

Lumen Technologies, Inc. NYSE:LUMN
Company Conference Presentation
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Call Participants

EXECUTIVES

Christopher David Stansbury
Executive VP & CFO

ANALYSTS

Anastazia Goshko
BofA Securities, Research Division

Presentation

Anastazia Goshko

BofA Securities, Research Division

Thanks for joining us at the Bank of America Leveraged Finance Conference. I'm Ana Goshko from the fixed income research side. I cover telecom and technology. And we're thrilled to have Lumen Technologies with us, Chris Stansbury, the company's Chief Financial Officer. So Chris, thank you so much for joining us.

Christopher David Stansbury

Executive VP & CFO

It's great to be here.

Anastazia Goshko

BofA Securities, Research Division

Great. So any opening comments before we dive into Q&A?

Christopher David Stansbury

Executive VP & CFO

I would just say what a difference a year makes, right, I mean, if you think about the conversations a year ago versus where we are today, but that's what this is about.

Anastazia Goshko

BofA Securities, Research Division

Yes. So what a difference a year makes. Because at this fixed income conference a year ago, I'd say it was a little more tense.

Christopher David Stansbury

Executive VP & CFO

Popular for different reasons, right?

Question and Answer

Anastazia Goshko

BofA Securities, Research Division

Yes. Okay. Great. Okay. So let me just start with a big picture question. So you and Kate, CEO of the company, have said that your best dollar of investment spent is an enterprise. While residential, I think you've effectively said, it's like -- is noncore and an area that you want to exit.

But what we, from the investor side, have seen has been a series of increasingly high transaction multiples on residential ILEC assets that have particularly focused on fiber upgrades. So does this make you pause and rethink your capital allocation strategy? And even as you look to monetize your ILEC assets, should be -- should you be stepping up your fiber-to-the-home pace?

Christopher David Stansbury

Executive VP & CFO

It's a good question, but let's put some context around this. We said publicly that our payback period on consumer fiber-to-the-home is about 9 years, whereas on the Enterprise business, it's in that 18 month to 3-year time frame, depending on the contract. So it's a much faster time to return, and that's with what we have to sell today.

And when we think about the broader competitive landscape, it's pretty clear that the thesis of the convergence of wireless with fiber-to-the-home is a way to shorten those payback periods. And obviously, there's a lot of activity in that space right now to bring that convergence. So the answer on the consumer side is it's a great asset, but it's an asset that is probably better suited in somebody's hands that has a wireless offering.

And obviously, with the activity that's taken place in the market, it's a very attractive asset right now. So in terms of would we increase the pace of spending there right now? No. And the reason is there's an enormous opportunity in the enterprise space. So when you look at that competitive landscape, there's really no other competitor who is investing at the pace that we are to digitize the network and make it more easily consumable.

The enterprise space has really been defined by decreasing price per bit and selling as a commodity for years. That's not our focus. Our focus is on bringing value to CIOs to support an AI economy where the movement of workloads, massive workloads, quickly with low latency from one hyperscale cloud provider to another with maybe some edge compute in the middle.

Those are the kinds of services that companies are screaming for, and we're the only ones investing in that space. So when you take the time to pay back, but you combine it really with what the competitive set looks like, our ability to win and our right to win is really much greater in the enterprise space.

Anastazia Goshko

BofA Securities, Research Division

Okay. This is a question we had a chance to speak last night, and I posed this question. I thought your answer was interesting. So when you're having your C-suite meetings with Kate and the broader C-Suite team, what are your key topics of conversation and key priorities?

Christopher David Stansbury

Executive VP & CFO

So really, the theme, I would say, is how can we go faster? We see this tremendous opportunity that's in front of us. And getting new digital product to the market is obviously critical. But underneath that, when you -- because that is a multiyear progression. Underneath that, it's really about executing on the day-to-day.

And today, that involves a lot of the PCF deals, which not only bring us some welcome and much-needed cash at this point in our transformation, but it's also really the beginnings of creating an ecosystem. So these dark fiber deals, where we're building networks for the customers, those customers are all co-located with Lumen's network. That's incredibly powerful when you look at the companies that are involved here. And ultimately, that sets us up well for digitally providing services as we go forward. So there's an enormous amount of focus around that.

The second piece would be our ability to bring further efficiency in the business, which also unlocks a much faster path to digitizing the network. So today, the enterprise network is really four networks. And if you're a customer of Lumen's, you know how much blue, red, orange, green you buy. That's how we define the networks. And by the end of next year, we'll have that conversion to one network.

It's a lot easier to digitize and NaaS-enable 1 network versus 4. And in doing so, it allows us to unlock an enormous amount of efficiency. So huge focus there. And then there's the strategic question really around the opportunity given the external market on the consumer side. And so we'll see how that plays out.

Anastazia Goshko
BofA Securities, Research Division

Okay. So you brought up the PCF deals. So can you address the -- I think this is the main question that I think you're asked all the time is whether you have sold your future by agreeing to these dark fiber deals with what are likely to be the 4 largest users of AI-related bandwidth, who, otherwise, would have paid you a lot more if they were buying recurring capacity than buying these conduits and fiber strands. And how do these PCF deals set you up to sell core enterprise services on like a recurring basis?

Christopher David Stansbury
Executive VP & CFO

Yes. It's a good question. There's been a lot of noise in the market, I mean, I think, particularly on the short seller side, where there's just been a lot of misinformation flying around. We have not sold our future. And candidly, the conversations with the customers weren't around, hey, somebody else can give it to us for x. There was nobody else at the table. And there was nobody else at the table because of the breadth of our network, both intra and intercity.

And the customer's alternative was, really, do they build it themselves? That was the decision point. And when you look at our ability to run network, the one thing that I consistently heard when I joined Lumen was the thing that Lumen does really well is run networks. And so to do that with us versus going on their own and then trying to recreate that footprint, which would be really hard, particularly in the intercity basis, just didn't make sense.

The other thing is that from a hyperscale standpoint and AI training, which is what all of this supports, the most precious resource is time. There's a race to train these algorithms so that they can get to market and let large enterprise run their companies on these algorithms. And so our ability to quickly deploy, because the conduit is already in the ground, is unparalleled. And so that has a value to it. If you think about the way we price the contracts, it's really at replacement cost, it wasn't at a discount.

And so the thesis that, well, we would have gotten more if we had held back later. No, they would have gone and built it themselves. And by the way, if you go back a year ago in the conversations around our debt and the TSA, I think the TSA agreement really unlocked our ability to go capture those deals because it allowed us to be focused and not distracted with balance sheet stuff. We could really focus on customers. And so that's how we win.

Now we're debating, actually, whether we disclose how much capacity we have remaining. Because think about capacity, really, as 2 variables. There's space in empty conduit. How much empty conduit remains? And then there's how much fiber can you get through any given conduit? And the reality is, is that we do have capacity. We didn't sell our future because the agreement with Corning gives us an advantage in terms of the amount of fiber we can pull through any one conduit.

So our ability to increase capacity even in conduit that is being used today is substantial. And so we looked very carefully at our ability, not just to support this training phase of AI, but the next phase, inference, when large enterprise starts to consume more IP and waves, and we've got capacity to support that.

Anastazia Goshko
BofA Securities, Research Division

Okay. So we've already seen a lot. So it's \$8.5 billion of announced deals so far. We've already seen a big amount of upfront cash, maybe like roughly about \$1.6 billion come in, in the third quarter. I think, per your guidance, you kind of estimate another \$200 million to \$400 million in the fourth quarter to really get \$2 billion of upfront cash in 2024.

But you haven't increased your CapEx guidance for 2024. So obviously, it means your CapEx is really going to start in '25. So can you just help us think about kind of what the ins and outs on the cash flow and the CapEx like -- is going to be?

Christopher David Stansbury

Executive VP & CFO

Yes. It's -- I mean, forecasting cash flow is going to be a nightmare, obviously, as we go through this because of the size of the dollars that we're dealing with. So really, think about these builds, particularly in the first \$8.5 billion taking place over the next 2 to 3 years. So the cash is going to largely be received in those 2 to 3 years, and the CapEx will take place over that time frame.

There'll be volatility, obviously, from quarter to quarter, and there's also the impact of tax. We'll have a tax bill that we have to pay within 12 months after receiving the cash upfront. So at some point, I can't tell you when that is yet, there will be a year where we could have little to potentially negative cash flow just because there won't be any more inflows coming in, and we'll have that tax payment at the end.

So to help with that, when we give guidance for '25 on our next earnings call, we'll also give preliminary guidance for '26. And then I would anticipate, sometime next year, we'll give you a more multiyear view of how that flows as things solidify.

Anastazia Goshko
BofA Securities, Research Division

Okay. I'll come back to guidance. But -- so you've said on these PCF deals, customers are asking you to move faster. Are you facing any labor or material constraints in your time to market? And then, also, any issues with these conduits being so old? Any kind of degradation that you're...

Christopher David Stansbury
Executive VP & CFO

Yes, I'm sure we'll run into some issues along the way. We haven't yet in any material way. We haven't had issues with labor. If anything, to the contrary. There was a bit of a gold rush mentality of fiber-to-the-home and overbuilders. If we were sitting here two years ago, right, there was a lot of activity, and then that dried up.

And so there were a lot of construction companies that had made investments to support those builds that were then left without contracts. And so the timing worked really well for us. We've got great partners who are working with us every day to build these networks. We're looking at it really kind of West, Central and East in terms of how we divide that up, and people are at work today. So it's -- it really is a great partnership model that we've created, and no shortages.

Anastazia Goshko
BofA Securities, Research Division

Okay. So on the additional PCF deals, I think you've said like \$3.5 billion-ish of opportunity. But these next round of deals, they're going to largely be new routes that really don't leverage the existing conduit. So this first round, the \$8.5 billion were really not even competitive because you had the conduit that really no one else could compete with.

So this next round of deals, a couple of questions. One, is it now more competitive? Are other guys coming in to compete? Is it -- are you really marketing largely to the same customers but just in areas where they want to expand? And does that actually give you an inside edge?

Christopher David Stansbury
Executive VP & CFO

Yes. So they are existing customers. And really, when you think about it, again, these companies are powerhouses at innovation around AI, and that's their focus. Our strength is in managing and running networks. And so I don't think it makes a lot of sense for customers to want to split up how those networks operate, particularly when there's an existing footprint of dark fiber, and they want to create city-to-city pairs that maybe improve latency, for example, to go separate that out and have it in a different system.

That said, we don't take that for granted, right? We're not trying to take advantage of that situation. And we're working with those customers on detailed cost plans right now. I mean, we're using drones with LiDAR technology to understand what the soil conditions are, for example, that we'd have to bore through and how many bridges we have to cross, et cetera.

So we're in that phase right now. The real trick here is -- as we look at city pairings and building new routes, is getting as many customers involved in that as possible. because what we don't want to do is, in 2 years, come back and say, okay, now we're going to go open up those trenches again. It makes sense to do it all at once. So there's a lot of coordination that has to take place.

And then the third variable would really be how much additional capacity do we want to build that doesn't have contract volume committed to it today, but ultimately, could be of real value in the inference phase when large enterprise starts to consume more. And so those are decisions that we're looking at right now. We're not going to do the Level 3 approach of 25 years ago of build it and they'll come, and we're just going to put a bunch of conduit in trenches. We're going to be thoughtful about it, but that work is going on right now.

Anastazia Goshko
BofA Securities, Research Division

Is there -- can you talk a little bit about your deal with Corning? You had already referenced it. And how does it provide you an ability to maximize the new fiber strands being deployed while you're out there like blowing fiber through these conduits?

Christopher David Stansbury
Executive VP & CFO

Yes. So we've been cautious about specifics around that. What I would say is that we have access to the newest technology. And because of the volumes we're buying, we secured an enormous amount of their production capacity in high-capacity cable that has multiple strands in it. And it's got attributes that allow us to blow that fiber very efficiently. So I don't really want to say more than that. But we do -- we've got a great relationship with Corning, and the fact that we've got access to so much of their capacity is this beneficial.

Anastazia Goshko
BofA Securities, Research Division

Okay. So outside of the PCF deals, I think you recently mentioned seeing some increased demand for waves and IP with large enterprises in the mid-market segment. Just anything you can tell us about -- is that momentum continuing, accelerating and what you're generally seeing on the macro? And how could the new environment we're going to be in with a new administration impact you, in particular, with regard to your public sector exposure?

Christopher David Stansbury
Executive VP & CFO

Yes. So we are seeing those trends continue. We've seen dramatically higher rates of sales on IP and waves versus where we were a year ago. We actually readjusted our capital budget to support more build of those waves. And it's really large enterprise is consuming more and more data, and that will continue to grow. So as we look at our investment plans going forward, we will continue that pace. And it's really -- we publicly said we put 6 million miles of fiber in the ground, another 6 million to come. That's outside of the PCF deals, which are, frankly, tens of millions of fiber miles.

And that's really to support where enterprise is going. And that is shifting very rapidly from 100-gig to 400-gig waves that, ultimately, that fiber is scalable to 800-gig and 1.6-terabyte as the equipment that powers that fiber evolves over the next couple of years. So that's where enterprise is going. That's what the demands are. And our footprint is unparalleled in terms of the volume and quality of fiber that we're putting in the ground to support that.

Anastazia Goshko
BofA Securities, Research Division

Okay. I want to pivot now to the resi business. So are there any updated thoughts on the best way to separate and exit what you consider to be this -- like the noncore residential business? So you mentioned various possible scenarios, JVs, wholesale arrangements, only selling the fiber-upgraded assets, retaining copper. I think what would be cleanest would be an approach to the way that the company monetized the Eastern part of the footprint, which would just be like a wholesale sale of the ILEC. Is that your preferred approach? And is that even possible in this environment?

Christopher David Stansbury
Executive VP & CFO

It really comes down to valuation. And again, I don't -- I want to be really clear about something that it's a great business, right? And the management team and the broader team that's running that business is being recognized within the industry for what they're doing, and the penetration that they're driving, the quality of the enablements that they're driving. So they're doing a fantastic job.

It comes back to valuation and what that looks like. And there's a couple schools of thought. If there's valuation to separate that business in its entirety and it allows us to delever, great. But there's, I think, an active debate around which assets really are the most

valuable, obviously, fiber-to-the-home. When you look at what people who are in that space are saying publicly about the number of passings that they want to drive, it's really all about the fiber.

And so the question remains then, what valuation could you get on those copper assets? And if you think about our business today and you think about it in 2 pieces, you've got a copper asset that generates most of the EBITDA in the consumer space. Because in the fiber side of the business, we're investing the EBITDA that's generated there in driving penetration. On the fiber side, we're consuming all of the CapEx, so that \$800 million to \$1 billion a year of cash consumption.

So the question would be on the copper side because our penetration that remains is 9% of the total footprint but a lot of that is in rural areas where it's going to be around for a long time. And so the open question would be whether a buyer would pay us kind of a DCF valuation that made sense versus us keeping it ourselves and running that over the remainder of its life. So those are the questions that are on the table, and we'll have to see where that takes us.

Anastazia Goshko
BofA Securities, Research Division

If you were to break it up into pieces, would it really be more like a -- you're talking about the copper asset, but is it really like on a state-by-state basis? So you would take a state that's much more rural and doesn't have the density, and as that fiber upgraded and then you take like a state like where you have a major NFL city and like a fiber hub, and is that way to separate?

Christopher David Stansbury
Executive VP & CFO

Yes. I think, logically, it wouldn't make sense to split up any given state if you want to look at it on a state-by-state basis. I think, though, the question would be, again, fiber versus copper, and that's what we'd have to see.

Anastazia Goshko
BofA Securities, Research Division

Okay. I wanted to touch upon just the \$1 billion of planned cost saves. So that's really in the business segment. And all of that is really the duplicative systems, the order systems, the billing systems. And is a lot of that really all just kind of headcount related because the process are still very manual?

Christopher David Stansbury
Executive VP & CFO

Yes. I mean if you think about it, again, I talked about the 4 different networks. And to be clear, it's Level 3, CenturyLink, tw telecom and Global Crossing. And so acquisitions. And historically, I think the company did a phenomenal job of bringing off-net traffic on-net. They did a great job of getting rid of headcount redundancy. But what was never addressed underneath all of that was actually fixing the technology so that it was one clean network.

And so today, when a customer orders services from Lumen, our own operations team can't see an order for customer A that says, okay, here's all the things we're delivering. They see it in piece parts because it's coming through, I think, it's 13 order entry systems across those 4 networks, and it's messy. It's not a great customer experience. And so the real goal here is simplifying, streamlining our service delivery for customers and doing that in a much more efficient way, which, ultimately, is largely delivered digitally but the benefit is an enormous cost savings.

Now the other part of it is that the people that run those networks, a lot of them are nearing the end of their careers. These are old IT systems that are no longer supported. And so there's also this existential question of, hey, we've got to get this work done because the knowledge experts are soon to be finishing their work careers and moving on to the next chapter of their lives. So these things all kind of fit together, and that's why we're being so aggressive about it right now.

Anastazia Goshko
BofA Securities, Research Division

Okay. So I want to end, since we're a credit conference, on some debt questions. I know maybe on the equity side, people's eyes glaze over when we start talking about different debt silos and secured, unsecured, et cetera. But I think an important point for everybody is you actually have quite a bit of cash, even though some of those cash, a lot of it has to go to CapEx. But you have cash profitability that you're going to retain from the PCF deals. You also had proceeds from, I think, the European sale that you still haven't deployed.

So you recently just did a debt tender, a cash tender effectively for all of your debt that was due through 2028. Some people hit that offer. Some people -- some investors didn't. But nonetheless, you've sent a signal to the market that you can address maturities through 2028. You're going to have like a big tower in '29, but that's kind of definitely down the road. So you guys have runway.

What are the plans from here? And one question we get a lot is on your equity. So obviously, the equity is like multiples and multiples higher than it's been for a long time. You get asked about, would you issue equity or could you issue a convert and use like a low-coupon convert to help take out higher-cost debt? But just if you can give us a vision for where you are.

Christopher David Stansbury
Executive VP & CFO

Yes. So there's -- look, the capital structure has lots of opportunity in it. And there's some really great tools, and you've listed a number of them. I mean securitization gets thrown out there as well. It really comes down to the order of operations because there's only so much that we can do at any one time. We're trying to eat an elephant, right? So the focus is on the big things first. We've talked about some of those. And I think that then unlocks which path we go down after that.

But I would say that our ability to look at the term loan, and yes, equity is a lever. And while the multiple on the stock is much higher than where it was, the reality is, it was trading at a level that was effectively presuming insolvency. So I think we're back into a more fair territory. I think, right now, it's a little discounted from where we'd like it to be. But I don't think it's a huge opportunity area right now.

When you look at how much could we actually raise versus what we paid down, is it a tool? Yes. Is it a priority today? No. So it's really about doing the big things first and then seeing what follows from there. But lots to do and lots of tools available to us.

Anastazia Goshko
BofA Securities, Research Division

Is it fair to say that you're probably looking at what the outcome will be for the residential business before you make any kind of major decisions on the capital -- on the debt structure?

Christopher David Stansbury
Executive VP & CFO

I think it's a significant variable. And again, we're not saying anything publicly about what's going on there, other than that since the Frontier shareholder vote, things have gotten a lot warmer, right? It's the next largest asset that's out there. And as a result, I think we owe it to ourselves and to our constituents to understand what that valuation parameter looks like. And then, to your point, things would cascade from there.

Anastazia Goshko
BofA Securities, Research Division

Okay. And then the tax basis on that business is low.

Christopher David Stansbury
Executive VP & CFO

Low, yes.

Anastazia Goshko
BofA Securities, Research Division

So you pay taxes, but I think you've been pretty clear about saying that you would need it to be a delevering deal.

Christopher David Stansbury
Executive VP & CFO

Absolutely. That's it.

Anastazia Goshko
BofA Securities, Research Division

You need to have to pay down debt.

Christopher David Stansbury
Executive VP & CFO

Yes. The transaction has to be delevering, or we're not going to do it. And that's one of the table stakes items that's on our list.

Anastazia Goshko
BofA Securities, Research Division

Okay. We have like 2 minutes. Are there any burning questions from the audience? No? Okay. Okay, I guess we're doing a good job with you.

Christopher David Stansbury
Executive VP & CFO

There you go.

Anastazia Goshko
BofA Securities, Research Division

Talent. So there's been just -- a lot of talent brought to the company by Kate. Do you feel like you guys have the people you need, both at kind of the upper levels, but also like in the sales organization?

Christopher David Stansbury
Executive VP & CFO

Yes. I mean, obviously, talent is a journey. It's not a destination. I would say, certainly, in upper management, yes. I mean the talent that has joined this company is absolutely staggering, and it's exciting, right? It's exciting to see where they can take the company as we go forward.

There's been a lot of improvement, a lot of work across the company. But to your point on sales within sales as well, we brought in new partners to help deal with certain parts of the sales motion. There's still more that we can do there, and we are going to do, but that will unfold as time goes on. But broadly speaking, it's not that we have huge talent gaps that need to be filled. It's really how can we optimize and build from here.

Anastazia Goshko
BofA Securities, Research Division

What are the economics and the pros and cons on the sales partner side?

Christopher David Stansbury
Executive VP & CFO

So the biggest issue is, is that when you have an installed base of legacy revenue as sizable as ours, it's impossible to get to those customers for things like renewals with a direct sales force. You just can't build a sales force that's big enough. And so we brought in partners to help address specific activities like renewals. And there's enormous efficiency that can be brought to that because of the scale they can bring.

Anastazia Goshko
BofA Securities, Research Division

Okay. Great. So I'd like to leave a minute to allow you to highlight anything you believe is important that maybe we didn't cover. Any sort of key takeaways?

Christopher David Stansbury
Executive VP & CFO

Yes. Look, because it is a credit conference, and because of where we were a year ago, I just want to reiterate something I said at dinner last night, which is, the TSA deal and all the struggles that it took to get through that really did unlock our ability to go capitalize on PCF. The customers that signed those contracts are sophisticated customers. And they knew that if they did business with Lumen and things went south, that those assets would still be there.

But their concern was one of focus. Would we be distracted because we're sitting in court proceedings? And so getting that TSA done at a time when the AI explosion was happening, that wasn't planned. But the reality is, is that early this year, as we were finalizing the

TSA, it was very clear that these customers were moving very aggressively on time frames, frankly, that are around contracts at the size that aren't normal because of the boom in AI.

So that TSA agreement really did unlock the path to that \$8.5 billion that we've captured and the \$3.5 billion that we're working to close right now. So it was critical. It was a critical moment in our journey, and stay tuned. I look forward to sitting here next year and talking about where we are then.

Anastazia Goshko

BofA Securities, Research Division

Okay. Great. Okay, Chris, thank you so much for being with us.

Christopher David Stansbury

Executive VP & CFO

Yes. Thanks.

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