

## Q4 2011 Earnings Call

### Company Participants

- Corporate Participant
- Mario Arruda Sampaio, Head of Capital Market and Investor Relation

### Other Participants

- João Pimentel
- Michael Gaugler
- Vladimir Pinto

### Presentation

#### Operator

Good morning ladies and gentlemen. At this time we would like to welcome everyone to SABESP Conference Call to discuss its Results for the Fourth Quarter of 2011. The audio for this conference is being broadcast simultaneously through the Internet at the website [www.sabesp.com.br](http://www.sabesp.com.br). At the same address you can also find the slide show presentation available for download. We inform that all participants will only be 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]. Please note that this event is being recorded.

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 guaranties 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 the 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 expresses 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 Market and Investor Relations and Ms. Nara Maria Marcondes França, Head of Accounting.

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

## Mario Arruda Sampaio

Hello everybody. Thank you for joining us for this fourth quarter, actually we're going to be more focusing on the year-end results. We have a here couple of slides to go through. Let's start by slide three. Here we present the water and sewage billed volume which was 3.1% higher than in 2010, with billed volume increasing across all consumption category.

This increase in billed volume was due to the increase of 2.5% in water connections, and 3.6% in sewage connections to the intensification of fraud prevention initiatives and to the increase in the rate of replacement of water meters and São Paulo metro region. The loss ratio assume, re-assumed its downward trend reaching 25.6%. In December, after a period of stability in 2010 due to reduced or discontinued maintenance initiatives caused by difficulties and delays in the bidding process related to the renewal of the maintenance costs which affect our loss ratio reduction effort. You'd like to know that the corporate program for water loss reduction for the period between 2012 and 2019 is been reviewed in such a way that the water loss goals for the coming years will be adjusted. The exact figures, we are still under discussion. They are still under discussion and this is nonetheless, the priority and focus will be maintained and this program continues to be of relevant importance for the company's long-term strategy.

Now let's move to slide four where we will comment our financial results. Net operating revenue increased by 7.6% in 2011, note that this figure includes construction revenue which recorded a 4.4% growth in the period. On the other hand, gross operating revenue which excludes construction revenue moved up by 8.5% being positively affected by the build volume upturn of 2.6% for water and 3.6% for sewage and also by the tariff increase of 4.05% as of September 2010 and 6.83% as of September 2011.

Costs and expenses including the construction cost totalled 7.5 billion, 14% above 2010. However, if we exclude construction cost, cost and expenses increased by 18.4%. EBITDA remained flat at 3.2 billion between 2010 and 2011. The EBITDA margin came to 32.4% versus 34.9% in the previous year margin came to 32.4% versus 34.9% in the previous year. When we exclude the effects of construction revenue and cost, EBITDA margins turns up turns out to 41.1% in 2011 versus 44.7% in 2010. If we, in addition to excluding construction revenue and cost, also exclude non-recurring additional actuarial liability of R\$157 million, something that we will discuss later on, EBITDA margin for this year reaches 43.1%.

A big drop, 8.4% from 2.7 billion to, into 2010 to 2.4 billion in 2011, yet net income totalled 1.2 billion, 25% less than 2010 mostly due to the 448 million negative income of the exchange rate variation on foreign denominated loans and financing, as a result of the 12.6% appreciation of the dollar against the real in 2011 versus a 4.3% depreciation of the dollar over the real in 2010.

Now, let's move to slide five. Present here are the main variations in cost and expenses in relation to the previous year. Cost of expenses moved up by 14% over 2010, the main factors behind this expansion were the increase of 47.7% in general expenses; 39.2% in depreciation and amortization; 28.8% in payroll and benefits and 13% in treatment supply.

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On the other hand, we highlight the 48.3% decline in loan write-off; the 47.7% increase in general expenses was due in great part to the provision of R\$162.1 million corresponding to 7.5% of the revenue obtained from providing sanitation services to the city of São Paulo, net of the that are transferred to the municipal sanitation and infrastructure fund and in accordance to what you already know the São Paulo Metropolitan service contract that we signed with the city and with the state of São Paulo.

Note that the provision, note that the 7.5 provision in 2010 began at the third quarter of that year, while in 2011 it covered the whole year. Another factor that also fuelled cost items and general expenses was the provision for legal contingency.

Moving to depreciation and amortization expenses. As you can see, they grew by 39.2%, mostly due to the amortization current adjustments between the asset's useful life and the contract duration whichever is the shortest one, something that will be recurring for the next quarter, but let's highlight that in this contract for this period, the main variation and the main adjustment refers to the amortization of intangible assets related to the São Paulo Metro region service contract with the city and the state government.

Regarding payroll and benefits, the 28.8% increase was predominantly associated with acquisition of actuarial liabilities, note that a relevant part of these expenses are non-recurring in the coming quarters, as is the case of the actuarial liabilities in the plan, remembering that the plan is a complementary retirement benefit for those employees that moved from previous state companies into SABESP, and it's ruled by law 4819 and this amounted to 157.5 million.

Another addition to cost was the migration of 22% of our employees from the defined benefit plan we call the Sabesprev Mais, sorry from the defined benefit plan let's call our old plan to the new plan called Sabesprev Mais, which is a defined contribution plan that generated expenses of 60.8 million.

We also recorded 22.4 million increase related to the penalties or fine that are applied to the employers due to employee dismissal, this is under the Government Severance Indemnity Fund, we call here the FGTS, due to two reasons. One was the higher number of lay-off this year 2011, mainly as a result of the Conduct Adjustment Agreement with the state prosecutors, which you are already familiar. For the record, just for the record this last year we laid-off 1,148 employees against 870 in 2010 and 1,900 in 2009 when we began this adjustment agreement.

The second reason for the increase is due to the new labor legislation that modifies the calculation of severe - motivated by employer lay-offs. Nonetheless let's think about this, if we analyze exclusively payroll and benefits. Direct cost, we know 12.9% expansion, a controlled and resealable expansion.

The 13.3% growth in treatment supply was due to replacement of aluminum sulphide by aluminum polychloride and the increase of acquiring consumption as a result of water source condition, remember that water sources conditions are very sensitive to the type of chemicals that are applied during the production, water production process.

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On the other loan rates declined by 112 million or 48%, chiefly due to higher provision that in 2010 related to private customers totalling 34 million, and to municipal public entities totalling 140 million of which 54 million was related to the São Paulo municipal government, in other words 2010 we had a greater provision based than in 2011, that is the reason for the difference of 112 million.

Let's move now to slide six. Here it presents the main variations in the items that affected our net income. Net operating revenue vary positively by 697 million or 7.6% over 2010. Cost and expenses impacted negatively, R\$920 million, representing an increase of 14% figure higher than the net operating revenue growth, we just commented.

Other revenue and expenses presented a decline of 92.1 million, mainly due to provisions related to assets from past possession, related exactly to assets from past possessions with the city of Maceió and also due to write-off of absolute assets. Net financial revenues and expenses had a negative impact of 254 million on the result for the period.

This variation was predominantly due to the negative exchange rate effect due to the 12.6% appreciation of the dollar in 2011 versus the 4.3% depreciation in 2007. This variation generated an impact direct impact of 448 million in the expenses of 2011.

The increase in financial expenses related to the exchange rate based ratio was partly offset by a reduction of approximately 33.6 million in interest rate expenses on domestic loans and financing compared to 2010. This is due in great part to the amortization of the eight and the ninth debentures issuance in June and October 2011 respectively, as well as the reduction in financial expenses as a result of the lower need for interest revision on losses.

Financial revenue also supported financial revenue sorry, moved by R\$153.4 million, partly offsetting the negative effect of exchange variation. All this, thanks to the higher financial revenues obtained due to the higher cash availability. Finally income taxes, social contributions fell by 164 million, mostly due to the exchange impact and partly mitigating the negative obviously partly mitigating the effects of this event as we can see.

Let's move to slide seven. Let's talk about the debt. In February 2012, the company issued for public distribution a 15th debenture, in the amount of R\$771 million. This was made through two series and was placed with restricted placement efforts, pursuant to the CVM Instruction 476. The first series totalled R\$287 million, interest paid was, interest offered was 0.99% a year with amortization recurring on year three, four and five while the second series totalled 484 million with interest rate of EPCA inflation index plus 6.2% year with amortizations on year six and seven.

Important that is to note that the proceeds of these issues were used to settle financial commitments already in 2012. More specifically to amortize a portion of the second series of the 11th debenture issuance, totalling R\$202 million, was secured in March, and especially the prepayment in the February of the 13 debentures issues totalling 600 million due in August 2012.

Also in the February, the company entered into a loan agreement with the Japan International Cooperation Agency, we call it JICA, in the amount of 33 million, ¥33,584 billion which equivalents for approximately R\$710 million at the execution day. To support the second phase of the Corporate Program for Water Loss Reduction, investments in this phase of the programs are estimated in total of R\$1.1 billion, 390 million of which represents the best part in this project.

The long-terms are the traditional 25 years with the 7 year grace period, and an interest rate of 1.7% year and obviously yen exposure. Note that in 2011 the company amortized a total of R1.9 billion, and raised funds in the amount of 1.7 billion, obviously these funds raised through capital markets and also through financing. At the same time its cash position increased from 2 billion in 2010 to 2.1 billion in 2011. Not to say that in the same period net debt to EBITDA ratio remained flat at 2.0 times.

In this context I would like to highlight our debt profile as you already know the fact that SABESP is a mix capital company, the fact to financing from multi-lateral and official public entities and international arena which offer special funding conditions such as the just mentioned loans with 25 years, seven year grace period and very low rates, absolutely unparallel in Brazil whether public or private funding.

Nonetheless the cheap and long-term international financing does impact our total currency exposure for fourth quarter and foreign denominated debt exposure corresponds to 36% of our total debt. But as you can see on the slide, the maturity of the debt is very much spread out through time, so with very little amortization concentration. In fact, the greatest one being a \$140 million Eurobond maturity, four years ahead of us in 2016.

Let's move to the next slide and let's talk our last theme for this presentation on ARSESP. We would like to give you an update, very quick update on the development of the new tariff methodology that has been made public for discussion by the ARSESP, the State Sanitation and Energy Regulatory Agency.

As you already know then in January, ARSESP published its initial tariff methodology proposal for the first cycle and held public hearing, the last one being in São Paulo, a week ago. The main points addressed by ARSESP in these public hearings were; the agency reiterated the published timetable and confirmed that it will perform the tariff revision by the end of August.

Although, this has very recently changed as you will see and we will comment further on. ARSESP and SABESP will discuss investment plan proposed before the tariff cycle which will be included in the tariff proposal. ARSESP will perform an audit on the asset base that is being studied by company by SABESP.

Part of the productivity gains will be passed onto customers. So this is very, very summary of the highlights they made on their public hearing. On the other side, during the hearing, SABESP was allowed to make its points and comments, some of which we would

like to share with you, such as the inclusion of revision for doubtful accounts in the tariff, something that was not clearly contemplated.

A first cycle that is longer than the proposed five years. The company also highlighted that our tariffs are already at the low-end side when compared to tariffs from other state sanitation companies in Brazil. As you can see on the slide eight. So flip to eight and nine of this presentation.

As per the regulatory OpEx, considering the company has been constantly cutting cost. As it can be seen by the low tariff levels when compared to Brazilian peer we recommend the regulator should consider our current OpEx as he has already said, he will consider as a starting point. But at already at efficient level. We find necessary also greater flexibility for SABESP to request tariff revision any time and for any reason, and not to be kept by a specific events or trigger values.

At last we also reiterated that we're responsible for approximately 30% of the investments in basic sanitation in Brazil last year. We consider the public hearings to have been very favorable to the company and the profit as a whole, and we're optimistic on the methodology for our business.

Finalized we would like to bring to your attention that SABESP has just edited resolution 319 dated March 23, and published on March 24th that was Saturday in the public diary or newspaper we know here is a DOE, a new time table for the disclosure of the tariff methodology, which modifies all dates of each of the original expense.

We highlight that the changes in the dates of SABESP's presentation of its efforts based, moved from March 31 2012 to August 31 2012, and the publication of the final tariff revision and the initial tariff from August 30, 2012 to November 31, 2012.

The next and the last slide represent a summary of the time table now with old dates on the left side and the new dates on the right side, and these are involved to facilitate your comparison. Well that concludes our initial results, and now we would like to open for question-and-answer.

## Questions And Answers

### Operator

[Operator Instructions]. Your first question comes from Michael Gaugler of Brean Murray Carret.

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

Good morning everyone.

**A - Mario Arruda Sampaio**

Good morning Michael.

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

Congrats on a nice quarter.

**A - Mario Arruda Sampaio**

Thank you.

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

Your opening remarks and presentation answered a lot of the questions that I had coming into today's call. I guess I would swing first two the fourth quarter results. One thing I noticed and you did a nice job on your overview on the annual results, but I noticed the fourth quarter cost to sales were higher than what would normally be anticipated. And I was wondering, what was behind that?

**A - Mario Arruda Sampaio**

Okay. Let me, let me put on hold just for a second. Thank you. Michael, Michael just coming back to your question, you asked specifically cost to sales or overall cost, SG&A?

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

Just the cost of sales line in the fourth quarter?

**A - Mario Arruda Sampaio**

Okay. Michael, we're having hard time finding the specific line you're asking. I apologizes but if you could be more specific, it would help us.

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

That's fine. We can follow-up after the call. Just to kind of make it briefer and easier, the other question that I had, you mentioned in your remarks about reducing headcount on an annualized basis in 2011 and you gave the numbers for 2010 and for 2009 as well.

**A - Mario Arruda Sampaio**

Yeah.

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

When you look out into the future, you've really, I mean in the years that you've been -- the headcount has been reduced rather dramatically; is there a lot left in terms of the ability to reduce headcount or are you looking -- when look out to the future -- you see it as, pretty much at the staffing levels that you're going to need to run the business going forward?

**A - Mario Arruda Sampaio**

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I think Michael -- let me just chat with the Rui because I think Rui might be the guy to make the point here. Just a second. Micheal, just to make sure I am in the right track here with Rui, but I think that we're adding a lot of capacity for the next years and these years.

I think what we can see is, not further reduction but -- also not any significant increase as we move on in the year move on in the years to come. So we're adding significant amount of treatment facility, a significant amount of network and obviously network of more labor intensive than the facilities.

But we think, we reach on a per employee level that is fairly reasonable. We do find obviously, we can work some gains more related to how are we structured and how our division is distributed and so forth, this has been an ongoing effort in here with not yet any major significant changes. If we centralize or we do not centralize, some of the -- some of the activities which could bring some SG&A benefit. But in terms of total headcount, I think the call is basically what Rui just guided us to tell you.

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

Okay. And then one final question, I noted in the past the company has been looking to expand outside the São Paulo region, and had established some preliminary, I guess for lack of a better term joint ventures in other areas of South America. And we haven't heard a whole lot about that in the recent calls. And I'm wondering, do you see the company expanding outside of the São Paulo metro region still? Or are you pretty much focused now on the mandate to increase water and sewage coverage to the maximum in your existing geographic footprint?

### **A - Mario Arruda Sampaio**

I believe that the company did its first introduction into different markets in the different way to understand little bit of the game. The new administration is putting some pressure on us to propose something more structural, and well driven in such that it does not deviate managements time. And at the same time provides for us to take the opportunity that are out there and growing and so forth.

But nonetheless, I believe that from the strategic planning exercising went through here. The focus of this company is to expand, to accomplish its full sanitation program for the 363 municipalities we currently operate. And look for opportunities that are close by metro region and São Paulo states. And all of these through some mechanism again that will give SABESP management focus and articulate in a better way as it moves forward.

So in summary, we did not, we are focused in what we do, but we are working hard to bring a structure that can help us, support and be part of this expansion whether first in the state of São Paulo or further on outside the state of São Paulo. Okay.

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

Alright. Thank you, gentlemen. I'll, that's my last question.



## A - Mario Arruda Sampaio

Okay. And we owe you the cost of sales, but we might come back with something. Okay.

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

Sure.

## A - Mario Arruda Sampaio

Thank you, thanks Michael.

## Operator

[Operator Instructions]. This will be the final announcement. [Operator Instructions]. We do have a question from Marcelo Sá of Bradesco.

## Q - Vladimir Pinto {BIO 1554020 <GO>}

Hi everyone, actually here is Vladimir Pinto, Marcelo had to leave the call. My question is on the municipalities that buy water and sewage service on bulk. How the situation of those who are not paying is evolving, any definitions or any developments you'd like to share with us? Thank you very much.

## A - Mario Arruda Sampaio

Okay. Give me, Vladimir give me just one second. Mario back here.

Let me give it this way, in general, we continue the procedure as usual. We invoice the municipality. We already, not even consider in our revenues a portion of what we historically know that they are not paying the balance of that we are going to suggest this, legal proceedings as you know in Brazil take a long time. We have been winning some of these legal proceedings. These legal proceedings to some extent have led some of the municipalities to look after SABESP before negotiation. We have basically one case that we are developing a negotiation. It's something public, its public also in the sense that even the municipal council had passed the law approving the negotiation.

We're talking about Diadema. Diadema is a case where at sometime in the past, we operated the system. They took over the system on a one-side decision. They assume the assets, they have never paid back the assets to us. We went into litigation and in this perspective and actually we won.

The other part is that they also have not being paying the full bill. We are working with Diadema is an agreement where a new company will be established. And basically, we will, our part of the company will be paid through by that deal.

I believe we can't have any cash outlay in this acquisition, a part of this company. Any case, this is a, this is a, let's say, on the works and a positive side. We also were in a discussion with the municipality of Mauá, which is very much the same case. We, at some

time in the past, operated the city of Mauá assets. They took over. They have never identified us for the assets.

We went to court, we have to some extent won in court. But then again, they did not accept to do any type of negotiations such as the Diadema. And giving that the payment for the value of the assets will be done through, through a new federal law that allows the municipality to pay in a very, very long long-term. It's called the precautionary. We consider that is very, very little and very insignificant, the return of this value from the assets. So, we decided to provision. So that is one of the reasons our bottom-line was fairly hit during the period of the provision of 86 million, obviously did not help the bottom-line.

On the other side, on the other ones we're just business as usual. We provide water, they pay parts and we go to court. That's -- but we're always trying to approach and see if we can find any type of arrangement that can eliminate this, recover the past and establish a more let's call neutral future and positive future.

**Q - Vladimir Pinto** {BIO 1554020 <GO>}

Okay. May I do another question please? On the Sanitation Fund, do you have any news on the backing through this fee on the city of Sao Paulo to the tariffs into account? Do you have any information you could give us please?

**A - Corporate Participant**

Yeah. The information I can give you is always the public information, which is made available by ARSESP. The information we have and we interpret from ARSESP is basically was disclosed during exactly this methodologies cycle. There is a part of the proposal that the ARSESP will allow legal and contractual non-pass through of non-related operational fees or cost or transfers or whatever. There is a specific line that we can interpret that, that is where the ARSESP will fit the transfer to the tariff of the 7.5%. As you can see, it is an interpretation, it's still fairly not clear. But we believe that is where they will fit the -- okay.

**Q - Vladimir Pinto** {BIO 1554020 <GO>}

Alright.

**A - Mario Arruda Sampaio**

So basically, you will get if you leave in São Paulo. The idea is that, you will get a water bill, showing how much you -- what was your water consumption and how much you're paying for that? What is your sewage consumption, how much you're paying for that?

And then specific line saying an outline -- any specific contractual fee or any related transfer of funds that is being passed to the end user, according to any legal obligation established between the party and this is we have potentially the 7.5% will be passed --

**Q - Vladimir Pinto** {BIO 1554020 <GO>}

Alright. Thank you very much.

## A - Mario Arruda Sampaio

Okay. You're welcome.

## Operator

And the next question is from João Pimentel of BTG Pactual.

## Q - João Pimentel

Good morning everyone. I have a question. Last night we saw the regulatory release, the new date for the tariff revision and specifically it seems that the tariff revision that was expected to happen in August will now happen in November.

My question is, as the best tariff readjustment happens in September and the tariff revision will now happen in November, is it going to be the case that the tariff method, the new tariff -- the new methodology will only be implemented, only in the next tariff revision, in the next year in 2013 because like as it happened with the distribution companies in the utility sector that we saw, that was -- as the tariff revision happened after the date of the tariff revision, of that specifically, they were postponed to the next year.

So my question is, is that going to happen with our -- as well or can we expect the tariff revision -- was supposed to happen in September 2, happened only in November already with the new methodology?

## A - Mario Arruda Sampaio

Okay. We, we only know what you know in terms of, what was put out recently by the regulator. So let, our interpretation first is, is that what happened was a technical adjustment on the schedule, is just a technical adjustment and it's very clear.

We are working on the asset base, it's surmounting work. The regulator obviously have been following our work and once we get it done, he has to do the same work. So I think as much as it happen in other, we think as much it happens in other sectors, it is normal for technical adjustments in the timetable in the schedule.

So, I think our statement is, we do not consider this a postponement as we saw in the past. We see the regulator very much in doing, very strong efforts to implement this tariff, first review. So we believe that the November date continues a very strong date.

Now the second part, the question really is, we do have in August a announcement of September implementation of tariff adjustments to inflation, where we used the parametric formula. And the thought was that, if they were both going to occur at the same time, both being the tariff adjustment plus the revision, whatever the outcome was the revision.

And the point is, if you move the revision to November, what will happen to the August adjustment? I think what we can only say is that, we expect that the adjustment will be

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implemented based on the parametric formula in August that is our expectation and in November, the new tariff will be implemented over what was adjusted in August.

Now, specifically if that is going to happen or not, I think it's going to be definitely one of the questions we're potentially going to formally make to the regulator. For the company, we believe that no further postponements will happen other than the one just shown here.

### **Q - João Pimentel**

Perfect. Thank you very much.

### **A - Mario Arruda Sampaio**

Okay.

### **Operator**

[Operator Instructions].

### **A - Mario Arruda Sampaio**

Just one point, it's Mario again. Just to make sure that, when I said tariff revision and the value of that, it can be always plus or minus. I did not want to make any statement that the tariff revision will necessarily outcome -- generate a outcome above inflation, okay. So that's it. So just to make sure that, I'm talking about the event and not the outcome of the events. Sorry to interrupt.

### **Operator**

And again, this will be the final announcement. [Operator Instructions]. Showing no further questions. I will now turn the conference back to SABESP for their final remarks.

### **A - Mario Arruda Sampaio**

Well, once more thank you very much for your time, and for your questions. We will hold the Portuguese conference later on the day. So for those you interested we invite you to participate, along with the conference we will also have a meeting with analysts here at the same time. So thank you and see you soon for the first quarter results. Good bye.

### **Operator**

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

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