

Q2 2021 Earnings Call

Company Participants

- Antonio Garcia, Chief Financial Officer and Investor Relations Officer
- Eduardo Couto, Director of Investor Relations
- Francisco Gomes Neto, President, Chief Executive Officer

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the ESG flight plan event in Embraer Second Quarter 2021 Financial Results. Thank you for standing by. I'm Felipe Colsada [ph], and I'll be your host for today. At this time, all participants will watch our financial results presentation. Right after, we will conduct a question-and-answer session and instructions to participate will be given at that time. (Operator Instructions). As a reminder, this presentation is being recorded and webcasted at Reuters platform.

Before we begin, just a legal statement. This conference call includes forward-looking statements or statements about events or circumstances, which have not occurred. Embraer has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance. These forward-looking statements are subject to risks, uncertainties and assumptions, including among other things, general economic, political and business conditions in Brazil and in other markets where the company is present. The words believes, may, will, estimates continues, anticipates, intends, expects and similar words are intended to identify those forward-looking statements. Embraer undertakes no obligations to update publicly or revise any forward-looking statement because of new information, future events or other factors.

In light of these risks and uncertainties, the forward-looking events and circumstances discussed on this conference call might not occur and the company's actual results could differ substantially from those anticipated in the forward-looking statements. Participants on today's conference our Francisco Gomes Neto, President and CEO; Antonio Carlos Garcia, Chief Financial Officer in Procurement; and Eduardo Couto, Director of Investor Relations.

And now I would like to turn the conference over to Francisco Gomes Neto. Please go ahead, Francisco.

Francisco Gomes Neto {BIO 19328044 <GO>}

Thank you, Felipe. Good morning to all and thank you for joining our call today. I hope that all of you are well and safe and thank you for your interest in our company. As you will see

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in Antonio's presentation our results for the quarter were strong. The Q2 results are a clear example that our strategic planning has been well executed with the right focus and discipline showing significant improvement in our financial performance.

Before we go into more details regarding the Q2 results, I'd like to highlight the good momentum, we are going in the different business segments. In Commercial Aviation we announced a new firm order for third E195-E2 jets from the Canadian Porter Airlines with the purchase rights for 50 more aircraft. We also announced new firm orders for 34 E175 jets to Horizon Air and SkyWest to be operated for Alaska Airlines and Delta Airlines. This new orders and order activity campaigns reiterates the continuous interest in the E-Jet family as the best option in the regional aviation market. In Executive Aviation, we keep up the momentum with the record sales in the quarter. We maintained our price discipline strategy and had a strong backlog growth with book-to-bill in excess of 2 to 1 for this business.

In Defense and Security, we delivered 7 Super Tucano aircraft in the first half of the year, although we had strong performance in our cyber-security and systems integration companies with double-digit revenue growth in the first half of this year compared to the first half of last year. Further in the second quarter, the KC-390 Millennium reached an important milestone by successfully performing on paved runway tests. Although we are currently in negotiations with the Brazilian Air Force on the KC-390 Millennium contract, we continuing to be focused on the new export sales campaigns for this aircraft as well as the Super Tucano.

In Services and Support, we are pleased with the strong second-quarter results with better revenues and higher margins as traffic recovery and the strong maintenance activity drove 55% revenue growth in the second quarter. It is exciting to see the continued positive sales activity in services with new signed with several important customers across all markets at (inaudible), driving backlog expansion for this segment during the period. This was further highlighted by the contract we signed with Porter Airlines for a 20-year total support program. With respect to innovation, we continue to make progress on partnerships in the Urban Air Mobility ecosystem through our subsidiary, if in a segment with strong growth potential in the years to come. In addition, our services collaborative platform Beacon signed agreements with key customers such as Republic for its maintenance applications.

Finally, on the Operations front, we continue to see great improvements. We expect a 16% increase in inventory returns compared to 2020 and a 20% reduction in production cycle time of our aircraft this year positively impacting working capital and production costs.

I will now hand it over to Antonio Garcia, our CFO to give further details on the financial results and I will return in the end. Thank you.

Antonio Garcia {BIO 21338149 <GO>}

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Thank you, Francisco. And good morning everyone. I will start with our backlog for the quarter. On Slide 7, the graph shows we ended the second quarter at \$59 billion, up \$1.7 billion or 12% from the prior quarter. This represents a return to the same \$15.9 billion we were at in 2020 before the pandemic begin.

In our Commercial Aviation business, we closed 48 aircraft sales in the quarter, spread across several different airlines. In Executive Aviation, we had a record second-quarter sales, our solid backlog in demand for light and larger business jets continue to grow. The backlog in service and support and Defense and Security also grew from the prior quarter's level. In summary, it was the best sales quarter since mid 2019. This give us confidence in our plans for future revenue growth and improvements.

Moving to Slide 8 you can see the continuous improvement in aircraft deliveries compare last year in both Commercial Aviation Executive Aviation. In Commercial Aviation, we delivered 14 aircraft in the quarter. This represents a 56% increase compared to the prior quarter and 250% increase compared to the second quarter in 2020. Year-to-date delivers, we were at 23, almost 2.5 times higher than the same period in the prior year. Of these 23 delivers, 14 were E2s, compared to 4 E2 in the same period last year. Sales continue to perform very well for the E2 as the most efficient right side of the single-aisle aircraft for the world post-pandemic.

In Executive Aviation, we delivered 12 jets -- light jets and 8 larger jets, for a total of 20 aircraft in the second quarter. This represents 54% increase compared to both first quarter 2021 and the second quarter of the prior year. Year-to-date delivered -- Executive Aviation delivered 33 aircrafts, a 50% increase compared to the first half of 2020. As noted in the guideline, the guidance 2021, we published this morning, we expect deliveries of commercial jets to reach between 45 to 50 aircraft and executive jets to reach between 90 to 95 aircrafts.

On the Slide 9, we show Embraer's net revenue. Embraer had solid revenue growth in the quarter as all for business units, so we bounced stronger from the pandemic. Our topline more than doubled compared to the second quarter of last year. Growth came primarily from higher deliveries in Commercial Aviation, although all our segments showed much-improved growth during the quarter. Year-to-date net revenue was just under \$2 billion, \$767 million or 65% increase over 2020. Net revenue breakdown by business show Embraer diversification with Commercial Aviation, representing 34% of the total revenues; Service and Support 28%; Executive Aviation 22% and Defense 16%. It's important to highlight the stronger recovery in Commercial Aviation as this business was severely impacted by the pandemic last year.

On Slide 10, SG&A expenses reduction continues to trend very favorably over the last six quarters. We were many highly focused on the SG&A efficiencies that are being implemented since the company's restructuring last year. Although the second quarter had a slight increase in SG&A, this was primarily driven by increase in provision for profit sharing and performance basis incentives program due to better expected results for the company 2021 as compared to 2020. Combined with the consolidation of expenses from Tempest, our new cyber-security company acquired in the end of 2020.

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Selling expenses remain at historical low levels compared to the prior quarter. Selling expenses increased 4%, while net revenue increased over 40% sequentially. As a percentage of net revenue, selling expenses was 4.2% in the second quarter compared to 5.7% in the first quarter. We achieved these results by leveraging our sales activity as volume increase, combined with a more cost-efficiency digital sales effort.

Slide 11 shows our adjusted EBIT and adjusted EBITDA. We are very encouraged by the strong margin performance across all business segments in the second quarter. Our adjusted EBIT margin was 9.3% up 13 percentage points over the first quarter. Our adjusted EBITDA margin was in double-digits at 14% or up over 16 percentage points from the first quarter. Both of these profitability metrics have recovered to the levels not seen before 2020. For the first half of 2021, our adjusted EBITDA margin was 3.9% and our adjusted EBITDA margin was 9.2% both well above prior year's level. This improvement comes from several factors including higher deliveries, resulting higher revenue, better gross margin on improved pricing mix, production efficiency, fixed cost leverage on higher volumes and favorable tax obligation reversal of this quarter of approximately \$25 million.

All of our segments have much better performance in the second quarter. Adjusted EBIT margin by segment in the second quarter were as follows: Commercial Aviation was at 1.7% negative, which although negative shows a great improvement from last year. Executive Aviation was at positive 8% with a strong price discipline and consistent profitability. Defense and Security was at positive 25% led by Super Tucano deliveries along with positive adjustments on certain defense contracts. And Service and Support was at 19% as a strong contribution from the spare parts programs.

Slide 12 shows our adjusted net income, it was positive \$44million or \$0.24 per ADS in the second quarter. These represents the first net profit on a quarterly basis since 2018. The recovering adjusted net income is primarily driven by improved operating margins, reductions in financial leverage also contributed to improved profitability and any future debt reduction would naturally have any additional positive impact on earnings.

Moving to Slide 13, I'd like to begin with free cash flow. Free-cash flow in the second quarter was positive at \$45 million, \$272 million higher than the first quarter and \$517 million higher than the same period of last year. This is a remarkable achievement. Although year-to-date, the cash flow is negative at \$181 million, this is compare with our free cash flow burn off around \$1 billion of the first half of 2020. We expect positive free cash flow for the second half of the year 2021 as indicated in this morning guidance.

Now to investments, our total investments were \$50 million in the second quarter and \$89 million year-to-date, both of which are in line with last year levels. This is important because it shows, we continue to invest in our future. We have been very judicious in balancing the need to invest in our future with the need to preserve cash.

Slide 14 shows our cash and liquidity position. We ended the quarter with \$2.49 billion cash and cash equivalents, a slight increase from the end of the first quarter. Our debt balance was at \$4.3 billion, a slight decrease from three months ago. Our average debt maturity remains at four years. We expect to continue to generate cash in the second half of 2021

and beyond so our leverage we will naturally decrease. This will correspondingly reduce our net interest expense and have an additional positive impact on our income.

Finally moving to Slide 16. Embraer has published 2021 financial delivers guidance for the first time since with the start of the pandemic. Despite risks of the economic recovery, vaccination rates around the world and with a solid first half and good visibility for the remainder of the year, we decided to share the marked our targets for 2021.

We expect to deliver between 54 to 50 commercial jets, just to correct 45 to 50 Commercial aircraft in 2021, and 90 to 95 Executive jets in the year. We have good confidence in those figures at our Skyline are already filled for both segments. Combined with the growth in Defense and Security and continued recovering Services and Support trough recovered globally, we expect consolidated revenues to be between \$4 billion to \$4.5 billion this year, represent a low double-digits growth at the midpoint compared to the last year. Adjusted EBIT margin should be in the range of 3% to 4% and adjusted EBITDA for 2021 should be between 8.5% to 9.5%.

Embraer had in the first half of 2020 margined in these ranges, as we expect this good margins to repeat in the second half of the year. It's important to mention that those margins include cost related to the reintegration of Commercial Aviation as well as expenses related to the arbitration process. Finally, our free cash flow guide is a range from free cash flow usage \$150 million to a breakeven for 2021. We had turned that to \$181 million of free cash flow usage in the first half of the year. So we are anticipating Embraer to generate up to \$180 million cash in the second half of 2021 without any cash inflows from M&A projects.

With that, I conclude my presentation and hand it back over to Francisco for his final remarks. Thank you very much.

Francisco Gomes Neto {BIO 19328044 <GO>}

Thanks, Antonio. The second-quarter results and the guidance for the year reinforce our confidence in our strategy. And this confidence motivates us to accelerate the performance improvements and the delivery of our long-term strategic plan with focus and discipline. As I had mentioned in the past, this year is one of recovery and next year and beyond, we plan to capture Embraer's full potential to grow with profitability.

Looking ahead, we foresee in the medium-term the potential to double the size of the company and that doesn't include new strategic projects. We are going to be bigger and stronger, focusing not only on the topline but also much higher profitability. We are already showing some positive results of the hard work our united and motivated teams of employees have done over the past several months. With the expectation for positive operating profit this year and much better, free cash flow performance with a clear potential to breakeven for the year. This will be supplemented by partnerships and new programs to drive even higher growth opportunities. We are also advancing on our ESG journey. And right after the Q&A session, we will share with you our new ESG

commitments. I invited everyone is therefore to remain online for these ESG events, which we will start just after the results Q&A.

Also, we are looking forward to a new chapter of Embraer with our extraordinary shareholder meeting scheduled for next Monday. We expect our shareholders to approve the election of two international Board members with extensive global aerospace industry experience. Following constructive feedback from analysts and shareholders to improve our corporate governance. These candidates have deep technical knowledge, strategic profiles and an innovative thought process. Finally, I will close today by thanking everyone for the strong quarter. It always starts with our people and their focus and passion on executing our strategic planning. As I mentioned to you in the last earnings call, we are a different company today. We are in a process of transformation and we are moving fast.

Thank you for your interest and confidence in our company. Over to you, Felipe.

Questions And Answers

Operator

Thank you very much, Francisco. And before we continue, we'd like to show your video check this out. (Video Presentation).

And now, let's move on to our question-and-answer session. We are preparing the sat here and remember that questions can only be sent through the Reuters platform. Eduardo Couto will be our moderator and he already had some questions with him. Eduardo, over to you.

A - Eduardo Couto {BIO 18009973 <GO>}

Thanks, Felipe. We start now the Q&A. So let me see the questions that we have. First question we have is, can you give an update on this pack in negotiations with Eve? I don't know, Francisco or Antonio, who wants to take that.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Yes, thank you, Edu. Thanks for the question. I mean at this point of time, we can say that the negotiation is moving very well. I would say. We are very optimistic with this process.

A - Eduardo Couto {BIO 18009973 <GO>}

Okay. Moving on the questions. Second question we have, what work has Embraer being doing to develop electric aircraft in making this product more viable for customers?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Thank you. Also a good question. Well, we had our first technical flight recently with ipanema, full electric and we hope to present these aircraft to the public soon. And we are continuing to invest in this electrification field as a one-off the innovation fronts that we have, I mean, to be in line with the ESG activities that we are moving fast in Embraer.

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A - Eduardo Couto {BIO 18009973 <GO>}

Great. Third question we have from investors is from Victor Mizusaki from Bradesco. He said Defense showed a material gross margin expansion in the second quarter, can you give more details about that? Antonio?

A - Antonio Garcia {BIO 21338149 <GO>}

Victor, thanks for the question. We had in the second quarter two main effects on the Defense side. First one, was the Super Tucano delivery that we were not able to deliver in Q1 that flows to the Q2 figures. In addition to it, we have the adjustments. In the defense contract, we have in the local currency in Brazil, where I would say both effect, higher deliveries in Super Tucano and I just meant that the contracts lead us to this 25% margin in Q2.

A - Eduardo Couto {BIO 18009973 <GO>}

Okay, very good. Next question comes from UBS. Could you comment on the \$25 million reversal mentioned in the press release? Also what was the positive cost base revision related on the results?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

So thanks for the question. First point, we built up a provision in 2018 for the Brazilian guys here (foreign language) that we have a claim, discuss -- being discussed since 2018 and we were able to gain this claim in the second quarter, that's why we reversed this tax position that was also read adjusted in 2018, that's why we're also considering in our results.

And the second question was in regards to the contracts, we have an adjustment here around \$8 million in the second quarter that were both effects. It's important also to mention that even that we have this tax reversal, \$25 million let's put first quarter and the second quarter, we do have other types of course that we are not adjusting that's also not, I would say for example reintegration of Commercial Aviation and arbitration costs, which is more or less net, this \$25 million, I would say. The numbers we are seeing right now I'd say let see combined Q1 and Q2 is really -- for me describe the real performance of the company.

A - Eduardo Couto {BIO 18009973 <GO>}

We have several questions about EVE, I'll try to summarize them. So basically any general updates on your eVTOL initiatives would be very helpful, particularly on negotiations with Zanite. We are ready talked a little bit, but maybe an update of the eVTOL, Francisco, Antonio?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Yeah, well, we -- as I said, we are very excited with this initiative, with this product. I mean we -- we had the first flight with the prototype (inaudible) 123, a successful test, by the way. Now, we are preparing the next test with the prototype (inaudible) 121 and technically

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it's moving very well. We are planning the certification by 2025 and entering service in 2026. And about the negotiation with Zanite I mentioned already, that's moving very well.

A - Eduardo Couto {BIO 18009973 <GO>}

Okay, very good. Now moving to Business jets. We have a question from Credit Suisse. Business jet has been very strong and on the first quarter results you mentioned half of the deliveries were first-time buyers in the second quarter, how much were first-time buyers? Maybe we can give an overview of the Business jet market as well?

A - Antonio Garcia {BIO 21338149 <GO>}

I can do it. I'd say -- today in or backlog, the portion of first-time buyers, I would say is a third -- something like 30% in your backlog and deliver for the whole year, we are talking about 30% first-time buyers. And we are going with the market, if you see the industry, book-to-bill between 1 to 5 to 2 to 1 (inaudible) 1 to 2 and we are, I would say a little bit above that and it's doing very well, but for sure the first buyers pushing also the market especially in the light jets category.

A - Eduardo Couto {BIO 18009973 <GO>}

Now there is a question on Commercial from Credit Suisse. Your guidance for commercial deliveries of 45 to 50 seems low given your -- you have already delivered 23 jets. Are there any supply chain issues that could prevent you from being above that range? Also they're asking what do you see in terms of deliveries for 2022, any color on that?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

See, let's take into account that Commercial is still suffering from the pandemic. What we are giving as a guidance to deliver this year is that a little bit higher to last year. Last year we delivered 44 and for sure, we are selling more, but is going to impact more 2022 and the fact that we deliver at the 23 aircrafts is because it's well divided throughout the year. That's why the 47, I would say 45 to 50 is the number we are having and we do see, I would say around 30% for next year, between 65 to 70 aircraft, which has to be confirmed, but is more or less the number you are seeing. It's important to mention, we do see Commercial Aviation coming back to historical levels at Embraer from 2023 onwards. We are selling more, but their sales counter we are closing right now is going to fulfill this timeline starting 2022 and 2021 is more or less the same level from 2020.

A - Antonio Garcia {BIO 21338149 <GO>}

If you allow me, I would like to make a link between this answer and the result of the company. It is true that in this first half of the year comparing to the first half of last year, we did much better in terms of deliveries, in terms of results. The numbers speak by themselves, but if you look at the guidance for the entire year, you see that -- as planned, we won't see a huge increase in volumes in the Commercial or Executive. Yes, we are seeing some growth -- moderate growth this year compared to the last year, but the improvements in their results, I mean, either the EBIT coming from almost a minus 3% last year to something between 3% and 4% of this year or the free cash flow for minus \$900 million last year to something between minus \$150 million and zero this year, all this good performance is coming from efficiency gains, fuel efficiency gains. We really did a good

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rightsizing the organization. We are improving. I mean a lot of activities on cost reduction, on inventory reduction in all the company. You know, I mean, pushing the sales for the future. So again I mean for next year on, we expect that with stronger growth in the volumes -- in all the business units and with this more efficient and agile company there you see a much better performance. So that's why our result is coming from this year from efficiency gains from some additional sales, of course, but mainly from efficiency gains.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Just completing the question from supply chain issues, what we are putting in the guidance, what we agreed with our customer for this year, at least for the Commercial Aviation, we have not seen any supplier chain, I would say promise this year.

A - Eduardo Couto {BIO 18009973 <GO>}

We have several other questions. So the next one is related to margins and free cash flow. So the question is how do we see margins per business in the long term and what sort of free cash flow conversion EBITDA into free cash flow conversion does Embraer expect?

A - Antonio Garcia {BIO 21338149 <GO>}

So I -- in regards to margin, we did see -- in a long-term perspective, we do see services supported double digit as it is today. We do see Executive in this sense, single higher digit area, we are more or less also today. And we do see the the Commercial Aviation, I would say mid single-digit cross between 3% to 5% in the long term. That's what we see in regards to profitability for the company. And in regards to the cash, the conversion from EBIT to EBITDA would prefer to talk, we are seeing today, a 50% conversion from EBIT to cash flow. We still need to improve something, but is more or less the math, which I'm using internally with this in the long run 50% of their EBIT being converted into cash for the years to come.

A - Eduardo Couto {BIO 18009973 <GO>}

So the next question is from JP Morgan, Marcelo Motta. Any update on the sales campaigns for Commercial Aviation? Could we see more orders during the second quarter?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Good question. Yes, we have a lot of active sales campaigns ongoing in our Commercial Aviation. We just announced for this sales for Skywest with 16 aircrafts and yes, we have more to come.

A - Antonio Garcia {BIO 21338149 <GO>}

By the way, the Skywest is not part of the backlog in Q2. We are going to book these 17 aircrafts in Q3.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

17 aircrafts, correct. Thank you. Antonio.

A - Eduardo Couto {BIO 18009973 <GO>}

There is a question here from Lucas from Santander. Talking about inflation, can you please comment on how the company is seeing the raw material inflation and how is the company offsetting these impacts?

A - Antonio Garcia {BIO 21338149 <GO>}

I would say we do see in our final projects, inflation, I would say all index we have with our suppliers between 2% to 3% for next year and to the customer side, we have also the -- the real adjustment clause with the index I would say -- our takeaway for next year is a balance between what we have internal inflation and the pass through to the customer base.

It's more or less what we are seeing, but there is some indicators spike in inflation indexed for next year, that we are going to discuss for our customer base. Moreover, we do have -- we did this year and we are doing this year and with that we do have also a lot of design to well activity inside Embraer to reduce the base of the costs we have today without any impact from any inflation or indicators.

A - Eduardo Couto {BIO 18009973 <GO>}

Very good. So now moving to new projects, there is a question from (inaudible). Any update on the partnerships for the Turboprop aircraft?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

That was a question. Well, this front is also moving very well, especially with the most -- with the recent interest of US Airlines in that product. So we see that product as a good alternative for that market and other markets as well and also as a preparation for new technology in the future. So we are very optimistic and working hard to accelerate this partnership front.

A - Eduardo Couto {BIO 18009973 <GO>}

Okay. I think we have at least one final question, it's back to Commercial Aviation. What do you expect -- it's from WTS. What do you expect in the mid to long term in Commercial Aviation as we are seeing recovering demand for flights and also renewal for having more sustainable fleets?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Good question, thank you. So again, we have no -- I mean globally 94% of the Embraer fleet back in the skies. In the US I mean 97% of the Embraer fleet is flying again. So it shows that the recovery in the domestic market really is coming and that's why we are working in very, very -- a lot of sales campaigns in that segments for E1s and E2s as well.

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So we are working hard to take advantage of this moment. As Antonio mentioned that we see volumes growing in 2020, but strongly from 2022, but strongly from 2023 onwards.

A - Eduardo Couto {BIO 18009973 <GO>}

I think a final question, it's related to Defense. Can you please comment on the expectations for new KC-390 orders?

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Well, as I said in the opening, we are working in many sales campaigns for -- for important sales campaigns for the KC-390. And also, I mean we are working to develop partnerships that will help us to open new markets for that great aircraft.

A - Eduardo Couto {BIO 18009973 <GO>}

I think that's what we had on the Q&A. So I think that concludes the Q&A. I want to thank you all for the questions and the time. So now Antonio or Francisco any comment? Thank you all.

A - Antonio Garcia {BIO 21338149 <GO>}

Yeah, thanks a lot.

A - Francisco Gomes Neto {BIO 19328044 <GO>}

Thanks a lot. So thanks for your interest and support in our company. We are living in really a special moment. As I said before, this year is the year of recovery, the year of turnaround and for Embraer. And in the numbers, as I said before they speak by themselves. We expect to have a much better year in 2021 compared to the last year, coming from a very tough crisis as you know and we hope to -- we expect to capture the new Embraer potential from -- to grow from 2022 onwards. So thank you very much for your support. Thank you.

Operator

So this concludes today's Q&A session, that in turn concludes Embraer's second quarter 2021 financial results presentation. Thank you very much for your participation.

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