

## Q3 2019 Earnings Call

### Company Participants

- Cristiano Cardoso Teixeira, CEO. Chief Financial & IR Officer and Member of Executive Board
- Douglas Dalmasi, Packaging Director
- Flávio Deganutti, Paper Business Director
- José Gertrudes Soares, Commercial Director of Pulp
- Marcos Paulo Conde Ivo, Chief Financial & IR Officer and Member of Executive Board
- Unidentified Speaker, Unknown

### Other Participants

- Carlos De Alba, Equity Analyst
- Daniel Sasson, Research Analyst
- Gabriela Elerati Cortez, Banco de Investimento S.A., Research Division
- Marcio Farid Filho, Research Analyst
- Thiago K. Lofiego, Director & Head of the LatAm Pulp & Paper and Metals & Mining Equity Research
- Unidentified Participant, Analyst

### Presentation

#### Operator

(Interpreted) Good morning. Welcome to Klabin's audio conference. (Operator Instructions) As a reminder, this conference is being recorded and broadcast live via webcast. And you may access it at [cast.comunique-se.com.br/Klabin/3Q19](http://cast.comunique-se.com.br/Klabin/3Q19), where the presentation is also available for download.

Before proceeding, we would like to clarify that forward-looking statements that might be made during this call in relation to Klabin's business outlook, projections, operating and financial targets and potential growth should be understood as mere assumptions based on the company management's expectations in relation to the future of Klabin. Such expectations are highly dependent on market conditions, on the overall economic performance of the country, of the industry and of international markets. Therefore, they are subject to change.

With us today in São Paulo, we have Mr. Cristiano Teixeira; Mr. Marcos Ivo; and other officers of the company. Mr. Teixeira will comment on the company's performance during the Third Quarter of 2019. And afterwards, the officers will be available to answer any questions that you might have. Now I would like to turn the call over to Mr. Teixeira.

Mr. Teixeira, you may begin.

**Cristiano Cardoso Teixeira** {BIO 17567319 <GO>}

(Interpreted) Welcome, everybody, to the conference call about the Third Quarter of '19 results.

In pulp, we migrated with tranquility the volumes that we have in contract with our partner to the Klabin commercial team that which actually is not only guaranteed volume but also delivered the best price performance vis-à-vis the indicators of the sector. In coated board we increased significantly our sales. And the replacement of plastic packaging finally offered real opportunities, especially in terms of the carrier board, the coated board that is used for beer packaging. In kraftliner, tapping into our flexibility, we integrated more paper into the packaging chain, reducing the purchase of third-party papers and prioritizing margin in the export market. In industrial bags and corrugated boxes, we grew our revenue by 6% year-on-year, confirming that service is essential to our clients.

Regarding Puma II, the Klabin engineering team is ahead of the original project schedule, evidencing our commitment regarding what we promised.

And now with great pride and satisfaction, I would like to give the floor to our CFO and Investor Relations Officer, Marcos Ivo.

Welcome, Marcos. And our best wishes.

**Marcos Paulo Conde Ivo** {BIO 21106710 <GO>}

(Interpreted) Thank you, Cristiano. Thank you for being with us during the Klabin conference call of the Third Quarter of '19.

I would like to start by stressing 2 points of growth, in the coated board, sales volume, 191,000 tons in the quarter, an expressive growth, 25% on a year-on-year basis. And the pulp production volume in the last 12 months reached 1,545,000 tons, 3% higher than the nominal capacity of the plant.

Now going to Slide #3. The sales volume in the quarter was 799,000 tons, a drop of 6% on a year-on-year basis, explained mainly by the scheduled maintenance stoppage in the pulp unit. In this period, the domestic market represented 57% of the total sales volume, an 8percentage point increase on a year-on-year comparison. Year-to-date, the volumes grew by 3% vis-à-vis the previous year, amounting to 2.5 million tons.

Net revenue in the quarter were BRL 2.5 billion, a 12% reduction comparing to the Third Quarter of 2018. And this reduction is explained by the lower sales volume in the period and the drop in the prices of pulp and kraftliner. In the first nine months of 2019, Klabin had 5% growth in net revenue. And this growth in net revenue in the first nine months of

the year are evidence of the advantages of the Klabin business model, which is integrated and diversified. And mitigating the impacts of the unfavorable scenario for commodity prices.

Adjusted EBITDA in the quarter was BRL 1,396 million, whereas the EBITDA margin in the period was 56%. Net of the nonrecurring event of tax credit, the EBITDA in the quarter was BRL 776 million with a 31% margin.

Now going to Slide #4. The volume of pulp sales was 326,000 tons in the quarter, with a drop of 18% on a yearly comparison due to the scheduled stoppage for maintenance purposes that occurred in July during 16 days. Net revenues from the pulp unit reached BRL 724 million in the quarter, a drop of 36% year-on-year due to the lower volume of sales and also the drop in pulp prices.

In the paper and packaging business, the volume of sales in the quarter was 474,000 tons, a 3% increase on a year-on-year comparison. According to the same comparison, the net revenue grew by 7%, reaching BRL 1.7 billion.

On Slide #5, the pulp unit, which, as I said before, in July, had the scheduled maintenance stoppage that occurred on schedule and on budget, confirming the technical and financial feasibility of 15-month campaigns. It is worth mentioning the good operating performance of the unit after the maintenance stoppage taking production of the last 12 months to 1,545,000 tons, higher than the nominal capacity, which is 1.5 million tons per year.

As we said in the previous conference call, the pulp production cash cost, net of the effects of the maintenance stoppage. And that includes all the fiber produced by Klabin, was BRL 716 per ton in the quarter, a 10% reduction on a quarter-on-quarter basis. The average price of the pulp unit sales was \$560 per ton in the quarter, showing a reduction lower than what we can see in the market list price, showing the benefits of the marketing and fiber and market mix of Klabin strategy. And due to the 15-month campaign, the next stoppage for maintenance purposes of the pulp unit is estimated for October 2020.

On the next slide, the volume of sales of coated boards, anchored by a strong shipping to the external market, was 191,000 tons in the Third Quarter of '19, representing a strong growth, 25% vis-à-vis the same period of 2018. Net revenue in the coated boards business was BRL 691 million in the period with a 27% increase on the same comparison basis. And the expressive growth in the sales volume and net revenue show the success of Klabin's strategy in terms of developing new products, new markets, together with a good moment for the coated board market.

On the next slide. The company closed the Third Quarter of 2019 with a net debt of BRL 15.1 billion. And the increase that we see in relation to the last quarter -- or the previous quarter is explained mainly by the devaluation of the real in the period that impacted the dollar-denominated debt of the company and by the disbursement of BRL 430 million for the Puma II project. Thus leverage, measured by net debt-to-EBITDA ratio in the last 12 months, closed the quarter at 3.4x, a 0.4% (sic) (0.4x) increase vis-à-vis the previous quarter. And the leverage measured in U.S. dollars, that better reflects the company

indebtedness due to our exports closed the quarter at 3.1x, the same level as the Second Quarter of '19. The company's cash at the end of September was BRL 12.2 billion, sufficient to cover the amortization in the next 64 months.

On Slide #8, the average tenor of the company's debt closed the quarter at 91 months, annual amortizations up to 2022. The period during which the disbursement of the biggest part of the Puma II CapEx was disbursed -- were reduced in a significant manner going to BRL 2.8 billion in September last year to BRL 1.3 billion currently. The liquidity position and the debt profile reflected especially in the average term and the amortization schedule leave the company with a robust balance sheet in order to (take) the next investment cycle already underway.

On the next slide, Klabin generated in the first nine months of '19 an adjusted free cash flow of BRL 742 million vis-à-vis BRL 1.4 billion in the same period in 2018. The reduction is explained mainly by the impact on the working capital due to the prepayment of REFIS, of financial expenses coming from the liability-managed process and the higher payment of income tax.

On Slide 10, dividends. Klabin paid to shareholders in the last 12 months dividends and interest on equity amounted to BRL 1 billion representing a 6.3% (sic) (6.1%) dividend yield.

And on the next -- on the last slide, Puma II, in a measurement carried out on October 20, already showed 6.6% of construction progress of the project, referring to Phase 1, slightly above the original schedule of the project -- about the CapEx of the project in 3Q '19 disbursement, BRL 430 million; year-to-date disbursement amounting to BRL 718 million. And by the end of 2019, this should be BRL 1.6 billion as overall disbursement together with the physical evolution of the project. Klabin has been carrying out tests with (equalizers). And the product has been delivering very good results in tests carried out in different markets and regions in the world.

Now Cristiano, the other officers and myself will be available to answer your questions.

## Questions And Answers

### Operator

(Interpreted) (Operator Instructions) Our first question comes from Daniel Sasson from ItaÃº BBA.

#### Q - Daniel Sasson {BIO 19234542 <GO>}

(Interpreted) My first question has to do with pulp. We have been seeing different trends in terms of hardwood and softwood prices. And the spread has been increasing to \$110. So could you please talk about the different trends that you see in the market -- in the 2 markets as you sell both fibers, hardwood and softwood, or per region, do you believe that the spread could even be bigger? And do you already see some stability in hardwood fiber. But how long should we wait until we see a recovery in the other fiber?

And still talking about pulp, this was the First Quarter of a few months without any interference of the agreement that you had with Fibria/Suzano as of August, in fact. If you could talk about the mix, the geography mix, if you are gaining market share in Brazil, what benefit this could bring to you. And I think that lower logistic cost and lower working capital involved and more tax benefits. So this would help us a lot.

## A - Unidentified Speaker

(Interpreted) Thank you, Sasson. And I would like to ask Soares to answer your question.

## A - Jos  Gertrudes Soares

(Interpreted) Daniel, your first question regarding the spread, what we have been noticing is that the long fiber or softwood see some degree of price recovery, still timid. But now in October, some players have announced an increase of up to \$20. And part of that was incorporated to the price. And I would say that at the end of the process, we are increasing \$15 of the \$20 announced. And this leads pulp to \$560 to \$570, depending on the softwood. As you know, ours is SBSK. And the prices that you follow in general -- in China are NBSK. So SBSK has a price that is \$30 lower than NBSK. And we have been seeing that in softwood fiber, clients have started to rebuild their inventories albeit slowly. And this is what has been driving this price increase. And this increased the spread to over \$100, about \$105, the level today of the spread.

And the next step, as you've said yourself, is a movement towards hardwood fiber, or the short fiber. I believe that this will be stable for a few months. And the major event is the Chinese New Year. And up until then, I do not believe that there will be an expressive price increase. Maybe some small adjustments and some movement towards hardwood. We have been working with \$70, \$60 historically. And when it goes beyond \$100, it becomes interesting to migrate towards hardwood fiber.

So this is how we see the next few months. Some upward movement but still superficial and a major change may be occurring after the Chinese New Year, which this year will be on January 25, at the beginning of the year. So we will have a First Quarter already with some kind of activity, a more expressive activity in this direction. And you talked about recovery of hardwood or short fiber. Then you asked about the agreement that we had with Fibria. We are working very hard.

And in terms of placing volume in Europe, which was a market where our fiber had been less exposed by Fibria's marketing. And we already have a very big -- well, this in Europe in April -- from April to July, there were trials at the clients and concluding the approval of the quality, that has already been concluded. And right now, we are starting to supply based on the inventory that we built in our Austria facility. In September, we started to deliver from this inventory. And this is driving sales at the pace that we expect. And our idea is to sell 1/3 of the volume in Europe, 1/3 in Asia and 1/3 in the Americas, this (schedule) shows that we are reaching these targets. And in Brazil, we had an increase of market share because of the availability of our volume, our contracted fiber was 900,000 of 1.1 million. And now after this domination, we can participate in some accounts where we had a still timid participation. And the process has been rather successful. And we have a mix of about 30% Brazil and 70% in the international market. And this is how we

are working. And the contract in Europe indicate that the presence of Klabin is welcome. We have clients already contracted. And part of the clients will postpone their definition of the shake hand a little bit.

And today, we have 50% already contracted and 50% that should happen during the London Pulp Week. Inventories, as I've said, we saw an increase in inventories. And you saw this on our figures. And this inventory was built because as of January with the contract already onstream in the European market, there's a need to deliver from this inventory, (inaudible) to inventory are estimated at 25,000 tons per month. We should see this as a constant volume from our inventories. And we will close the year in December with an inventory level lower than we ended 2018. The increase in the chain in Europe, was the volume that we had here in Brazil with the contract received. And we had a shift in terms of locations. So it's no longer here and now it's in Europe.

## Operator

(Interpreted) Thiago Lofiego, Bradesco BBI.

## Q - Thiago K. Lofiego {BIO 16359318 <GO>}

(Interpreted) We have been hearing, well some producers have been selling major volumes in Asia. Is this a concern to you, maybe paper producers are building up inventory, taking advantage of the lower prices. And maybe this will be translated into a lower demand from now on? And do you believe -- or do you agree with that? And when will we see an uptick in demand for short fiber or hardwood fibers more specifically? And the second question, coated board volumes remain an interesting situation as you showed. But conversion is lower -- slower. What about the corrugated box and sacks? And when do you see a more consistent recovery? And do you see any signs of recovery in the short run?

## A - Unidentified Speaker

(Interpreted) We will start with Soares. Thank you, Thiago, for your question. Then Flávio and Douglas will be talking about their specific markets.

## A - Jos@ Gertrudes Soares

(Interpreted) Thiago, thank you for the question. Your question about the rebuilding of inventories by clients in hardwood fibers specifically, of course, you followed the levels of inventory in China, there was a drop of 300,000 tons. And we do not have -- we don't see yet what is going on in October. But there should be a recovery as of the Fourth Quarter. But we do not see any rebuilding of inventories due to better prices and clients taking advantage of that. In fact, this exchange of inventories from the hands of the producer to the paper producers is mostly due to demand. The Chinese clients started to operate with very low inventories. And of course, there was an increase in demand in the Third Quarter because of the Chinese market. And it was only due to a demand situation, there is no speculation involved. We do not see that. What could happen, as I said before, is some movement towards hardwood going from softwood because of the delta that is higher than \$100 per ton. And we see a stability for the Fourth Quarter. And in the First Quarter of 2020 after the Chinese New Year, we will have some more color, maybe a

First Quarter still stable with some upside but ramping up as of the Second Quarter of 2020.

### **Q - Thiago K. Lofiego** {BIO 16359318 <GO>}

(Interpreted) You said -- what about you? Is demand still weak? Or do you see any signs of more positive signs in Europe?

### **A - Unidentified Speaker**

(Interpreted) Well it is still weak. Not in tissue, not in specialty papers, where we see a slight recovery already. The clients are a little bit more bullish. But we still feel a still weak demand in the other areas so -- thank you.

### **A - Flávio Deganutti**

(Interpreted) This is Flávio, Thiago, from the paper market. And I would like to talk about the coated board market. This is an important recovery in the coated board market, especially for exports and the seeds planted in 2018 and the diversification of destination and portfolio. They are bringing very important results in 2019. Cristiano has already talked about the carrier board for the beer market and coming from the migration from plastic to paper. And together with that, we also have another market that I would like to talk specifically about, cups, styrofoam and other non-sustainable materials. So they are being replaced by cups made from fiber. And in Brazil -- well this is important, in Brazil and abroad. And we still have a major part of this market. And this is a cup that has one of the -- one of the faces is brown. And mainly in Asia and Oceania and Europe. And we have been exploring this part of the market that has a good profitability, brings a good profitability to our business. And also for liquid food. And we are well positioned for this year.

Now I would like to give the floor to Douglas. And he will talk about the packaging market.

### **A - Douglas Dalmasi**

(Interpreted) Thiago, thank you for the question. And looking at the year, we see still a moderate growth in corrugated boxes, 0.6% growth year-to-date. And stable in the quarter. We see on the industrial bags side, in civil construction, we see a recovery year-to-date. But still with a very low base. The civil construction consumption is still very low. But this growth already shows a slight recovery in this (curve.) But the comparison base is too -- very low. And so regarding this market, we see this quarter slightly better and a slight recovery this month. And this should happen in the next quarter. In the medium run, looking to 2020, we estimate or we expect the market to grow more than it grew in 2019. And following a better growth of the country overall and in the markets where we are present, we expect on the industrial bag side, civil construction has an important increase -- improving the basic conditions of the country, employment and income.

And on corrugated boxes side, there are some niches where we have a major participation. For instance, in the protein market, we saw this year a very strong growth in exports from this market. And we expect it to continue in 2020. And on the fruit side, this is a major, important and potential market for us. And that requires our virgin paper and

integration in the chain. And the trend is an upward trend. And recently, there were some important news about this, which was China accepting melons from Brazil to be exported to China. And already talking about the growth of -- in a few years, doubling the planted area in Brazil. And Klabin is very well positioned in this market. So in a nutshell, the integration of this year was very important, going from exports and more toward the domestic market. And next year and in the medium run, we expect this to grow and bringing advantages to the company and reducing purchases from -- of third-party paper.

## Operator

(Interpreted) Marcio Farid, JPMorgan.

### Q - Marcio Farid Filho {BIO 19997079 <GO>}

(Interpreted) I have a few questions. The first one to Cristiano, some update regarding the discussion in the next few months (and there,) a follow-up to Soares, inventory adjustment that you have been carrying out in order to make the chain more adjusted for the phase after the termination of the contract (which has ended), has it been completed? And could we see production and sales more aligned maybe for the Third Quarter of next year? And another point regarding costs for pulp, we have already saw a significant drop, excluding the maintenance stoppages. What is the perspective? And what lines should impact the production cost of pulp from now on?

### A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

(Interpreted) Thank you, Marcio. Regarding the royalties issue, we are still waiting, as I said in other calls. A working group was created in the Board of Directors of Klabin and the members are independent members. They got on board as of June this year, during the first Board meeting. And they are discussing the team that we have been offering all the necessary information and bringing a level of transparency to this team and with the valuation of the brand and legal opinions and so on and so forth. So everything is being offered. And we expect that in the next few months, they might make some recommendation both to you and myself. We will be able to evaluate the recommendation. And then we expect the decision on the part of the Board. So Soares will continue with inventories and (markers) about costs.

### A - Jos  Gertrudes Soares

(Interpreted) Thank you for the question. Regarding inventories, I said answering a previous question, we shifted volume that was here at the (boat) in order to be placed on Fibria ships. And we displaced this as of January to European clients. And up to July, we were shipping to Europe from Brazil, which is a disadvantage from the logistic viewpoint because our competitors have local product. So we had to build the inventory in Europe. And it's ready. And as of September, we were able to sell based on this inventory. And we will continue to ramp this up, in January -- in January, we will be able to have a volume equal to the sales forecast. But the point is that we will close the year, with production and sales very well aligned, our inventory level at the end of the year will be lower than it was at the end of 2018. And this will happen still within this quarter.



This is (inaudible) about costs. In fact, we had a good Third Quarter from the viewpoint of costs. And our plants are operating with a good operating performance, which collaborates towards the cost per ton to remain at the level that they are. And for the last quarter in 2020, we do have the plants operating at full capacity, giving this contribution to cost dilution. And looking at Puma in the next quarter, more specifically, the level that we have reached now is a new level. And our expectation is that the cost for the Fourth Quarter will be lower than the average that we had during the year up to September.

## Operator

(Interpreted) (Antonio) with Bank of America.

## Q - Unidentified Participant

(Interpreted) A follow-up on cost, regarding the Puma stoppage compared to the previous years, when we saw a more relevant increase in the cost per ton and even in the number of days. Could you explain what happened and what could we expect for the next ones? And the second question to Soares is a follow-up on pulp. It is more structural. The industry was seeing that this level of cost, well, there would be some closures of capacity. And what is the reason for that? Is the curve more flat? Is it flatter now? Could you give us your views?

## A - Unidentified Speaker

(Interpreted) Thank you, (Antonio). First, Marcos Ivo and then Soares.

## A - Marcos Paulo Conde Ivo {BIO 21106710 <GO>}

(Interpreted) (Antonio), in relation to the cost of the Puma stoppage. The period of stoppage was longer, 16 days. And we had a scope. The scope was bigger than normal this year. As I said, the stoppage happened on schedule and on budget. This was the first year where we had a campaign of 15 months. And we confirmed the technical and financial feasibility of that. And we are sure that this can be replicated, or that I should say 15 months from now on. And looking at the stoppage for October 2020, this will be smaller, shorter. This year, we had 16 days stoppage. And next year, it will be 11 days. And this would bring the cost down because of the smaller production loss.

## A - Jos  Gertrudes Soares

(Interpreted) (Antonio), thank you for the question. Regarding cash cost, your question, the levels were that this was -- was getting close to cost of marginal producers. And there should be more excessive downtime, maybe as a consequence. And we didn't see that. We saw regular stoppages. We didn't have any outstanding or exceptional event this year. We are producing well. Everybody producing well. And by that, I mean, the industry in general. Anyway, what we see is that prices are stable. They are no longer dropping. There is a relative stability at the levels 450, 460 in China. And there was a slight increase in the last (ForEx.) But this is what we see. Some people -- well, the price is anchored on the higher cost of production. And maybe the curve shifted a little bit because of the better performance. And this year, we didn't see any major event, neither in Brazil nor in

Indonesia or China. We only had some one-off situations, small ones. And so this all contributed to a reduction in cost. This is how we see it.

## Operator

(Interpreted) Carlos De Alba, Morgan Stanley.

### Q - Carlos De Alba {BIO 15072819 <GO>}

Couple of questions. Could you comment again on -- or update us on the disbursements for Puma II? How do you see the CapEx in the next few years? Then also going back to cost questions, what are the trends -- or if they have changed at all in terms of the cost of transportation wood from forest to the mill?

### A - Unidentified Speaker

(Interpreted) Thank you, Carlos. Marcos Ivo will answer your question.

### A - Marcos Paulo Conde Ivo {BIO 21106710 <GO>}

(Interpreted) Carlos, in relation to Puma II, the disbursement estimated up until the end of 2019 is BRL 1.6 billion. And the disbursement estimated for 2020 is around BRL 3.8 billion. In relation to wood, Klabin has been tapping into opportunities of acquisition regarding wood from third parties and preserving our own forest for future supply in a strategic move. The level of the cost -- fiber cost that we had in the last 2 quarters is the level that we expect to see in 2020.

## Operator

(Interpreted) Gabriela Cortez, Banco do Brasil.

### Q - Gabriela Elerati Cortez {BIO 18801371 <GO>}

(Interpreted) Could you clarify the kraftliner market situation? There was an increase in competitiveness in the international market. And this brought a negative pressure on prices. Which were the drivers? And what is your expectation for 2020? Could you give us some color about this market, please?

### A - Unidentified Speaker

(Interpreted) Thank you, Gabriel. Our paper officer, Flávio will answer your question.

### A - Flávio Deganutti

(Interpreted) Gabriela, thank you for your question. The kraftliner market depends on American flows and the performance of these economies after the U.S., Europe. Then there is an important effect of the trade war, impacting flows, especially from China to the United States and vice versa. And which brought a negative pressure on this market in the last nine months. And positive side is that we see in the last couple of months, we see some stability, the same that we see in pulp with less U.S. exports. But with stability of

prices in the market and some small moves regarding specific destinations. As of now, we expect an upside based on the position that we already have. And that could come in a few months' time. And not in the short run. Thank you.

## Operator

(Interpreted) As there are no more questions, I would like to give the floor back to Mr. Cristiano Teixeira for his closing remarks.

### A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

(Interpreted) Thank you very much for your questions. And I -- I'll bring our view to the Third Quarter, the good performance of the plants will continue to bring stability vis-à-vis the cash cost. And combined with our commercial dynamism, we should be able to capture these opportunities that will come mainly in the domestic market. We are sure that the Brazilian economy will be showing a strong recovery. And Klabin more and more will be close to clients within the structural context and the pace of investment that is benchmark in the sector, Klabin continues to be focused on the long-term view with initiatives of sustainability and innovation that guarantee not only a good performance for the next few years but also for the next few decades.

Thank you, all very much. And I would like to invite you all to participate on November 22 at Klabin Day. Thank you very much.

## Operator

(Interpreted) Klabin's conference call has come to an end. Thank you very much for your participation. And we wish you a good day. Thank you.

(Portions of this transcript that are marked Interpreted were spoken by an interpreter present on the live call.)

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