

## Q3 2018 Earnings Call

### Company Participants

- Eduardo Fischer Teixeira de Souza, Chief Executive Officer Region II
- Leonardo Guimaraes Correa, Chief Financial and Investor Relations Officer
- Rafael Nazareth Menin Teixeira de Souza, Chief Executive Officer Region I
- Ricardo Paixao Pinto Rodrigues, Investor Relations and Financial Planning Director

### Other Participants

- Andre Mazini, Analyst
- Gustavo Cambauva, Analyst
- Jorel Guilloty, Analyst
- Luis Stacchini, Analyst
- Luiz Mauricio Garcia, Analyst
- Marcelo Motta, Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen. Thanks for waiting. Welcome to the conference call of MRV Engenharia. We would like to inform you that all participants are going to be in listen-only mode during the company's presentation. We'll then start the Q&A session when further instructions will be provided. (Operator Instructions) Now we are going to turn the call to Mr. Rafael Menin. Please Mr. Menin, you may start.

#### Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Good morning, everyone. Thanks very much for attending our call. It is a great satisfaction to once again present positive results and net income of BRL174 million, which is spectacular. More important than that, as a coincidence, this week we had an exercise of revisiting our releases of the past 11 years, and it was interesting to see that what we have said since we went public, and future deliveries were extremely consistent. MRV is the only company in the segment that recorded for 11 years in a row profits for every quarter, gross margin always without much volatility. We have been generating cash for many years, very low leverage and that's true. How right we were in terms of our long-term strategy. And as important as that, the company's capacity of execution. So 11 years reporting spectacular results.

So I would like to talk a bit about what is to come. MRV, in the past three years has been making quite relevant investments, not only in land bank, but also back off, technology,

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customer relationship, and that allowed the company to be a bit heavy. If you take a picture of the present, but I'm not -- I have no doubts that once again we have the right strategy. Today, we have a platform that is extremely sophisticated with national coverage, a brand that is extremely strong, a high quality product. So today we have a digital platform that has high technology, and customer relationship that is second to none. And thinking further, and we are investing more and more in the relationship with our customers after the delivery of keys with a series of benefits today. So today, we have co-management of all developments delivered, and we are adding services to development. That has a cost. We know that in the short term, it demands investments in technology and change, but I have no doubt that the company is once again ahead of the market, anticipating demands of these customers that are more digital and they want services from the company. So the company got it right.

And our shareholders and analysts that follow us, we will see in the following quarters, we are going to release that a bit more on our MRV within 30 days, very nice things to come in the next quarters. And I have no doubt that MRV platform is to work not only in the Minha Casa Minha Vida program, you know the FGTS has already represented 30% of our portfolio share. So we are ultra-prepared. We are going to continue to operate in the economical segment, but also extending our portfolio to a larger number of customers. So we are going to work with FGTS. We are thinking of a new financing model. So a lots of sophisticated in -- sophistication in our MRV operation. And I have no doubt that that will translate into even more satisfactory returns to our partners, clients and employees. So I'm very comfortable and safe -- confident that the strategy defined by the company will place us in a very different position compared to the remainder of the sector.

I'm going now to turn to Leo to talk a bit about financial indicators and LOG.

### **Leonardo Guimaraes Correa** {BIO 15387486 <GO>}

Well, good morning, everyone. First I would like to once again highlight LOG. You know that we are continuing our schedule, our timeline for the spin-off process. We are going tomorrow to have a meeting of the Board of Directors calling the General Meeting to make the resolution on the spin-off. This movement -- these two companies have different cash flows with different multiples. So clearly there was a lack of recognition on the part of analysts and investors of LOGs value within MRV, so our objective was to unlock the value of the company, and make those companies just follow their natural directions independently.

For MRV, at first, as an increasing ROE, you have on the website some presentations on that, and I do encourage you to take a look at these presentations and take a dive deep down into LOGs number to better understand a bit of its outlook, which is quite positive. So you have the absolute warehouses that are being replaced. Finally, the market is starting to recognize the value of these warehouses that are more well structured and they are paying for that. And also there is a migration of physical to electronic commerce, which demands a higher number of warehouses.

As for MRV, more financially speaking, we had cash generation that was very strong in the third quarter. This is going to continue. There is an upward trend. Of course there is a

volatility in between quarters, sometimes a bit more, a bit less, but as a whole we are doing very well. Our net debt is very low and we had already allocated 50% [ph] of the results of 2017 to be paid out in the form of dividends. We have already paid out 25%, and in the short period of time we are going to complete the payout of the remainder amount. Looking forward, while we are within months of a new administration for Brazil, that brings more clarity to the market. So in terms of possibilities we see a higher increase of dividends compared to past payout amounts.

Well, now we are going to open for your questions.

## Questions And Answers

### Operator

Well, ladies and gentlemen, we will now start the Q&A session. (Operator Instructions)  
The first question comes from Gustavo Cambauva from BTG Pactual.

#### Q - Gustavo Cambauva {BIO 17329406 <GO>}

Hi, good morning. I have two questions. The first and even as a follow on what Leo has mentioned about the new administration. Could you comment a bit about what it's been like for you? Have you been discussing anything with the new administration about the Minha Casa Minha Vida program? Do you see any likelihood for a change in the program or even in the FGTS, there is the workers' compensation fund. The media has been reporting on lots of things, but we would like to know what kind of discussions the segment has been having with the new administration?

And my second question is with regard to the fourth quarter. You have a guidance of launches, so we would like to know what it's going -- what it's like in the month of October if you were in line with your guidance? And in the Minha Casa Minha Vida program you did have some difficulties for the reallocation of budget for the past quarter. What is it like today? Are you back to normal completely in terms of companies and individuals? Is everything going on okay? Or do you still have any kind of barriers that may impact the fourth quarter? Thank you very much.

#### A - Eduardo Fischer Teixeira de Souza {BIO 17580321 <GO>}

Hi, this is Fischer. Let's go little by little. Okay. First, the new administration. What do we see is going on? Well, first, our segment associations have been talking to -- first, the candidates and now the new administration. So what is basically the general line? Our sectors of construction was much affected in previous years, and it is a very important segment for the economy for the generation of income, employment, so it is consensus that this is an activity to be preserved and encouraged more so. So, although we are having preliminary discussions, we don't see anything that would change our strategy or that would bring disturbances in terms of the worker compensation funds, Minha Casa Minha Vida program, even if it changes names. So basically we believe that the talks are of continuity and consideration. I do not see anything right now that would bring me any kind of concern. Of course, we are watching out for that, but we don't have any concerns with that regard.

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Answering your question on the fourth quarter, backward (inaudible). So first we have the difficulty in September and October, that's correct. Because of the reallocation we conducted it and now we are starting to rehire companies and individuals in the beginning of November. So the situation is coming back to normal. That will not affect our strategy for launches in the fourth quarter. All our fourth quarters are traditionally very strong. October started very well in terms of sales and launches, so we are continuing our pursuits to have the strongest fourth quarter of the year. It should be the strongest quarter of the year. And nothing changes. Even if in the end of the year we have some difficulty with spending the transfers would take place in January, so I do not see any changing strategy of our business. So launches in the fourth quarter should be very good and sales as well.

**Q - Gustavo Cambauva** {BIO 17329406 <GO>}

Okay, thank you very much. Good morning.

## Operator

Our next question comes from Andre Mazini from Citibank.

**Q - Andre Mazini** {BIO 20377100 <GO>}

Hi, everyone. Thanks for your call. My question is in your housing platform. Last year you're saying that you're going to focus on Minha Casa Minha Vida using SBPE. Looking forward, what do you think is going to be the percentage of the general sales with SBPE? And also you talked about the generation of sales, sometimes people feel that they want to be a bit more asset-like, they don't want to buy houses, but the installments of Minha Casa Minha Vida are very low, sometimes lower than rental, and this can change, and it's the best change. I know that MRV is also working in the rental market, probably not in a large percentage of your balance sheets, but what do you see like in terms of services and perks to have some more thorough solution for people that are looking for housing if the rental market makes sense?

**A - Ricardo Paixao Pinto Rodrigues** {BIO 21232785 <GO>}

Hi, this is Ricardo, Andre. Starting with the housing platform. The way we want us to be seen from now on is as a platform, a housing platform that is complete. So we have always focused on segments 2 and 3 of the market, that has always been our main focus. Four or five years ago we had the percentage of SBPE, which was about 30%. Then when we didn't have as many funds in the savings account, we started to focus on levels 2 and 3 of the program. Then the level 1.5 came out, which was interesting at that time. We have always been positioned in a very conservative way in the 1.5 segment. We know that it's immense cash, and so the Board of Directors said we could have only 20% of our product at the 1.5. The 1.5 product can also fit the Class II, because they have the quality characteristics that are demanded. So we are going to focus on lines 2 and 3 of the program, and SBPE can have up to 20% of volume and 25% of the general sales value. See that the average price is a bit above what we're talking about in the Minha Casa Minha Vida program.

Also it's important to say that we went to have an industrial donation in those areas. We don't want to have a standard low-income average with old-time constructions. We want to have industrial constructions with the same model of transfers in the plan, so that's what we want. And Rafael is going to talk about rentals.

### **A - Rafael Nazareth Menin Teixeira de Souza** {BIO 16905756 <GO>}

Hi, Andre. It is exactly what Ricardo mentioned. The company is thinking about what the market is going to be like in 10 years' time. So all investments we are making in IT, technology, systems, team, people, that eventually do cost, an additional cost in the short time, takes in consideration that the market is going to change. So we have a superstructure platform now in 150 feet [ph] in Brazil from North to South altogether with quality, very good customer relationships, offering lots of services after delivery. We are thinking of the MRV way of life.

We had some surveys among American leaders and we brought to us this idea. So in the coming quarters we are going to release information about that. But we have seen no parallel in the interest -- industry. So we are very enthusiastic about this project. And we have a prototype in the company development for rental. It's so very small. But at the right time we are going to give a bit more color about that return capital structure. It's nothing that will change the MRV model, it's quite liked in terms of capital structure, but further on, we are going to hear about that. So you know that MRV is always seeding new movements. We are always managing the company in very long cycles, trying to predict and direct to market trends. Today we are a leader in Latin America, and we are very confident that the way we are working, the strategy that we have of having this housing platform with several source of funding, housing solution, services and benefits, will position us very differently from the remainder of this sector.

### **Q - Andre Mazini** {BIO 20377100 <GO>}

Okay, thank you very much. (Foreign Language)

### **Operator**

Our next question comes from Luis Stacchini from Credit Suisse.

### **Q - Luis Stacchini** {BIO 18717891 <GO>}

Hi, good morning, everyone. Thanks for your call. I also have two questions. The first, talking about the increase you're having 600 million, you said the -- about some projects in the Northeast that were funded by the Banco do Brasil, we're thinking of completing the construction and then passing it to Caixa do Brasil. But it seems that the speed of (inaudible) is not seen to the faster cycles of construction. Is it true? Do you think that you are closing remaining inventories? I would like to know what is your strategy to reduce the limits of your inventory that is ready? I don't know, decrease the speed of construction? I would like to hear a bit about that.

And also about dividends. In your release, you talked a bit more qualitatively with the cash generation and the results. You are thinking of increasing your payouts, you have been

about -- paying about 50%. What would be the level of increase of payouts for the coming years? And do you think that will change your appetite for growth? Does it make changes in the company?

**A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}**

Hi, Luis, good morning. First about your ready inventory. It's right. The reason is construction that we funded with PV. There was a bit of restriction in credit. So these constructions are being completed, and after completed we are funding them with Caixa and other banks. So for this point in time we have an increase in ready units. It's not really any different from normal. Some developments are sold in six months, others take a bit more time. But from the point of view of an overall metrics, I would say, we are selling about 40,000, and building 40,000, and funding 40,000 units a year. So I would say that we have a very good balance. At some point in time you'll have an increase of ready units, but then they are putting to the market and absorbed, especially now that we are recovering from a very strong recession, the economy is getting a little better and that makes it easier for us to put the inventory into market.

As for dividends, well, unfortunately I do not have a number to give you. This is determination of the Board of Directors. But clearly we have shown that we are able to grow and still continue to generate cash. The reason for the company to be with gross cash that was very hard -- very high was because we are going through a period of uncertainty. If you go back 12 months ago and you will remember the discussions of -- it is something that has to be taken into consideration even to any four months behind. We are talking always about long cycles, especially financially. I think that uncertainties are being less back, and as they are then the excess cash will settle. I mean, generation of cash will be close to our profits and we are going to have a higher payout, but in due time, the Board is going to give us numbers.

**A - Ricardo Paixao Pinto Rodrigues {BIO 21232785 <GO>}**

Luis, just to add to Leo's answer -- this is Ricardo. The inventory of ready units that is going up, as you mentioned, it did go up. After it is sold and it is transferred, it becomes cash generation and that contributes to the policy of dividends that Leo was talking about.

**Q - Luis Stacchini {BIO 18717891 <GO>}**

Thank you. If you just allow me a follow-up in terms of ready units. Do you know what is the volume that you have in general sales value with Banco do Brasil?

**A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}**

I do not have the number by heart. I would have to look into it. Luis, I can get back to you with the number.

**Q - Luis Stacchini {BIO 18717891 <GO>}**

Okay, thank you very much.

**Operator**

Our next question comes from Marcelo Motta from JP Morgan. Our next question comes from Marcelo Motta from JP Morgan.

**Q - Marcelo Motta** {BIO 16438725 <GO>}

Hello, good morning, everyone. Two questions. First, if you could comment on your gross margin trend. Along the year it has been a bit more compressed. Is that a true trend? Is there anything specific for 2018? And also equity income when we are talking about the equity methods, we see it's a bit volatile. You'll have the prime MRL. So do you think that in the short term we would see it with a positive contribution? And when you have a spin-off of LOG, LOG still went up the components of those lines to be a bit less negative. So what do you think is going to happen to this line after the spin-off? Thank you.

**A - Eduardo Fischer Teixeira de Souza** {BIO 17580321 <GO>}

Hi Marcelo, this is Fischer speaking. Okay. As for gross margin. Well, basically what happened is that we have a percentage that was higher in the 1.5 segment and you'll have a lower gross margin in this segment, and you have revenues faster than the two segments. So you'll have a drop of gross margin, but a faster revenue with lower margins. To transfer the long term, and I think, Ricardo mentioned that, is that, we have a determination from the Board to limit our participation in the 1.5 segment in MRV. Where the future is not really clear about this product, perhaps we're going to have some limitations about it in the future, so we decided to be a bit more conservative in operating in the segment 1.5. So for the future, our margin is not going to change much from the 32%, 33% which is today. And as segment 2 affect more the revenues, it tends to go on. So it's not a strategic concern. I think this is an effect of the 1.5 segment.

As for the equity line, it was with a bit of isolation because of the participation of holdings of prime MRL in the Midwestern real, but we have been calling your attention for sometime now for two or three years. These companies, if you think operationally, now they are doing very well. The margins are already higher than MRV. We even mentioned that about two or three releases or calls ago. So when those margins captured up, sometimes you'll have this -- bit of an isolation -- that as a whole the result is very good. So again this is not a concern. We should have a bit of changes -- ups and downs, but not much different from what we have seen.

**Q - Marcelo Motta** {BIO 16438725 <GO>}

Okay, thank you.

**Operator**

Our next question comes from Luiz Mauricio Garcia from Bradesco.

**Q - Luiz Mauricio Garcia** {BIO 17432519 <GO>}

Good morning, everyone. I have a question about the pro-soluto dynamics, the portfolio is growing strongly if you have metrics on sales over the 18 months would be the duration of the portfolio would go from 15% to 20% in one year. So when are we going to see the

growth of the portfolio more stable? And do you think that for it to stabilize you're going to have a difference in margin or any changes in scenario?

And the second, I would just like a follow-up on the Minha Casa Minha Vida program. We continue to see a dynamics in the market with a large growth of companies that are coming into the program, new entrants, some small, some mid-sized, some large companies, and some say that the budget next year is going to end even closer or faster than this year because of so many players in the segment. What do you think the dynamics is going to be like? We don't believe that budget, for next year is going to be much higher than what it is this year. So what do you think the dynamics is going to be like with a large number of players and the same amount of money?

## **A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}**

Hi Luiz, this is Rafael speaking.

Okay. First about the pro-soluto. Well, indeed, with the company started a strategy about 1.5-year ago, we are building our portfolio, it's not what we wanted but that's life. The banks decreased LTV, so we are having a bit more of pro-soluto. But more important than that is provisioning. When you see a margin in the products sold in the month of October or September, the margin post provision is the same margin that it was 1 year, 1.5-year ago. So once again, we're investing a lot in technology, statistical analysis, so the granting of credit is quite sophisticated now. So it is not really of a concern in our portfolio. Of course, we have losses, but MRV is a company that has a bank that generated portfolio of almost 1 billion a year and we lose about 100 million. It is important that this is provisioned. Today we have 330 million plus provisions with regards to pro-soluto. A technical assistance, we have 100 million for legal provisions. So by far, we are the company with the largest provision in the segment.

I would say the most responsible and less volatile as well. When you compare to other players, sometimes you have a volatility that we don't understand. The company has been in the market for many years and sometimes the line is positive and then negative. With MRV, we work as a clock. We are always consistent. Our provision 1.5-year again was 120 million, now our provision is 350 million. So once again, if the bank financed 90%, we would have a very low portfolio, but that's what life is. The banks are also important for our operations to go on. The crucial point is to know how to grant credit, and MRV, I'm very confident. It's a company that has invested the most money and resources in technology and statistical analysis should grant credits responsibly.

As for the Minha Casa Minha Vida program, there is competition as always, perhaps today a bit more. But again, because MRV works in more than 150 cities, gives us operational flexibility. Some markets are more competitive, others have no competition at all, and MRV -- perhaps, I am being a bit proud, but I would say some of the cities we operate, we have almost zero competition. So we have an operation that is more complex, it's hard working, but it gives more flexibility.

And with regards to the program, Eduardo and Leo, they talked about the 1.5 segment. In the beginning, we had -- we took it with a grain of thought. We had initial budget of 9



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million, and then the villain with budget was the 1.5 segment, small companies, even some public companies were very aggressive to the 1.5 segment. They did not have a cap and they consumed resources faster and the discussion that is going on and the government is aware of that is that the 1.5 has to have a cap with less incentives, with less volume. So I think that it's going to be good for next year. In fact, I think that we learned this year for our budget next year to last until the end of the year. And the good thing about the current administration and the next administration, I think that it is very responsible. So this year this budget when it gets to 9 billion, no more resources as of the 15th of December, it's done. It's it. And it has to be so. In the past, it was like this. If you have a demand of 500,000 units, just let them go and then we'll solve the problem. Today we don't have this problem. So we have a much better governance. If you'll have a budget, you'll have to stick to the budget. So this year we saw a problem in the accounting and that will certainly be corrected for next year. So it is a small hiccup, we believe, and we think it was positive. The private [ph] governance, the Ministry of Cities, Caixa, Abrainc are establishing parameters for not to have a problem in the budget for next year. So again, we are very confident, very confident. MRV, we are working with SBPE. We are also having other sources of funding, and I believe we are the most protected company. Again, a bit more investments in the short-term in systems and brands, but for the long-term we are extremely comfortable, and we are going to have an operation with very little volatility, a very resilient operation, which is what we have been showing in the past 11 years. That's how I started my remarks. If you get our releases of 2007, 2008, 2009, 2010, you are going to see consistency, and that is very interesting about the company what we talked about, what we did, and we did a lot of the talk. So we are quite comfortable.

I read your report this morning and we talked a lot. I admire you as an analyst. You are very acquainted with the segment. Sometimes we have different views. You are more focused on today's picture, and Eduardo and I, we are preparing the company for the next 3-5 years. So it's natural that sometimes we have a different opinion, but you always have -- you always have very good comments. Thank you very much.

**Q - Luiz Mauricio Garcia** {BIO 17432519 <GO>}

Thank you.

**Operator**

Our next question comes from Jorel Guilloty from Morgan Stanley.

**Q - Jorel Guilloty** {BIO 18291521 <GO>}

Good morning, everyone. I have two questions. The first, cash generation was very strong in the third quarter, and also you have a strong number of launches. Do you think this was a one-off situation that you're going to go down? Or do you think you're going to stay with those level in the short and midterm? And also the new administration and Minha Casa Minha Vida, you recently said that you have no concern about the continuity of segments 2 and 3. But do you see growth in the launches of the segments?

**A - Eduardo Fischer Teixeira de Souza** {BIO 17580321 <GO>}

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Well about cash generation, the third quarter was higher than normal, I would say, higher than the profit. I think we're going to have some volatility, but because of the sale of the ready units, and because we capped, is likely lower cash generation in the first and second quarters, mostly because of the launches with Banco do Brasil, then it tends to grow. So as our long-term goal the cash generation should be the same as our profit. Quarter-on-quarter sometimes they may vary because sometimes you'll have a little higher volume of the payment of Land Bank or a bit more receiving or a bit more construction, but I do not see the cash flow much different from our profits from our income.

**Q - Jorel Guilloty** {BIO 18291521 <GO>}

And the second question about the Minha Casa Minha Vida program. Do you see growth in the segments of 2 and 3 in terms of financed launches, or do you think it's going to be flat?

**A - Leonardo Guimaraes Correa** {BIO 15387486 <GO>}

The worker's compensation fund has a five-year budget. So in terms of volume financed, I think it's going to be according to budget. It is a number that is very close to the number of 2018. I think that the constraint as Rafael mentioned is going to be with regards to subsidies. We know that the administration is in a more delicate tech situation. All discussions are to decrease our deficit. And because inside the fund (inaudible) with the low interest rates, we don't have much room for that. So the volume of the subsidies, especially for segment 1.5 is going to be lower. This is just a matter of doing the math.

Now because the company has always had to reveal that all products, all segments that consume too much subsidy have much higher volatility because you depend on the government's budget and things not always develop as you expect. So we prefer to focus on my -- more market, I would say, segments, because the cycle is long, we are planning for launches in two, three years' time. I preferred to focus on those more self-sustainable market segment. But again, going back to your question, the financed volume is going to be very close to what we have in 2018, because of the capacity of the fund, and because it is a five-year budget.

**Q - Jorel Guilloty** {BIO 18291521 <GO>}

Okay, thank you very much.

**Operator**

(Operator Instructions) Ladies and gentlemen, we are now closing the Q&A session. We are going to turn the call back for the company's CEO for his final remarks.

**A - Eduardo Fischer Teixeira de Souza** {BIO 17580321 <GO>}

Well, once again we would like to thank you very much for attending. And the final message is just to summarize everything we've mentioned in our release and in this call. We are looking into 2019-2020 with optimism. What we created in 2018 was an even broader housing platform, and we are going to turn the year already starting with our

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SBPE plan. With savings, with records of capitalization and lower rates, I think that we have in hands a huge potential. I'm very optimistic we are going to be able to add a product to our portfolio that will be quite representative in the coming years. As Ricardo [ph] said, we are bringing industrial technologies for construction and apartments that are financed by the savings account with very interesting partnership with banks for the financing in the plan, so we are looking into MRV for '19-'20 very optimistically in terms of growth. Leo, in the final question was talking about the workers compensation funds. We believe there is still to be captured in terms of market share, especially from the small ones, the formal ones that will eventually come to the formal side, and in my mind, we have huge potential to capture value with this new platform of savings in the large cities of Brazil. So as Rafael mentioned, we are looking in the next three, four, five years and we're building MRV of the future. And in this room we see margins of growth coming from those lines. So I think this is to be monitored in the future quarters along 2019. That will bring lots of value to us. So that's it.

Thank you very much and best regards.

## Operator

MRV Engenharia conference call is now closed. We thank you very much for attending and wish you a very good day.

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