

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

EXECUTIVES

Christopher David Stansbury
Executive VP & CFO

ANALYSTS

James Schneider

Presentation

James Schneider

Good afternoon, everybody. Welcome to the Goldman Sachs Communacopia and Technology Conference. My name is Jim Schneider. I'm the telecom analyst here at Goldman. It's my pleasure to introduce Lumen Technologies and CFO, Chris Stansbury. Very welcome Chris.

Christopher David Stansbury

Executive VP & CFO

Great to be here.

Question and Answer

James Schneider

So I think it's fair to say that AI is a running theme at this conference. We've heard from many companies this morning, including Verizon in telecom space about what AI means to them. You've made a series of announcements recently on this topic. I'd like to unpack what it means for your business, starting with the Microsoft-related deal along with other customers that you announced. Maybe just kind of give us some incremental details if you can on the agreement. I'd like to dive in from there.

Christopher David Stansbury
Executive VP & CFO

Yes. So I mean, obviously, in terms of the agreement itself, what was in the press release is really all we can say. It is two way, we're using AI inside of our company, right? We're one of the launch partners with Copilot. We're using it extensively to help drive efficiency in our business, and that includes the integration with GitHub and code development and whatnot. So we've really been able to unlock a lot of productivity.

We've obviously talked about expanding our relationship on the data side, right, and outsourcing a lot of our data center work and then the AI deal. And we view the AI TAM opportunity really as 3 phases. We're in the first phase right now where the race is for the companies that are developing these large learning algorithms. They need to train those algorithms, and there's a race to see who can build the best algorithms the fastest because the next phase is really when a larger enterprise starts to use those to run their businesses.

So a lot of the connectivity that you see being acquired today is really to support the data center builds that are there to support that training. As we say internally, AI needs data, data needs data centers, and data centers need connectivity and that's us.

James Schneider

Yes. And then maybe just kind of give us a sense of like, how should we think about like with all the capacity you're building for this large, a set of first customers in the first \$5 billion of the deal, what kind of capacity feature are they buying for those data centers? Maybe give us a sense of roughly how many data centers you can interconnect with this. Is it mainly a kind of a training first and then inference later kind of use case? Or how should we think about the use case and how the profile evolves over time?

Christopher David Stansbury
Executive VP & CFO

Yes. So it really is the training phase for right now. So if you think about why Lumen, why our footprint and why nobody else? So much of it really rides on the fact that over the years and really many, many years ago, 25 years ago, in fact, this large intra and intercity network of conduit was built. And the beautiful thing about conduit is you can quickly deploy fiber through those tubes. And speed is the resource that these large companies don't have right now time, right?

They're trying to figure out how to accelerate as much as possible. So when you look at the network footprint of that conduit today, it is either on routes where those data centers are being built or very close to them and it's easy to pipe into. And that's unparalleled, particularly when you talk about the intercity piece because, again, the data needs to get to where it needs to get. And the intercity piece is very hard to replicate, digging up city streets and major metros.

And so when you take that into consideration, you take into consideration our expertise and speed and deployment, the digital tools that we're bringing, which will dramatically increase the flexibility of consumption as time goes on, all of those things were key in the decisions that our customers make.

James Schneider

Maybe talk about some of the competitive advantage. I think you kind of touched on it already, but what are the most important drivers of that? Is the fact that you already had the sort of the conduit and it was like faster type of market effectively for that? How much of it was the unique routes? How much of it was your sort of willingness to do dark fiber deals? And was there anything that was just kind of -- obviously given Kate's historic relationship with Microsoft, was that a big factor in the deals as well?

Christopher David Stansbury
Executive VP & CFO

Yes. I mean, so first of all, Microsoft was the only company that wanted to do a press release at the time. There's over 10 companies in that \$5 billion basket. So Microsoft is obviously an important partner with us, but there are other companies as well that have fed into that. So it goes beyond the relationship with just Microsoft. But yes, speed in deployment, our ability to do that very well.

Over the last 2.5 years I've been at Lumen, I've obviously gotten a lot of feedback, a lot of it not great as we're in the middle of a turnaround. The one exception is our ability to deploy these networks at speed and with very high quality. So this is something that we're known for, and that's one of the key reasons customers came to us.

But the footprint is critical, right? It's not something that anybody else can replicate. It's why we were at the table and others weren't, and it's why there's a hard list of \$7 billion in opportunities that's being discussed as I sit here right now, and we're making great progress against that.

James Schneider

I guess maybe give us a little bit more sense if you can. You mentioned over 10 customers. Can you maybe give us a little bit of sense of the diversity of those customers? I think you talked about kind of broad strokes, some social media type companies. Is it also large corporates? Or is it more kind of hyperscaler social media companies with a large kind of internal data center presence?

And how many of them actually know how to actually deal with dark fiber and manage dark fiber because that's not a common skill that most companies have?

Christopher David Stansbury
Executive VP & CFO

Yes. So the companies are the hyperscalers, the large tech firms, it's also cloud providers. Basically anybody who's in that AI learning algorithm and training mode right now, right? They're the ones that are driving data center demand. And it's really interesting to us, frankly, because we've been talking about this now for many quarters. And there's been great, great research that's been done on data center explosion and all of the industries that are impacted by that from rare earth minerals, all the way through to construction companies and power grids, and no one ever talked about the connectivity.

What good is a data center sitting in the middle of nowhere with low temperatures and access to electricity if the data can't get there and can't go anywhere? And so that last leg is absolutely critical, and it has to be low latency because latency kills AI and our ability to deliver that is really what drove it.

So the decision for these companies -- these companies are not companies that have cash resource problems. The decision for these companies were, do they build it or do they buy it? And if they buy it, there's really only one place that can give them the full-scale solution they're looking for, and that's us. And they chose us because of our ability, to your point, to not just build those networks, but in many cases, manage it for them because we do that very well.

James Schneider

Want to get to some of the mechanicals of things that you can talk about it, but just give us a sense of the additional pipeline of \$7 billion you mentioned. How does the profile of those companies or potential customers differ from the initial \$5 billion? Meaning, is there a broader set of like small, like large enterprises but not in that kind of traditional hyperscaler AI set? Or how do we think about that?

Christopher David Stansbury
Executive VP & CFO

No, I would say it's much the same. Largely different companies. There is some overlap where there are different pieces of the network that companies that may be in the \$5 billion want to have done elsewhere, but the profile looks very similar.

I would say that again, these are big chunky deals, right? They're very complex. They take time to negotiate. We've got some that are closer in, some that are further out. We would never give an estimate on when we think they're going to close because if we did, we'd be wrong. But I would say that they are very real. They are our right to win. And over half of those deals look a lot like the \$5 billion in terms of they're an existing conduit and would look much the same.

The other portion is new builds. And so those are a little further out. We're looking at what those look like, but those would be new routes that are highly attractive.

James Schneider

And just if you think about the very long term. I mean these are 20-year deals, right? So I guess, how do we -- I mean a lot of investors I speak with are trying to kind of dimension the total opportunity for -- let's see, just take just those customers that are contemplated in that initial tranche of 2 sets of deals. Would that build enough capacity forever for those customers? Or are we talking about 5% of the capacity they may need over 10 to 20 years?

Christopher David Stansbury
Executive VP & CFO

It's a good question, and the honest answer is no one knows. Clearly, in the race to get these AI models trained, the worst outcome for our customers would be not having enough connectivity, not having enough compute power. And that's why you see CEOs of these companies talking about I'd rather have more than less because the race is to get those things trained. The same is true for connectivity.

We've done extensive work looking at our capacity and our ability to increase capacity also through fiber technology, our relationship with Corning. And there's a lot of things around that relationship that we can't disclose, but there are attributes to the fiber that we're able to deploy that maximize how many strands we can get through the conduit that we have.

And so for Phase 1, I think the \$12 billion of opportunity between the \$5 billion and the \$7 billion largely addresses the training phase. Beyond that, when we see large enterprise starting to light up, they're already doing it today but lighting up even more waves and IP, we'll be very well positioned to take advantage of that.

James Schneider

Can you maybe give us some sense about how these deals just work mechanically and from a financial perspective? I mean you took up your 2024 free cash flow guidance as a result of the deal, how does the cash flow, flow? Meaning we see that cash out front, you outlined some of that in terms of CapEx later on, your taxed on that. So give us a sense of like the lag times here? And how does the net cash flow kind of accrete to the company over time? Does it sort of just go higher over time with escalators there? Or how do we think about how to model this?

Christopher David Stansbury
Executive VP & CFO

Yes. The beauty of these deals, and we did a video around this and filed an 8-K before our last earnings call to try to give some context because it is different. But the beauty is that the biggest piece of the cash is received upfront. And you can't even really do an IRR calculation on it because there's no outflow of cash before there's an inflow. We don't fund the working capital for this, which is what you saw in the guidance changes for this year. Now you saw CapEx go up, but you also saw free cash flow go up. At the same time that you saw EBITDA come down because there's OpEx to support these builds.

So really over a 3- to 4-year period is the construction phase where we're deploying fiber through the conduit. We're building huts along the way, 400 to 500 per network build where there's equipment that repowers the signal. There may be compute power in there. It's very complex. And the cash received and the CapEx for that is in those first 3 or 4 years. That's about 90% of the total cash flows from the project.

To the extent that the customer wants to pay us for space and power in those huts or pay us operating and maintenance for managing that work on their behalf, that's roughly 10% of the total contract value. And that cash would be received in the year the services are provided. So the up-front piece while we're in construction, that cash sits in deferred revenue, it gets amortized in over the life that the services are lit. So the remaining, if it's a 20-year deal, 16, 17 years in the contract, and then the 10% is received in those windows.

What's really important, though, from a Lumen standpoint is very high NPV. We're monetizing an asset that was paid for 25 years ago when the conduit was put in the ground. And it's really a bridge from our legacy past. It's obviously enterprise connectivity has gotten a bad rap because it's declining, and it's declining because nobody has invested in it.

And when you look at the digital future we're bringing, where we're going to be able to deploy network connectivity and security and edge compute, on a digital basis, self-provisioning with the customer, no truck rolls, that's what we're building to. And so these deals really are a bridge from the legacy to the new. They fund the gap that we saw in our projections, that you saw in our projections around higher coupon from the TSA agreement, the funding we needed to invest in the business, a little bit of pension funding, cash to pay, pay down near-term maturities. The \$5 billion alone address that gap over the next 3 years. \$7 billion would be incremental to that. That takes us to '28 or so, '27, '28, where we start to see revenue growing again.

And so Phase 1 was the cash flow. Phase 2 is EBITDA stability. We have said for some time that '26 and beyond will be EBITDA growth. We're committed to that. In fact, when we give guidance for '25, we'll probably give guidance for '26 at the same time. '25 EBITDA will be down because of the investment for the deals and the legacy declines. '26 EBITDA at this early stage looks a lot like this year. And it's because we're unifying what our 4 enterprise networks into 1 by the end of next year. There's \$1 billion in cost savings that we'll build between now and '28, and that's why we have great conviction in the EBITDA, and then revenue follows after that.

James Schneider

Maybe just one last piece on this. I guess relative to the \$5 billion itself, I think at last year's Investor Day, you talked about having 6 million intercity fiber miles, and you wanted to double that over time. Help us understand whether this announcement today or recently was incremental to that? Or just it helps you accelerate that with prefunding? Or -- and maybe kind of is the Corning deal also kind of incremental to what you had already planned to do?

Or was it kind of just an additional part of what you had really thought as being a pretty big customer of theirs anyway?

Christopher David Stansbury
Executive VP & CFO

Yes. It's all incremental. So the \$5 billion to \$7 billion the announcement with Corning, that was all around this AI deployment for the training, and that is in addition to the fiber that we're deploying, the additional 6 million fiber miles.

And look, that's critical because we do see growth in Waves and IP. In fact, roughly speaking, in the first half of this year, we had already sold as much in Waves as we sold the entirety of last year. So the Waves market is obviously growing. That will only, that pace will only increase as companies start to use AI. And let's face it. It's -- AI is at its early stages today, large enterprise is really not leveraging it in a major way. That will come. And when it comes, that connectivity will be critical.

So we're well positioned for it. The fiber that's going in the ground has gone on the ground and is going to be going into the ground as it relates to those 12 million miles, is 400 gig capable today. But as the equipment that powers that changes over the next 24 months, that has scalability to 800 gig and 1.6 terabytes. So that's a network that no one else can touch right now. And we're very focused on that.

James Schneider

And then relative to that, I mean, I think you talked about the fact that was -- you were the only people at the table for the initial deal. Kind of curious, I mean, obviously, now I think historically, fiber services has always been a relatively competitive space. You do have competitors. I'm kind of curious what you expect the competitive response to be on the next set of the deals or the next deals after that?

And sort of like what do you feel like your differentiators in the first deal are going to be the same going forward?

Christopher David Stansbury
Executive VP & CFO

It's interesting, and it's the right question. The answer is there is a level of competitive insulation here because no one has the footprint or the reach that we have today. But importantly, and I'd say this is even a more important factor for our customers. There's no one else investing in the enterprise space, period. Who is investing CapEx in enterprise telecom today other than Lumen? Even a fraction of the pace that Lumen is.

Our 2 major competitors, their next best dollar is spent on wireless and the consumer and Fiber to the Home. That is less of a focus of ours. And I know we're going to get to that in the conversation.

We have an enormous untapped capacity and competitive advantage in the enterprise space. That's what you're starting to see in these AI deals. And that's where we see the greatest opportunity to make a difference. I mean, truly, being able to -- we've used these words before, by cloudify telecom, what does that mean?

I mean you think about it, right? Today, many of you in this room can open up your laptop and provision cloud storage or compute, right? 20 years ago, you couldn't do that. That is exactly what we envision the future of enterprise telecom to be. That's how you will provision and deploy your network needs as it relates to connectivity. No one has done that, and no one is spending money to do that.

And so I think there lies the answer. The footprint, combined with the investment profile and where we're going to digitize enterprise telecom, there really is no one else.

James Schneider

I want to go to other parts of your business, but I just want to also kind of leave with relative to your guidance for this year. Took down your EBITDA guidance by about \$250 million in this last set of results. How much of that was sort of driven by the costs associated with the up-front cost of doing these deals? Was there any part of it that was driven by the legacy declines that you're seeing? So how do you kind of frame those 2 factors?

Christopher David Stansbury
Executive VP & CFO

Yes. So we -- our guidance for the year in EBITDA was \$4.1 billion to \$4.3 billion and pre these deals we were signaling kind of lower end of the range because of what is real legacy declines that the entire industry is seeing. I mean these companies are bringing people back to the office. They're also shrinking the footprint. There's less connectivity -- connections associated with that. So I would start with that thinking and then the balance is really driven by the deal.

James Schneider

Now just in terms of the overall kind of core business, you've talked about public sector being the first segment to see revenue stabilization. Are these deals we just talked about going to sort of pull forward materially the large enterprise stabilization or not? Or is public sector is still going to be the first thing to turn yet?

Christopher David Stansbury
Executive VP & CFO

Public sector will be the first to turn because we're starting to see that now. And we're seeing those are really big like USDA as an example. USPS. Those were sold last year, the year before, and they take years to deploy. That's when revenue starts to get recognized, and that's being seen right now.

As it relates to large enterprise, yes, of course, as these deals start to turn on and that revenue that sits in deferred revenue on the balance sheet starts to light up, that will benefit us, but that's not for another 3 or 4 years.

The biggest opportunity we have in large enterprise and frankly, mid-markets is around execution on the core business and increasing the percentage of our mix that really is the new services like IP and Waves.

And what drives that? Where the single biggest opportunity is around churn. And there's good churn and there's bad churn, right, good churn is the churn that's beyond our control. It obviously negatively impacts us, but there's nothing we can do about it. That's things like office consolidations.

Bad churn is our inability through the size of our sales force, for example, to get to customers who are moving out a term, right? Their contract is expired, and they're moving on to the next form of connectivity, IP and Waves. We do very well in that space. We should do better than anybody else in that space, given our footprint and capabilities.

And what we don't have and what we haven't had is enough sales resources to go after that. So we've gone through a really detailed process to understand that. We've started to light up sales partners who will be focused on that renewal piece specifically, so that our sales force can be focused on net new. And so we're excited about that. We'll see where that takes us.

I would tell you that when we look at the modeling for '25 and '26, there's no heroic assumptions in that. I think we're being very realistic. But I think that's a real opportunity for us to slow the decline rate in the coming quarters and years. So we'll see how that works out.

James Schneider

Now over the past couple of decades, I would say, you and your predecessor companies and others in the telecom space as well have lost a lot of share in SMB specifically, some of your telecom peers seem excited about the ability to win share back either through fiber, fixed wireless or other means. Is that a focus area for you at all that segment of the market? And how much share do you think you have in that segment of the market in SMB and where do you think it goes?

Christopher David Stansbury
Executive VP & CFO

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Guessing our existing share is difficult. I would tell you though, clearly, cable, in particular, has done a very good job of attacking that space. And I would say more broadly, the mid-market space is one that's underdeveloped for Lumen. It's always been underdeveloped. Again, they were trying to sell with a direct sales force. There's no way you can scale to mid-markets with only a direct selling motion.

And so a lot of work has gone into the partner ecosystem. But again, if you think about the digital future, that's tailor-made for mid-markets, right? So self-provisioning and deployment of network. So that's a real opportunity for us, and we've got resources focused against it, but that digital future is key to that.

James Schneider

Switching to our mass market business for a moment. It's obviously been a lot more topical recently. You've seen T-Mobile announced a few JV deals. They've talked about the impact of convergence. Now you saw Verizon for Frontier last week get announced. How do we think about sort of the strategic review for that business for you? And I guess, have you seen an uptick in interest in that business from external bidders over the last few months?

Christopher David Stansbury
Executive VP & CFO

Yes. So a few things. It's -- we have 2 great businesses. And we have 2 great businesses, but they just don't belong together. The return profile of the enterprise business, the return profile of the consumer business look very different. They attract a different kind of investor. And so putting them together doesn't benefit either of those groups.

What we have consistently said though is that while our long-term mission/vision is clear that we're going to be an enterprise-focused company, that to monetize that consumer asset, it was all about fiber in the ground. And that's why we've been committed to building what we've been building, and the team is doing an absolutely outstanding job. We're getting great enablements, and we're driving penetration today that is at or above-market rates. So it's a strong asset. And we have consistently said that it's a space that needs to be and will be consolidated, but we won't be the consolidator.

We're now in an environment where the external environment is becoming more conducive to that. To your point, we've seen a lot of deals. Obviously, the announcement last week, our asset is attractive. Post a Verizon/Frontier scenario, we're the next largest player in that space with very attractive markets. So we'll see how it plays out. I would say that the market was warming up and we were fielding calls and last week only increases that interest. So nothing formal to say at this point, but I think the market is our friend right now on this, and we'll see where that takes us.

James Schneider

Can you help us understand your footprint a little bit better for the copper assets you have? If you wanted to upgrade them to fiber, kind of what would it be in terms of cost of path to upgrade those remaining assets?

And if you think about kind of both your fiber and copper assets, kind of how do you think about the overlap you see both with the cable and other fiber providers out there in the market?

Christopher David Stansbury
Executive VP & CFO

So our existing footprint has about 18 million potential homes in it. 8 million of those are probably locations where it would not be economical for us to run fiber today. So think of 10 million as the universe and 4 million of those are already built. Our cost to build right now is about \$1,250 to \$1,500 per enablement, and that has stabilized over the last year or so. There was obviously some inflationary pressures that everybody faced for a little while, but that has stabilized. So that's the broader footprint and the broader opportunity.

And when you think about the markets that we have, our big major metros are Minneapolis, Denver, Seattle, Portland, Las Vegas, Phoenix. There's also a chunk in Florida that's attractive. So we'll have to see. It could be a scenario where somebody wants to buy the copper and the fiber. It could be a scenario where they only want to buy the fiber, and that's okay.

What I can absolutely say is we are not going to do any transaction that does not delever the business. So we will either get paid value for the copper that makes sense or we won't, and we'll monetize the fiber and we'll manage the copper for cash and use that to pay down debt. So it's a tremendous opportunity for those assets to be in the right hands for the long term, but it's also a tremendous opportunity for us to fundamentally change the capital structure of the company and focus us on enterprise.

James Schneider

I'd like to round out the discussion with a couple of financial questions as to sort of as we wrap up here. Maybe talk about the kind of financial implications. You alluded to it before, but you said 100 -- excuse me, \$1 billion of incremental cost-cutting actions that you announced last quarter.

You said EBITDA is going to be down next year because of declines, then pop back up in '26 to around 2024 levels. Can you give us any kind of sense of the moving parts to this. And as we get to the point of EBITDA growth and stabilization in '26, where will revenues be from a kind of a growth perspective?

Christopher David Stansbury
Executive VP & CFO

We're still doing some work on that. So not quite there. Again, we would say that the order is free cash flow stabilization now, right, EBITDA, V-shaped recovery. '26 looks a lot like '24 and growing thereafter. And really, the key driver there is next year.

Right now, if you're a major customer of Lumen, you know that you don't buy enterprise networking from Lumen. You buy it from TW Telecom, CenturyLink, Level 3 and Global Crossing, and you patch it all together through 13 order entry systems and multiple billing systems, and it's a mess, okay? By the end of next year, we will have that unified into one network.

So the customer experience dramatically improves. Our ability to turn off multiple legacy IT systems that were never integrated goes away. So that with the cash flow, we're intentionally pulling forward OpEx one-time next year to get to that point of network unification, and that's what starts to drive the \$1 billion in cost savings.

So we'll realize a lot of that in '26. We won't get to full run rate until '28. And that's probably about the time that we see total revenue growing. Now between now and then, you should see rate of decline improve as we deal with some of the churn issues that we've talked about. But more importantly, we drive a greater percentage of the mix through that growth bucket, which is really things like IT and Waves and edge compute and security.

James Schneider

And relative to the balance sheet, I think it's fair to say that clearly, like people feel probably more comfort in the overall situation of posture today than they did before. You also announced the debt exchange just very recently, I believe it was last week. From an asset sale perspective, is there anything else besides the consumer business do you think you could do?

Christopher David Stansbury
Executive VP & CFO

Really small things. I mean there's definitely stuff around the edges that we consider, but it's not -- none of them are needle movers. I mean the reality is if you look at assets inside of Lumen that I think are our key target areas for us. Clearly, as we start to address things like the network complexity, the decisions on consumer, there's a lot of real estate that exists in telecom to power all these networks. I think there's a lot of work we can do on that.

But again, in the greater scheme of things, nothing that moves the needle in a major way. It really is, at this point, the consumer question.

James Schneider

And then just maybe one question I've been getting from investors quite a bit is given the stock performance in the past few months, kind of begs the question about if you really want to deliver the balance sheet and give yourself a lot of comfort there, one thing you could consider is stock sale. Is that something that's under consideration?

Christopher David Stansbury
Executive VP & CFO

Yes. I know that the bankers love that idea. I would say to you that it's not a focus right now. Our focus is on execution. There are great ways to delever this company and to get the capital structure where we want it ultimately for the long run by winning the \$7 billion, by making sure that we do the right things around the consumer business. And that's where our resources need to be focused.

At the same time, look at this conversation. A year ago, we would have spent the first 33 minutes talking about the balance sheet, right? Now we're spending the last 2 minutes talking about the balance sheet. So we spent 33 minutes talking about our strategy.

The last thing that we want to do, I think, for very little gain, frankly, is shift that discussion back to one of financial maneuvering because we're not in a position where we have to do that. It's about executing the strategy. It's about executing on the things that we know we can and should win at, and the rest will take care of itself.

James Schneider

Fantastic. I think with that, we're just out of time. So thank you very much, Chris, for being with us today. We appreciate it.

Christopher David Stansbury

Executive VP & CFO

Great. Thanks a lot.

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