

Q1 2003 Earnings Call

Company Participants

- Luciana Rashid, Executive Manager Investor Relations

Other Participants

- Carlos Deleon
- Christian Audi
- Frank McGann
- Gustaf Santos
- Paul Ching
- Rodrigo Golles
- Unidentified

Presentation

Operator

Ladies and gentlemen. thank you for standing by and welcome to the Petrobras conference call. At this time, all lines are in a listen-only mode. Later, there will be a question-and-answer session and instructions will be given at that time. If you should require assistance during the call, please depress star zero. As a reminder, this conference is being recorded. At this time, I would like to turn the conference over to Luciana Rashid [ph], Executive Manager of Investor Relations at Petrobras. Please go ahead, ma'am.

Luciana Rashid

Good morning, or good afternoon, ladies and gentlemen. welcome to our conference call to discuss First Quarter 2003 results. There will be a playback facility for this call. For instructions on accessing the playback please contact the Global Consulting Group in New York at 212-807-5064.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from those anticipated in any forward-looking comments or as a result of macro economic conditions, market risks and other factors. Finally, let me mention that this conference call will discuss Petrobras results prepared in accordance with Brazilian GAAP. At this moment, we are unable to discuss any questions related to U.S. GAAP results.

We have with us today our CFO and Investor Relations Director Jose Sergio Gabrielli de Azevedo. He will comment on the company's First Quarter 2003 results. And after that, he will be available to answer any questions you may have. Mr. Gabrielli you may begin.

Jose Sergio Gabrielli de Azevedo: Good morning. Good afternoon, ladies and gentlemen. It's a pleasure to be here with you in this -, Webcast and have the opportunity to talk about Petrobras First Quarter results for 2003.

Before presenting the results, we would like to make some comments on the macro economic environment. This quarter we saw a strong recovery of the margin between the average grant price and the average realization price PMI that favored Petrobras' results. The average grant

increased from \$26.78 to 31.51 a rise of about 18%. While that realization price increases from 96.81 to 123.35 reales, representing an increment of almost 28%.

Moreover, the average exchange appreciated in 4.9%, that implies that in dollar terms, the average realization price grew about 34%. In relation to the First Quarter of 2002, these variables are still more favorable to Petrobras' results. Grant average went from 21.17 to \$31.15 a rise of 48%, while the realization price increased from 55.78 -- 0.28 to 123.35 an increase of 123%. Accompanied [ph] by a 47% depreciation. In other words, in the last 12 months, the average realization price in dollars increased approximately 52%.

Next slide, please. Our gross profit in the First Quarter 2003, grew 61% compared with the Fourth Quarter 2002. We achieved these results thanks to an 18% rise in net of -, revenue reflecting the increasing domestic [ph] -. And gasoline prices back on December 29th of last year. This increase brought prices close to international market levels at the prevailing -, rate. Net operating revenues was also boosted by contractual monthly adjustments in the price of NAFTA, jet fuel and fuel oil again due to international prices and the exchange rate. The export rates [ph] of crude oil are -, in higher value added exports as the share of derivatives increased.

Cost of goods sold fell seven % as a result of a -, fall in sales volumes in the domestic market of 11% of depreciation -, that reduced the cost of imports and international costs. The reduction in expenses with future abandonment -, adopted in 2003 accordance with FASB 143 also contributed to reduced production costs of the net oil.

The net profit in the First Quarter grew 96% in relation to the previous quarter. And reached 5,545,000,000 -, mainly as a result of the increasing gross margins but also as a result of the stability of -. And financial income of 703 million reales is still significant. But 50% less than in the last quarter of last year as a result of a smaller appreciation of the exchange rate.

The provision for losses on contract was a thermal -, power plan of 709 million reales in the First Quarter was similar to the Fourth Quarter of 2002 of 724 million reales.

Next slide, please. In comparison to the First Quarter of 2002, the results are -, significant registering 118% growth in the net operating income, 477% of -- in operating profit and 540% in net profit. The macro economic factors that contributed to these results all ready have been discussed. To them, we must add the increase in oil production of six %, the reduction of six % in domestic sales -, growth of net profit.

The net financial revenue added 706 million reales in the First Quarter compared to 143 million the First Quarter of 2002 when there was no movement in the real in relation to the dollar.

All of the operational expenses increased from 2.1 billion reales in the First Quarter of 2002 to 3.5 billion reales mainly as a result of provisions for losses with thermal -, plans and general increase in overhead in administrative expenses.

Net slide, please. The reduction of three % enlisting costs is excluding government participation in the First Quarter of 2003 in relation to the previous quarter. Results from the low production in the end of last year as a result of the listing of piece 34 [ph] in October and all of the scheduled maintenance stoppages. In relation to the First Quarter of 2002, lifting [ph] costs in Dallas [ph] fell 18% as a result of higher production and as a result of conversion to dollars of cost expressed in the EVI's [ph]. Including government [ph] participation [ph] lifting [ph] costs were up 14% due to the higher reference price for -, inline with the international commodity markets. Costs were also boosted by the increased rate of the government participation on -, lifted from the Marlene Suit Feud [ph], as well as high output from the feud [ph].

Domestic refining costs were unchanged at \$0.9 per barrel. This reflected a higher Fourth Quarter expenses [ph] queues [ph] arising from scheduled maintenance stoppages. However, there was -, in the First Quarter 2003 costs due to the conversion in to dollars of cost originating in local currencies which were impacted by the appreciation of the real against the dollar. This cost fell 13% in relation to the same period of the previous year, again, due to current conversions. And also more efficient use of chemical and catalyst products.

Next please. Segmented results -, E&P reflected the strong increase in production and the variation of the international prices. We cannot absorb that net operating revenues for E&P tends to follow very closely the price of bench crude oil, with the exception of Fourth Quarter 2002, when production fell in relation to the previous quarter. This -, was correct in these First Quarter of 2003. In contrast, results of the supply segment are influenced by the fact that the domestic realization price and international oil price are not entirely linked while transfer prices practiced by the E&P reflects both international price and the exchange rate movements.

Net operating revenues of the supply segment was squeezed by rising raw material costs and a shrinking -, market. -, for the supply segment is consequently much more volatile during the period. In E&P the increase of the operating revenues in First Quarter of 2003 in relation to the First Quarter of 2002, results from the following factors, increase in 4.1% of the national production of oil and NGL and natural gas. Increase in the price of the bench oil in 49%. Depreciation of the real by 47%, increase in the availability of Marlene [ph] oil for exports.

In the supply segment, the increase in 95% of operating revenues is related to increase up to 123% of the average realization price. Growth in the export of derivatives of 60% of each [ph] gasoline increased 24%.

Next please. Continuing this trend of the past few years, our exports were up 6.1% and oil product exports 27% compared to the Fourth Quarter 2002. Now comparison with the First Quarter of 2002 it's even more dramatic with increases of 41% in oil and 60% in oil products. Higher exports reflect the increase in domestic production, favorable prices for -, crude on the international market. And recently the contraction in the domestic market. The company's net -, balance of oil and derivatives remains unchanged at an average of 120,000 barrels per day in both the First Quarter of 2003 and the Fourth Quarter of 2002. The duty of oil stocks ahead of the Iraq war presented a detaining improvement in this performance during this First Quarter, in spite of lower domestic demand.

First quarter 2003, net debt fell nine % compared with the position on December 31st, 2002. This all ready reflected the 5.1% appreciation of the real against the dollar during the course of the quarter. And the impact this had on debt 19% of reaches [ph] dollar [ph] linked [ph]. The increase of 28% in cash, in holdings, in marketable securities as a result of stronger cash flow also contributed to a reduction in the net debt. Petrobras debt to equity ratio declined to 45% from 53% in the Fourth Quarter, also reflecting the impact of the real depreciation against the dollar and increase in our cash position.

The total value added generated by Petrobras increased 89% in the First Quarter of 2003 in relation to the same period of 2002. The economic contribution of the company to the government grew 79.9% in the First Quarter in relation to the same period in the previous year with the following highlights. Sixty-four % growth in tax obligations that totaled 11.7 billion AIS. One hundred fifty-nine % increase in the government participation reflecting the increase in production of the fuse with high productivity namely Marlene [ph], Albacora [ph] and Marlene Suit [ph]. The increase average price in foreign currency as determined by the ANP in the exchange rate that reflected on these prices.

Thank you for your attention. And now we are beginning the question-and-answer session. As part of our commitment of transparency I would like to inform that tomorrow we will be launching a new

investor relations Web site. We formulated -, offering better services and complete information. Thank you. Let's go now to the Q&A session.

Questions And Answers

Operator

Thank you. Ladies and gentlemen. we will now begin the Q&A -- the question-and-answer session. If you have a question or a comment please press the star key followed by the one key on your touch-tone phone now. If at any time, you would like to remove yourself from the questioning queue press star followed by two. Please restrict your questions to two at a time.

Our first question comes from Gustaf Santos [ph] from Credit Suisse First Boston.

Q - Gustaf Santos

Hi. Good afternoon. Well the first question is I understand that the maximum losses for 2003 with electricity purchase contracts were almost totally provisioned. I'd like to have an idea of how much you currently expect in terms of maximum loss for 2004.

And the second question is also related to thermal plants [ph], I'd like to hear from you about the possibility of increasing the interest that Petrobras has in -, plants [ph] as a way to reduce the losses with electricity purchase contracts. Does the net present value of these contracts differ substantially from the net present value of the plans to justify such a movement?

Jorge Sergio Gabrielli de Azevedo: Could you repeat the last part of the question? I had some problem listening to you.

Yes, I'd like to understand, especially -- well there are some comments in the press recently talking about the possibility of Petrobras increasing its interest in several thermal plans SO8 [ph] to reduce losses. I'd like to have an idea of -- in terms of net present of the contracts, compared to the net present value of the projects of the -- or the plants [ph] is they decide substantially to justify such a movement.

Jorge Sergio Gabrielli de Azevedo: Okay. The first question, I think that we -- we think that we are expecting change in the regulatory framework. And we think that during 2003 you are going to change the exposure of Petrobras doing -- making some decisions on the equity participation of Petrobras and our partners and making some decisions on short term contracts from thermal plants [ph]. Which means we have not a clear -- very precise view of that's going to happen in 2004.

That's' the reason why we are making provisions for 94% of our expected exposure in 2003, which means that I cannot go in any more detail for 2004 right now.

In relation to the profitability of changing the participation of Petrobras in thermal plants [ph] is one of the reasons why we think that is comparing the net present value of the contracts, with the net present value of our equity participation. And sometimes, maybe, this is going to be better for us if we buy our complete participation on those thermal plants [ph].

Okay. Thank you.

Thank you. Our next question comes from Carlos DeLeon [ph] from Deutsche Bank.

Q - Carlos Deleon {BIO 16867888 <GO>}

And I just have two questions, in the First Quarter, domestic oil product volume sales fell by six % year-on-year. And I'd just like to know what we can expect for the remainder of the current year?

And secondly, I just wonder if there any new developments in the company's efforts to renegotiate the conditions for the purchase of gas from Bolivia.

Jorge Sergio Gabrielli de Azevedo: In relation to the fell [ph] of the domestic demand we think that this is going to be a little bit different right now because we have a reduction price. I think we think we have a real emphasis on this two or three months ago. We have a elasticity [ph] of demand in our domestic market and we're going to have a demand that's constant, which means that we cannot pass through completely the increased international price.

As we have now a reduction under the national price and we are following some reduction in Brazil we think that the domestic demand may increase in the next few months. In relation to the purchase of gas from Bolivia we are still negotiating with the -- Brazilian government and Bolivian government and Petrobras and the -- our partners are negotiating. We are in the process of negotiation and I cannot disclose more information right now.

Just follow up on the first question then, with lower selling prices on refined oil products and clearly volume growth will recover to some degree but -, are you talking of -- are you expecting a positive volume growth?

Jorge Sergio Gabrielli de Azevedo: Foreign growth. Yes, we are exporting what we cannot sell to the Brazilian markets. Our exports are the remainder of what we cannot sell to the Brazilian market.

All right, thanks.

Operator

Thank you. As a reminder, ladies and gentlemen. to pose a question simply dial star followed by one on your touch-tone phone now. Our next question comes from Frank McGann [ph] from Merrill Lynch.

Q - Frank McGann {BIO 1499014 <GO>}

Two questions. First, just to follow up on the demand issue, I was wondering if perhaps you could comment on what you're seeing in the market in terms of import competition? For a while your prices have been a little bit higher than import parity [ph] prices. And I was wonderful if you had seen responses to that in different parts of the market.

And then secondly, related to the oil price decline from a crude standpoint and a profitability standpoint clearly that will have some effects. Part of that, I would assume will be offset by lower up stream taxes. But I was wondering if you could just comment on both the effects you expect to see as oil prices come down related to earnings. And what kind of cost actions you might take to reduce your cost to reduce somewhat the sensitivity to the oil prices?

Jorge Sergio Gabrielli de Azevedo: Well we have a reduction of costs of seven % this semester. We have now some -- we -- our stock of products increased this semester by two billion reals. We think that -, I want to emphasize that because on the past we say these many times that the Brazilian market has a positive elasticity [ph] of demand.

And as we think now we can increase our sales in the domestic markets. But if we keep prices above the international prices, we can see some movement, still a very tenuous very small movements of some contractors that may bring new supply to the domestic market. But it's

nothing -, right now. But we've -- that's a threat that we have in our contractable [ph] market right now.

Okay. Thank you, very much.

Jorge Sergio Gabrielli de Azevedo: Well costs you mentioned something on our cost side. We think that if the crude oil price goes down for the next few months. And we don't think this is going to happen very steeply this also has an effect on our costs also because we sell from our E&P to the - to our supply side. And our margin can increase and we can compensate some of this movement within the company. That's the beauty of being an integrated company.

Operator

Our next question comes from Rodrigo Golles [ph] from Bear Stearns.

Q - Rodrigo Golles

Hi. Good afternoon. Just two questions. The first one is regards your price realizations. There's been a pretty significant narrowing of your price relations relative to brand or WTI. I was wondering if you could expand upon that beyond the effects change quarter-on-quarter. Also, your elimination during the quarter grew quite a bit. And I was wondering if you could expand upon that as well. Thank you.

Jorge Sergio Gabrielli de Azevedo: Rodrigo, I don't know if I understood. You said that our margin PMR brand reduced?

The differential for ...

Jorge Sergio Gabrielli de Azevedo: No, it increased. We had 0.73 cents per barrel in December. And now we have something like between three point something. Increase from 0.73 to three something. It's not the same as international difference between plants [ph] and -. But this margin increased in Brazil not reduced.

Well I'm -- well your price realization for the First Quarter were \$30 per barrel, right?

Jorge Sergio Gabrielli de Azevedo: Thirty-four.

Thirty-four.

Jorge Sergio Gabrielli de Azevedo: I think. Let me check here. PMR in dollars.

Just so I can double check what was your deferential for ...

Jorge Sergio Gabrielli de Azevedo: Thirty-four point eight nine.

So what was the deferential for the First Quarter.

Jorge Sergio Gabrielli de Azevedo: The First Quarter deferential was 347.

Okay.

Jorge Sergio Gabrielli de Azevedo: And it was 0.73 or -. Not a reduction, increase in the margin.

Okay. I'll have to double check my numbers. All right. In regards could your elimination, could you explain why they grew so much?

Jorge Sergio Gabrielli de Azevedo: Elimination inter segments?

Right.

Jorge Sergio Gabrielli de Azevedo: Yes, everything was done regularly on our consolidated numbers.

Yes, they jumped, from what I'm looking at, they jumped to about 19 billion for the quarter in AI terms.

Jorge Sergio Gabrielli de Azevedo: Yes. But we have a grant price that is \$31 now and was 21 last quarter. It's \$10 more per brand, per barrel and we have an increase in absolute numbers. The exchange rate was three -- was 2.7 something. And now is 3.49. The combination of the two -- the composite effect of -, -- higher -. And a -, rate that's much higher now.

Okay. Right. Thank you.

Operator

Thank you for your question. As a reminder, ladies and gentlemen. if you would like to pose a question please press the star key followed by the one key on your touch-tone phone now. Our next question comes from Paul Ching [ph] of Lehman Brothers.

Q - Paul Ching {BIO 16212054 <GO>}

Hi. Good afternoon. Two quick questions. The income tax and total contribution for the quarter is about 36.6%, somewhat higher than the full year 2002 and obviously 2001 average tax rate and contribution. Going forward, is that a reasonable estimate going forward? Or that it should going back down to us in to the 34percentile rate.

Secondly, on the cost of goods sold, sequentially from the Fourth Quarter it's down about seven %, does it all contribute to the lower domestic product sales? Or are there other things that we should be aware of that?

Jorge Sergio Gabrielli de Azevedo: Reduction costs is a result of -, rate, appreciation, increasing reduction. And we also have an important effect of the change in the accounting procedures for the abandonment [ph] of the wells that we are adapted now the SFAS 143 requirements.

...

Jorge Sergio Gabrielli de Azevedo: ...abandonment of the ...

But the abandonment of the future rate is that going to be impacted? Should it be on the sales and SG&A line instead of the costs of goods sold? Why you will be impacted on the cost of goods sold?

Jorge Sergio Gabrielli de Azevedo: Well the Brazilian GAAP it goes to the results. And in the U.S. GAAP it goes to the stockholders -- -, to my accountant whether he can explain in more detail for the technical issue.

Okay.

Q - Unidentified

The change in the Brazilian GAAP results was -. And the rest of the GAAP change will be in the results, Okay.

Q - Paul Ching {BIO 16212054 <GO>}

I was looking at the costs of goods sold that is down seven %. But I suppose that the change in the accounting policy for the future abandonment of the rate or -, is going to be resulting in a change in your operating costs, not at the costs of good sold. So ...

Jorge Sergio Gabrielli de Azevedo: Not on the cost of good sold, why? It effects both I think as far as I understand the second [ph] accounting procedures.

Okay. Can you tell me then how big the cost of goods sold positive impact by then?

Jorge Sergio Gabrielli de Azevedo: Can you repeat please?

What is the impact by the change in the accounting rule in the cost of goods sold.

Jorge Sergio Gabrielli de Azevedo: Well we have a reduction of costs of good -- costs of abandonment of 400 -- how much was it Maria Angelo [ph]? In our Fourth Quarter last year we had 348 million reales of cost of abandonment and now we have it at two million. When down -- no that's not -- 400 million to two million, is that true? All of this? We have a big, big change more than I was expecting.

So 436 million.

Jorge Sergio Gabrielli de Azevedo: One hundred thirty-eight million goes down to two million.

Right. So it's a reduction of 436 million. Wonderful. And how about the income and social tax contribution going forward? It's the First Quarter is at the reasonable level?

Jorge Sergio Gabrielli de Azevedo: What's happening? Social contribution forward?

Right. That should we apply the same way around 36.6% going forward? Or that that rate is going to move forward ...

Jorge Sergio Gabrielli de Azevedo: Yes, there is no change in the Brazilian tax law. The results is that because have better results. We have a net process of 5.5 billion reales. And this increase our income tax.

Okay. Very good. Thank you.

Jorge Sergio Gabrielli de Azevedo: The exchange -- the tax bracket -- the tax ratio is the same. But we are paying now on absolutes services because we have a higher profit in this semester.

I would like to apologize to Rodrigo Golles [ph]. The people here are saying that we had a mistake in our economic scenario. And maybe that changed in the denomination of the curves. The red curve is our PMR. And the blue curve is brand [ph] and that's the reason why maybe we was induced to mistake all in the English version.

Operator

Thank you. Ladies and gentlemen. as a reminder, if you would like to pose a question simply press the star key followed by the one key on your touch-tone phone now. Our next question comes from Christian Audi [ph] from Morgan Stanley.

Q - Christian Audi {BIO 1825501 <GO>}

Good morning. I had two questions. The first, should we expect, any more accounting changes to be forth coming to your U.S. GAAP or Brazilian GAAP numbers? And two with respect to the losses you're incurring or the provisions your making with relation to the losses with -, what other tangible specific steps are you taking to try to solve the situation. Obviously, you've all read mentioned that you tried to negotiate certain contracts. But I was just wondering if you're working on any other options to avoid going through this in '04.

Jorge Sergio Gabrielli de Azevedo: Well as an informed -- we have no expectations to change accounting procedures for this year. That's what our accounting people are saying here. That we don't have expectations. We are fine tuning our use of the U.S. GAAP procedures. But we don't think that we are going to see any dramatic changes in our accounting procedures from now.

Q - Unidentified

This is the last question being asked, should we just end it?

Yes.

Yes, Okay. We can.

Or should we ask for another or should we prompt again?

Q - Christian Audi {BIO 1825501 <GO>}

You're live by the way.

Q - Unidentified

We're live?

Jorge Sergio Gabrielli de Azevedo: There's some technical problems.

Okay. Great.

Jorge Sergio Gabrielli de Azevedo: The second thing is on the thermal plans ...

Hello?

Okay. Hold on just a second.

Q - Christian Audi {BIO 1825501 <GO>}

Hello?

Jorge Sergio Gabrielli de Azevedo: Can I go? I have some technical issues right now.

Go ahead, Mr. Gabrielli.

FINAL

Bloomberg Transcript

Jorge Sergio Gabrielli de Azevedo: Yes, Okay. We on the thermal plans we are trying to take some of these movements, make some movements in different directions. We are trying to start a process of negotiation to change our equity participation on those thermal plans. So comparing the net present value of our contracts with our commitments with the equity participation of those companies.

We are trying to increase our commercialization -, to try to make some contracts in the short run to minimize our losses in the short run. We are making to discuss alternative locations for some of the turbines that we have in order to increase our possibility to dispatch those turbines. And we are expecting very much in a change in the regulatory frame work during this year in order to have a more stable market for the supply of power services from thermal electric combined with hydro electrical power sources.

But this process of negotiation of the regulatory framework is lead by the administration of mining and energy. We hope that this is going to come out with a very good change in the regulatory framework by the end of the year.

Okay. Thank you.

Operator

Thank you. Our next question comes from Rodrigo Golles from Bear Stearns.

Q - Rodrigo Golles

Hi, guys. Just a quick question cap ex. Your cap ex for the quarter was about \$1.3 billion, whereas your target for the year is about, if I'm not mistaken 7.2 billion. Are you still looking at 7.2 billion for '03? Or so can we expect a rise in the upcoming quarters?

Jorge Sergio Gabrielli de Azevedo: Yes, we are aiming for 2003 7.2 -- 7.1 -- \$7.2 billion for the year. We had less than what we expected for this year. But if you compare with the last year increase of our investments, we invest this year -- this quarter \$3.59 billion reales. And last quarter we invest something like 2.7 last year.

We increased in relation to the quarter. But we are going to catch up the difference during the year, we hope that we can -. We don't forecast any big financing -- funding problems for the 2003 -.

Okay. And in regards to international strategy can you comment on any plans that you may have in order to support production volumes at Paris or any other international areas?

Jorge Sergio Gabrielli de Azevedo: Well now that we have finished processing in Argentina, we can say that we are now above two million barrels a day, when we incorporate -, production at Petrobras which is a very good results for the company. We plan to consolidate our investment in trying to make the strategy of discussing the use of the different assets that we have internationally. But we are aiming mainly to the Latin American markets, to the West Africa and the Gulf of Mexico. And that's our area that we are aiming the most of our reinforce [ph] for the 2003.

Okay. Thank you.

Operator

Thank you. Ladies and gentlemen. as a reminder, if you would like to ask a question, simply press the star key followed by the one key on your touch-tone phone now. And gentlemen. there are no more questions at this time. You may proceed with your closing statements.

Jorge Sergio Gabrielli de Azevedo: Thank you, all for being here. I hope that next quarter we can have as good results as we had now. It's a very good pleasure to be in the company so big numbers to show to the market, to the investors and to the -. Thank you, very much.

Ladies and gentlemen. your host is making today's conference available for replay starting one hour from now and lasting through June second. You may access this replay by dialing 1-800-858-5309. That number again, 1-800-858-5309. At the voice prompt enter the access code 40469 followed by the pass code 97898. International participants may access the replay as well by dialing 334-323-7226 and entering the same access code and pass code. The replay will be available approximately one hour from now. This does conclude our Petrobras conference for today. Thank you, very much for you participation. You may now disconnect.

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