

Q3 2020 Earnings Call

Company Participants

- Carlos Cyrino, Director, Investor Relations
- Gustavo Estrella, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Andre Sampaio
- Marcelo Sa

Presentation

Unidentified Speaker

Good morning to everyone. Welcome to the Presentation of Results of the Third Quarter 2020. My name is Carter Cedeno [ph], I'm the Director for Investor Relationships of the group and today, I will be the MC for our event. Today we have Gustavo Estrella, President of CPFL Energia; Mr. Pan, Director, Vice President, Finance and Investor Relations and other executives of the company. I reinforce that due to the pandemic, we're still connected from our residences. So we apologize if there's any failure in any connection and reinforce that we'll work to re-establish communication the soon as possible. All the presentations will be done in Portuguese and we have simultaneous translation for English.

For this, all you have to do is click on the interpretation button that shows up on the bottom part of the platform. If you want to see the presentations in English, you can also find this on the website of our RI. I'd also like to inform all the participants that after the presentation of the company, we will begin our session of questions and answers. All the questions will be done live and to ask to do that all you have to click on the button raise hands, which is also at the bottom of the screen. Please remember that this event is being recorded.

I'm now going to give the floor to Gustavo Estrella to begin the presentation of the results. Thank you very much.

Gustavo Estrella {BIO 18109709 <GO>}

Good morning to everyone. We're beginning the presentation of the results of the third quarter 2020. Going to the next slide where we have the highlights. Here for our quarter, it was -- it has positive results. We clearly can see that we've had recovery for the market. So we start here with a load growth of 1.6% in the concession area. We're going to demonstrate details a bit further forward. Part of this comes from residential consumption.

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It's clearly taken the consumption and also an effect -- positive effect of temporary [ph] EBITDA BRL1,954 million, a growth of 20.8% in relation to the third quarter of 2019. The net profit BRL1,352 million, an increase of 80% in relation to 2009. We recognized the fiscal credits and we'll talk about this further forward.

Our net debt BRL13.3 billion and this is a leverage of 1.93 times, very comfortable, and it will be impacted by the payment of dividends up to the end of this year, but in general, it's a leverage of about 2 times, very comfortable and very much below what we expected. Also a movement here of change of debts prepayment of our debts especially in CPFL renewables. This is something that we had forecasted. We concluded this process now in the month August. The total of 3 billion debts pre-paid and renegotiated with the important reduction in our average cost of financing. So we have this process which concluded in August and the benefits and the totality will take place after the fourth quarter.

We also have an important quarter in relation to the program of investments of the company, an investment of BRL770 million, a growth of 25%. In relation to 2019, our expectation is to deliver the investment for 2020. In spite of the pandemic, we delayed the execution of the investments at the beginning, but the expectation is that we will be able to deliver. We also had an important process in CPFL Piratininga, which was the readjustment of the tariffs, an ordinary adjustment with an impact of tariffs for the consumer 9.82% and reflects on installment B 17.02% especially a higher IGP-M in the last two months. We also have resources for the COVID account, the total value is BRL1,280 million. We also have a value of \$100 million left over, but part of the COVID account has already been used, also helping in the liquidity of the company and it reduces the tariff impacts in our distributors short-term.

We also now on the 30th of September, we have the integration plan of CPFL renewables. It's also a promise and we did this restructuring between generation and renewables and this has been concluded now on the 30th of September. We also publicized an extremely important plan. It's our strategic sustainability plan for to '22, '24 linked to the ESG. It's a plan that's very complete and detailed where we define all the actions and the goals of the CPFL Group related to the ESG term in the period from 2020 to 2024. We've also publicized this to the market in detail for this period. Part of the plan is also the hospital CPFL program. We see some challenges here to execute this program, because we are talking about energetic efficiency in public hospitals and of course in pandemic periods, it's always a higher or a bigger challenge, but we were able to invest over BRL50.5 million. We reached 48 hospitals BRL150 million in 200 hospitals in our concession areas. So it is a program that's going very well.

Now, let's go to the next slide. Here, we have the sales of energy in the third quarter. As I said, this is a recovery sign, we can see that the load on the concession has gone up 16.4%. The sales went up 0.4% and when we look at the right side, we can see that this growth comes led by residential consumption, a growth of 8.8%. As I said, we have here in temperature effect, average temperatures that are higher than last year and hear clearly this is a sign that the consumption is taking on again in the residential. The industrial even though it's negative, it does show recovery signs. I think this is a very positive sign not only for CPFL, but for the economy in general. We can notice this in the slums,

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migration of those people who have left our market and have gone to the basic network. So this is a movement of increase and decrease, but if you put it on the same base, the increase of the residential would be 1.3% and not 3%. So it's a sign of recovery that we compare especially with the second quarter of 2020.

When we look at the left hand side at the bottom of the slide here, we see the main performance of the segments of consumption. So we can see some sectors of different activities showing a positive consumption, the food industry, which is very important industry with a growth of over 11% and rubber and plastic, 2% chemistry and vehicles which had a decrease of 17%. If we compare the decrease that we had in the second semester 2020, this decrease was 42%. So even in the negative field, we can see in the vehicle field or segments a recovery in the consumption of energy. When we look at the commercial area, the retail consumers, a lot of place is still closed and the wholesale was 3%, the telecom positive 4.7% and health services 4.5%. So in general, what we notice there's a -- with a positive effect of temperature what we can see is a recovery, which gives us a positive perspective for the next months.

Let's go to the next slide. Here, we can see the accumulated for nine months. So the data is worse than the third quarter, so you can see a ramp of recovery of the consumption went up 8.8%, the accumulated -- the industry with 7.5% and commerce with 9.5%. So I think this gives us a sign of the trend of recovery of our market in the more recent months. Let's move on to the next slide. Another topic which is very important and during this year of 2020 is default and losses. We can see here the default. We go back to the levels pre-crisis, I think this is very important number for the company. It's sign of recovery of the default here in the third quarter. We have some effects, some renegotiations of carried out, but even with these renegotiations, we would reach a percentage of about 0.7%, a little bit lower in the third quarter of 2019 level pre-crisis where we start to notice a retake of the pre-crisis levels of default.

So it's not a coincidence, but in this quarter, we have our billing actions again. And here, we are doing this as of August when we close this in about -- we go from a level from October on of 236 cuts per month. So the expectation is that we will be able to control our defaults in the fourth quarter losses. We have some difference here, billing calendars at the base of preparation. So in general, when we carry out calendar adjustment, we have stability in the loss percentages when we compare it to 2019. I think this is also good news given the pandemic period that we're going through. We've also intensified the fight against the losses. We are recovering energy with a 177,000 inspections and also the installation of Telemetry for the urban clients.

Now let's go to our next slide with performance of generation. We have here a drop in the third quarter and this trend here has reverted already in the fourth quarter with a big increase of the PLD, but in the comparison decrease of the PLD in relation to 2019, also an increase or an improvement of the GSF in the third quarter 2020 in relation to 2019, an improvement of 21.3%, an improvement -- a large improvement here in the flow hydraulic, the large ones with the growth of 88% with rainfalls in the third quarter. We know that this is already reverted in the fourth quarter and the PCH specially in the state of Minas Gerais with a growth of 27.3%. Wind generation, I think we have good news here. The first one in relation to the performance of the wind. We can notice an increase in the generation in

our wind farms. You can see 1.3%, 1.4%. You can see the performance better than 2019. We're getting close to the P50 with 95% performance and also the availability. So we have an important increase of availability of our engines reaching in this quarter of 2020 97%, a growth of 2.2%, which impacts capacity of generation combined this gives us an interesting moment.

Now let's go to the next slide and I'm going to give the floor to Mr. Pan for him to talk a bit about the results of the third quarter.

C: Yuehui Pan: Chief Financial Executive Officer and Investors Relations Officer: CPFL Energia S.A.:} Thank you, Gustavo. Good morning to everyone. The EBITDA has been of almost BRL2 million, an increase of 21%. The distribution segment has had gone back to have a good result with an increase of 26.7% showing a certain recovery after the most difficult period of the pandemic. The gain of the market and the tariff was of BRL140 million highlighting the performance of the residential class, which was benefited by the effects of the pandemic with social isolation and working from home office and also by the high temperatures.

In the sequence, the financial assets of the concession had an increase of BRL58 million due to the higher IPCA. Last year, the IPCA was 0.31% and in the third quarter of 2020 was 0.86%. We also had an important reduction in the PMSO BRL39 million and the PDD the reduction of BRL26 million is the result of some negotiations that we carried out, but also it is response -- a very effective response to the cuts much higher than our expectations. As a negative impact, we have the effect of the tariff revision of the CPFL for Piratininga, which generated a benefit of BRL42 million last year. This was something extraordinary. The other variations added BRL5 million. The trading service and others, these segments they remain stable. Lower margins in trading were compensated by the good performance of CPFL services and CPFL efficiency.

In the next slide, we have an alteration from the conventional generation, which had an EBITDA 3.2% higher. The main effect were the lower costs with GSF. Besides the drop of the PLD, the GSF was also better than last year. As Gustavo has already showed us, the readjustment of the price of the contracts was compensated by other factors. In CPFL renewable, the EBITDA went up 26.3%. The main effect was a higher wind generation with BRL31 million. Other positive effects were the GSF BRL26 million and the inflation -- the pass over the inflation the contracts BRL26 million as well. The PMSO also generated a gain of BRL18 million, a good part as a result of the synergy obtained with the integration of the company to the CPFL Energia Group.

In the slide 11, we show the performance of the net profit which was of BRL1.4 billion in the period, a hike of 80.8% in relation to the third quarter of last year. Besides the variation of the EBITDA, we had the financial result a decrease of BRL60 million, the depreciation varied BRL36 million and the taxes had an increase of BRL291 million. In the financial results, we have to highlight some effects. The first one is the MTN. After the gain of over BRL250 million in the first quarter of 2020, it starts to give back part of that result with the improvement of the spreads -- the risk spreads in the market. The second effect has to do due to the extraordinary revenue that we had last year when the resources of the Re-IPO were in the cash of energy -- CPFL Energia.

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Besides this the update of the liabilities and assets, the sectorial financial assets, they had a reduction of BRL20 million. On the other hand, the expenses with net debt had a reduction of 9BRL9 million, explained in part by the drop of the interest rate [ph] and part of the plan from the liability management. The other items all added up had a -- were worse and BRL16 million. As for taxes in this quarter, we had an extraordinary effect in the value of BRL271 million referring to the recognition of fiscal credits, which is a result of the fusion of our generation assets, which improve the yield of the group.

In the next slide, we show the results -- accumulated results up to September 2020. The variation of the EBITDA was positive again and this comparison with a hike of 4.4% or BRL205 million. We highlight here the distribution that grew almost 5% favored by the good performance in the market and tariff with a highlight to the performance of the residential class. The reduction of the PMSO is also a positive highlight in this segment. Another highlight is the renewable generation with a hike of 10.1% equal to BRL83 million. This is the result of a higher availability and the contract readjustment even though wind is still a little bit lower than the accumulated in last year.

Now, the net profit increased 43.7% or BRL826 million. This result was very much favored by the lower CDI and the drop in the cost of the debt which zero the gain of BRL321 million, besides a positive effect of MTM with BRL198 million. Up to now we have a gain of BRL420 million in the financial result if we compare to the last year. We also have a positive effect in taxes due to the extraordinary gain accounted for in the third quarter due to the reasons that I've already mentioned.

In slide 13, you will notice we have the CapEx. In this period, we carried out an investment of BRL770 million, an increase of 25% in relation to the same period last year. In division per segment, we had in distribution a total investment of BRL601 million to improve, modernize and maintain the electrical system. For generation and transmission, we had BRL98 million for renewables, giving continuity to the projects of Gameleira and shareholding [ph], BRL54 million for transmission for the projects Maracanau, Sul I and Sul II, and BRL1 million for conventional generation. Finally, for the segment of service, we destined BRL16 million.

Now, let's move to the next slide. We have here the in-depthness of the company. The first chart shows the net debt BRL13.3 billion. The EBITDA over the last 12 of months reached BRL6.9 billion. The leverage measured by the net debt and the EBITDA was 1.93 times. In the chart beside this, we have the cost of the debt during the last year's real and nominal. The drop in the third quarter is due to the lower cost of the debt according to our liability management plan where we finalize the prepayment of the loans of the BMDS and also the drop on the interest rate SELIC. The variation of the IPCA affected the nominal cost. However, the real cost is only 0.5% in September.

Now in the composition of the gross debt, we see that the higher exposure is indexed to the CDI with 77%. The rest would be 21% IPCA and 2% TJLP. The cash at the end of the semester was close to BRL7 billion with a coverage index of 1.92% times the amortization short-term. The average time for amortization is 2.68 years.

Well, that's what I had to say. Thank you very much. And now I give the floor back to Gustavo Estrella.

Well, we have the last slide here. We're going to talk about what we've been done socially. We've engaged the company a lot in the topic of sustainability. We have these pillars of ESG more and more incorporated to our business strategy. I think that our intention is that we have a sustainability plan, which is sustainable and long-term. So our idea is that this be more and more incorporated to our business strategy and this has been our strategy. So as I mentioned here, I think this is one of our big highlights of the program of energetic efficiency. So CFFL in the hospital, it's BRL150 million, 200 million in hospitals. We were able to advance this year with project investing BRL50 million and this is part of a 11th commitment with a sustainability plan. So I think all the actions and initiatives they are somehow linked and incorporated to our sustainability plan.

CPF Young Generation, that's the third -- 13th commitment in our sustainability plan. We have a series of partnerships with institute, (Foreign Language), the seminar program which will be translated as harvest program. It's focused on volunteers, this is very important. Our idea is to bring collaborators to participate and to engage more and more in these topics and these programs that our company has and a short-term action last is a program of donations focus on the pandemic. BRL5 million donated to 20 public hospitals and BRL1 million to the another program. We also made a donation to the state of Sao Paulo. The idea is to look at the sustainability plan with a profile long-term, but also paying attention to the short-term necessities and that's what we did with this donation program.

Well having said that, I end my presentation. I thank you for your participation, for your presence and I'm available here with my team and we can start then our Q&A session. Thank you very much.

Questions And Answers

A - Unidentified Speaker

(Question And Answer)

A - Carlos Cyrino {BIO 21090309 <GO>}

Thank you, Gustavo. Thank you, Mr.Pan, for your excellent presentation. So we're now going to start the next step. We're going to open the session for questions-and-answers, and we're going to obviously follow the order in which they were made. To ask a question, you're going to have -- the questions will be live. There's a little button at the bottom. You should raise your hand. This is in the bottom part of the screen. And then, we'll go in sequence. So I can see that we have already questions. The first question is Marcelo Sa from Itau Bank. Thank you, Marcelo, for your participation. You can then ask your question.

Q - Marcelo Sa {BIO 16454581 <GO>}

Hi, guys. Thank you for the call. I have two questions and they're more in the regulatory side. The first question, I would like to know if you have any vision about the new

technique of operational costs that ANEEL applied last week? They've changed the criteria to define average efficiency instead of being the database reported, it's a target? And then you have to reach this 83.8%. I'd like to know what you know about -- what you think about this change?

Another point is ANEEL included in the methodology other dimensions. So now they're also dealing with the cost side of incentives, the quality of incentives. They have also labor issues. I want to know what you think of this? It calls my attention, for example, when I look at the spreadsheets, a negative effect, especially in this -- the labor part for CPFL. This reduces the final -- the efficiency and the loss ends up by helping in the efficiency. I'd like you to comment. This is the first question I have about operational costs.

And the second is if you could give us an update about the discussions of ANEEL about the PIS/Cofins. They were actually to have a public hearing in September. This didn't happen. And I want to know if there's any plan for this? Thank you very much.

A - Carlos Cyrino {BIO 21090309 <GO>}

Thank you, Marcelo, for your question. Well, starting your first question, operational costs, as you said yourself, it's a technical dense notification. We're having the opportunity to analyze all the details, all the spreadsheets that were given. It's a consultation that will have two phases. ANEEL, itself, has already announced this. So there's going to be a lot of work moving forward.

About the first target, the efficiency, it's a way of doing it. Before ANEEL used to use as efficiency, the efficiency of the company is above 50% efficiency, and now they're using the average efficiency as a reference. So you would have the companies with 100%, reaching a maximum of 120% passover. This is not that different from before. There were a few companies that were over 125%. But really, it is a change. And of course, we have to analyze in detail the reasons why this has been done and obviously analyze the argument used by ANEEL.

So we're in the phase of understanding these arguments for the change of the reference, okay, Marcelo? It is a change. It's a difference in terms of concept methodology. They had quite a lot of changes, so that's why I said that we are analyzing this very detailed way. The inputs and products had several changes. So the labor issues is now part of the panel of the -- there rounds, so we have to evaluate the impact of this and more than this, the standardization. And because the condemnations, they have a certain -- we have to see if all the companies are doing it the same way. So I think this is the first point for us to evaluate, how they're standardizing this type of issue.

Quality, as you said, it has also changed. But in general and trying to summarize things, it's a technical notification that does change the modeling. ANEEL, itself, is forecasting two phases of discussion. And we are actually, all our specialists, evaluating all the details and the concept. I think, what's interesting in their modeling is to check the arguments used and the robustness of this modeling to see if it's the necessary for the results.

As for PIS/Cofins, we have nothing new to add. I think, it's more or less in the same point that it was before. I think there are so many events in the middle of the way here that I think that it's an issue of prioritizing an issue of this short time. So we don't really have any news in terms of this subject. What we're expecting is that there is a public consultation that will be opened in relation to this term for a final solution. So if you remember, there was a subsidies. There were questions that were answered by all society. And then, we were talking about a second phase with a public consultation. So we're waiting to see what is going to happen, whether it's public consultation of ANEEL. I don't know if I was clear. Do you have any other question, Marcelo? Did you understand?

Q - Marcelo Sa {BIO 16454581 <GO>}

No, you were very clear, Andre. About the operational cost, there's something else that called my attention in the current methodology. ANEEL, the data is every two years. When you're nearer to the revision, you have a more updated number. The way that they're proposing it now is that the data actually will be churned at the same time as the methodology, so once every four years. So if a distributor is very far from the revision, the cost that's going to be used as a reference to the efficiency analysis is the cost way back. And this actually can impact the company in the process because it's not being used across 2018 or 2019, which will probably be the case. And when this methodology is closed, so it won't get the best number of these companies. Do you think there can be any different deal for companies that are being privatized because this ends up by being not good for the companies, right?

A - Unidentified Speaker

Marcelo, I think, for all of them because the four-year update is very distant even for companies that in quest of this efficiency. To be honest with you, now the data update with the distance that we have between the tariff revisions is already something extremely complex. You have revisions, five, four years, unmatched. This already happens naturally. This process of you having comparisons that are not the fairest possible. So when one is doing a revision in '22, the other one in '23, there's one year of difference, which can be this update of a window of two years. So I think in general, we have to contribute to the update as a whole. Marcelo, independent of the four years, this was already a point that we were mentioning. It was already something that had to be dealt with because the difference in tariff cycles was already putting this in check because even the main group, different years. So you say, well, what year will it be for efficiency? What year will it be for updating? So I think, there's a space for this. And I agree, companies in a situation such as this will be much more penalized if this update takes four years, for sure.

Q - Marcelo Sa {BIO 16454581 <GO>}

Thank you. Thank you very much.

A - Carlos Cyrino {BIO 21090309 <GO>}

Thank you, Marcelo, for your question. Thank you, Andre, for your very clear response. I'm going to reinforce here to ask the questions. These are live questions. You have to click on the little button, that's below the monitor. Raise hand and I'll be asking for the questions in the order. We have another question here, Andre Sampaio from Santander

Bank. I'm opening here Andre. Andre, thank you very much for participation. Please go ahead with your question.

Q - Andre Sampaio {BIO 19422379 <GO>}

Good morning, folks. First of all, I have some construction work here in the building, so if there's noise, I apologize. But since Andre talked about the subject, I would like to think that Sa didn't go into the methodology pack. It's the factor T and the migration for the band of regulatory costs, if you could comment a bit about this decision of accelerating the migration for the band of regulatory cost. And the second question in relation to Renovaveis. I think that's what most called our attention in the recovery of the results of the third quarter, availability and generation of wind. What would be the forecast for the future? Do you think this availability will remain in the future? And how is this generation coming in the fourth quarter?

A - Unidentified Speaker

Well, Andre, in relation to band in UP. I think that this really is a change that we have to analyze with care, the criteria of the bands, the limits, the lower and higher minutes, and it's another discussion about updating. It's an old discussion. Look, I'm going to reach the minimum, and way back ANEEL established the XT Factor, and some had the maximum, and you want to reach the minimum. So once again, I don't want to run away from the question, but these are things that we're still trying -- we have to do simulations.

Of course, they are results to analyze. But right now, we are internalizing the models because what we do with the technical nodes of ANEEL is transform our internal models to verify if everything is okay. And once more in the line of the target efficiency, I think we have to reach this conceptually, this T band. The difficulty when we carry out a methodological change is to verify, if there's safety that this treatment will -- I don't like to use the word isonomy, but it's something long term. The worries that you carry out a change, you do some simulations. It seems to have stability, but then medium term, it's not stable, and you'll start identifying this, like the company's way -- they didn't have a minimal limit, and they couldn't reach the minimum that they had right to.

So we have to be very careful with this. And based on the discussion of the methodology way back, I can't tell if it's good or bad. What we're doing is evaluate this. We're doing this with a lot of care. And the second question is not for me to answer.

Well, I think about availability, for sure, our expectation is to preserve this availability. I think this is a fruit of everything that we've done this year, especially in the biggest challenge in the parts when we did the primarization of the OEM service. I think the results are already showing up in a positive way. So the idea is that we preserve this availability given our new form of operating.

In relation to the wind performance, as you know, it's difficult for us to forecast. We had, in fact, an important improvement during the last month. The expectation is to keep up this wind performance in about 90% of P50. It's more or less what we have today. So the expectation for this quarter is to maintain the performance, which was a little bit lower

than the third quarter. I think in general, the expectation is positive. And especially when you compare the first semester this year, we had a low wind performance. So the expectation is to get closer to the P50. This is already happening. So it's much more similar to the third quarter than the first and second one. So I think, it's a more positive perspective in relation to wind as well.

A - Carlos Cyrino {BIO 21090309 <GO>}

Thank you, Andre, for your question. I have another question from Anna Theresa from SMB [ph]. Thank you very much for your participation, Anna. You can move ahead with your question.

Anna, can you (Foreign Language)

I think, we don't have any more questions, so we're going to end our Q&A. If there's any doubt or any question or anyone wants to ask a question later, our team of relationship with investors, we're here to clarify your doubts.

Before giving the floor to Gustavo for its final considerations, I'd like to remind you that on the 2nd of December, we will be doing a CPFL Investor Day, and we count with -- on your participation. You've probably received the save the date, and we'll be sending the official invitation next week. Well, I'm going to give Gustavo Estrella the floor for his final considerations.

A - Gustavo Estrella {BIO 18109709 <GO>}

Once more, thank you for the participation in our call. In general, what we said here, we clearly can see that the market is recovering. And I think, this gives us an important sign for the future. And also the default, everything is more sort of under control. I think the cuts, we have something also, which is a positive perspective to control the default. What we've done is to preserve our investment plan.

So all the goals and the long-term efficiency, productivity, everything has been preserved to the maintenance of our CapEx program, a robust CapEx of about over BRL2 million that we should realize that guarantees the sustainability of the company, medium and long term. The optimization movement of our debt stock, I think, is also extremely important, with a higher reduction of our financing costs, not only for the low levels of CDI, but also search of efficiency in the losses of the market that we are able to do successfully, the volume of debts, and this gives us this perspective of a positive view in the next quarters.

Of course, we have a series of variables, the pandemic itself. Even though the numbers of infections and deaths are decreasing, there's always a risk of a second wave. And this always makes us tense. We have to monitor things. Besides all this economical recovery, fiscal issues, it brings us external variables to our business. But in general, I believe that we're -- after having a challenging time, I think the third quarter is bringing more hope for our businesses and for the company. I thank you all for your participation, and have a wonderful afternoon.

A - Carlos Cyrino {BIO 21090309 <GO>}

We're now ending our call for the third quarter of 2020 CPFL Energia, and we thank you all for your participation. Have a wonderful afternoon, a good weekend, and see you soon.

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