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Kommunalkredit Austria AG

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Table Of Contents

Rating Score Snapshot

Credit Highlights

Outlook

Key Metrics

Anchor: Reflects Kommunalkredit's Geographically Diverse Exposures

Business Position: Kommunalkredit Is A Specialized Niche Bank With High Geographic Diversification

Capital And Earnings: We Expect Capital Injections To Accompany Kommunalkredit's Ambitious Growth Plans

Risk Position: A Good Track Record Despite High Single-Name Concentrations

Funding And Liquidity: Larger Reliance On Price-Sensitive Deposits

Comparable Ratings Analysis

Table Of Contents (cont.)

Support:No Uplift For Government Or Additional Loss-Absorbing Capacity
Support

Environmental, Social, And Governance

Key Statistics

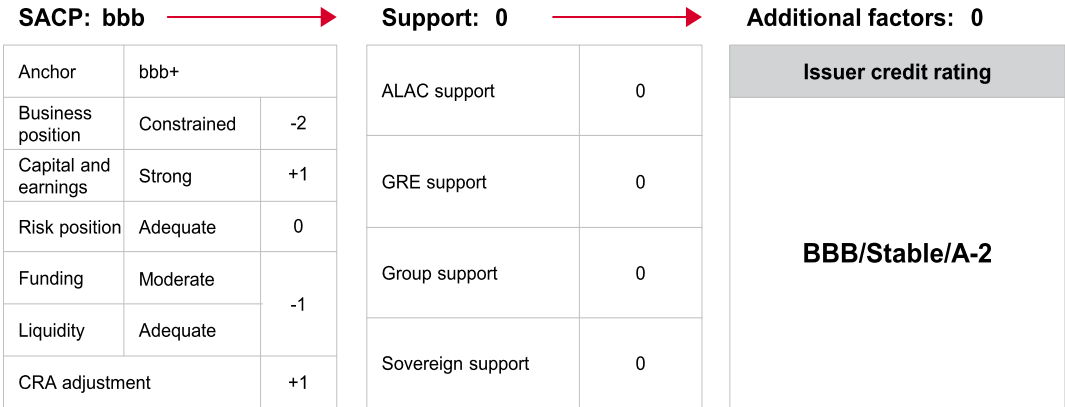
Related Criteria

Related Research

Kommunalkredit Austria AG

Rating Score Snapshot

Issuer Credit Rating
BBB/Stable/A-2



ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Extensive expertise in infrastructure, energy, and sustainable finance projects, with well-established relationships with public-sector customers.	Business concentration on niche bespoke products and services, with a limited number of customers.
Low credit-risk costs and nonperforming loans underpin robust asset quality.	Tail risks from a small number of opportunistic transactions, high business growth rates, and syndication risks.
Strong risk-adjusted profitability supports a high capital buffer.	Small size, and highly dependent on key personnel.

Balance between Kommunalkredit Austria AG's solid earnings and risks from its concentration in the niche business model. The bank's high returns rest on its extensive expertise in infrastructure, energy, and sustainable finance projects. Its strong profitability and the ability to syndicate up to 50% of its new business reduce the risks that stem from its small size and high revenue concentration. We anticipate ongoing strong new business inflow at attractive margins in green energy and social infrastructure in the next two years. We forecast Kommunalkredit will generate a favorable 12%-15% return on equity between 2024 and 2026.

Kommunalkredit's internal and external capital generation is a strength. We expect the bank to maintain strong capitalization, with a risk-adjusted capital (RAC) ratio of 14.0%-15.0% over the next two years, after 14.5% at year-end 2023. We anticipate that Altor Funds (Altor) will become Kommunalkredit's 80% owner pending regulatory approval. It is likely that Altor will fully support the continuance of Kommunalkredit's management's business strategy, risk

appetite, and capital needs, including Altor's announced €100 million capital increase in February 2023.

We anticipate Kommunalkredit will maintain solid asset quality metrics, supported by ongoing corporate governance improvements. We expect its loan book to remain resilient to market turbulence and economic swings. It has a more concentrated portfolio than many other European banks however, with high single-name concentrations, increasing its exposure to adverse economic scenarios or single events.

Outlook

The stable outlook reflects our expectation that, during the next 12-24 months, Kommunalkredit will be able to maintain sound earnings and asset quality, strong capitalization, and prudent lending and underwriting standards. We think the bank's current strategy and risk governance, including execution of the business pipeline, will not change under the incoming majority shareholder, Altor.

Downside scenario

We could lower our ratings on Kommunalkredit if the bank's loan portfolio deteriorated, with a subsequent rise of nonperforming assets and credit losses. Similarly, we could lower our ratings on Kommunalkredit if it adopted a more aggressive growth strategy that stretched its resources, or if material risks arose from higher risk taking within its loan syndication portfolio. Weakening profitability could also put pressure on the ratings.

Upside scenario

An upgrade is unlikely over the next 12-24 months because we expect Kommunalkredit's business expansion and growth of risk-weighted assets (RWAs) will restrict further improvement of our RAC ratio. In our view, the amount of unseasoned loans in its portfolio since 2020 on the back of the portfolio growth, and concentrations on the loan book make the bank vulnerable to asset quality deterioration.

Key Metrics

Kommunalkredit Austria AG--Key ratios and forecasts

(%)	--Fiscal year ended Dec. 31--				
	2022a	2023a	2024f	2025f	2026f
Growth in operating revenue	33.3	28.2	4.7-5.8	7.6-9.3	6.4-7.9
Growth in customer loans	5.2	30.0	9.0-11.0	10.8-13.2	6.3-7.7
Net interest income/average earning assets (NIM)	3.3	4.5	3.8-4.2	3.6-4.0	3.4-3.8
Cost-to-income ratio	44.9	41.3	44.9-47.2	46.4-48.8	46.8-49.2
Return on average common equity	19.9	21.7	14.6-16.2	12.4-13.7	11.6-12.8
New loan loss provisions/average customer loans	0.0	0.0	0.1-0.1	0.1-0.1	0.1-0.2
Gross nonperforming assets/customer loans	0.0	1.3	1.4-1.6	1.5-1.6	1.5-1.6
Risk-adjusted capital ratio	13.5	14.5	16.0-16.9	14.1-14.8	14.3-15.0

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

Anchor: Reflects Kommunalkredit's Geographically Diverse Exposures

The 'bbb+' anchor for Kommunalkredit is one notch lower than that of a purely Austria-based bank. This reflects our view of the weighted-average economic risk of Kommunalkredit's exposures in countries where it operates and on the industry risk of Austria, which is the bank's domicile and the jurisdiction responsible for the regulation of the group.

Kommunalkredit pursues lending in several countries, and we take the bank's international corporate exposures at year-end 2023 into account when analyzing its economic risks. Most of the bank's exposures are in countries with weaker economic risk scores compared with Austria, therefore, our weighted economic risk score for Kommunalkredit is '4' on a scale of 1-10 ('1' is the lowest risk and '10' is the highest).

Business Position: Kommunalkredit Is A Specialized Niche Bank With High Geographic Diversification

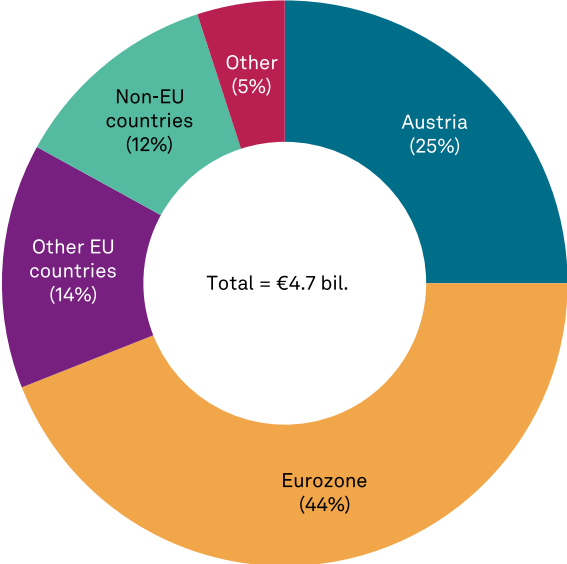
We think that Kommunalkredit's concentrated business model, small size, and high dependence on key personnel, make the bank more sensitive to adverse scenarios compared with peers. We balance this against the bank's material strategic and operational progress following its reprivatization and restructuring in 2015, and significant improvements in its profitability and operating efficiency in the past three years.

Kommunalkredit's business stability is notable amid macroeconomic deterioration, and it benefits from its expertise in infrastructure and energy financing, and public finance. The bank's key focus is on sourcing, underwriting, and advisory services in the early stages of the project life cycle, complemented by an active syndication strategy for long-term investors. Most of its loan portfolio is located outside of Austria, with a focus on the EU. While the composition of its loan portfolio is relatively balanced between infrastructure and energy financing, and public finance, about 90% of new business in 2023 came from infrastructure and energy financing.

Chart 1

Most of the loans are outside of Austria

Loan portfolio by country and region as of Dec. 31, 2023

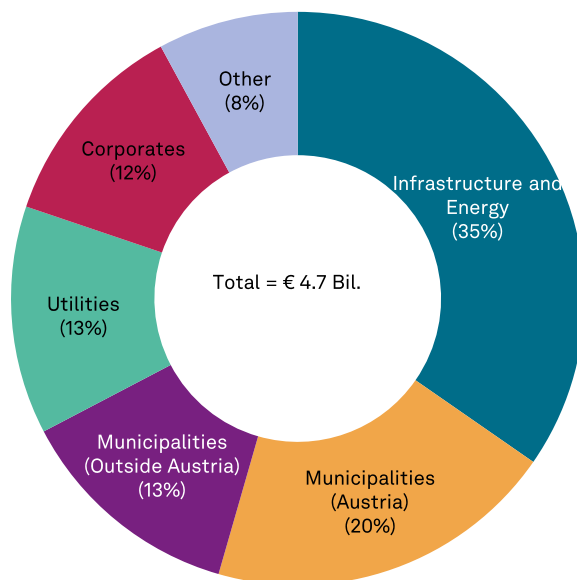


Source: Company reports.

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Chart 2**The loan book is directed towards the infrastructure and energy sector**

Loan portfolio by borrower type as of Dec. 31, 2023



Source: Company reports.

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We anticipate that business growth will accelerate in the next two-to-three years, aided by the targeted €100 million capital increase from Altor--which we expect to be completed during the next 12 months. We estimate that Kommunalkredit's loan book will increase by about 30% by year-end 2026. Current shareholders Interritus and Trinity Investments DAC will remain minority shareholders, each holding 9.9% alongside Altor's 80.0% stake. The remaining 0.2% will be held by the Austrian Association of Municipalities.

Capital And Earnings: We Expect Capital Injections To Accompany Kommunalkredit's Ambitious Growth Plans

We expect Kommunalkredit's capitalization to remain a rating strength, and we forecast that the bank's RAC ratio will remain 14%-15% over the next two years. Our forecast is based on the following assumptions:

- The targeted capital increase of €100 million will be finalized within the next 12 months. However, we think the capital injection will be consumed by the bank's planned growth over the next few years.
- S&P Global Ratings' RWAs will increase by about 80% by year-end 2026. This reflects the bank's growth ambitions, as well as a structural shift in its portfolio as public-sector exposures expire.

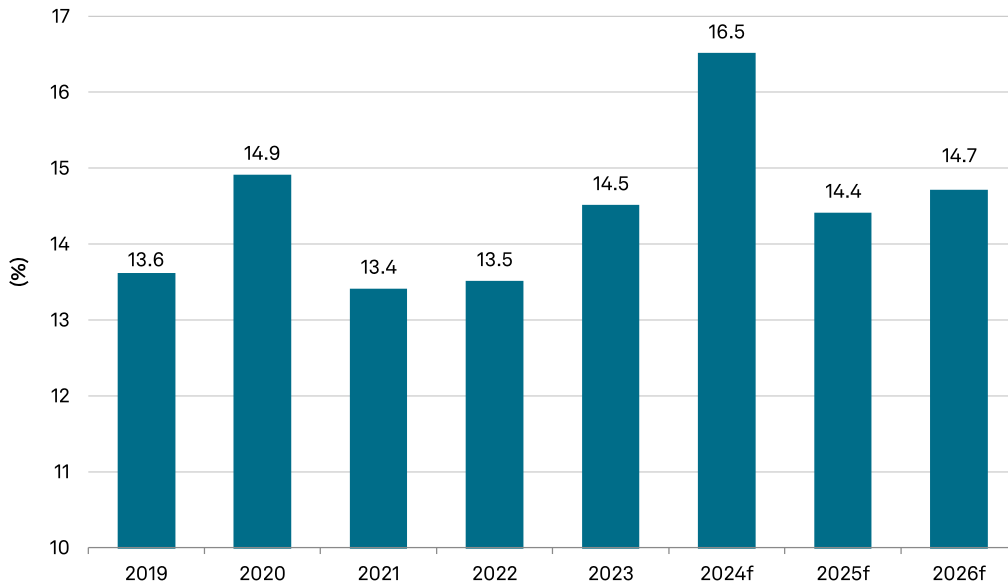
- No dividend payouts between 2024 and 2026.

The difference to the regulatory tier 1 ratio of 18.3% at year-end 2023 mainly reflects that we deduct €60 million of revaluation reserves from total adjusted capital, our main capital measure.

Chart 3

We expect Kommunalkredit's RAC ratio to remain strong

Evolution of RAC ratio between 2019-2026f



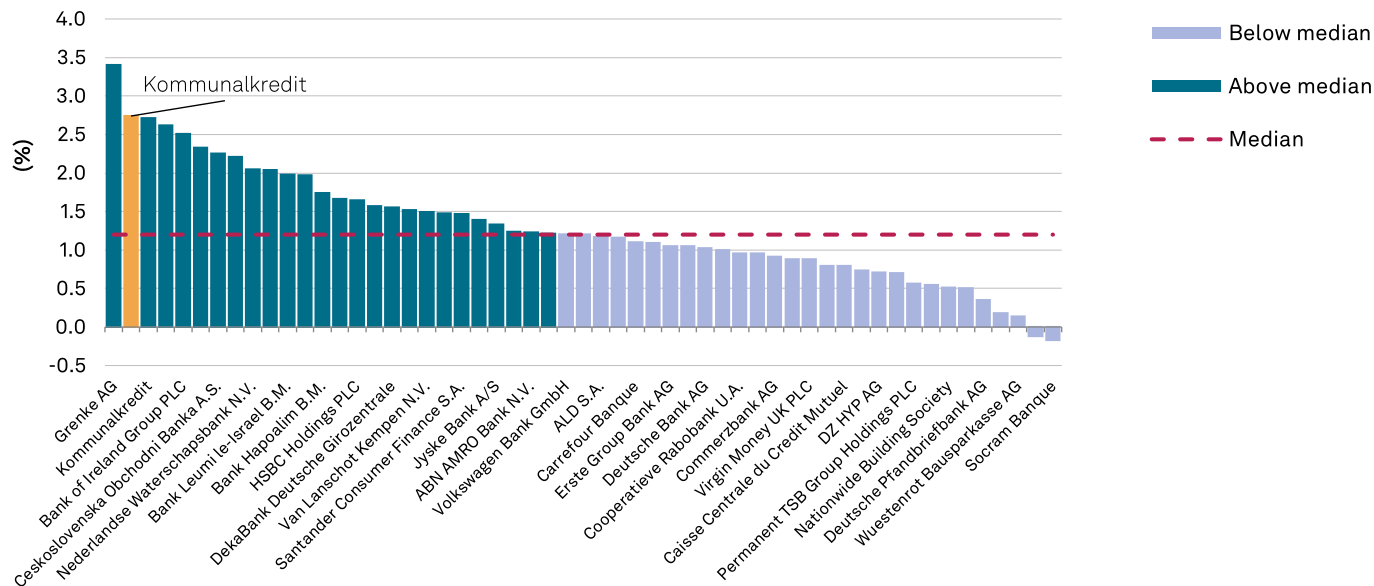
f--Forecast. RAC--Risk-adjusted capital. Source: S&P Global Ratings.
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We expect the earnings buffer, which measures the capacity for a bank's earnings to cover its normalized credit losses, to be approximately 2.5% over the next two years. This puts Kommunalkredit in the top decile of European banks in countries with similar levels of economic and industry risk.

Chart 4

Strong earnings enable Kommunalkredit to cover losses better than peers

Peer comparison of earnings buffer in 2024f



f--Forecast. Earnings buffer - Preprovision operating income less normalized losses divided by S&P Global Rating's risk-weighted assets. Peers include rated European banks in countries with similar economic and industry risk (i.e. anchor of 'bbb+'). Source: S&P Global Ratings.

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Risk Position: A Good Track Record Despite High Single-Name Concentrations

We think Kommunalkredit is adequately capitalized for the risks it takes. Apart from complexity in some infrastructure and energy financing transactions, the bank does not have complex products on its balance sheet. The bank has maintained a robust asset quality since its reprivatization and restructuring at the end of 2015.

Kommunalkredit reported a nonperforming asset (NPA) ratio of only 1.3% as of Dec. 31, 2023 (based on S&P Global Ratings definition), after no NPAs previously. Its €145 million of stage 2 exposures as of year-end 2023 represent 3.0% of the total loan portfolio, which is lower than peer average. We note that the largest default will likely be recovered over the next 12-18 months. Most of the remaining NPA exposures are insured by export credit agencies. We think the bank will see inflows of new NPAs considering its growth plan and event risks in its concentrated loan portfolio, keeping its NPA ratio at close to 1.5% through 2026.

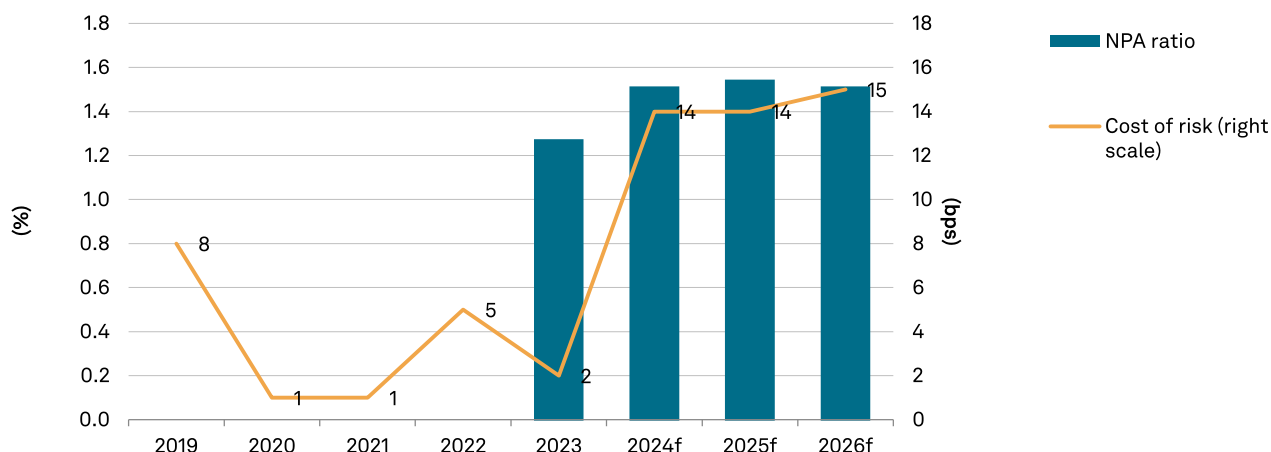
We see concentration risks due to Kommunalkredit's focus on certain sectors, large single-name exposures, and high expected lending growth in the coming years. We anticipate the cost of risk to increase but remain manageable in the

next 12-24 months at about 15 basis points.

Chart 5

Kommunalkredit's asset quality has normalized in 2023

NPA ratio and cost of risk between 2019-2026f



f--Forecast. Source: S&P Global Ratings.
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Funding And Liquidity: Larger Reliance On Price-Sensitive Deposits

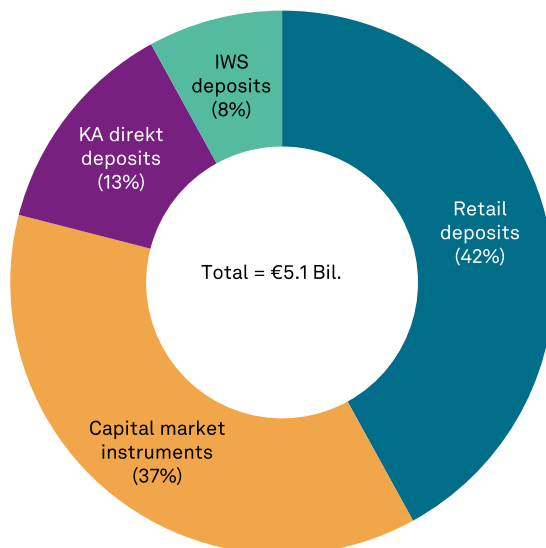
We consider Kommunalkredit's funding as weaker than that of many of its global peers. Although its share of short-term wholesale funding has decreased against a significant rise in deposits, including more stable term deposits, we view the bank's online marketed deposits as more price sensitive and less sticky. The bank's stable funding ratio (SFR) increased to a record strong 124% at year-end 2023, higher than the average 110%-115% we usually see at other European banks. That said, the SFR does not reflect on concentrations in the bank's wholesale deposit base. The top 20 deposits made up 22% of total customer deposits at year-end 2023, which is significantly higher than the typical ratio of 5%-10% at other banks.

Kommunalkredit has broad liquid assets of €1.5 billion at year-end 2023 which cover about 0.8x of total wholesale funding. This is in line with peers. In addition to cash and reserves at the central bank, Kommunalkredit's liquidity position is bolstered by access to a free liquidity reserve consisting of high-quality liquid assets of €864 million at year-end 2023. The liquidity coverage ratio stands at 542% as of year-end 2023 exceeding the regulatory minimum of 100%.

Internal liquidity stress tests ("time to wall") as of December 2023 indicate Kommunalkredit could uphold business operations for at least one year without access to capital markets, but we note it usually ranges between 6-12 months. These stress tests are implemented on a regular basis. The bank has an adequate maturity distribution of its capital market instruments, which limits concentration and roll-over risks.

Chart 6**Wholesale funding is the dominant refinancing source**

Refinancing structure as of Dec. 31, 2023



KA Direkt - Wholesale deposits from municipalities and public sector companies. IWS deposits - Direct business with corporate/institutional customers. Source: Company reports.
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Comparable Ratings Analysis

Kommunalkredit benefits from a one notch uplift, which reflects strong earnings generation and better performance compared with other European banks. Our adjustment is informed by our analysis of the bank's peers and captures characteristics not fully covered by other rating factors.

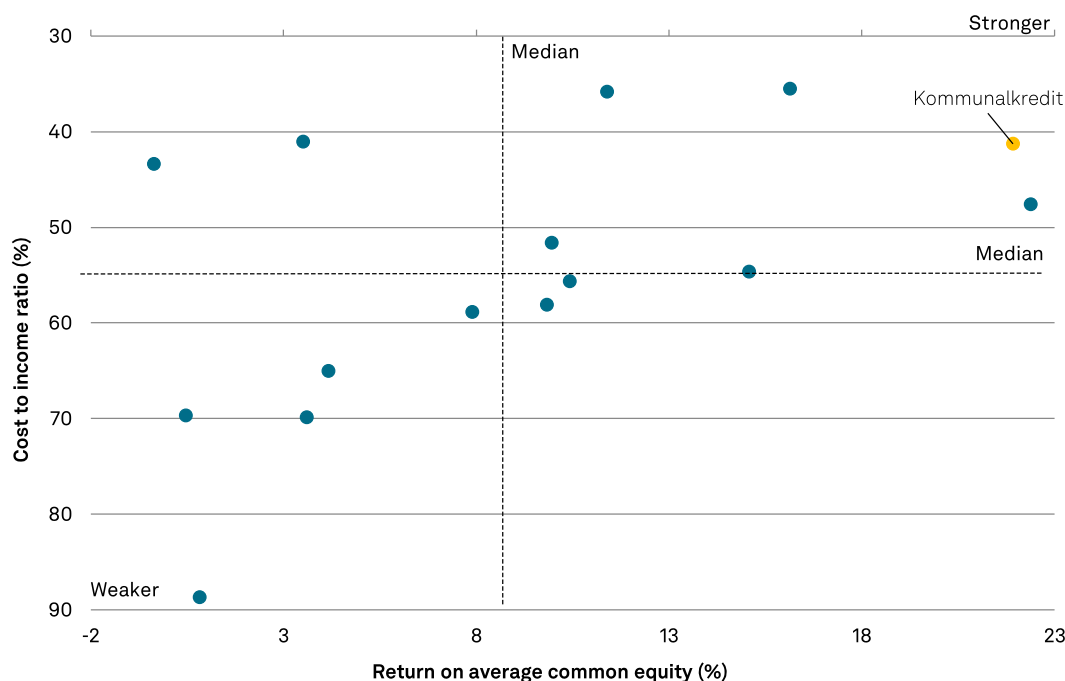
The bank reported a record high after-tax profit of €101 million at year-end 2023, translating into what we measure as a return on average common equity (ROCE) of 21.8% and a cost-to-income ratio of 41.3%. By contrast the median ROCE for the peer group was 8.8% and the cost-to-income figure was 55.0%. Kommunalkredit's risk-adjusted profitability, measured as core earnings to S&P Global Ratings' RWAs metric, also reached 3.0%, far surpassing the median for the peer group of 1.1%. We think Kommunalkredit has stronger earnings power and higher efficiency compared with banks with a 'bbb-' stand-alone credit profile (SACP).

We expect Kommunalkredit's profits will dip over 2024 as net interest margins normalize and costs rise alongside its growth plans. Nevertheless, we believe the bank will maintain its solid earnings capacity in the future compared to peers.

Chart 7

Kommunalkredit's strong earnings outperform peers

Peer comparison of return on average common equity and cost to income ratio as of year-end 2023



Peers include S&P-rated European banks with a stand-alone credit profile of 'bbb-'. Source: S&P Global Ratings. Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

Support: No Uplift For Government Or Additional Loss-Absorbing Capacity Support

The long-term rating on Kommunalkredit is at the same level as the SACP. We recognize that the Austrian bank resolution framework is advanced, and we therefore include uplift in our ratings on systemic banks that we expect to build sizable bail-in-able capital volumes over the coming years. However, we see a resolution scenario for Kommunalkredit as unlikely, reflecting our view of its low systemic importance, and therefore we do not incorporate any uplift under our additional loss-absorbing capacity criteria.

Environmental, Social, And Governance

Governance factors are a moderately negative consideration in our credit rating analysis due to the bank's high dependence on key individuals. We partly balance this weakness against the material strategic and operational progress made following its reprivatization and restructuring in 2015, which resulted in better risk management practices. We will monitor further enhancements in governance standards and the broader internal control infrastructure to keep pace with growth because the bank grows quickly.

Key Statistics

Table 1

Kommunalkredit Austria AG--Key figures					
	--Year ended Dec. 31--				
(Mil. €)	2023	2022	2021	2020	2019
Adjusted assets	5,864	4,624	4,427	4,423	4,305
Customer loans (gross)	4,221	3,247	3,085	2,755	3,017
Adjusted common equity	447	354	273	262	218
Operating revenues	232	181	136	104	83
Noninterest expenses	96	81	69	61	58
Core earnings	101	77	49	32	26

Table 2

Kommunalkredit Austria AG--Business position					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Return on average common equity	21.7	19.9	13.3	10.4	9.3

Table 3

Kommunalkredit Austria AG--Capital and earnings					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Tier 1 capital ratio	18.3	17.3	18.7	20.0	17.8
S&P Global Ratings' RAC ratio before diversification	14.5	13.5	13.4	14.9	13.5
S&P Global Ratings' RAC ratio after diversification	11.6	10.8	11.1	12.3	10.3
Adjusted common equity/total adjusted capital	92.5	90.7	88.8	100.0	100.0
Net interest income/operating revenues	82.9	69.4	58.0	74.0	70.4
Fee income/operating revenues	16.6	16.5	21.7	27.4	29.9
Market-sensitive income/operating revenues	0.0	8.4	7.4	(1.6)	(3.5)
Cost-to-income ratio	41.3	44.9	50.6	58.4	69.1
Preprovision operating income/average assets	2.6	2.2	1.5	1.0	0.6
Core earnings/average managed assets	1.9	1.7	1.1	0.7	0.6

RAC--Risk-adjusted capital.

Table 4

Kommunalkredit Austria AG--Risk-adjusted capital framework data					
(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government & central banks	3,128	49	2	109	3
Of which regional governments and local authorities	1,248	11	1	51	4
Institutions and CCPs	367	50	14	56	15

Table 4

Kommunalkredit Austria AG--Risk-adjusted capital framework data (cont.)					
Corporate	2,703	2,475	92	2,467	91
Retail	0	0	0	0	0
Of which mortgage	0	0	0	0	0
Securitization§	0	0	0	0	0
Other assets†	88	120	136	85	97
Total credit risk	6,286	2,693	43	2,717	43
Credit valuation adjustment					
Total credit valuation adjustment	--	14	--	18	--
Market Risk					
Equity in the banking book	18	0	0	162	875
Trading book market risk	--	0	--	0	--
Total market risk	--	0	--	162	--
Operational risk					
Total operational risk	--	233	--	435	--
	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global Ratings RWA	% of S&P Global Ratings RWA
Diversification adjustments					
RWA before diversification	--	2,940	--	3,332	100
Total diversification/ Concentration adjustments	--	--	--	829	25
RWA after diversification	--	2,940	--	4,161	125
		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
Capital ratio					
Capital ratio before adjustments		539	18.3	483	14.5
Capital ratio after adjustments‡		539	18.3	483	11.6

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions.

‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. CCPs--Central counterparty clearing house. Sources: Company data as of Dec. 31, 2023. S&P Global Ratings.

Table 5

Kommunalkredit Austria AG--Risk position	--Year ended Dec. 31--				
	2023	2022	2021	2020	2019
(%)					
Growth in customer loans	30.0	5.2	12.0	(8.7)	(2.3)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	24.9	24.7	21.1	21.2	31.2
Total managed assets/adjusted common equity (x)	13.1	13.1	16.2	16.9	19.7
New loan loss provisions/average customer loans	0.0	0.0	0.0	0.0	0.1
Gross nonperforming assets/customer loans + other real estate owned	1.3	0.0	0.0	0.0	0.0
Loan loss reserves/gross nonperforming assets	6.9	N.M.	N.M.	N.M.	N.M.

N.M.--Not meaningful. RWA--Risk-weighted assets.

Table 6

Kommunalkredit Austria AG--Funding and liquidity					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Core deposits/funding base	65.5	58.7	48.9	55.6	50.6
Customer loans (net)/customer deposits	127.3	141.7	165.7	130.1	160.7
Long-term funding ratio	93.9	98.0	92.5	88.0	85.0
Stable funding ratio	123.9	111.7	108.0	111.9	98.1
Short-term wholesale funding/funding base	6.7	2.2	8.4	13.2	16.4
Regulatory net stable funding ratio	135.0	129.0	122.0	N/A	N/A
Broad liquid assets/short-term wholesale funding (x)	4.4	7.7	2.3	2.1	1.0
Broad liquid assets/total assets	25.3	14.4	16.5	23.4	14.6
Broad liquid assets/customer deposits	44.8	29.1	39.2	48.9	33.5
Net broad liquid assets/short-term customer deposits	37.9	37.7	41.8	44.1	2.2
Regulatory liquidity coverage ratio (LCR) (%)	542.0	348.0	735.0	N/A	N/A
Short-term wholesale funding/total wholesale funding	19.2	5.2	16.1	29.7	33.2
Narrow liquid assets/three-month wholesale funding (x)	36.8	16.6	2.7	13.1	3.9

N/A--Not applicable.

Kommunalkredit Austria AG--Rating component scores

Issuer Credit Rating	BBB/Stable/A-2
SACP	bbb
Anchor	bbb+
Economic risk	4
Industry risk	3
Business position	Constrained
Capital and earnings	Strong
Risk position	Adequate
Funding	Moderate
Liquidity	Adequate
Comparable ratings analysis	+1
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And

Assumptions, Dec. 9, 2021

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Austrian Banks In 2024: Downside Risks Are Contained, April 18, 2024
- Kommunalkredit Austria AG Upgraded To 'BBB/A-2' On Strong Earnings And Better Performance Than Peers'; Outlook Stable, March 13, 2024
- Banking Industry Country Risk Assessment: Austria, Aug. 1, 2023

Ratings Detail (As Of April 22, 2024)*

Kommunalkredit Austria AG

Issuer Credit Rating	BBB/Stable/A-2
Senior Secured	A+/Stable
Senior Unsecured	BBB

Issuer Credit Ratings History

13-Mar-2024	BBB/Stable/A-2
10-Mar-2023	BBB-/Positive/A-3
24-Feb-2021	BBB-/Stable/A-3

Sovereign Rating

Austria	AA+/Stable/A-1+
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*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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