

Research Update:

EDP - Energias de Portugal 'BBB/A-2' Ratings Affirmed On Updated Strategic Plan; Outlook Stable

March 31, 2023

Rating Action Overview

- EDP - Energias de Portugal S.A. (EDP) recently unveiled its 2023-2026 strategic plan, which will further accelerate growth in contracted renewables and regulated networks--mostly in Europe and the U.S.--with an ambitious €25 billion of gross capital expenditure (capex), while maintaining credit metrics commensurate with the 'BBB' rating.
- EDP will focus mainly on accelerating renewables growth, adding 18 gigawatts (GW) of new capacity by 2026, which should support its position as an energy-transition leader.
- We anticipate that these investments will be funded partly by an additional €4 billion debt, resulting in largely negative discretionary cash flow (DCF) over 2023-2026. The €1 billion capital increase at EDP level will be used to fund the buyout of minorities of EDP Brazil, thereby helping to simplify the group's corporate and business structure.
- We affirmed our 'BBB/A-2' long- and short-term issuer credit ratings on EDP.
- The stable outlook reflects our expectation that EDP's funds from operations (FFO) to debt will remain comfortably between 19% and 20%, and debt to EBITDA below 4.0x over 2023-2026, and that the group's EBITDA growth and cash flows will benefit from a profitable investment plan and a financial policy oriented toward a 'BBB' rating.

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Rating Action Rationale

EDP's investment plan will significantly increase the scale of its renewables footprint, solidifying its position as a global energy-transition leader. EDP has announced total investments of €25 billion, of which €21 billion should expand the group's renewables capacity by 18 GW over the 2023-2026 strategic plan, reaching total installed capacity of 33 GW globally by 2026. This compares with a capacity of 22 GW in 2022. We expect that 40% of these investments will be deployed in the U.S., followed by 40% in Europe, with the remaining share split between South America and the Asia-Pacific region, where EDP established its position through the Sunseap acquisition in 2022. We estimate ongoing cost inflation and high interest rates, coupled with price uncertainty, could reduce returns for renewables projects across Europe and U.S. We

view EDP's locking 50% of its onshore wind turbine and 90% of its solar panel component needs until 2024 as very credit supportive, because this reduces project execution risks under a rising-cost environment. In addition, we expect that the group will sell majority participations across its projects, aiming to share the risk with partners, which we see as reflective of prudent financial risk management. EDP aims to sell about 30% of the renewable capacity built during the business plan. A majority share of renewables generation (80%-90%) is contracted notably through purchase price agreements (PPAs) with a relatively long tenor.

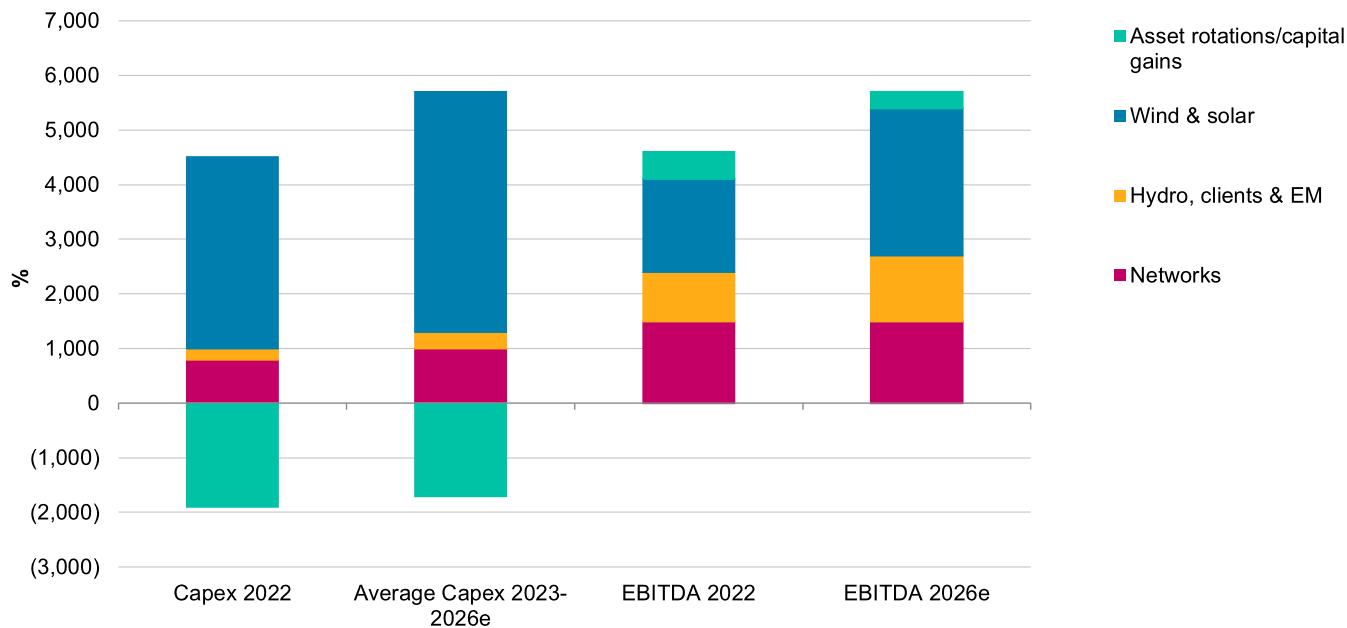
EDP's solid experience should mitigate the risks associated with the investment plan. The ambitious plan entails some execution risks, in our view, especially in less mature and more capital-intensive offshore wind technology; also, the authorization process is slowing the deployment of renewables capacity in Europe and in the U.S. That said, EDP has a solid execution track record and a relatively high amount of already-secured pipeline. We understand that around 40% of the planned 18 GW capacity has been secured (that is, renewables capacity that already has long-term contracted remuneration in place) while the remaining 60% is in the pipeline. In addition, the bulk of capex is concentrated on increasingly mature technologies, with 40% on a solar utility scale and 40% on onshore wind, where the group has built a track record, thereby limiting operational risks. Remaining capacity (3.3 GW) will be allocated to offshore wind, solar-distributed generation, and storage.

In our view, the plan supports EDP's business risk profile. This is because growth should stem mainly from renewables and, to a lesser extent, networks, mostly in countries with high credit ratings, notably within North America and Europe. Details of the plan include:

- About 85% of capex will be allocated to renewables, client solutions, and energy management, while about 15% to networks. The EBITDA contribution from networks will decrease from 33% in 2022 to 26% by 2026, while renewables (wind and solar) will increase from 48% in 2022 to 53% by 2026. The hydro, client solutions, and energy management (EM) segment's share of EBITDA will remain fairly stable to 2026; and
- The share of investment in terms of geography will be split between Europe and North America (40% each), South America (15%), and close to 5% in Asia-Pacific. In terms of renewables, investments will mostly be focused on onshore wind and solar utility scale. Of networks, the plan intends to increase the regulated asset base (RAB) in Brazil, from 19% of EDP's total RAB in 2022 to 24% in 2026.

Chart 1

EDP's Evolution Of Capex, Asset Rotation, And EBITDA Over The Business Plan



Note: Capex does not include financial investments. e--Estimate. Source: S&P Global Ratings.

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We expect EDP's credit metrics will remain between 19% and 20%, thanks to strong EBITDA growth mitigating negative average free operating cash flow (FOCF).

EDP's annual gross investments are expected to average about €6.1 billion over 2023-2026 (from €5.3 billion, including financial investments, in 2021-2022) to significantly accelerate the development of its solar and wind renewables generation fleet.

As part of EDP's newly announced 2023-2026 strategy, total expansion investments dedicated to the energy transition will be about €23 billion. This will be mainly funded by:

- Organic cash flow of about €9 billion;
- A targeted €7.0 billion of asset rotations;
- Other flexible sources of funding such as disposals targeting about €1 billion over the business plan;
- About €4 billion of additional debt; and
- €1 billion of capital increase at EDPR, which was concluded in March 2023.

We forecast annual free operating cash flow (FOCF) to remain negative at €2.0 billion-€2.5 billion over 2023-2025, with a peak in 2023, while DCF will be about negative €2.9 billion-€3.4 billion (per year) supported by EDP's asset rotation plan. Our base-case scenario assumes about €6.8 billion

of asset rotation (€1.7 billion-€1.8 billion annually), mostly related to the sale of renewables projects to partners, which should reinforce EDP's balance sheet. We estimate shareholder distributions remaining at about €0.9 billion per year and working capital outflow being structurally negative mainly because of tax equity credits EDP receives in the U.S. to develop renewables. We expect EBITDA at a 6% compound annual growth rate (CAGR; over 2022-2026), owing to solid deployment of the renewables capacity portfolio (target to add above 4 GW annually) offsetting debt increases.

Last year's results were above our expectations, despite extreme drought in Portugal and several acquisitions. Credit metrics for 2022 were affected by extreme drought in Portugal, notably in the first half of 2022, and the planned acquisition of Singapore-based solar developer Sunseap and Germany-based solar developer Kronos, through EDP's 71% owned subsidiary EDPR, for about €800 million and €250 million, respectively. Despite these events, the 2022 financial performance was above our expectations, with EDP's funds from operation (FFO) to debt reaching about 19.0% versus 17.5%-18.5% as previously expected. EDP's reported EBITDA increased to €4.5 billion or 22% versus 2021, which compares with S&P Global Ratings-adjusted EBITDA of about €4.2 billion. This is mainly because of continuous growth in EDP's renewables business reflecting portfolio expansion (average megawatts installed have increased 9% compared with 2021), higher average selling price, and recovery of wind resources.

In our view, EDP's financial policy remains geared toward the 'BBB' rating, which is supported by the group's commitment to maintaining the rating. We see EDP's more selective investment strategy amid ongoing uncertainties as reflective of the group's prudent risk management. We expect EDP will operate on average at FFO to debt of between 19% and 20% over the next two-to-three years, which is our threshold for the current rating. We also note EDP's commitment to the current 'BBB' rating. If EDP encounters any operational or financial underperformance in its current plan, we would expect it to take credit supportive measures such that FFO to debt remained above 19% and debt to EBITDA below 4.0x. EDP also lowered its dividend payout to 60%-70% from 75%-85% previously, which we view as positive, notably in the period of heavy investments.

The recent intention to delist EDP Brazil financed by capital increase at EDP level will reduce cash flow leakage in Brazilian operations slightly offset by reduction of ownership in EDPR. A credit consideration for EDP is its relatively complex group structure, with significant and diverse minority shareholders in most of its foreign holdings (notably EDPR, 71.20% owned). In March 2023, EDP announced a tender offer for the acquisition of shares issued by EDP for the purpose of delisting its Brazilian subsidiary EDP Brazil, where it has a 57.55% stake, which is expected to reduce the gap between consolidated and pro forma FFO to debt. Conversely, with the recent capital increase at EDPR, EDP's minority holdings slightly increase, because it will now own 71.20% from 74.98% previously. The reduction of the ownership is also due to the recent announcement to change EDPR's dividend policy to a scrip dividend. EDP already announced its intention to opt for shares instead of cash, which could increase EDP's ownership in EDPR, and we note that EDPR is almost fully funded internally. Financial leverage at EDPR is lower than consolidated leverage, meaning the consolidated debt mainly lies at the EDP level. Moreover, with expected asset rotations which could potentially widen the gap between pro forma and consolidated FFO to debt, we will monitor the risk of increased cash flow leakage.

We expect the contribution from network activities to remain stable at 25%-30% of EBITDA throughout the course of the 2023-2026 business plan. Following the integration of Spanish power distribution system operator (DSO) Viesgo Holdco in December 2020, EDP reinforced its

regulated network operations in Portugal and Brazil. These will represent a relatively stable 30% of EBITDA over 2023-2026. Iberian networks are protected by mostly supportive regulatory frameworks. On Dec. 15, 2021, the Portuguese Electricity Regulator ERSE announced its final decision on electricity tariffs for 2022 and parameters for 2022-2025, which we view as mostly supportive.

Outlook

The stable outlook reflects our expectation that EDP's FFO to debt will remain between 19% and 20% and debt to EBITDA below 4.0x over the 2023-2026 period, and that the group will continue investing in regulated activities and renewables in a balanced way while maintaining a financial policy oriented toward a 'BBB' rating.

Downside scenario

We could lower the ratings if, over 2023-2024, EDP's FFO to debt drops below 19% or the group is unable to reduce leverage, with adjusted debt to EBITDA remaining above 4.0x. One or more of the following scenarios could lead us to take a negative rating action:

- EDP experiences any operational setback, such as lower-than-expected profitability from installed assets or material delays in construction that are not compensated by supportive credit remedy measures;
- Increased presence of minorities, which would result in higher-than-expected cash flow leakage;
- A material heightening of country risk in Portugal and (secondarily) Brazil, including adverse regulatory or fiscal effects); and
- Inability to achieve the €7 billion asset rotation target over 2023-2026 without any measures to reduce capex.

Upside scenario

We view an upgrade as unlikely, given the company's current financial policy and ambitious investment plan. That said, rating upside would require EDP to achieve FFO to debt above 25% under its current business risk profile.

Company Description

EDP is a vertically integrated utility company. It is the largest generator, distributor, and supplier of electricity in Portugal, and the third-largest electricity generator on the Iberian Peninsula.

EDP is one of the largest wind power operators worldwide. Through its subsidiary EDPR, the group develops and operates wind and solar energy generation in 29 markets across Europe, North and Latin America and, more recently, in the Asia-Pacific region with the Sunseap acquisition.

In Brazil, EDP is the fifth-largest private operator in electricity generation, with two electricity distribution concessions (EDP São Paulo and EDP Espírito Santo). It is Brazil's fourth-largest private supplier in the liberalized market, and recently entered into power transmission there.

EDP reports its operations under the following two business segments:

- Renewables (56% of 2022 EBITDA), client solutions, and EM (11%): This segment includes EDP's hydro, wind, and solar power assets across all geographies. EDP's renewables capacity accounts for 79% of total installed capacity, equivalent to 20.7 GW. Client solutions and EM include EDP's supply activities in Iberia and Brazil, thermal generation, and EM businesses.
- Networks (33%): This segment includes EDP's electricity distribution activities in the Iberian Peninsula (25%) and Brazil, transmission lines in Brazil, and electricity last resort supply activity in Portugal.
- As of Dec. 31, 2022, EDP had an installed capacity of 26.2 GW and generated 61.4 terawatt hours of electricity over the previous 12 months, about 74% of which came from renewables.

Our Base-Case Scenario

Assumptions

- Economic growth to be set to decelerate in 2023, but medium-term prospects to remain strong, backed by the planned execution of significant EU funds. We expect this trend to minimize affordability issues but also allow for a moderate increase in system revenues.
- A significantly higher price environment with electricity prices gradually decreasing over the coming years. We expect EDP to benefit from the elevated prices for its unhedged portion of its generation. Average wholesale prices are forecast at about €120 per megawatt-hour (/MWh) in 2024, gradually decreasing thereafter. By 2026, we expect electricity price to normalize at about €100/MWh.
- Reported EBITDA of €4.9 billion-€5.0 billion in 2023, compared with S&P Global Ratings-adjusted EBITDA of €4.7 billion-€4.8 billion, which we expect to benefit from material growth in EDP's accelerated renewables buildout of about 4.5 GW per year. EBITDA growth is mostly attributable to the fast renewables capacity increase, while networks operations are forecast to remain stable.
- We do not include any foreign exchange hit.
- Negative working capital mainly due to tax equity credits received.
- Cash taxes averaging €260 million over 2023-2025.
- Cash interest paid to increase to about €820 million on average annually, resulting from the material interest rate increase causing the average cost of debt to rise from 2.9% to 4.3%.
- Gross capex and financial investments of about €6.1 billion per year over 2023-2026. The total gross investment plan covering 2023-2026 includes a total of €25 billion in gross investments, of which we anticipate about 85% to be spent on renewables development and 15% on networks.
- Dividends (including dividends to minority shareholders) averaging €900 million over 2023-2025.
- Disposals, targeting about €1 billion per year over 2023-2025.
- Asset rotation totaling about €7 billion between 2023-2026.
- A capital increase within EDP of €1.0 billion has been incorporated into our forecast for 2023.

- About €1 billion in proceeds annually from tax equity credits in the U.S. are included in our forecast.

Key metrics

EDP - Energias de Portugal S.A.--Key Metrics

(Bil. €)	2021a	2022a	2023e	2024e	2025e
EBITDA (bil. €)	3.3	4.2	4.7-4.8	4.9-5.0	5.1-5.2
FFO (bil. €)	2.7	3.2	3.6-3.7	3.8-3.9	4.0-4.1
Capex and inv. (bil. €)	3.3	3.5	6.0-6.2	6.0-6.2	6.0-6.2
Dividends (mil. €)	931	1,000	900-930	900-930	900-930
Debt (bil. €)	14.5	16.9	18.0-19.0	19.0-20.0	19.0-20.0
FFO/debt (%)	18.3	18.8	19.5-20.5	19.5-20.5	19.5-20.5
Debt/EBITDA (x)	4.4	4.1	3.6-4.1	3.6-4.1	3.6-4.1

a--Actual. p--Preliminary. e--Estimate. Capex and inv.--Capital expenditure, includes financial investments. FFO--Funds from operations. All data is adjusted by S&P Global Ratings.

Liquidity

We view EDP's liquidity as strong, reflecting the company's proactive financing and healthy cash flow. In particular, projected sources of liquidity (predominantly operating cash flow and available bank lines) exceed projected uses (mainly necessary capex, debt maturities, and dividends) by more than 1.5x for the next 12 months and more than 1.0x in the following 12 months. EDP's strong bank relationships and proven access to the debt capital markets support our assessment of the liquidity position as strong. Furthermore, EDP's prudent financial policy, which minimizes exposure to cash collateral requirements, further supports our assessment. We do not include in our liquidity calculation proceeds from asset rotations, which we forecast to be about €1.7 billion annually. Should the group be unable to achieve its asset rotation targets, gross capex would be adjusted accordingly.

We estimate the following principal liquidity sources for the 12 months from Dec. 31, 2022:

- Unrestricted cash of about €4.9 billion;
- About €6.4 billion in available committed lines maturing beyond 12 months. In particular, EDP has a €3.7 billion revolving credit facility (RCF) maturing in 2027 and a €2.1 billion RCF maturing in 2025;
- €1 billion in proceeds from capital increase concluded in March 2023; and
- Forecast cash FFO of about €3.9 billion.

For the same period, we estimate the following principal liquidity uses:

- Debt of €3.5 billion maturing within the next 12 months;
- Estimated working capital outflows of more than €500 million;
- Estimated €6.1 billion in gross capex; and

- Dividends of about €880 million, including dividends to subsidiaries' minority shareholders.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

The power industry bears environmental risk well above other sectors because it is at the forefront of the energy transition and faces pressure to decarbonize the generation mix. It also has above-average social risk, given its considerable influence on local communities, including on customers' electricity bills; as a local employer; as a significant contributor to local taxes; and by ensuring safe operations at generating facilities. Moreover, renewables face some environmental and social risks, as the significant acceleration of new builds requires more land and acceptance from local communities, together with workforce adequation (see "ESG Credit Indicator Report Card: Power Generators," published Nov. 18, 2021.)

ESG factors have an overall neutral influence on our credit rating analysis of EDP. EDP is a world leader in renewable energy generation and has a strong commitment to the energy transition in its latest strategic plan for 2023-2026. The plan predominantly focuses on renewable generation and phasing out coal by 2025 (9.7% of installed capacity at year-end 2022). Its generation fleet comprises 79% renewables (versus 30%-50% for closest peers). EDP aims to double its buildout wind and solar capacity by 2026, versus its 2019-2022 plan, with an additional 18 GW (mainly wind, with 15.5 GW deployed and 8 GW solar PV), resulting in a net added capacity of 11 GW post asset rotation. The group stated publicly that it will reduce the intensity of CO₂ emissions (scope 1 and 2) by 95% up to 2030 (compared with 2020 levels). EDP is also committed to reducing absolute scope 3 emissions by 45% over the same timeframe. In 2022, EDP generated 160 grams of carbon dioxide equivalent per kilowatt-hour (gCO₂/kWh) under scope 1 and 2 emissions, up from 157 gCO₂/kWh in 2020, due to high thermal availability and poor hydro performance, and still in line with best-in-class utilities. Governance uncertainties related to the previous CEO's suspension in 2020 have been resolved, with the nomination of Miguel Stilwell De Andrade as new CEO at the end of January 2021, and we currently assess EDP's management and governance as satisfactory.

Issue Ratings - Subordination Risk Analysis

Capital structure

EDP's policy is to issue most of its debt at the parent company directly, or via its financial subsidiary EDP Finance BV, and lend the proceeds to its operating companies. However, we calculate structural subordination to be about 20% because of the amount of debt at the subsidiaries. We think EDP's size, diversity of cash flow generation, and financial ring-fencing of its Brazilian subsidiary and direct ownership of a fair amount of operating assets strongly mitigate structural subordination issues.

Analytical conclusions

The issue rating on EDP's senior unsecured debt is 'BBB', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure. We rate the hybrid bonds 'BB+', two notches below EDP's 'bbb' stand-alone credit profile.

Ratings Score Snapshot

Issuer credit rating	BBB/Stable/A-2
Business risk:	Strong
Country risk	Intermediate
Industry risk	Intermediate
Competitive position	Strong
Financial risk:	Significant
Cash flow/leverage	Significant
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	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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
- 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 Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Ratings Affirmed

EDP - Energias de Portugal S.A.

EDP Finance B.V.

Issuer Credit Rating	BBB/Stable/A-2
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Senior Unsecured	BBB
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Junior Subordinated	BB+
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Commercial Paper	A-2
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EDP Finance B.V.

Senior Unsecured	BBB
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Commercial Paper	A-2
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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