

CLEAR CHANNEL COMMUNICATIONS INC  
Form 10-Q  
August 09, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2010**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**  
Commission File Number

**001-9645**

**CLEAR CHANNEL COMMUNICATIONS, INC.**

(Exact name of registrant as specified in its charter)

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**Texas**  
(State or other jurisdiction of  
incorporation or organization)

**74-1787539**  
(I.R.S. Employer Identification No.)

**200 East Basse Road**  
**San Antonio, Texas**  
(Address of principal executive offices)

**78209**  
(Zip Code)

**(210) 822-2828**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Pursuant to the terms of its bond indentures, the registrant is a voluntary filer of reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, and has filed all such reports as required by its bond indentures during the preceding 12 months.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<b>Class</b>	<b>Outstanding at August 6, 2010</b>
Common stock, \$.001 par value	500,000,000

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form in a reduced disclosure format permitted by General Instruction H(2).

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. UNAUDITED FINANCIAL STATEMENTS OF CLEAR CHANNEL CAPITAL I, LLC****CLEAR CHANNEL CAPITAL I, LLC****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

	June 30, 2010 (Unaudited)	December 31, 2009
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,504,730	\$ 1,883,994
Accounts receivable, net	1,323,697	1,301,700
Other current assets	459,264	473,151
<b>Total Current Assets</b>	<b>3,287,691</b>	<b>3,658,845</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Structures, net	2,027,471	2,143,972
Other property, plant and equipment, net	1,142,005	1,188,421
<b>INTANGIBLE ASSETS</b>		
Definite-lived intangibles, net	2,423,875	2,599,244
Indefinite-lived intangibles	3,551,918	3,562,057
Goodwill	4,092,443	4,125,005
Other assets	761,379	769,557
<b>Total Assets</b>	<b>\$ 17,286,782</b>	<b>\$ 18,047,101</b>
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued expenses	\$ 943,340	\$ 995,740
Current portion of long-term debt	916,043	398,779
Deferred income	187,470	149,617
<b>Total Current Liabilities</b>	<b>2,046,853</b>	<b>1,544,136</b>
Long-term debt	19,535,311	20,303,126
Deferred income taxes	2,079,500	2,220,023
Other long-term liabilities	834,416	824,554
Commitments and contingent liabilities		
<b>MEMBER S DEFICIT</b>		
Noncontrolling interest	446,716	455,648
Member s interest	2,118,303	2,109,007
Retained deficit	(9,337,822)	(9,076,084)
Accumulated other comprehensive loss	(436,495)	(333,309)
<b>Total Member s Deficit</b>	<b>(7,209,298)</b>	<b>(6,844,738)</b>

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<b>Total Liabilities and Member s Deficit</b>	\$ 17,286,782	\$ 18,047,101
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See notes to consolidated financial statements.

**Table of Contents****CLEAR CHANNEL CAPITAL I, LLC****CONSOLIDATED STATEMENTS OF OPERATIONS****(UNAUDITED)****(In thousands)**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Revenue	\$ 1,490,009	\$ 1,437,865	\$ 2,753,787	\$ 2,645,852
Operating expenses:				
Direct operating expenses (excludes depreciation and amortization)	600,916	637,076	1,198,263	1,255,425
Selling, general and administrative expenses (excludes depreciation and amortization)	376,637	360,558	725,933	738,094
Corporate expenses (excludes depreciation and amortization)	64,109	50,087	128,605	97,722
Depreciation and amortization	184,178	208,246	365,512	383,805
Impairment charges		4,041,252		4,041,252
Other operating income (expense) net	3,264	(31,516)	7,036	(34,410)
Operating income (loss)	267,433	(3,890,870)	342,510	(3,904,856)
Interest expense	385,579	384,625	771,374	771,678
Equity in earnings (loss) of nonconsolidated affiliates	3,747	(17,719)	5,618	(21,907)
Other (expense) income net	(787)	430,629	57,248	427,449
Loss before income taxes	(115,186)	(3,862,585)	(365,998)	(4,270,992)
Income tax benefit	37,979	184,552	109,164	164,960
Consolidated net loss	(77,207)	(3,678,033)	(256,834)	(4,106,032)
Amount attributable to noncontrolling interest	9,117	(4,629)	4,904	(14,411)
Net loss attributable to the Company	\$ (86,324)	\$ (3,673,404)	\$ (261,738)	\$ (4,091,621)
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(74,223)	133,058	(113,672)	85,715
Unrealized (loss) gain on securities and derivatives:				
Unrealized holding (loss) gain on marketable securities	(412)	8,551	3,533	(1,610)
Unrealized holding loss on cash flow derivatives	(4,992)	(47,393)	(8,146)	(75,750)
Reclassification adjustment	(1,366)	(513)	(1,141)	3,120
Comprehensive loss	(167,317)	(3,579,701)	(381,164)	(4,080,146)
Amount attributable to noncontrolling interest	(11,572)	19,509	(16,240)	10,337
Comprehensive loss attributable to the Company	\$ (155,745)	\$ (3,599,210)	\$ (364,924)	\$ (4,090,483)

See notes to consolidated financial statements.

**Table of Contents****CLEAR CHANNEL CAPITAL I, LLC****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)****(In thousands)**

	2010	Six Months Ended June 30, 2009
<b>Cash flows from operating activities:</b>		
Consolidated net loss	\$ (256,834)	\$ (4,106,032)
<b>Reconciling items:</b>		
Impairment charges		4,041,252
Depreciation and amortization	365,512	383,805
Deferred taxes	(135,808)	(194,991)
(Gain) loss on disposal of operating assets	(7,036)	34,410
Gain on extinguishment of debt	(60,289)	(440,338)
Provision for doubtful accounts	7,791	24,206
Share-based compensation	16,624	19,306
Equity in (earnings) loss of nonconsolidated affiliates	(5,618)	21,907
Amortization of deferred financing charges and note discounts, net	105,596	120,352
Other reconciling items - net	3,757	(3,444)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(66,994)	79,415
Increase in deferred income	42,320	45,507
Increase (decrease) in accounts payable, accrued expenses and other liabilities	18,166	(92,683)
Increase (decrease) in accrued interest	45,188	(17,837)
Changes in other operating assets and liabilities, net of effects of acquisitions and dispositions	(19,583)	1,212
Net cash provided by (used for) operating activities	52,792	(83,953)
<b>Cash flows from investing activities:</b>		
Sales of investments net	200	23,689
Purchases of property, plant and equipment	(103,409)	(92,623)
Acquisition of operating assets	(10,814)	(6,930)
Proceeds from disposal of assets	11,107	37,332
Change in other net	(2,637)	6,643
Net cash used for investing activities	(105,553)	(31,889)
<b>Cash flows from financing activities:</b>		
Draws on credit facilities	148,304	1,622,444
Payments on credit facilities	(104,541)	(149,376)
Proceeds from delayed draw term loan facility		500,000

Proceeds from long-term debt

6,844

Information as of market close on  
April 10, 2019:

**Bloomberg Ticker Symbol:** BAC  
**Exchange:** NYSE  
**Current Stock Price:** \$29.07  
**52 Weeks Ago:** \$30.48  
**52 Week High (on 8/8/2018):** \$31.80  
**52 Week Low (on 12/24/2018):** \$22.73  
**Current Dividend Yield:** 2.06%

The following table sets forth the published high and low closing prices of, as well as dividends on, the underlying stock for each quarter from January 1, 2016 through April 10, 2019. The closing price of the underlying stock on April 10, 2019 was \$29.07. The associated graph shows the closing prices of the underlying stock for each day from January 1, 2014 through April 10, 2019. We obtained the information in the table and graph below from Bloomberg Financial Markets, without independent verification. The historical performance of the underlying stock should not be taken as an indication of its future performance, and no assurance can be given as to the price of the underlying stock at any time, including on the determination dates.

Common Stock of Bank of America Corporation (CUSIP 060505104)	High (\$)	Low (\$)	Dividends (\$)
<b>2016</b>			
First Quarter	16.43	11.16	0.05
	15.11	12.18	0.05



Second  
 Quarter  
 Third Quarter 16.19 12.74 0.075  
 Fourth Quarter 23.16 15.63 0.075  
**2017**  
 First Quarter 25.50 22.05 0.075  
 Second  
 Quarter 24.32 22.23 0.075  
 Third Quarter 25.45 22.89 0.12  
 Fourth Quarter 29.88 25.45 0.12  
**2018**  
 First Quarter 32.84 29.17 0.12  
 Second  
 Quarter 31.22 28.19 0.12  
 Third Quarter 31.80 27.78 0.15  
 Fourth Quarter 30.43 22.73 0.15  
**2019**  
 First Quarter 29.82 24.56 0.15  
 Second  
 Quarter 29.17 28.54 -  
 (through April  
 10, 2019)

We make no representation as to the amount of dividends, if any, that Bank of America Corporation may pay in the future. In any event, as an investor in the Contingent Income Auto-Callable Securities, you will not be entitled to receive dividends, if any, that may be payable on the common stock of Bank of America Corporation.

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Morgan Stanley Finance LLC

Contingent Income Auto-Callable  
Securities due April 21, 2022

Based on the Performance of the  
Common Stock of Bank of America  
Corporation

Principal at Risk Securities

Common Stock of Bank of America  
Corporation – Daily Closing Prices

January 1, 2014 to April 10, 2019

\*The red solid line indicates the  
hypothetical downside threshold  
price, assuming the closing price of  
the underlying stock on April 10,  
2019 were the initial share price.

This document relates only to the securities offered hereby and does not relate to the underlying stock or other securities of Bank of America Corporation. We have derived all disclosures contained in this document regarding Bank of America Corporation stock from the publicly available documents described above. In connection with the offering of the securities, neither we nor the agent has participated in the preparation of such documents or made any due diligence inquiry with respect to Bank of America Corporation. Neither we nor the agent makes any representation that such publicly available documents or any other publicly available information regarding Bank of America Corporation is accurate or

complete. Furthermore, we cannot give any assurance that all events occurring prior to the date hereof (including events that would affect the accuracy or completeness of the publicly available documents described above) that would affect the trading price of the underlying stock (and therefore the price of the underlying stock at the time we price the securities) have been publicly disclosed. Subsequent disclosure of any such events or the disclosure of or failure to disclose material future events concerning Bank of America Corporation could affect the value received with respect to the securities and therefore the value of the securities.

Neither the issuer nor any of its affiliates makes any representation to you as to the performance of the underlying stock.

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Additional Terms of the Securities

Please read this information in  
conjunction with the summary terms  
on the front cover of this document.

**Additional  
Terms:**

If the terms described herein are  
inconsistent with those described in  
the accompanying product  
supplement or prospectus, the terms  
described herein shall control.

**Interest  
period:**

The quarterly period  
from and including  
the original issue date  
(in the case of the first  
interest period) or the  
previously scheduled  
contingent payment  
date, as applicable, to  
but excluding the  
following scheduled  
contingent payment  
date, with no  
adjustment for any  
postponement thereof.

**Day count  
convention:**

Interest will be  
computed on the basis  
of a 360-day year of  
twelve 30-day

months.  
 The record date for each contingent payment date shall be the date one business day prior to such scheduled contingent payment date; provided, however, that any contingent

**Record date:** quarterly coupon payable at maturity or upon redemption shall be payable to the person to whom the payment at maturity or early redemption payment, as the case may be, shall be payable.  
 The accompanying

**Underlying stock:** product supplement refers to the underlying stock as the “underlying shares.” Bank of America Corporation. The accompanying

**Underlying stock issuer:** product supplement refers to the underlying stock issuer as the “underlying company.” The accompanying

**Downside threshold price:** product supplement refers to the downside threshold price as the “trigger level.”

**Postponement of maturity date:** If the scheduled final determination date is not a trading day or if a market disruption event occurs on that day so that the final determination date is postponed and falls less than two business days prior to the scheduled maturity date, the maturity date of the securities will

be postponed to the second business day following that final determination date as postponed.  
If a contingent payment date (including the maturity date) is postponed as a result of the postponement of the relevant determination date, no adjustment shall be made to any contingent quarterly coupon paid on that postponed date.

**Postponement of contingent payment dates:**

**Antidilution adjustments:** *The following replaces in its entirety the portion of the section entitled “Antidilution Adjustments” in the accompanying product supplement for auto-callable securities from the start of paragraph 5 to the end of such section.*

5. If (i) there occurs any reclassification or change of the underlying stock, including, without limitation, as a result of the issuance of any tracking stock by the underlying stock issuer, (ii) the underlying stock issuer or any surviving entity or subsequent surviving entity of the underlying stock issuer (the “successor

corporation”) has been subject to a merger, combination or consolidation and is not the surviving entity, (iii) any statutory exchange of securities of the underlying stock issuer or any successor corporation with another corporation occurs (other than pursuant to clause (ii) above), (iv) the underlying stock issuer is liquidated, (v) the underlying stock issuer issues to all of its shareholders equity securities of an issuer other than the underlying stock issuer (other than in a transaction described in clause (ii), (iii) or (iv) above) (a “spin-off event”) or (vi) a tender or exchange offer or going-private transaction is consummated for all the outstanding shares of the underlying stock (any such event in clauses (i) through (vi), a “reorganization event”), the method of determining whether an early redemption has occurred and the amount payable upon an early redemption date or at maturity for each security will be as follows:

· Upon any determination date following the effective date of a reorganization event and prior to the final determination date: If the exchange property value (as defined below) is greater than or equal to the initial share price, the securities will be automatically redeemed for an early redemption payment.

· Upon the final determination date, if the securities have not previously been automatically redeemed: You will receive for each security that you hold a payment at maturity equal to:

Ø If the exchange property value on the final determination date is greater than or equal to the downside threshold price: *(i) the stated principal amount plus (ii) the contingent quarterly coupon with respect to the final determination date*

Ø If the exchange property value on the final determination date is less than the



downside threshold price: (i) the stated principal amount multiplied by (ii) the share performance factor. For purposes of calculating the share performance factor, the “final share price” will be deemed to equal the exchange property value on the final determination date.

Following the effective date of a reorganization event, the contingent quarterly coupon will be payable for each determination date on which the exchange property value is greater than or equal to the downside threshold price.

In the event exchange property consists of securities, those securities will, in turn, be subject to the antidilution

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adjustments set forth in  
paragraphs 1 through 5.

For purposes of determining whether or not the exchange property value is less than the initial share price or less than the downside threshold price, “exchange property value” means (x) for any cash received in any reorganization event, the value, as determined by the Calculation Agent, as of the date of receipt, of such cash received for one share of the underlying stock, as adjusted by the adjustment factor at the time of such reorganization event, (y) for any property other than cash or securities received in any such reorganization event, the market value, as determined by the Calculation Agent in its sole discretion, as of the

date of receipt, of such exchange property received for one share of the underlying stock, as adjusted by the adjustment factor at the time of such reorganization event and (z) for any security received in any such reorganization event, an amount equal to the closing price, as of the day on which the exchange property value is determined, per share of such security multiplied by the quantity of such security received for each share of the underlying stock, as adjusted by the adjustment factor at the time of such reorganization event.

For purposes of paragraph 5 above, in the case of a consummated tender or exchange offer or going-private transaction involving consideration of particular types, exchange property shall be deemed to include the amount of cash or other property delivered by the offeror in the tender or exchange offer (in an amount determined on the basis of the rate of exchange in such tender or exchange offer or going-private transaction). In the event of a tender or

exchange offer or a going-private transaction with respect to exchange property in which an offeree may elect to receive cash or other property, exchange property shall be deemed to include the kind and amount of cash and other property received by offerees who elect to receive cash.

Following the occurrence of any reorganization event referred to in paragraph 5 above, all references in this offering document and in the related product supplement with respect to the securities to “the underlying stock” shall be deemed to refer to the exchange property and references to a “share” or “shares” of the underlying stock shall be deemed to refer to the applicable unit or units of such exchange property, unless the context otherwise requires.

No adjustment to the adjustment factor will be required unless such adjustment would require a change of at least 0.1% in the adjustment factor then in effect. The adjustment factor

resulting from any of the adjustments specified above will be rounded to the nearest one hundred-thousandth, with five one-millionths rounded upward. Adjustments to the adjustment factor will be made up to the close of business on the final determination date.

No adjustments to the adjustment factor or method of calculating the adjustment factor will be required other than those specified above. The adjustments specified above do not cover all events that could affect the determination closing price or the final share price of the underlying stock, including, without limitation, a partial tender or exchange offer for the underlying stock.

The Calculation Agent shall be solely responsible for the determination and calculation of any adjustments to the adjustment factor or method of calculating the adjustment factor and of any related determinations and calculations with respect to any distributions of stock,

other securities or other property or assets (including cash) in connection with any corporate event described in paragraphs 1 through 5 above, and its determinations and calculations with respect thereto shall be conclusive in the absence of manifest error.

The Calculation Agent will provide information as to any adjustments to the adjustment factor or to the method of calculating the amount payable at maturity of the securities made pursuant to paragraph 5 above upon written request by any investor in the securities.

**Trustee:**

The Bank of New York Mellon

**Calculation agent:**

MS & Co.

**Issuer**

In the event that the

**notices to registered security holders, the trustee and the**

maturity date is postponed due to postponement of the final determination date, the issuer shall give notice of such

**depository:**

postponement and, once it has been determined, of the date to which the maturity date has been rescheduled (i) to each registered holder of the securities by mailing notice of such postponement by first class mail, postage prepaid, to such registered holder's last

address as it shall appear upon the registry books, (ii) to the trustee by facsimile, confirmed by mailing such notice to the trustee by first class mail, postage prepaid, at its New York office and (iii) to The Depository Trust Company (the “depository”) by telephone or facsimile confirmed by mailing such notice to the depository by first class mail, postage prepaid. Any notice that is mailed to a registered holder of the securities in the manner herein provided shall be conclusively presumed to have been duly given to such registered holder, whether or not such registered holder receives the notice. The issuer shall give such notice as promptly as possible, and in no case later than (i) with respect to notice of postponement of the maturity date, the business day immediately preceding the scheduled maturity date and (ii) with respect to notice of the date to which the maturity date has been rescheduled, the business day immediately following the final determination date as postponed.

In the event that the securities are subject to early redemption, the issuer shall, (i) on the business day following the applicable determination date, give notice of the early redemption and the early redemption payment, including specifying the payment date of the amount due upon the early redemption, (x) to each registered holder of the securities by mailing notice of such early redemption by first class mail, postage prepaid, to such registered holder's last address as it shall appear upon the registry books, (y) to the trustee by facsimile confirmed by mailing such notice to the trustee by first class mail, postage prepaid, at its New York office and (z) to the depositary by telephone or facsimile confirmed by mailing such notice to the depositary by first class mail, postage prepaid, and (ii) on or prior to the early redemption date, deliver the aggregate cash amount due with respect to the securities to the trustee for delivery to the depositary, as holder of the securities. Any notice that



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is mailed to a registered holder of the securities in the manner herein provided shall be conclusively presumed to have been duly given to such registered holder, whether or not such registered holder receives the notice. This notice shall be given by the issuer or, at the issuer's request, by the trustee in the name and at the expense of the issuer, with any such request to be accompanied by a copy of the notice to be given.

The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee, on which notice the trustee may conclusively rely, and to the depositary of the amount of cash to be delivered as contingent quarterly coupon, if any, with respect to each security on or prior to 10:30 a.m. (New York City time) on the business day preceding each contingent payment date, and (ii) deliver the aggregate cash amount due, if any, with respect to the contingent quarterly coupon to the trustee for delivery to the depositary, as holder of the securities, on the applicable contingent payment date.

The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee, on which notice the trustee may conclusively rely, and to the depository of the amount of cash, if any, to be delivered with respect to the securities, on or prior to 10:30 a.m. (New York City time) on the business day preceding the maturity date, and (ii) deliver the aggregate cash amount due with respect to the securities, if any, to the trustee for delivery to the depository, as holder of the securities, on the maturity date.

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Additional Information About the  
Securities

**Additional  
Information:**

**Listing:** The securities will not be listed on any securities exchange.

**Minimum ticketing size:** \$1,000 / 100 securities

**Tax considerations:** **Prospective investors should note that the discussion under the section called “United States Federal Taxation” in the accompanying product supplement does not apply to the securities issued under this document and is superseded by the following discussion.**

The following is a general discussion of the material U.S. federal

income tax consequences and certain estate tax consequences of the ownership and disposition of the securities. This discussion applies only to investors in the securities who:

- purchase the securities in the original offering; and

- hold the securities as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the “Code”).

This discussion does not describe all of the tax consequences that may be relevant to a holder in light of the holder’s particular circumstances or to holders subject to special rules, such as:

- certain financial institutions;

- insurance companies;
- certain dealers and traders in securities or commodities;
- investors holding the securities as part of a “straddle,” wash sale, conversion transaction, integrated transaction or constructive sale transaction;
- U.S. Holders (as defined below) whose functional currency is not the U.S. dollar;
- partnerships or other entities classified as partnerships for U.S. federal income tax purposes;
- regulated investment companies;
- real estate investment trusts; or
- tax-exempt entities, including “individual retirement accounts” or “Roth IRAs” as defined in Section 408 or 408A of the Code, respectively.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds the securities, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. If you are a partnership holding the securities or a partner in such a partnership, you should consult your tax adviser as to the particular U.S. federal tax consequences of holding and disposing of the securities to you.

As the law applicable to the U.S. federal income taxation of instruments such as the securities is technical and complex, the discussion below necessarily represents only a general summary. The effect of any applicable state, local or non-U.S. tax laws is not discussed, nor are any alternative

minimum tax consequences or consequences resulting from the Medicare tax on investment income. Moreover, the discussion below does not address the consequences to taxpayers subject to special tax accounting rules under Section 451(b) of the Code.

This discussion is based on the Code, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date hereof, changes to any of which subsequent to the date hereof may affect the tax consequences described herein. Persons considering the purchase of the securities should consult their tax advisers with regard to the application of the U.S. federal income tax laws to their particular situations as well as any tax consequences arising under the

laws of any state,  
local or non-U.S.  
taxing jurisdiction.

### **General**

Due to the absence of statutory, judicial or administrative authorities that directly address the treatment of the securities or instruments that are similar to the securities for U.S. federal income tax purposes, no assurance can be given that the IRS or a court will agree with the tax treatment described herein. We intend to treat a security for U.S. federal income tax purposes as a single financial contract that provides for a coupon that will be treated as gross income to you at the time received or accrued in accordance with your regular method of tax accounting. In the opinion of our counsel, Davis Polk & Wardwell LLP, this treatment of the securities is



reasonable under current law; however, our counsel has advised us that it is unable to conclude affirmatively that this treatment is more likely than not to be upheld, and that alternative treatments are possible.

Moreover, our counsel's opinion is based on market conditions as of the date of this preliminary pricing supplement and is subject to confirmation on the pricing date.

**You should consult your tax adviser regarding all aspects of the U.S. federal tax consequences of an**

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**investment in the securities  
(including possible alternative  
treatments of the securities).  
Unless otherwise stated, the  
following discussion is based on  
the treatment of each security as  
described in the previous  
paragraph.**

#### **Tax Consequences to U.S. Holders**

This section applies to you only if you are a U.S. Holder. As used herein, the term “U.S. Holder” means a beneficial owner of a security that is, for U.S. federal income tax purposes:

- a citizen or individual resident of the United States;
  
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state thereof or the District of Columbia; or

· an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

*Tax Treatment of the Securities*

Assuming the treatment of the securities as set forth above is respected, the following U.S. federal income tax consequences should result.

*Tax Basis.* A U.S. Holder's tax basis in the securities should equal the amount paid by the U.S. Holder to acquire the securities.

*Tax Treatment of Coupon Payments.* Any coupon payment on the securities should be taxable as ordinary income to a U.S. Holder at the time received or accrued, in accordance with the U.S. Holder's regular method of accounting for U.S. federal income tax purposes.

*Sale, Exchange or Settlement of the Securities.* Upon a sale, exchange or settlement of the securities, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized on the sale, exchange or settlement and the U.S. Holder's tax basis in the securities sold, exchanged or settled. For this purpose, the amount realized does not include any coupon paid at settlement and may not include sale

proceeds attributable to an accrued coupon, which may be treated as a coupon payment. Any such gain or loss recognized should be long-term capital gain or loss if the U.S. Holder has held the securities for more than one year at the time of the sale, exchange or settlement, and should be short-term capital gain or loss otherwise. The ordinary income treatment of the coupon payments, in conjunction with the capital loss treatment of any loss recognized upon the sale, exchange or settlement of the securities, could result in adverse tax consequences to holders of the securities because the deductibility of capital losses is subject to limitations.

***Possible Alternative Tax Treatments of an Investment in the Securities***

Due to the absence of authorities that directly address the proper tax treatment of the securities, no assurance can be given that the IRS will accept, or that a court will uphold, the treatment described above. In particular, the IRS could seek to analyze the U.S. federal income tax consequences of owning the securities under Treasury regulations governing contingent payment debt instruments (the “Contingent Debt Regulations”). If the IRS were successful in asserting that the Contingent Debt Regulations applied to the securities, the timing and character of income thereon would be significantly affected. Among other things, a U.S. Holder would be required to accrue into income original issue discount on the securities every year at a “comparable yield” determined at the

time of their issuance, adjusted upward or downward to reflect the difference, if any, between the actual and the projected amount of any contingent payments on the securities. Furthermore, any gain realized by a U.S. Holder at maturity or upon a sale, exchange or other disposition of the securities would be treated as ordinary income, and any loss realized would be treated as ordinary loss to the extent of the U.S. Holder's prior accruals of original issue discount and as capital loss thereafter. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the securities, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features.

Other alternative federal income tax treatments of the securities are possible, which, if applied, could significantly affect the timing and character of the income or loss with respect to the securities. In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses on whether to require holders of "prepaid forward contracts" and similar instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the

nature of the underlying property to which the instruments are linked; whether these instruments are or should be subject to the “constructive ownership” rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge; and appropriate transition rules and effective dates. While it is not clear whether instruments such as the securities would be viewed as similar to the prepaid forward contracts described in the notice, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect. U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities, including possible alternative treatments and the issues

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presented by this notice.

***Backup Withholding and  
Information Reporting***

Backup withholding may apply in respect of payments on the securities and the payment of proceeds from a sale, exchange or other disposition of the securities, unless a U.S. Holder provides proof of an applicable exemption or a correct taxpayer identification number and otherwise complies with applicable requirements of the backup withholding rules. The amounts withheld under the backup withholding rules are not an additional tax and may be refunded, or credited against the U.S. Holder's U.S. federal income tax liability, provided that the required information is timely furnished to the IRS. In addition, information returns will be filed with the IRS in connection with payments on the securities and the payment of proceeds from a sale, exchange or other disposition of the securities, unless the U.S. Holder provides proof of an applicable exemption

from the information reporting rules.

**Tax Consequences to Non-U.S. Holders**

This section applies to you only if you are a Non-U.S. Holder. As used herein, the term “Non-U.S. Holder” means a beneficial owner of a security that is for U.S. federal income tax purposes:

- an individual who is classified as a nonresident alien;
- a foreign corporation; or
- a foreign estate or trust.

The term “Non-U.S. Holder” does not include any of the following holders:

- a holder who is an individual present in the United States for 183 days or more in the taxable year of disposition and who is not otherwise a resident of the United States for U.S. federal income tax purposes;
- certain former citizens or residents of the United States; or
- a holder for whom income or gain in respect of the securities is effectively connected with the conduct of a trade or business in the



United States.

Such holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities.

Although significant aspects of the tax treatment of each security are uncertain, we intend to withhold on any coupon paid to a Non-U.S. Holder generally at a rate of 30% or at a reduced rate specified by an applicable income tax treaty under an “other income” or similar provision. We will not be required to pay any additional amounts with respect to amounts withheld. In order to claim an exemption from, or a reduction in, the 30% withholding tax, a Non-U.S. Holder of the securities must comply with certification requirements to establish that it is not a U.S. person and is eligible for such an exemption or reduction under an applicable tax treaty. If you are a Non-U.S. Holder, you should consult your tax adviser regarding the tax treatment of the securities, including the possibility of obtaining a refund of any withholding tax and the certification requirement described above.

***Section 871(m) Withholding Tax on Dividend Equivalents***

Section 871(m) of the Code and Treasury regulations promulgated thereunder (“Section 871(m)”) generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or

deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an “Underlying Security”). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a “Specified Security”). However, pursuant to an IRS notice, Section 871(m) will not apply to securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on the terms of the securities and current market conditions, we expect that the securities will not have a delta of one with respect to any Underlying Security on the pricing date. However, we will provide an updated determination in the pricing supplement. Assuming that the securities do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the securities should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If Section 871(m) withholding is required, we will not be required to pay any additional amounts with respect to the amounts so withheld. You should consult your tax adviser

regarding the potential application  
of Section 871(m) to the securities.

***U.S. Federal Estate Tax***

Individual Non-U.S. Holders and  
entities the property of which is  
potentially includible in such an  
individual's

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gross estate for U.S.  
federal estate tax  
purposes (for  
example, a trust  
funded by such an  
individual and with  
respect to which the  
individual has  
retained certain  
interests or powers)  
should note that,  
absent an applicable  
treaty exemption,  
the securities may  
be treated as  
U.S.-situs property  
subject to U.S.  
federal estate tax.  
Prospective  
investors that are  
non-U.S.  
individuals, or are  
entities of the type  
described above,  
should consult their  
tax advisers  
regarding the U.S.  
federal estate tax  
consequences of an  
investment in the  
securities.

***Backup  
Withholding and  
Information  
Reporting***

Information returns will be filed with the IRS in connection with any coupon payment and may be filed with the IRS in connection with the payment at maturity on the securities and the payment of proceeds from a sale, exchange or other disposition. A Non-U.S. Holder may be subject to backup withholding in respect of amounts paid to the Non-U.S. Holder, unless such Non-U.S. Holder complies with certification procedures to establish that it is not a U.S. person for U.S. federal income tax purposes or otherwise establishes an exemption. The amount of any backup withholding from a payment to a Non-U.S. Holder will be allowed as a credit against the Non-U.S. Holder's U.S. federal income tax liability and may entitle the Non-U.S. Holder to a refund, provided that the

required  
information is  
timely furnished to  
the IRS.

## **FATCA**

Legislation  
commonly referred  
to as “FATCA”  
generally imposes a  
withholding tax of  
30% on payments to  
certain non-U.S.  
entities (including  
financial  
intermediaries) with  
respect to certain  
financial  
instruments, unless  
various U.S.  
information  
reporting and due  
diligence  
requirements have  
been satisfied. An  
intergovernmental  
agreement between  
the United States  
and the non-U.S.  
entity’s jurisdiction  
may modify these  
requirements.  
FATCA generally  
applies to certain  
financial  
instruments that are  
treated as paying  
U.S.-source interest  
or other U.S.-source  
“fixed or  
determinable annual  
or periodical”  
income (“FDAP  
income”).  
Withholding (if  
applicable) applies

to payments of U.S.-source FDAP income and to payments of gross proceeds of the disposition (including upon retirement) of certain financial instruments treated as providing for U.S.-source interest or dividends. Under recently proposed regulations (the preamble to which specifies that taxpayers are permitted to rely on them pending finalization), no withholding will apply on payments of gross proceeds. While the treatment of the securities is unclear, you should assume that any coupon payment with respect to the securities will be subject to the FATCA rules. If withholding applies to the securities, we will not be required to pay any additional amounts with respect to amounts withheld. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the potential application of FATCA to the securities.

**The discussion in the preceding paragraphs, insofar as it purports to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitutes the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the securities.**

**Use of proceeds and hedging:** The proceeds from the sale of the securities will be used by us for general corporate purposes. We will receive, in aggregate, \$10 per security issued, because, when we enter into hedging transactions in order to meet our obligations under the securities, our hedging counterparty will reimburse the cost of the agent's commissions. The costs of the securities borne by you and described beginning on page 2 above comprise the agent's commissions and the cost of issuing, structuring and hedging the securities.



On or prior to the pricing date, we expect to hedge our anticipated exposure in connection with the securities by entering into hedging transactions with our affiliates and/or third-party dealers. We expect our hedging counterparties to take positions in the underlying stock, in futures and/or options contracts on the underlying stock, or positions in any other available securities or instruments that they may wish to use in connection with such hedging. Such purchase activity could potentially increase the initial share price, and, as a result, the downside threshold price, which is the price at or above which the underlying stock must close on each determination date in order for you to earn a contingent quarterly coupon, and, if the securities are not redeemed prior to maturity, in order for you to avoid being exposed to the negative price performance of the underlying stock at maturity. In

addition, through our affiliates, we are likely to modify our hedge position throughout the term of the securities, including on the determination dates, by purchasing and selling the underlying stock, options contracts relating to the underlying stock or any other available securities or instruments that we may wish to use in connection with such hedging activities, including by purchasing or selling any such securities or instruments on one or more determination dates. As a result, these entities may be unwinding or adjusting hedge positions during the term of the securities, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the final determination date approaches. We cannot give any assurance that our hedging activities will not affect the value of the underlying stock, and, therefore, adversely affect the value of the

securities or the payment you will receive at maturity, if any. For further information on our use of proceeds and hedging, see “Use of Proceeds and Hedging” in the accompanying product supplement for auto-callable securities.

**Benefit plan investor considerations:** Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) (a “Plan”), should consider the fiduciary standards of ERISA in the context of the Plan’s particular circumstances before authorizing an investment in the securities. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our affiliates, including MS & Co., may each be considered a “party in interest” within the meaning of ERISA, or a “disqualified person” within the meaning of the Internal Revenue Code of 1986, as amended (the “Code”), with respect to many Plans, as well as many individual retirement accounts and

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Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also “Plans”). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the securities are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the securities are acquired pursuant to an exemption from the “prohibited transaction” rules. A violation of these “prohibited transaction” rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for those persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions (“PTCEs”) that may provide exemptive relief for direct or indirect prohibited transactions

resulting from the purchase or holding of the securities. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Code Section 4975(d)(20) provide an exemption for the purchase and sale of securities and the related lending transactions, provided that neither the issuer of the securities nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than “adequate consideration” in connection with the transaction (the so-called “service provider” exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to transactions involving the securities.

Because we may be considered a party in interest with respect to many Plans, the securities may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) or any person investing “plan assets” of any Plan, unless such purchase, holding or disposition is eligible for

exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibited. Any purchaser, including any fiduciary purchasing on behalf of a Plan, transferee or holder of the securities will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the securities that either (a) it is not a Plan or a Plan Asset Entity and is not purchasing such securities on behalf of or with “plan assets” of any Plan or with any assets of a governmental, non-U.S. or church plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code (“Similar Law”) or (b) its purchase, holding and disposition of these securities will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any Similar Law.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the securities on behalf of or with “plan assets” of any Plan consult with their counsel regarding the availability of exemptive relief.

The securities are contractual financial instruments. The financial exposure provided by the securities is not a substitute or proxy for, and

is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the securities. The securities have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the securities.

Each purchaser or holder of any securities acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (A) the design and terms of the securities, (B) the purchaser or holder's investment in the securities, or (C) the exercise of or failure to exercise any rights we have under or with respect to the securities;

(ii) we and our affiliates have acted and will act solely for our own account in connection with (A) all transactions relating to the securities and (B) all hedging transactions in connection with our obligations under the securities;

(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are



not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests are adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Each purchaser and holder of the securities has exclusive responsibility for ensuring that its purchase, holding and disposition of the securities do not violate the prohibited transaction rules of ERISA or the Code or any Similar Law. The sale of any securities to any Plan or plan subject to Similar Law is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by plans generally or any particular plan, or that such an investment is appropriate for plans generally or any particular plan. In this regard, neither this discussion nor anything

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provided in this document is or is intended to be investment advice directed at any potential Plan purchaser or at Plan purchasers generally and such purchasers of these securities should consult and rely on their own counsel and advisers as to whether an investment in these securities is suitable.

However, individual retirement accounts, individual retirement annuities and Keogh plans, as well as employee benefit plans that permit participants to direct the investment of their accounts, will not be permitted to purchase or hold the securities if the account, plan or annuity is for the benefit of an employee of Morgan Stanley or Morgan Stanley Wealth Management or a family member and the employee receives any compensation (such as, for example, an addition to

bonus) based on the purchase of the securities by the account, plan or annuity.  
Client accounts over which Morgan Stanley, Morgan Stanley Wealth Management or any of their respective subsidiaries have investment discretion are not permitted to purchase the securities, either directly or indirectly.

**Additional considerations:** The agent may distribute the securities through Morgan Stanley Smith Barney LLC (“Morgan Stanley Wealth Management”), as selected dealer, or other dealers, which may include Morgan Stanley & Co. International plc (“MSIP”) and Bank Morgan Stanley AG. Morgan Stanley Wealth Management, MSIP and Bank Morgan Stanley AG are affiliates of ours. Selected dealers, including Morgan Stanley Wealth Management, and their financial advisors will collectively receive from the agent, Morgan Stanley & Co. LLC, a fixed sales commission of \$0.20 for each security they sell. In addition, Morgan Stanley Wealth Management will receive a structuring fee of \$0.05 for each security.

MS & Co. is an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley, and it and other affiliates of ours expect to make a profit by selling, structuring and, when

applicable, hedging the securities. When MS & Co. prices this offering of securities, it will determine the economic terms of the securities such that for each security the estimated value on the pricing date will be no lower than the minimum level described in “Investment Summary” beginning on page 2.

MS & Co. will conduct this offering in compliance with the requirements of FINRA Rule 5121 of the Financial Industry Regulatory Authority, Inc., which is commonly referred to as FINRA, regarding a FINRA member firm’s distribution of the securities of an affiliate and related conflicts of interest. MS & Co. or any of our other affiliates may not make sales in this offering to any discretionary account. See “Plan of Distribution (Conflicts of Interest)” and “Use of Proceeds and Hedging” in the accompanying product supplement for auto-callable securities.

**Contact:**

Morgan Stanley Wealth Management clients may contact their local Morgan Stanley branch office or our principal executive offices at 1585 Broadway, New York, New York 10036 (telephone number (866) 477-4776). All other clients may contact their local brokerage representative. Third-party distributors may contact

Morgan Stanley Structured Investment Sales at (800) 233-1087.

**Where you can find more information:** Morgan Stanley and MSFL have filed a registration statement (including a prospectus, as supplemented by the product supplement for auto-callable securities) with the Securities and Exchange Commission, or SEC, for the offering to which this communication relates. You should read the prospectus in that registration statement, the product supplement for auto-callable securities and any other documents relating to this offering that Morgan Stanley and MSFL have filed with the SEC for more complete information about Morgan Stanley, MSFL and this offering. You may get these documents without cost by visiting EDGAR on the SEC web site at [www.sec.gov](http://www.sec.gov). Alternatively, Morgan Stanley, MSFL, any underwriter or any dealer participating in the offering will arrange to send you the product supplement for auto-callable securities and prospectus if you so request by calling toll-free 1-(800)-584-6837.

You may access these documents on the SEC web site at [www.sec.gov](http://www.sec.gov) as follows:

**Product Supplement for  
Auto-Callable Securities  
dated November 16, 2017**

**Prospectus dated  
November 16, 2017**

Terms used but not defined in this document are defined in the product supplement for auto-callable securities or in the prospectus.

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