

Q1 2020 Earnings Call

Company Participants

- Andre Barreto Chiarini, Chief Logistics Officer
- Andrea Marques de Almeida, Chief Financial and Investor Relations Officer
- Anelise Quintao Lara, Chief Refining and Natural Gas Officer
- Roberto da Cunha Castello Branco, Chief Executive Officer, Director
- Rudimar Andreis Lorenzatto, Chief Technology and Production Development Executive Officer
- Unidentified Speaker

Other Participants

- Andre Hachem
- Barbara Halberstadt
- Bruno Amorim
- Bruno Montanari
- Christian Audi
- Frank J. McGann
- Pedro Medeiros
- Rodolfo Angele
- Vicente Falanga

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Petrobras Webcast with Analysts and Investors about the First Quarter of 2020. We'd like to inform that all participants will follow this transmission by internet as listeners. After introduction, Q&A session will begin. You can send us questions by email at petroinvest@petrobras.com.br.

Present with us are Roberto Castello Branco, Petrobras' CEO; Andrea Almeida, Chief Financial and Investor Relations Officer; Anelise Quintao Lara, Chief Refining and Natural Gas Officer; Andre Barreto Chiarini, Chief Logistics Officer; Carlos Alberto Pereira de Oliveira, Chief Exploration and Production Officer; Nicolas Simone, Chief Digital Transformation and Innovation Officer; Roberto Furian Ardenghy, Chief Institutional Relations Officer; Rudimar Andreis Lorenzatto, Chief Production Development Officer; and as well as other companies executives. The presentation will be available on our website.

And now we will start with Petrobras' CEO, Roberto, please you can begin.

Roberto da Cunha Castello Branco {BIO 3193867 <GO>}

Thank you, Carla. It's a pleasure to be here with you to exchange some ideas and to disclose some information about our company. The world is dealing with twin shocks. On the one hand, we have the worst public health crisis since the Spanish Flu, 100 years ago. And a very severe recession, very severe and synchronized recession. All lives and livelihoods are at risk.

At Petrobras, our number one priority is health, health of our employees and health of our company. To deal with the health threats, we launched several measures to protect our employees, including a massive testing. Up to today, we have tested 22.5% of all employees and using home office, reducing personnel operations at a level -- an average level of 50% of the total labor force at operations.

In order to deal with the threats to our health, we are preserving our liquidity. I have withdrawn revolving credit facilities, and increased our total cash holdings up to US\$15.7 billion. We cut CapEx spending by almost 30%, US\$3.5 billion and are pursuing a minimum reduction of our operating costs of US\$2 billion. We are developing several initiatives to do that. We organized under our liquidity committee that interacts with all operational areas of the company. They are the sentinels of our resilience and recovery, because we are not dealing with not only the short-term, but accelerating the execution of strategy that was put in place back in January 2019, in order to emerge from the severe crisis as a stronger company and able to generate a lot of value to shareholders. I said that we are executing several deep cuts in capital expenditures and operating costs, but we're doing this given the preservation of the safety of the company and our commitment to sustainability. Petrobras is executing its good corporate citizenship of helping the Brazilian society to cope with the threats arising from the COVID-19 virus.

We have donated PCR tests, 3 million liters of foods and several other medical and materials to public hospitals. We're helping with our scientists and our high-power computers to develop research related to the COVID-19 problem. As I said, this such execution has been accelerated, our commitment to maximize value through the increase in return of capital employed and reduction of cost of capital remains in place.

We are proceeding a full review of our project portfolio. The competition for capital was enhanced in order to have a stronger capital discipline in a scenario of lower price of oil as we're seeing in the future. We believe that the recovery will be slow and the price will converge to a plateau of \$50 per barrel in the future. So, we have to enhance the capital discipline to allocate capital on the most efficient way, results will be shown later.

Our divestment program remains intact business as usual. Of course, we may have some delays in the execution, but the main block of assets, the refineries, the process is going ahead with some delay, of course, but we do expect that by year end, we have signed sales and purchase agreements with several players. Different from 2008, when we had a global financial crisis. Now, we have a global economic crisis.

The central banks reacted very fast to inject liquidity in the markets. So liquidity is not a problem, which facilitates the divestiture program. Well, having said that, I would say that we are confident that with the help of our professionals, highly committed with the company and high skilled people combined with the world-class assets will survive to this crisis, and after that will be even stronger than we are now. We are very fastly learning the lessons offered by the crisis and this will be applied for sure in the benefit of lower costs and higher efficiency and productivity.

Now, I pass to Carla to manage the conference.

Questions And Answers

Operator

(Question And Answer)

Thank you, Roberto. Now, we'll begin our Q&A session. The first question comes from Frank McGann with Bank of America, Merrill Lynch.

Q - Frank J. McGann {BIO 1499014 <GO>}

In refineries are there any issues with the mixed products being produced with demand and some remaining strong and for others weak? How do you adjust the productions late? And the second question is what is the current expectation for crude oil output over the next few months in the reminder of the year?

Operator

Anelise, would you like to start and then Capo?

A - Anelise Quintao Lara {BIO 20915362 <GO>}

Yes, yes. Thank you, Frank for the question. You're right. We have to - yes, we had some issues with the mix of products being produced in our refineries in order to meet the difference in the demand. That's why we did some adjustments in the operational side of the refineries in order to deal with these issues. Let me give you an example. For instance, in the FCC unit, we can adjust for certain percentage of production between gasoline and LPG. In this last weeks, we had an increase in LPG demand and a decrease in gasoline. So we adjust FCC units in all of refineries in order to meet this demand. Another example concerns diesel and the fuel with low sulfur content, and sometimes we can reduce the production of diesel and increase the production of bunker low sulfur oil. This is not an easy task to do, but we can manage some in the processing of the refineries in order to use different catalysts and other things in terms of temperature, pressure that we can deal with this difference in the mix of projects during this crisis. Okay?

A - Unidentified Speaker

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Hello. Frank. Regarding the expectation for crude oil output for this year and also for the next month, what we have been seeing is that the production for April that we have already realized, it's still in the same level of the first quarter, a little bit less than that because of the effects of the COVID-19 and also the effects of the reduction on the demand for oil, but the fact is that we have been having a very good operational efficiency and we have to consider that now we have reduced production due to the fact that we have the mothballing of the shallow water platforms, and also we can have some effect regarding the people that we have on board and so that sometimes we have to reduce the efficiency of the platforms, but the fact is that we are still maintaining the same goal, the same target that we have for the year, the 2.7 million barrels of oil equivalent per day plus or minus 2.5%. So the current scenario is we have a lot of uncertainties, it is difficult to forecast what's going to happen, but if we have the same partner and we have the same efficiencies that we have been having so far, we still are keeping the same goal for the year.

Operator

Thank you. Our next question comes from Rodolfo Angele from JP Morgan regarding storage.

Q - Rodolfo Angele {BIO 1541593 <GO>}

One of the key concerns in the sectors related to the available spare capacity the companies have. How is Petrobras' current spare capacity? The second question is regarding Chinese (Technical Difficulty) -- recover and relevant export markets. We've been seeing some high frequency data pointing to recovery fuel demand there, with utilization rates for depot refiners also increasing. How did that reflected on Chinese demand for your crude?

Operator

Chiarini, would you like to start?

A - Andre Barreto Chiarini {BIO 21746050 <GO>}

Yes. Thank you, Carla. I'll start and then I'll pass to Quintao Anelise to complement. So Rodolfo, thank you for your question. I'll start by exploring our overall storage capacity. In addition to available storage on our FTSO, the storage on the vessels performing our offloading operations, those are which are in transit, and then I'm not talking about any vessels hired by us just for floating the storage. And also considering the relevant storage capacity in our refineries, we also have various terminals of our subsidiary Transpetro covering the whole country, totaling a very relevant storage capacity of crude oil. The nominal capacity of crude oil in our systems is over 15 million cubic meters, also for storage capacity of fuel, we're talking about 4.7 million cubic meters. Currently, inventory levels of both oil and fuels are under control and we have enough spare capacity. Over the recent weeks, we have managed to reduce inventory levels of gasoline which are currently within the range considered ideal for us. With regards to crude oil inventories, we are operating within their ideal range and we are also monitoring both the adequate load of refineries and also the export volumes to operate at the lower level of such ideal

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range by the end of June. We have recently revised it down what historically were our ideal levels of crude oil inventories so that we can generate even more cash during this crisis. We are pretty confident that if necessary, we will have the logistics boarding capacity to set even higher records in crude oil exports, at least 10% increase over the 1 million barrels per day record set in April. Our commercial team has been developing a long-term relationship with Shandong Refineries in China, where our oil has strong demand even during the crisis because crude oils from Lula, Iracema, Sapinhua and Buzios Fields have the same overall characteristics of a specific Chinese oils such as Shengli, KENCO, that are experiencing decline in production.

As we're starting to see a slow recovery in our domestic market and as we have been able to adjust the fleet and product mix of our refineries to increase production of diesel fuel oil and bunker oil, we are most probably going to have increased export volumes of those higher value-added products thus reducing oil exports not due to demand constraints nor logistics constraints, but to generate higher margins. Having said that, we are not foreseeing oil production cut due to demand constraints in the short term and we are not facing any problems related to storage capacity in the near term. I'll pass to Anelise to follow on.

A - Anelise Quintao Lara {BIO 20915362 <GO>}

Just a quick remark on what Andre has said is that we don't see any issue regarding the demand of our crude oil especially in China nowadays. I mean If you have more oil to export, we will be able to find the market for that. The main issue is the economics. Of course, we prefer to process this oil here in Brazil and to sell in our domestic market, because of the higher margins. But what we see now is that the demand of fuel in China is ramping up very fast, and they're eager to buy more oil from us.

Operator

Thank you, Anelise. Thank you, Chiarini. The next question comes from Bruno Montanari with Morgan Stanley.

Q - Bruno Montanari {BIO 15389931 <GO>}

As we are now some two months into the crisis, can you comment on key lessons learned, and how those might come contribute to Petrobras emerging from this situation even stronger? Has the crisis somehow accelerated any measures that were considering to be implemented to make the company more efficient? And the second question. As the company materially increase exports in an oversupply oil market with higher transportation costs, how does the net back of exports compare with the net backs of sales on the domestic markets for refineries? Roberto, would you like to start?

A - Roberto da Cunha Castello Branco {BIO 3193867 <GO>}

Yes. I'll respond to the first question. Thank you, Bruno, for the question. Well, first of all, we learned the most obvious lessons. We will be able in the future to reduce travel expenses, no need for many travels. Home office is being very successful. We have adapted very well to home office. So in the post COVID-19 period, we see that it's very feasible to work with 50% of our personnel in corporate activities in home office, that will

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save costs, we'll be able to leave several buildings and this will provide us with significant savings. We learned also that home office has been very productive. We have a very - look at very extensively with home office. And other lessons learned, already learned during the crisis is that teamwork was reinforced with an integration of corporate and business areas has been great. So several ideas has been raised to cut costs, to increase efficiencies. This integration has been highly productive to us. This is the lesson learned.

Another lesson was shown in the increase of exports in the months of particularly in April where we reached an all-time high level of exports to -- exports of oil -- crude oil. This was feasible due to the stronger integration between logistics and marketing and we are acquiring much more flexibility. We're dealing with the domestic market and international markets. This includes not only logistics and marketing but refining and oil production. The integration of this added much more efficiency and we are able to discover new horizons in our ability to market and sell oil and fuels. This is a shortlist at the moment. But I do believe that it's to be highly, it has a high potential to contribute to value generation over time. So every crisis has two sides, negative one and positive one. We think that we are enjoying the good lessons and extracting significant benefits from the positive side of the crisis. I'll pass now to --.

A - Anelise Quintao Lara {BIO 20915362 <GO>}

It's me, Roberto.

A - Roberto da Cunha Castello Branco {BIO 3193867 <GO>}

Anelise. Sorry, I forgot the question.

A - Anelise Quintao Lara {BIO 20915362 <GO>}

Yeah. Hi Bruno. Just a quick comment on your question about the net back of export compared with the net backs of sales to our domestic refineries. Of course, the net back of our domestic sales are higher than the net back of our export, but it has been like that since 2016, when Petrobras has a strategy to have this parity -- import parity prices for gasoline and diesel. It's an important pillar of our strategy to keep our company healthy. And keeping that, having an important parity prices for our products in Brazil, we have a better net back for net back prices margins. This is also done even in this crisis, when the import parity prices decreased and some people, they didn't believe that we will follow this reduction in price, but we did. In the first quarter, you see a reduction in gasoline and diesel in Brazil around 50%, not all these price went to the our vendors or -- opposed to our gasoline offices but from Petrobras refineries, we achieved a great reduction both in gasoline and diesel following the tightening port prices.

Operator

Thank you, Roberto and thank you, Anelise. The next question comes from Luiz Carvalho regarding our pricing policy. So oil dropped almost 70% in the low and Petrobras was able to pass through refineries close to 50%. However, pump prices dropped only 10%. In addition, foreign exchange rates depreciated significantly recently. Question is how much of a challenge will be to follow oil prices rebound and foreign exchange valuation?

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A - Roberto da Cunha Castello Branco {BIO 3193867 <GO>}

Well, Luiz. This is a frequent question. One of the most frequently asked questions and the experience is telling investors and analysts that we are following international price. We have no problem in following them. Of course, during a period, we are an oil producer, we are not an oil trading company. If you follow international price at every moment we have to put someone in front of a Bloomberg screen and adjusting price instantly, there's no purpose in doing that. We -- our pricing policy is to adjust to international price after the observation of the trends. It's much more than just having a clock to adjust every minute. And during the severe drop in fuel price. We are not driven just an explanation. We are not driven only by oil price, or driven by fuel price because they carry are a crack spread, may be highly positive, some cases, they maybe negative. So in a downward trend, we tend to have price higher than the international price during some days. In an upward trend is the contrary, we tend to have our price lower than international price during some days, but we follow them. We see an upward trend in gasoline price taking place since April 22. And we made, we have made two price increase, one of 12% and other one of 10%, if needed, if we think that's needed, another price increase, of course, we will go ahead, there are no problem at all.

Carla, please.

Operator

Thank you, Roberto. Our next question comes from Pedro Medeiros with Citi.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Can you give more color on costs and expenses savings expectations throughout 2020? And that's the first question. Andrea, please. And then Petrobras has been successfully narrowing the selling discounts of oil exports relatively to the Brent in the last quarters. Can you discuss how is the selling spread of Brazil oil exports behave relatively to the Brand throughout the second quarter?

A - Andrea Marques de Almeida {BIO 19358739 <GO>}

Hello, Pedro. Thanks for the question. We announced the additional \$2 billion reduction in operating expenses. And definitely this is not everything that we are doing, but this is what we up to now are able to announce, and that number definitely there are included there are many items. I think the mothballing of the drilling rigs, the -- from the postponement of the con -- the negotiation in contracts that we are postponing some payments. We started this discussion first in the postponing of all payments and now we are going to get back to the table and even connect to the review of the portfolio. We will be able to renegotiate with a big -- again, always important to mention, we are going to focus on the big suppliers. But after the review of the overall portfolio, we might find other and additional cost reductions related to some of our contract. We continue to find to try to find cost (Technical Difficulty) I have been talking about the adjustments of our health system. We are talking about adjustments to our overall structure to reduce costs related to personnel. We will be doing additional items, but up to now we have the overall embedded into that additional \$2 billion that we announced.

A - Anelise Quintao Lara {BIO 20915362 <GO>}

Concerning the second question, Pedro, our -- you are right. We are selling our oil relative to Brent in a good margin in the next quarters, but this margin has been reduced in the first quarter, it was lower than in the last quarter of 2019 because of the volatility of the oil price in the market. It affects also the premium of our oil and the surplus of oil in the market also is an issue. So if you -- in my opinion, in the second quarter, you'll see the same behavior. High volatility of oil prices impacting our margins in terms of oil, but it's still keeping a positive margin especially because of the quality of our oil, okay?

A - Roberto da Cunha Castello Branco {BIO 3193867 <GO>}

Just a little remark from what Andrea said is that the CapEx cuts that we announced for 2020, will not affect the startup of the production system in the short-term production. Just to emphasize that.

Operator

Thank you. We just received a question. This time it's from Christian Audi with Santander.

Q - Christian Audi {BIO 1825501 <GO>}

You had originally planned to reduce production by 200,000 barrels a day, but given rise in export demand, should we understand that the original 200k cuts will no longer be needed? Chiarini, would you like to start? We also have another question from Christian Audi to Andrea. Could you please comment on the hedge accounting for the exports contracted for April to December? What level of exports are already contracted for the spirits and what products are involved?

A - Andre Barreto Chiarini {BIO 21746050 <GO>}

Okay. Thank you, Carla. Yes, we do not expect to have further cuts due to demand constraints in the production of oil. We are experiencing a very volatile and complex market dynamics these days. So our team is continuously monitoring and reassessing production levels, domestic sales in order to define our let's say export targets. That can vary over time, but we are not foreseeing, as I said before, oil production cuts due to demand construction in the short-term.

Andrea?

A - Andrea Marques de Almeida {BIO 19358739 <GO>}

Okay. Fine. Talking about the hedge accounting, I think it's important. We had an impact on the results as well together with the impairment related to the hedge account. So what happened? To explain in small words, we do have hedged accounting considering the future exports that we have or the exports we have for the future, being a hedge to our debt in U.S. dollars. Whenever we have a deep reduction in the price, like we hedge right now, what is going to happen? The forecast of the value of our exports for the future, they are going to be reduced. So we will have less exports in value to be protecting the debt in U.S. Dollars. That's exactly what happened. So it's -- what is in and what we used to

forecast the exports, is definitely we have to prove or we have to use the past experience to show that we will have volumes and -- definitely the price we have to adjust together with the price that we adjusted for the overall portfolio. We expect the exports to continue to be the way we have seen. Again, China has been an important I would take place after we see China going back. We saw higher exports as we release to the markets. And we expect to continue to have that, but we don't force -- forecast. It's not just these that we are forecasting for the hedge account, we have to prove looking to the past.

Operator

Thank you. Our next question comes from Andre Hachem with Itau.

Q - Andre Hachem {BIO 20209966 <GO>}

So in the last crisis, Petrobras took the opportunity to renew several contracts. However, when looking at the current status of suppliers in the industry today, as an example the rig services, many of them have not yet recovered from last crisis. In this regard, is there still room for further contract revision? Is there anything that can be done in regards to FPSO leases? Rudimar, would you like to start?

A - Rudimar Andreis Lorenzatto {BIO 20949096 <GO>}

Yes, Andrea. Petrobras procurement area with the technical areas are at the moment under negotiation or already in negotiation with the supplier and we already made progress in some areas. So far, we have made renegotiation movement, aiming to adjust the cash flow for 2020. And we are now planning a new wave for negotiation to adapt the current contracts to the new market reality. Rigs and leased FPSOs are strategic services and we are still studying the detail to define some new objectives and negotiation strategies.

Operator

Thank you. Our next question comes from Bruno Amorim with Goldman Sachs.

Q - Bruno Amorim {BIO 17243832 <GO>}

What's the current level of utilization of Petrobras storage facility, both oil and fuels? Is utilization still going up or it started to fall given the recent pick up in demands in oil prices? And there's also a second question. Given the strong depreciation of the BRL, can you please remind us the impact of a 10% depreciation of BRL on your upstream EBITDA per barrel in the U.S. Terms, all else equal. So maybe Chiarini, would you like to start about the storage capacity?

A - Andre Barreto Chiarini {BIO 21746050 <GO>}

As I mentioned before, inventory levels of both oil and fuels are under control and as we have enough spare space and we have been adjusting the production and also adjusting the feed of the refineries to adequately meet the demands of the internal market and exports, we don't see any problems regarding storage in the near term. In fact, the inventory levels are going down. Gasoline inventory levels have been going down over

the last weeks, and also oil inventory levels are also going down, especially by the end of June, but they're perfectly under control, and there's no concerns about that at the moment.

(Inaudible) Okay. Following up with the question of the impact of real-dollar in our EBITDA. I have the number (inaudible) and now after the adjustments, we made we have for instance a change in our real-dollar, we have around \$200 million impact, positive impact on EBITDA. So we see that the further depreciation of the real that we observed in the -- right now actually, it's going to further increase or improve our results in Petrobras.

Operator

Thank you for (inaudible). The next question comes from Lilyanna Yang with HSBC. So please give us some color on demand for fuels, gasoline, diesel in April and May. Is demand in Brazil recovering fast? Any estimates for the second quarter, third quarter and fourth quarter in terms of demand? Please Anelise, you go ahead.

A - Anelise Quintao Lara {BIO 20915362 <GO>}

Hi, Lilyanna. In terms of demand for fuels, what we're seeing so far is that we had a huge impact in the first weeks of April, that we got reduction on diesel around 50%, in gasoline 65%, in jet fuel 90%, and even during April and now in May, we are seeing a recovery, especially in gasoline, but also diesel is getting better. So and other products also. Our main concern is jet fuel. We don't believe that jet fuel could be recoverable as soon because of the international flights and all over the world, it's not only in Brazil and this will affect probably the demands of jet fuel the whole year. But diesel, gasoline, bunk and naphtha and other oil products, we are seeing almost a complete recovery in the third and fourth quarter. Okay?

Operator

Okay, thank you. Our next question comes from Vicente Falanga with Bradesco.

Q - Vicente Falanga {BIO 16406266 <GO>}

How are the conversations with local groups about the sale of refinery going? With the exchange rate at, does this impact the transactions? Anelise, would you like to start?

A - Anelise Quintao Lara {BIO 20915362 <GO>}

Well, we are talking with different players that are interested in our refineries, it is not only local players but also international ones. As I said, we see that the interest is continuing. So we don't see any of the players saying that they will give up. It's a good sign. And what we see is that we had to postpone the binding offers, because of the crisis and we hope that by the third or fourth quarter of this year, we could have the binding offers already presented. So we can go on with the negotiations with the first player and sign the contracts in the first quarter of 2021.

Operator

Thank you, Anelise. And now it's our last question. Our last question comes from Barbara Halberstadt with JP Morgan.

Q - Barbara Halberstadt {BIO 18022271 <GO>}

So this is for Andrea. What is the plan regarding the debt level? Any liability management plans for the year? Is there any risk of covenant breaches?

A - Andrea Marques de Almeida {BIO 19358739 <GO>}

So, thanks for the question. Regarding the debt level, we announced that we want-- so our goal for the year is to end the year with \$87 billion of total debt. If we can do better, definitely we will look and try to do better, but that's the goal for the year. And the medium and long-term, we keep the \$60 billion. That's the debt we believe is the one that Petrobras should have to be prepared for the volatility of any scenario, including the one we are just experiencing right now. Regarding liability management, and -- liabilities management, we will look for opportunities for -- to -- always actually, this is always. Now we are focused on liquidity, but if there is opportunity - there are opportunity in the market to extend the term of the debt and roll some of the debt that we just got, definitely we will take the opportunities. And the last point was -

Operator

Regarding covenants.

A - Andrea Marques de Almeida {BIO 19358739 <GO>}

Okay, covenants. And the covenants, we just have - the debt would be MBS with the financial covenants. There is the net debt to EBITDA 5.5, but we don't believe we're going to get there. But we have all the documents ready, even to ask for waiver if necessary.

Operator

Thank you all. At this time, our Q&A session is over. If you have any further questions, please send us an email to our Investor Relations team. And now, Roberto will make his final remarks. Please Roberto, go ahead.

A - Roberto da Cunha Castello Branco {BIO 3193867 <GO>}

Thanks, Carla. I would like to thank you for your interest and attention to our video conference. As I said before, we are very confident on the survival and emergency of Petrobras as a stronger company. During a crisis, courage and optimism are key. And we have as our main lives in this process, highly committed to people and highly skilled people. And this, combined with the world-class assets we have, I am sure that Petrobras will continue to generate a lot of value to shareholders. Thank you. And I expect to see you soon in another opportunity.

Operator

Thank you, ladies and gentlemen. The audio of this webcast will be available at Petrobas website. Thank you very much for your interest and have a great day.

A - Roberto da Cunha Castello Branco {BIO 3193867 <GO>}

Stay safe.

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