

Research

Evonik Industries

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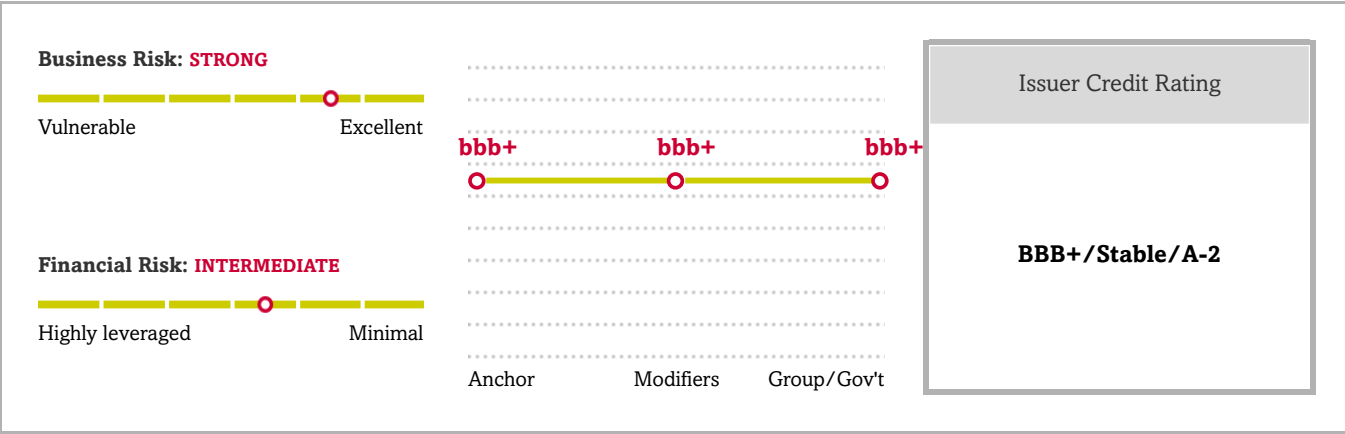
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Credit Highlights

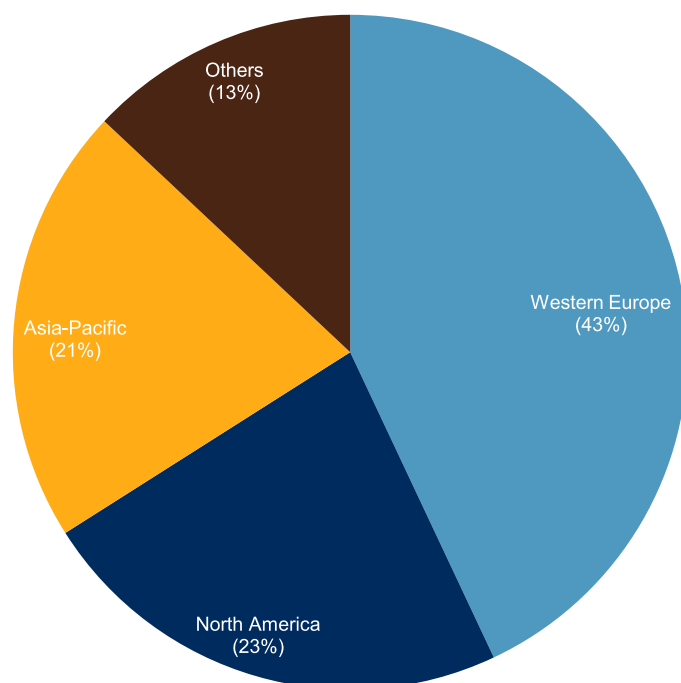
Overview	
Key Strengths	Key Risks
Leading global specialty-chemicals manufacturer with healthy market positions.	Cyclicality of some chemical activities and exposure to volatile raw material prices.
Significantly reduced exposure to cyclical and/or commoditized products following disposal of methyl methacrylates (MMA) business.	High concentration of revenue from the developed markets of Western Europe and North America.
Average but resilient profitability overall, with potential improvement over the medium term thanks to cost saving initiatives.	Significant post-retirement obligations.
Successful integration of recent acquisitions.	
Supportive financial policy and management's commitment to a solid investment-grade rating.	

The sale of the MMA business is an important step in the transformation of specialty chemicals group Evonik Industries (Evonik). The sale of the mature and capital-intensive MMA business has materially reduced the cyclicality of Evonik's portfolio and should result in more resilient profitability. In line with its strategy, S&P Global Ratings expects the company will continue to sharpen its focus on specialty chemicals and its identified growth areas--health and care, smart materials, specialty additives, and animal nutrition.

The proceeds from the MMA disposal will be used to pursue the company's current strategy. We understand that Evonik will use the proceeds, after deductions (such as pension obligations and cash tax payments), to strengthen its balance sheet and fund internal and external growth projects. These include the \$625 million acquisition of U.S.-based chemicals producer PeroxyChem, and the construction of a €400 million polyamide 12 plant in Marl, Germany. Based on this, we expect credit metrics to remain comfortably at the upper end of our guidance for the current rating.

Chart 1

Evonik's Sales By Region In 2018



Source: S&P Global Ratings.

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Outlook: Stable

The outlook is stable because we expect Evonik will generate solid adjusted EBITDA of €2.0 billion-€2.2 billion in 2019, despite headwinds from some end markets such as auto, and €2.1 billion- €2.3 billion in 2020. We also factor in Evonik's financial policy commitment to a solid investment-grade rating and anticipate that dividends and acquisitions (if any) will be financed prudently. We view a ratio of adjusted funds from operations (FFO) to debt of 30%-40% as commensurate with the rating.

Downside scenario

We could lower the ratings if we anticipated that our adjusted FFO to debt would decline below 30% without the near-term prospect of recovery. This could be caused by a significant drop in profit due to a weaker market environment, or come through material debt-funded acquisitions.

Upside scenario

Upside rating potential could emerge over time if Evonik can maintain resilient performance via a higher share of specialty chemicals in its product portfolio, visible EBITDA contributions from acquisitions and expansion projects, and a financial track record of adjusted FFO to debt in the 40%-45% range--including increased free cash flow after dividends. A financial policy commitment to a higher rating would be important for any upgrade considerations.

Our Base-Case Scenario

Assumptions	Key Metrics																
<ul style="list-style-type: none">Global GDP growth of 3.3% in 2019 and 3.6% in 2020.A much weaker auto industry in 2019 than 2018-2017.A continued tough environment for petroleum derivatives in terms of volumes, and some softness in prices.Modest segmental growth with nutrition and care affected by the softer methionine market and resource efficiency affected by the macro environment.Gross proceeds from the MMA sale of €3 billion.Spending of about €700 million for acquisitions in 2019, mainly on PeroxyChem assuming the transaction closes by year-end, and continued bolt-on acquisitions in 2020-2021. We note the somewhat uncertain timing of the PeroxyChem transaction, which is currently delayed by a lawsuit filed by the U.S. Federal Trade Commission.Capital expenditure (capex) of €0.9 billion-€1 billion per year.Dividends of €0.5 billion-€0.6 billion per year.	<table><tr><th></th><th>2018A</th><th>2019E</th><th>2020E</th></tr><tr><td>EBITDA (bil. €)*</td><td>2.4</td><td>2.0-2.2</td><td>2.1-2.3</td></tr><tr><td>FFO (bil. €)*</td><td>1.9</td><td>1.8-2.0</td><td>1.9-2.1</td></tr><tr><td>FFO to debt (%)*</td><td>34.6</td><td>38-40</td><td>38-40</td></tr></table> <p>*Fully adjusted by S&P Global ratings. A--Actual. E--Estimate. FFO--Funds from operations.</p>		2018A	2019E	2020E	EBITDA (bil. €)*	2.4	2.0-2.2	2.1-2.3	FFO (bil. €)*	1.9	1.8-2.0	1.9-2.1	FFO to debt (%)*	34.6	38-40	38-40
	2018A	2019E	2020E														
EBITDA (bil. €)*	2.4	2.0-2.2	2.1-2.3														
FFO (bil. €)*	1.9	1.8-2.0	1.9-2.1														
FFO to debt (%)*	34.6	38-40	38-40														

Base-case projections

We expect Evonik to replace MMA's EBITDA contribution through acquisitions and organic investments. We forecast adjusted EBITDA of €2.0 billion-€2.2 billion in 2019, down from €2.4 billion in 2018 due to the sale of MMA, before increasing to €2.1 billion-€2.3 billion from 2020 onward. We factor in the synergy realization from recent acquisitions, benefits from cost savings programs, and organic growth projects such as the polyamide 12 capacity in Marl.

Evonik enjoys ample rating headroom. We anticipate ample headroom for the rating due to improving credit metrics. For example, we forecast FFO to debt to improve toward the higher end of our 30%-40% guidance thanks to support from excess funds available and the disposal of the cyclical MMA business. Despite continued strong cash conversion, we believe that Evonik will utilize its cash flows for investments, modest acquisitions, and dividends, resulting in a relatively stable leverage over the forecast period.

Company Description

Evonik is one of the leading specialty chemical companies, with about €6.5 billion of revenue reported from continuing operations in first-half 2019.

The group's activities comprise three segments: Nutrition and care, resource efficiency, and performance materials. Evonik serves a range of diversified end markets including food and animal feed, consumer and personal care, and auto and mechanical engineering.

In nutrition and care, Evonik is the world's largest producer of methionine, used in animal (mainly poultry) feed, and the group considers this to be one of its most important profit contributors. The segment also makes cosmetic ingredients, such as specialty surfactants, and household products including fabric conditioners, solutions for the health care industry and superabsorbent materials.

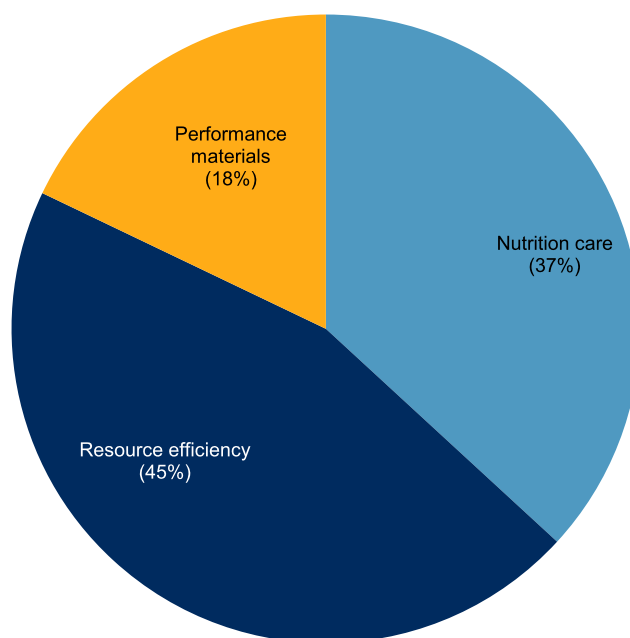
In resource efficiency, the company produces inorganic materials, such as silica and silanes for tires, coatings and adhesive resins, oil additives for the auto and industrial end markets, crosslinkers, polyamide 12, and hydrogen peroxide used in pulp and paper bleaching, and other applications.

In performance materials, the company produces naphtha-based C4 derivatives and hydrocyanic acid products, as well as alkoxides that are used, among other things, for the manufacture of biodiesel.

On March 4, 2019, Evonik signed an agreement to sell its MMA business to Advent for €3 billion. The MMA business comprised large-volume monomers such as methylmethacrylate, various specialty monomers, and the PLEXIGLAS® brand of PMMA molding compounds and semi-finished products. The methacrylate business has been reclassified to discontinued operations. The transaction closed on July 31, 2019.

Chart 2**Evonik's Revenue By Segment In First-Half 2019**

Post MMA business disposal



Source: S&P Global Ratings.

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Business Risk: Strong

Evonik's business risk profile is underpinned by the size and strong market position of its specialty chemicals activities, as well as global market reach. The specialty business portfolio was further strengthened by the sale of the mature and cyclical MMA business.

Evonik benefits from greater diversity in terms of end markets and product ranges than most of its peers, while at the same time there are limited synergies between its rather-unrelated business units. About one-third of its sales come from nutrition and care products, with less than 20% from the more cyclical auto end markets and well-diversified exposure to other end markets. The group also has a good track record in research and development, which accounts for 3.0%-3.5% of its annual sales.

We view Evonik's profitability as average within the specialty chemicals industry, supported by efficiency programs in group-wide selling, general, and administrative functions. The company is targeting savings of €200 million by 2021 and in addition has several business-specific initiatives like 'OLEO 2020' for household and personal care.

The company's exposure to commoditized and/or cyclical products including amino acids, C4 derivatives, and

superabsorbers for baby care has reduced compared with a few years ago, but is still material. This has resulted from Evonik expanding in more stable activities but also the current trough in conditions. Cyclical products could represent a material portion of Evonik's EBITDA if prices normalize. We see this as a weakness for the group, given the higher volatility of these products compared with the rest of its offerings and their sensitivity to economic cycles and supply-demand balances. However, we note the much smaller proportion of Evonik's profits stemming from one key product, methionine.

We note that Evonik has built its second methionine plant in Singapore, doubling its production capacity in the country to 300,000 metric tons per year. The decision to expand reflects the 5%-6% growth in demand for methionine, fueled by the professionalization of meat production. However, the oversupply situation is continuing and we expect little recovery in methionine prices during the remainder of 2019. That said, we recognize Evonik's first quartile cost position thanks to its backward integration and technological expertise in complex methionine production, both of which support the profitability of the methionine business even at the current low point in the cycle.

We note the enhancements to diversity thanks to recent acquisitions, and recognize Evonik's strategy to accelerate growth and attain a sustainable EBITDA margin of 18%-20% on average over the cycle through cost efficiencies and a further shift toward specialty chemicals. In our view, a track record of sustainably better and stable margins would be a key indication of the strengthening business profile, with the MMA business disposal an important milestone on this path.

Peer comparison

Table 1

Evonik Industries--Peer Comparison					
Industry Sector: Chemical Companies					
	Evonik Industries	BASF SE	Solvay S.A.	Eastman Chemical Co.	LANXESS AG
Ratings as of Sept. 4, 2019	BBB+/Stable/A-2	A/Stable/A-1	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2
(Mil. €)	--Fiscal year ended Dec. 31, 2018--				
Revenue	15,024.0	62,675.0	11,299.0	8,866.3	7,197.0
EBITDA	2,414.0	10,368.5	1,975.5	1,955.6	968.7
Funds from operations (FFO)	1,988.6	8,766.2	1,531.7	1,554.0	735.3
Interest expense	158.4	774.3	276.8	224.3	103.4
Cash interest paid	158.4	506.3	208.8	225.2	77.4
Cash flow from operations	1,780.6	8,208.2	1,356.7	1,388.1	454.5
Capital expenditure	1,026.0	3,864.0	711.0	457.7	497.0
Free operating cash flow (FOCF)	754.6	4,344.2	645.7	930.4	(42.5)
Discretionary cash flow (DCF)	182.9	1,323.2	282.9	299.8	(127.8)
Cash and short-term investments	1,128.0	2,644.0	1,103.0	197.4	1,395.0
Debt	5,745.4	26,315.9	6,584.8	6,225.9	2,028.2
Equity	8,075.0	36,109.0	9,024.0	5,134.1	3,023.0
Adjusted ratios					
EBITDA margin (%)	16.1	16.5	17.5	22.1	13.5
Return on capital (%)	10.7	10.8	6.4	11.8	9.4
EBITDA interest coverage (x)	15.2	13.4	7.1	8.7	9.4

Table 1

Evonik Industries--Peer Comparison (cont.)					
FFO cash interest coverage (x)	13.6	18.3	8.3	7.9	10.5
Debt/EBITDA (x)	2.4	2.5	3.3	3.2	2.1
FFO/debt (%)	34.6	33.3	23.3	25.0	36.3
Cash flow from operations/debt (%)	31.0	31.2	20.6	22.3	22.4
FOCF/debt (%)	13.1	16.5	9.8	14.9	(2.1)
DCF/debt (%)	3.2	5.0	4.3	4.8	(6.3)

Financial Risk: Intermediate

Our view of Evonik's financial risk profile takes into account the group's FFO to debt of close to 40% in 2019 under our base-case scenario, which is within the 30%-40% range commensurate with the ratings.

During first-half 2019, Evonik generated adjusted EBITDA of about €1.1 billion, leading to an FFO of about €0.8 billion. This is moving in line with our base-case estimates of about €2.1 billion of EBITDA and about €1.9 billion of FFO for full-year 2019. Over the course of 2019-2020, we also anticipate Evonik will generate strong free operating cash flow of €0.6 billion-€0.7 billion, allowing the company to deleverage gradually. We also assume that the company will continue its focus on high-margin businesses via internal initiatives and external opportunities, with the proceeds from the sale of the MMA business to be mainly utilized to pursue future growth opportunities rather than deleveraging.

We note Evonik's financial policy commitment to a solid investment-grade rating and assume that capex, dividends and future acquisitions (if any) will be balanced appropriately or prudently funded. This was demonstrated by the issuance of a €500 million intermediate equity content hybrid instrument to finance the acquisition of the Huber Silica business in 2017.

Financial summary

Table 2

Evonik Industries--Financial Summary					
Industry Sector: Chemical Companies					
	--Fiscal year ended Dec. 31--				
(Mil. €)	2018	2017	2016	2015	2014
Revenue	15,024.0	14,419.0	12,732.0	13,507.0	12,917.0
EBITDA	2,414.0	2,361.0	2,194.0	2,433.0	1,879.0
Funds from operations (FFO)	1,988.6	1,891.1	1,570.7	1,999.5	1,475.2
Interest expense	158.4	167.9	164.3	173.5	229.8
Cash interest paid	158.4	156.9	131.3	97.5	173.8
Cash flow from operations	1,780.6	1,624.1	1,819.7	2,019.5	1,034.2
Capital expenditure	1,026.0	1,036.0	942.0	908.0	1,044.0
Free operating cash flow (FOCF)	754.6	588.1	877.7	1,111.5	(9.8)
Discretionary cash flow (DCF)	182.9	16.4	317.7	620.5	(493.8)
Cash and short-term investments	1,128.0	1,163.0	4,940.0	2,733.0	1,370.0

Table 2

Evonik Industries--Financial Summary (cont.)					
Industry Sector: Chemical Companies					
	--Fiscal year ended Dec. 31--				
(Mil. €)	2018	2017	2016	2015	2014
Gross available cash	1,068.0	1,052.0	4,668.0	2,655.0	1,370.0
Debt	5,745.4	5,770.6	2,176.8	1,829.1	2,959.6
Equity	8,075.0	7,777.0	7,750.0	7,576.0	6,522.0
Adjusted ratios					
EBITDA margin (%)	16.1	16.4	17.2	18.0	14.5
Return on capital (%)	10.7	11.7	13.4	15.4	11.3
EBITDA interest coverage (x)	15.2	14.1	13.4	14.0	8.2
FFO cash interest coverage (x)	13.6	13.1	13.0	21.5	9.5
Debt/EBITDA (x)	2.4	2.4	1.0	0.8	1.6
FFO/debt (%)	34.6	32.8	72.2	109.3	49.8
Cash flow from operations/debt (%)	31.0	28.1	83.6	110.4	34.9
FOCF/debt (%)	13.1	10.2	40.3	60.8	(0.3)
DCF/debt (%)	3.2	0.3	14.6	33.9	(16.7)

Liquidity: Strong

We view Evonik's liquidity as strong based on our estimate that sources will exceed uses by 1.6x over the 12 months from June 30, 2019, and 1.5x over the subsequent 12 months. Evonik's debt documentation does not include any covenants and the group has a track record of addressing its maturities well ahead of time.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> At June 30, 2019, about €0.5 billion of estimated cash and liquid investments. A €1.75 billion undrawn revolving credit facility (RCF) maturing in 2024. The facility is not subject to any financial covenants. FFO of €1.6 billion-€1.7 billion over the next 12 months, according to our base-case credit scenario. Net proceeds from the MMA business sale of about €2 billion. 	<ul style="list-style-type: none"> Short-term debt of €0.9 billion at June 30, 2019. Assumed capex of about €1 billion, of which €0.5 billion is maintenance capex. Dividends of €0.5 billion-€0.6 billion. Moderate working capital outflows of about €0.15 billion in the next 12 months, including €0.1 billion of peak intrayear working capital needs. About €0.7 billion for acquisitions.

Debt maturities

As of Dec 31, 2018:

- 2019: €0.2 billion

- 2020-2021: €1.2 billion
- Thereafter: €2.5 billion

Environmental, Social, And Governance

We consider Evonik's exposure to environmental risk factors as on par with the chemical sector. The company has established a group-wide environment, safety, health, and quality management system based on statutory and normative frameworks, including ISO standards, the UN Sustainable Development Goals, and internal regulations. It has already been able to reduce its absolute greenhouse gas emissions by about 30% since 2008, and has set a target to reduce emissions by another 20% by 2025. In addition, Evonik introduced internal CO₂ pricing as additional criteria in the management of major investments. Evonik uses co-generation plants at several of its large sites. It announced plans to replace the last coal-fired power plant at its Marl site by 2022, and has integrated structures linking chemical production and energy generation. In 2018, Evonik spent €43 million on environmental protection, compared to a total of €340 million since 2012. The company also generates approximately 50% of its sales from products and solutions that help improve resource efficiency in customers' applications. We believe social factors are currently not a material risk for the rating. Furthermore, we view Evonik's governance as a supportive factor for the ratings, reflecting management's experience and expertise, governance fully in line with best practices, and the balance of different stakeholders' interests.

Reconciliation

Table 3

Reconciliation Of Evonik Industries Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

--Fiscal year ended Dec. 31, 2018--

Evonik Industries reported amounts									
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Dividends	Capital expenditure
Reported	4,084.0	7,729.0	2,275.0	1,359.0	51.0	2,414.0	1,704.0	552.0	1,032.0
S&P Global Ratings' adjustments									
Cash taxes paid	--	--	--	--	--	(267.0)	--	--	--
Cash taxes paid: Other	--	--	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	--	(121.0)	--	--	--
Operating leases	546.0	--	115.0	35.1	35.1	(35.1)	79.9	--	--
Intermediate hybrids reported as debt	(250.0)	250.0	--	--	(2.7)	2.7	2.7	2.7	--
Postretirement benefit obligations/deferred compensation	2,482.0	--	7.0	7.0	70.0	--	--	--	--

Table 3

Reconciliation Of Evonik Industries Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)									
Accessible cash and liquid investments	(968.0)	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	5.0	(5.0)	(5.0)	--	(5.0)
Capitalized development costs	--	--	(1.0)	(1.0)	--	--	(1.0)	--	(1.0)
Dividends received from equity investments	--	--	12.0	--	--	--	--	--	--
Nonoperating income (expense)	--	--	--	13.0	--	--	--	--	--
Noncontrolling interest/minority interest	--	96.0	--	--	--	--	--	--	--
Debt: Guarantees	22.4	--	--	--	--	--	--	--	--
Debt: Other	(171.0)	--	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	11.0	11.0	--	--	--	--	--
EBITDA: Foreign exchange gain/(loss)	--	--	(5.0)	(5.0)	--	--	--	--	--
Depreciation and amortization: Impairment charges/(reversals)	--	--	--	41.0	--	--	--	--	--
Total adjustments	1,661.4	346.0	139.0	101.1	107.4	(425.4)	76.6	2.7	(6.0)
S&P Global Ratings' adjusted amounts									
	Debt	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid	Capital expenditure
Adjusted	5,745.4	8,075.0	2,414.0	1,460.1	158.4	1,988.6	1,780.6	554.7	1,026.0

PP&E--Property, plant, and equipment.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Intermediate
- **Competitive position:** Strong

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb+

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Strong (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Specialty Chemicals Industry, Dec. 31, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- EMEA Chemical Companies, Strongest To Weakest, Aug. 2, 2019
- Industry Top Trends Update: Chemicals, July 25, 2019
- S&P Global Ratings Publishes Updated Global And Regional Corporate Rating Component Scores Reports, July 18, 2019
- ESG Industry Report Card: Chemicals, June 3, 2019
- Country Risk Assessments Update: February 2019, Feb. 18, 2019
- Industry Top Trends 2019: Chemicals, Nov. 13, 2018

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+ / a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+ / a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of September 4, 2019)***Evonik Industries**

Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Short-Term Debt	A-2
Subordinated	BBB-

Issuer Credit Ratings History

09-May-2012	BBB+/Stable/A-2
06-May-2011	BBB/Stable/A-2
21-Sep-2010	BB+/Positive/B

*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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