

# Svenska Cellulosa Aktiebolaget SCA

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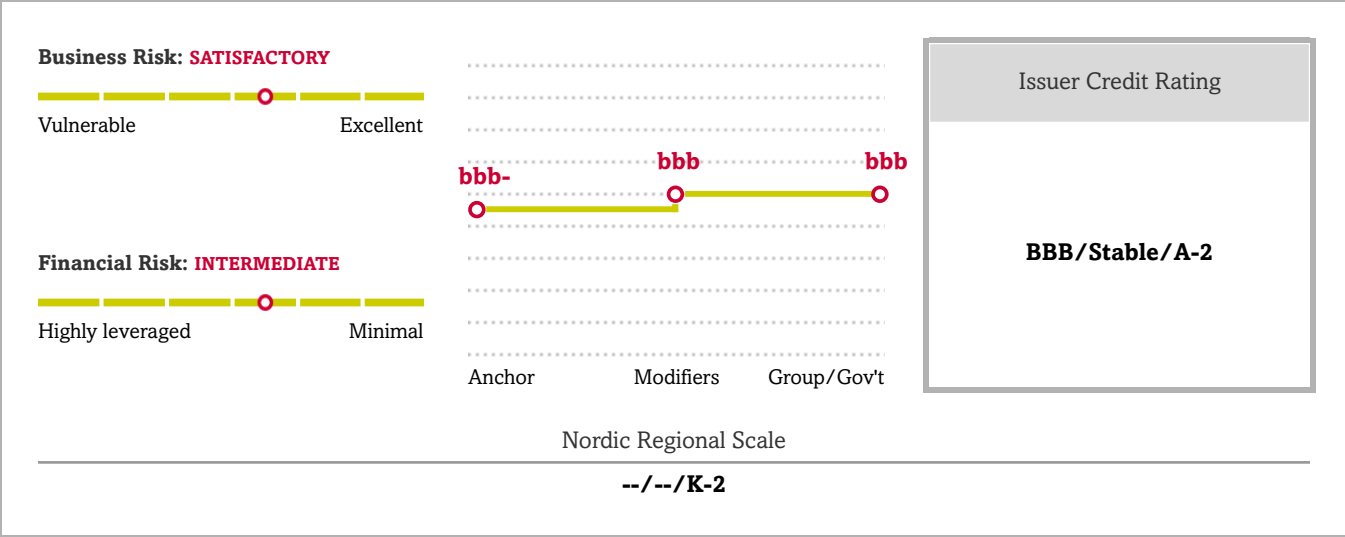
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# Svenska Cellulosa Aktiebolaget SCA



## Credit Highlights

### Overview

| Key Strengths                  | Key Risks   |
|--------------------------------|---|
| Extensive forestland holdings. | Exposed to volatile pulp, wood, and paper prices.         |
| Highly efficient asset base.   | Some exposure to the declining publication paper markets. |
| Strong cash flow generation.   | Exposed to foreign exchange fluctuations.                 |

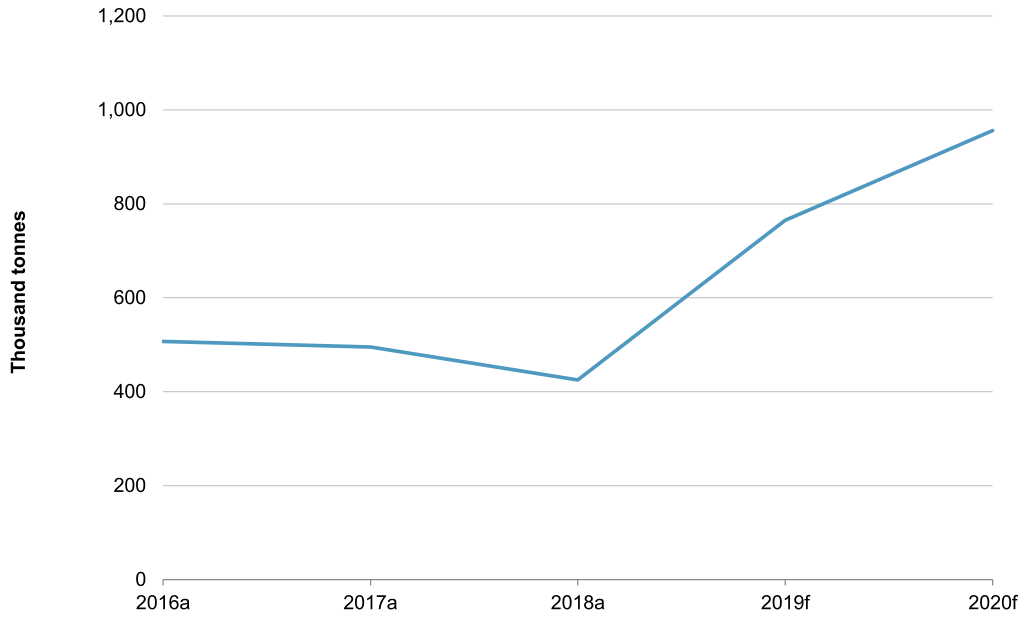
*Svenska Cellulosa Aktiebolaget SCA (SCA)'s Östrand mill is expected to operate at full capacity from 2020.* Investments to expand Östrand's northern bleached softwood kraft (NBSK) pulp production capacity are largely complete. The mill is expected to be one of the most cost efficient mills in the industry and should be operating at full capacity by 2020. Higher pulp volumes and the return to a more normal level of investments should lead to higher free operating cash flow (FOCF) in 2019.

*We anticipate SCA's operating performance will be stable over the next 12-24 months.* Market conditions were very favorable in 2018, with strong demand and high selling prices. While we expect slightly lower selling prices for pulp, wood, and kraftliner in 2019, we expect SCA's credit metrics will remain stable and supported by the group's integrated business model.

*SCA's very efficient cost structure is supported by its vertical integration into wood, pulp and energy.* The group also has very efficient logistic operations, supporting its forest operations.

**Chart 1**

**S&P Global Ratings' Estimate of SCA Pulp Deliveries**  
NBSK and CTMP combined



a--Actual. F--Forecast. NBSK--northern bleached softwood kraft. CTMP--Chemically pre-treated mechanical pulp.

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## Outlook: Stable

The stable outlook on Sweden-based forest products company SCA reflects S&P Global Ratings' expectation that the company's credit metrics will remain stable in 2019 due to steady earnings in the midst of softer, yet healthy, end markets.

### Downside scenario

We could lower the rating if operating performance deteriorated markedly. This could be triggered by a significant and extended downturn in both the group's paper and pulp segments. We could also lower the rating if SCA's credit metrics significantly underperformed against our forecasts for 2019 and 2020, because of, for instance, weaker profitability. We view funds from operations (FFO) to debt below 30% over a prolonged period as commensurate with a lower rating.

### Upside scenario

We could consider raising the rating if SCA's financial risk profile improved, with FFO to debt remaining above 45% on a sustainable basis. We would also expect the company's financial policy to reflect a commitment to maintaining such credit metrics.

## Our Base-Case Scenario

| Assumptions   | Key Metrics  |              |              |           |
|---|--|--------------|--------------|-----------|
| <ul style="list-style-type: none"> <li>• Eurozone economic growth of 1.1% in 2019 and 1.4% in 2020.</li> <li>• Increasing NBSK pulp sales volumes in 2019 and 2020, as the Östrand pulp mill ramps up to full capacity.</li> <li>• A slight decline in NBSK pulp and kraftliner prices in 2019.</li> <li>• Net sales growth of 10.9% in 2019, thanks to additional pulp volumes at Östrand.</li> <li>• Slightly lower S&amp;P Global Ratings-adjusted EBITDA margins (22.3%) in 2019, due to lower selling prices in paper and pulp.</li> <li>• Working capital outflows of about Swedish krona (SEK) 300 million in 2019 and SEK250 million in 2020.</li> <li>• Capital expenditure (capex) of SEK1.6 billion–SEK2.2 billion in 2019 and 2020, from SEK3 billion in 2018. SEK1.0 billion–SEK1.2 billion of this will relate to maintenance capex and the remainder to expansion projects.</li> <li>• SEK1.2 billion dividend in 2019. We expect dividends will increase modestly from 2020.</li> </ul> | <b>2018a</b>                                       | <b>2019e</b> | <b>2020e</b> |           |
|   | EBITDA margin (%)                                  | 25.9         | 22.3         | 21.0-22.0 |
|   | FFO to debt (%)                                    | 53.9         | 40.7         | 43.0-45.0 |
|   | Debt to EBITDA(x)                                  | 1.7          | 1.9          | 1.7-1.9   |
|   | a--Actual. e—Estimated. FFO—Funds from operations. |              |              |           |

### Base-case projections

*We anticipate a slight reduction in SCA's EBITDA margins.* Following 18-24 months of significant price increases, both NBSK and kraftliner experienced price reductions in the latter part of 2018 and the first quarter of 2019. While we continue to view the fundamentals of these markets as healthy, we expect lower price levels will reduce SCA's EBITDA margins in 2019 and 2020.

## Company Description

SCA is a Swedish forward integrated forest products company. It is Europe's largest private forest owner, with 2.6 million hectares of forestland (2.0 million hectares of which are productive). The book value of this forestland is SEK32 billion. The value of its forest has historically increased every year, with more trees planted than harvested.

In 2018, sales were SEK18.8 billion and S&P Global Ratings-adjusted EBITDA was SEK4.9 billion. Over 51% of its external sales relate to paper (kraftliner and publication); over 35% to wood, and the remainder to pulp.

The group is the third largest kraftliner manufacturer in Europe. Although kraftliner prices are volatile, e-commerce,

the transition from plastic packaging to environmentally friendly materials, and food safety regulations continue to drive growth. We expect that new capacity additions in Europe will remain limited.

Demand for publication paper is in structural decline, but we expect recent capacity closures in the industry will support healthy pricing levels in the short term. SCA's position is supported by a very competitive cost structure (it operates the fifth largest publication paper mill).

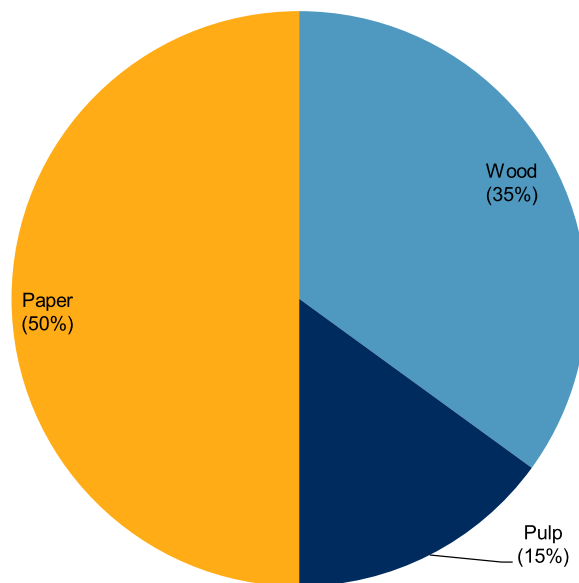
SCA also operates five sawmills that transform the most valuable parts of trees into sawlogs. Its sawmills are well invested and sizeable. Its wood products are sold to the wood traders (manufacturers of furniture, doors, for example) and building materials traders.

With the expansion of Östrand's pulp capacity to 900,000 tonnes, we expect pulp sales will increase over the next two years. SCA mainly focuses on NBSK pulp, used for packaging and tissue applications. The group also produces 100,000 tonnes of chemically pre-treated mechanical pulp (CTMP) used in hygiene and packaging products.

SCA also rents out some of its forestland to wind-power operators, and is diversifying into the production of wood-based biofuels (largely used in its own plants).

**Chart 2**

**SCAs 2018 Sales Breakdown By Segment**  
External sales



Source: S&P Global Ratings.

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## Business Risk: Satisfactory

Our business risk assessment reflects SCA's leading market positions in the kraftliner and publication paper segments, its cost efficient asset and logistic operations, and its large forestland holdings.

The volatility of its cost (pulp, wood) and product segments (kraftliner, publication paper, wood, pulp) partially mitigated these strengths. Furthermore, SCA has a small scale compared with industry giants such as UPM-Kymmene and Mondi Group, leading to lower economies of scale. SCA's business risk also remains constrained by the structural decline in publication paper.

### Peer comparison

Table 1

| Svenska Cellulosa Aktiebolaget SCA -- Peer Comparison |                                     |                                     |                   |                                     |
|---|-------------------------------------|-------------------------------------|-------------------|-------------------------------------|
| Industry Sector: Paper/Forest Products                |                                     |                                     |                   |                                     |
|   | Svenska Cellulosa Aktiebolaget SCA  | Holmen AB                           | UPM-Kymmene Corp. | Metsa Board Corp.                   |
| Rating as of May 7, 2019                              | BBB/Stable/A-2                      | BBB+/Stable/A-2                     | BBB/Stable/A-2    | BBB-/Stable/A-3                     |
|   | --Fiscal year ended Dec. 31, 2018-- | --Fiscal year ended Dec. 31, 2017-- |                   | --Fiscal year ended Dec. 31, 2018-- |
| <b>(Mil. SEK)</b>                                     |                                     |                                     |                   |                                     |
| Revenues  | 18,755.0                            | 17,269.0                            | 98,361.1          | 19,780.7                            |
| EBITDA  | 4,852.0                             | 2,796.5                             | 16,611.3          | 2,477.5                             |
| FFO   | 4,473.4                             | 2,568.2                             | 13,939.5          | 2,137.9                             |
| Interest Expense                                      | 116.6                               | 64.3                                | 1,119.3           | 195.2                               |
| Cash Interest Paid                                    | 149.6                               | 7.3                                 | 549.4             | 185.0                               |
| Cash flow from operations                             | 3,663.4                             | 2,544.2                             | 15,816.3          | 1,571.1                             |
| Capital expenditures                                  | 3,058.0                             | 701.0                               | 2,987.2           | 688.8                               |
| Free operating cash flow                              | 605.4                               | 1,843.2                             | 12,829.1          | 882.3                               |
| Discretionary cash flow                               | (448.6)                             | 835.2                               | 7,847.2           | 122.3                               |
| Cash and short-term investments                       | 648.0                               | 356.0                               | 7,035.6           | 1,116.2                             |
| Debt  | 8,304.0                             | 3,112.3                             | 13,485.8          | 3,585.8                             |
| Equity  | 39,062.0                            | 22,035.0                            | 85,135.0          | 13,460.1                            |
| <b>Adjusted ratios</b>                                |                                     |                                     |                   |                                     |
| EBITDA margin (%)                                     | 25.9                                | 16.2                                | 16.9              | 12.5                                |
| Return on capital (%)                                 | 7.4                                 | 7.0                                 | 11.5              | 14.7                                |
| EBITDA interest coverage (x)                          | 41.6                                | 43.5                                | 14.8              | 12.7                                |
| FFO cash interest coverage (x)                        | 30.9                                | 354.1                               | 26.4              | 12.6                                |
| Debt/EBITDA (x)                                       | 1.7                                 | 1.1                                 | 0.8               | 1.4                                 |
| FFO/debt (%)  | 53.9                                | 82.5                                | 103.4             | 59.6                                |
| Cash flow from operations/debt (%)                    | 44.1                                | 81.7                                | 117.3             | 43.8                                |

**Table 1**

| Svenska Cellulosa Aktiebolaget SCA -- Peer Comparison (cont.) |       |      |      |      |
|---|-------|------|------|------|
| Free operating cash flow/debt (%)                             | 7.3   | 59.2 | 95.1 | 24.6 |
| Discretionary cash flow/debt (%)                              | (5.4) | 26.8 | 58.2 | 3.4  |

SEK--Swedish krona.

We view SCA's business risk profile to be similar to that of Swedish peer Holmen. Both companies are of similar size with Nordic production assets and large forestland holdings. We believe SCA's exposure to expanding markets, such as kraftliner paper and NBSK pulp, is an advantage.

UPM-Kymmene is substantially larger than SCA, and much more diverse in terms of products and customers. However, UPM also has a much larger exposure to publication paper and is less profitable than SCA.

SCA's business risk profile is stronger than Finnish peer Metsä Board due to a more efficient asset-base, reflected in its superior profitability.

## Financial Risk: Intermediate

We expect SCA's credit metrics will remain sound over the next 12-24 months, as stable demand and healthy pricing conditions will lead to adjusted FFO to debt of about 40%-45%, and adjusted debt to EBITDA of 1.7x-2.0x in 2019 and 2020. Credit measures are supported by our expectation that SCA should generate healthy and increasing free operating cash flow (FOCF) following the conclusion of its investments at Östrand.

We note that current credit metrics provide SCA with some flexibility to invest in organic growth and pay shareholder returns.

## Financial summary

**Table 2**

| Svenska Cellulosa Aktiebolaget SCA--Yearly Data |                               |           |           |           |           |
|---|-------------------------------|-----------|-----------|-----------|-----------|
| Industry Sector: Paper/Forest Products          |                               |           |           |           |           |
|   | --Fiscal year ended Dec. 31-- |           |           |           |           |
|   | 2018                          | 2017      | 2016      | 2015      | 2014      |
| <b>(Mil. SEK)</b>                               |                               |           |           |           |           |
| Revenues  | 18,755.0                      | 16,664.0  | 117,314.0 | 115,316.0 | 104,054.0 |
| EBITDA  | 4,852.0                       | 3,662.0   | 19,579.0  | 19,338.5  | 16,664.0  |
| FFO   | 4,473.4                       | 3,364.6   | 14,675.2  | 15,792.6  | 13,102.2  |
| Interest Expense                                | 116.6                         | 234.4     | 1,157.8   | 1,405.9   | 1,515.8   |
| Cash Interest Paid                              | 149.6                         | 267.4     | 1,104.8   | 1,337.9   | 1,460.8   |
| Cash flow from operations                       | 3,663.4                       | 3,066.6   | 15,943.2  | 14,378.6  | 12,289.2  |
| Capital expenditures                            | 3,058.0                       | 3,555.0   | 9,318.0   | 7,506.0   | 5,692.0   |
| Free operating cash flow                        | 605.4                         | (488.4)   | 6,625.2   | 6,872.6   | 6,597.2   |
| Discretionary cash flow                         | (448.6)                       | (4,702.4) | 2,397.2   | 2,969.6   | 3,033.2   |



Table 2

## Svenska Cellulosa Aktiebolaget SCA--Yearly Data (cont.)

## Industry Sector: Paper/Forest Products

|                                    | --Fiscal year ended Dec. 31-- |          |          |          |          |
|------------------------------------|-------------------------------|----------|----------|----------|----------|
|                                    | 2018                          | 2017     | 2016     | 2015     | 2014     |
| <b>(Mil. SEK)</b>                  |                               |          |          |          |          |
| Cash and short-term investments    | 648.0                         | 538.0    | 4,482.0  | 5,042.0  | 3,815.0  |
| Gross available cash               | 648.0                         | 538.0    | 4,482.0  | 5,042.0  | 3,815.0  |
| Debt                               | 8,304.0                       | 8,151.6  | 37,116.5 | 31,405.6 | 40,097.9 |
| Equity                             | 39,062.0                      | 36,753.0 | 79,519.0 | 75,691.0 | 72,872.0 |
| <b>Adjusted ratios</b>             |                               |          |          |          |          |
| EBITDA margin (%)                  | 25.9                          | 22.0     | 16.7     | 16.8     | 16.0     |
| Return on capital (%)              | 7.4                           | 2.7      | 12.4     | 12.5     | 10.8     |
| EBITDA interest coverage (x)       | 41.6                          | 15.6     | 16.9     | 13.8     | 11.0     |
| FFO cash interest coverage (x)     | 30.9                          | 13.6     | 14.3     | 12.8     | 10.0     |
| Debt/EBITDA (x)                    | 1.7                           | 2.2      | 1.9      | 1.6      | 2.4      |
| FFO/debt (%)                       | 53.9                          | 41.3     | 39.5     | 50.3     | 32.7     |
| Cash flow from operations/debt (%) | 44.1                          | 37.6     | 43.0     | 45.8     | 30.6     |
| Free operating cash flow/debt (%)  | 7.3                           | (6.0)    | 17.8     | 21.9     | 16.5     |
| Discretionary cash flow/debt (%)   | (5.4)                         | (57.7)   | 6.5      | 9.5      | 7.6      |

FFO--Funds from operations. SEK--Swedish krona.

## Liquidity: Strong

We continue to assess SCA's liquidity as strong, supported by available cash of SEK637 million, full availability under the syndicated credit facilities, and our expectation of strong operational cash flow generation. We expect the company's liquidity sources will exceed liquidity uses by at least 1.5x in the next 12 months. We also believe that the company will maintain a conservative financial policy and ensure strong liquidity coverage.

| Principal Liquidity Sources  | Principal Liquidity Uses   |
|--|--|
| <ul style="list-style-type: none"> <li>Available cash balance of SEK637 million as of Dec. 31, 2018;</li> <li>Access to SEK8 billion under revolving credit facilities RCFs)*; and</li> <li>Forecast unadjusted FFO of about SEK3.5 billion in 2019.</li> </ul> <p>*While our liquidity analysis considers the next 12 months from Dec. 31 2018, we note that the size of the RCF was reduced to SEK6 billion as of March 1, 2019.</p> | <ul style="list-style-type: none"> <li>Capex of SEK2.2 billion;</li> <li>SEK2.6 billion commercial paper maturities;</li> <li>A potential working capital increase of about SEK300 million;</li> <li>Acquisition spend of SEK260 million; and</li> <li>Dividend payments of SEK1.2 billion.</li> </ul> |

## Other Credit Considerations

We apply a one-notch positive comparable ratings analysis modifier to account for the value of the company's extensive forestland assets, which we believe our anchor does not fully reflect. We view SCA's 2.6 million hectares of forestland as credit enhancing, because it could provide a potential liquidity buffer. Although SCA views its forestland as core and does not intend to sell it, we believe it could be readily monetized at significant value in a distressed situation.

### Environmental, Social, And Governance

As a forest products company, environmental concerns are paramount to SCA. As Europe's largest private forestland owner, the group promotes sustainable forest management and its growing forest binds a net of four million tons of carbon dioxide (CO<sub>2</sub>) annually, which makes SCA a net absorber of CO<sub>2</sub> emissions.

SCA also continuously invests in improving industrial assets' energy efficiency. The Östrand pulp mill, for example, will be a net seller of green electricity and heating, once it reaches full production capacity.

SCA is also seeking to expand its renewable energy generation. In addition to biofuels production, the company leases out forestland for wind power projects.

We view governance as a supporting factor for the ratings, reflecting management's experience and expertise, governance in line with best practices, and the balance of different stakeholders' interests.

## Reconciliation

Table 3

### Reconciliation Of Svenska Cellulosa Aktiebolaget SCA Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. kr)

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

#### Svenska Cellulosa Aktiebolaget SCA reported amounts

|  | Debt    | EBITDA  | Operating income | Interest expense | S&P Global Ratings' adjusted EBITDA | Cash flow from operations | Capital expenditure |
|--|---------|---------|------------------|------------------|-------------------------------------|---------------------------|---------------------|
|  | 7,825.0 | 4,573.0 | 4,002.0          | (4.0)            | 4,852.0                             | 3,505.0                   | 3,086.0             |
| <b>S&amp;P Global Ratings' adjustments</b> |         |         |                  |                  |                                     |                           |                     |
| Cash taxes paid                            | --      | --      | --               | --               | (229.0)                             | --                        | --                  |
| Cash taxes paid - Other                    | --      | --      | --               | --               | --                                  | --                        | --                  |
| Cash interest paid                         | --      | --      | --               | --               | (29.0)                              | --                        | --                  |
| Operating leases                           | 1,127.0 | 279.0   | 92.6             | 92.6             | (92.6)                              | 186.4                     | --                  |

**Table 3**

| <b>Reconciliation Of Svenska Cellulosa Aktiebolaget SCA Reported Amounts With S&amp;P Global Ratings' Adjusted Amounts (Mil. kr) (cont.)</b> |             |               |             |                         |                              |                                  |                             |
|--|-------------|---------------|-------------|-------------------------|------------------------------|----------------------------------|-----------------------------|
| Postretirement benefit obligations/deferred compensation   | --          | 1.0           | 1.0         | --                      | --                           | --                               | --                          |
| Accessible cash & liquid investments   | (648.0)     | --            | --          | --                      | --                           | --                               | --                          |
| Capitalized interest   | --          | --            | --          | 28.0                    | (28.0)                       | (28.0)                           | (28.0)                      |
| Income (expense) of unconsolidated companies   | --          | (1.0)         | --          | --                      | --                           | --                               | --                          |
| Nonoperating income (expense)  | --          | --            | 10.0        | --                      | --                           | --                               | --                          |
| D&A - Asset valuation gains/(losses)   | --          | --            | (679.0)     | --                      | --                           | --                               | --                          |
| Total adjustments  | 479.0       | 279.0         | (575.4)     | 120.6                   | (378.6)                      | 158.4                            | (28.0)                      |
| <b>S&amp;P Global Ratings' adjusted amounts</b>  |             |               |             |                         |                              |                                  |                             |
|  | <b>Debt</b> | <b>EBITDA</b> | <b>EBIT</b> | <b>Interest expense</b> | <b>Funds from operations</b> | <b>Cash flow from operations</b> | <b>Capital expenditures</b> |
|  | 8,304.0     | 4,852.0       | 3,426.6     | 116.6                   | 4,473.4                      | 3,663.4                          | 3,058.0                     |

## Ratings Score Snapshot

### Issuer Credit Rating

BBB/Stable/A-2

### Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

### 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:** Satisfactory (no impact)
- **Comparable rating analysis:** Positive (+1 notch)

## 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
- ARCHIVE - General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Forest And Paper Products Industry, Feb. 12, 2014
- 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

### 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               |
| <b>Satisfactory</b>   | a/a-                   | bbb+   | <b>bbb/bbb-</b> | 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 May 23, 2019)\*

#### Svenska Cellulosa Aktiebolaget SCA

|                              |                |
|------------------------------|----------------|
| Issuer Credit Rating         | BBB/Stable/A-2 |
| <i>Nordic Regional Scale</i> | --/--/K-2      |
| Senior Unsecured             | BBB            |

#### Issuer Credit Ratings History

|             |                         |                    |
|-------------|-------------------------|--------------------|
| 07-Apr-2017 | <i>Foreign Currency</i> | BBB/Stable/A-2     |
| 20-Dec-2016 |                         | BBB+/Watch Neg/A-2 |
| 21-Feb-2014 |                         | A-/Stable/A-2      |
| 07-Apr-2017 | <i>Local Currency</i>   | BBB/Stable/A-2     |
| 20-Dec-2016 |                         | BBB+/Watch Neg/A-2 |

## Ratings Detail (As Of May 23, 2019)\*(cont.)

|             |                              |                  |
|-------------|------------------------------|------------------|
| 21-Feb-2014 |                              | A-/Stable/A-2    |
| 07-Apr-2017 | <i>Nordic Regional Scale</i> | --/--/K-2        |
| 20-Dec-2016 |                              | --/Watch Neg/K-1 |
| 18-Oct-2010 |                              | --/--/K-1        |

\*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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