

Q3 2015 Earnings Call

Company Participants

- Luiz Eduardo Falco Pires Correa, Chief Executive Officer
- Luiz Fernando Fogaca, Chief Financial Officer and Investor Relations Officer

Other Participants

- Andrea Teixeira, Analyst
- Franco Abelardo, Analyst
- Thiago Macruz, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, welcome to CVC's Third Quarter 2015 Earnings Conference Call. Today with us are Mr. Luiz Eduardo Falco, Chief Executive Officer; and Luiz Fernando Fogaca, Chief Financial Officer and Investor Relations Officer. This event is also being simultaneously webcast and be accessed at www.cvc.com.br/ir. There, please click on the link, Webcast 3T15. You can also download the presentation there. All presentations are being presented in Brazilian reais according to Brazilian Accounting Principles as well as based on the Brazilian Accounting Committee.

Before going on, we would like to let you know that any statements made during this conference call relative to CVC's operating goals and business outlook are based on CVC's management's beliefs and assumptions and rely on information currently available. Forward-looking statements are not a guarantee of performance. They involve risks and uncertainties since they refer to future events and therefore depend on circumstances that may or may not occur. Investors should understand that the general market conditions, industry conditions and other operating factors may affect the future performance of CVC and lead to results that will materially differ from such statements.

Now, I'll turn the call over to Mr. Luiz Eduardo Falco from CVC that will start the presentation. Please Mr. Falco, you may go on.

Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Hello, good afternoon, everyone. It is a pleasure to start our conference call to discuss the earnings of the third quarter 2015. With regards to our agenda today, as usual, first, we're going to approach the main actions developed in this quarter and then we will present the financial results and finally, we are going to open for questions.

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To start, I would like to approach the recently developed initiatives in the company. As you know, the Brazilian macroeconomic environment continues challenging and the third quarter '15 was marked by the high volatility in exchange rates, which made consumers delay the purchase of international packages, waiting for a more stable exchange rate.

As we have witnessed in the past, the consumer is less sensitive to exchange volatility, to exchange rates themselves. The drop in sales International and Sea segments, both affected by the exchange rate, was fully offset by the double-digit growth in sales in the domestic segment. It's important to mention that although the dollar exchange rate is much higher than before, the recent stabilization already enables us to start recovering sales in these two segments and thus can already being felt in the first days of November.

The company in this environment adapted very quickly its product portfolio by means of offering very appealing products of short-term. We launched several promotional materials, increased the presence of the national destinations in our advertisement and window-shops. We also focus on the offering of added-value services like insurance, car rental, tours and also CVC credit card offers supported by an effective marketing strategy. We've recently also launched a new insurance modality with Bradesco that will cover for the payment of trips in the case of unexpected events such as unemployment or physical disability.

In the case of a loss, the insurance will also receive a bonus equivalent to 20% of the value of the package to be used during the trip and also it will cover for the installments is still outstanding. This type of insurance is unusual in the tourist segment and CVC will not take any risks.

Another topic is that we are close to complete our store expansion plan for the periods 2016 to 2018. We already have the formal commitment of 43 master franchisees for the opening of 259 new stores during the period. Altogether, the total opening should be above 300 stores when the plan is completed, that will mean about 100 stores per year as we have been doing in recent years.

On August 31, we also completed the acquisition of Submarino Viagens and control of Rextur Advance. Only one month after acquisition, we already have more efficient, flexible organizations by means of eliminating any overlaps. This new organizational structure will enable the companies to support their growth strategies and reduce costs significantly. The three businesses are going to operate in a separated way. Additionally, we continue to seek opportunities to reduce costs and also have cross-sell of travel products, including corporate hotels and car rental.

Finally, I would like to highlight that for the fifth year in a row, CVC was awarded by the Top of Mind Folha DE Sao Paulo awards that recognize the preferred brands in Brazil. Given the strength of our brand and the quality of services provided, we are champions of this category, receiving 19% of mentions of spontaneous recall and improving four percentage points compared to 2016. 10 percentage points above the second runner up.

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On slide five, I'm going to talk about the CVC Group with acquisition of RexturAdvance and Submarino, we consolidated our position as a leading company in the travel segment in Brazil, with bookings that account for 8.9 billion in the last 12 months and operations in the leisure and corporate segments by means of brands that are referenced in their respective sectors. Additionally, the acquisitions are fully in line with our omni-channel strategy. That is operating in all channels, thereby strengthening our presence in the online channel by means of Submarino and travel agencies by means of Rextur, that are basically operating these two channels.

We also see further opportunities for commercial synergy and cost reductions that we are going to start capturing already in the fourth quarter.

For the financial results, I'm going to turn the call over to our CFO, Luiz Fogaca, that will give you the numbers.

Luiz Fernando Fogaca {BIO 18466257 <GO>}

Good afternoon, everyone. Just for the purpose of standardizations, when we talk about CVC, we are talking about the results of CVC travel operator alone. And when we talk about CVC Group, we're going to include in addition to CVC, RexturAdvance and Submarino Viagens.

On page seven, we are going to talk about bookings in the period. Confirmed bookings amounted to R\$1.369 billion in the third quarter '15, accounting for a decrease of 0.3% compared to the previous year. The double-digit growth of confirmed bookings in the domestic segment offset the drop in the International segment and Sea Cruises that was caused by the depreciation of 55.5% of the Brazilian real compared to the dollar. We saw the real going from 2.27 in the third quarter '14 to R\$3.54 in three quarter, '15. In addition to that, a drop in the trust of consumers and volatility in the exchange rate made consumers to buy their packages closer to the date of the trip. Less time promotions conducted by our suppliers also contributed for this change in consumer behavior in that confirmed bookings in the third quarter '15 for traveling on the same quarter had strong growth of 14% compared to the previous year, whereas bookings for future traveling in the fourth quarter or even in 2016 had drop of 6%.

Going to page eight, -- forgive me, let me say that, yes, page eight. I'm going to talk now about bookings per channel and store opening. Despite the challenging economic environment, confirmed bookings by means of our online channel continue to show consistent growth. This is a result of the investments that we have made in our platform in addition to improvement in our conversion rates. All sales channel had growth in the first nine months of the year compared to 2014.

We continue with our process to open new stores. We opened 20 new stores in the third quarter, totally 103 net openings in the last 12 months. We closed the quarter with 954 exclusive stores and reaffirmed our plan to open 100 new stores in the year of 2015.

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Going to slide number nine, we're going to talk about bookings and net revenues. We had an increase in bookings of 19.9% in the third quarter and 16.2% year-to-date compared to the same period last year. This growth results from several promotional actions that were implemented by our partners and suppliers as well as several sales and marketing initiatives carried out by CVC, in addition to a more favorable comparison base in the third quarter '14, where consumers delay to their vacations to December '14 and January '15 because of the World Cup that was held in Brazil in the third quarter.

Net revenues of CVC was 211 million in the third quarter '15 and 581 million year-to-date, respective growth of 19.1% and 17.6% compared to the same period last year. In 2015, we have been presenting consistent improvement in our margins, a result of a more favorable product mix with an increase in our share in the domestic segment, which has better margins. Comparison to the same period last year was affected by a higher demand for international packages in the third quarter '14 because of the World Cup, which enable us to have better margins in that period.

Net revenues of the CVC Group was 229 million in the third quarter and 5598 [ph] million year-to-date, respective margins of 14.6% in the third quarter and 14.9% year-to-date. Here, it's important to highlight that the evaluation of margin of Rextur and Submarino is made over sales and CVC over-boarded customers because of the different natures of our business.

On slide 10, we are going to talk about EBITDA. Adjusted EBITDA was 117 million in the third quarter, an increase of 18% when compared to the same period last year. As a percentage of the net revenues, adjusted EBITDA was 55.7%, a drop of 40 basis points compared to the previous year. The adjusted EBITDA of CVC Group was 120 million in the third quarter '15. Adjusted EBITDA totaled 295 million year-to-date, accounting for an increase of 18.7% compared to 2014. As a percentage of net revenues, adjusted EBITDA reached 50.8%, 50 basis points above the same period last year. The adjusted EBITDA of CVC Group was 298.4 million year-to-date.

Non-recurring expenses were 11.8 million in the third quarter and are related to our compensation program based on stocks in the amount of 4.4 million, M&A expenses in the amount of 5.1 million and expenses with restructuring of 2.2 million. In the first nine months of 2015, non-recurring expenses accounted for 24.2 million because of our stock-based compensation program of 14 million, M&A expenses of 7 million and restructuring expenses of 2.2 million. It's important to highlight that September was the first month of operation of RexturAdvance and Submarino Viagens as part of the CVC Group and therefore several synergies had not yet been captured at the time.

In the beginning of the month of October, as we mentioned, we implemented a new structure in the Group which already represented important reductions in the expenses of both companies. Additionally, commercial synergies are already being implemented gradually since the beginning of October, which will enable better results for the two companies in the fourth quarter.

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Going to slide number 11, we are going to talk about net income. The adjusted net income was 54.4 million in the third quarter, an increase of 20.5% in the period and already includes the financial costs relative to acquisition of the two companies in September. The adjusted net income of CVC Group was 53.4 million in the third quarter. The adjusted net income year-to-date totaled 132 million, growth of 25.6% compared to the previous year. The adjusted net income of CVC Group was 131.5 million year-to-date.

Going to pages 12 and 13, we are going to talk about the company's cash flow in the quarter and year-to-date. You can see that the generation of cash flow in the third quarter was 37.5 million, impacted by the change of our working capital dynamics basically because consumers changed behaviors and are buying travel packages closer to the date of their travels. The difference between the purchase date and their actual travel decreased from 78 days in the third quarter '14 to 70 days in the third quarter '15, similar to the 71 days observed in the third quarter '13. As we can see, we had strong improvement in terms of working capital in the third quarter of 2014 compared to '13 and now we are basically back to the levels of 2013.

On slide 13, we can see cash consumption of 18.4 million year-to-date, once again, strongly impacted by the delay of purchase from consumers. If we normalize the working capital by the same effect of eight days, we would have a generation of operating cash of 100 million year-to-date.

Going to page 14, we are going to talk about investments and return on invested capital. Investments accounted for 6.6 million in the third quarter '15. The investment of CVC Group was 8 million in the same period. The investments made year-to-date accounted for 23.7 million in CVC and 25 million including RexturAdvance and Submarino Viagens. Return on invested capital for CVC Group was 43.2% in the last 12 months ended on September 30, 2015, three percentage points above the same ROIC of CVC in the past 12 months closed in September 2014. This increase has to do with the capital structure of RexturAdvance that basically needs no working capital.

Going to page 15, I'm going to talk about indebtedness. The net debt balance on September 30, 2015, was 414 million, already considering the debt for the acquisition of RexturAdvance and Submarino Viagens against 150.9 million on September 30, 2014. Taking into consideration the advanced receivables, net debt was 457.7 million on September 30, 2015, and 230.7 [ph] million on September 2014, an amount that respectively represent 0.7x and 1x the EBITDA accumulated in the last 12 months. That related to the acquisition of RexturAdvance and Submarino Viagens will be maturing six years and 10 years respectively with annual payments of the principal amount and quarterly interests in the case of RexturAdvance. Both debts are adjusted by the CDI.

In 2015, the company raised debt in foreign currency, which are completely protected by means of swap operations with an interest rate in Brazilian currency of 104.5% of the CDI in average. Financial expenses increased 26% in the third quarter, mainly due to the increase of the interest rate CDI and the new debt related to the acquisition of RexturAdvance and Submarino Viagens with interests of 2.3 million in the period regarding these acquisitions. In addition, annual comparison is impacted by a negative adjustment of

earn-out due to the founding -- owed to the founding shareholder in third quarter '14 because in that period, the IGP-M was negative.

We would like to thank you very much for being with us in this conference call and we are going to open for Q&A.

Questions And Answers

Operator

Thank you. The floor is now opened for questions. (Operator Instructions) Andrea Teixeira from JPMorgan would like to ask a question.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Hello, good afternoon, everyone. I would like to have an update if you can about bookings for the fourth quarter. And also what you think you're going to move on in terms of synergies with Submarino, Rextur, what kind of combined margins should we expect for the fourth quarter and the year of 2016? Thank you.

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Hello, Andrea. We do not provide for cash for the future. But just for you to understand, we had two impacts of a strong dollar, one was April that the dollar went from 2.60 to 3.20; and now in August that it went to almost 4.20 and now is back to 3.80. What we see is that whenever we had such impacts, as it happened with the World Cup, the next month is affected, but then people kind of get used to that, vacations are coming, people are going to go on vacations and they start to make plans. So, we see some of this in the fourth quarter. Brazil still has lots of challenges, but the numbers we have been achieving are single digits, but positive and we see this as a trend. Obviously as things tend to stabilize, historically, we tend even to achieve better results in the future.

As for operations, we're talking about different operations. One is an ATA [ph] operation. The other is the transfer to travel agencies and the other is to the real operator. So what obviously we're going to do is the following. We're going to first identify all possibilities for cost synergies and we are going to adapt and implement them very fast. As Fogaca mentioned, we already did something in these regards and we haven't captured the results yet because they were talking about October 2. But we are also considering cross-sells among the businesses, but this is something that will take a bit longer because we have to adjust platforms connect one platform to the other, supply hotels, cars from one platform to the other and also train our sales teams. Again, you're talking about different businesses and the teams have to be trained to sell a larger portfolio of products. So we believe that the year of 2016 may be perhaps a bit more complicated, but we believe we have much room to work and we may generate very good business opportunities.

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

And just to add to what Falco mentioned, we have several synergies as he mentioned. We integrated platforms between CVC and Submarino. Therefore giving access to a portfolio

of hotels for Submarino that is much better, and we see already a growth in the hotel mix and sale of hotels in Submarino with a better margin. As Falco mentioned, we implemented a very good structure in terms of eliminating overlaps on October 2. In the beginning of the year, we are going to centralize the three operations in the city of Santo Andre and with that, we are going to improve integration between areas, IT, the dynamics is going to be much easier.

Q - Andrea Teixeira {BIO 1941397 <GO>}

So is it -- well, thank you very much for your answers. So, is it reasonable to expect that along 2016, the combined margin for CVC Group is going to be closer to CVC historical margins or not, because the nature of the business is less profitable? The CVC business is standalone, we should not expect that or perhaps just an improvement. And as for demand as you mentioned, I should imagine that the consolidators and online audiences, are they different from what you have with CVC? Are you being more affected by the kind of clients that you have from this type of clients?

The question is this improvement that you're having along the fourth quarter because the dollar is more stable, is it for all the channels or is it just for stores and distributors? Just for me to understand the dynamics of the market better?

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

Well, with regard to margins, again, as Falco mentioned, you're talking about very different businesses. CVC has a rate that is close to 15%, a consolidator that only sells tickets, transfer credits almost a mediator. We have margins that are closer to 5%. So, a company like Rextur that has 3 billion bookings with a margin of 5.6%. The consolidated margin will never be close to the 15%.

On the other hand, this is a company that has a much leaner structure. It is a simpler product, it's just the ticket. So, it is a very lean operation in terms of operations of systems and you can have EBITDA margins with lower differences compared to CVC. But CVC, when you're talking about the leisure segment, CVC has the best margins in the market. Rextur is the leader in the consolidated business. So they have their own differential, they had their best platform, a very good team, very good relationships, they are also affected by the dollar, but with the stabilization they are recovering.

And Submarino is a company with a very strong brand, has been in the market for more than 10 years, a DNA of an online company. They are going through the implementation of a new platform, but month against month, we see an important recovery. In September, we had sales of Submarino of approximately 30 million. In October, we are already at 40 million. So we are resuming levels that we had before the implementation. Of course, there is always a learning curve, but we are going to see some of it reflected in the fourth quarter, especially when Submarino has the broader portfolio of products of CVC.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay, thank you very much.

Operator

Franco Abelardo from Morgan Stanley would like to ask a question.

Q - Franco Abelardo {BIO 17416219 <GO>}

Hello, good afternoon. (Foreign Language) I'd like to explore your level of growth, what you can see for Rextur and for Submarino? You said that Submarino is recovering sales, 40 million in October. How much that means in terms of sales growth year-on-year? Is it more or less than CVC online? Also for Rextur, we believe that this kind of market is having a decrease in sales year-against-year. So, I would like to know what Rextur's sales are like and if this integration can be disruptive, that is cause some kind of negative impact on sales? This is my first question. Thank you.

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Hello, Franco, this is Falco. Thanks for the question. When we talk about the omni-channel strategy, it is not that we're just going to mix lots of things and have something else in the future. We want to be a company that makes money, an operator that makes money, a consolidator that makes money and because we are ambitious, we want to be the best in the three segments. So we cannot really mix the businesses. But our vision is the following, differently from companies that only have a channel. We believe that customers look for the channel that best fits that and we want to be present in all of them, so that we can capture the customer wherever they are.

So we're starting from the perspective of the customer. That's why our margins have more to do with the businesses individually than the sum of businesses. Of course, that we are going to optimize the back office. Of course, we are going to try to reduce costs for the companies to have more margins. This also has to do with the strategy that we've put together and we are the first to have the three channels with three independent brands operations, each one wanting to maximize their factory. And I did the breakdown, Franco, just to tell you the following.

Because they are three different factors, they have different dynamic in. When the GDP goes down, the business corporate goes down. When the dollar exchange rate goes up, the leisure goes down. Business will continue to grow because they have to have meetings abroad. So these are dynamics that are individual when you have a very good promotion with an air company with hotels, the ATA channel can capture that faster, because they have a faster distribution for an audience that works more with the issue of price.

So the answer to your question is that we are going to change as the market changes and as customers are more or less affected by the drop in GDP, an increase of the dollar, et cetera. In the case of Rextur and Submarino, just for you not to have an answer, Rextur and Submarino are a bit more affected because of the business. The business segment has gone down and both companies do have a greater business mix. CVC has a very little business mix. Submarino has 50% and Rextur about two-thirds, which is normal for this kind of company. But on the other hand, you have to think of other things. GDP has gone down, but the important thing is whether it has stopped going down. If it stops going

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down, we start to resume our businesses. And if it goes up, we start to increase our businesses.

In Submarino, we also have another dynamic, we changed platforms. When Submarino had the first platform, it had about 30 million; and in October with the new platform with the work that the Submarino developed today are at 40 million. Of course, growing 30% in two months, this is not what we are going to expect for the company all the time. They are in a phase where they can start to have a very good channel in Brazil. What is most important is to have an OTA that generates profit, not a company that just consumes cash as it was tried in the country sometime ago. So the answer to your question is very dynamic and depends on what is going on.

We always work with normal growth. A vacation market, when it is at crisis 7% to 10%, outside crisis between 10% to 12%, business market a bit more affected by the GDP variation, when the GDP variation stops, it stops and OTA half of each one of these markets. So depending on what you want to project to Brazil. We think that 2016 is going to be an year where we have an opportunity of growth in the different channels because of different opportunities.

Q - Franco Abelardo {BIO 17416219 <GO>}

I see. So, you think that 2016, in terms of GDP, you are not expecting neither a drop nor an increase in GDP?

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

Well, I don't know. What I'm saying is that the way that we operate our retail, we believe that 2016 is going to be a bit neutral. Whatever had to drop has already dropped, the GDP is going to be a bit more stabilized and so we'll purchase it. So, we already feel in international traveling, for instance, some people that are resuming to buy tickets to have their vacations overseas. It's not because the dollar went up that people are no longer going to spend, I don't know, their 25th wedding anniversary in Paris. Perhaps, they want stay two weeks, they will just one week, but we do see an economy that is a bit more neutral for 2016 and we have to grow in market share.

I think this is an important point. CVC, Rextur, they are leaders in the segments they operate and they always have better performance than the market. So even next year with a slight drop in the GDP, Rextur can increase market share and so can the CVC. CVC has been showing in recent years that it performs better than the market.

Q - Franco Abelardo {BIO 17416219 <GO>}

The second question is perhaps a bit more technical with regard to margins. When you broke down, when you started, Fogaca, you said that Rextur margins are over sales and not bookings. Based on the numbers that you released and then it's just a month, I could calculate a product merging of about 6% for Rextur plus Submarino Viagens. And you have an EBITDA margin on top of that of 17%, that would be comparable to CVC's 15% and EBITDA of 55%. Am I doing the math right? Is this level a EBITDA 17%, I understand

that this is just a moment [ph]. But is it a good margin for the remainder of the year. What do you think the EBITDA margin is going to be in these new businesses?

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

Well, once again, you're talking about very different businesses. The 6% is correct over booking. When I talk sales, I say booking and when I talk about CVC, I am talking about the sales. The EBITDA margin is very much affected because September was the first month of operation in the two companies in the Group. In the case of Submarino was immense with negative EBITDA, which we are not going to see in the fourth quarter, lots has been done. Sales were stabilizing because of the new platform. We've reduced headcount on October 2, integration of platforms that are still taking place.

So if you think of Rextur margins there, historical level is closure to 35% EBITDA margin, compared to their intimidation revenues and Submarino has all online companies has a start that is always negative EBITDA breakeven, but the idea is to recover growth perhaps in the first months working with a breakeven EBITDA for Submarino and create a sustainable, profitable base for growth in 2016 and 2017.

Q - Franco Abelardo {BIO 17416219 <GO>}

Okay, very clear. Thank you very much.

Operator

(Operator Instructions) Thiago Macruz from Itau BBA would like to ask a question.

Q - Thiago Macruz {BIO 16404924 <GO>}

Hello, good afternoon. I would like to ask about your suppliers. I suppose that they are also seeing a very challenging scenario for 2015 and people react to incentives. I was thinking if you expect any restriction of capacity for 2016 that might change your capability to negotiate prices, what do you think in terms of your suppliers adjusting their capacity for 2016?

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Hello, Thiago. Hotel capacity won't have any kind of adjustment, perhaps with air companies. But air companies work with demands here. Lower demand will make an adjusted supply. Their elasticity is limited. You see, for instance, the US dollar went up, companies decreased their prices, but with that they also decreased their capacity and no one can live if they cannot have enough revenues to pay for their costs.

Anyhow, this is a cyclic movement. Sometimes capacity goes up, sometimes it goes down. We might have some decreased capacity, some percentage, air companies perhaps are going either not to increase lines or perhaps cut some lines, but from the point of view of a tour operator, we are working with off-peak hours. And as for the business, corporate segment, whenever someone wants to travel in peak hours, we are ready to sell. So again, we work with demand not as much with supply. We know that supply is cyclic for

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some routes probably we are going to have decreased capacity, but other routes may even offer increased supply.

And as for our capacity to sell, which is a concern of yours, a company that works in the three channels offers opportunities to capture customers in the three channels. Of course, they are independent operations with different dynamics, but we understand and manage that. But we do maximize what is good for our suppliers and for ourselves, and we try to work with them and have fully booked sales.

Q - Thiago Macruz {BIO 16404924 <GO>}

Okay, thank you very much. Thanks for your answer.

Operator

(Operator Instructions) We are going to turn the call back to Mr. Falco for his final considerations.

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Well, first of all, I would like to thank you very much for having joined us in this conference call. We understand that given the novelty of working with different companies in separate, you may have a bit more questions and once again, we are here for you to answer all your questions. Our IR team and Financial Department is available to help you understand the dynamics of each business, so that you can make the projections for your business.

And the fourth quarter, it's going to be the first time that these businesses are going to be consolidated and will try should be the explanation as clear as possible so that you can see the business as a whole, which was our strategy, but also the different leverages and behaviors of each one of these businesses. Thank you very much. Again, our team is here for you. If you need us, just give us a call. Thank you very much.

Operator

CVC's conference call is now closed. We thank you very much for joining us and wish you a good day.

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