

## Q4 2012 Earnings Call

### Company Participants

- Alexandre Dinkelmann, EVP, Strategy & Finance, IRO
- Gilsomar Maia, Planning Director
- Laercio Cosentino, CEO

### Other Participants

- Loren Lewallen, Analyst
- Michel Morin, Analyst

### Presentation

#### Operator

Good morning. Welcome, everyone, to Totvs' Fourth Quarter 2012 results conference call. Today with us, we have Mr. Laercio Cosentino, CEO; Mr. Alexandre Dinkelmann, Executive Vice President of Strategy and Finance; and Mr. Gilsomar Maia, Corporate Finance Officer. (Operator Instructions)

Today's live webcast may be accessed through Totvs' website at [www.totvs.com/ir](http://www.totvs.com/ir). Before proceeding, we would like to mention that during this conference call, forward-looking statements may be made relating to Totvs' business prospects, operational and financial estimates and goals, based on the beliefs and assumptions of Totvs' management on information currently available.

Forward-looking statements do not guarantee performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore are dependent on circumstances that may or may not occur.

Investors should understand that general economic conditions, industry conditions and other operational factors could also affect Totvs' future results, and could cause these results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Laercio Cosentino, who will begin the presentation. Mr. Laercio Cosentino, you may begin the conference call, sir.

#### **Laercio Cosentino** {BIO 6567039 <GO>}

Good morning, everyone. Welcome to Totvs' last quarter of 2012 results conference call. 2012 was another year opportunities of Totvs. We've been able to combine a growth

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flat[ph] and margin, decreased our (inaudible) that drives demand in our agenda, seeking the goal of make for us a global benchmark of enterprise and management solution with flexible and scalable solution of our Company in different maturity and space.

Despite all the complex macroeconomic scenarios of the year, the Company's presence grew in all revenue lines and deepen its vertical segmentation process in 2012, which involved from development to distribution of its solution, make each channel increasingly preparing to explore the market potential.

Important to highlight that this growth was achieved with paying attention to the loyalty of our customers, reflects the maintenance[ph] revenue growth and stability of recurring[ph] revenues of the year. Despite this attention[ph] of the loyalty, this growth also claims, are convinced by margin expansion and cash generation, which among other things, is due to the efficiency gains in different Company areas. In particular, in service and develop areas and also the payroll tax relief we are getting from Brasil Maior Plan.

Now, I'd like to invite Alexandre Dinkelmann to proceed with the last quarter of 2012 earnings release.

### **Alexandre Dinkelmann** {BIO 16100739 <GO>}

Thanks, Laercio. Good morning, everyone. Firstly, I will start talking about the two acquisitions we announced recently, PC Sistemas and uMov.me, presented on slide two. With PC, we expanded our position in the Brazilian segment of Distribution, Wholesale and Retail, a segment that shows great dynamism and above-average growth of the Brazilian economy, in which PC is leading with 34% of the largest wholesalers, distributors as customers, according to the ranking of the Brazilian Association of Wholesalers and Distributors.

We see significant opportunities for synergies with these operations. PC adds solutions to Totvs' portfolio that integrates the value chain comprised by distributors, wholesalers, and retailers, including the so-called cash and carry market. On the other hand, Totvs' expands the expansion of PC Solutions portfolio, preserving its differentiated service model provided to customers.

With uMov.me, we initiated Totvs Ventures operations, performing the first investment in a cloud mobility technology platform provider, which provides solutions for companies of different sizes and segments, supporting multiple platforms for smartphones and tablets, facilitating the field process automation and their integration with management systems.

Totvs Ventures will enable the acceleration of this start-up which will have Totvs as a partner as well as user and distributor of such mobile technology. The investment will complement the offering of mobility solutions for Totvs' customers, with publications that meet the segments of Retail, Distribution, Logistics, Manufacturing and Service, among others.

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Totvs Ventures is a Totvs subsidiary focusing on investments and start-ups with high market potential, seeking to leverage the revenue generation and growth of invested companies, growing beyond the role of a financial investor, due to our task[ph] of generating synergies with Totvs.

Both acquisitions are fully aligned with the Company's acquisition strategy set in early 2012. We'll continue to focus on execution of this strategy, being selective and vertical, aiming to strengthen Totvs market leadership and strategic position, adding businesses with prospects of high growth rates and clear opportunities of synergies with Totvs, thus, replicating the Company's historical growth with margin expansion and value addition.

We understand that Totvs has a unique position in the Brazilian market to create synergies and acquisitions. When we take into account our own technology platform, our wide range of products and solutions, as well as our broad distribution network on the continental scale.

Now, I invite Gilsomar Maia to proceed from slide three.

### **Gilsomar Maia** {BIO 16400533 <GO>}

Thanks, Alexandre. Good morning, everyone. Going now to 2012 results, the Company's total net revenues grew 12.4% in 2012 and 10% in the quarter. These results reflects the strength and resilience of Totvs business model, beside the potential market for enterprise management software, especially, amongst small and mid-sized companies.

Net revenue from license presented on the slide four grew 9% in 2012, and 10.5% in Q4. The growth of license in 2012 was concentrated on sales to new customers, which grew 31% over 2011, with the average ticket 30% higher, mainly due to a lower level of sales to large customers in 2011, when compared to the Company's historical average.

This license growth of 9% in 2012 surpassed the 8% growth achieved in 2011, even with the Brazilian GDP growth rate dropping from 2.7% to approximately 1%. This growth behavior is due, among other factors, to measures for deepening the segmentation initiated in the last quarter of 2011, which will continue in 2013.

Services revenues on slide five ended 2012 with growth of 15.2% in full year, and 10.1% in Q4. Important to note here that the services revenue growth was accompanied by margin improvement, the growth of services above the license is due to the set[ph] of growth of services not directly related to software implementation, such as management consulting, e-learning, and services related to cloud computing, which also contributed to the margin improvement.

With 12.4% growth in the year, maintenance revenue exceeded BRL608 million in 2012 as shown on slide six. In Q4, the quarter-on-quarter growth of these lines show that is no doubt mainly due to licenses sold in prior periods. The lower IGP-M in Q4 and also the cancellation of differentiated support level, SLA, of old versions that were used by customers who migrated to current versions.

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In addition to maintenance, Totvs has other recurring revenues consisting primarily of monthly software rental, BPO and cloud computing services. The total recurring revenue shown on slide seven was above 56% of total revenues, surpassing BRL800 million in the year.

As we did in previous quarter, we begin to disclose the total recurring revenue of Totvs. Here, we highlight the stability of recurring revenue percentage, even with a consistent double-digit growth of total revenue, what shows the long-term relationship we have with our customers, allowing us to expand the universal solutions and services offered to them over time.

Now, on slide eight, total operating cost and expense fell 2.6percentage points between 2012 and '11, as a percentage of total net revenues. This reduction is more concentrating the growth of licensing fee costs, cost of services and R&D expense, which decreased by 2percentage points over the same period, as shown at the bottom of the slide.

The reduction[ph] of this growth occurred mainly by efficiency gain in service teams, and also by accelerated growth in revenues of services not directly linked to software implementation, which add more margin. As this group concentrates most personal expense, the payroll tax relief resulting from Brasil Maior Plan also contributed to this reduction in the year.

The larger relevance of these costs and expense grew between Q3 and Q4 as a percentage of that total net revenue, came primarily from increased headcount of development teams already flagged in previous quarters, and due to wage increase, resulting from collective agreements in Belo Horizonte, Porto Alegre and Joinville.

The Company will continue to seek efficiency gains in this block of costs and expense in the coming period, especially in the lines of licensing fees, costs and services. Totvs pursuit readily reached the R&D level of 12% of net revenues by 2016 without jeopardizing the investments necessary to run the R&D roadmap. So this level will be reached through a scale economy, that is, revenues grow faster than the expense.

Moreover, it's important to reiterate to all analysts and investors that the Company's R&D investments are not capitalized, thus the profits reported by Totvs fully reflects the performed R&D investments and there is no deferred effect on such lines.

Moving to slide nine, the group of expenses related to the commercial process of the Company, consisting of advertising expense, sales commission and data remained stable as a percentage of net revenue between 2012 and 2011. In this group, selling expense was less than revenue in the period. Since this line had an opposite behavior in 2011.

On the other hand, marketing expense and bad debt grew faster than the net revenue in the same period. This growth in advertising expense was expected because of a revision on the communication plan held on Q4 '11, and the bad debt growth is mainly related to the delinquency raising, especially on consulting and implementation services rendered to large companies in Brazil.

Although the delinquencies also increased amongst small and mid-sized customers over the year, the G&A and management fees group of expense, reduced 0.5 points as a percentage of net revenue in 2012. Basically, due to the combination of the scale gain, reduction of certain statutory positions being made in Q2, after change of hiring regime for some officers and payroll tax relief before mentioned.

EBITDA grew 22.5% in 2012, representing 1.9percentage points above CAGR of the last five years as shown on the slide 10. EBITDA margin reached 26.7%, the historical highest annual margin obtained by Totvs, representing 2.6percentage points above 2011 margin. This reflects the gains on development, selling and implementation, mentioned in the two previous slides.

The chart on the right illustrates well that over the years, the Company's EBITDA margin may fluctuate but is key again, proportionate by the combination of Totvs business model in the target market leads to margin expansion in the long term.

Now, the conference returns to Alexandre Dinkelmann proceeds from slide 11.

### **Alexandre Dinkelmann** {BIO 16100739 <GO>}

Thanks, Maia. As we all remember, in the Fourth Quarter of 2011, we began the process of reviewing the strategic plan for the international markets that comprised, one, revision of internal processes and structures and change of the main leaders of the operations; two, franchising of regions where we used to have only branches, strengthening of the role of local entrepreneurs with franchises, helping to increase the distribution effectiveness with the appropriate cost structure; and three, adjustment of the geographic and offering scope, focusing on verticals with attractive growth potential and low localization effort.

These revisions resulted in the new strategic plan, orienting international operations to achieve sustainable growth and profitability in the long-term. The initial effects of this plan on the international market's operations are presented on slide 11.

In Brazilian reais, net revenue grew 22% and negative EBITDA declined 39% in 2012. Even this regard in the Brazilian real devaluation of 9% in 2012, this result gave us the confidence that we are on the path of sustainable growth, seeking to reach EBITDA breakeven by the end of 2014 and grow sales in order to have international operations representing between 3% to 5% of the Company's consolidated revenue by 2016.

We reaffirm our view that international market is a strategic initiative that positively impacts our long-term position in Brazil, among the other factors, due to the growing internationalization of the Brazilian economy and our customers.

Moving to slide 12, the digital TV operations ended 2012 with net revenue growth of 61%. In addition to revenue growth, the reduction of cost structure held at the end of the first semester, resulted in the decrease of 84.5% of the negative EBITDA. 2013 will be the first year with the mandatory adoption of the Brazilian standard of digital TV, which

established a minimum of 75% of the TV sets produced in the Manaus Free Trade Zone with this technology embedded.

The fact of this rule, and the current costs structure creates a more predictable and favorable scenario for the decision-making process about the future of this business, as well as for the achievements of the breakeven in this operation in 2013.

Now, on slide 13, the EBITDA growth of almost 23% in 2012 was followed by more than 22% of net income growth, resulting in a 150 base points of net margin increase that reached 14.7%. That reduction in 2012 was offset by a bigger effect of marking to market of convertible debentures and a higher effective tax for the year.

Regarding cash generation presented on slide 14, the 2012 generation amounted to BRL307 million, accounting for 82% of EBITDA. CapEx remains low and in line with historical levels. In the same period, gross debt declined 30%, mainly due to debentures conversion and to the amortization of the BNDES finance line. Thus Totvs ended the Fourth Quarter with a net cash position of BRL163 million. This scenario shows the Company's financial strength for new organic and M&A investments. We understand that Totvs is able to access competitive funding instruments, in terms of costs and term, for our investment plan, and I reaffirm we will go for them when needed.

Lastly, the slide 15 summarizes how the management team has been guiding its strategic agenda and how it sees the performance of 2012, based on the three pillars of growth, loyalty and margin. Regarding growth, we highlight the service revenue growth of 15%, net revenue growth of 12.4% besides 31% growth of license sales to new clients, despite the more complex macro-scenario in 2012.

In terms of loyalty, we highlight the maintenance revenue growth of 12.4%, more than BRL800 million of recurring revenues in the year, and Totvs brand ranked as the 23rd most valuable Brazilian brand, as per Interbrand study.

Finally, regarding margin expansion, we have almost 27% of EBITDA margin, a net margin of 14.7%, an increase of 260 base points and 150 base points, respectively, over 2011. These indicators show that Totvs is on track of its strategic objectives, having the rare combination of resilience, growth and margin expansion.

Now, I would like to invite Laercio to proceed with his final remarks.

**Laercio Cosentino** {BIO 6567039 <GO>}

Thanks, Alexandre. As it's already know by all, at the last Board meeting held on January 24, the Board of Directors unanimously[ph] elected Mr. Pedro Passos as the Chairman and Mr. German Quiroga as the Vice Chairman. These changes happen to meet the best practice and corporate governance led us out in the (inaudible) of Novo Mercado and clarify the best personal contributions to operations on a global company[ph].

After chosen[ph], we still have (inaudible) as a CEO and remain the Board member. At the same meeting, Marilia Rocca's presently mentioned[ph] as a Board member to assume the Vice President of this. In place of Marilia, as independent Board member, the management indicate Maria Helena dos Santos[ph], former CDM president[ph] and Bovespa Superintendent, has been[ph] included for approval in the next ordinary stakeholders meeting of -- held on March 5.

Therefore, Totvs being the first among public company with capitulation[ph] of chairman and CEO position listed on Novo Mercado no longer (inaudible). So the Board will have a composition shown on slide 16, with two independent Board members are head of its President and the Vice President.

Also on January 24, the Board of Directors elected executives who are ahead the strategic position from February 1st, 2013, and we will be responsible for a medium and a long-term strategy goal of the Company as presented on slide 17.

Apart from[ph] the Executive Vice President, Strategy and Finance, led by Alexandre Dinkelmann, the Services and the Relationship led by Rodrigo Caserta; Technology led by Weber Canova; (inaudible) Vice President, Systems and Segment led by Gilsinei Hansen; Client and Remote Services led by Wilson de Godoy; Business Vice President led by Marilia Rocca; and Human Relations and Organizational Infrastructure led by Alexandre Mafra.

So Totvs beginning 2013 is stronger and better prepared to enforce its leadership and capture the growth of Brazilian and Latin American markets.

From now on, we will be available for the Q&A section.

## Questions And Answers

### Operator

Thank you, sir. The floor is now open for questions from investors and analysts. (Operator Instructions) The first question we have comes from Michel Morin of Morgan Stanley. Please go ahead.

### Q - Michel Morin {BIO 1873971 <GO>}

Good morning, everyone. Thanks for taking the question. Just on your maintenance revenues, in your press release, you flagged that the slower growth there this quarter was related to the lower adjustment from inflation, but also from the migration of clients from older solution versions, and I'm wondering on that second point, if you can help us by giving us a sense of how meaningful that was, given that I'm assuming it's not necessarily recurring in nature. Thank you.

### A - Gilsomar Maia {BIO 16400533 <GO>}

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Good morning, Michel, this is Maia speaking. In terms of the second element, as you said, regards customers migrating to current versions, there we see the effect in terms of revenues, but there is a secondary effect in terms of our efficiency because in relative terms, we prefer to have all customers based on the same version.

In terms of revenue effect, we are not disclosing isolated element, but what I could say is it's not a recurring element, as you mentioned, so maybe you can try to estimate that based on the effect of IGP-M inflation index on the Q4.

**Q - Michel Morin** {BIO 1873971 <GO>}

Right, okay. But I guess we can figure out what the inflation impact was, but it's just that as I look at this on a sequential basis, I think this is the first time ever, maybe the second time ever, that you've had a sequential decline in maintenance revenues, so that's why it would be helpful to know if -- I'm assuming that there isn't anything else underlying that would have caused that. Is that a fair assumption?

**A - Gilsomar Maia** {BIO 16400533 <GO>}

Yes. That's the main element, dropping this figure. But also we should consider the previous licenses as well.

**Q - Michel Morin** {BIO 1873971 <GO>}

Right.

**A - Gilsomar Maia** {BIO 16400533 <GO>}

There are three components there affecting this line.

**Q - Michel Morin** {BIO 1873971 <GO>}

Right, okay. But your license revenues have been growing sequentially throughout the last 12 months which is why normally we should see a sequential uptick here. So my -- just on that point still, can you give us a sense of how many of your clients -- I don't know if you want to talk about it in terms of the revenues that you generate from maintenance -- but how many of your clients are on kind of the main platform if you want to call it that, and what is the potential for you to, in the future, migrate other clients to more current versions? Can you give us a sense of what is left to do there in terms of future migrations?

**A - Gilsomar Maia** {BIO 16400533 <GO>}

Okay, just to make clear, our normal maintenance covers the current version and the previous one. These customers are paying a kind of a SLA service, like additional maintenance, they're based in older versions, and when we consider our total installed base, customers on the older versions, they're a few percentage of that there is no relevant element similar to that in the future.

**Q - Michel Morin** {BIO 1873971 <GO>}

Okay. Great, thank you very much.

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## Operator

(Operator Instructions) It looks like we have a follow up from Michel Morin of Morgan Stanley.

### Q - Michel Morin {BIO 1873971 <GO>}

Okay, well listen, if there's no one else in the queue, I'll keep on asking questions. So Alex, I think at the Investor Day, we had asked you about the long-term margin guidance that you've provided which I believe is to deliver a margin of between 27% and 30% by 2016, so you know, it's obviously -- you're on the cusp of hitting that goal already, but I think that at the Investor Day you had specifically said that the trend between now and then really should be an upward trend.

Given that you ended 2012 kind of at a low point in terms of margin, is it still fair to assume that 2013 should be an up year in terms of margins as a percentage of revenue?

### A - Alexandre Dinkelmann {BIO 16100739 <GO>}

Hi, Michel. Good morning. Of course that's -- we are always working to perform better than the previous year, okay? This is something that's natural for Totvs not only in terms of margins but also in terms of growth. I would not like to give you a guidance in terms of margins for 2013. As you know, our policy is not in this direction.

So for the time being, I would say that we are pretty comfortable about achieving these long-term guidance so we want to operate by 2016, we think this range. And for us it's really important to really allocate capital now in our investment program in order to really reinforce our growth prospects. As you know, all investments in R&D are reflected in our profit and losses statement. So in this sense, we believe that we can increase our margins in the next years, but for 2013, I prefer not to give any guidance.

### Q - Michel Morin {BIO 1873971 <GO>}

Okay. All right. Thank you very much.

## Operator

(Operator Instructions) The next question we have comes from Loren Lewallen of Select Equity Group. Please go ahead.

### Q - Loren Lewallen {BIO 17231394 <GO>}

Hi. Good morning. Thank you for taking the question. I'm wondering if you could comment at all about the current margin or the margin -- and also the margin you expect to get eventually with the PC Sistemas acquisition.

### A - Alexandre Dinkelmann {BIO 16100739 <GO>}

Hi, Loren. This is Alex speaking. We don't want to disclose the margins of PC Sistemas but it's important to mention that we see a lot of opportunities in order to increase

profitability. This is a profitable company and we can add a lot of synergies in terms of our capacities of distribution, the portfolio that we can bring to PC's clients and also some synergies in terms of technology. So in our sense, this deal is accretive.

We are pretty confident that we can increase margins in the next years of the business. We can make it grow more than it was in the past.

**Q - Loren Lewallen** {BIO 17231394 <GO>}

Got it, and if I could ask one other question, a bit unrelated, is if you could talk about how Q4 came in relative to your own internal expectations? It seemed like it was a bit below the Street, and I was wondering if it also is below what you were expecting. And also, if you could comment on the current business environment in Brazil, obviously, we've seen an economy that failed to accelerate as expected, going through the back half of last year, and I'm wondering, as you look at the current business environment, what you are seeing.

**A - Alexandre Dinkelmann** {BIO 16100739 <GO>}

Hi, Loren. We are never satisfied with our results, because we believe that we can do better. So of course, that when we look at revenues, you know our expectations were higher than that. But it's important to analyze the results in line or in light with the whole macro scenario. So we end the year of 2012 growing the business more than 12%, top line, of course taking into account the social security contribution, just to compare 2011 and 2012, with the same basis.

So in line with this more complex scenario, we are happy with the performance of top line. But of course, that we could do much better and our plans were higher than this performance. It's also important to mention in terms of margins, the R&D that increased this quarter, it's very important for us really to pave the way for the next years in terms of growth. So it's very important, and as we have said before, during 2012, we were actually expecting an increase of R&D in our cost structure. So this is in line with our expectations.

And as you know in software, R&D, the cycle of the R&D is larger than one quarter, and the results that will be captured because of this R&D will be reflected in the next quarters.

**Q - Loren Lewallen** {BIO 17231394 <GO>}

And that's very helpful. And in terms of the current environment, you see in Brazil?

**A - Alexandre Dinkelmann** {BIO 16100739 <GO>}

We believe that this year 2013 will be better than 2012, when we look at the macro scenario. 2012 was really disappointing, when we look at how GDP growth -- performance was. So we start the year with the confidence that this year will be better than last year, and across different industries.

**Q - Loren Lewallen** {BIO 17231394 <GO>}

Are we seeing signs of that in the business, or is this more a macroeconomic observation?

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**A - Alexandre Dinkelmann** {BIO 16100739 <GO>}

It's a combination of these two dimensions. When we see macro indicators and also the pipeline and the level of activity that we have with our clients, and discussing opportunities projects, so it gives us confidence that this year will be better than 2012 for the whole economy.

**Q - Loren Lewallen** {BIO 17231394 <GO>}

Great, thank you very much for your time.

**Operator**

And next we have Michel Morin of Morgan Stanley.

**Q - Michel Morin** {BIO 1873971 <GO>}

Hi, so I was wondering Alex if you could comment a little bit about what you're seeing on the competitive front. Any of your competitors doing anything that you've noticed that may be impacting the market? Then also, I think that you were quoted in the press yesterday, about acquisition pipeline, so I was wondering if you can comment a little bit about what you're looking to do in terms of acquisitions, what specifically you'd be looking for, and in particular, whether or not there is anything that would take you more meaningfully beyond Brazil?

**A - Alexandre Dinkelmann** {BIO 16100739 <GO>}

Okay, Michel, in terms of the competitive landscape, the situation stays the same. So we are not seeing any relevant change in the level of competition. So we, of course, that we analyze competition depending on the segment that we are talking about. So at the high end market, as you know, we compete directly with SAP and Oracle. In the SMB, the competition is more related to regional players and niche guys, so the players that are dedicated to specific niches of the industry.

At the base of the pyramid, when we talk about micro-enterprise, then the market's really fragmented. So no news in terms of competitive landscape. The competition is tough for everybody, which makes us work better every day.

In terms of M&A, as I have said, Totvs is active. We are always analyzing opportunities. For us, it's really important that the targets bring a very good fit with our strategy so we want to explore the maximum synergy in terms of distribution, in terms of portfolio of product, in terms of technology. This is the mantra for us when we talk about M&A.

So yes, you should expect M&A activity in the next years. It's part of our DNA. We could present to you investors and shareholders a very good track record in terms of M&A and we will combine M&A opportunities with organic growth.

**Q - Michel Morin** {BIO 1873971 <GO>}

And specifically, is there anything beyond Brazil that we should anticipate either this year or next?

**A - Alexandre Dinkelmann** {BIO 16100739 <GO>}

We are analyzing some opportunities abroad, but they tend to be small and niche, so nothing that should be understood as transformational.

**Q - Michel Morin** {BIO 1873971 <GO>}

Great, thank you.

**A - Alexandre Dinkelmann** {BIO 16100739 <GO>}

And just a final comment, even when we talk about M&A abroad, we want to really exercise our possibilities of synergies between Brazil and the international markets. That's also a very important pillar in our strategy.

**Q - Michel Morin** {BIO 1873971 <GO>}

Okay. Perfect. Thank you very much.

## Operator

(Operator Instructions) At this time, it appears that we have no further questions. We'll go ahead and conclude our question-and-answer session. At this time, I would like to hand the conference back over to Mr. Laercio Cosentino for any closing remarks. Sir?

**A - Laercio Cosentino** {BIO 6567039 <GO>}

I would like to say thank you for all who contributed to the success of Totvs in 2012, especially our customers, partners and shareholders. Thank you very much.

## Operator

And we thank you, sir, and to the rest of management for your time. We thank you all for attending Totvs' Fourth Quarter results conference call. At this time, you may disconnect your lines. Thank you, everyone, and have a great day.

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