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Hawaiian Electric Industries, Inc. NYSE:HE

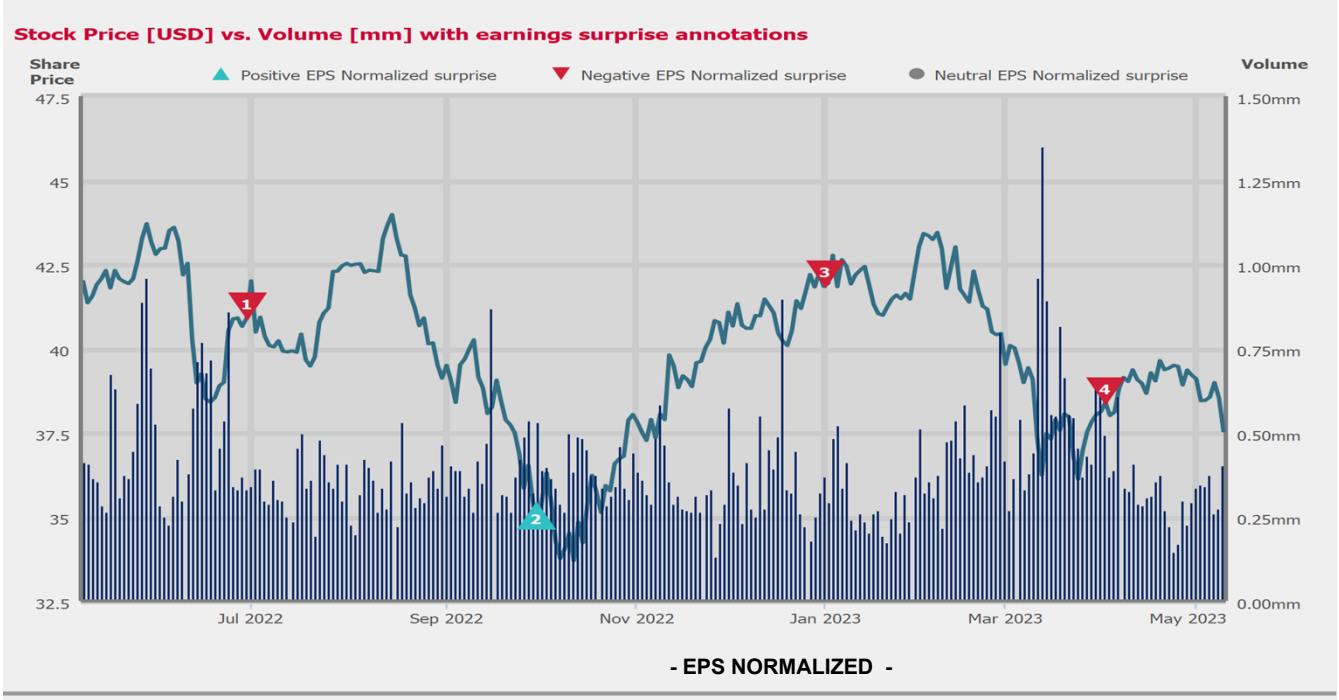
FQ1 2023 Earnings Call Transcripts

Tuesday, May 9, 2023 8:15 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2023-			-FQ2 2023-	-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.53	0.50	▼ (5.66 %)	0.57	2.27	NA
Revenue (mm)	755.82	928.24	▲ 22.81	741.80	3471.07	NA

Currency: USD
Consensus as of Apr-24-2023 1:00 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2022	0.52	0.48	▼1 (7.69 %)
FQ3 2022	0.54	0.57	▲2 5.56 %
FQ4 2022	0.55	0.52	▼3 (5.45 %)
FQ1 2023	0.53	0.50	▼4 (5.66 %)

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Table of Contents

Call Participants	.....	3
Presentation	.....	4
Question and Answer	.....	8

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Paul Patterson
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Presentation

Operator

Good afternoon. Thank you for attending today's Q1 2023 Hawaiian Electric Industries, Inc. Earnings Conference Call. My name is Alexis, and I will be your moderator for today's call. [Operator Instructions]

I would now like to pass the conference over to Mateo Garcia, Director of Investor Relations. You may proceed.

Mateo Garcia
Director of Investor Relations

Thank you, Alexis. Welcome, everyone, to HEI's first quarter 2023 earnings call.

Joining me today are Scott Seu, HEI President and CEO; Paul Ito, HEI CFO; Shelee Kimura, Hawaiian Electric President and CEO; and Ann Teranishi, American Savings Bank President and CEO; and other members of senior management. Our earnings release and our presentation for this call are available in the Investor Relations section of our website.

As a reminder, forward-looking statements will be made on today's call. Factors that could cause actual results to differ materially from expectations can be found in our presentation, our SEC filings and in the Investor Relations section of our website.

Now Scott will begin with his remarks.

Scott W. H. Seu
President, CEO & Director

Aloha kakou. Greetings, everyone. Thank you for joining us today. I'll give an overview of our results, update you on our businesses and the Hawaii economy, and then turn the call over to Paul to further discuss our financial results and guidance.

Our combination of businesses continued to deliver solid results in the first quarter. ASB's low-risk community banking model, supported by a strong primarily retail deposit franchise, showed its resilience. And with 86% of deposits from our retail customers and 85% of total deposits F.D.I.C. insured or fully collateralized, ASB is a very different bank than the banks that have experienced challenges in recent months.

The utility continues to show its ability to deliver consistent performance, under performance-based regulation, or PBR, and operate efficiently to deliver earnings growth. Our consolidated first quarter earnings of $54.7 million and earnings per share of $0.50 reflects strong execution from across our enterprise.

The utility executed well, growing net income to $47 million, despite elevated costs from storms during the quarter. And ASB grew net income over the fourth quarter of last year, generating net income of $18.6 million. As a reminder, last year's first quarter results included a $0.06 per share gain on sale in the holding company and other segment.

Turning to the utility. We continue to progress key initiatives to integrate more renewables, while improving the reliability and resilience of our grids. In late March, we filed our draft Integrated Grid Plan, or IGP, which proposes a clear plan forward to meeting our state's clean energy goals, while prioritizing reliability and affordability.

The draft IGP identifies four key objectives within the next 5 years, including stabilizing utility rates and advancing energy equity, growing the marketplace for customer scale and large-scale renewables, creating a modern and resilient grid, and securing reliability through diverse energy sources and technologies. Our IGP is crucial to achieving our state's clean energy goals of net-zero carbon emissions and 100% renewables by 2045.

Our Stage 3 RFP has continued to progress as planned. Bids were submitted in April, and the utility has bid in for firm renewable generation, consistent with the reliability requirements under the competitive bid framework. The RFPs are seeking a total of over 1,700 gigawatt hours of energy annually, and between 600 and 800 megawatts of firm renewable capacity. Bid award notifications for Hawaii Island, Oahu and the variable and storage components of Maui's RFP are expected in late October.

We are continuing to connect renewable projects and the infrastructure required to deploy renewables reliably and efficiently to our grids. Last month, we placed in service a 30-megawatt solar project that includes 120-megawatt hours of storage on Hawaii Island. We also now have 0.25 million smart meters deployed, servicing over 50% of our customers. These meters help us to integrate more

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renewables and to get distributed energy resources connected to our system faster, while providing data that helps us operate our grid more efficiently.

We also plan to connect the 185-megawatt Kapolei Energy Storage project to our grid this summer. The project will provide load shifting and fast frequency response services, enhancing grid reliability as we continue accelerating the integration of renewable energy.

Turning to the bank on Slide 4. ASB remains well positioned, operating in Hawaii's unique banking market, which is characterized by loyal customers, a healthy economy and stable real estate values.

Our depositor base, 86% of which comprises retail deposits, has remained a steady source of funding during the quarter, with no unusual changes to customer behavior as a result of challenges elsewhere in the banking industry. ASB remains a consistent contributor to earnings and cash flow. And during the quarter, paid HEI $14 million of dividends.

We continue to see positive trends in credit quality and our high-quality loan book, most of which is real estate secured, saw a continuation of historically low delinquency rates and net charge-offs, and overall solid condition of our borrowers during the quarter. ASB's unique banking market, strong liquidity and capital ratios and high-quality retail deposit base give us confidence we are well positioned to continue delivering solid financial results.

Turning to the economy on Slide 5. Hawaii's economy continues to show strength across key indicators. And the University of Hawaii Economic Research Organization, which provides regular forecasts of our state's economy, is still projecting growth in Hawaii in 2023, driven by a continued recovery of tourism and expected strong military construction spending.

Hawaii's unemployment rate was 3.5% in March, an improvement from 3.6% in February and in line with the national average. As a reminder, unemployment here has fared comparatively well during downturns and performed better than the national average during the financial crisis.

Visitor arrivals are near pre-pandemic levels. In March, about 901,000 visitors arrived in Hawaii, an increase of 14% from last year, and a 97% recovery from March 2019. International arrivals nearly doubled compared to last year in March, with Japanese arrivals increasing tenfold. Notably, visitor spending has been very strong. And in March, it was up over 20% compared to last year, and up over 23% compared to pre-pandemic levels.

Hawaii's housing market has also been resilient. And while sales volumes are lower, given high mortgage rates, median prices at about $1 million in April are still hovering near record highs.

I'll now hand the call over to Paul to further discuss our financial results and outlook.

Paul K. Ito
Executive VP, Treasurer & CFO

Thank you, Scott. I'll start with our results for the quarter.

We generated consolidated net income of $54.7 million and EPS of $0.50 compared to $69.2 million and EPS of $0.63 last year. As a reminder, our results in the prior year's quarter included a $0.06 per share gain on the sale of the EverCharge equity investment recorded at Pacific Current, and also reflected bank earnings that were elevated by a net benefit from the release of reserves.

Our consolidated last 12 months ROE remains healthy at 10%, which is down from 10.9% last year due to lower bank earnings and the previously mentioned gain at Pacific Current in the prior year. Utility ROE continues to improve and increased 10 basis points to 8.2%. And bank ROE on an annualized basis was up 180 basis points compared to the same quarter last year, given the impacts of unrealized losses in the investment securities portfolio on shareholders' equity.

On Slide 7, we show major variances across the enterprise compared to the first quarter of last year. Lower bank net income was primarily due to higher noninterest expense, which was driven by higher compensation and benefits costs, a higher provision compared to the negative provision recorded in the first quarter of last year, and lower noninterest income due to a gain on sale of real estate recorded in the fourth quarter of last year. These items were partially offset by higher net interest income, primarily due to higher interest and dividend income, partially offset by higher interest expense.

On the utility side, on an after-tax basis, we saw $7 million in higher annual revenue adjustment, or ARA revenues, $1 million higher AFUDC and $1 million higher major project interim recovery mechanism revenues. These were partially offset by higher O&M,

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primarily from higher storm restoration costs and higher depreciation, higher interest expense from higher borrowings and higher heat rate.

The holding company and other segment variance was driven by last year's gain on sale at Pacific Current, and in the current year, lower performance from Pacific Current and higher holding company interest expense.

Turning to Slide 8. Utility CapEx for the quarter was $112 million, nearly twice the CapEx in the first quarter of 2022. For the full year, we continue to forecast CapEx in the $370 million to $410 million range.

On Slide 9, we show utility earnings drivers for the remainder of the year. The utility has performed well so far this year, operating efficiently and managing O&M, despite $2.8 million in higher pretax expenses related to the storms we saw in the first quarter. Efficient execution will remain a key area of focus for us for the remainder of the year as we work to manage O&M increases within the 3.68% inflationary adjustment allowed under the ARA.

Performance incentive mechanisms, or PIMs, will also be a key driver of our full year earnings. Fuel prices have moderated from the beginning of the year, with no significant impact from the fuel cost risk-sharing mechanism.

As a reminder, benchmark prices are set on January's full prices for each fossil field type, and prices in the first quarter trended below those benchmarks. Lower fuel prices have also contributed to lower customer bills and rates on all islands are now lower than they were last spring when we started feeling the impacts of Russia's invasion of Ukraine.

We remain on track to be within the $1 million to $3 million guidance we issued in February for the RPS-A PIM. And as Scott mentioned, we've been making good progress connecting renewable projects to our grid. In summary, we still expect total net PIMs of approximately $4 million for 2023.

Turning to the bank, on Slide 10. This slide shows key differentiators that underpin the solid, low-risk and predictable community banking model that has consistently contributed to HEI's earnings and cash flow for many decades through many different cycles.

As a community bank, with a focus on relationship banking, the vast majority of our customers are 86%, comprise the retail segment. Our retail customer base is loyal and long tenured with nearly 50% of our retail customers having been with us for more than 10 years. We also have strong commercial customer relationships, with nearly 40% of our commercial accounts having a tenure of more than 10 years.

In addition to the tenure of our customer deposits, which contributes to funding stability, 85% of ASB's deposits are F.D.I.C. insured or collateralized. This is a very high level of insured deposits and is a key differentiator that contributes to deposit stability.

Despite the mainland bank turmoil during the quarter, total average deposits were essentially flat, down a modest 0.8% in the first quarter of 2023. On an end-of-period basis, total deposits were up 0.7% since the end of last year.

In short, we did not see unusual customer behavior as a result of the mainland bank failures. And our consistent, reliable and sticky retail deposit base continues to provide us with a predictable and low-cost source of funding.

Turning to Slide 11. ASB's conservative underwriting and management practices have allowed us to build a loan book of exceptional quality. ASB's focus is straightforward real estate secured lending within our Hawaii communities that we know and understand. The vast majority of ASB's loan book, 82% is backed by real estate.

Our lending is done at conservative loan-to-value ratios, which stand at less than 50% for residential and less than 55% for commercial real estate on a weighted average basis.

There has been a lot of focus on the quality of commercial real estate, or CRE loan portfolios of regional banks in recent months. Our CRE loan portfolio is diversified and well margined against property value declines, and we have had historically minimal loss experience within our CRE portfolio.

In fact, through the Great Financial Crisis and its aftermath, we had no charge-offs of commercial real estate loans. Office loans have also been an area of focus for regional banks. Our office CRE loans have strong credit metrics and comprise only 2% of our total loan portfolio.

Turning to Slide 12. Higher interest rates have continued to benefit our yield on earning assets, which was up 21 basis points in the first quarter to 3.49%. Last quarter, we said that we were seeing pressure from higher funding costs that we would need to pay down higher cost borrowings in order to expand net interest margin.

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Due to deposit trends in the sector, we continue to see pressure, like many banks, our net interest margin from higher funding costs, although our cost of funds remains relatively low compared to similarly sized peers. Cost of funds for the quarter was up 28 basis points to 66 basis points, which was due primarily to a shift in funding that pressured our net interest margin.

You can see at the bottom left of the slide, we've had a higher proportion of average wholesale borrowings to total funding sources in the first quarter at 8% versus 3% of our funding mix in 2022, although the amount of wholesale borrowings outstanding at end of the first quarter declined from year-end. During the quarter, our net interest margin was down 6 basis points to 2.85%. We expect similar dynamics to persist for the remainder of the year.

Turning to drivers for the rest of the year on Slide 13. Due to the shift in funding mix mentioned, we are expecting net interest margin to be lower for the full year than previously anticipated. We continue to focus on opportunities to pay down higher cost funding sources and operate efficiently. We expect the Fed to remain on pause for the remainder of the year.

Provision for credit losses, although hard to predict is also a crucial driver for our operation. We continue to see strong trends in credit quality, with low net charge-offs compared to historical levels, and we still expect provision to be in the 0 to $10 million range for the year.

On Slide 14, we show our updated guidance expectations for the remainder of the year. We are reiterating our utility guidance of $1.75 to $1.85 per share. As mentioned, achieving performance incentive mechanism rewards, while avoiding penalties and managing O&M expenses, remain key areas of focus for management.

Turning to the bank's outlook for the remainder of the year. Higher short-term interest rates and a challenging deposit environment have created margin pressures across the banking sector this year. Although, we've been able to keep our funding costs low compared to peers, we are still seeing some compression in net interest margin. And we now expect net interest margin for the year to be 2.8% to 2.9% versus our previous expectation of 3% to 3.15%.

Due to higher funding costs, we expect bank EPS to be at the low end of our EPS guidance range of $0.75 to $0.85. However, it is still early in the year and uncertainty remains regarding how the Fed will proceed on interest rates and how our funding mix and costs will be impacted. Provision is also one of the more difficult items to predict. So we will be revisiting the bank guidance range as the year progresses.

We still expect holding company and other segment losses of $0.34 to $0.36 per share. We have seen slightly higher holding company and other segment expenses. As a result, we are expecting to be at the high end of that range. We do not anticipate any equity issuances for 2023. Based on the combined forecast for the segments' consolidated earnings are expected to be in the lower half of the $2.15 to $2.35 guidance range.

I'll now turn it back over to Scott, who will provide closing remarks.

Scott W. H. Seu
President, CEO & Director

Mahalo, Paul, and mahalo to all of you for joining us today. In summary, we had a solid quarter. The utility continues to execute well under performance-based regulation, and we've already hit important milestones this year in our clean energy transition.

ASB's conservative business model, with our mostly retail and largely insured deposit base, continues to prove its benefits. Our bank remains a low-risk, reliable and consistent contributor to earnings and cash flow. We continue to see strong value and consistent results from our combination of businesses.
With that, let's open up the call for questions.

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Question and Answer

Operator

[Operator Instructions] The first question comes from the line of Julien Dumoulin-Smith with Bank of America.

Julien Patrick Dumoulin-Smith
BofA Securities, Research Division

Mahalo. I appreciate it. Can you guys hear me?

Scott W. H. Seu
President, CEO & Director

Hey, Julien. Yes, we can.

Julien Patrick Dumoulin-Smith
BofA Securities, Research Division

Appreciate it. I was just curious with respect -- or first of kicking it off. I know you talked about overall not seeing too many changes on the bank deposit side, but have you seen any change in behavior for the uninsured deposits within the quarter? Just talking about that component of the deposits.

Scott W. H. Seu
President, CEO & Director

No, we've not seen any unusual. Nothing like that, Julien.

Julien Patrick Dumoulin-Smith
BofA Securities, Research Division

Okay. Excellent. And then maybe more substantively, can you talk about some of the offsets to the reduced NIM and higher noninterest expense? Obviously, a few different pieces moving around. You described it in the prepared remarks.

But what are the offsets keeping within the range?

And then related here, if you can talk about that NIM percentage and the confidence that you have that will be unchanged for the balance of '23. I think in particular, ASB has been offering additional CD promotions since 3/31. Just what gives you that confidence on NIM as it stands under -- as you described it today?

Paul K. Ito
Executive VP, Treasurer & CFO

Julien, this is Paul. Thanks for the question.

So what we're looking at in terms of offsetting some of that NIM pressure is, of course, managing noninterest expenses. And then the other key factor is what provision will look like for the balance of the year. So maybe I'll start with provision.

So currently, in Hawaii, we feel pretty optimistic about the rest of the year. We haven't been seeing weakness in the economy. As you know, Yujiro had put out a report earlier, and I think there's one slated to be released soon. But they continue to have confidence in the Hawaii economy, again, given the strong construction sector that we expect in 2023 as well as the international tourism recovery that we're slowly seeing this year.

So I think the backdrop is favorable for fairly good in terms of credit quality going forward here, but that's a key assumption. Again, we do expect continuing favorable credit trends.

And then on the noninterest expense side, we're closely looking at expenses and how we can be more efficient. We've been taking a number of steps to reduce expenses across the organization. And so we've identified a number of cost-saving opportunities that we'll be executing on.

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So those two things are what gives us confidence in terms of achieving that NIM range. Now of course, there -- it depends on how things play out for the rest of the year, right, in terms of the economy, in terms of credit quality. But at the moment, we're feeling pretty confident about those items.

Julien Patrick Dumoulin-Smith
BofA Securities, Research Division

Got it. All right. Excellent. And how are core deposits and CDs trended just even of late, right, in terms of post quarter close?

Paul K. Ito
Executive VP, Treasurer & CFO

Yes. So we have seen -- after quarter end, we have seen average deposits decline. It was about $76 million in April. And April is, I would say, a little bit more of a vault to month in terms of deposits. It is the month where a lot of tax payments go out. So that wasn't unexpected.

I think historically, we've seen deposits compared to March in April, typically go down in general. What we saw was continued shift from core to sort of money market actually went up, so we continue to see that. So nothing, I would say, unusual, but we are continuing to see that trend over time.

Operator

The next question comes from the line of Paul Patterson with Glenrock Associates.

Paul Patterson
Glenrock Associates LLC

Can you hear me? Okay. Just on the CD thing, what's the rate differential that you guys are providing for CDs now versus regular deposits?

Paul K. Ito
Executive VP, Treasurer & CFO

So it's about 1.25% difference between CD rates and deposits.

Paul Patterson
Glenrock Associates LLC

Okay. And what's the absolute number, I guess?

Paul K. Ito
Executive VP, Treasurer & CFO

So just to clarify, and maybe I'll just have Dane. He has the numbers in front of him.

Scott W. H. Seu
President, CEO & Director

Dane Teruya is the CFO of American Savings Bank.

Dane A. Teruya
Executive VP & Chief Financial Officer

Bring up CD REITs in the range of about 3.75.

Paul Patterson
Glenrock Associates LLC

Okay. And then on Slide 10, you have -- and I apologize for missing this, I must have been a little distracted. What is this 10-year deposit for 10 years? What does that refer to? Could you just -- I apologize for missing this. Could you elaborate a little bit on that again?

Paul K. Ito
Executive VP, Treasurer & CFO

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Okay. I'm sorry, we're going...

Scott W. H. Seu
President, CEO & Director

While Paul brings up that slide, Paul, what we're trying to focus on is the fact that at American Savings, many of our deposits have very long duration with us. So these are not deposits or customers that are coming in and out, and that's what we're trying to stress. We'll get that point across there.

Paul Patterson
Glenrock Associates LLC

So I mean, in other words, you said that 10-year CDs with you guys?

Paul K. Ito
Executive VP, Treasurer & CFO

No, no, no. This is -- their relationship with the bank. So having been a customer for the bank.

Scott W. H. Seu
President, CEO & Director

Yes, that just underscores the retail -- the heavy retail base that we have here at ASB.

Paul Patterson
Glenrock Associates LLC

Okay. I'm a little bit like wow. Okay. That's helpful. Yes, I guess that makes sense. And I just was wondering, if there's talk about doubling the F.D.I.C. insurance to 500, if that were to happen, what would happen to that 1.2 -- the 15%? Do you have any -- I mean, in other words, what would the uninsured rate be? What would be the percentage of deposits that would be uninsured if they were to double it?

Ann C. Teranishi
CEO, President & Director of American Savings Bank

Yes. Paul, this is Ann, Ann Teranishi. So the 15% would dip far lower. Our average retail deposit amount is 16,000 and our overall average is 18,000. So it just gives you a sense of the size and scope of our retail deposit base. So yes, we imagine that, that amount would go down further. We haven't done specific calculations around that $500,000 amount.

Scott W. H. Seu
President, CEO & Director

Yes. And Paul, I'd just reiterate an interesting factoid, which is ASB in terms of its amount of insured deposits at 85% actually is one of the highest performing banks in the entire country from that perspective. So we would see -- we would continue to have that view.

Paul Patterson
Glenrock Associates LLC

Yes. No, it looks -- I mean -- and the commercial looks -- and you guys highlighted this very diverse. I was just wondering, are you seeing any vacancy issues or -- within any of the areas that you've got exposure to?

Scott W. H. Seu
President, CEO & Director

Nothing significant. In fact, the overall occupancy here in Hawaii has been fairly strong, considering both office and retail. Most of the activity that you're seeing in some of the other cities, like San Francisco and other locations, Hawaii is doing much better than those locations in terms of vacancy.

Ann C. Teranishi
CEO, President & Director of American Savings Bank

Yes. And Paul, this is Ann. The other thing I would add is, we are not oversupplied in the state on office. So office supply is much less than in some of those other metropolitan areas.

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Operator

Thank you for your questions. [Operator Instructions] There are currently no further questions waiting at this time. So I'll now pass the line back to Scott Seu for any closing or additional remarks.

Scott W. H. Seu
President, CEO & Director

So I just want to thank everybody again for joining us today. We look forward to another quarter of solid results, supported by stable, efficient and reliable performance at the utility and our bank.

So again, thank you, everybody.

Operator
That concludes the Q1 2023 Hawaiian Electric Industries, Inc. earnings conference call. Thank you for your participation. You may now disconnect your line.

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