I have June in front of me, we went from a 14% mark-to-market to a 13% mark-to-market. I don't think it was meaningful, but I think what you are referring to is when you look at the gross rents, particularly in Toronto, where we went from \$59 per square foot down to \$54 per square foot --.

**Karine MacIndoe** - BMO Capital Markets - Analyst

Yes, are you -- (multiple speakers) the proportionate --.

**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

That would've been driven almost solely by FX.

**Karine MacIndoe** - BMO Capital Markets - Analyst

Yes, the 13% that you are citing is for assets under management. If you go to the proportionate section, you're looking at a decline from like 12% to 6%.

**Bryan Davis** - Brookfield Office Properties Inc - SVP and CFO

Yes, but even on that basis, when you look at market rents, again, Toronto \$54 versus \$59. FX driven, Calgary \$48 versus \$50 in the prior quarter. That would be FX driven. All of them would be FX driven. You may have a bit of timing just related to sort of in-place rents. But nothing meaningful from a commentary on where we think rents are going in the Canadian market. In fact, Jan's here, he could probably speak to that.

**Jan Sucharda** - Brookfield Office Properties Inc - CEO Canadian Operations

Well, I was going to say that our view is that, if anything, there has been some upward momentum still happening in Western Canada. So, it would be all FX related in this case.

**Karine MacIndoe** - BMO Capital Markets - Analyst

Okay. So, no major read throughs. Looking forward over the next year or so, lease expiry schedule, and the discussions that you are having, are there any larger tenant expiries that we need to be thinking about that maybe could translate to another short-term hit? And ultimately, where do you see your occupancy level moving over the next year? Like dealing with some of the recent vacancies, could we see an uptick or should we be assuming flat?

**Ric Clark** - Brookfield Office Properties Inc - CEO

So, we have got above average, I guess that's the best way to put it, rolls in 2013 and 2015. And other than the tenants that we have discussed publicly, we don't -- we still feel that we have a chance, a good chance to keep those tenants that are rolling in those years. So, I don't think we have missed any, Tom or Jan -- or Jan or Mitch, if I have or not, and please feel free to speak up.

As far as our overall leasing goes, we just came out of the first stage of our business planning sessions for next year, and as always, our hope and expectation is to make progress on our overall occupancy. I think our goal for next year is to get back up



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to closer to the 95% level. The US -- and Canada and Australia are both sort of 98%-plus, and have performed very solidly, not unexpectedly given those economies. And the US is the one that has been a little more difficult. So, that would be a major area of emphasis for us in 2012 is to get the US back, to catch it back up. So, we're working hard at that.

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**Karine MacIndoe** - *BMO Capital Markets - Analyst*

Okay. That's great. Thanks.

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**Ric Clark** - *Brookfield Office Properties Inc - CEO*

Thank you.

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**Operator**

We'll go next to Stephen Boyd with Cowen and Company.

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**Stephen Boyd** - *Cowen and Company - Analyst*

Hi, good morning, guys. I was hoping you could review the details and thinking behind the Brookfield Residential notes restructuring? And specifically, I'm curious if there were any third-party refinancing alternatives that were explored sort of in lieu of the restructuring?

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**Ric Clark** - *Brookfield Office Properties Inc - CEO*

Bryan, do you want to talk a little bit about that?

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**Bryan Davis** - *Brookfield Office Properties Inc - SVP and CFO*

Yes, sure. So, we were approached by Brookfield Residential to restructure the notes. In specific it was related to the amortization of the senior note, \$50 million per year until its maturity, I believe, in 2016. Ultimately they were looking to have additional capital, so that they could continue to pursue opportunities in these markets. Our objective was to have availability of that capital. So, you know, we agreed effectively to restructure the notes, but we also put in place the right to sell those amortization amounts up to Brookfield Asset Management in each of those periods. So, net-net, the economics of our notes and the ability for us to extract capital out of them remains unchanged as a result of that.

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**Stephen Boyd** - *Cowen and Company - Analyst*

Okay, great, thank you.

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**Operator**

And for our final question, we'll take the last question in queue from John Guinee from Stifel Nicholas.



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**John Guinee** - *Stifel Nicolaus - Analyst*

Hi, couple of quick questions. John Guinee here. First, a lot of your peers are raising their dividend again. What is your dividend policy, Ric? What are you thinking in that regard?

**Ric Clark** - *Brookfield Office Properties Inc - CEO*

Well, John, on that, as you know, it is a Board decision. What we have historically done is sat down with the Board in February, and gone through our picture for the coming year, and given a recommendation to the Board. I think, for us, and I don't want to speak for the Board on this because, again, it is their call, but we are going through a period where we will have meaningful capital expenses in order to re-let the World Financial Center, and in the space at 1 New York Plaza. So, given that, we might not raise in 2012, but I don't want to say that for sure because the Board will make that call.

**John Guinee** - *Stifel Nicolaus - Analyst*

Okay. And then the second question is -- what is your thinking these days on downtown LA? There is a portfolio there that is getting cleaned up and getting a little more easy to understand. Are you guys positive on that market? What are you thinking?

**Ric Clark** - *Brookfield Office Properties Inc - CEO*

Well, I think it might be -- and I'll have Mitch jump in, and Dennis, if you want as well. I think long term, downtown LA is, it's lower Manhattan but 10 years or so behind. And upgrades in transportation have brought more and more employees downtown. The retail establishments are popping up, some great restaurants and retail. The entertainment amenities are popping up, and the residential has been developing over the last several years. So, I am pretty high on it. I think, though, that there is a couple of years until we get there, just given what has happened in the economy over the last couple years. And [from time to time] that kind of happens. There's a lot of optimism about downtown LA and a lot of momentum, and then it kind of stalls. And then it starts up again. So, long term, I like it.

Mitch, do you have some views?

**Mitch Rudin** - *Brookfield Office Properties Inc - President & CEO - US Commercial Operations*

No, Ric, I completely share your assessment, both on your views and in terms of the timing of it. The one thing I would add is that I think we have, notwithstanding talking into that potential 7-year to 10-year timetable, there is a greater comfort now that it is actually happening in LA. When you go there, you see different patterns at night. You actually see people going to dining, you see people who are coming into downtown to have dinner. LA Live has made a huge difference. So, while it has a ways to go, it has at least started. And from a little roundtable that we had about 6 weeks ago, with a number of real estate professionals out there, as it was concluded, even though there was a difference of opinion, they all agreed that 2 years ago we never would have even had this discussion.

**John Guinee** - *Stifel Nicolaus - Analyst*

Great, thank you.

**Operator**

And ladies and gentlemen, this does conclude today's question-and-answer session. For closing remarks, I'd like to turn the conference back to Mr. Ric Clark.

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**Ric Clark** - Brookfield Office Properties Inc - CEO

Thank you. Thanks everyone for joining our call today. We hope to see you at NAREIT or on our Investor Tour in Houston the day before. And we look forward to being in touch as things progress. So, thanks again for joining our call today.

**Operator**

Ladies and gentlemen, this does conclude today's discussion. We appreciate your participation. You may disconnect at this time.

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