

Q1 2015 Earnings Call

Company Participants

- Andre Covre, Chief Financial Officer

Other Participants

- Andre Sabrera, Analyst
- Christian Audi, Analyst
- Frank McGann, Analyst
- Ileana Yank, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to Ultrapar's First Quarter 2015 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at www.ultra.com.br/ri. Please feel free to flip through the slides during the conference call. Today with us we have Mr. Andre Covre, Chief Financial and Investor Relations Officer, together with other executives of Ultrapar.

We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. After Ultrapar's remarks are completed, there will be a question-and-answer session. At that time further instructions will be given. (Operator Instructions) We remind you that questions which will be answered during the Q&A session may be posted in advance in the webcast. A replay of this call will be available for one week.

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 Ultrapar's Management, and on information currently available to the Company.

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 Ultrapar and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Covre, who will present Ultrapar's results in the quarter and discuss other [ph] perspectives. Mr. Covre, you may now begin your

conference.

Andre Covre {BIO 15233513 <GO>}

Good morning, good afternoon to everyone. It's a great pleasure to be here with you today. We'll discuss Ultrapar's performance in the first quarter and talk about the near term perspectives. I have here with me to help answering your questions, executive officers from our business units and Investor Relations team.

Turning on slide three, -- our consolidated performance. Very pleased to start a year with another quarter of earnings growth in a very fast economic environment in Brazil. We had a strong growth of 41% in EBITDA boosted by some one-off effects in Ipiranga. Excluding these effects, consolidated EBITDA totaled 855 million up 22% over first quarter 2014. Net earnings totaled 387 million up 55% over the first quarter 2014. These results show once again the resilience of our businesses. The characteristics that allows us to manage the company to grow even in a weak economy with high ensuring levels of inflation and interest rates as shown on the right hand side charts.

In addition to the non-resilience of the Otto cycle in Ipiranga, of the bottle LPG and Ultragaz of the liquid storage in Ultracargo and of Extrafarma as a whole, the exchange rate is an important part of this resilient dynamics at Oxitenno which has dollarized markets.

Therefore, under weaker economic conditions, when Oxitenno's volumes are generally weaker as well the real devaluation benefits the company's results and in this first quarter the real devaluation was above 20%. In addition to the resilience we had made significant investments in the company which exceeded R\$2 billion since early 2014 and benefitted the results. At Ipiranga and Ultragaz, we extended the geographical footprints of the networks with increasing quality of the resellers and differentiation to clients.

At Oxitenno we strengthened the focus on specialty chemicals with great differentiation and scale. At Ultracargo we expanded our storage capacity, we extended terminals and wider geographical coverage and higher demand growth areas. And in February 2014 we added Extrafarma to Ultra. Increasing operating scale and differentiation allowed us improved sales mix and stronger operating efficiency of our businesses.

On Slide four comment on the performance of the businesses and starting with Ipiranga, as seen in prior periods, the growth in volume continued to be boosted by the increase in the light vehicle fleet, which positively influences the light vehicle fuel sales known as Otto cycle.

As you can see in top left chart, the Brazilian vehicle fleet is estimated to grow in 2015 by 4% prior to the end of 2014 or 5% in the yearly average. For the purposes of this simulation we assumed 13% drop in car sales for the year as estimated by the Otto Motors Industry Association and Favia from our side, we continue to expand Ipiranga's service station network. We have been doing this through significant investments in opening new service stations and converting on branded ones with a focus on the

Midwest Northeast and North regions of Brazil, which are above average growing regions, mainly due to the lower vehicle penetration.

We closed the first quarter of the year with 7,044 stations up 3% over the end of March 2014. In the Northern regions, the service station grew 8.5%. This investment has allowed the company to grow and obtain improved sales mix. We've been increasing share of sales through service stations, also known as the Reseller segment as shown in the graph on the top right.

And it is in the Reseller segment where we find the largest potential for our strategy of differentiation through constant innovation, services, and convenience, helping to increase the flow, the traffic flow at the service station, customer satisfaction and loyalty. With this strategy, customers have higher value-added products and services [ph] our resellers are provided an additional source of revenue and differentiated positioning, therefore maximizing the profitability of the chain as a whole including Ipiranga.

This philosophy of convenience and services has become well known in Brazil to some marketing campaigns. The most famous ones are "Ask at the Ipiranga Service Station" and "Ipiranga, a complete place waiting for you." Both of them summarize a valued proposition of Ipiranga's clients and resellers.

With such elements, volume in the first quarter was up 1% with a 5% increase in the Otto cycle partially offset by a 2% drop in diesel affected by deceleration of the economy. The EBITDA net of extraordinary effects totaled 583 million, up 17% over first quarter 2014 following the same trends seen in recent quarters.

Including the external effects mainly by few imports and inventory gains EBITDA reached 715 million. Looking out towards the current quarter to talk about our expectations, I would like first to remind you that these are not specific projections, but rather trends, levels and orders of magnitude of earnings progression. In Ipiranga the trends and economic conditions that influence the last few quarters haven't changed and are still present in the second quarter and therefore our expectations for this quarter is of an evolution both in terms of volume and EBITDA similar to the last few quarters excluding the quarter extraordinary effects of this quarter.

Now moving to Oxiteno, sales volume of specialty chemicals in the domestic market fell by 3%, mainly influenced by the slowdown of economy and in exports, the volume of specialty chemicals was down 11% in the first quarter due to lower sales to Argentina and the decision to discontinue our private line sold to the latter market.

Total glycol sales was down -- were down 25%, a significant percent change, which. However is not unusual in the case of this product due to its commodity nature. In this particular quarter, the drop was mainly a result of the schedule stoppage in March of the Camacari plant. Normal operations have already been resumed.

With these three elements, total volume fell 8% between first quarters. However, represented an improved sales mix of specialty chemicals accounting for 89% of the total,

three percentage points above that of the first quarter 2014.

Despite the volume drop, the weaker Real in the quarter contributed to a very positive earnings progression. Added to that we saw reduction in raw material prices in the last few months, mainly ethylene. And with this EBITDA reached 145 million, up 33%. EBITDA margin reached R\$288 million per ton, influenced by EBITDA growth and improved sales mix. For the current quarter we expect the earnings progression to be much stronger than the one showed between first quarters for basically four reasons.

First with regard to volumes, given the weak economy, we expect to see a drop in the year-over-year comparison, but that should be significantly smaller than the one presented between first quarters due to the resumption of the operations at the Camacari plant.

Second, the exchange rate at the moment is even more favorable than the average one in the first quarter with a greater exchange rate difference compared to the second quarter last year than the Real appreciated.

Third reason in the second quarter of 2014 EBITDA decreased by 8% compared to the previous year, therefore making it a relatively weaker compression basis. And finally in the first quarter of 2015 we had a one-off loss with foreign customer, which we do not expect to happen again.

Moving to Ultragaz, in the first quarter this year, sales volume grew 3%. In the bottled segment, which has very resilient volumes in moments of crises, we implemented certain commercial initiatives from new resellers and leveraged the faster growth in the North and Northeast regions, which led to a 4% increase in the segment.

In the bulk segment, we grew 1% as a result of investments to capture new customers in the segments of residential condominiums and small medium sized businesses, which are the focus of our strategy. Such growth in the bulk segment was partially offset by the lower demand of large customers heavily influenced by the weaker economy.

Ultragaz EBITDA amounted to R\$72 million, up 19% over first quarter 2014. This increase results mainly from the increased sales volume and the commercial initiatives of differentiation and management of sales channels.

For the current quarter, the trends of the last quarter remains but specifically with regards to EBITDA, a smaller growth is expected due to a concentration of marketing initiatives scheduled for the second quarter. During this weakening Brazil we will launch a new communications campaign for Ultragaz, the new brand signature will strengthen the partnership in support of Ultragaz to growth Brazilians that want to do more.

Talking now about Ultracargo on Slide 7, in the first quarter, Ultracargo presented an average storage 5% higher than that of the first quarter 2014. This growth was mainly due

to the higher handling of fuels as a result of increased local demand, few imports by distributors and increased demand for fuel oil for terminal power plants.

Investments made in recent years with acquisition of the Itaquí terminal and expansions in Suape and Aratu allowed Ultracargo to be positioned to capture this growing demand of fuels.

The chemical segment turned partially offset such growth as a result of the lower demand influenced by the macroeconomic conditions. In view of all of this, EBITDA grew 15% compared to first quarter last year reaching R\$48 million. Before talking about our expectations for Ultracargo in the current quarter, I would like to provide you with some information about the fire incident that took place in our Santos terminal. Starting on the left side of the slide, on April 2, part of the Santos terminal operated by Ultracargo was hit by fire which lasted nine days and affected six tanks of gasoline and ethanol.

Such tanks had a total capacity of 34,000 cubic meters, which represent 4% of Ultracargo's total capacity or 10% of Ultracargo's capacity in Santos. The image at the bottom of the slide, we highlight the tanks affected in red line. Due to the incident Ultracargo's activities in Santos remains suspended for almost the whole month of April. Activities were resumed at the end of April in area not contiguous to the affected one. However, the remaining part remains interrupted which corresponds to a capacity of 185,000 cubic meters, which is equivalent to 55% of Ultracargo's capacity in Santos or 23% of Ultracargo's overall capacity. In 2014 the Santos terminal contributed 69 million to Ultracargo's EBITDA.

On the right side, we will give you some color on the resources deployed in the fire fighting and the management of the incident leading us to an unprecedented mobilization. At the time of the accident we had 98 people and 10 trucks at the terminal, which were immediately ordered to leave the site. The procedure was successfully accomplished and because of that there were no casualties or injuries.

Contingency action plans of the terminal with the surrounding areas we immediately triggered Ultracargo's Executive Board transferred itself to the terminal. The company mobilized about 100 employees from the fiber grades in a 24-hour regime to join local authorities in the fire fighting department assisting the fire fighting.

Seven tug boats were rented and pumped billions of liters of sea water to the fire fighting trucks. During the nine days, the company used all supplies of liquid foam generator available in Brazil and also in port to the product. About 500,000 liters of the product were used. During the incident Ultracargo also maintained an open and continuous communication channel. 19 update statements were issued and the company had 870 interactions with the press over the period and averaged almost a 100 a day. In other words, the company spared no efforts which were significant.

With all of this, coming back to expectations for the quarter, our estimate for the fire incident will have an economic impact in Ultracargo prevalent to half of last year's EBITDA

with expenses and costs concentrated in the second quarter and the recoveries from insurance obtained over the second semester.

Now into slide nine with Extrafarma, first I remind you that we closed to Extrafarma position on January 31 and therefore we consolidated from February 1. And as a consequence some comparisons are boosted by the effect of an additional month in 2015, which we have tried to place on an comparison basis on this slide.

We finished March with 226 stores, 13% higher than the 20 stores on March 2014, a growth that is above the 9% market growth according to the large truck store chain association, Abrafarma. On a comparable basis, only considering the months of February and March, revenues increased by 19%, 9 percentage points above the average growth of the domestic market measured by Abrafarma. The growth was due to the increase in the sales of drug stores with more than 12 months to so called same-store sales and the increase in the number of stores.

Abrafarma's EBITDA totaled 5 million in the quarter, almost half of the first quarter last year. Such reduction is mainly tuned with the added expenses for restructuring the company for more accelerated growth including a new distribution center. Such expenses will generate benefits over time as the company accelerates it's growth.

We also had increases above inflation in personnel and electricity. For the current quarter, our expectation is of an evolution more positive than the one we had between first quarters with a result similar to the one we had in the second quarter last year as a consequence of the significant revenue growth already compensating the added expenses for supporting the accelerated growth of the company.

The last slide highlights our priorities and longer term outlook, which have not changed and you're probably aware of that. At Ipiranga we'll continue to invest in expansion of the network and our added services with a focus on the Northern regions of Brazil the fastest growing regions.

Our investments also include the expansion of the logistics infrastructure to meet the growing demand for fuels in Brazil. From a marketing standpoint, we continue to move forward in our strategy of differentiation increasing the offer of product services and convenience, caps [ph] increase the traffic flow at the service station, customer loyalty and satisfaction.

At Oxiteno we will continue to focus on innovation to proximity with customers and development of new products and applications. The company will continue capturing the benefits of the investments made in the expansion of specialty, production capacity in Brazil, now in a more favorable foreign exchange environment. At Ultragaz, we're investing to capture new customers focusing on the residential and smaller medium size businesses where we have an increasingly more differentiation preposition and therefore great potential to add value.

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We will continue our permanent focus on management of cost and expenses. At Ultracargo as already mentioned our priority is to analyze, clarify, and manage the impacts derived from the recent incident at Santos. At the same time we continue to work on starting our expansion in the Itaquí terminal.

Finally, at Extrafarma the focus is on the acceleration of the opening of new stores as anticipated in the last conference calls, we expect to reach a phase of about 25 store openings per quarter which we estimate to occur in the second semester.

With this, I conclude what we had prepared for today, I thank you for your attention and we can take any questions you might have.

Questions And Answers

Operator

Thank you. The floor is now open for questions (Operator Instructions) And our first question comes from Frank McGann from Bank of America Merrill Lynch. Please go ahead.

Q - Frank McGann {BIO 1499014 <GO>}

Hi, good afternoon. Just a couple questions if I could. One is just in terms of seasonality, you started the year very strongly with some one-offs in the quarter. I'm wondering how you're thinking about the normal strengthening as you go through the year versus the first quarter.

And then secondly, in terms of the insurance recovery for the fire, is -- do you expect that will largely compensate for most of what you estimate the one half of last year's EBITDA, in terms of the costs of that?

A - Andre Covre {BIO 15233513 <GO>}

Thanks for the question, Frank, and the presence. The estimate that I gave of an impact of equivalent to half of last year's EBITDA is already considering insurance recovery. So that's the math effect and as I mentioned we expect most of the expenses be concentrated on the second quarter that's when the fire took place and that's when we made most of the expenses and most of the recoveries be on the second half of the year.

On seasonality, our stronger quarter on average tends to be the third quarter. The first quarter is an average quarter generally, we have had a number of one-off events in the quarter which if we put aside meant a 22% growth in EBITDA for the consolidated Ultra. As I mentioned the trends in the various business remain present with an acceleration in the case of Oxitenó and forward expectation that we have even stronger evolution for Oxitenó in the second quarter.

On the other hand, we obviously have a negative one-off effect in Ultracargo this quarter. Though isolating the one-off effects for the first quarter and in the second quarter, I think we are overall in the similar trend.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. If I could follow-up with one question just on Extrafarma. I mean, if you annualize the first quarter, you'd come up with something well below what you reported for the full year last year. I was just wondering how you're seeing the development in terms of earnings in Extrafarma?

A - Andre Covre {BIO 15233513 <GO>}

Well, there's a great degree of seasonality in store openings. We can see that even in our previously existing businesses in the case of Ipiranga, there has not been any new gas stations that I put in the network during the first quarter and then by the other hand a lot of it happens in the last quarter of the year.

The pharma retail business is no different, the industry reported significant store openings at the end of the year and very small store openings in comparison now on the first quarter. So this is a characteristic of the market. We expect still a bigger number of store openings in our case on the second quarter, and sometime during the second half of the year, we expect to reach 25 store openings per quarter. So we're training -- we are moving on the plan that we have made it's not worse, not bad than we had projected.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Andre Sabrera from Credit Suisse. Please go ahead.

Q - Andre Sabrera

Hi. Good afternoon, everyone. Two questions, please, if I may, Andre. One on volumes of the Otto cycle. You already made some comments on the guidance, but I was just wondering how you are seeing the more recent data points. The year started strong, but then February and March a little bit weaker. It's hard to look month to month, but I just wondered how you were seeing the trading in volumes. And the second question related to that is how do you see Ipiranga will fare in a lower-growth environment? Do you think you'll still, given we'll not see price hikes from PBR soon if prices stay where they are -- how are you seeing your pricing power? And how you are seeing your ability to cut or to keep the G&A in Ipiranga relatively flat, please? Thank you.

A - Andre Covre {BIO 15233513 <GO>}

Andre, you know very well I'm not a big fan of monthly volumes. I don't think they are good indication of trends. Overall monthly volumes in January grew 6%, and they fell 8% in February, then they grew 6% in March. And monthly volumes were fully of noise it's

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nothing else because of the number of working days in this quarter because this was amplified because there was a significant pre-notice of the price increases. So there is probably some movement of volumes from February to January. So the best view I can give you on volumes is one that you know very well. Diesel follows GDP on the long run and Otto cycle fuels follow the size of fleet on the long run. You might see variations on a quarterly basis, but the correlation's pretty strong.

In terms of a lower growth environment, we actually have had a decline in the sales of diesel for now at least two quarters and that has not changed the dynamics in the market which is focused on creating more value to the customer, our proposition is the well known (inaudible) Ipiranga gas stations, our competitors use their own tools, but together we're competing on who has got the best gas station that can serve best customers and that trend seems to continue.

Q - Andre Sabrera

Okay. Any, efforts to cut G&A at Ipiranga or are you happy with the trend? Thank you.

A - Andre Covre {BIO 15233513 <GO>}

Well, expenses and costs is obviously a thing of constant attention. Having said that, Ipiranga has been for a long time now a company where volumes have grown significantly and whenever you're on a growth path, would consider rather difficult if not dangerous to be a company that is growing fast with an extremely lean cost base.

Should the environment of declining GDP to be maintained, then you start having a few percentage growth in volume overall and that might trigger the view of that vision. However, I think even the most pessimistic views of the Brazilian economy do not account for a sequence of GDP declining over the next several years.

Perhaps this year, if you look at the Central Bank research published a 15 days most people are now expecting flat year for 2016 and a growth in 2017. But, should that be different, and diesel sales continue to decline compensating the growth in Otto cycle then obviously expenses will be looked into a different optic.

Q - Andre Sabrera

Perfect, very clear. Thank you.

Operator

Our next question comes from Christian Audi from Santander. Please go ahead.

Q - Christian Audi {BIO 1825501 <GO>}

Thanks. Congratulations with the results, Andre, and the continued impeccable execution that you guys show. I had two questions. On Ipiranga when you talk about the outlook, and you were very clear in terms of maybe EBITDA growing between 13% and 17% although that is not a guidance

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I just wanted, I was just curious when you talk about that, do you foresee a second half of the year in Brazil purely from a macro point of view kind of staying similar to what we've seen in the first quarter or eroding? I'm just trying to get a better grasp of as you look out and as you talk about your expectations. Do your expectations take into account similar economic conditions or a deterioration in economic conditions?

And then the second and final question. In the past you've always continued to show an improvement in your return on investment capital. Last year we had a bit of a pause. But, looking at the first quarter and the outlook for the second quarter, do you foresee your ability to continue to improve returns on your investment capital to continue? Thanks.

A - Andre Covre {BIO 15233513 <GO>}

Hi Christian thanks for your presence and your questions. At Ipiranga the key drivers of our results have been the investments and our differentiation strategy. That's what combined has led to the levels of EBITDA growth in the recent past. When we look to the second half of the year, we continue to do same things, we're not assuming that economy gets any weaker than already is.

Most people currently expect GDP decline of about 1% in Brazil, when our crystal ball is no better than other people. So we are factoring that in and we're seeing that in the -- fact [ph] of that in our diesel sales, which have declined 3% and little bit of that is the loss of the particular customer, but the rest is the fact of GDP.

In terms of capital returns indeed last year we had a pause. As we have had the chance to speak and explain, last year was a very unusual year, because of two reasons first in Ipiranga we had a very strong comparison base to 2013 where we had three refinery price increases and the four 2013 [ph] had three meaningful inventory gains and 2015 only had a small one -- 2014 only had a small one towards the end of the year.

And in the case of Oxiteno, we spend most of the year on a very unusual combination of weakening GDP and strengthening Real all the way to September and as you know a very artificial situation. Things have now been allowed to float normally and, hence, the significant evaluation of this year, probably compensating last year. So with all of this, I see last year as it's unusual point in our evolution of results returns and, therefore, we expect to continue to resume an improvement in capital returns this year.

Q - Christian Audi {BIO 1825501 <GO>}

Great. Last question. Turning to Oxiteno, we saw very high -- R\$280 for ton margin in the first quarter. Based on your comments, that could improve in the second. My question relates more to the second half of the year. If we were to take an average of the first half of the year based on your comments today, what do you think we should assume for the second half of the year? A similar dynamic or maybe be more conservative about being able to reach a similar level of dollar per ton in the second half of the year?

A - Andre Covre {BIO 15233513 <GO>}

Another way of looking at it Christian is that last year's EBITDA was above 400 million, in average FX at 230 and should the real stay about three, the average FX of the year would be about 290. So that is R\$0.60 more the average FX and as you well know every R\$0.10 on the average FX contributes about R\$50 million of yearly EBITDA for Oxitenó, everything else the same.

But that would take EBITDA alone only this FX on 400 to 700, unfortunately not everything is the same, the economy is weaker, the volumes are declining. Therefore I'm not indicating that we're going to come to that point, but in many case even if you discount for a volume decline and other aspects, it's a pretty significant growth in relation to last year, which is not much different than the 50% that we just had on this quarter.

Q - Christian Audi {BIO 1825501 <GO>}

Understood. Thank you very much.

Operator

(Operator Instructions) We have a question from Ileana Yank from UBS. Please go ahead.

Q - Ileana Yank

Hi thank you for taking my questions. Andre, if you had like limited amount of money -- well, it might not be the case -- but, would you rather spend it in adding more into fuel distribution or it's better to go into something like in the Ultragaz, or maybe just focus more on the kind of retail drugstore part of your business? Thank you.

A - Andre Covre {BIO 15233513 <GO>}

We put it on the highest return project, whatever that is. The one that has the biggest TVA?

Q - Ileana Yank

And what do you think could be like? Under current circumstances and the availability of assets and might be for sale for instance? I don't know if you had any preliminary assessment?

A - Andre Covre {BIO 15233513 <GO>}

I'm not sure I understood you, Ileana. Could you repeat?

Q - Ileana Yank

Yeah. Just something like, if you have a -- given the current, situation, potential assets that might be available for sale. And if, you know, you were to have a preliminary assessment, right, so where to spend more of the time to dig more about it and see what can bring you more returns. Would you have any views if it's really expanding onto more retail or really into, distribution? Or on the, -- well, in which of these three areas?

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A - Andre Covre {BIO 15233513 <GO>}

Unfortunately, I can't give you a really good answer because that depends on the specifics of the situation if you're -- you seem to be wanting to know if we have a preference of business to invest.

Q - Ileana Yank

Yes.

A - Andre Covre {BIO 15233513 <GO>}

And the answer to that is no. We don't have a preference of business to invest. If we have any business where we don't think we can make good investment and achieve attractive capital returns, that's a business we will sell and we've done that in the recent past. In 2010, we concluded that we could not create significant value on the trucking business of Ultracargo. And then we decided to sell it and we sold it.

Q - Ileana Yank

Okay. Fair, thank you.

Operator

Having no further question this concludes the question-and-answer session. At this time, I would like to turn the floor back over to Mr. Andre Covre for any closing remarks.

A - Andre Covre {BIO 15233513 <GO>}

Thank you very much for everyone's presence and your interest in Ultra. Look forward to seeing you in about three months. Have a great weekend.

Operator

Thank you. This concludes Ultrapar's first quarter 2015 results conference call. You may disconnect your lines at this time.

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