

# Q2 2017 Earnings Call

## Company Participants

- Nora Mascarenhas Lanari, Head of Investor Relations
- Roberto Antônio Mendes, Chief Financial Officer and Investor Relations Officer

## Other Participants

- Alexandre Falcao, Analyst
- Leandro Fontanesi, Analyst
- Lucas Marquiori, Analyst
- Pedro Bruno, Analyst
- Pedro Furtado, Head of Investment Analysis
- Rogério Araújo, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning and welcome to the Second Quarter 2017 Conference Call for Localiza Rent a Car. Hosting the event today are Mr. Roberto Mendes, CFO; and Ms. Nora Lanari, Investor Relations Director.

We would like to inform that the numbers in this presentation are stated in million of Brazilian real and based on IFRS. The presentation will be recorded and all participants will only be able to listen to the conference call during the company's presentation. Immediately afterwards, we'll start the Q&A session for analysts and investors when instructions will be provided.

The conference call audio and the accompanying slide presentation are being broadcast simultaneously over the Internet at the address, [www.localiza.com/ri](http://www.localiza.com/ri). The slide presentation can be downloaded at the same address by clicking on the banner 2Q17 Webcast.

Before proceeding, we would like to clarify that any statements made in the conference call concerning the business outlook of the company, forecast as well as operating and financial targets represent the opinions and assumptions of the company's management, which may or may not occur. Investors must comprehend that economic conditions and other operating factors may affect the company's future and lead to materially different results from those stated in this call.

To start the second-quarter 2017 teleconference, I will turn the floor to CFO, Roberto Mendes.

### Roberto Antônio Mendes {BIO 7289124 <GO>}

Good afternoon and thank you for attending our conference call. Second Q 2017 was spectacular in growth and profitability for Localiza. Our fleet has passed the mark of by 150,000 cars. Localiza effect is checkbox reservations that fits in via (02:06) Facebook, Localiza Mensal Flex (02:13) and the exclusive launch of Audi Q3 and Q3 Body (02:20) Toyota Prius Hybrid was turn up the new (02:23) features of the year. We have remained committed to excellent in execution, quality of service and increased productivity. With that, we are even more competitive.

I now present on slide number 2 the operational highlights of the second-quarter 2017. Car Rental division volume grew impressive 29.2% when compared to the second quarter of the previous year. The Fleet Rental division's volume grew 9.1%. 20,201 cars were sold, representing a growth of 46%. In the end of the second quarter 2017, Localiza System fleet reached 151,750 cars, a growth of 21.6%.

On the next slide, we present the second quarter's financial highlights. The net revenue grew by 39.7%. EBITDA and EBIT followed the growth, increasing 27.5% and 31.6% respectively. This quarter's net income was BRL 129.3 million, a record with an increase of 31.9% when compared to last year's quarter. In short, we showed a strong growth in from the top to the bottom line.

To present the details of the second-quarter results, let me give the floor to the Director of Investor Relations, Nora Lanari. Please go ahead.

**Nora Mascarenhas Lanari** {BIO 18838335 <GO>}

Thank you, Roberto, good afternoon.

On slide number 4, we declared the growth in the Car Rental division. In the second-quarter 2017, the volumes grew 29.2%, net revenues increased 21.1% when compared with the second-quarter 2016, impacted by the drop in the average rental rate of the Car Rental division as shown on slide 5.

The average rental rate in the quarter was 6.7% lower than the second-quarter 2016. The accelerated growth strategies focused on cost control and productivity gain support the drop in the average daily rate and contribute to higher profitability, that we'll see later.

Year-on-year, the utilization rates increased 1 percentage point, reflecting the initiative to manage rates in order to stimulate demand, the mix of segments and the improvement in fleet management.

On slide number 6, we have the number of Car Rental branches. In the second quarter this year, the branch network was extended by 17 corporate branches, which added to the 18 branches opened in the first quarter, totaled the number of 368 locations. Localiza System has 506 locations spread throughout Brazil and another 71 in 6 other countries in South America.

The new locations to the network in the second quarter of 2017 were previously franchisees out list (05:47) that were bought in the beginning of June and their impacts on the company's results will be seen in the next quarter.

On slide 7, we see the evolution of volumes and revenues from Fleet Rental division. In second Q 2017, the volume grew 9.1% and net revenues presented a growth of 10.6%, totaling BRL 176 million, reflecting the 2.1% increase in average rate rental.

On next slide, we present the fleet change. 35,935 cars were purchased and 20,201 were sold, totaling investment of BRL 721 million. Just in the first semester, the company purchased 51,000 cars.

On slide 9, we present the evolution of Seminovos stores to support the growth of Car Rental. Three stores were opened in this quarter, adding seven stores to the network this year. Seminovos network ended the quarter with 91 point of sale. During the year, new stores shall be opened to support the fleet renewal due to the strong growth of Car Rental division.

On slide 10, we present the end of period fleet. On Car Rental 22,226 cars were added and on Fleet Rental 5,662 cars were added when compared to the end of period fleet of the second half of 2016. Localiza System ended the first half of the year with 151,750 cars or a 21.6% growth.

Slide 11, presents a 39.7% growth on consolidated net revenue in the quarter due to a growth of 17.6% in rental and 62.8% in Seminovos revenues. Increasing Seminovos revenue reflects the growth of 46% on of sales volume, and 11.7% in the average price of cars sold.

On slide 12, we present the consolidated EBITDA. In the second quarter of 2017, the consolidated EBITDA grew 27.5% or a BRL 64.4 million. In the first semester, EBITDA was BRL 600 million. The Rental Car division EBITDA margin was 34% in the second quarter, which is an increase of 2.4 percentage points growth, when compared to the second quarter 2016. This improvement is due primarily to the growth in the business volume, cost reductions, (08:40) gains of scale.

The Fleet Rental division showed an EBITDA margin of 61.8% in the quarter, 3.2 percentage points decrease when compared to the second Q 2016, reflecting the drop in the basic interest rates, as well as lower depreciation. Seminovos division showed EBITDA of 7%, a 1.7 percentage point increase over second Q 2016.

On slide 13, we present the evolution of the average depreciation per car in Car and Fleet Rental division. In Car Rental division, the average annualized depreciation per car was BRL 1,372, a BRL 113 million decrease over first Q 2017, reflecting the company's expectation regarding sale prices and stock. We highlight that depreciation is calculated based on expectations of future sale price, net of the average discount and selling costs.

In the Fleet Rental division, average depreciation per car in second Q 2017 was 10.2% lower than the first Q 2017, totaling BRL 2,989. In depreciation of the contracts are, in most cases, for two or three years and the depreciation benefits from the increase in new cars price, which occurs during the car's useful life.

Slide 14 shows consolidated EBIT, which increased BRL 56.6 million, 31.6% higher than in the second Q 2016. RAC EBIT margin including used car sales results from renewals which grew 5.8% -5.8 percentage points to 35.1%. In Fleet Rental division, EBIT margin including used cars sales results increased 3.3 percentage points reaching 54%.

On the next slide, we present the record net income. In this quarter, net income stands a BRL 129.3 million, a 31.9% increase when compared to the second quarter 2016 due to the increase of BRL 64.5 million in EBITDA, partially offset by a higher car depreciation of BRL 8.3 million and a higher net financial expenses of BRL 17.7 million. The increase in car depreciation was due to fleet growth and increase on the average depreciation of Car Rental division.

Increased financial expenses of BRL 17.7 million in financial, is a function of the increase of the average net debt as a consequence of investment for fleet expansion offset by the drop in the basic interest rate.

Slide 16 and 17, we show the free cash flow. BRL 374.6 million of cash was generated by general - rental operations in the first semester of 2017. BRL 146 million were invested in fleet renewal. Another BRL 42.2 million (sic) [BRL 45.2 million] (12:05) were invested in other property. Cash generated by operations net of fleet renewal CapEx was BRL 183.4 million. The company added 10,548 cars during the semester. The free cash flow before the interest was BRL 161.2 million.

On slide 18, we present the change in net debt. The net debt was increased by just BRL 67.4 million in the first half of 2017 even with the increase of 10,548 cars in the fleet with BRL 62.9 million investment in the new headquarters and payment of BRL 86.6 million as interest on own capital.

Slide 19, we present debt maturity profile June 30, 2017. Localiza maintains a strong cash position and a comfortable debt profile consistent with the company's growth scenario. On June 30, the company had BRL 2.3 billion in cash.

On slide 20, we present solid debt ratios of the company. The comfortable levels of leverage supports the growth target.

Finally, we present the company's ROIC. On the second Q 2017, Localiza ROIC was 15.7%, 6.9 percentage points spread (13:40) over the cost of debt after taxes. The drop in the basic interest rate, already expected by the company, contributed for the 1.7 percentage point increase on spreads.

Let us now move to the Q&A session.

## Q&A

### Operator

First, Lucas Marquiori from Banco Safra.

#### Q - Lucas Marquiori {BIO 17907247 <GO>}

Good morning, everyone (14:13) everyone. A question about the growth volume on Rental Car, the loss had come from monthly rentals, leasures and individuals, is there any significant change in growth and have you noticed a recovery from corporate loans more related to business activity? That's the first question. And the second question is, we've seen a drop in the cost and expenses for selling Seminovos cars - second-hand cars, could you explain where that's coming from?

#### A - Nora Mascarenhas Lanari {BIO 18838335 <GO>}

Thank you. Thank you for your questions, Lucas. The good news about the growth of RAC that all segments are growing. Monthly rates as wells as individuals, but every segment is growing. As for Seminovos, there has been a significant movement in sales, which reduced the fix cost of Seminovos. This new stores are (15:28) of next year, but we are managing cost in general very well, and that's also considered in (15:39) because SG&A dropped from 10% to 8% in the semester.

#### Q - Lucas Marquiori {BIO 17907247 <GO>}

Thank you, Nora.

### Operator

The next question comes from Alexandre Falcao from HSBC.

#### Q - Alexandre Falcao {BIO 5515455 <GO>}

Good morning. I have two questions. The first one refers to the real (16:04) not included, how does that impact the rental base for you? There is an account there, I would like to know whether you can share with us what will be the consequences in terms of continuing the growth of the company from now on?

Second question, regarding EBITDA margin and car sales looks a bit higher. (16:30) just about this quarter or there has been a change because I think it's quite high? Are we going back to the level of 4.7% - or 4% or 5% or should we remain on 7%?

#### A - Roberto Antônio Mendes {BIO 7289124 <GO>}

Thank you, Falcao. This is Roberto speaking. Thank you for attending the call and for the questions. With regards to the acquisition of Hertz, when we looked at that in the (16:58) we were 9,000 cars, 4,000 in fleet and 5,000 in rentals (17:05). Of course, those 5,000 will generate a yield, but those in the fleet will have an immediate impact on the fleet volume.

We have to make the most of what they have done so far, some investments from abroad. So, I cannot still give you any guidance on what will be the volume captured, but we will try to capture as much as possible because we do want to benefit synergy with this acquisition we made.

And based on that, we planned to reach foreign customers (17:51) as well as customers worldwide that when make reservation for car rental in Brazil, looked for a known brand and now we are in the best brand, the best brand ever are known in the car rental worldwide.

As for the growth in EBITDA margin of Seminovos it was higher, (18:13) flat and depreciation adopted in the past. In the past, we used to have a depreciation at around BRL 1,400 or BRL 1,500 and when we sell the car, we will sell it slightly higher because when – so some of them increase in prices and this profitability happened (18:40) were a bit conservative.

We are making some adjustments to deprecation for this period, so in the long run we expect this EBITDA margin to become lower. This is what we seek with this change in depreciation, this won't happen overnight, but it's a trend that will happen in the long run. I would say long run, nine months, that's when these cars are – let say one year from now and these cars will be sold.

#### **Q - Alexandre Falcao** {BIO 5515455 <GO>}

Thank you. Just one question. If you could give us a quick follow-up, you made a really impressive figure BRL 14 million for CapEx and fleet renewal to create this new fleet, so course this is not a recurring fact. How much of this is an outlier, it will go back to more usual rates or do you intend to keep (19:53) until the end of the year at least?

#### **A - Operator**

Well, this calculation or this account has a lot to do with the variation of the supplier with the car manufacturers. So since there is a cost change, it will increase to a higher rate because of the last purchase we made in the end of the quarter. So for this variation not to be so big in the next quarter. So we'll continue with acquisitions with a certain period, but the variation in the suppliers account will – probably won't be – will not be so high as it was in the this quarter.

#### **Q - Alexandre Falcao** {BIO 5515455 <GO>}

Okay. Thank you.

#### **Operator**

The next question comes from the Pedro Bruno from Santander.

#### **Q - Pedro Bruno** {BIO 19082978 <GO>}

Good morning. My question is continuing on the last one when we saw depreciation reduction, since the half – second half of the last year until this quarter, whilst the margin remained high at 5% and even when higher in this quarter, where do you see this margin? Okay, you've answered that, but where should we think of the depreciation level? What will be the depreciation levels for (21:14) in the fleet that is compatible to the Seminovos margin of 4% as commented by Roberto?

#### **A - Roberto Antônio Mendes** {BIO 7289124 <GO>}

Your question is the value depreciation margin, there is a delay okay. The depreciation we're using now, the margin now is based on depreciation that was calculated in the second half of the last

year when we started cars, would go up lower than inflation, but we had a positive surprise in terms of the increase in car prices.

Now also we have a gain in terms of the efficiency in Seminovos, the SG&A used to be 10 point something percent of the revenue from sales of Seminovos, and now it dropped to 8.1% if I'm not mistaken. So we had a 2 percentage points of gain and so the new depreciation calculations will take into account this scenario, sale cost is lower than we considered in the past, and also we work with different expectations in terms of increasing car prices.

So having said that, we can now use the depreciation that is lower, not to have margins at this current level, we believe that the levels (22:51) in this question, we would go back to 4% or 5%. The historical levels in Rental Car is good. We don't need such a high margin. So we're going to work on both ends. We have started working with the lower depreciation so that margin in the future next year will go back to more reasonable levels.

### **A - Nora Mascarenhas Lanari** {BIO 18838335 <GO>}

Pedro this is Nora, if I could also add, it's also important to highlight that the average age of cars has dropped from 10.2 months to 13.7 months, this also contributed to the increase in prices. We expect car prices to increase less than they used to in the past. Although, there will be some increase still.

Also, SG&A of Seminovos both for RAC and Fleet has dropped 2 percentage points, so the EBITDA margin in Seminovos in RAC went to 6.1%. And also given the reduction of 2 points in SG&A, so the expectations are okay. And in the Fleet depreciation comes from the second half of last year, close to BRL 3,800 to something close to BRL 3,000. But contract renewals are gradual, so the convergence of the fleet margin to a lower rate, lower level will also come gradually.

### **Q - Pedro Bruno** {BIO 19082978 <GO>}

Okay. Thank you. This is very clear. And thank you for the complete explanation. Just a quick follow-up. Is the level of depreciation that we are reaching today at BRL 3,000, do you believe that this is a level compatible to a more normalized margin for (24:50) in the future and the Rental Car also 1,400 that we saw in the second quarter, does this reflect the full adjustment or should we expect further depreciation in the next quarters?

### **A - Operator**

We believe that current levels are consistent levels.

### **Q - Pedro Bruno** {BIO 19082978 <GO>}

Thank you. This is very clear.

### **Operator**

The next question comes from Rogério Araújo from UBS.

### **Q - Rogério Araújo**

Good afternoon. Thank you for the opportunity. Congratulations on the results. I have two questions. First, a follow-up (25:25) more on Seminovos, but I would like to know how much do you calculate in your depreciation account? How much do you calculate the SG&A over sales price and also the EBITDA margin of Seminovos cars? You have some room to guarantee so what is the EBITDA margin that you calculate?

And also about that, isn't your - in your decision, is there any factor showing that the vehicle depreciation should be lower than historical value, maybe larger discount with the car

manufacturers or maybe locally the mix of cars is different today. So new cars in Brazil have highly increased, people are refusing to buy new cars, are willing to pay a smaller difference from Seminovos compared to new cars than we used to see in the past. So, is there anything different from what we used to have in the past? And then I will ask you the second question in a minute.

**A - Nora Mascarenhas Lanari {BIO 18838335 <GO>}**

Thank you for your question, Rogério, this is Nora. As for assumption, these assumptions are adjusted according to the market evolution, so we are marking cars to market, it's around 8% and this is what we used for assumption in terms of depreciation calculation.

When you ask me if it's different from the past, when you look at 2010 up to 2014, it was around BRL 1,200 up to BRL 1,500. In these periods, we had a market period that was very busy and other times, the market was not so busy.

**Q - Rogério Araújo**

Nora, but the price of new cars have increased negative nominal levels.

**A - Nora Mascarenhas Lanari {BIO 18838335 <GO>}**

Well, from 2010 to 2012 not necessarily, this is Nora, and we look at the public prices that suggested by manufacturers and the price at those car dealers, which may be considered to be different.

**A - Roberto Antônio Mendes {BIO 7289124 <GO>}**

We have gains of scale, et cetera. One thing we have set the (27:46) other, but also adding to Nora's answer, this amount is at every quarter is one (27:54) and it's in our balance sheet, either reflecting the reality. We also completed a discount that granted the negotiation. So, there is a percentage of discount 1% to 2%. On historical months, we try to figure and we removed this discount from future values.

So, we're quite accurate when we calculated depreciation, not to have any depreciation surprise in the future, which would lead this to maybe a negative margin, which is the worst possible thing to happen. So, we won't let that happen to have a negative margin. So, because it's zero (28:41), so we never wanted to be zero.

And also to complete, Rogério, on the last point of your question, you asked the estimated SG&A, SG&A committed around BRL 8 million (28:55), this assumption may change in the next quarter, but the EBITDA margins we aim for zero, but of course, sometimes you tell better than you expected or you spend less to sell the car and then the car generates a positive margin of EBITDA upon on sale.

Something important to highlight in your report, our average reduction of margin on EBITDA mainly offset by a drop in depreciation. So, it's on one hand the EBITDA margin in the future may be lower, depreciation could also have a reduction effect. So, both things go together, (29:37).

**Q - Rogério Araújo**

Okay. Thank you, Roberto and Nora. As for the second question, is the spread of ROIC and cost of debt, we expect it to continue to drop. Do you think it would go back to historical levels around 8% or not?

**A - Operator**

Well, last year, our spread (30:04), but we knew that there would be a decrease in exchange rates. We believe that (30:11) quite healthy. We see that shareholders are happy with the value

generation and that's what we think.

## Q - Rogério Araújo

Okay. Thank you.

## Operator

Next question comes from (30:26) from Financial Research.

Good afternoon. Congratulations on your results. I have two questions. First, about the dynamic of net investments. We've seen that in this quarter, it's much more intense than last year. Do you intend to maintain this level of car purchase or are you going to work with an average fleet rate based on more flexible (30:53)? The average has dropped due to cannibalization by the main players in the market or is that a price strategy?

## A - Roberto Antônio Mendes {BIO 7289124 <GO>}

Well, starting with the second question. This is Roberto. This is a price strategy. We do have a pricing system that tries to obtain the maximum growth to make the most at this moment to - because now we have the volume of 130%.

As for the dynamic of investment, we will buy cars according to the estimated demand. Also, we'll look into what the cars we'll sell to renew the fleet. Last year, we bought 90,000 (31:48) cars, 30,000 in the first semester and 60,000 in the second half. So, the anniversary of those cars are sold after one year of law, that's required by law not to pay taxes.

So, in the second half of the year, we do not have so many cars available to be sold, because 35 plus (32:11) others that were aged. So, we sold 40,000 in the second half. In the second half, we'll have to sell more cars, 60,000 from last year. So, at least those cars will be sold in order to maintain a quality fleet to meet demand for car rental.

Now, if you look at the average age of cars sold is around 30 (32:44) and this is a great fit here. After 12 months, we want to sell the cars faster and buy a new one to replace it to keep the quality standard and customer satisfaction, which is great, over 80 percentage points.

So, your question in general, investment will be linked to the demand, also looking at every month to see - to make the necessary adjustments to maintain growth and keep a renewed fleet.

## Q - Operator

Okay. Thank you.

Next question comes from Pedro Furtado from Prada.

## Q - Pedro Furtado {BIO 2249867 <GO>}

Good afternoon, Roberto and Nora. I would like to know about the average age of cars sold, especially on RAC? It would go into 16, 17 months (33:43) in 2016 and in the first quarter of 2017, it was close to 15 (33:49), now has dropped. I would like to understand what attributed to an increase in this average age of cars and now why has it dropped? What are the trade-offs that you take into account to (34:05) decide whether you're going to decrease or to sell cars factored or stick to them more?

## A - Operator



Well, thank you, Pedro. Last year, there was atypical, because there was a delay in cars delivered from manufacturers. We reported that often. So, given the situation that the fact that we cannot meet the demand, that we cannot have the new cars in fact as we wanted, so we had to increase the average age, which reached the 15 and 16 months (34:47). But we chose to do that. It happened because of the strong growth without having a response at the same speed from manufacturers in terms of delivery of new cars, but we aim at selling cars at 13 months of use. At the 12 month of use, cars already prepared for sale and then, it reaches our store immediately afterwards and it will be sold. For Seminovos, for example, 12 months becomes 13 months, because there is a period of time that we have to prepare this car and sell it.

**Q - Pedro Furtado** {BIO 2249867 <GO>}

Okay. The second question is your cash in banks that is quite high at this quarter. I would like to understand in terms of debt management whether you consider repurchasing any (36:01) that you could repurchase now?

**A - Roberto Antônio Mendes** {BIO 7289124 <GO>}

Well, we have not yet made this decision. This is Roberto. Our expectation of growth may require those funds. These funds are being invested at a satisfactory rate. So, I don't lose liquidity and I don't increase risks in order to invest this amount in cash. So, right now, we're quite comfortable and we don't plan that you're seeing that, that far. It doesn't mean that I won't do it, but right now we have a very conservative treasury management, we don't want to take any risks and we don't want to do anything (36:58).

In addition to that, we used cash to buy Hertz that was now approved by CADE.

**Q - Pedro Furtado** {BIO 2249867 <GO>}

Okay. Thank you.

**Operator**

The next question comes from Leandro Fontanesi from Bradesco BBI.

**Q - Leandro Fontanesi** {BIO 20270610 <GO>}

I have two questions. The first one, you've created a recovery in terms of ROIC, would you be willing to consider a drop in this ROIC and then closer to 15% and you did in the past, also you see an opportunity to increase in market share or if competition gets stiffer, would you consider getting closer to 15%?

The second question, could you give us an update on your franchisees that you bought from franchisee (38:00) would you plan on doing that, these franchisees will lose profitability?

**A - Nora Mascarenhas Lanari** {BIO 18838335 <GO>}

Hi, Leandro. This is Nora. Thank you for the question. Let me talk about the last one, to purchase of franchisees, it's part of our business and there is an opportunity to do that. These are opportunities that arrive and we decided to buy them. We cannot say necessarily that we'll do that, because new cities we are opening franchisees.

**A - Roberto Antônio Mendes** {BIO 7289124 <GO>}

As for the ROIC, Roberto is now answering, our goal is to spread. We are at a company that wants to generate value for shareholders. So, the spread of ROIC minus the cost of the debt, this is the figure we look for. We expect interest rates to decrease and increase in growth. So, we always look at profitability and growth imbalance, the two of them to be able to maximize both,

maximizing ROIC or – and spreads can clash with our growth strategy. So, we have focused on the two areas to have top-line and bottom-line always in a good level.

**Q - Leandro Fontanesi {BIO 20270610 <GO>}**

Just one question about franchises. When you mentioned acquisition, where would that go, for example in cash flow, there would be as an investment in fees or acquisition (39:37) in fixed assets?

**A - Operator**

It goes to cost, we don't – nothing goes to the asset, everything goes to the bottom line.

**Q - Leandro Fontanesi {BIO 20270610 <GO>}**

Okay. Thank you.

**Operator**

Right now, we end the Q&A session. I will now like to give the floor to Nora for her final comment.

**A - Nora Mascarenhas Lanari {BIO 18838335 <GO>}**

We would like to thank you all for participating in our conference call and to inform that IR team is available for any further questions that you may have.

Good afternoon. Good afternoon, (40:21).

**Operator**

This concludes Localiza Rent a Car conference for today. Thank you very much for attending and have a good day.

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