

Q2 2010 Earnings Call

Company Participants

- Antonio Carlos Bassalo, Accounting Officer
- Unidentified Speaker, Unknown
- Wilson Ferreira Junior, CEO

Other Participants

- Antonio John Cada, Analyst
- Marcos Severine, Analyst
- Pedro Infratini, Analyst
- Ricardo Cavanagh, Analyst
- Sergio Parmachero, Analyst
- Tatiana Rays, Analyst
- Venusius Cayu, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for waiting. Welcome, everyone to CPFL Energia Second Quarter 2010 earnings results conference call. Today with us, we have the executives Mr. Wilson Ferreira Junior, CEO of CPFL Energia. And other officers of the Company. This call is being broadcast simultaneously through the internet in the website www.cpfl.com.br/ir.

In that address, you can also find a banner through which the presentation will be available for download. We inform that all participants will be able to listen to the conference call only during the Company's presentation. After the presentation, there will be a question and answer session. At that time, further instructions will be given. (Operator Instructions) It is important to mention that this teleconference is being recorded.

Before proceeding, we would like to mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of CPFL Energia management and on information currently available to the Company. Forward-looking statements are not guarantees of performance.

They involve risks, uncertainties. And assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions. And other

operating factors could also affect the future results of CPFL Energia and could cause results to differ materially from those expressed in such forward-looking statements. Now I'll turn the conference over to Mr. Wilson Ferreira Junior. Mr. Wilson, you may proceed.

Wilson Ferreira Junior {BIO 20013669 <GO>}

Good morning, to all investors and analysts. Thank you for joining us in this earnings call, where we intend to share with you the highlights for the Second Quarter of 2010 and the results of the CPFL Energia Group for the six months.

I'm going to move to page two, where we have the 2Q 2010 highlights. During this conference, we're going to see a growth of 2.1% in sales in the concession area of our distribution companies. I'm going to tell you a little bit about the annual cumulative adjustments of CPFL Paulista and RGE. These are the values incorporated to parcel B, Paulista in April, RGE in June 2010.

We will be talking about the distribution of dividends. As a highlight in this quarter, the funding that we have just completed and internalized that the resources of BRL500 million through a rural credit line. This funding will reinforce the resources for CapEx and working capital of the distribution companies (inaudible). It is a very positive operation with an average cost of 98.5% of the CDI.

We'll talk about the continuation of the process of private networks' incorporation. This is very important in the tariff readjustment. This reinforces the remuneration of assets. You probably followed the appreciation of the shares of the Company surpassing Ibovespa and IEE. And we'll talk about the fact that CPFL Energia was elected the most suitable electric power company in Latin America by Management & Excellence.

Okay. Now let's move to the results. And I'll make a disclaimer. In the following slide, we'll observe some nonrecurring effects. But to make it clear, we're going to be talking about reported results. And particularly to the analysts, it is important to have a disclaimer of nonrecurring results versus the recurring results.

In net revenue, we have a slight decrease as in the reported number or in the recurring number BRL2.614 billion the reported and BRL2.613 million compared to the same period of the first year, where we had BRL2.548 million. And this was very much impacted by the tariff adjustment of the distribution companies, which we will mention later on in this presentation.

It is important to highlight the EBITDA result. The reported result is 14% better, BRL693 million in the quarter. And the result of the nonrecurring effect, which we will detail in the next slide, the result is BRL731 million corresponding to a 4.6% growth compared to the same quarter of 2009.

And in net income, we are reporting BRL384 million net income in this quarter, 33% increase compared to the same period of last year, where it was BRL299 million. In

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recurring values, we reached BRL337 million, plus 9.8% compared to the recurring value BRL307 million in the Second Quarter of 2009.

In the following page, on page three, we give you an idea of these nonrecurring events, what happened, both in the Second Quarter of this year and in the Second Quarter of last year. In the bottom part, we have the recalculations related to RGE 2009 annual tariff adjustment index. The base date changed to June the 19 instead of April, as it used to be. This was agreed between the agency and the distribution company. And obviously because of this effect, there is a recalculation, which impacted EBITDA in BRL23 million and the net income in BRL19 million. This is a nonrecurring effect.

As of now, the RGE readjustments will take place in June in the blue line. At some extent the other deliveries for the Company, particularly to the cooperatives as they were granted with the state. On the other hand, due to the reversal of provisions made in the past in the presented fashion, when we did not have a clear criteria for PIS, Cofins. And the A agency, this criteria now was clarified and more recently confirmed by the IRS.

So we had a reversal BRL40 million in the EBITDA, which impacts the net income in BRL29 million. So these are the effects that were incorporated to the results of the Company in the Second Quarter of 2010. The total effect in the EBITDA is a positive BRL63 million effect and a positive effect of BRL48 million in the total net income.

However, it's important to highlight that in the Second Quarter of 2009, we also had the acknowledgment of acceptance regarding previous periods in CPFL's services. It was due to the ERP and SAP systems. We recognized a number of pending issues, which impacted the EBITDA in BRL8 million and the net income in BRL5 million. And we also had in the agencies Aneel fine related to RGE's ELC and EFC.

So we had a total EBITDA effect of minus BRL8 million and in the total net income minus BRL18 million. Obviously, with that, that's how we make up the recurring results of the Company with a 1.3% drop in the net revenue with BRL2.613--EBITDA BRL631 million. And the 9.8% growth in the net income, BRL337 million, excluding these nonrecurring effects.

Now on page four, we give you the details about the market behavior, which actually drives the results of the Company during this quarter. We can see the top left-hand corner the concession area sales. Written above in blue the growth in the captive market, the market built by the distribution companies, a 5.4% increase.

And we see an extraordinary recovery, particularly in the industrial segment, those consumers that are served to buy their distribution companies metric. These are free consumers, who pay a rate to use the distribution system. These large consumers have been very much impacted by the global financial crisis. So the reference of last year was lower, where we can see a vigorous growth of 27.1%, which totals 3,290 gigawatt hour in this quarter.

Total energy sales by the concession companies and commercialization companies correspond to a growth in the concession areas of 10.1%, slightly greater than 13,000

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gigawatt hour.

In the bottom part, we highlight how we breakdown sales growth by the main consumer classes. We continue to see an important growth of consumption in the residential class. We'll give you some details on the growth drivers--a 6.2% growth in the commercial class, also very heated right now. I'd like to remind you that those for the residential segment and commercial segment, last year's crisis practically did not interfere with these segments. At no point did they decrease their consumption compared to previous quarters. So they continue to sustain an important growth trend--in the commercial plus 7.4% growth in sales.

Now looking at the industrial segment, either for small industrial consumers, non-free consumers, served or supplied by distribution company or the large ones that are served by the commercialization companies, the industrial segment as a whole showed a 13.3% growth. And with the others, public, lighting, et cetera, make up a concession area sales growth of 10.1%.

Now still in the bottom part of the slide, we show you the behavior of the six months, the semesters. We see here 6.6% growth compared to the first half of 2007 to 2008. In the first half of 2009, there was a slight drop. That was the moment of the global financial crisis, which impacted the large industrial customers. And now there is a significant recovery, 9.3% increase, 25,841 gigawatt hours. So we have energy volumes superior than the first half of 2008, which was the reference number before the global crisis.

Now moving onto total energy sales in blue, we have since billed by the distribution companies, showing 5.4% increase and, in orange, the sales in the free market through our commercialization companies showing a drop of 5%.

It is important to highlight here that last year, due to an important strategy to optimize our portfolio, we participated in that adjustment auction. We were one of the top three players in that auction. And obviously, we didn't have any adjustment auction this year. This is the reason why we showed this drop because, last year, we had a volume that was being sold to the adjustment auction. And this year, we don't have it.

Adding the sales of the captive market and the free market, the total energy sales of the group grew 3.1% this year.

Now on page five, I give you the details about the behavior that drove these sales. And we start discussing some prospects. First point--and this is an interesting chart. We follow that up in the Company and have been following for about ten years, which is the daily consumption of energy, power per residential consumer.

You can see that in June of 2010, we reached a consumption very close to the first month of the rationing period, the power rationing period. So we could see nine years of pronounced drop, 6.42 down to 5.16. And there was a lot of reduction in the consumption by residential consumers. But there was a recovery over these nine years, obviously maintaining on one hand new efficiency standards per consumer. And they're using more

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efficient equipment, light bulbs, refrigerators. And alike, even TV sets. And obviously, due to an important growth during this period, an increase in consumer income. And they are buying new home appliances. And this is why we see this recovery.

Now the 6.4 recovery is due to consumers being a lot more comfortable with a lot more home appliances than they had a decade ago. But there's room for further growth. And here, we give you some numbers. The main growth drivers to increase energy sales in the residential class is linked to family income. So we are comparing here a 12-month comparison. We see greater number of formal job positions generated more than 2,100,000 new formal jobs created. And it was an important consequence in the income mass, up 3.8%, from BRL30 billion to BRL31 billion. So these are two important growth drivers pushing a continuous growth of sales in the residential segment.

And then we talk about credit, which in the past years has probably been the main driver pushing the sales of home appliances for our consumers. As you can see, there was an increase in credit supply, up 11.5% in this period in the last 12 months from BRL28 billion to BRL31 billion. And there was an increase in the average financing maturity from 29 to 37 months.

Down below, we show you that this behavior is expected to continue in the coming year. We see here an estimation of the evolution forecast of credit over GDP, which is around 49.5%. We highlight that 17% is linked to individuals. And that should expand in the coming years, reaching 70% in 2014.

We highlight that over one-third of that volume is credit to individuals, loans to individuals. That will push more the sales of more home appliances, more furniture, more comfort in the home. And obviously more power consumption in this segment, the residential segment.

Just to prove this effect of an increase in the family income and credit, we show you that furniture and home appliances sales in the past 12 months have increased by 11.3%. We see solid growth in this segment (inaudible) sustainable.

Moving onto page six, we have an evaluation of the industrial class. There's a big risk growth. But what are our expectations now for this class, industrial class? On the left side, in green, we see industrial production comparing the two quarters, Second Quarter 2009 versus the Second Quarter of 2010, showing a 14% increase in the pre-crisis level.

And when we compare that to the chart on the right, we see the capacity utilization, installed capacity utilization. The industry--when they reach 80% of the installed capacity, starts dictating an expansion of the capacity. They start placing orders, particularly for capital goods. And the fact that we reached 82.3% of installed capacity utilization in the industry clearly translates to an increase in the production of capital goods, a 36% increase. This is sustainable growth, proving all of the theses of the industry. And we see an expressive increase in capital goods.

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Another relevant piece of data has to do with exports. In the past quarters, I have observed that the domestic market has surpassed the pre-crisis levels in terms of sales, which we were still a bit concerned about exports. But when we look at the average of the quarters, we see that the average for the first half of 2008, the pre-crisis period, about \$745 million for the first half of '08. And in the first half of '09, we had a 24.5% decrease.

Recovery was very slow. But as you can see, in the first half of 2010, we're close to \$723 million for the semester's average. It is a drop of 3%. It is a significant recovery, particularly in this past quarter, the Second Quarter of 2010. So I believe that we showed the capacity of Brazilian exports. The Brazilian exporting companies have to export. This has been sustaining growth rates in the industry.

It's important to highlight the trend behind all of that. We see here between 2000 and 2004 the rate of productive investment over the GDP of 16% average for the period. In the past four years, that rate increased to 17%. And (inaudible), we're estimating that the rate of productive investment over the GDP will reach 20%. In the First Quarter of 2010, we're at 18%. So there's a lot of--there's a relatively good room for growth, which should push growth in power consumption by the industry.

On page seven, we can detail the results for the quarter. Let's talk about EBITDA and net income. We have a reported EBITDA of BRL691 million. We excluded nonrecurring effects of the Second Quarter of 2009. So we had a recurring EBITDA of BRL699 million in that quarter. This is basically affected by three components so that we reached the BRL731 million EBITDA for this quarter with a 4.6% increase.

The first is a reduction in the net revenues, absolute amount of BRL36 million. This is impacted by the increase in concession area sales. We see here captive market and the TUSD volume, which is quite expressive in this quarter. And we have a negative effect as well, the reduction of 5% in free market sales, BRL60 million. And rate adjustments, rate adjustments with a reduction of financial components and Parcel A items, average customer perception minus 4.1%. So we see less sales in the free market and negative rates applied to the Parcel A items in this quarter, in particular affecting the distribution companies that had readjustments, CPFL Paulista and RGE, as I mentioned previously.

And these rate adjustments were negative because there was also a reduction in the cost of energy and charges. And that's what allows EBITDA to grow. And so we have reduction of 7% in the energy costs and charges. Reduction in cost of Itaipu energy, that's a foreign exchange effect. And the reduction in the cost of charges. You will remember that last year we had the enforced charges with an effect, which is superior to BRL75 million.

And finally, we have an increase in operating costs and expenses. I just wanted to highlight this because this is compared to a reference number of last year, where we had a very strict program, control program. So the baseline was very low in 2009, one of the lowest operating costs we have ever had. Then we had the collective bargaining agreement, which increased the salaries in almost 7%, which increased expenses by BRL7 million; royalties due to the increase of energy generated in the period BRL4 million; maintenance of assets and licensing and use of software, software to process energy--electricity bills

that amounted to BRL6 million; and the set of smaller expenses. We highlight legal and judicial expenses and the loss with assets disposal, BRL6 million. So we see BRL47 million increase in operating costs and expenses, BRL7 million alone with personnel.

So in terms of EBITDA, 14.8% increase in the EBITDA, BRL1.612 billion compared to BRL1.349 billion in the first half of '09.

On page eight, detailing our net income, our recurring net income, BRL307 million, is impacted by 4.6% increase of the EBITDA, BRL32 million. There is an 11.6% reduction in the financial income, particularly due to an increase in the interest revenues, BRL28 million. The financial expenses increased a little bit more than the financial revenues. GPD-I is what indexes our costs for the private pension plan. So there's a slight increase of BRL9 million in the financial income.

The reduction of 0.6% in depreciation and amortization and the private pension entity due to the actuarial revaluation, there was an effect. This will happen in the four quarters of the year. The positive effect was BRL23 million.

So we had a positive effect by the private pension entity and the EBITDA. That corresponds to an increase in income tax and social contribution by BRL17 million. Our recurring net income is growing close to 10% and the reported net income growing 33%. And the comparison between the quarters is important, BRL774 million of net income in the first half of 2010 compared to BRL572 million in the first half of '09. There was a significant increase.

On page nine, especially in the case of distribution, well, we finalized all the tariff adjustment processes, ending with RGE. So other than the sales in the captive market were due to the reactivation of sales in the free market, which caused a TUSD volume increase and the positive final readjustments in Parcel B of 1.93%. Well, that contributes to an important and recurring increase between the Second Quarter of '09 and the Second Quarter of 2010 of 27.2% in the reported EBITDA.

Our renegotiating with the agencies--our distribution companies were the first ones to sign a new agreement with them after recurring effect of 12.8%, sales in the captive market, TUSD. And the annual tariff readjustment; in nonrecurring, as I mentioned before, the reversal of the PIS, Cofins provision by CPFL Paulista and the recalculations of RGE annual tariff adjustment index.

With that, we have the recurring EBITDA for the Second Quarter of 2010, 66% which refers of our group with distribution. 25% is linked to generation and 9% to commercialization and consolidated EBITDA margin of 28% and a net margin of 13%.

Now it is true that because of the startup of two power plants in this quarter, first the Chapeco, EPASA. And Baladin, we are going to have an increase in the share of generation for this, the first six months of the year.

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Moving onto page ten, the result, BRL774 million proposal by--proposed by our Board declared dividends and dividend yield, the approval and distribution of dividends. The yield--we see 8.6% in the annual base, close to 3.9% in the semester base, share with an average value of BRL36.41.

I'd like to highlight because this company pays good dividends and has been paying good dividends since its IPO, we are paying 161 per share in the first half, which is the second largest dividend paid in six months in the past five years. Since the IPO, in the past five years, we have paid BRL 7.1 billion in dividends, a dividend yield of almost 87% of the value of the share when it started being traded five years ago.

That's an important comparison, especially when we look at page 11. Now we have for the first time this variation or assessing the market cap of the Company ever since the IPO. Based on the chart, CPFL Energia is the second largest company in terms of market cap in Brazil, the largest private company. It has been confirmed over time.

However, it's important to highlight the important behavior, specifically vis-a-vis its main competitors or the largest companies in Brazil in terms of market cap. What happened to these companies over the same period? We can see that the largest company, state-owned company, Eletrobras, obviously the growth is 35% as market cap reaching BRL28 billion. And over time, we had BRL4.4 billion as dividends.

Over the same period, we appreciated 134% at CPFL. And just to remind you, now our value--our stock is at 39, traded at L41 today. But here, we have BRL39 per share. The value today is higher than--well, almost BRL21 billion. But at 19 it grew 134%. And as market cap, it is the second largest energy group in Brazil, the largest private group. However, it distributed BRL6.5 billion as dividends. And it's proposing right now the distribution of additional BRL0.8 billion, amounting to BRL7.3 billion.

Right, after that, we have two players clearly identified by you. But the state player grew by close to 60% with distribution of BRL5.9 billion as dividends. A great private player for generation, growth was 139%, distributing BRL4.8 billion.

So CPFL, as you can see, was the largest or the stronger in this period, growing very fast in terms of market cap, undoubtedly thanks to a very successful strategy, very diversified for generation, distribution. And guided basically by operating efficiency and financial discipline.

Now moving to page 12. So we can see some indicators for distribution. And that's the result by the way--well, many people ask us very often about delinquency. As you can see in the mid part of the chart, the state of Sao Paulo reduced delinquency rates. But it's still high, 5.6% for all sectors. And on the left, you can see delinquency in the group, particularly distribution. Generation and commercialization, we had zero delinquency. For distribution, there is some delinquency, 1.5%, remaining stable over the period. As you can see, it's low delinquency and stable.

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In Brazil as a whole, delinquency increased 5.3% over the same period. So we are stable. The state of Sao Paulo is slightly better, dropping 2.5%. And Brazil slightly worse, increasing delinquency by 5.3%.

Many people question about quality. And we want to show that both frequency and duration of our outage are in line, virtually no increase in duration and a slight reduction in the frequency of our outages as a group, lower than 6%. And naturally, we are excluding the blackout effects. On the other hand, non-technical losses or the so-called commercial losses in the first half of the year, we also included to our results a recovered revenue of BRL60 million, a result of inspections and 227,000 inspected customers selected with an intelligent billing system. And we were able to identify 33,000 irregularities that were immediately corrected.

Now moving to page 13, you will have a picture of Foz do Chapeco, the civil construction ready. The dam is at the right height. And it's ready now, 94% concluded. We have the spillways, too. And the plan--well, the filling, the final filling required is on the operating license. The filling is from two to three weeks. And that's necessary for the whole commissioning with water in the hydraulic system of the plant.

So we already worked on all the dry commissioning. And for this, we are awaiting as a result of a joint effort of a company, the Ministry of Mines and Energy, attorney's office. And series of articulations. As you know very well, we had Ebamas strike. And that delayed our authorization process to finally fill the plant. So this is expected to be concluded this week. And we have the plant up and running by September.

On the next slide on page 14, we have EPASA, our thermopower plant. We have two actually in the north of the country in the state of Paraiba. And we have 51% stake. 72% of our investment has already been performed. We expect to have it up and running in October this year. And our fixed revenue will be--well, the investment will be BRL310 million in total. We have already invested BRL242 million.

And finally, on page 15, we have our investments in sugarcane-run plants. We have five projects underway, under construction. One of them is about to be concluded. And now Baldin will start generating as of next week. And then--by the way, for CPFL Day, we are going to visit this plant. But we have these five projects, 230 megawatts of installed power, close to BRL600 million invested in total.

As you can see on the chart, here we can see the effects and startups of each one of the plants and investments or the investment growth up to June 2012. Our pipeline is very important. Over the next few months, we'll be disclosing new investments in this area.

And finally, a couple of words on our CPFL wind farms, seven wind farms in the state of Rio Grande do Norte--we highlight that in July we had installation licenses. And in August this year, we start working on the sites, working sites for the investment of BRL768 million in the state of Rio Grande do Norte so we can have the plants up and running by July 2012. So I'll be sharing with you the status of our investment in wind power.

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Now a couple of words on commercialization, commercialization and services actually. And basically highlighting two initiatives--the first initiative is growth of our CPFL total network. Here we have an increase of 84% in our service seats or points, a result of a strategy to leverage this network. We have a promotional action with consumers. And over the period, we had additional 20% in the number of transactions, 25% in gross revenue of this project.

CPFL Atende is our platform for customer service, growing more than 100% in our service points, the number of calls 133%. And gross revenue virtually 478%, reaching BRL3.3 million in the Second Quarter.

Now before I conclude, on page 18, a disclaimer on the net debt of the Company, BRL6.4 billion--and BRL1.375 billion as cash and cash equivalents to be used to pay dividends. Our capital structure remains the same, 44% of equity, 56% of debt and the equity-debt 2.1 times, slightly lower compared to last year. And obviously, once we have these three projects going on, once we assess, excluding the debt because EBITDA of these projects begin to appear right now. So our ratio will be 1.7. That's pro forma considering EBITDA and debt, excluding investments to be concluded.

Now on page 19, we highlight funding via rural credit. And that's a new financing modality, maturity within five years. And a coupon of 98.5% of CDI. And it can be to working capital or expansion of distribution companies. Two years ago, we had--our last year by the way we has debentures of two years--and now we are facing the conclusion of these debentures and an extension for five years.

It is a similar profile for the debt, especially for CDI at 62%, long-term interest rate 31%, IGP 6%. And that led to an increase in our financial expenses. And that's the index of the debt with pension funds at the time of our privatization.

And now we also have a disclose of the debt cost, 9.5%, slightly higher due to a rise in CDI. But in real terms, it's going down with 4.4%.

Now on page 20, CapEx for distribution--that's our--well, we're investing BRL1.8 billion, this year more than BRL1 billion in distribution. It is the main investment, highlighting that over the quarter 43% of the investment has already been performed, as you can see on the chart.

I'd like to highlight important figures. We can have a more accurate assessment on CPFL Day in August, showing the importance behind the incorporation of private networks that are many private networks in the hinterland of the state of Sao Paulo. And they are related to consumers. And we are trying to have them included so we can obviously improve them. And that has an important impact in the inclusion of our asset remuneration base.

We can show BRL348 million invested. It started this year. And it's an important action, particularly for Paulista for power and light. And we started in January and will be up and running in August this year with RGE at Santa Cruz and to Paulista to concessioners with private networks to be incorporated. We'll be starting in September and October. In other

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words, we'll be including to the remuneration base BRL387 million by adding more than 3,000 kilometers of private networks. That's very important to reinforce our base, more than organic growth behind these companies at their base.

On page 21, some data related to our capital markets performance--in Brazil, our shares higher than Bovespa and IEE and, in U.S., greater than Dow Jones and Brazilian Titans, in addition to the main indexes, like ITAG and so on and so forth.

Performance over the last 12 months is also positive, growing by 33% compared to Bovespa 18%, in the U.S., virtually 50% against 15% Dow Jones. And the volume of business, the number of deals increasing as well--total volume of transactions BRL31.5 million, BRL17 for Bovespa, BRL14 in New York.

To conclude, some recognition and merit notes, highlighting a British agency TruCost assessing carbon intensity for energy companies, a study on 107 energy companies worldwide. And CPFL Energia was considered the less intensive--carbon intense company.

And we could maintain our first place as the most sustainable company in Latin America, according to Latin Finance studies, together with Management & Excellence. And also an important highlight, for the first time ever, CPFL was included in Exame Melhores e Maiores Magazine as the best company in the energy industry. And CPFL Paulista is also the best among distributor companies, distribution companies. So important recognition over the quarter.

So my team and I are here to answer your questions. Thank you.

Questions And Answers

Operator

Ladies and gentlemen. we'll be starting the question and answer session. (Operator Instructions) Our first question comes from Sergio Parmachero from Safra.

Q - Sergio Parmachero

Good morning, Wilson. I have a series of questions. But I'll ask two questions. The first question has to do with the CapEx program. In the newspaper, there is an article showing that you'll be seeking new opportunities for generation and adjusting lower prices. So I'd like to have a better understanding of your view when it comes to peers. We were talking about higher than 12%. So what's your current view to be adapted to the new market?

And then the second question, also related to CapEx, in two years, your CapEx will virtually be going down to half of what you already have. So you pay almost 100% of dividends. You're already investing more than BRL1.8 billion. And your capital structure is optimized. So down the road, when you really decrease CapEx, your capital structure will not be optimized anymore. So what opportunities in addition to generation will you be

seeking? Will you be focusing in Brazil only? Or are you going to seek other kinds of activities?

Now the second question has to do with our activities with M&A, mergers and acquisitions with energy. Do you have other activities? What is your priority, electro? Where else will you be focusing as far as M&A goes?

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Sergio, thank you for your questions. We are happy to hear from you. Let us start with CapEx. The newspapers, they give the headline. But accounting is not so--is not exactly the same. What I mentioned in the headline for the newspaper was that I keep on being surprised with projects when the rate of return is lower than the capital cost. I'm being very straightforward. I have no doubt about it. I admit that the rate of return, the capital cost reduced due to the better macroeconomic scenario, which is solid. So naturally, the cost of capital will go down.

And I'll be very honest with you. I believe these rates are still at two digits, maybe slightly higher than 10, no longer 12 for generation, especially due to a drop in the equity in a sector like this. But I insist we're speaking of hydraulic generation, long-term generation, investing from four to five years. And we know this investment--well, that's something that you consider in your balance sheet. But it still involves risks concerning the environment or risks related to geological risks. So there is a series of risks to be mitigated, construction, for instance, due to the spread to be used on top of our equity cost. So I believe they're still close. They are lower now. But they're close or slightly higher than ten.

So obviously, for that purpose, what I report in the newspapers, which is what I can do, is to encourage the group, particularly the engineering group, to work on technical development to optimize our projects so we can remain competitive. Our projects need to have rates of return that can be shared with the market and add value. Otherwise, the impact will be similar to those found by some of our competitors. They are penalized by the market. So the Company is very diligent.

I believe the equity--well, that's something that we insistently consider in your assessments. But in long-term projects by the Company, when we don't master all the variables, such as environment, geology, hydraulics, it is prudent and necessary to use risk spreads that naturally with engineering or financing capacity be mitigated over time. Otherwise, all we'll have is to work with our equity or generating no value at all.

On the other hand, I agree with you. When we consider CapEx for the group, look, my CapEx for distribution is continuous, ongoing. And that's the fruit of all the commitments taken with the agency and are included in CapEx in the flow of the so-called factor X. That's the main investment of the Company, BRL1.8 billion. Almost BRL1.1 billion is related to distribution. This is sustainable over time. It's a long-term concession.

And chances are to have agitative growth with two levers for growth. The first one is the number of consumers, more behaved, growing by 2.5% or 3%, depending on the concessionary. And obviously, we have to the market growth volume of our energy. And

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we also have investment associated to support the volume, especially substation, new conductors, transmission lines. And so on and so forth.

I don't expect a decrease in that regard. However, what is driving this drop? It is driven--well, unlike distribution and generation, we need projects to signal investments. And now we have the conclusion of a big hydraulic project. And the whole line of investment for the future or the pipeline for construction involve fast maturation for wind energy or biomass. And in less than two years, they'll probably be concluded. So down the road, we expect to keep on seeking projects in that area. That's why my frequency with the capital markets--well, I want to share on a quarterly basis new venture, be it for biomass or development of hydropower plants or small hydropower plants. And we'll be present in the auction for the wind farms. We have six farms there.

So to work on our capital, we also have to focus on generation projects. So we have for renewables, too, the Company is ambitious. We want to be the leaders in the market for renewable sources, especially wind farms and biomass and small hydropower plants. And we also want to improve our engineering to be involved in big generation projects. The best opportunities will be starting right now by year end with tele CDs.

When it comes to M&A activities, well, you are familiar with that. This is very important to the Company. And I think we made that very clear in our analysis when we created a vice presidency to keep an eye on all market opportunities, specifically for consolidation of distribution. So unfortunately, the media speculate a lot. I don't have any news vis-a-vis an objective action taken by the Company in order to seek or--well, you mentioned Enel Energia, for instance.

Naturally, here we have dear relations to be supported with our shareholders, for instance. So if I could give you a driver, the main driver for consolidation has to do with scale. And then any asset could be considered. But I have no doubt--our experience shows that very well--that geography is very important. Concessions that are close to the platform that is here, the largest in Brazil--we have a distribution company accounting for 14% of the market. In the southeast and south, they will always be our top priority because that's when we have more conditions to add value, to share good practices, efficiency, good quality levels. And obviously operating costs lower than the limits set by the agency.

So we're keeping an eye on opportunities. We are also--well, we envisage that in future years, also thanks to a definition related to concession terms, well, several concession companies surrounding ours are going to be expired. So we believe that either through growth in generation, as I said before, going for hydraulics and renewables, or by keeping an eye to prophecies for M&A--and at the end of some concessions, we believe we'll be able to optimize or keep on having our capital structure optimized, Sergio.

Q - Sergio Parmachero

Now just one last statement--in your last comment related to the maturity of concessions close to your area, could you elaborate that better? So you're mentioning Sespy and Sespy's plant. In other words, the government is not going to renew these concessions automatically?

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A - Wilson Ferreira Junior {BIO 20013669 <GO>}

No, I was just referring more specifically to distribution companies. We have several distribution companies. More than half of distribution companies will expire by 2015. Some are very small. I believe one of the important signals to the government, especially considering the model that we are beginning to--we are beginning to mitigate some effects of lack of quality or sometimes when you're not competent enough to implement more technology, sometimes due to financial constraints. And now we are including to our small hydroplant space acquired in recent years ERP 7.0 from SAP. We want to expand other SAP products.

So that would be unfeasible, considering the original size of the Company and also sharing the automation of substations so our level of service becomes better and more effective, in addition, sharing intelligent systems to assess commercial losses and reduce them. So this investment, a big group can share these with smaller companies. And maybe there is opportunities here to be identified so we can lower the number of concession from the moment this expansion is made by incorporation or any process that can streamline our areas and allow for better geography and above all provide better quality and more efficiency to our consumers.

Q - Sergio Parmachero

Congratulations on the earnings.

Operator

Our next question comes from Venusius Cayu from Credit Suisse.

Q - Venusius Cayu

Wilson, hello. Good afternoon. Thank you for the presentation. I have two questions related to the results for the quarter. I would like to know if you or your team can quantify the effect in the contract additive that CPFL's fined, referring to the effect of the charges, the effects in the quarter or in the year. That's my first question.

And the second question is--could you give us more detail on the reasons that led to a change in the private pension entity? It used to be a small expense and increased quite a lot.

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Venusius, I cannot give you an accurate number. But I'll get back to you. Actually, I'll put this information--I'll post it in the website. We can evaluate. The average effect is about 2.8% of the EBITDA. But I cannot give you the accurate figures for each one of the operations. Paulo will share with me and Gustavo, we will post this information in the website.

As for the pension plan, I'm not an expert. But Bassalo is here with me--he is our Accounting Officer--will help. What I can tell you is, at the end of the year, we have a provision for expenses with the private fund entity. And then we have an evaluation of the

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actuarial. The difference in the value is what the incorporation of this BRL23 million, possibly due to differences in what we would be contributing and what is being required. But I'm going to give the floor to him so he can give you more on that.

A - Antonio Carlos Bassalo

Good afternoon, to all. Regarding the pension plan, it's relatively complicated to do the calculations. But the concept is relatively easy to understand. At the end of the exercise, we calculate by the external actuarial or the future projections for the pension plan asset and liabilities.

So what results in expense or revenues, the projection of the costs for the following year. In specific case of 2010, that report shows the projection of a revenue. That's why we have this BRL23 million while last year we had a cost of approximately BRL3 million for the year. We're talking about BRL23 million for the quarter. We're going to close the year with almost BRL90 million of gain for 2010.

In 2011, we're going to have a new report in the end of the year, which will be what we will adopt the projections of gain or expenses for 2011. It really depends on the investment on the pension plan and the expected, estimated. And projected results of these assets.

Q - Venusius Cayu

This effect for the year of 2010 is a non-cash effect, agree?

A - Antonio Carlos Bassalo

Yes, you're correct.

Q - Venusius Cayu

Thank you, very much.

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Thank you, Venusius.

Operator

Our next question comes from Ricardo Cavanagh from Raymond James.

Q - Ricardo Cavanagh {BIO 1702523 <GO>}

Good afternoon. I have two questions. The first is related to a question that has been already asked. What would be your opinion today regarding the possibility of achieving the goal for the five-year investment period in terms of doubling market share in distribution and implementing the capacity of generation in the segment, counting on Bellamonte?

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And the second question is--in terms of what we saw of generation returns, what do you see as the trend of returns in the distribution tariffs in the next cycle of tariff review?

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Thank you for the questions, Ricardo. As for the possibilities of achieving the strategic plan of the Company, as I told you, we are on the right track. Possibilities are quite high. Our goal is by 2014 to reach about 5,000, close to 5,000 megawatts of installed capacity in our pipeline. With the investments announced alone and the completion of projects, we're close to 3,000. I'd say that if we are effective in the next hydraulic auctions, I think that the plan for 2014 remains.

Now I'd like to highlight that the plan was drafted with the prospect of creating value. The plan considers the differences in equity cost and debt cost for a whack and an internal return of projects according to the whack. So it's still creating value in the Company. So it's not just reaching the physical value. The important thing is to generate value or create value, be more effective, have higher return rates because with that we can create the same value with a lower volume. But that is just the baseline.

(inaudible) maintain an expectation of a value creation. So in generation, I guess it depends more on us. And I think that we are quite well positioned in the renewables area. We have a challenge in the hydraulic area. But it's obviously--it's obvious that the track record of the Company is very favorable. And we can adjust.

As for distribution, now that's harder. I cannot guarantee that I'm going to double the size of the Company. If we double the size of the Company, then a lot of value will be created. That's why in one of the previous questions I talked about the importance of scale and geography to create value. The Company is not just pursuing market share. We are pursuing opportunities that will bring market share eventually. But our goal is to create value.

(inaudible) some of the players, foreign players in the market and also we mentioned a little while ago about some smaller concessions, some cooperatives that are coming to the end of the concession. I continue to be optimistic. But unlike generation, this is not dependent explicitly on us.

I understand that there are and there will be opportunities for consolidation. This is good for the country. It will allow large groups to have CapEx to sustain growth at better rates and will consolidate good practices to offer better quality and will allow us to sustain the process of creating value and sharing that with our consumers in the form of lower rates. But the logic of consolidation, just like in a developed country, is present so that we can make the country one single country in terms of energy.

The first step is universalization. The second step is sharing good practices so that we can have on one hand good quality services, reliable systems, et cetera. And on the other hand, a low fluctuation of tariffs and rates than what we see today. So consolidation, we'll have to address all that in coming years. At least at the Company, for everything that we have done in all of these topics is a strong candidate to be an agent of consolidation.

So I remain optimistic regarding the theme of distribution with the timeframe of 2014. As for the whack, there are two things here. The whack should have--and I said should--have a slight decrease basically because the cost of capital and the cost of debt decreased slightly.

Today, I was talking to Gustavo. And this is one of the things that I would like to address during CPFL Day. I was telling him that this should be slightly different than some of the expectations created by the banks. And why do I say that? A distribution company makes an investment, a CapEx investment, which is a daily investment, different than a transmission company that makes a one-time investment to create a platform. And that investment remains stable over time. In the case of distribution, investment is ongoing. A distribution company has to face different loan rates.

I'm just trying to clarify this for you. If you observe--okay. This is important. If you observe BNDES, if they look at transmission or distribution investments, what do they do? They give a small maturity for the distribution companies than for the transmission company. The cost spread by BNDES is greater for the distribution company vis-a-vis the transmission company. And in the specific case of this comparison, they finance less the distribution company than they finance the transmission company. And this is assessment made by the largest development bank in Brazil, BNDES, one of the largest funding institutions for distribution as well.

So the phenom finances, maximum of 60%. So what do you do with the rest of the CapEx? If you're going to have debt, you're going to issue debentures. I shared 98.5% of the CDI operation, which is quite good. In the past quarter, we also demonstrated that with an advanceable debenture at 107% of the CDI. These extremely (inaudible) values for the distribution company and for the industry, they're greater than the CDI.

Last year, for example, we didn't borrow 111% of the CDI or 118% of the CDI. So we have to make up the debt. The debt shall not come from BNDES because BNDES will not finance everything. We have to add some debentures and our own equity into that breakdown in the capital structure. And all of that has to be recognized, the limited agency has a new whack. The regulatory agency has done that. But there was some external factors involved, the crisis, increase the cost of the distribution companies, particularly for funding. And distribution companies suffered, just like other companies as well.

So I don't want to give you any figures. I cannot give you any figure right now. But my expectation is that there will be an improvement. There is an improvement in the macroeconomic condition of the world, of the country. There's no doubt about it. The cost of debt is dropping and the cost of equity as well.

On the other hand, we should not forget that we have to make a capital structure feasible for the tariff cycle. And that depends not only on the BNDES benchmarks. But it depends on how we will complement the funds that we get in the capital market because there's no full loan given by BNDES for distribution companies. So my vision is that the whack will drop slightly. And the reasons for that is all these that I mentioned. But it will not drop

markedly because in this cycle, there will be events that have to be taken into account in this first.

Q - Ricardo Cavanagh {BIO 1702523 <GO>}

Thank you, very much.

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Thank you, Ricardo.

Operator

Our next question comes from Ms. Tatiana Rays from Citigroup.

Q - Tatiana Rays

Good morning. Thank you. So much for the conference call. My question has to do with the generation and commercialization segments. We can see a drop in the sales volume. So we wonder if--does it have anything to do with a seasonality strategy more oriented to the second half of the year when inventory prices should be different?

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Tatiana, not exactly. More specifically, for commercialization, we have an effect, a nonrecurring effect when you compare the quarters. Last year, for instance, due to the crisis, we had an adjustment auction. And we were one of the top players to supply volume. Obviously, at that time, we made use of renegotiations of major agreements with consumers, free consumers.

And for clear reasons, they had reduced production. And therefore, we could negotiate the volume we would deliver. It was positive for them. Theoretically, the volume would not be used--and also positive to us because we could work on the volumes, having in so-called adjustment auction. And then we are the three largest players. So the strategy last year had that corrective respect because the auction happened during the Second Quarter. The adjustment auction this year should be slightly later. And then we can go back to such a strategy. So the main reason is this.

Now I'd just like to say that for the future, why does the Company--why has the Company been devoted so much to biomass and sugarcane? In addition to being able to partner--it's a very interesting partnership by the way to farmers, to plant owners--they can also leverage the venture because the PPA, well, it is the largest operator of biomass in Brazil. Something around 30% of the production is acquired by the Company. So our expertise is very reasonable to operate in the market, particularly for these consumers, mid-sized or A4 consumers, from 500 or 530 megawatts. In addition to the portfolio are distribution companies. We know that countrywide that's the reason.

Now on giving a PPA, you also make the plant--well, you can finance the plant. The PPA is of a traditional company in the factor, the most efficient. And it was awarded by SME

Magazine. And then there was a challenge to make profits out of the venture. So volumes tend to grow because up to now CPFL Brazil and its related companies never worked on a backing of generation from the same group. All the plants, as you know, have PPAs with distribution companies according to the older or previous model.

As of now with these projects, especially related to biomass or the so-called lack of contracts with the small power plants, this will be backing for CPFL Brazil so we can increase its volumes in the future. So that's our strategy.

Q - Tatiana Rays

Perfect. Thank you.

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

You're welcome.

Operator

The next question comes from Antonio John Cada from BTG Pactual.

Q - Antonio John Cada

Good afternoon, Wilson. It's a simply question. On a quarterly comparison, we can see an important drop in the EBITDA of Piratininga due to volume. In your opinion, what caused this drop?

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

John Cada, that's a very timely issue. I don't think I'll be able to answer that right now. But please bear in mind that--well, the main business of distribution companies that make up the revenue is exactly the platform of the assets for the Company. The smaller the company--and that's typically for Piratininga. It runs something like 9,000 square meters. So the contribution you have in terms of performance and efficiency is lower.

According to our--for sure, I must admit I was not curious enough to go deeper into that assessment. But that's something I will do and I'll also share with everyone. There's nothing that is atypical at Piratininga, especially because we had a review late last year. So performance is according to the original expectations, not too many up sides in the Company.

Q - Antonio John Cada

Perfect. Thank you.

Operator

Our next question from Mariana Coehlo from Itau Securities.

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Q - Marcos Severine {BIO 3322666 <GO>}

Actually, I'm Marcos Severine from Itau. Wilson, I have a question much related to the financing of projects. Talking about the infrastructure in general with the need for a new investment of about BRL200 billion in infrastructure related to electricity above BRL30 billion a year.

So my question is--regarding BNDES, in the recent project, we saw a change in the financing conditions, particularly Bellamonte in increasing the amortization period from 20 to 30 years, 20 considering an increase that was established for Girau and Santa Antonio, the special BSI, wine financing, machinery and equipment with a 5.5 nominal cost for (inaudible). And given the huge unusual investments in the coming years in infrastructure in general, will you see BNDES resources coming for it?

Do you see any other financing or loan source out of BNDES? How can the Company approach these alternative sources? And do you believe that by seeking a new run source, would you need to increase the cap prices, particularly for generation so as to deal with a possible reduction in amortization periods or a possible increase in the cost of these new loans, just to ensure the same internal return rate that we could see in the past two auctions? We could observe was about 9% to 10%, depending on the discount for the auctions. So that's one question.

And a third question, still related to BNDES, is--given the need of BNDES capital wise, do you believe that they might sell assets? I'm talking about the Braziliana and the BNDES part.

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Thank you for the questions. As for another source of loan, I think that the candidates for presidency--Minister Dilma Rousseff has been talking about making infrastructure possible. And I think that this is very clear in their minds. So we have an extraordinary source, BNDES.

In all possible ways, they have been the partner of infrastructure. They have been releasing loans on a timely basis with adequate payment terms and period I think, good spreads as well. And this was an important contribution.

Now is this something the economy growing strongly, vigorously? You'll have to seek new sources of a loan. And this has been mentioned particularly by Minister Dilma. So yes, we'll have to seek alternative sources in the domestic market and perhaps going abroad again because of the quality of the investments that we will be able to offer to foreign investors. I think the world was already investing with longer payment periods than we were used to having in Brazil.

I think in the domestic market, Minister Quito Montika has talked about the need to create some sort of instrument that will either reduce the income tax for whoever's investing or that will allow us to extend payment periods and decrease the costs.

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I think that one way or another, the government can encourage that, either eliminating some taxes, just like they did for the white wine or reducing the taxes for cars. We think the government has instruments to remove some of the burden to investment, to allow greater loans.

I think that we do need to seek alternative sources of loans. I think that inside Brazil, Brazil is improving quite a lot vis-a-vis other economies. And there are many other opportunities, long-term opportunities, that will be well balanced and will allow long-term issuances in reals.

And the question is--and I guess you addressed that--the cost. Yes, there is a cost to be paid. Yes, we're going to be making a number of investments. When I say we, it's the industry as a whole. And these values will be perceived. If they're higher, when they tend to be slightly higher, then the loans by BNDES, that will be--we'll have to incorporate the higher costs of these works.

This is important, particularly in generation. We're used to using capital structures with 30% equity, 70% debt. Now with an elevation in the cost of debt, unless there is an expectation that the return prospects will be reduced, well, that will translate into an increase in the cost. I don't think that will be significant because we were already at very low values.

And just like I answered the very first question in this call, I believe that what matters the most to society and to the industry is that these works be well done and delivered on time. We cannot ignore the so-called risk involved. And if there's a risk, there's a spread to be incorporated to the capital cost. If the capital cost doesn't change, if the risk doesn't change, if the cost of debt is increasing, we definitely need to have a slightly higher profitability. And the impact as well will be an increase in the cost.

As for your last question regarding the BNDES capitalization, I must admit that I agree with you in your diagnosis. But I cannot--I'm not able to tell you whether BNDES would be selling assets or not. I think that BNDES has been very well disciplined regarding the origin of their capital and management of their assets. For some of them, they could get quite a profit. They do have that possibility ahead of them. But this is a decision that goes beyond the technical level. It has to do with the political issues involved. And I cannot address that. I think that that is a possibility. But the decision is not exclusively technical in my opinion.

Q - Marcos Severine {BIO 3322666 <GO>}

Thank you, very much.

Operator

Our next question is from Pedro Infratini from J.P. Morgan.

Q - Pedro Infratini

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Good afternoon, Wilson. You mentioned a lot about biomass and renewable sources. When we think about CapEx going down over the next years, when you consider the sources migrating from special auctions, A minus three, for instance, in the short term, how do you see that? How are you going to be competitive with other sources? Thank you.

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

I'll turn the floor over to our colleague Roberto because it's a more specific question.

A - Unidentified Speaker

Thank you, Wilson. Thank you, Pedro. According to our expectations, there is a real trend in the mid-long-term basis for this auction for the sources. If you think about the auction for renewable sources, you have biomass directly competing with wind energy. So chances are this will really happen on a midterm basis. So we believe that's not a short-term trend. But it could be possibly on a midterm basis.

Q - Pedro Infratini

Thank you. And do you also see a room maybe to compete for efficiency with other sources, I mean, not only biomass and wind but maybe hydropower, for instance? Do you see room for that in the future?

A - Unidentified Speaker

There is a trend to have it. But there's more on a long-term basis. In the short term, we expect competitive sources to compete among themselves. And we expect to the auction. But obviously, to be close to water, especially considering these prices, I think you should take the longer. I don't believe it would happen on a midterm basis or something from three to four years.

Q - Pedro Infratini

So one last question. So you need more technology and in fact CapEx? What about Brazil? For wind power here, you also have theaters of air generators in Brazil. Is that what has prevented competitiveness or migration? How do you see this lower CapEx?

A - Unidentified Speaker

For the first auction, there was a paradigm shift. I think there are two important elements here. First, the government was very wise to make use of an outlook or a perspective for an installation of a set of plans for air generators in Brazil. And considering the volume, there was a very strong competition in some of them, where even suppliers became partners. In this case, it was also like that.

So obviously, I believe there is a perspective, a long-term view, to have generators installed. And chances are--I'm not going to say that these values will go down. But they would remain stable at lower prices, considering the scale and specifically considering the long-term. We talk a lot with suppliers. And Brazil still has some disadvantages in terms of

raw material and skilled labor. And it prevents it from having the best price for these generators.

And another important thing to see in the next auction, well, the last time those generators showed were the air generators manufacturer in Brazil for financing reasons. From that, firms wanted to have them assembled in Brazil rather than the imported ones. Now if we notice what happened over the last six months, there was also an important decrease of the euro rates compared to the real rates. And the main manufacturers of these generators come from Europe. So the crisis in Europe and maybe the lower value might lead to some differences in the auction. But that's something to be followed.

Now just to add, I'd like to say that the neutral Parcel A or the effect was BRL19 million over the quarter or 3.4% of the EBITDA as a company. So this is in note number three of the balance sheet. So remember the question, the previous question? Venusius asked the question, right? So BRL19 million, on note three, you have it disclosed.

Q - Pedro Infratini

Thank you for answering my question.

Operator

We're coming to the end of the Q&A session. I'd like to give the floor to Mr. Wilson Ferreira Junior to proceed with his closing statements.

A - Wilson Ferreira Junior {BIO 20013669 <GO>}

Well, again, I would like to thank all of you for your attention, for the time you took to join us in this earnings call. It is very satisfying to us to share growing results to you with value creation. I believe that all of the figures that we presented to you in terms of market prospects, energy consumption are very challenging numbers for the future.

We have to stimulate the growth of our generation, distribution. And transmission platforms. And there are some opportunities as well. I believe that in the light of its strategy, CPFL has to pay attention to having financial discipline and to have intelligence to enjoy these opportunities the best way possible. This is what I expect for the coming quarters. And I hope to be sharing good results to you in the coming quarters.

Thank you, very much for joining us. Have a great afternoon.

Operator

That concludes CPFL Energia audio conference for today. Thank you, very much for your participation. Have a good day.

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