

## Y 2013 Earnings Call

### Company Participants

- Mario Azevedo de Arruda Sampaio, Head of Capital Markets and Investor Relations
- Rui de Britto Alvares Affonso, Chief Financial Officer and Investor Relations Officer

### Other Participants

- Hasan Doza, Analyst
- Michael Gaugler, Analyst
- Unidentified Participant

### Presentation

#### Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP's conference call to discuss its results for the fourth quarter of 2013. The audio for this conference is being broadcast simultaneously through the Internet on the website, [www.sabesp.com.br](http://www.sabesp.com.br). In that same address, you can also find the slideshow presentation available for download.

We inform you that all participants will be only able to listen to the conference during the Company's presentation. After the Company's remarks are over, there will be a Q&A period. At that time, further instructions will be given. (Operator Instructions).

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of SABESP's management and on information currently available to the Company. Forward-looking statements are not guarantees 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 in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of SABESP and could cause results to differ materially from those expressed in such forward-looking statements.

Today with us we have Mr. Rui Affonso, Chief Financial Officer and Investor Relations Officer; Mr. Mario Arruda Sampaio, Head of Capital Markets and Investor Relations; and Mr. Marcelo Miyagui, Head of Accounting.

Now I'll turn the conference over to Mr. Arruda Sampaio. Sir, you may begin your conference.

## **Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Okay. Well, good afternoon everybody. Thank you for attending one more earnings conference call. We have today a 12 slide presentation and we would like to discuss the main events in the period, but we will focus most of the slides to comment and to discuss the water situation in the Sao Paulo metro region.

Obviously after the presentation, we'll be open for a question and answer session. So let's start on slide three. We have the Company's billed water and sewage volume which moved up 2.8% in the period due to the increase of 2.7% in water connection and 3.5% in sewage connections.

The high temperatures especially in the fourth quarter of last year had a direct impact on the increased consumption of water in (inaudible) also on the sewage volume. This was in line with expected growth of approximately 2.5% in fact a little bit over in billed water volume and between 3% and 3.5% in billed sewage volume. Obviously the later influenced by the Company's continuous investment in expansion of the sewage sector.

Let's move to slide four, we will very briefly comment on our financial results. Net operating revenue grew 5.4% positively affected by the upturn in billed volume and tariff increases. Cost in selling, administrative and construction expenses increased by 4% in the period. As a percentage of net operating revenue these costs and expenses decreased from 73.2% last -- in 2012 to 72.3% in 2013.

Adjusted EBITDA increased by 11.1% from 3.6 billion in 2012 to 4 billion in 2013. The adjusted EBITDA margin came to 35.4% in 2013 versus 33.6% in 2012. Including construction, revenues and cost, the adjusted EBITDA margin came to 44.6% in 2013 against 43% in 2012. Net income totaled 1.92 billion, slight 0.6% increase over 2012.

Now on slide five, we will again very quickly review the main variations in cost in relation to the same period in the previous year. Cost and expenses moved up by 4% over 2012. Excluding construction costs, cost and expenses climbed 6.2% due mostly to the increase of 35.6% in treatment supplies, 10.8 in payroll and benefits, and 10.7% in taxes. On the other hand, credit write-offs expenses fell by 45.9% in the period. You will find more details on our earnings release regarding our costs (inaudible).

So next slide six presents the main variations in the items that affected our net income, which totaled again BRL1.9 billion. Net operating revenues increased by 5.4% or 578 million over 2012. Cost and expenses grew by 4% or 317.9 million below revenue growth. Other operating expenses net of revenues fell by 35.4 million.

Financial revenues and expenses had a negative impact of 187.5 million or net income in the period. Finally, income tax and social contribution increased due to the higher taxable debts [ph].

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Let's move now to slide seven. On this slide and the next slide, in fact we will briefly talk about the Sao Paulo metro region water supply system and more specifically the Cantareira system, which -- which is experiencing a water scarcity. But first, let's understand the Sao Paulo metro region water supply system. The slide shows the map of the system and supply areas as well as the system's capacity and average production in 2013. As you can see the system is very expensive and complex comprising many treatment stations and their respective reservoirs, some of them outside the metro region of Sao Paulo, such as the Cantareira. More than 55,000 kilometers of water networks 1,200 kilometers large water mains, 187 distribution reservoirs and over 6 million water meters.

On this slide, we would like to highlight on one side, the importance of the Cantareira system with the total production capacity of 33 cubic meters per second, which alone supplies water to a population of 10 million in the metro region of Sao Paulo being 8.3 million in a direct basis and 1.7 million on an indirect basis. And also highlight the broad inter-connectivity between the water systems, which allows the transfer and partial exportation of water from one system to the other.

In fact since the hydrological scarcity event of 2004, we have invested heavily in increasing system inter-connectivity precisely to cover part of the supply, water supply in regions where another system is experiencing operational stress or water shortage. As we will see later on, this feature has been today responsible for approximately 20% of the supply now occurring to part of the region normally supplied by the Cantareira system, reducing with this (inaudible) the pressure on the Cantareira reservoir.

Let's now move on to slide -- to the next slide. In fact, in the next three slides, we will show the level of the reservoirs that comprise the Sao Paulo metro region water supply system, and specifically the Cantareira system, as well as information on recent rainfall and temperature conditions in the region, the two most important factors in determining the flow of water to reservoirs and water consumption.

So on slide eight, we show historical data on all of the reservoirs that compose the system between 2003 and '14. As you can see reservoir levels did not recover during the rainy season in the Cantareira, and Alto Tiete systems as they usually did in previous years, highlighting that the Cantareira system has more -- was more affected, in fact, but on the other side of the other systems reservoir levels recovered normally.

In the specific case of the Alto Tiete system, reservoir level recovery would have been even higher had not been -- exporting have not been this system exactly exporting water to serve part of the population covered by the Cantareira systems and this has been occurring since we began the program in February, as we already mentioned.

On slide nine, we show the Cantareira system's monthly reservoir levels since 2003. As you can see unlike in previous year the reservoir level recoveries, which normally occurs in October and continues until March, the rainy season in the Sao Paulo metro region did not happen in this cycle.

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On slide 10, you can see the rainfall in the Cantareira system reservoirs from October to February was substantially lower than the period average, while the temperature in the Sao Paulo metro region was higher than in the same period last year. The rain shortage in the period had a direct impact on water inflow to the Cantareira system reservoirs. As you can see, in January, February and March the inflow was lower than the minimum recorded in the respective month since the system was built in 1973.

As for the high temperatures, it is worth remembering that such conditions increased water consumption and therefore affect all the systems that supply the Sao Paulo metro region. We would like to remind you that the Cantareira system reservoirs are located in the PCJ river basin composed of the Piracicaba, Capivari and Jundiai rivers whose water availability is also responsible for supplying several cities in the interior of Sao Paulo including the city of Campinas and its metropolitan region. The PCJ basin is responsible for supplying water to approximately 20 million people including Sao Paulo metro region population covered by the Cantareira system.

Considering the water situation in the PCJ basin, the National Water Agency, the ANA and the State Electricity and Water Department, DAEE together the public parties responsible for granting water use in this base ordered a reduction in the minimum authorized water outflow from the reservoirs comprising the Cantareira system from 33 cubic meters per second to 27.9 cubic meters per second. So that's immediately complied with measures in the areas covered directly by the Company and passed on the reduction in the same proportion to the municipalities in the Sao Paulo metro regions that are covered by the Cantareira system and receive this water from us on the wholesale basis.

Let's move to slide 11. Here we highlight the Company's initiatives to deal with the low reservoir level of the Cantareira system and its impact on other water supply systems of the Sao Paulo metro region. These are short-term measures aiming to guarantee continuous water supply in the region until the beginning of the next rainy season this October and water availability in fact throughout 2015 cycle. On February 3rd, the Company launched a bonus program for consumers served by the Cantareira system. The program consist of giving a 30% discount in the total bill that is, that includes water and sewage. For consumers who reduced their water consumption by 20% in relation to their average consumption in the last 12 months, that is from February 2013 to January 2014.

This strategy of encouraging rational use, rational use of water and reducing consumption volume was successfully applied by the Company in the water scarcity period that we faced in 2004. In terms of water volume, the goal of the bonus program together with the transfer of water from the Alto Tiete and Guarapiranga system to the areas normally served by the Cantareira system. Another operation initiative is to reduce the pressure on the Cantareira water reservoirs.

So far we have managed to reduce demand and consequently water production in Cantareira system by three cubic meters per second sufficient to meet the previously mentioned limit imposed by the two public agencies ANA and DAEE. The results obtained with the bonus programs are already noticeable. Today we can say that 37% of the population served by the Cantareira system has met the reduction goal and we see a 30% discount on the water and sewage bill.

Regarding the financial impacts of the discounts in revenue decline, we believe it is still too soon to comment on and predict trends for the programs complete cycle, which should last until December. What we know is that there will be an impact and that measures will be taken by management to minimize this impact on the Company's liquidity and financial balance. We will talk about this later on. Another ongoing measure is the implementation of equipment and infrastructure to capture the water available in the Cantareira system reservoir, which is currently below the reservoir gravity outflow level thus impeding its use.

This water availability is being called technical reserve. So the initiative to capture the technical reserves will require investments in equipments and works of approximately 80 million and should be ready for use in June. The volume of the water that we will be able to extract from the technical reserve is equivalent to approximately 20% of the current Cantareira system storage capacity and should be sufficient to supply the population served by this system, by the Cantareira system until the beginning of the rainy season in October and November, this is the scenario that is already considering in a very low, extreme low rainfall, in fact, we're using the lowest observable historical series. So, it's a very conservative projection.

In addition to these measures, we announced today that the Company will extend the bonus program to all municipalities in the Sao Paulo metro region directly served by SABESP. The extension of the program to the other systems is necessary in order to expand the benefit of the bonus to those who do not belong to the Cantareira system and have been saving water and also to regulate consumption in all the supply systems as they can serve part of the population served by another system as it is the current case with the Alto Tiete, Guarapiranga system providing water to the Cantareira system areas.

Now let's move to our next slide, slide 12. On this slide, we would like to show everything that SABESP has done, is doing, and will continue to do in order to maintain regular and quality water supply, specifically in this case, we're showing is for the Sao Paulo metro region. All this is the result of the Company's long-term plan, which is in compliance with and has the consent from all government parties responsible for the long-term planning of water availability and supply in the region.

Between 1995 and 2013, SABESP invested BRL9.3 billion, resulting in an increase of 15 cubic meters per second in water availability, production capacity, transport, preservation and distribution. This means water for an additional 5.5 million people. Just for a comparison, the city of Salvador has 2.9 million people and the city of Fortaleza, 2.6 million people, which means that the increase was enough to serve these two cities joined together.

In numbers in this period our investments have increased water source availability by 14.9 cubic meters per second, increased production capacity by 15.5 cubic meters per second from 57.6 cubic meters per second to 72 -- sorry, 73.2 cubic meters per second, increased treated water reservoir volume by 130,000 cubic meters, added another 175 kilometers of main and 11 kilometers -- 11,000 kilometers [ph] of distribution networks implemented approximately 1.8 million new water connections, reduced water losses and reduced water losses by more than 9%, whatever methodology to estimate water loss is adopted.

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So this is what we have done. Regarding what we're doing to ensure supply in the next four years, we highlight three initiatives amongst several others. The first of which is the water loss reduction program. In this case, the Company has already made relevant progress, but continues working to further reduce losses. In this case, specifically, investments will total 5.9 billion between 2009 and 2020.

On the other hand, it is worth noting that the loss reduction program has time and volume limitations in relation to increasing water availability in the region, which forces us to expand production and water -- to expand production and water sources. This is what we're doing with the construction of a new water system, the Sao Lourenco system, which will expand the water production by 4.7 cubic meters per second. The project has already been contracted and is being implemented at this moment and will absorb investments of BRL2.2 billion and start up is scheduled by 2018.

SABESP's third initiative is the construction of an inter-connection between the Jaguari Reservoir, located in the Paraiba do Sul River basin, which has excess water and the Atibainha reservoir in the PCJ basin, which belongs to the Cantareira system. With this inter-connection, it will be possible to send water from one system to the other in order to improve both systems' balance and water availability. This inter-connection was already included in the water resource steering plan of the Sao Paulo Macro-Metropolis developed by the state water secretary with implementation by 2020.

Due to the more extreme climate variation observed recently and in order to further secure water supply for the 20 million inhabitants that use the PCJ river basin, the Sao Paulo state government and SABESP decided to anticipate its construction, so that the inter-connection will be available as of 2016.

On slide 13, more specifically, you can see that this project provides for the possibility to transfer 5 cubic meters per second to 8 cubic meters per section of water between the Jaguari and the Atibainha reservoirs. Once in place their inter-connection will initially help in the recovery of the Cantareira system reservoir levels, but in general, will reduce systemic risk in several future scenarios benefiting the two regions served that is the PCJ river basin that serves the Sao Paulo metro region and the Paraiba do Sul basin, which in fact also serves partly or greatly the Rio de Janeiro city. Investments in this interconnection include the construction of tunnels, pumping stations, dams, reservoirs totaling approximately 500 million SABESP will be responsible for its application and construction.

Considering on the other hand that the estimated time for the execution of this project varies between 12 months and 14 months as of the beginning of the works, which should be in a couple of months and that the corresponding disbursement should happen between 2014 and '16. We believe that the Company has enough time to make the necessary adjustments to its investment plan and work on adequate funding.

Moving to our last slide, we will talk about the investment plan, and we'll make some additional considerations, beginning with the tariff revision process. As you must all know on March 12 ARSESP held a public hearing on the regulatory agencies proposal for the

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final tariff of SABESP's first tariff revision. At the time SABESP made a presentation in which it explained its methodology for estimating water losses and the different methodologies and criterias available (inaudible) and proposed an alignment now to analyze and measure.

The Company also highlighted an issue in ARSESP's proposal that the Company believes merits [ph] in more detailed discussion more specifically the criteria used for excluding pipelines from the asset base.

But that contributions were delivered to ARSESP on March 17th, contribution deadline was March 19th. The next step in this process is a disclosure by ARSESP on April 10th of the final tariff the PO, and the X factor that is the productivity factor.

Moving to investments, we invested 2.7 billion in 2013, more than -- a number that is -- a figure greater than in 2012. Of the total invested amount 1.1 billion was allocated to water and 1.6 billion in sewage. In terms of geographic distribution, 1.6 billion went to the Sao Paulo metro region and 1.1 billion to the regional systems. Note that the large volume in the regional system is associated with the Onda Limpa, the Clean Wave Program, in fact the largest sewage De-pollution Program in coastal areas in Brazil.

We have also disclosed our new CapEx plan, the Company plans to invest 12.8 billion between 2014 and '18, 3.9 billion of which in water, directly in water, 6.3 billion directly in sewage and 2.5 billion in several water and sewage operation initiatives. This investment plan is an update of the previous plan and incorporates the years of 2017 and '18. It was developed focusing on the expansion of our water and sewage systems so as to expand the coverage of sewage collection and treatment services and increase and protect our water sources in order to meet growing demand in the 363 municipalities we currently operate.

However, this plan was developed and approved before the water scarcity situation became evident in the Sao Paulo metro region, which means that it does not incorporate the immediate investments we're making to face the situation or those previously planned for after 2018 such as the interconnection between the Jaguari and the Atibainha rivers.

Due to the water scarcity situation we're facing and its suspected impacts on cost and revenue as a result of the bonus program and the investments to capture the technical reserve, the Company's management has decided to adopt an immediate contingency plan program on the 2014 budget and reschedule and prioritize annual investments. So that the immediate effects of the measures will minimize the impact on the Company's financial balance and maintain its liquidity in a situation similar to the one observed in the original budget plan.

More specifically the Company has already approved the budget contingency plan and reduction of BRL700 million in 2014. It is important to note that this measure will not necessarily imply in an equally similar decline in the Company's OpEx and CapEx over 2013. But that there will not be a significantly higher increase. Investments for 2014 will be

rescheduled, so that the pressure on the Company's cash flow will be lessened. With these measures, we believe the Company will remain robust from a financial standpoint.

Well, that is what I have to say. Now, we'll open for questions.

## Questions And Answers

### Operator

Thank you. (Operator Instructions). Our first question will come from Michael Gaugler of Brean Capital. Please go ahead.

### Q - Michael Gaugler {BIO 7139923 <GO>}

The afternoon, everyone.

### A - Mario Azevedo de Arruda Sampaio {BIO 16570252 <GO>}

Good afternoon, Michael.

### Q - Michael Gaugler {BIO 7139923 <GO>}

Thank you for the overview on the water supply situation. It was very, very helpful. Certainly -- kind of looking at this, I'm wondering beyond what you've kind of outlined here in the presentation, is it feasible to perhaps drill more wells or even consider adding desalination capacity to augment surface water supplies in the short term?

### A - Mario Azevedo de Arruda Sampaio {BIO 16570252 <GO>}

Michael, I mean, I'm sure that our technical group, the guys that Lee [ph] manage, there they look at all the alternatives. I mean, as you know, the water scarcity in Sao Paulo is -- metro region is (inaudible). There is less water available per capita here than in the dry areas of Brazil. So we believe that the technical group has gone after the most readily available sources and the technical reserve seems to be the quickest way to bring bulk water availability into the system.

I believe perhaps we have not heard from the technical group these alternatives you mentioned. Okay.

### Q - Michael Gaugler {BIO 7139923 <GO>}

Okay. Sure. And then I just have one other question, with the final tariff coming up on April 10th, I believe the last time we spoke and correct me if I'm wrong, that the OpEx reduction language had been reduced. It had been, I believe 600 million and was now roughly 450 million. Just wondering if that's accurate.

### A - Mario Azevedo de Arruda Sampaio {BIO 16570252 <GO>}

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Michael the OpEx reduction in relation to the amount we had in the business plan is lessened. Let me just check the exact number here. Give me a second.

Michael, we're looking at it, but it's definitely not the 600. I just want to see if we can have a better number for you.

**Q - Michael Gaugler** {BIO 7139923 <GO>}

Sure.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Michael, we're looking at it to be more precise, let's do this. You have another question let's take it or move on and before we end the call, I'll let everybody know, okay.

**Q - Michael Gaugler** {BIO 7139923 <GO>}

Okay, okay. That's my only two questions. Feel free to move on.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Okay, we'll -- but we'll answer before we finish here. Okay, thanks.

**Q - Michael Gaugler** {BIO 7139923 <GO>}

Thanks.

**Operator**

Thank you. Our next question will come from Hasan Doza of Water Asset Management. Please go ahead.

**Q - Hasan Doza** {BIO 17222230 <GO>}

Hi, Mario, hi Rui, how are you gentlemen?

**A - Rui de Britto Alvares Affonso** {BIO 5808118 <GO>}

Fine.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Great Hasan.

**Q - Hasan Doza** {BIO 17222230 <GO>}

I have a quick question for you on the tariff. If you look, in the note that was published the 4.67% increase, can you help me understand as to what portion from your understanding is inflation that is included in that 4.7%?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Okay. Let me check that. Hasan, Hasan?

**Q - Hasan Doza** {BIO 17222230 <GO>}

Yeah.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

We -- the exact number, we don't have it right of (inaudible) here. But the inflation component in our view, inflation being, inflation from November to April and there is a projection there, should be the difference --

**A - Rui de Britto Alvares Affonso** {BIO 5808118 <GO>}

(inaudible).

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Okay, the real increase the above inflation increase is around 2.32%. So the difference to 4.67 is inflation.

**Q - Hasan Doza** {BIO 17222230 <GO>}

Got it. That's helpful. So just so I understand it properly, this recommendation that came out earlier in the month, so basically the recommendation from last year, which I believe was also 2.3 and change, so their recommendation of a real increase of 2.3% approximately, that hasn't changed. So it's really that sort of right now where it stands in terms of a 2.3 something percent real increase versus your --

**A - Rui de Britto Alvares Affonso** {BIO 5808118 <GO>}

(inaudible).

**Q - Hasan Doza** {BIO 17222230 <GO>}

That versus your original request I believe was like 13%?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Now, let's put it this way. I don't think you can compare the 2.35 with the 2.32. The 2.35 was an anticipation, because it would be a final one adjustment later on, which never happened. Okay. So that 2.35 was not then clear whether it incorporated inflation or not. In fact, yeah, after all we use the 2.35 as part of inflation. So you can't deduct from what -- at least we can't, we didn't that the 2.35 was the above inflation increase proposed at the time, okay.

So this is your estimate. This is not our estimate, this is your relation, a relation we don't correlate that way, okay. What we see is around 2.35% -- 2.32% above inflation increase bringing the tariff all the way to April application now, okay. That's what we see.

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**Q - Hasan Doza** {BIO 17222230 <GO>}

Perfect. And just to make it apples-for-apples, because I'm -- as you correctly highlight, I'm stripping the inflation out from the 4.67 which I agree with you in your inflation plus is 2.3. And the last question is just to make it apples-to-apples that 2.3 compares with your request of a 13% increase, right. So we should compare the recommending 2.3 and you guys ask for a 13% real increase, something in that magnitude. Correct?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Let me put it this way, when we started the process, we filed our business plan. That business plan, with that level of OpEx, with that level of investment and other variables implies in a 13% increase.

We've been lone in this process, so you can ultimately say, yes, our beginning, our start request [ph] on a very different business plan than today in terms of how much volume will be invested and so forth versus '13. Now, what they're saying is, 2.35 above inflation. Yes, but it's not again the bid/ask situation anymore.

**Q - Hasan Doza** {BIO 17222230 <GO>}

Okay, fair enough. But thank you for the clarification. Thank you.

**Operator**

Our next question will come from (inaudible). Please go ahead.

**Q - Unidentified Participant**

Yeah, hi everyone.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Hi, Havia [ph].

**Q - Unidentified Participant**

How are you? Could you comment on, if you'd still expected that the Sao Paulo royalty tax, which is around BRL300 million to BRL400 million you are paying will be pass through and what's your expectation on the timing for that had we pass through to the tariff?

**A - Rui de Britto Alvares Affonso** {BIO 5808118 <GO>}

Okay. Just a second please. Havia, our understanding is that the royalty, which we don't call royalty, we call transfer, okay, is the pass through. Our understanding that it is suspended until the entire tariff process is concluded. So we don't expect its application anytime soon. There is a lot to do on tariffs still.

**Q - Unidentified Participant**

Thank you. But this will be pass through of entry.?

**A - Rui de Britto Alvares Affonso** {BIO 5808118 <GO>}

Well, that is how it is billed into the contract we signed with the city of Sao Paulo and the state government as a pass through to tariff. Okay.

**Q - Unidentified Participant**

Okay. Thank you.

**A - Rui de Britto Alvares Affonso** {BIO 5808118 <GO>}

Okay.

**Operator**

(Operator Instructions). And there appears to be no further questions at this time, I would like to turn the conference back to SABESP for their final remarks.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Okay. I think we still owe Michael and all you guys an answer on that difference. But Michael, definitely it's not the 600 million. We will see if we can get the information precise out and let you know, okay. But it's definitely less, it's closer to the 350 million difference, okay.

So said that, I want to thank everybody for attending the call, myself and Angela, we are available here in the Investor Relation area and hope to be seeing talking to you soon. Thank you.

**Operator**

Ladies and gentlemen, the conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines. And once again, the SABESP conference call has ended. You may now disconnect your lines.

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