

Q1 2019 Earnings Call

Company Participants

- Gustavo Henrique Santos de Sousa, Executive VP of Finance & IR Officer
- Paulo Rog rio Caffarelli, CEO

Other Participants

- Andr a Martins, Analyst
- Eduardo Nishio, Financial Sector Analyst, Research Division
- Eduardo Rosman, Analyst, Research Division
- Felipe Gaspar Salomao, Analyst, Research Division
- Giuliana Agrumi, Analyst
- Rafael Berger Frade, Research Analyst

Presentation

Operator

Good morning, everyone. And thank you for waiting. Welcome to Cielo First Quarter of 2019 Results Conference Call. With us here today, we have Mr. Paulo Caffarelli, Gustavo Sousa and Victor Schabbel. This event is being recorded. (Operator Instructions)

This event is also being broadcast live via webcast and may be accessed through Cielo website at <http://ri.cielo.com.br/en> where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Those following the presentation via the webcast may post their questions on our website. They will be answered by the IR team after the conference is finished.

Before proceeding, let me mention that forward statements are based on the beliefs and assumptions of Cielo management and on information currently available to the company. They involve risks and uncertainties because they relate to future events. And therefore, depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. Paulo Caffarelli. Mr. Caffarelli, you may proceed with the presentation, sir.

Paulo Rog rio Caffarelli

A good morning to all of you. I would like to greet you and thank you for participating in our conference call.

We're going to begin with our results and strategies. The results that we are showing you today show that we are aligned with the strategy when we took over Cielo last year. Our commitment is to guarantee the best experience and the best final cost for our clients. I am not referring to one or another isolated action.

Cielo has a medium; and long-term commitment with its clients as well as with its shareholders. And you can be sure that we have carefully analyzed this combination to guarantee the lowest cost of the full package, which is what is expected in the market. That is why the evaluation of the payment means industry should not be done only basing yourselves on the net revenue curve. This is a medium; and long-term result. Our results show that we are doing well and continue heading the sector.

This month, we concluded the restructuring of the company, focusing on the creation of 3 business units: Large Accounts, Retail and Entrepreneurs. And Cielo, up to this point, did not work with Entrepreneurs. And while reorganizing the operational area, we hope to have better logistics service.

When we speak about acquirers, this is a commodity product. We have prices, we have the product per se, technology, marketing. But what is more important is the customer's experience ever more because of their empowerment.

Additionally, we are active in all of the market segments. And we have reached Entrepreneurs that invoice up to BRL 120,000 a year. Formerly, they were not part of our focus. We have broken with that (inaudible) of not selling machines. Our company has sold more than 600 machines in only one year. Only last week, during the launch of our campaign to sell machines, we had an increase of 35% in sales.

As we have promised, we have also enhanced our sales force. We went from 700 associates working in sales to 2,200 salespeople in practice. This means that the 700 that were active will now act as farmers in offices and offering services to clients. And we have 1,000 new associates that are now focusing on the prospection of new clients. Our goal in this case is to reach a prospection of 2,000 customers per day. And up to present, we're at 1,600 new customers per day for Cielo.

We are revising all of our expense liners -- lines to have an operational enhancement. Our company has to have the size, enabling it to generate businesses and results. And according with -- to our commitment for the best customer experience, we had an increase in average satisfaction. Since 2016, we had not grown our customer base. Please note this, since 2016. In the First Quarter 2018, the base of customers increased 16%. Gustavo will then speak about the figures referring to this.

And I can state that the true leadership that we want goes beyond market share and it goes through a lower cost, greater transparency and simplicity. The name of the game is simplicity. This is what we prefer because, as of today, our customers at Cielo will have

100% of the amount they have paid for the machine coming back to them. We're going to offer them a machine. The only requirement is for clients to sell during 3 consecutive months an amount of BRL 1,600. And this condition is a clear rule. The machine will be theirs if they perform with this BRL 1,600 during three months for credit.

We also know that one of the needs of the customers is to receive their sales ever [ph] faster. Beginning in the second fortnight of May, the customers can receive their credit instantly. All they have to do is adhere to this modality, our digital account. This holds true for present-day customers and new customers. This issue of instant credit does not limit itself to the digital account nor to banks.

We don't have any limitation in terms of banks. Any bank that is in accordance with our requirements can also carry out this instant payment to their customers. And this is a new technological development. It is an average sophistication. And with this, we are able to act very rapidly. We understand that the market we act in is dynamic. And to seek better conditions for our customers should become a daily exercise.

I conclude my address once again affirming our full commitment with the best possible service and the best final price for the customers. And we're determined to remain part of this competition. I would like to mention that as part of this highly competitive scenario, it's more important to evermore observe this relationship between acquirer customer, acquirer merchant. And to think of the final price, that will be practiced between these 2.

This is a flag that Cielo is carrying. It is something that I personally advocate in our environment. And what is important at the end of this is not to migrate from one fight to another, from rental to advances. What is important is for the customer to have a full vision of the total cost, the final cost in this relationship.

I would now like to give the floor to Gustavo. And at the end, we will return to a Q&A. We have 2 directors here: Danilo Caffaro, our Product Director; and Edison, our Operations Vice President and the Director responsible for the field of Entrepreneurs at Cielo. I give the floor to Gustavo.

Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

A good day to all of you. And thank you, Caffarelli. We begin the presentation on Slide #3, where we have a summary of our performance.

We begin with the financial volume where we totaled BRL 158.8 billion (sic) BRL 155.8 billion [ph] in terms of financial volume, representing a growth of 3% vis-à-vis the same period in 2018. This is the strongest growth in the year. In the last 2 quarters, we had a drop in these metrics. And this could prove that we are inverting the trend.

In terms of the sale of POSs, we have had a good performance. The sale of equipment was 102,000, representing 88,000 higher than what we had during the same period last year. And the First Quarter 2018 was the period for the acquisition of Stelo. We have already sold more than 600,000 POSs in combined numbers between Cielo and Stelo.

Our active base of customers ended at 1.2 million customers at the end of March, a growth of 6% in one year. And this growth is mainly in the segment of micro entrepreneurs. The net revenue is BRL 2.8 million (sic) BRL 2.8 billion [ph], remaining stable vis-À-vis the same period last year. And this, thanks to an increase of 3% in volume and a more aggressive pricing because of the extremely competitive environment in our market.

Our net income totaled BRL 548 million, a drop of 40% vis-À-vis the same period in 2018. This is explained due to the stability in revenues, a reduction in the revenues of receivables and an increase in our sales force. So what we see this quarter is a more aggressive price strategy that we had already communicated in the Fourth Quarter of 2018 and the full impact of the new hirings for our sales team and the beginning of our marketing campaigns.

We go on to Slide #4 where we have a view of the main financial indicators. I would like to focus on those that I have not mentioned formerly. The EBITDA this quarter was BRL 820.7 (sic) BRL 820.7 million [ph], a drop of 4% (sic) 34% [ph] vis-À-vis the last year. And the 6% (sic) 29.6% [ph] EBITDA margin compared with 44.6% for the same period in 2018.

The dynamic is very similar to what I referred to net revenues: stability and the consolidated revenues of Cielo; an increase in costs with personnel because of the reinforcement of our sales force; and an increase in volume and negotiation with new brands; and an increase in losses with doubtful credit. We have a high turnover in our sector. And all of this refers to rental of equipment. The customer no longer uses the equipment but has not canceled the product. Because of the high turnover in our industry, these figures have increased.

We go on to Slide #5, where we see the yield of Cielo's net revenue. You can observe a drop, which is a reflex of the more aggressive pricing strategy. As has been communicated by Cielo, we're disputing client by client in all price variables. As mentioned by Mr. Caffarelli, we see the yield of revenues in the First Quarter of 2019 vis-À-vis the First Quarter 2018. The positive points, though, is that increased level of revenue are an increase in the automatic hiring of credit; and secondly, an increase in the volume captured for full acquirers for Amex and Hiper brands. This is what prevailed and led to a reduction of net revenue, which is the price variable.

The last purple column shows a reduction of 18 basis points, once again due to price. Now price, once again, predominates in terms of our drop in net revenue compared to the Fourth Quarter. We had a reduction of 5 basis points compared to the Fourth Quarter '18. And once again, the main variable was price with a reduction of 7 basis points.

We now go on to Slide #6 where we show you the changes made in our sales force. Caffarelli, in the opening, spoke about the total sales force for Cielo. Here, you have information focusing on the Retail segment. And first, we should speak about our sales model. In the previous model, we had professionals that were responsible for maintaining the relationship with customer, selling products and for seeking new products. We have changed this. We have created a category of farmers who are responsible for maintaining

the relationship with customers. And we now have hunters responsible for bringing in new accounts, new customers. And therefore, we have gone from 500 to 1,500 hunters and farmers, 500 are farmers, 1,000 are hunters. And the relationship of the customer with the sales force has improved substantially.

As a result of the more competitive pricing, the increase in our sales force and the change in our commercial model with farmers, we have had an improvement in customer retention. And we had the first multiple addition of customers at Cielo after many months. We have information since January of 2018. And for the first month, now you can see that we have a net addition of new clients or customers.

And in the Fourth Quarter conference call, Cielo had already communicated that it was willing to become fully competitive in its search for new customers to increase its market share. And this new commercial model has come in place with the hiring of new professionals. We contracted this entire team beginning in January. And this strategy is proceeding at full steam. This may be a new indicator that the strategy is leading to improvement.

We go on to Slide #7 with metrics for volume and bases. In the first graph, the active base of customers was a 6% increase vis-à-vis last year, financial volume with an increase of 3% vis-à-vis 2018 and a credit volume with a 2-day payment was 16%. This shows that this amount of BRL 19.2 billion recorded in the First Quarter shows a penetration of 21%, the highest penetration in this historical series. These may be the first indicators of a more aggressive price strategy and a commercial model with a reinforcement of the sales force, showing the first signal of reversion.

With this, I would like to return the floor to Caffarelli.

Paulo Rogério Caffarelli

Simply to conclude the presentation, a comment in terms of what we are adjusting in the company so that it can participate in a prepared way in this highly competitive scenario. Not because we are a leader, are we creating a shield. As I mentioned, we are reorganizing the entire structure of the company. We are highly active in terms of the new strategy. We have had a reinforcement of the sales force, as mentioned by Gustavo, a new modality of pricing. We do have prices to be highly competitive.

And I would like to insist that we have to make a choice. And the choice is to leave share aside to continue to be a leader in this market and to work on the resumption of growth, which is beginning to appear, thanks to this reversion. Since 2016, we had not grown in terms of the customer base. And in this quarter, we began to have some growth.

Another highly important issue for us is the recognition of surveys. We have had a substantial growth in the last survey, which shows that we're on the right path. We have no other solution besides having the best service, excellent service and offering an excellent experience to our customers.

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We go on to the next slide, please. To consolidate what I said about the customer, the customer is at the center of our focus and it cannot be different in this fight where we have products and services that are commodities. We have the 3 business units: one for Large Accounts, one for the Retail and one for Entrepreneurs, each with their specific focus. And we have a share of Cielo in all of the acquiring segments in the country. We're the only company that is active in all of these segments. And to support this, we have the marketing area under the chairmanship of Cielo.

When we speak about the price dispute, above this dispute, we have that of communication, which means that we have to be evermore effective in our communication because of the competition. In the operations area, a full restructuring. And we're adjusting this area so that the customer can have a resolution immediately through a simple contact with our company. And the product area, that has to permanently surprise, innovating with products. But we cannot be satisfied with this. As we have at Cielo, we have to have products that the market is still lacking. And to shelter all of this, we have the technology area. We have to work with high availability, our systems work 24/7 and other areas involved in this process.

With this, ladies and gentlemen, we would like to conclude this very brief introduction by reaffirming that our role at present is based on a medium; and long-term vision. We cannot focus on Cielo with its present-day results. We should think about the medium; and long-term results as part of the initiatives that we have put in place to enhance sales, to enhance the number of customers accredited with us. But above all, because of the work that we're doing in the company to seek operational efficiency. The size of Cielo has to be appropriate based on our capacity to grow.

Now once again, Cielo will never give up on being the leader in this market. With this, we would like to go on to the Q&A session. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Our first question is from Mr. Eduardo Rosman from BTG Pactual.

Q - Eduardo Rosman {BIO 16314825 <GO>}

I have 2 questions. The first, in terms of the guidance, we have a First Quarter with BRL 550 million. If you multiply this by 4, it will be below your minimum point. You have several initiatives and investments to enhance the company in the medium term. And there's a new policy of HEDI [ph] that had an impact on the price of shares in the segment. And the market is looking towards an even fiercer competition. Do you think that it will be possible to deliver the guidance? Or will it have to be reduced?

The second question refers to payout. We saw that the company policy has increased. CapEx is increasing. In the short term, EBITDA is suffering pressure. I would like to know if you can continue with the 70% payout policy.

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A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Eduardo, we have Caffarelli to speak to you.

A - Paulo Rog rio Caffarelli

When it comes to the guidelines, we have the following. Now the net income presented in the First Quarter falls within our expectations, which means that we do have projections for other semesters of volumes that will enable us to attain this guidance that is between BRL 2.3 billion, BRL 2.6 billion. It is still very premature to reinforce or to make comments on guidance. I would prefer to wait more, to wait for this entire process to fully accommodate in terms of competition instead of reviewing our guidance once again. The guidance, therefore, is carefully being looked upon.

When it comes to the payout, we're reinforcing the payment of 70%, the amount foreseen. And we will define future payments as we move along. Evidently, if it makes sense to retain resources because of our expectation of market opportunities or because of a funding need to be able to face an increase in advances, then we will have to discuss this once again. But what is valid in the first semester is a payout of 70%.

Operator

Our next question comes from Felipe Salomao from Citibank.

Q - Felipe Gaspar Salomao {BIO 20899985 <GO>}

I have 2 questions. The first, you mentioned, Caffarelli, at the beginning of your address that Cielo is going to announce a promotion, rental-free machines for customers that have a certain level of invoicing. And my first question is, if you could once again give us more details on this specific promotion that you mentioned in your opening address.

The second question refers to the question made by Rosman. We're referring to already your main competitor offering prepayment for transactions for customers that have an account at Ita  Bank. Now which will be Cielo's reaction to this new move? What do you think of this? Do you feel that it will be necessary to follow through with Rede? Can you do things differently? Which is your relationship with Bradesco and Bank of Brazil when it comes to offering a lack of payment for those who have an account in Banco do Brazil or Bradesco? I would like to hear your remarks on the hedge promotion and what you will do to combat this offer.

A - Paulo Rog rio Caffarelli

Salomao, pleasure to speak to you. And let's clarify several issues. The issue of the POS, the machine, we're giving it based on the condition that our customer will have, during 3 consecutive months, sales of BRL 1,600 in credit. Once again, if they sell for three months BRL 1,600, the machine will become their property; this, for 3 consecutive months. And for us, we don't have to collect the machines. We don't have to pay to receive the machines. We'll be the merchants.

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Now I would like to clarify the following. What we're doing in practice is a change. We do carry out advances in two days. We're now doing it simultaneously. Of course, there is a cost attached to this. It's not completely free of charge. We're doing it through the Cielo digital account at present. And we have opened this to all of the partnering banks of (inaudible) -- Cielo. This is open to all banks who wish to adjust to this instant payment. We're going to offer all of the technological requirements. And once they are in place, they will be able to make these instant payments.

I'm not going to comment in terms of the attitude of the competitor. I'm going to focus on our own case. What I am proposing for Cielo personally is the total final cost. I believe that because of a reason of respect towards consumers and merchants, they should know exactly which is the end cost that they are paying, regardless of whether it is a rental, a sale or a rate of advance of receivables. Now we have to focus on this evermore because it is important for the comparison to be made among acquirers, not only looking at a single line item. But the full picture. And I can ensure you that we have been working strongly so that Cielo can have extremely competitive prices. This is what we are proposing at present competitive prices and excellent service to our customers.

Operator

Our next question comes from Mr. Eduardo Nishio from Plural Bank.

Q - Eduardo Nishio {BIO 15333200 <GO>}

My question is a follow-up to the question made by Salomao. I would like to gain a better understanding of the rates at D+2 and instant payment. How much are you charging for this? And it was 4.99% MDR. Now basically, you have 3 models at present. Hedge [ph] does not charge for the advance, Santander has a flat MDR of 2% paid in two days and SafraPay eliminating the MDR but charging for the advance. Therefore, there's a mix-up of things in the total cost that was mentioned by Caffarelli, which of course is very interesting because MDR is being confused with the advancement. I would like to gain more color in terms of this strategy.

And -- well, in the case of Hedge, they're advancing the entire amount for small and medium merchants. And the funding remains at the company. At the bank, 100% controlled by ItaÃ Bank. In your case, this is not the case. You have a part of the market. So I would like to know which is the strategy to advance this volume for credit cards and credit card for site payments, cash payments.

A - Paulo RogÃrio Caffarelli

Thank you for your question. And it's excellent to hear these remarks to reinforce the idea of the customers and cost because this justifies the fact that it's impossible to make a comparison.

We would like to clarify the following. For some time, we have already been putting the D+2 in place. What we're doing at present is bringing the customers that already practice D+2 to Cielo as long as the customers will receive their money in the Cielo digital account. Once the customers have adapted to this. And we believe the development will be very

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rapid, the banks can make advances to their customers' D-0 [ph] at the bank's convenience. All of our customers not necessarily will migrate to D+2. We have customers that work with D+30 or other types of operation.

When it comes to the cost of this operation, we're charging BRL 1.99 for debit, BRL 4.99 for credit and BRL 5.59 for payment in installments. This is a cost that is fully aligned with the market. And it is our understanding that this complies with the needs of the customers, especially the Entrepreneur customers who quickly need the money as soon as they make the transaction.

Operator

Our next question comes from Mr. Rafael Frade from Bradesco Bank.

Q - Rafael Berger Frade {BIO 16621076 <GO>}

Several points. First, regarding the POS base. During the quarter, this drew the attention in terms of the difference in growth and stability of active merchants at such a critical moment of POS rentals. And of course, this will have an impact on revenues. Is this based on a discount policy for POS or not?

The second question, you mentioned that you sold more than 600 POSs, where you have 273,000 that are active. Well are these simply entry figures? Do they refer to the activation of sales? I would like to gain a better understanding of these 2 figures, if possible.

A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Thank you for the question. This is Gustavo speaking. First of all, your comment referring to our POS equipment base. We have 2 different ways of looking upon this. And we show this side by side when we speak about active POS base and where we have observed a growth of the base of rentals. We should recall that Cielo has the highest share in the large accounts. And many of these clients have an infinity of terminals. Another metric that we offer to the market is our active merchant base. And in this active merchant base, we had a small decrease in terms of rentals vis-à-vis the Fourth Quarter. We ended the Fourth Quarter with 974,000 POSs; in the quarter of 2019, 949,000 terminals. What was important was the sale of machines, therefore.

Now if we go to another point, referring to the sale of machines, we sold more than 600,000. And the concept that we have in terms of our metrics, 272,000 of the active merchant base with acquired POSs, this refers to customers that have carried out transactions in the last 30 days. And the difference is because either the customers have not used their POS in the last 30 days or because they have returned them. Now our activation is around 70%, which is above that of our competitors in general.

You go ahead. You can make your comment.

Q - Rafael Berger Frade {BIO 16621076 <GO>}

Gustavo, simply a follow-up on the sale of POS equipment. I understand that in the sales made by Stelo, we cannot see the impact because it falls on another holding company. But when Cielo sells the POS, what happens with the revenue of sales and the cost of sales in the results of Cielo Brazil?

A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Each entity recognizes the cost that corresponds to them. Once again, what corresponds to Cielo will be part of the Cielo P&L. And the same holds true for Stelo and other companies. Would you like to add anything?

Operator

Our next question is from Andréa© Martins from XP Investments.

Q - Andréa© Martins

Caffarelli spoke about hunters and expense controls. I would like to know your opinion in this jump of 1,600 customers to 2,000 a day. This will mean that you have to resize your expenses and the incentives for your teams. Are you in a learning curve? Or with a budget that you have, will this be sufficient for this leap in terms of capture?

A - Paulo RogÃ©rio Caffarelli

Thank you for your question. And I'm going to give you a response with items that tend to go in different directions. First, the hunters initiative and the expansion in our sales pace is following several metrics. We have also planned training efforts. And what we may have in the coming months is an adjustment of strategy, that is to say the size of our sales force or policies. And this could either increase or decrease. The company has just implemented the strategy that it stated. And we may have to make some adjustments. At this point in time, I do not expect great expense deviations because of this.

Now the part of the response in terms of savings, this is an initiative that Cielo already has a base 0 or matrix budget that is being intensified and reviewed. We may expect continuous investment and a more generous budget for anything connected to commercial expenses, relationship with customers and an improvement of this relationship. Now the corporate routine will be carefully reviewed. This is an initiative that is coming about. And we do expect to have savings and greater efficiency throughout the year.

Operator

(Operator Instructions) Our next question is from Felipe Salomao from Citibank.

Q - Felipe Gaspar Salomao {BIO 20899985 <GO>}

And the question is the following. It is somewhat more theoretical. And perhaps you could explain a specific point. As we mentioned before, one of your competitors have offered

free prepayment. My doubt is the following: how much sense would it make for us to wait that -- well, as the prepayment of the first installment will be cheaper, does this mean that the customers will anticipate more to avoid the interest rates? Which means that the company would not change that much.

Obviously, the payment volumes were the increase. But the take rate, the revenues would not change considerably because the customers say that it could be free to receive receivables in the first installment. They will try to do this without paying interest rate. I would like to know if it's possible to explain this or if it's too early to think about this?

A - Paulo Rog rio Caffarelli

It's Caffarelli. And I think your observation is very interesting. It is a trend. But we are unable to assess this. We can only do it through time. What you were stating could make sense. But we cannot affirm this. Through time, we will be able to better analyze this.

I would like to make the most of the question by Salomao because of our guidance. We are maintaining our guidance. When I mentioned that it is being reconsidered, we are maintaining it. If we had to change the guidance, we would point to this change. As I mentioned to you, the results of the 4 quarters of this year are results with different amounts and growing amounts. When we carry out a simple calculation of multiplying that BRL 540 million by 4, this is not the reality. We have to take into account our growth strategy that will take place quarter-after-quarter. We're maintaining the guidance. And that's that.

Operator

Our next question comes from Giuliana Agrumi from Ita  BBA.

Q - Giuliana Agrumi {BIO 20844407 <GO>}

I have a question on share. Cielo, in the last few years, has lost a great deal of market share. What are you thinking in terms of market share? Are you thinking of having an increase until 2020? When will you stop losing your market share?

A - Paulo Rog rio Caffarelli

This is Caffarelli. I will begin answering your question. First of all, I would like to reaffirm once again our intention. We have moved away from our focus in profitability to think about market share. Now this is a medium; and long-term race. It is important, of course, to maintain our market share. And everything we do is geared towards increasing our market share. And we begin to see signs of this. Something that happened in this quarter that was very satisfying is that for the first time after 2016, we have stopped losing clients. And we see that there is a change in this process because everything -- because of everything that we're building. Once again, we cannot have a short-term vision. We have to look at this process in the long term. 2019 will continue to be a year of consolidation, a year of adaptation of Cielo for a gain that is completely different from the gain we had in 2018 and three years ago.

Operator

Excuse me, this concludes today's question-and-answer session. I would like to invite Mr. Paulo Caffarelli to proceed with his closing remarks. Please go ahead, sir.

A - Paulo Rog rio Caffarelli

Once again, I would like to thank all of you for participating. It is important for us to speak about our strategies to debate our performance. And I would like to end up by thanking all of you, thanking the Cielo team and stating that our IR field is at your entire disposal should you have any further questions. Please have a very good day.

Operator

The Cielo conference call ends here. We would like to thank all of you for your participation. And have a good day.

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