

## Q1 2014 Earnings Call

### Company Participants

- Mario Azevedo de Arruda Sampaio, Head of Capital Markets and Investor Relations
- Unidentified Speaker

### Other Participants

- Ezequiel Fernandez, Analyst
- Hasan Doza, Analyst
- Sergio Tamashiro, Analyst
- Unidentified Participant

### Presentation

#### Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP conference call to discuss its results for the first quarter of 2014. The audio for this conference is being broadcast simultaneously through the Internet in the website, [www.sabesp.com.br](http://www.sabesp.com.br). In that same address, you can also find the slideshow presentation available for download.

We inform that all participants will only be able to listen to the conference during the company's presentation. After the company's remarks are over, there will be a Q&A period. At that time, further instructions will be given. (Operator Instructions).

Before proceeding, let me 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 SABESP's 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 SABESP and could cause results to differ materially from those expressed in such forward-looking statements.

Today with us we have Mr. Rui Affonso, Chief Financial Officer and Investor Relations Officer; Mr. Mario Arruda Sampaio, Head of Capital Markets and Investor Relations; and Mr. Marcelo Miyagui, Head of Accounting.

Now, I'd like to turn the conference over to Mr. Arruda Sampaio. Please, sir, you may begin your conference.

## **Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Good morning, everybody or maybe good afternoon at this time. Thank you all for attending one more earnings conference call. We will hold a nine-slide presentation that discuss the main events in the period and then as usual, let's go for a question-and-answer session after that.

Let's start on slide three. Here we have the company's growth -- water and sewage volume. This volume and sewage volume was dropped by 5.2% in the period, driven by the 2.7% expansion in water connection and a 3.5% expansion in sewage connection.

The high temperatures in the first month of the year directly impacted higher water consumption and as result also greater sewage consumption. This increase in -- this 4.9 increase in billed water and 5.5% increase in billed sewage both above the Company's expectation, which were approximately 2.5% for water and 3% to 3.5% for sewage. This was a typical growth, particularly in the first two months of the year and greatly interested by the high temperatures of the period. In fact, with this, in this respect, it's worth commenting that the average temperatures in the first quarter of 2013 was 23.4 degrees centigrade compared to 26 degrees in the same period; that is almost three degree above.

Let's go to slide four. Here we briefly highlight our financial results. Net operating revenue grew 5.6% over the previous year, driven by the upturn in sales volume and sales increases. Cost in selling, administrative and construction expenses increased 6.1% in the period as a percentage of the net operating revenue cost participation moved up from 72.5% in first quarter '13 to 72.9% in the first quarter '14.

Adjusted EBITDA increased by 10.2% from R\$921.5 million in first quarter '13 to 1 billion in first quarter '14. Adjusted EBITDA margin in first quarter, '14 reached 36.4% compared to 34.8% in the same period last year. Including construction revenue and costs, adjusted EBITDA margin increased to 44.5% this quarter, compared to 42.4% first quarter 2013. Net income totaled 477.6 million, reducing 3.7% year-over-year.

Let's now go to slide five. We show here the main variations in cost, relation to the same period in the previous year. There was a 6.1% increase in cost and expenses compared to 2013. If we exclude the construction cost, cost and expenses climbed 5.8%, mainly due to the 37.6% increase in services, 33.3% rise in depreciation and amortizations and as well as the 7.8% in payroll and 7.4% rise in (inaudible). On the other hand, credit write-off expenses grow by 60.7%, tax expenses and general expenses down 60.9% and 29.1% respectively. For greater details on each of our cost, you can find in our earnings press release, if you want to dig in.

On slide six, next slide, we present the main variations in the items that affected our net income, which totaled 477.6 million. Net operating revenue increased by 5.6% or 147

million over the same period of 2013. Cost and expenses including construction costs were up R\$117.4 million or 6.1% year-on-year. Other operating revenues and expenses fell by about 52.2 million. Net financial revenues and expenses including foreign exchange variation increased slightly by 0.2 million in the period. Finally, income tax and social contribution showed its positive variation of 3.8 million due to the lower operating income in the first quarter of 2014 as compared to 2013.

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Go to slide seven. On this slide we show the levels of the reservoirs that make up the Cantareira System during the rainy season, of once from October 2013 to March 2014. More specifically, as you can see, there was an absolutely a typical behavior in rainfall regime. That is exactly when the reservoir level that formed this system should have been replenishing to face the period of low rainfall which runs from April to September, the opposite situation occurred.

This custody of rainfall directly impacted the inflow of water to the reservoirs of the Cantareira System in the month of January, February and March. Turn out was lower on the minimum recorded in the respective month due to construction of this system in 1973. Due to this behavior, the company decided in April to adopt -- I'm sorry in February to adopt the bonus program in the Cantareira System and later to the entire, extended to the entire Sao Paulo natural region. And performed an emergency investment to capture water, what we call the technical water reserve available in the reservoirs that are part of the Cantareira System, something we will comment in more detail on the next slide.

So, specifically then moving on the following two slides, we will comment on (inaudible) using water from the technical reserve. This reserve is -- the technical reserves in the reservoirs that are part of the Cantareira System, it consists of the water that lies below the minimum level attachment by gravity, because extraction demand pumping. The technical reserve available represents approximately 40% of the volume available in the system for removal by gravity. In numbers, the technical reserve is roughly 400 billion liters of water.

Of this total volume, we intend to withdraw a little bit short of 200 billion gallon. Remember that the total volume of water withdrawn by gravity is close to 1 trillion liters. In other words, if we have the current water availability withdrawn by gravity in the Cantareira System plus, the availability with pumping we mentioned about, will have approximately 300 billion liters available or the equivalent to almost 30% of this system water availability under normal condition. With this volume, the company believes that there is sufficient availability of water to continuously supply the areas served by the Cantareira System until the beginning of the rainy season, that is in October.

But with the withdraw of water from the technical reserve as already mentioned, with this required emergency investment. These are ready, fracked since yesterday May 15, and we are, today, withdrawing water from the technical reserve available specifically in the Jaguari Reservoir.

In general, the emergency investments required to extract water from the technical reserve is a set of drilling and equipment. A dam has been built around the catchment tunnel, so that the water that will be pumped into can flow its course to the treatment

plant by gravity. The pipe that captures the water and the technical reserve is then extended along the reservoir, but there is obviously the availability with various availability.

There will be 14 floating diesel-driven pumps with individual pumping capacity. In fact, 17 with individual pumping capacity of 2 cubic meters of water per second, what will allow a full transfer of about 30 cubic meters per second through the pipes in the dam that has been mentioned before.

At the end of this process, the water from the technical reserve will reach the Guarau water treatment facility, where we undergo the usual rigorous water treatment process. It has taken by the water can be absorbed as on slide 9. Water should be pumped from the Jaguari, Jakati [ph] reservoirs should run from May until August. After this period, the same pumps will be moved to the (inaudible) to pump the water from this technical reserve until the rain pattern normalizes again remembering that the rainfall season starts in the October and runs through March.

On slide ten let's talk about the best initiatives to keep consumers supplied under this intense dry period in addition to intensify institutional campaigns for the rational use of water with a series of steps and guidelines on saving water.

As you all know, in February of this year, we implemented a incentive program based on a bonus system under which consumers will reduce their water consumption by 20% earns a 30% discount on their water and sewage bill. Initially, this program focused on consumers served by the Cantareira system and would last for seven months beginning on February 1st, 2013.

Nonetheless, In April, the program was expanded to the end of 2014 and in fact to the entire metropolitan region of Sao Paulo. This expansion of the bonus program to consumers covered by other systems with necessary -- not only to benefit residence of the greater Sao Paulo metro area, who were already saving water, but also to better manage consumption in all water, all the other water supply systems as these are the news to supply water to those consumers who is always served by the Cantareira system as already mentioned.

The objective of this program is to encourage the population of the metro region of Sao Paulo to reduce water consumption and collaborate with water supply crisis caused by the worst drought in 84 years, the highest temperatures seen in decades during January and February in the metro region of Sao Paulo and the consequence low water reservoir levels that supply approximately 50% of the population of the metro region. And again, there is the Cantareira system.

The population has responded positively to the appeals to reduce water consumption and evaluation of the area covered by the Cantareira system in March, shows that 37% of water connections faced more than 20% and therefore earns a bonus of 30% on their water sewage bill, 39% reduced consumption, but did not reach the amount during development, the bonus and 24% in fact increased water consumption.

This total evaluation for the month of April indicates that 39% of the water connections stays more than 20% and therefore earns the 30% bonus, 42% reduced consumption, but did not earn the bonus till 19% increased consumption. That is, this month, a total of 81% of consumers reduced consumption.

So, the water stays in, Just in April with the bonus program just to have -- for you to have an idea is enough to serve approximately 950,000 people. In addition to the bonus program, SABESP also launched a series of actions for those directly supplied by the Cantareira system, with investments made in interconnection between Sao Paulo metro region water supply system, we can transport part of the water produced in one region to another. In this sense, the Guarapiranga system in now supplying 1.1 thousand liters per second, and Alto Tieteis transporting 2.1 thousand liters per second through the Cantareira, which leads to a total 2 million people previously served by the Cantareira system now being supplied by the Guarapiranga and Alto Tiete system.

Without the best investments over the years, this interconnection between water system would not have been possible. The reallocation of water together with program -- with a program to reduce water consumption, have allowed for uninterrupted water supply for the entire population served directly within the greater metro region of Sao Paulo.

We were also just like right now to emphasize the investments that SABESP has been making in its water system between 1995 and 2013. These investments totaled 9.3 billion in nominal terms, resulting in an increase of 15 cubic meters per second in water availability and production, transportation, reservation and distribution capacity. This mean, sufficient water availability for the population of 5.5 million.

We'd also like to highlight the investments on a new water supply system (inaudible) system, which would spend water production by 4.7 cubic meters per second. This project has already been contracted and has been implemented. The investments are expected to reach 2.2 billion with the start-up by 2008.

Finally, in first quarter '14 alone, the company has already invested R\$553 million, but against, 535 million in first quarter 2013.

These were our initial comments and now we'd like to open for questions.

## Questions And Answers

### Operator

(Operator Instructions). And we have a question from Hasan Doza from Water Asset. Please go ahead.

**Q - Hasan Doza** {BIO 17222230 <GO>}

Hi Mario, hi, Rui. How are you.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Fine, Hasan. We were expecting.

**Q - Hasan Doza** {BIO 17222230 <GO>}

I have two questions. One just to wrap up the tariff process, just so as we close the tariff process from the approximately 5.1% of the tariff increase, when it is implemented? About 2.2% is going to be the real increase, which is compares to the 12%, 13% you guys had asked for and (inaudible). And remainder is the catch up inflation from November of last year to April of 2014. Is that the right way to think about the 5.1%?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Hasan, Rui is next to me. Let me just make sure I got your numbers and we'll give a precise number. Give me just a seconds. Hasan, first the increase allowed by the regulator is 5.44%, okay? Now, we need to just to check because the figure we have is in a different period that you after, which I don't think is worth commenting. So, you're asking from November, the last increase until April that's it?

**Q - Hasan Doza** {BIO 17222230 <GO>}

No, no. I guess my question was, on the 5.4% increase that you're getting, the real increase which the company had been in discussions with your request about a year and a half ago, the real portion of the 5.4% is approximately 2.3% if I understand it correctly. So I just wanted to confirm that the real increase that giving you even the approximately 2.3% out of your total of 5.4%?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Yeah. About that if you measure from November last year to April of this year, okay?

**Q - Unidentified Participant**

Okay. So that exactly what I want to make sure that the two you're getting a real increase of 2.3 and the remainder of that -- the difference between 2.3 and 5.4 is basically making you catching up inflation up until April 2014, right?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

From November 2013 to April 2014, yes.

**Q - Unidentified Participant**

Perfect. Got it. Got it. That's very helpful. Thank you.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

You're welcome.

**Q - Unidentified Participant**

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The second question I had in terms of your Cantareira volume, your slide number seven and eight were extremely helpful, so I appreciate the company doing that. And looking at that slide number seven, where you have your Cantareira level and the question that I have is, if you look at the technical level included here at 26% approximately and the reservoir had been decreasing about at a rate of 4%, 5% per month, so it looks like exceeding that rate of decline continues in about in four, five months, the reservoir could potentially be dried, which would be around October.

So how do you kind of think about that potential issue of running the reservoir dry if this level of decline continues even without getting that volumes?

**A - Mario Azevedo de Arruda Sampaio {BIO 16570252 <GO>}**

Let's discuss, it's not an easy math, first. The consumption from January to February, March, all the way to May was certainly not be the same consumption from now all the way to October. Just to have an idea, we have enabled to reduce extraction of the water from the Cantareira water systems from 31.7 which was the volume we were attracting during the month -- the month average volume during the month of February. We are down to extracting 23, okay, so that's a lot less. So if you were to think about it, this water, we are talking just about the Cantareira System. So we're extracting less, almost 8 cubic meters per second less than we were in January and February, okay. So certainly it's not just rough mathematics here.

The other issue is if take January and February, this was the highest ever reported temperatures for the metro region and we are absolutely correlated to temperature.

Now think about this, when you incentivize the people, not to consume giving them a bonus for that, pricing for that during the winter season period. So with lower temperature and in fact lower sun of infidency with reduced -- less evaporation from the reservoir.

So all in, our friend is a little bit more optimistic than the one you put out, okay. We are sure that we can move further into or further down the year until the rainy season pick up. In fact, just to remember again, rainy season starts in October and runs through March. Okay.

**Q - Unidentified Participant**

That's very helpful. And the one area I would follow up would be that, I agree with you that the level of extraction in January and February was high as it was -- the unusually hot weather, at the same time it was also the rainy season which (inaudible) much it had some after rain effects and water had been extracted, but going forward in the next several month the usage could be less because it is less warmer than it was back in January and February, but you also have less rain in the next several months. So how do going to think about that dynamics?

**A - Mario Azevedo de Arruda Sampaio {BIO 16570252 <GO>}**

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That's the point. Let's -- if you remember the last conference call in our conversation in between that, the way the -- the plan was like this, the way we are -- the projections, which is how much water we need to track from the technical reserve is basically driven the assumption that the rain we will average rain, we will observe from now all the way through September is that the minimum (Technical Difficulty) recorded historically. Are you there?

**Q - Hasan Doza** {BIO 17222230 <GO>}

Yes, I'm here.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Okay. As we recorded so if we assume that the rainfall in the Cantareira for this month and all the way through September, the end of September is equal to the lowest ever recorded what the technical volume we are able to reach further down the year closer in fact we are able to reach the rainy season. So we will not have to do any rationing for sure throughout the period. So this is a worst-case scenario. If it does rain above average it could be that we can even extracting water from the technical reserve that depends on the rain pattern. I'm just giving you the scenario (Technical Difficulty) to make sure that the volume from the technical reserve is sufficient.

**Q - Hasan Doza** {BIO 17222230 <GO>}

Next in slide two actually one more question. One last question would be and this is very helpful so thank you again, is that, in terms of your pumping operations that's going on right now. So is that operation basically 100% utilization meaning the pumps that you are running to access the dead volume, if all, when did it start and as of today is that happening as for utilization of the pump?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

We started yesterday, Hasan. And I understand where it's going on full speed.

**Q - Hasan Doza** {BIO 17222230 <GO>}

Okay. Thank you again, Rui. Thank you, Mario. Really appreciate all the colors. Thank you so much.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

No problem. Bye-bye.

**Operator**

Our next question is from Sergio Tamashiro from Safra. Please go ahead.

**Q - Sergio Tamashiro** {BIO 2274485 <GO>}

Okay. Thank you. Good afternoon, everyone. Just some follow-up questions on Hasan's question. The first one is regarding target you know and last April the ARSESP will be



3.15%. And if you just mention that they would allow this path flow as soon as we had in favor of the market conditions. And one could be this favorable situation. And if let's say that as opposed that the price hike is allowed in November, if the anniversary of the annual price hike will be changed in April to November or it will be maintaining in April?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Thanks Sergio, its Mario. I understand from what you asked, let me recall it. We were allowed to apply a 4.44% increase as part of the tariff review as of May. And we were also allowed to decide upon when to implement that giving the current hydraulic situation. And when we implemented, we would then be allowed to correct monitoring the 544 [ph]. The company has decided to solve the application of this implementation, it's not a tariff adjustment, it's a tariff review. Of the tariff review, all the way to the end of this year.

So we will implement anytime soon as soon, and soon means as soon as we understand this prices has been overcome. We expect that certainly as soon as possible, so thus [ph] we have been in discussion with you in this call, and the previous -- anytime by late September or early October, when rain hits us. So all in all, that is it.

Now, as for the tariff adjustments anniversary, the regulator has set a new date, sorry has set not a new date, has already established April as the anniversary date. So, as of now, our tariff adjustment to inflation will be in April.

**Q - Sergio Tamashiro** {BIO 2274485 <GO>}

Okay. Got it. And the second question about the bonus program on slide number 10, that if you could give us a different color on these numbers because you just mentioned 19% increase consumption, 39% reached bonus. But overall, how could we believe [ph] that the consolidated numbers will behave in the next quarter? You mentioned that in the first quarter it increased 4.9% as opposed to historical average between 2% and 3%. So, how could we expect it in the second quarter consumption growth or a decline? How could we translate -- how these numbers into annual growth?

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

I mean, the projections for the future is something that we have (inaudible) so we don't share as you know, okay. So we would like to comment it going analytically on the last -- this quarter, you have to understand again, that this extraordinary volume and when we said extraordinary because as I said, it's above our expectation came from this huge high temperature which we (inaudible) and yourself too suffered. So volume was definitely pushed up by temperature.

Now, we're going in to a colder period, so we naturally would expect less volume consumption. In addition to that, the months of April, May and June will be fully covered by the bonus program throughout this higher metro regions of Sao Paulo. But the number that we showed has basically one month where there is no incentive program in place, February in terms of volume, okay, not in terms of revenue, but in terms of volume. There is one month that has -- two months with the Cantareira systems -- and two months with the Cantareira system.

So when you look at the bonus program chart and the people who adhere to it, when we say in March, means March revenue, invoicing [ph] and revenue, I'm sorry.

And so, it refers to the consumption in April. And in April, it refers to the consumption, sorry, the March refers to February and April refers March. So, I'm trying to explain to you what happened in the first quarter. Now when we move to the second quarter, what you should expect is a bonus program adherence and we would expect also at these levels or even better in the period of colder lower temperatures. That's what we like to share with you.

**Q - Sergio Tamashiro {BIO 2274485 <GO>}**

Okay. And my last question regards, there is a pumping program (inaudible) in diesel engines. And so, how could we explain this constitutes to cut in the service of lines, which already increased 37%, 38% year-over-year? And by how much -- what would be the extent? And also, if would be limited to service or to this diesel or also to the materials? subsequent the second (Technical Difficulty). Sergio, this is (inaudible) we are extremely trying to classify it properly. The diesel we will utilized will be counted in the supply line of our results. Okay. No projections there, okay. So if you want to be -- as any impact, sorry.

Is it significant the cost increase or -- not much your?

**A - Unidentified Speaker**

The amount is when we say that we would be spending R\$80 million with the pumping system that this value is included in that 80 million

**Q - Unidentified Participant**

Okay. And also in terms of the frequent suppliers for the chemicals due to the uses of the dead volume if they should also increase?

**A - Unidentified Speaker**

Well that's one of the reasons as we put out slides let's say. The slide what's number that, slide eight. If you look at slide eight as it's willing for everybody. So let's hope all the press look -- it's a variable volume in fact all the waters that runs downstream of the reservoirs they are captured exactly below the gravity level, exactly from the technical volume. So if the water was not good there is higher natural region of compenance would not have been drinking this water. So my answer to you is that we don't expect any change in treatment materials.

**Q - Unidentified Participant**

Okay. Got it. Thank you.

**A - Unidentified Speaker**

Water has been drunk by the continuous region for almost 40 years okay.

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**Q - Sergio Tamashiro** {BIO 2274485 <GO>}

Okay. Thank you.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Okay.

**Operator**

Our next question comes from the field Ezequiel Fernandez from Scotiabank. Please go ahead.

**Q - Ezequiel Fernandez** {BIO 17243886 <GO>}

Hi. Good afternoon. Thank you for taking my call. And two quick questions not related to that how much to think of (inaudible) I think on a plan change of preparing structure or the setting of the quarter (inaudible) related to the client update formulae and second question is I have not see your press release, the CapEx break down into waters -- treatment maybe I have looked it somewhere else I don't know if you could give us some color on that?. Thank you.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

We don't show the -- sounds on a quarterly basis on the usage of the CapEx and that's why you don't find it. And usually you don't disclose fully year end, in terms of the tariff structure or as the quality factor, you are asking which will come first in terms of priority. Let me check with our colleague here, two guesses to be effective. (inaudible) here the tariff structure discussion and discard, we discard the first meeting with them, so with the next in the agenda after the quality factors this is green, that this will happen throughout this cycle but the implementations expected to happen only next cycle that means after 2017.

**Q - Ezequiel Fernandez** {BIO 17243886 <GO>}

Okay. Thank you very much. And good luck and -- better luck.

**A - Mario Azevedo de Arruda Sampaio** {BIO 16570252 <GO>}

Thank you.

**Operator**

Next we have a follow up from Hasan Doza, please go ahead.

**Q - Hasan Doza** {BIO 17222230 <GO>}

Hi, guys. It could follow up from the previous question, in terms of the any incremental cost you have to deal with the drought whether it would be pumping cost which is OpEx or even the capital cost of buying the pump what is the process and time spend for recovery of those costs (inaudible)

## A - Unidentified Speaker

Okay. A second, Hasan. Hasan I think the answer to your questions is the macro answer what driven here we are commenting here is that, there is a provision with the regulator of extraordinary recession for ordinary events. This certainly is one. So any incremental OpEx and CapEx we will discuss with the regulators.

There will as usual regulators, the balance of going from losses. So you shouldn't expect that right now. But you can expect something happening once all this crisis is overcome and we are back to normal which we hope to be as soon as possible and that we certainly will ourselves find the ground to present the impact, and imbalances that this generated and within the rules, with the regulator, we will go after that. Right. Potentially on this extraordinary revision possibility. Okay.

## Q - Hasan Doza {BIO 17222230 <GO>}

All right. Thank you.

## A - Unidentified Speaker

All right. Thank you.

## Operator

(Operator Instructions). There appear to be no further questions. Now I'll turn the conference back to SABESP for their final remark.

## A - Unidentified Speaker

Okay. Then again once more for attending this conference we'll be back here next quarter, but we are always available in the Investor Relations area myself and Angela. So everybody have a good day [ph] bye, bye.

## Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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