

Q4 2016 Earnings Call

Company Participants

- Adriano Rudek de Moura, Chief Financial Officer
- Antonio Sérgio de Souza Guetter, Chief Executive Officer & Director
- Franklin Kelly Miguel, Chief Executive Officer
- Luiz Eduardo da Veiga Sebastiani, Chief Financial Officer & Investor Relations Officer
- Sergio Luiz Lamy, Chief Executive Officer
- Unverified Participant

Other Participants

- Caio Carvalhal, Analyst
- Caio Lombardi, Analyst
- Maria Carolina Carneiro, Analyst
- Miguel Rodrigues, Analyst
- Pedro Manfredini, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for standing by. Welcome to Companhia Paranaense de Energia Copel's earnings call to discuss the results of the fourth quarter of 2016. All participants are in listen-only mode during the company's presentation. Later, we will hold a Q&A session when further instructions will be given.

Before proceeding, we should mention that forward-looking statement that might be made during this conference call related to Copel business outlook, projections, operating, and financial projections are based on belief and assumptions of the company's management and on information currently available to the company. Forward-looking statements are no guarantee of performance. They involve risks, uncertainties and assumptions because they relate to future events, and therefore depend on circumstances that may or may not occur. General economic conditions, industry conditions, and other operating factors may also affect the future results of Copel and could cause results to differ materially from those expressed in such forward-looking statements.

With us today in this conference call, Mr. Antonio Sérgio de Souza Guetter, CEO of Copel; Mr. Luiz Eduardo da Veiga Sebastiani, CFO and IR Officer; Mr. Gilberto Mendes Fernandes, Chief Corporate Management Officer; Mr. Fabio Malina Losso, Chief Governance, Risk & Compliance Officer; Mr. Sergio Luiz Lamy; CEO of Copel Geração and Transmissão; Mr.

Ricardo Goldani Dosso, CEO of Copel Renováveis; Mr. Adir Hannouche, CEO of Copel Telecomunicação SA; and Mr. Franklin Kelly Miguel, CEO of Copel Energia.

The presentation will be delivered by Copel's management and may be followed on the company's website at www.copel.com/ir.

Now, I will...

(03:04-03:15)

Unverified Participant

...as our Copel colleagues call him. Guetter started in Copel after being approved in a civil service exam in 1987, (03:24) trajectory in the company, his professional background includes several technical and management positions. And I highlight a few of them.

CEO of Fundação Copel de Assistência e Previdência Social, CEO of Copel Renováveis, CFO and IR Officer of Copel, and recently CEO, of Copel Distribuição, when he was able to follow all the regulatory challenges and the success on the 4th Tariff Review Cycle. At the time, our distribution company doubled its net remuneration basis, an important step to business perpetuity.

Therefore, I now turn the floor to our CEO for his initial remarks. Guetter, welcome.

Antonio Sérgio de Souza Guetter

Thank you very much, Sebastian (04:08). Thank you all colleagues here from Copel. Good morning, everyone. Before anything else, I would like to thank you, Vianna, for the work he has done. And he's leaving us today. And also, I'd like to thank all the executives that have worked with us. And also, on behalf of Copel, I want to congratulate Luiz Fernando Vianna for being appointed CEO of Itaipu Binacional, which I considered to be a great achievement for Copel and Paraná. (04:41) is renowned Paranaense in the domestic electric industry, and I'm sure he will be great in managing the company. And I hope we have an important partnership or so.

I have accepted Governor (04:58) invitation with a commitment to keeping Copel in the excellent growth pace, always focusing on projects with the right profitability in order to maximize the company value. We will aim more efficiency and greater sustainability without losing sight, of course, of our well-known quality. And also, we are concentrating on safety. We'll keep on working with ethics. And this is a commitment strengthened by the development of our governance, risk and compliance area which improves even further the company's management.

And this is an area that I helped structuring in 2016. Our challenges are not limited to running the company creating such goals. Brazil is going through complex times. The

country's political and economic instability in 2016 resulted in difficult state for the domestic productive industry, and there are low levels of energy consumption in general.

That's an area brought major challenges upon the energy industry and Copel. And we are going to discuss that along with the presentation. And despite of an adverse environment, we have invested BRL 3.6 billion in 2016, a record amount for us. Out of the total, around BRL 600 million paid rent done related to the 30-year concession of Parigot de Souza HPP, a landmark for Paraná's engineering in the coast of Paraná.

Consolidating the right decision of not anticipating the concession renewal of that asset in 2012 with that (06:50). Construction works have advanced in Colider HPP. We resumed works in (06:56), invested BRL 720 million in the construction of Cutia wind farm complex in Rio Grande do Norte.

In the transmission segment, we have concluded an important work with over 2,700 kilometers of transmission lines. We had six projects totaling an increase of BRL 198 million in (07:19). In the beginning of 2017, we energized (07:24) substation and the transmission line connecting it to (07:29) substation in the southeast of Paraná. It's part of (07:33) happened 50 days ahead of the date established (07:37) adding BRL 7 million to our revenue.

Still about the transmission segment, in 2016, we had developed on the RBSE indemnification. As you already know, the Ministry of Mines and Energy had determined the incorporation of RBSE in the regulatory remuneration basis, the restatement of assets valued (07:59) since 2012, and payment of indemnification by (08:02) starting on 2017 (08:06).

On February of 2017, and now recently issued Technical Note 23, establishing procedures and criteria to pay both (08:18) indemnification, and based on the same parameters, we remeasured the assets related to the RBSE, allowing us to post BRL 809 million to the revenue from the power grid used for 2016. It is worth noting that the indemnification will be received for a period of eight years as of July 2017, and that now has not ratified Copel's final report. Therefore, figures posted are based on this administration best estimate.

Another highlight was the creation of Copel Comercialização, a company focused on the energy commercialization for the free market, especially dedicated to the retail market having as a back up to the energy to be generated by Copel G&T, as agreed in a contract signed by the subsidiaries. In the Telecommunications segment, we have consolidated Copel Telecom as one of the main players of broadband in Paraná with record sales every month providing the fastest Internet in the country. Our grid has over 29,000 kilometers of optic fiber, and it reaches all 399 municipalities in the State of Paraná.

As you can see on slide 4, in the Distribution segment, our quality indicators show a significant performance. Our ELT (09:56) equivalent length of interruption per customer was 10.82 and EFC 7.23. These figures represent, respectively, an increase of 21%, 13% vis-à-vis 2015, and allow Copel Distribuição to be well positioned in order to meet

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required indicators to hold the concession. Really, this is an amazing result, very good. Nevertheless and despite of constant improvements in quality, the economic downturn is still affecting the results of the Distribution segment.

In 2016, consumption of the grid market, which includes captive market and all free consumers in Paranaense have dropped 2%, a revenue loss of BRL 90 million. And despite of the impact in consumption, the economic crisis has also caused delinquency rate to increase, especially in the beginning of 2016, when it reached 2% of total sales. Along the year, we worked to bring down delinquencies and helped to buy tariff reversion. 2016 ended at the rate of 1.6%, same level at the beginning of 2015, although a little over Copel historic figures.

Still, 2016 closed with allowance for doubtful debts at BRL 161 million (sic) [BRL 171 million] (11:29), BRL 123 million above the tariff coverage estimated for the year. I also would like to stress the modernization that we have done in Copel distribution networks. We installed automatic equipment, top equipment that improved quality and now to reduce cost. And also, that opens the possibility to offer new and non-regulated services connected to the distribution network. All of that happened because we had a survey of employee satisfaction, although we have significantly reduced our head count in our PMSO.

Finally, we should stress that the company, following the best accounting practices, reviewed the recoverable value of its assets by applying impairment tests, which resulted in the recording of BRL 582 million in loss provision for 2016, especially because of CapEx increase for projects under construction, low probability to start up Araucária TPP this year, and the one (12:51) scenario for gas sales by Compagas.

Very well. Well, I think I should say that we have management that is aiming for excellence and financial discipline. That's what we are trying to bring to you. Now, I would turn the floor to our CFO and IR Officer, Luiz Eduardo da Veiga Sebastiani, who will comment further on our results.

Luiz Eduardo da Veiga Sebastiani {BIO 17969160 <GO>}

Thank you very much, CEO Guetter. Now, turning to slide 5. Operating revenue was down 4% in the fourth quarter of 2016 vis-à-vis 4Q 2015, amounting to BRL 3.4 billion. And that was especially because of a 31% decrease in the electricity sales revenue that can be explained by an average drop of 13% in tariff in June, also because of the 4th Tariff Review Cycle of Copel Distribuição and the decrease of 13% of the captive market with the migration of customers to the free market.

Revenue from electricity sales totaled BRL 681 million and increased 10% showing the higher CTEE (14:08) revenue because of Copel Distribuição overcontracting which sold remaining energy in the short-term market. Revenue from the use of the power grid grew 23%, thanks to parts of the (14:23) increase, so a result of the 4th Tariff Review Cycle of Copel Distribuição, and to 17% increase in Copel G&T's rep fees (14:33) vis-à-vis 4Q 2015, as a result of the start-up of new transmission assets and the adjustment of contracts for inflation in the period.

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Other operating revenue, including telecom, gas distribution, and others posted a growth of 21%, a 32% increase in Copel Telecom revenue., thanks to the client base expansion, while posting of the fair value of the distribution concessions' indemnified assets dropped to 39%, reflecting the lower financial asset balance due to concession agreement renewal in December of 2015.

About this, a detailed explanation. In the 4Q 2015, the company reviewed its main accounting policies and reclassified from financial revenue to operating revenue the fair value of the distribution concessions' indemnified assets. That reclassification stems from the understanding that the infrastructure built by the public distribution service concessionaries should be based on the new replacement value, which aims to adjust operating cash flow of the unamortized investments that will be indemnified at the end of the concession agreement.

On slide 6, costs and operating expenses totaling in BRL 3.4 billion in 4Q 2016, 36% higher than the same period of 2015, mainly because of BRL 604 million in provisions and reversals. Of those, BRL 567 million referred to impairment of gas generation and distribution assets, as explained by our CEO, and other BRL 52 million related to ADD (16:38).

Cost with electricity purchase amounted BRL 1.3 billion, up 24% vis-à-vis the same period of 2015, resulting in higher hydrologic asset in (16:57) 4Q 2016, and comparison (17:01) with the posting of BRL 135 million recovered from the cost of energy purchase with the renegotiation of GFL (17:12) in 4Q 2015. Charges for grid use were down 38%, thanks to lower costs with system service charges because of lower thermal dispatch out of the order of merit. Managerial costs were up 4% in 4Q 2016, reflecting an increase of 8.7% with personnel, partially offset by lower costs without outsourced services.

Turning to slide 7. Our EBITDA was 78% lower than the amount recorded in 4Q 2015 amounting BRL 254 million in the fourth quarter of 2016, with the margin of 7% on the operating revenue. This drop is a result of the recording of BRL 567 million in impairments of gas generation and distribution assets, and of the 2% decrease in the grid market of Copel Distribuição. In 2016, cash generation for Copel G&T accounted for 75% of the consolidated EBITDA. Copel Distribuição and Copel Telecom accounted for 4% each. And other companies in the group added 17%, main contribution coming from (18:29).

On slide 8, consolidated net income for Copel in the fourth quarter, the company's result was negative in BRL 110 million, vis-à-vis net income of BRL 402 million profit in the same period of 2015. Analyzing the subsidiaries' results, we see that Copel Geração and Distribuição closed the quarter with a loss of BRL 144 million. Copel Distribuição posted net income of BRL 71 million and Copel Telecom net income of around BRL 20 million. For 2016, the company posted net income of BRL 948 million, a net margin of 7.2%.

Very well, these were our highlights. We are now available for your questions. Thank you very much.

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Q&A

Operator

Thank you. We will now start our Q&A session. Our first question is from Mr. Caio from Brasil Plural. Mr. Caio? Mr. Caio, please?

Q - Caio Carvalho {BIO 16605563 <GO>}

Hello. Good morning. My question – actually, I have two questions. First, I would like to focus on Araucária. We have seen that Araucária has not been dispatched in 2016 and did have a relevant impact in the prior year. We see that it's around BRL 240 (20:20). That was significant, but it is still much lower than the marginal cost pre-review of the parameters that we are working on. So, we have that amount pre-review for regulatory parameters. And I would like to understand what is the expectation for Araucária's dispatch, if you see possibilities of Araucária being dispatched out of the order of merit and how do you see that operation of the parameter that should happen starting on May for Araucária?

My second question, if you allow me, is more of an update. We see that there is a greater impact in the migration of captive consumer to free consumer in the fourth quarter of 2016. Can you tell us how that is going in the first quarter of 2017? Is it still at the same pace or not? These are my two questions. Thank you.

A - Operator

Thank you, Caio. I will turn the floor to Sergio Lamy, CEO of Copel Geração and Transmissão.

A - Sergio Luiz Lamy

Good morning, Caio. About Araucária HPP, we are following up and close all the perspectives for the energy scenario in 2017. And the scenario is deteriorating itself a lot. We have a very discouraging expectation for wind energy for 2017 to be low. So, our expectation is that this recent scenario will cause the possibility of dispatching Araucária even if it is out of the order of merit still in 2017.

Q - Caio Carvalho {BIO 16605563 <GO>}

And the second question, about the migration from the captive market to the free market?

A - Franklin Kelly Miguel

This is Franklin, CEO of Copel Energia and Copel Comercialização. Yes. Good morning. In fact, the migration for this year is much lower than last year. And that is explained by what (23:00) consumers were migrating because the energy is still more expensive. And so, the consumers that are migrating now in 2017, they're migrating because they decided to do it in 2016. But most consumers should stay in the captive market.

Q - Caio Carvalho {BIO 16605563 <GO>}

Thank you very much.

Operator

Our next question is from (23:54) from HSBC. (23:58)?

Thank you for this opportunity. I have a question about the impairment in the generation assets, especially in Cutia wind farm. If you can tell us more how much that come from CapEx, how much that come from discount, and what do you expect in terms of return in these projects? And on this line, I also would like to know what is Copel's strategy and Copel's priority for this year for cash use? Is that BRL 2 billion for CapEx in the year not including possible new auctions or new acquisitions? So, what can we expect there? Thank you.

A - Luiz Eduardo da Veiga Sebastiani {BIO 17969160 <GO>}

Good morning. Luiz Sebastiani. I will turn to Adriano, our accounting superintendent, but will comment on your first question about the impairment.

A - Adriano Rudek de Moura {BIO 3590957 <GO>}

Good morning, (25:09). About our impairment, as we mentioned, they are now in our wind farm. Two major events that had us recording the impairment, as we mentioned, was CapEx increase and that discount rate.

I believe that the major event was CapEx increase. We did have generators investments that represent 70% to 80% of the provisioned amount. And the discount rate also impact and correspond to that 20% difference.

These are the two major events that happened in 2016. I am sure that this amount impacts our return expectation, but this is something that could have an important impact in the company.

So, now, (26:09), I will turn the floor to Sergio Guetter to talk about investment perspective for this year and also to talk about transmission alliance and transmission investments that will happen. Thank you very much, and congratulations, Mr. Guetter.

A - Antonio Sérgio de Souza Guetter

Thank you very much, (26:29), and it's nice talking to you again. We are reviewing and analyzing investments possibilities and we will review our portfolio and we'll try to focus on Paraná's investment or those that have synergy with investments we already have, so especially an investment for transmission auctions that will happen here in Paraná.

And this probably will happen next year - I'm sorry, will happen next month. And I think that's what we have right ahead. But we want to strengthen our footprint in Paraná. We

want to review our portfolio focusing on strengthening our scale gains here to have investments close by in the state.

Q - Operator

Thank you. Can you tell me if you have a focus on cost reduction, whether in the holding or in the distributor, where there is low-discipline level?

Yes. We have started in the distribution company because it was pressed for cost reduction. We have identified any issues and worked with a cost reduction management, investing in new technologies. And also, redundancy - voluntary redundancy programs. And we intend to expand that to the whole group. So, as I said in the beginning of the presentation, maybe this is one of the pillars for a strict management cost-wise.

Thank you very much.

The next question is from Ms. Carolina Carneiro, Banco Santander. Ms. Carolina?

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Good morning. I just would like to have extra explanation on cost performance. Copel performance in this quarter was a little bit lower, but even then, we are talking about BRL 100 million of EBITDA in the quarter. And comparing that to the regulatory EBITDA potential for Copel, we do have a significant gap.

So, I would like to better understand what is that additional strategy? What is the target to drop costs in Copel and try to close this gap? Even considering the improvement we have seen, the PMSO in the distributor was higher but lower than inflation. So, I would like to understand how the company is going to try to close this gap between the real EBITDA and the regulatory EBITDA. Thank you.

A - Operator

Hello, Carol. We came up with a plan of five years so that we can meet our regulatory levels. We have already started having the results of this plan, which encompass cost reduction. But the main villain here for not reaching our target was really delinquency, especially because of higher price of energy. So, our ADD (30:35) was higher now, so judicial litigation, the market dropped.

So, these were the main villains. But in terms of personnel, we did have a significant reduction. With head count, we did not hire anyone and we had a reduction of 200 people in our head count. So, we do want to work with outsource services. And this is a path. We have to analyze if we are in the right track. And this is something for the long term. And I am sure that we are on the right track.

We also worked rigorously in our ADD (31:26) to bring it down. But unfortunately, we did have a few companies that broke (31:34) large companies that really caught us by surprise. But I believe that everything that could happen on the bad side has already

happened. We are structuring ourselves for ADDs (31:51) and delinquencies, as well as with the litigations. And I believe now we will go back to the right track.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Thank you very much.

Operator

Next question from Mr. Gabriel Simmons (33:21) Itaú BBA. Please Mr. Gabriel (33:25).

Q - Pedro Manfredini {BIO 21633245 <GO>}

Good morning, Guetter and everyone. This is Pedro Manfredini from BBA. I have a quick question about new growth opportunities. We will have an auction of the 24th with (33:40) and Paraná. And I would like to understand what is your mindset for this next auction and a few other transition opportunities that might come up along the year? Can we have an idea of the size if Copel is coming in? What is the potential investment? Are you looking for a partner or not?

And as analyzing renewable opportunities, we have seen that in the prior year. You have grown with M&A in renewables and I would say that this is not over. You probably have something ahead for renewables M&A. And I'd like to know if your balance sheet will be able to absorb all these opportunities for growth that you might envision?

A - Operator

Pedro Manfredini, I will turn your question to Mr. Sergio Guetter.

A - Antonio Sérgio de Souza Guetter

About the auction, yes, we are considering the possibilities of going until some of them are partners. And obviously, only if they have a good perspective for us who believe that this is a good possibility. But once again, as I said, we will be working with financial discipline. We are going to do the math, but it seems that we do have a few good investments ahead to take part on.

And about M&A, we are continuing it. So, wait a little bit. I'm just arriving. The company is considering the possibilities maybe for the second half of the year. We might have something new next year. Let's wait for the right moment.

Thank you very much, and it's nice talking to you.

Q - Pedro Manfredini {BIO 21633245 <GO>}

Thank you, Guetter, and congratulations on your new position, and congratulations on your challenge as well. Thank you.

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Operator

Our next question is from Mr. Caio Lombardi, Bradesco. Mr. Caio, the floor is yours.

Q - Caio Lombardi {BIO 17225206 <GO>}

Good morning, everyone. My question is also about investment program. I would like to know about leverage that has reached 3.1 times of EBITDA and your covenant is 3.5 times. So, what do you have in mind there in terms of leverage? Is that in limit or could it reach the covenant figure? Thank you.

A - Operator

Good morning, Caio Lombardi. Yes, in fact, we are paying close attention to that. And we did pay attention to that throughout 2016. We are very little below the covenant. So, the asset management of Copel is always reviewed. Our CEO, Guetter, is already seeing that perspective of allowing asset management and some actions that could be very important for the cash of the company and also for the company's indicators in terms of liquidity.

Also, we have actions that we have started in the prior management with our former CEO Vianna, and now stressed by Guetter to drop costs to have efficient management in the company. We have a lot of challenges to be met. But yes, once again, we are paying close attention to that topic. And we know that this year, we will be betting on a dropbox both (38:21) indicator. This is on a workday every day in the financial area.

And obviously, we are working with all subsidiaries. And we are working on revenue and expenses, and also to increase the efficiency of our company without losing focus on quality, which is an important brand here for Paraná. But we will go deeper on that financial management to drop costs and increase revenue.

Q - Caio Lombardi {BIO 17225206 <GO>}

Thank you very much.

Operator

Next question, from Mr. Miguel Rodrigues from Morgan Stanley. Mr. Miguel?

Q - Miguel Rodrigues {BIO 16533007 <GO>}

Good morning, everyone. Going back to Araucária, what is the situation of the gas contract and (39:22) the situation? How do you foresee the possibility of dispatch this year? And also, what do you expect for Paraná this year?

A - Operator

I will turn the floor to Sergio Lamy, CEO of Copel Geração and Transmissão.

A - Sergio Luiz Lamy

Good morning. About Araucária, we are negotiating. We have not decided yet. Not renew the contract that we had last year with Petrobras because this would entail to a very high amount in terms of generation. So, we are deciding (40:22) a possibility of working with Compagas at a lower rate, a lower value. And we are also negotiating a new gas contract with Petrobras in a way that we can get greater competitiveness for this year. But I believe that the dispatch out of the order of merit will be relevant in 2017, so that we can deal with this unfavorable conditions in the energy market.

And, Miguel, about your second question, this is in our balance sheet that relation of Copel with the State of Paraná Government and the contract of CLC (41:23). We do have the state involved and that the state is paying the interest of that renewal process. And now, we are waiting the state to bring back to effectiveness. If that does not happen, we will go back to the same terms of the contract. But there is no delinquency identified in the process. But because as I said, they have been paying interest, and this is an important asset that Copel has with the debtors. And they are also an important revenue source.

Q - Miguel Rodrigues {BIO 16533007 <GO>}

Thank you very much.

Operator

Our next question is from (43:05) Banco Safra. (43:11), please.

Good morning. I would like to know Copel Distribuição contracting for 2016 and prospective for 2017, and regulatory EBITDA after the 4th Cycle of Tariff Review of the company.

Luisa (43:41), on the over contracting of 2016 I would turn the floor to (43:52), our assistant engineer, for your question.

Good morning, Luisa (43:58). About the over contracting, this is a matter that has been faced by all distributing companies because of what is already has been explained the migration of consumers to the free market out of cost by the economic recession the country went through in 2016. And the prospective there has to do with a regulatory discussion, how these contracts will be taken in higher than what was regulatory estimated, and part of that is on the distribution companies.

And fourth quarter for Copel Distribuição, you can see that there is a reaction. And it seems to be a reaction to the economic situation of the country and a good prospective and the results of fourth quarter of the distribution company. And that places us in a comfortable position because the situation should be mitigated in the beginning of 2017. This is our expectation.

And about your second question. Can you repeat it, please?

After the 4th Cycle of Tariff Review, you had an increase in the regulatory EBITDA. So, what was the amount defined for the regulatory EBITDA in the company?

I will turn the floor to Adriano.

And the level of overcontracting, (45:55) on that? Hello?

A - Antonio Sérgio de Souza Guetter

This is Mr. Guetter. Maybe 2% higher than the limit in overcontracting, but all mechanisms that are now - is placing should eliminate the problem. We do not consider that a problem. We don't think this is a problem. And about the EBITDA, we will have BRL 1 million more in the remuneration base.

Q - Operator

Thank you very much.

Thank you, Luisa (46:36).

Next question, from (46:40). Please, (46:45).

Good morning. What is your forecast for profit in 2017?

We have a crystal ball here that we are just opening. Please bear with us. We don't have that type of forecast. We can't even say anything. But we expect that the market improves. We do have signs of economic recovery in the country. And I'm sure the worst is over. We also have signs of improvement in the electric segment regulatory issues. But in the past, they haven't balanced our industry, but - and we believe that we have good perspective. But of course, the amount, we can't say anything about it.

Thank you.

If there are no further questions, I would like to turn the floor to the company's management for their final remarks.

A - Unverified Participant

Very well. Thank you very much for your question, for participating in this conference call. We are always available to address your questions. Our team of investor relations also is available, so that we are growingly transparent. I feel very honored to be here with you. I am sure that we will have great challenges, but...

(48:48-49:12)

Operator

Please wait while we connect with the company.

[Abrupt End]

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