

Q3 2015 Earnings Call

Company Participants

- Romel Erwin, CEO, Technology and Quality VP Officer & Industrial VP Officer
- Ronald Seckelmann, CFO & IRO, Finance & IR VP Officer & Subsidiaries VP Officer
- Sergio Leite, Commercial VP Officer
- Wilfred Bruijn, MD, Mineracao Usiminas

Other Participants

- Alan Glezer, Analyst
- Carlos de Alba, Analyst
- Ivano Westin, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Roy Yackulic, Analyst
- Thiago Lofiego, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Usiminas conference call to discuss the Third Quarter of 2015 results.

(Operator Instructions) As a reminder, this conference is being recorded. I would like to mention that this conference call is being broadcast live on the Company's Investor Relations website <http://www.usiminas.com/ir>. The earnings release and the slide presentation are also available on that site. Participants who are listening to the conference in English may also ask questions directly to the speaker.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in many forward-looking comments as a result of macroeconomic results, market risks and other factors.

With us today are Usiminas Executive Board, Mr. Romel Erwin, CEO and Technology and Quality Vice President Officer; Ronald Seckelmann, Finance and Investor Relations Vice President Officer, Subsidiaries Vice President Officer; Mr. Sergio Leite de, Commercial Vice President Officer; Tulio Chipoletti, Industrial Vice President Officer; Mr. Nobuhiro Yamamoto, Corporate Planning Vice President Officer; Wilfred Bruijn; Bill, Managing Director of Mineracao Usiminas; Heitor Takaki, Managing Director of Usiminas Mecanica;

and Cristina Morgan, Head of Investor Relations. First, Mr. Seckelmann will comment on the Third Quarter 2015 results followed by Mr. Erwin with some additional considerations and concluding with the management will be available for a question-and-answer session.

Now with that the floor to Mr. Ronald Seckelmann.

Ronald Seckelmann {BIO 3722329 <GO>}

Thank you very much. Good afternoon. I would like to make a few comments about the operational and financial performance of Usiminas in this Third Quarter of 2015 and I will use the slides that you can see via webcast.

In the Third Quarter, our negative performance -- our performance was negative in almost all indicators, an 8% decrease in total steel sales, 36% drop in iron ore sales and a negative EBITDA and 26% [ph] and a net loss in this quarter.

The next slide shows the sales broken down where we can see not only a reduction in total sales but a worsening in geographic mix through our increased participation of exports which capped its absolute volume almost stable. But have increased their share to 36% of the total.

The next slide shows the EBITDA of the steel business with a negative result in this last quarter, with the contribution of negative participation of energy sales. On the next slide we see a strong reduction in the sales of iron ore. Then the EBITDA of mining business, although we had a positive contribution of sales on energy in the last four quarters, the sales of electric energy has highly contributed Mineracao results that other than that had been deteriorating.

The next slide shows the EBITDA and the consolidated EBITDA margin, which is negative as mentioned at the beginning and virtually with no contribution from the sales of energy.

Some positive indicators or exceptions in this quarter. We continue to be successful in reducing our general and administrative expenses. We were successful in managing our working capital. In the quarter in which sales have dropped differently from what we expected based on historical data from a season after Third Quarter, we were able to maintain the compatible patterns standards when compared to last year.

The inventory levels dropped by 18% to really contribute to a lower working capital when compared to the other quarters and strongly contribute to the strong cash generation of the Company. The indebtedness of the Company has increased, affected by the depreciation of real, which has reached 28% in the first six months. Our indebtedness has never reached -- exceeded BRL8 million and the net indebtedness also increased both in absolute and relative values measured by leverage.

Finally, CapEx, which is one of the items which is the focus of our management, we are trying to reduce CapEx to the minimum possible levels. This year we plan to stay slightly

below BRL750 million in CapEx with the substantial reductions in the quarter. These are the comments I had to make about operational and financial results.

And now I'd like to pass over to Romel who would like to make some comments.

Romel Erwin {BIO 17406447 <GO>}

Good afternoon, ladies and gentlemen. I would like to thank you for attending another conference call to talk about the earnings release results of Usiminas in this Third Quarter of 2015. Initially I would like to talk about the progressive worsening of the conditions of the steel market.

The excess production capacity of steel which currently amounts to 700 million tons puts significant pressure on international market prices. As an example, we can show the rhythm of exports of China. If we are to look at that, today we're talking about export volumes of about 113 million tons. And domestically we currently experience an unprecedented economic crisis in Brazil. For the 18th consecutive months, the industrial sector is shrinking.

In the first nine months of the year, the consumption of steel in Brazil was 18% lower than the same period in 2014 which in turn had been around 8% lower than in the same period of 2013. Which means that the Brazilian market has been deteriorating more and more for flat steel. This economic situation is reflected in our figures, which you had a chance to look at, I'm sure.

This should be a figure which require from us Manager of Usiminas and equally severe positioning firm as well as responsible. You know that this year as a way to adapt to market conditions, we stopped the operations of two blast furnaces, one in each plant and we have also stopped the operation of heavy plate mill in Cubatao. And now we are taking a step further towards this adaptation. Within an estimated period of three months to four months, we will shut down temporarily the primary areas of Cubatao. We're talking about shutting down temporarily the operations of sinter and coke plants, the blast furnace two of Cubatao and the steel mill of Cubatao. Therefore the operations of Cubatao plant will concentrate on the hot and cold rolling and the port terminal. Our purpose is to bring Usiminas to a new level of scale and productivity.

We are strengthening the competitive capacity of Usiminas with responsibility, courage and determination. But to support this plant, a series of other management actions are being taken. Our greatest effort is focused on cash management and dilution of fixed costs. Therefore, I list the several fronts on which we have been working intensively.

Capturing opportunities to increase prices and (inaudible) reduction and control of working capital that we already presented we were able to reduce from BRL2.7 billion to BRL2.4 billion, the working capital at the end of this quarter, the reduction and control of CapEx, the reduction and control of general and administrative expenses as well as third-party services, reduction of fixed costs with labor force adjustments, reduction of working hours and lay-off and search for opportunities to sell assets.

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Based on this set of actions, we will measure new efforts to reposition the competitiveness of Usiminas. Our actions are not isolated. They have a structural nature and are compatible with the new reality of the market.

Finally, we are aware of our results, we are aware of our challenges. But above all, we are aware of our potential.

Now we'll have a chance to discuss our plans even further and clarify any questions you may have. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we will now start the question-and-answer session. (Operator Instructions) We kindly request that members of the media direct their questions to Usiminas Media Relations Department on 5531-3499-8918 or to email imprensa@usiminas.com. Marcos Assumpcao, Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

My question is about the Company's leverage. As Romel said, you're making -- taking actions to reduce leverage through this difficult period going through in the Brazilian economy. Could you give us an idea of what level of CapEx you plan to have for 2016, whether it could be reduced even further?

Also in terms of working capital, what is your expectation to reduce working capital from now on? And in terms of Company leverage, do you intend to issue debt in short term maybe to lengthen the amortization schedule of the Company given that the current cash of the Company is not sufficient to pay -- to make payments in the next 12 months to 18 months?

Do you also have any plan to sell asset or maybe consider a capital increase to reduce the Company's leverage in the short term? Thank you.

A - Romel Erwin {BIO 17406447 <GO>}

Good morning. This is Romel. I will make some comments about the questions you asked. In terms of CapEx, we don't have figures for next year. We're working on our budget for 2016 and there are some indications that I can share with you.

In terms of CapEx, I think we can work with the hypothesis of having a CapEx of about half of what we have for this year. We're talking about something slightly below BRL150 million. So we can think about something half of this or rather BRL750 million and half of it. We had BRL2.4 billion in working capital this quarter. But with the recently announced measures I think we can lower that even further. So there is room to generate some cash by reducing the working capital. The sale of assets is one of the fronts we are looking at.

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You know the Company well. So you are aware that we don't have that many non-strategic assets available for sale. But we do have some and we are assessing that. We don't have anything to announce for now about that.

Well regarding the circumstances of whether the -- when the market circumstances become more favorable to plan, we'll try to plan our debt trying to refinance with maturity terms a bit more favorable. The expected leveraging, we expect it to rise, the leverage to rise because this quarter, we didn't have any covenants. Probably next quarter we will have a covenant observation and we'll make increased discussions with our main creditors in order to have the funds needed for the year-end.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Very good. If I could make just a quick follow-up regarding the shutdown of Cubatao, you've mentioned in the quarter there has been an increase in the expenses compared -- equipment expenses from BRL30 million to BRL70 million. What should we expect the behavior of this account to be from now on?

A - Romel Erwin {BIO 17406447 <GO>}

The amount of equipment that has been shut down will increase. So the trend for this line is to increase. But it also changes a bit in terms of depreciation, it kind of affects that. In total these figures change in terms of their line. When you separate cost of equipment shut down, they could be in terms of cost of goods sold. We tried to separate these expenses and costs in order to better reflect the real operation of the Company, the figures don't really change at the end because of that.

Operator

Thiago, Merrill Lynch.

Q - Thiago Lofiego {BIO 16359318 <GO>}

I have two questions. One for Romel. If you could comment on the restructuring assets in Cubatao, do you intend to buy plates from CSA or Ipatinga or would you discuss increasing the capacity for rolling both Ipatinga and Cubatao or you are shutting down even further there?

And second question for Sergio Leite, if you could comment on the domestic market with this removal of discount, is this really happening? Is it reasonable to expect an increase in average prices in the Fourth Quarter? Thank you.

A - Romel Erwin {BIO 17406447 <GO>}

Regarding the operation of Cubatao plant, we are shutting down the primary areas of the plant and we will keep hot and cold rolling unit on. And we will do this with external supply of plates that could come either from Ipatinga or by buying third-party plates. Of course, we will choose what's most attractive, economically speaking.

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A - Sergio Leite {BIO 18922519 <GO>}

You mentioned the cost reduction in Cubatao and the entire operation because of this restructuring we are conducting. We don't have the exact figures. But the main reason that led us to make this decision, as Romel said, is to adapt the Company to the existing market conditions because the market has been deteriorating strongly lately and we are trying to adapt the Company's size to this new market reality. After that there we will have the benefit of cost reduction. But I can't get you a figure about that right now.

Thiago, with regard to this price movement that we made, talking on October 9, I have two comments to make. Regarding the plant dispatches, this increase is being absorbed as usual. And the second comment is about the end, the Solucoes that is our distribution branch that is also able to implement this price movement. Considering this movement that we made on the 9 of October, I would say it's about 5% to 6%.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. Thank you. Can I go back to the first question and ask about this decision to shut down any additional milling unit, are you envisaging that?

A - Romel Erwin {BIO 17406447 <GO>}

No. So far, we are not.

Operator

Ivano Westin, Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

First, I would like to talk about steel exports. Is it reasonable to consider that the Third Quarter was a peak or do you expect any additional volume? And about the profitability of export, if you could give us the breakdown of profitability per product, it would be very welcome. And that's the first question. And the second that in line with the discussion of this most difficult scenario for the steel industry, do you expect any protectionist measures coming either like increasing import duties, for example? Thank you.

A - Romel Erwin {BIO 17406447 <GO>}

Ivano, regarding exports as Ronald mentioned, in the Third Quarter, we remained at that same level of the Second Quarter and as I mentioned in the previous quarter, we had a reduction in the export of plates. In the next quarter, in the fourth, we'll have a small reduction of exports. Given the dumpings of hot and cold milling in the US market, we are now moving to Europe. And in general, our export generates a positive margin over variable costs. So our EBITDA margin in exports made to Argentina that we considered (inaudible) domestic market and price equivalent to Brazil in the other margins as positive margin over variable costs.

In terms of government measures, we are working intensively with the government under their leadership of (inaudible) Brazil with other steel companies talking to the government,

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especially talking to four ministries; Ministry of Development, Industry, Planning, Finance, talking about the government, about this reality of the steel business in the world and in Brazil. The situation that the companies are facing and asking for some actions in terms of trade defense. And I think we're able to raise the awareness of the common men and these discussions continue.

So far, we haven't had any news in terms of actions to -- except for the anti-dumping actions for heavy plates that were implemented in the end of 2013. And after this implementation there were some two conventions, actions involving 14 countries with the barium [ph] and chromium additions. So these are normal measures to defend our commercial relations. And we are always talking to the government. But we have to see what actions will be implemented from the Brazilian government.

Q - Ivano Westin {BIO 17552393 <GO>}

Thank you. Just I would have a follow-up question for Bill if you allow me. Could you please comment on what you expect in terms of iron ore and the expected volume for next year?

A - Wilfred Bruijn {BIO 16707173 <GO>}

We continue to adjust the size of the Company to the size of the market and market conditions. And the exchange rate is helpful on one hand, on the other hand, international prices have shown a trend of really falling more and the price curves are not very exciting. Regardless of volume each ton must leave the Company with a level of competitiveness that is minimum. For next year, we are completing our budget right now. So I can't give you precise volumes. Also considering the action that we're taking in Cubatao. So we will have to look for some alternative routes that are being studied right now. But soon we'll have this final figure.

Q - Ivano Westin {BIO 17552393 <GO>}

Okay. Thank you. Could you then comment on the iron ore expectation?

A - Wilfred Bruijn {BIO 16707173 <GO>}

There are several ways to look at the cost of Mineracao mining activities. The best would be to talk about the cost of iron ore placed at the port but only considering the costs that are linked not to the dollar but to the real. So the Brazilian real. So we are thinking to have a cost around BRL40 and maybe even lower, depending on how many plants are we able to use next year, which will depend on the demand. But placed on the truck that will drive this ore. So what we notice compared to the previous quarter is that the dilution of fixed cost was lower because the fixed cost -- the production level was lower because sales of Usiminas decreased. We closed two high blast furnaces, one in Ipatinga and one in Cubatao. So any figure I give you is directly related to how many plants are operating and the market demand context. So you can use this figure as a reasonable basis for extra costs.

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Leonardo Correa, BTG.

Q - Leonardo Correa {BIO 16441222 <GO>}

To Ronald and Romel maybe, we have discussed several topics about what could be done in the coming months. The adjustment to shutdown Cubatao could be very helpful to adapt the capacity usage levels. I know it's hard to give a figure, Ronald. But just to fist to try it on this trend that in your mind, what kind of speed of improvement could you expect for the next quarter because usually these great movements have some initial costs? And in some previous questions you mentioned that there is an additional shutdown cost. Is that increasing every quarter and there may be some severance payments and costs associated with that? Is the impact on the metrics magnified in a scenario of negative EBITDA? Just an idea of a ballpark figure that the Company expects, when the Company expects to go back to a positive EBITDA to pay debts and all other liabilities?

And also regarding MUSA, the cash in bank that we look at consolidated for Usiminas is BRL2 billion or close to BRL1 billion. This cash belongs to MUSA. So what is the strategy of use of these funds. Could these cash be used to pay debt, to repay debt?

Sergio has mentioned that the premium level in the domestic market is around 5%. We see international prices dropping with no sign of getting stable, at least in the short run. So what about the renegotiation with the car industry? Probably you have started that, right, to finish -- complete that negotiation at the end of the year. So how are the discussions going, what's the possibility of a price adjustment in this scenario, in which customers are suffering heavily as well, at least in terms of volume? So how are the discussions, do you have any improvement in the top line that's most likely to come from prices only given that we expect the economy to still continue to shrink next year and it will be a recession most likely?

A - Romel Erwin {BIO 17406447 <GO>}

Thank you for your question. Good afternoon. About your first question, you set the tone actually. None of the actions we took or are taking will create a major change in the short run, none of them will radically change profit. All of them bring improvements that accumulate. And as you mentioned, in some of them we've started having an increase in cost and expenses in order to get the benefits later. So actually what we've done in the past has benefited us now. What we are doing now and plan to do in the future will bring benefits in the next quarter. So we did not calculate the expected results for 2016. But there will not be any radical change in the scenario.

We expect and seek a gradual and constant improvement considering the market circumstances. As for the cash, the BRL2.4 billion cash that we have at the end of the Third Quarter BRL1.3 billion are in MUSA and more than BRL1 billion outside MUSA in the holding company and its controlled subsidiaries. This higher cash availability at MUSA is because of the needs. The main -- MUSA has results and even with the poor results in this year, we can distribute a part of the cash there to Usiminas. But we will monitor that as needed.

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Leonardo, with regards to negotiations with the automotive industry, we have annual agreements with the car manufacturing industries. They are negotiated at the end of the year. They take -- these negotiations take two to three months. We are negotiating right now. It started in September. And as you mentioned they are delicate sensitive discussions given the results of the car industry. But our position in the negotiation table is to increase prices for next year. But we are just beginning these negotiations. It's still early to talk about the final result. Likewise, we have six months or three months agreements with the industry in general. We are negotiating them for next year and our position is to increase prices as well.

Q - Leonardo Correa {BIO 16441222 <GO>}

Okay. That's clear. Thank you. Another additional point, something that's not very clear, Ronald, you mentioned the CapEx. I know you have the final figures yet. But you are looking at something around BRL350 million from what I understood. Is this a level that you find sustainable or something around 50% or 60% lower than what we thought it would be a sustainable CapEx level for maintenance in the past?

I know that now the Cubatao has been shut down or will be shut down, you have more maneuver to adjust maintenance CapEx. But at what level can you run, I mean, the Company's operation? Do you think it will be around this level for two to three years or in 2017 should we expect a more normalized level?

A - Ronald Seckelmann {BIO 3722329 <GO>}

Well what's behind this strong reduction is a lower need for CapEx. Given Cubatao, just shut [ph] Cubatao as we are announcing today. And this figure is for next year. This is not a figure that we plan to have for the other years after that. I don't know how much of it would be possible to make in 2017, 2018, 2019. But we are focusing on 2016. So the figures are what we expect for next year.

Operator

(Operator Instructions) Carlos de Alba, Morgan Stanley.

Q - Carlos de Alba {BIO 15072819 <GO>}

If I annualize the cash from operations in the Third Quarter, I would get around BRL100 million and given that you just mentioned that none of the actions taken so far by management will result in a short-term benefit. So it seems that even with a CapEx -- a significant CapEx call it around BRL350 million to BRL400 million reais per year, the Company is going to be FX [ph] neutral in free cash flow. And yes, I know that the Company has about BRL2.4 billion reais in cash but that basically is going to go to repay debt in the Fourth Quarter and in 2016. And a not a lot of the cash, as was said before, belongs to Usiminas. So the situation is getting quite critical and my question is, are you guys considering on issuing equity at some point given how critical the situation is and there is more prospects for the market improving in the short term, as you said. And none of the actions taken by management are going to resolve in short-term benefit?

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A - Romel Erwin {BIO 17406447 <GO>}

You mentioned -- you made a comment about what we had commented before, being that all the actions that we have been taken and will take result in gradual improvements throughout time, none of them is really short term and that by looking at some indicators for the Third Quarter you reach some conclusions regarding cash generation and cash needs to pay that service and in your projection you find a need for additional capital that could be provided by selling assets or that may lead to a capital increase.

What I can say is that based on the assumptions you're using your figures are consistent but anyhow we are working on our own figures. We cannot compare our projections with your estimates because we still don't have our projections for next year completed and detailed.

As for the actions to provide more cash in addition to what the normal business operations could provide, I mentioned reduction in working capital, there is room for that, reduction of CapEx that we have room to do that next year. I mentioned selling assets, which we are trying to do that.

As for a possible capital increase, I would like to comment that some actions are the decision of Company's management. We are commenting on those. But there are actions that are on the hands of the Company's Board of Directors. But what I can say is that the Company's Board of Directors and officers of the Company are working very close in sync and in a very transparent manner in terms of the figures, actions and everything we should do. So in due time and if needed, we may announce other actions. But so far what we have thought about is what we have told you.

Operator

Alan Glezer, Bradesco BBl.

Q - Alan Glezer {BIO 17508681 <GO>}

I have two questions. The first one is regarding the covenants. In terms of the growth that amounts to BRL8 billion, how much of this is subject to covenants? What is the covenant that would apply and if there would be any negotiation to draw some of the covenants? Do you have any estimate of how much you would have to pay in a renegotiation?

My second question is about the strategy for Cubatao plant. I understand that you were shutting down one blast furnace and will buy plates from Ipatinga or a third party company. I would like to understand this -- if this strategy to shut down the production of plates could be also applied to mining, maybe stopping or reducing the production of MUSA and buying iron ore from third parties? These are my two questions. Thank you.

A - Romel Erwin {BIO 17406447 <GO>}

Good afternoon. Let me make some comments about the covenant first. We have few covenants on gross debt. They account for 15% of the total gross debt that's covered by

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gross debt covenants. The rest are covenants on net debt. I would say that 70% to 75% of our debt has covenants and out of these the net debt covenants are the majority.

In either case the indicator we established is 3.5. After publishing the results of the Third Quarter and given the prospects we have for the Fourth Quarter, we will start discussing and talking to our main creditors starting now. I really don't know what we will discuss in terms of the condition. Actually our list of creditors is relatively small. We have a few market transactions, most are bilateral transactions and Usiminas has an excellent relationship with all of its creditors which should facilitate a discussion in the next weeks or so.

Regarding the strategy to shut down the primary operation of Cubatao and the consequent use of iron ore from MUSA or third-party companies, we will be in constant analysis. MUSA must remain competitive in the best way possible and they must be able to allocate its ore in other markets now that Cubatao will no longer use iron ore from MUSA or third-party companies. So as I said in the beginning we're looking for other markets. But we're focused on margins and competitiveness, not necessarily translating into volume.

Operator

Roy Yackulic, Bank of America Merrill Lynch.

Q - Roy Yackulic {BIO 4201939 <GO>}

I think most of it has been discussed in a lot of detail. But I think that leverage is worrisome and I am sorry I missed what was the exact terms of the covenants that you say you are going to have issues with probably in the next quarter? And I don't understand why you didn't have them in quarter given that the leverage is so high. I have gross leverage of almost 10 times and net leverage of almost 7. And I guess those are more comments unless you can be more specific about the covenants, because I think it has been discussed in detail, this whole issue about leverage problems and free cash flow.

A - Romel Erwin {BIO 17406447 <GO>}

Your question about covenants, you're asking us to explain why we didn't have to renegotiate the covenants or request waivers

about the removal of covenants in this quarter. And the answer is because all our agreements involve moments of observation of covenants that are done either every six months or every year. So the compliance of covenants is done either half of the year or at the end of the year. There is no financial agreement that sets forth the observation of compliance with covenants at the beginning -- at the end of the first or Third Quarter, only at the end of the Second Quarter or First Quarter.

Q - Roy Yackulic {BIO 4201939 <GO>}

Can I do a follow-up? Did you answer the question of what was the covenant in specific numerical terms, did you answer that question and what percentage of the debt does it cover?

A - Romel Erwin {BIO 17406447 <GO>}

Yes, I made a comment on a previous question that our covenants are 3.5 times the net debt in the vast majority of cases. 70% of our covenants refer to net debt over EBITDA covenant with an indicator of 3.5 and there are very few contracts that have gross debt covenants. And in this case, it's 3.5 times or so. So I would say that 85% of our debt is covered by covenants, 15% gross debt and 70% net debt.

Operator

Since there are no further questions, I now would like to pass the floor to Mr. Romel Erwin for his final consideration.

A - Romel Erwin {BIO 17406447 <GO>}

Well I would like to thank you again for your attention and for attending this call. Once more I would like to emphasize the seriousness and commitment with which we will implement the actions we announced today.

We are a strong company and we plan to provide a new size to the Company and prepare it to the market challenges. I would like to highlight that Usiminas is the leader in technology. It supports a huge industrial chain and it has potential to gain more competitiveness. We know it's a difficult path. But it's a certain path and the right one. And we are working hard and we work even harder to overcome our difficulties and meet the expectations of our investors and of society in general. This is our commitment. Thank you very much to you all.

Operator

Ladies and gentlemen, this ends the conference call of Usiminas. In case you have any questions, the Investor Relations team is available to answer any questions you may have. Thank you very much for attending and have a good afternoon.

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