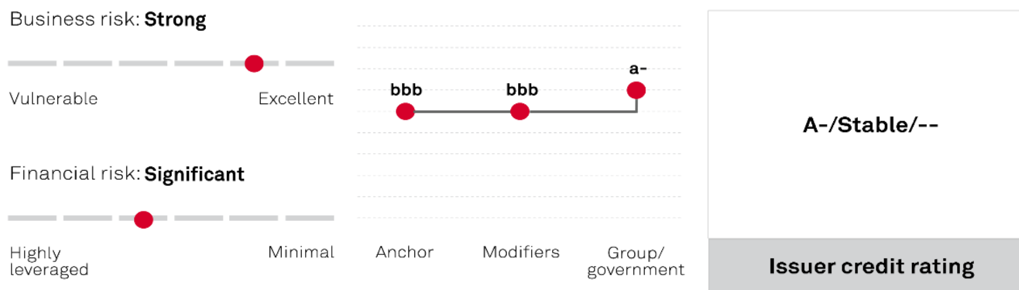
CEZ a.s.

August 9, 2024

Ratings Score Snapshot



Primary contact

Renata Gottliebova
Dublin
00353-1-5680608
renata.gottliebova
@spglobal.com

Secondary contact

Per Karlsson
Stockholm
46-84-40-5927
per.karlsson
@spglobal.com

Contributor

Maria Hjukstrom
Stockholm
46-8-501-559-44
maria.hjukstrom
@spglobal.com

Credit Highlights

Overview

Key strengths	Key risks
Sizable contribution from regulated activities following pending acquisition of Czech Gas Networks Investments S.a.r.l. (CGNI).	Higher lignite and gas exposure leads to substantial effects from carbon prices and carbon dioxide (CO2) allowances and exposes the group to larger transition risk to reach net zero emissions.
Low-cost generation fleet, with about 59% from nuclear, and 34% from coal and natural gas fired generation.	Only about 6% of generation from renewables, lower than peers.
Strong link with the Czech government, its 70% owner; important for implementing the state's policies.	Limited geographic diversification with EBITDA almost entirely generated in the Czech Republic.

With a preferred supplier now chosen and state support model in place, CEZ is moving forward with commissioning of new nuclear power generation. In July 2024, the Czech government announced Korea Hydro & Nuclear Power Co. Ltd. (KHNP) as the preferred supplier for the two new nuclear reactors to be built at CEZ's Dukovany site, which already houses four reactors with a combined capacity of 2,040 megawatts (MW). The two planned units would add up to 1,050 MW each of new capacity and the first reactor is to be completed by 2036. As part of the agreement with KHNP, the Czech government also included an option to have the supplier construct two more reactors at CEZ's second nuclear power plant in Temelín, with the option stretching for five years.

The risk associated with CEZ's construction of new nuclear units has been an uncertain factor in recent years, as the European Commission (EC) launched an investigation in 2022 into the appropriateness and proportionality of the proposed state support from the Czech government. In April 2024 the EC approved the government's proposed support scheme for the first reactor to be built. In our view, the proposed support from the government removes construction, offtake, and financial risks for CEZ. The support structure includes CEZ supplying power from the new unit to the state under a contract for difference arrangement, including a claw-back mechanism to ensure any additional gains are shared with the state. We also understand that CEZ could sell the plant to the state and receive compensation for costs incurred during the first stage if no agreements to proceed are achieved. Also, the EC has approved support for only one unit; support for the second is yet to be approved. In terms of financing framework, the government set up a commission (consisting of representatives of the finance and industry ministries as well as CEZ) to devise the financing framework for two units. The group is also in the preparatory stage for small modular nuclear reactor (SMR) construction with plans for the first SMR to be commissioned before the new large-scale unit at the Dukovany site.

CEZ shows commitment to decarbonization in its 2030 strategic plan with the announced divestment of Polish coal-fired assets. The divestment includes two combined heat and power plants with a combined capacity of 568 MW as well as two other subsidiaries. This aligns with CEZ's target to reduce its share of coal-generated electricity to 25% by 2025 and 12.5% by 2030 and is a step on the company's road to reaching net zero emissions by 2040. This strategy has in recent years led management to exit markets like Romania and Bulgaria, and partially exit Turkiye.

CEZ remains exposed to carbon price risk. It is pursuing a strategy of reduction in emission intensity but remains far above the EU Taxonomy threshold of 100 gCO2e/kWh, a measure of carbon intensity of greenhouse gas emissions associated with producing and consuming a transportation fuel, measured in grams of carbon dioxide equivalent per kilowatt hour (kWh). The company went from a company-reported intensity of around 380 gCO2e/kWh in 2019 to 270 gCO2e/kWh in 2023. In June 2024 the company issued a €750 million sustainability-linked bond, the second issuance under its sustainability linked financing framework since it was established in 2022. In September 2023 CEZ had its net-zero targets validated by the Science Based Targets initiative (SBTi).

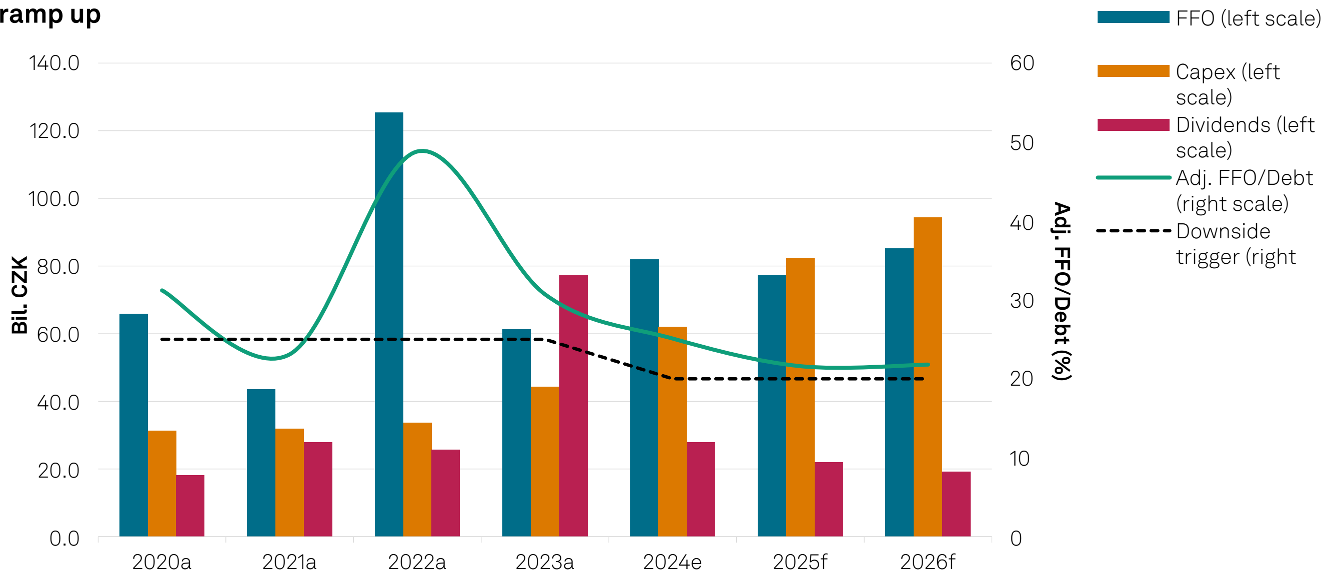
CEZ's integrated business model continues to underpin the strong business risk profile, supported by the recent acquisition of CGNI's regulated operations. The company owns the largest Czech electricity distribution network and after the closure of the acquisition of CGNI, expected in the third quarter of 2024, it will also have a majority stake in the country's largest gas distribution network. We assess the Czech regulatory framework for both electricity and gas distribution as strong. These activities provide the group with a favorable remuneration scheme, highly stable earnings, and minimal exposure to volume and inflation risk. Following the group's sale of its regulated assets in Romania and Bulgaria in 2021, and the subsequent high power price environment, the share of unregulated earnings has risen to around 85% of EBITDA in 2022-2023, up from 70% in 2021. Based on our current power price assumptions and the addition of €415 million–€450 million of additional regulated EBITDA annually from CGNI, we expect a return to the historical earnings mix with slightly less than 70% of CEZ's EBITDA to stem from unregulated activities in future. This supports the company's business risk profile because meaningful contributions from the stable gas and power distribution operations will continue to support cash flow.

Dividend payment for 2024 was approved at Czech koruna (CZK) 28 billion, in line with CEZ's dividend policy of 60%-80% of adjusted net income. This comes after several years of fairly aggressive dividend payments, exceeding 100% in 2020-2022. As leverage will increase through the acquisition of CGNI and because of continued investments, we see a reduction in the headroom in CEZ's credit metrics for the current rating. We understand that management will keep dividend payouts within the policy range over 2025-2026 as well as a mitigating measure.

We forecast that funds from operations (FFO) to debt will remain in the 20%-23% range after 2025, down from around 25% in 2024. CEZ posted strong results in 2023, with adjusted EBITDA reaching around CZK128 billion (about €5.4 billion), slightly down from CZK135 billion in 2022. With the gradual normalization of power prices, we forecast that EBITDA will follow the same trend over 2024-2026, declining to CZK120 billion-CZK130 billion in 2024 and CZK115 billion-CZK120 billion in 2025 (S&P Global Ratings-adjusted EBITDA includes CGNI's contribution despite final pending approval by EC). Furthermore, the Czech government's measures to tax generation revenue above the price caps and impose windfall taxes, which remain in place until 2025, will continue to affect CEZ's profitability. On Aug. 8, CEZ reported first-half results with reported EBITDA reaching CZK69.2 billion, up 11% from the same period in 2023. The company also raised its guidance for 2024 to CZK118 billion-CZK122 billion from CZK115 billion-CZK120 billion previously notably due to higher profits from commodity trading, lower deviation costs for customer consumption, and higher deployment of coal-power plants. Despite the revised guidance, S&P Global Ratings' base-case scenario is unchanged.

At the same time, we forecast that CEZ's net debt will gradually increase year on year, as investments increases. The acquisition of the 55.21% stake in CGNI will be fully debt-financed through a €840 million two-year loan agreement signed in March 2024 with a syndicate of seven commercial banks. Following the acquisition, we forecast that net debt will increase to around CZK320 billion-CZK330 billion in 2024 and then remain around CZK360 billion-CZK390 billion over 2025-2026. We forecast that capital expenditure (capex) will ramp up to around CZK60 billion in 2024 and CZK80 billion-CZK95 billion in 2025-2026, from around CZK46 billion in 2023, in line with its VISION 2030 strategic plan. CZK will direct most of this capex toward renewables and its regulated distribution networks.

Credit ratios are expected to remain above the rating threshold as investments ramp up



a--Actuals; e--Estimated; f--Forecasted; CZK--Czech koruna; FFO--Funds from Operations;
Source: S&P Global Ratings.

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Potential extraordinary backing from the Czech government continues to support the rating. In our view, CEZ benefits from potential moderately high extraordinary support from the Czech government given the company's importance in the implementation of the state's policies and strong link to the government. We expect the Czech government will continue to own about 70% of the company. Our view is further underpinned by CEZ's position as the dominant Czech power generator and the power distributor.

Outlook

The stable outlook indicates our view that although CEZ should post strong credit metrics over 2024-2025 thanks to the acquisition and strong power prices, we expect its FFO to debt to soften and remain between 19% and 23% thereafter. We consider FFO to debt of about 20% to be commensurate with CEZ's 'bbb' stand-alone credit profile (SACP) following the acquisition. In the medium term, we expect more than one-third of CEZ's EBITDA to come from regulated grids. We have not changed our view that there is a moderately high likelihood that the government of the Czech Republic would offer CEZ extraordinary support in case of need. This provides two notches of uplift to the SACP.

Downside scenario

We could lower the ratings on CEZ if we revised its SACP downward by one notch or more. This could stem from:

- FFO to debt falling below 20% without a clear path to recovery. This could be a result of unplanned outages causing a fall in generated output, or power prices decreasing significantly beyond our base case;
- The regulated grid business' contribution falling below one-third of total EBITDA for an extended period; and

- Increased political risk depressing CEZ's financial metrics, and leading, for example, to a largely negative ratio of discretionary cash flow (DCF) to debt. This could occur if the government of the Czech Republic extracts more cash from power utilities than we anticipate in our base case, by increasing dividends or imposing windfall taxes.

Upside scenario

We see limited upside potential for the ratings. An upgrade would require either a substantial, two-notch, upward revision of CEZ's SACP, a higher assessment of the likelihood of extraordinary government support, or an upgrade of the Czech Republic. That said, we could raise the SACP by one notch if CEZ's FFO to debt remains sustainably above 25% and its DCF to debt is less negative, alongside a supportive financial policy. A one-notch upward revision of the SACP would not trigger an upgrade, all else being equal.

Our Base-Case Scenario

Assumptions

Under our 2024-2026 base-case scenario, we assume:

- Real GDP growth in the Czech Republic of 1.3% in 2024, 2.5% in 2025, and 2.3% in 2026.
- The acquisition of 55.21% of CGNI for around €847 million, fully financed with debt.
- No significant changes to the regulatory framework for distribution companies, although the current regulatory period will end in 2025.

Generation

- In 2024, total electricity supply from production in the Czech Republic of 41-42 terawatt hours (TWh).
- Hedging of 71% of prices in 2024 (€120/MWh), 40% in 2026 (€97/MWh), 15% in 2026 (€80/MWh), and 3% in 2028 (€72/MWh).
- S&P Global Ratings' power price assumptions for Germany (Czech power prices remain linked to those in Germany, with price differences of €1-€3/MWh from 2025): €98.1/MWh in 2024, €86.1/MWh in 2025, €79.2/MWh in 2026, €74.4/MWh in 2027, and €66.8/MWh in 2028 for the unhedged volumes.
- CO_2 costs averaging around €79 per ton for 2024, €82 per ton for 2025, and €84 per ton for 2026.

Networks

- A pre-tax weighted-average cost of capital fixed at 6.54% for electricity distribution and 6.43% for gas distribution for the whole regulatory period until 2025.
- Our expectation that investments in the Czech distribution network will rise and remain at an increased level of about CZK18 billion. This compares with CZK8 billion in 2016, CZK11 billion in 2019, and CZK15 billion in 2022.
- A higher regulatory asset base, depreciation, and amortization affecting EBITDA.

Sales and energy service companies

- EBITDA from electricity and gas sales of around 5% of total consolidated EBITDA for 2024-2026.

Mining

- A fall in the amount of EBITDA from mining over 2024-2026, following a substantial increase to around 10% of total EBITDA in 2023, thanks to higher coal sales at higher realized prices.

Other and financial policy

- Adjusted EBITDA of CZK115 billion-CZK130 billion in 2024 and 2025, declining to about CZK100 billion-CZK110 billion in 2026 and 2027 due to normalized power prices. Of the total adjusted EBITDA, CGNI contributes around CZK10 billion-CZK11 billion on average in 2024-2026 (full-year contribution).
- EBITDA margins of about 30%-34%.
- An increase in capex to around CZK60 billion-CZK65 billion in 2024, then CZK80 billion-CZK85 billion in 2025 and CZK90 billion-CZK95 billion in 2026, driven by investments in new solar and gas capacity in the Czech Republic.
- A dividend of CZK28.0 billion in 2024 and a payout ratio of around 70% for 2025-2026, in line with CEZ's dividend policy.
- Average cash taxes of around CZK28 billion-CZK30 billion for 2024-2026.
- An average interest expense of around CZK10 billion-CZK11 billion for 2024-2026, a substantial increase from around CZK6 billion in 2023 due to new debt financing for the CGNI acquisition.
- The acquisition of CGNI for €847 million in the third quarter of 2024, but no other large debt-financed acquisitions.

Key metrics

Period ending	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026
(Bil. CZK)	2022a	2023a	2024f	2025f	2026f
EBITDA	135.3	128.1	120-130	115-125	100-110
Funds from operations (FFO)	125.4	61.3	78-83	75-80	83-88
Capital expenditure (capex)	33.6	44.3	60-65	80-85	90-95
Dividends	25.6	77.4	28.0	20-25	17-23
Debt	257.2	199.0	320-330	355-365	385-395
Adjusted ratios					
Debt/EBITDA (x)	1.9	1.6	2.4-2.6	2.7-3.0	3.5-4.0
FFO/debt (%)	48.8	30.7	24-26	21-23	21-23

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. f--Forecast. CZK--Czech koruna.

Company Description

CEZ is an integrated energy company present in a wide range of electricity-related businesses, namely, generation, distribution, supply, mining, and energy trading. CEZ is one of the leading economic entities in the Czech Republic. Furthermore, it operates in Germany, Poland, and Slovakia, as well as in France and Italy.

CEZ benefits from an unrivalled position in the Czech electricity market, with an approximate market share of 60% for its generation segment and 65% for its distribution segment. In 2023, it

reported EBITDA of CZK124.8 billion. CEZ's largest shareholder is the Czech Republic, which has a 70% stake in the share capital and voting rights. The remaining 30% is publicly listed. As of Dec. 31, 2023, CEZ's market capitalization was CZK515 billion.

Peer Comparison

CEZ is the largest generator, distributor, and supplier of electricity in the Czech Republic, and has a higher market share in its home market than closest peers SSE and EnBW. Notably, CEZ generates about 60% of all power in the country. The peer companies are relatively similar in EBITDA size, but CEZ has a smaller share of renewables in its power generation mix when not taking nuclear into consideration. CEZ shares the challenge of transitioning from coal with EnBW, and both companies generated around 30% of power from hard coal or lignite in 2023. However, EnBW expects a quicker coal exit, with the company's deadline set for 2028 compared with CEZ's expected exit by 2030, or by 2033 at the latest. Additionally, both companies benefit from the high profitability of coal generation, which provide significant resources to transform their asset mix.

CEZ a.s.--Peer Comparisons

	CEZ a.s.	EnBW Energie Baden-Wuerttemberg AG	Engie S.A.	SSE PLC	Enel SpA
Foreign currency issuer credit rating	A-/Stable/--	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Positive/A-2	BBB/Stable/A-2
Local currency issuer credit rating	A-/Stable/--	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Positive/A-2	BBB/Stable/A-2
Period	Annual	Annual	Annual	Annual	Annual
Period ending	2023-12-31	2023-12-31	2023-12-31	2024-03-31	2023-12-31
Mil.	CZK	CZK	CZK	CZK	CZK
Revenue	336,384	1,095,861	2,039,478	309,251	2,346,838
EBITDA	128,137	148,856	369,633	95,352	468,241
Funds from operations (FFO)	61,272	114,501	294,219	78,846	297,468
Interest	9,909	21,740	63,730	12,990	100,177
Cash interest paid	6,552	11,958	33,742	5,558	97,707
Operating cash flow (OCF)	137,090	22,414	306,941	110,575	356,430
Capital expenditure	44,315	103,205	173,874	71,422	305,113
Free operating cash flow (FOCF)	92,775	(80,791)	133,067	39,153	51,317
Discretionary cash flow (DCF)	15,340	(91,596)	32,186	10,285	(79,144)
Cash and short-term investments	17,549	139,069	409,501	30,635	164,043
Gross available cash	17,549	199,917	430,455	30,635	164,043
Debt	199,872	284,946	1,209,735	277,418	1,865,542
Equity	245,601	422,361	840,530	321,219	1,036,227
EBITDA margin (%)	38.1	13.6	18.1	30.8	20.0
Return on capital (%)	20.1	18.2	12.5	12.8	9.4
EBITDA interest coverage (x)	12.9	6.8	5.8	7.3	4.7
FFO cash interest coverage (x)	10.4	10.6	9.7	15.2	4.0
Debt/EBITDA (x)	1.6	1.9	3.3	2.9	4.0

CEZ a.s.--Peer Comparisons					
FFO/debt (%)	30.7	40.2	24.3	28.4	15.9
OCF/debt (%)	68.6	7.9	25.4	39.9	19.1
FOCF/debt (%)	46.4	(28.4)	11.0	14.1	2.8
DCF/debt (%)	7.7	(32.1)	2.7	3.7	(4.2)

Liquidity

We view CEZ's liquidity position as adequate under our criteria, based on our expectation that available liquidity resources will cover cash outflows by more than 1.2x in the next 12 months. Supportive qualitative factors include strong bank support, the company's high standing in the credit markets, and the ongoing benefits of its state ownership. We understand that management has arranged a two-year bridge loan to fully finance the acquisition, and we expect it to refinance this loan well in advance of its maturity.

Principal liquidity sources

We expect liquidity sources over the 12 months from June 30, 2024, to be:

- Unrestricted cash and liquid securities of CZK48.1 billion;
- Availability of about CZK69.2 billion under various committed back-up facilities maturing after 12 months. This is split across over 20 facilities and 13 institutions;
- Cash FFO of about CZK79 billion; and
- A euro-denominated bridge loan to finance the acquisition of CGNI of €840 million.

Principal liquidity uses

We expect that principal liquidity uses over the same period will include:

- Debt maturities of about CZK43.7 billion;
- Annual capex of about CZK62 billion;
- A dividend of about CZK28 billion; and
- Acquisition spending on CGNI of about CZK21 billion.

Environmental, Social, And Governance

We assess CEZ's management and governance score as neutral. Over the past decade, CEZ has committed to generating carbon-neutral electricity by 2040 and has implemented several measures to reduce its CO_2 emissions intensity by upgrading its lignite fleet and planning to close some of its least efficient lignite and hard coal plants. CEZ emitted 0.27 metric ton of CO_2/MWh in 2023 versus 0.57 in 2010.

We think that CEZ remains significantly exposed to challenges arising from carbon price developments and EU decarbonization objectives in light of its carbon-intensive fleet. This fleet will require substantial investment to generate carbon-neutral electricity. Electricity generation from coal was approximately 30% of CEZ's total output, or 15.4 TWh, in 2023. Additional risks lie in CEZ's sizable nuclear fleet (59% of output in 2023).

In 2015 and 2016, CEZ mismanaged the surveillance of its reactors, causing significant outages and additional costs. Its end-of-cycle liabilities for both decommissioning and nuclear waste

storage are also significant. We capture these in our debt adjustment for asset retirement obligations (approximately CZK47 billion in 2023).

From a social perspective, the Czech Republic's main political parties support both nuclear and coal, acknowledging nuclear generation's central role in preserving national energy independence. In recent years, renewable energy ambitions have increased, and the country's climate and energy plan envisages a significant increase in the share of production it targets from renewables to 22% in 2030 from 13.0% in 2020, or approximately 1 gigawatt of solar capacity.

We expect that CEZ will be a significant operator in the Czech Republic, but that it will require significant investments. CEZ's nuclear activities also pose several governance risks, as we believe that the uncertainty surrounding the government's decision on future nuclear reactor construction will continue to limit the long-term visibility of the company's overall structure and strategic directions.

Government Influence

We consider CEZ to be a government-related entity and believe that there is a moderately high likelihood that the Czech government would provide extraordinary support to CEZ in the event of financial distress.

Our assessment is based on CEZ's:

- Important role for the Czech government, as a provider of an essential service and a key player in the implementation of state energy policies.
- Strong link with the Czech government, as the latter is involved in key strategic decisions through its representation on CEZ's supervisory board. The finance ministry owns about 70% of CEZ, and the remaining shares are publicly held.

Issue Ratings--Subordination Risk Analysis

Capital structure

CEZ's debt structure comprises senior unsecured debt in the form of bonds and loans issued at the parent level. All the company's financial debt is at the CEZ level. Following the consolidation of CGNI in 2024, CEZ will have approximately CZK54 billion of debt at the subsidiary level, which we expect to raise the ratio of priority debt to 15%-20% of total debt. Since the priority debt ratio is below 50%, we do not consider CEZ's unsecured debt to be subordinated.

Analytical conclusions

We rate debt the issued by CEZ 'A-', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Rating Component Scores	
Foreign currency issuer credit rating	**A-/Stable/--**
Local currency issuer credit rating	**A-/Stable/--**
Business risk	**Strong**
Country risk	Intermediate
Industry risk	Intermediate
Competitive position	Strong
Financial risk	**Significant**
Cash flow/leverage	Significant
Anchor	**bbb**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**bbb**

Related Criteria

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
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- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- ARCHIVE | Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- ARCHIVE | Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Industry Credit Outlook 2024: EMEA Utilities, Jan. 9, 2024
- Eastern Europe: Higher Yields Will Weaken Credit Metrics And Liquidity, Jan. 8, 2024
- Eastern European Utilities' Regulatory Frameworks Are Varied, But Most Are Adequate To Strong, Sept. 18, 2023
- Czech Gas Networks Investments S.a r.l., March 6, 2023

Ratings Detail (as of August 09, 2024)*	
CEZ a.s.	
Issuer Credit Rating	A-/Stable/--
Senior Unsecured	A-
Issuer Credit Ratings History	
26-Nov-2020	A-/Stable/--
31-Mar-2020	A-/Negative/--
02-Oct-2006	A-/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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