

Northern Ireland Electricity Networks Ltd.

Primary Credit Analyst:

Gustav B Rydevik, London + 44 20 7176 1282; gustav.rydevik@spglobal.com

Secondary Contact:

Bjoern Schurich, Frankfurt + 49 693 399 9237; bjoern.schurich@spglobal.com

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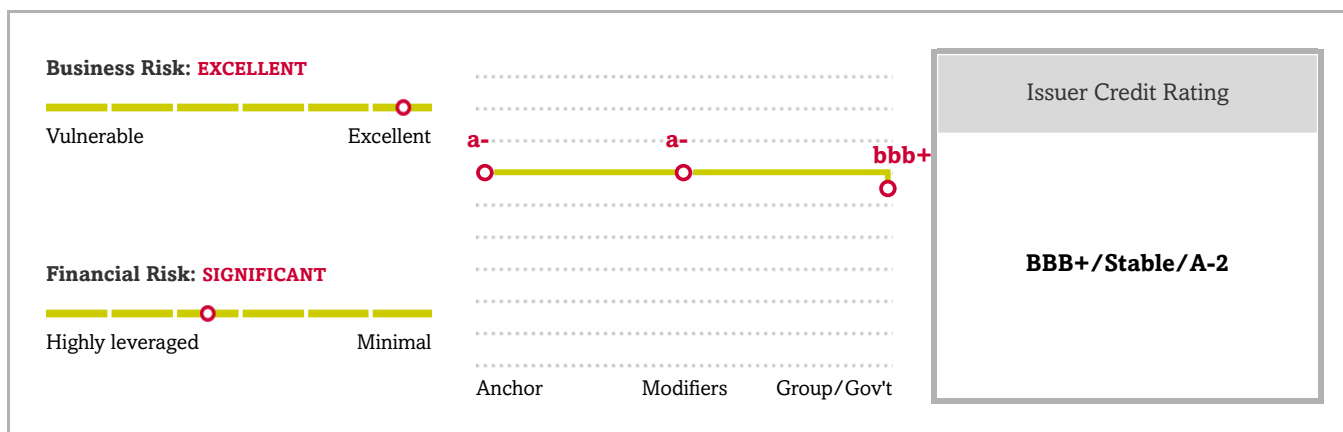
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Northern Ireland Electricity Networks Ltd.



Credit Highlights

Overview	
Key strengths	Key risks
Monopoly market position as the sole transmission system and distribution system owner and operator in Northern Ireland.	Challenging regulatory determination lasting through March 2024.
Earnings from stable and predictable cash flows from low-risk regulated network operations.	The possibility that, if the parent's (Electricity Supply Board) credit quality deteriorates, it will affect the credit rating on the utility.
The Northern Ireland Authority for Utility Regulation (Utility Regulator) providing good cash flow visibility under a supportive regulatory framework.	Short-term fluctuations in working capital and potential delay with the capital expenditure (capex) program due to COVID-19.
Proven relative resilience during the COVID-19 pandemic, although some near-term risks remain.	

Despite a tough regulatory period, Northern Ireland Electricity Networks Ltd. (NIE Networks) has delivered strong results. In 2020, NIE delivered 13% EBITDA growth alongside a 6% decrease in customer complaints year-on-year. Capex was lower owing to lockdown restrictions, leading to lower debt, steering adjusted funds from operations (FFO) to debt to 17.8%, in line with S&P Global Ratings' expectation.

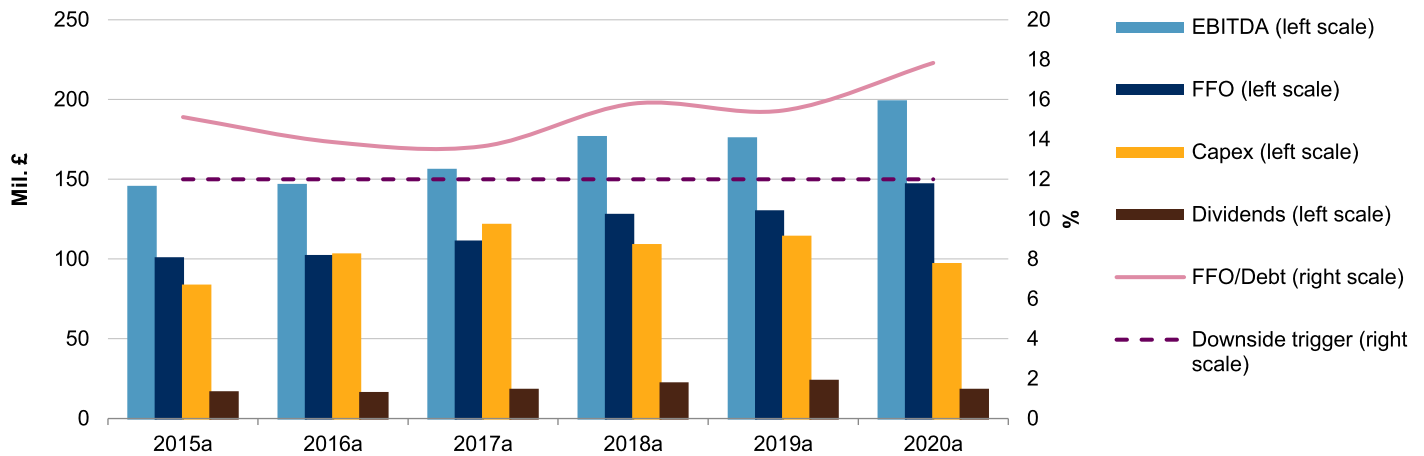
In our view NIE Networks has proven relatively resilient to the effects of the COVID-19 pandemic. This is because the company provides an essential service to its markets and is fully regulated. Lower demand on its regulated activities should only delay regulated earnings, although the company anticipated lower 2020 volumes in setting its tariffs. Ultimately, slowing economic conditions in 2020 depressed electricity demand to a limited extent (only 1% year on year). The company has implemented contingency plans to manage pandemic disruptions and we expect it to maintain credit metrics at a level consistent with the rating over the next three years.

Capex accelerates through 2021-2024, peaking in 2025. NIE Networks enters a new growth capex cycle through 2021-2025 mainly driven by D5 projects to enhance the capacity of the transmission system (£120 million), and the North South Interconnector (£100 million). The company has set a target to connect a further 300 megawatts (MW) in renewable generation capacity by 2023. This is complemented by increased maintenance capex to replace worn assets with greater reliability of networks to facilitate higher demand. Gross planned annual investment is forecast to be £150 million-£200 million over 2021-2025, compared with about £100 million per year previously.

Chart 1

NIE Networks Credit Metrics

Capex high as a % of EBITDA and FFO



a--Actual. FFO--Funds from operations. Capex--Capital expenditure. Source: S&P Global Ratings.

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The parent's credit quality constrains the rating. Although the Electricity Supply Board (ESB) supports NIE Networks' financing activities, the 'bbb+' stand-alone credit profile (SACP) on it constrains that on NIE Networks, which is 'a-'.

NIE Networks contributes modest-but-important earning to ESB. It contributed about £200 million to ESB's roughly £1.2 billion EBITDA in fiscal 2020. However, due to the geographic importance and being fully regulated, NIE Networks continues to play an important part in ESB strategy.

Outlook: Stable

The stable outlook on NIE Networks reflects that on parent ESB. S&P Global Ratings anticipates that the ratings on NIE Networks will move in line with ESB's SACP, assuming that NIE Networks remains a core part of ESB. A downward revision of NIE's stand-alone assessment would not be expected to affect the rating on the utility as long as the rating on the parent is unchanged.

The stable outlook on ESB mirrors that on Ireland. We expect ESB to maintain S&P Global Ratings-adjusted FFO to debt above 17%, based on its regulated network's stable contribution, and despite the sizable capex required to transform its generation portfolio.

Downside scenario

We could lower the rating on NIE Networks if we lower that on ESB. We would lower the ratings on ESB if we take a similar action on Ireland.

We would also lower the ratings on ESB if we revise down its SACP. For example if earnings are more volatile or if the group's profitability weakens. This could stem from lower returns from the regulated network businesses--reflecting underperformance against regulatory allowances--or weaker performance in the unregulated business.

ESB's SACP could also come under pressure if the group's debt increases without a simultaneous increase in FFO. This could be caused by an unexpected increase in capex, a debt-financed acquisition, or higher-than-anticipated dividend payouts.

We could revise down our SACP on NIE Networks from 'a-' if it is unable to achieve adjusted FFO to debt of more than 12%. Even if we revise down the company's SACP, we do not expect this to affect the rating on it if ESB's group credit profile (GCP) assessment does not change.

Upside scenario

NIE's ratings upside depend on ESB's ratings upside. We are unlikely to revise ESB's SACP upward over our three-year rating horizon, mainly based on the group's forecast metrics, which are affected by its sizable and partly debt-financed capex program. We cap our ratings on NIE Networks at ESB's SACP of 'bbb+'.

Our Base-Case Scenario

Assumptions

- Real GDP growth in the U.K. of 7% in 2021, 5.2% in 2022, and 1.9% in 2023.
- Continued regulatory visibility and high predictability of earnings from its regulated networks business.
- Revenue based on approved tariffs to Sept. 30, 2021; In line with the regulatory period 6 (RP6) plan thereafter tariffs

assume a 3.14% weighted-average cost of capital (WACC), including achieving 75% of customer-minutes-lost incentives.

- A dividend payout of up to a maximum of 60% profit after tax in 2021 and beyond (as per revised dividend policy)
- Annual net capex of £150 million-£200 million over 2021-2025.

Key metrics

Northern Ireland Electricity Networks Ltd.--Key Metrics*					
(Mil. €)	2019a	2020a	2021e	2022e	2023e
EBITDA	175.7	198.8	187-193	183-189	197-203
Debt	841.3	823.0	890-910	970-990	1,000-1,050
Dividends	23.7	18.0	23-28	18-23	22-27
Capex	114.1	96.9	163-167	185-189	151-155
FFO/debt (%)	15.5	17.8	15-15.5	13.5-14	14.5-15
Debt/EBITDA (x)	4.8	4.1	4.6-4.8	5.1-5.3	4.9-5.1
DCF/debt (%)	(2.8)	2.5	(7.8)-(8.4)	(7.4)-(7.8)	(2.9)-(3.3)

Capex--Capital expenditure. FFO--Funds from operations. DCF--Discounted cash flow. a--Actual. e--Estimate.

NIE Networks will achieve marginal negative-to-flat revenue growth over 2021-2022, with gradual recovery subsequently. We expect steady EBITDA margins until the end of RP6 leading to a relatively flat FFO to debt of 14%-15%.

We believe that NIE's dividend policy of up to a maximum of 60% of profit after tax is moderate given the flexibility. We expect the utility to continue to support credit metrics in line with the 'a-' SACP.

Solid cash flow is likely. We expect negative discretionary cash flow to debt over our forecast period due to sizable capex, spiking in 2025, required for the increase in transmission system capacity and the North South interconnector.

Company Description

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We believe that NIE's dividend policy of up to a maximum of 60% of profit after tax is moderate given the flexibility. We expect the utility to continue to support credit metrics in line with the 'a-' SACP.

Solid cash flow generation is likely over the coming years. We expect negative discretionary cash flow to debt over our forecast period due to sizable capex, spiking in 2025, required for the increase in transmission system capacity and the North South interconnector.

Company Description

NIE Networks is a wholly owned subsidiary of ESB. It is the only electricity transmission asset owner and electricity distribution network owner and operator in Northern Ireland. ESB owns the Irish transmission grid and owns and operates the distribution network in Ireland. Irish state-owned transmission system operator Eirgrid PLC and

subsidiary SONI Ltd. operate the transmission grids in Ireland and Northern Ireland, respectively.

NIE Networks serves around 895,000 consumers via a number of substations. In 2020, an estimated 7.4 terawatt-hours (TWh) of electricity was transmitted and distributed to consumers in Northern Ireland (compared with 7.6 TWh in 2019). The utility's assets comprise a 2,200 kilometer (km) transmission grid, 47,000 km of distribution lines, and over 300 major substations. NIE's transmission system is connected to that of Ireland through a 275 kilovolt interconnector and to that in Scotland via the Moyle interconnector. In addition to its core network activities, NIE Networks facilitates connections to the network, provides meters to consumers, and takes meter readings.

Peer Comparison

Table 1

Northern Ireland Electricity Networks Ltd.--Peer Comparison					
Industry sector: Electric					
	Northern Ireland Electricity Networks Ltd.	Elia Group SA/NV	National Grid PLC	Terna SpA	RTE Réseau de Transport d Electricité
Ratings as of July 22, 2021	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	A/Stable/A-1
	--Fiscal year ended--				
	Dec. 31, 2020	Dec. 31, 2020	March 31, 2021	Dec. 31, 2020	Dec. 31, 2020
(Mil. £)					
Revenue	282.2	2,215.7	14,779.0	2,302.2	4,237.1
EBITDA	198.8	926.4	4,648.0	1,633.1	1,729.3
Funds from operations (FFO)	146.8	642.2	3,610.0	1,162.4	1,363.0
Interest expense	36.8	123.4	1,058.0	92.7	196.6
Cash interest paid	34.9	137.0	797.0	166.7	173.1
Cash flow from operations	135.3	(656.1)	3,760.0	852.5	1,208.8
Capital expenditure	96.9	969.7	4,788.0	1,154.2	1,255.0
Free operating cash flow (FOCF)	38.4	(1,625.8)	(1,028.0)	(301.7)	(46.2)
Discretionary cash flow (DCF)	20.4	(1,759.9)	(2,481.0)	(781.6)	(412.3)
Cash and short-term investments	21.5	527.8	1,925.0	2,957.1	1,924.7
Debt	823.0	6,484.3	29,684.6	7,813.0	12,734.7
Equity	425.0	3,717.7	20,892.0	3,956.5	5,066.9
Adjusted ratios					
EBITDA margin (%)	70.4	41.8	31.5	70.9	40.8
Return on capital (%)	9.0	5.5	5.8	9.4	4.9
EBITDA interest coverage (x)	5.4	7.5	4.4	17.6	8.8
FFO cash interest coverage (x)	5.2	5.7	5.5	8.0	8.9

Table 1

Northern Ireland Electricity Networks Ltd.--Peer Comparison (cont.)					
Debt/EBITDA (x)	4.1	7.0	6.4	4.8	7.4
FFO/debt (%)	17.8	9.9	12.2	14.9	10.7
Cash flow from operations/debt (%)	16.4	(10.1)	12.7	10.9	9.5
FOCF/debt (%)	4.7	(25.1)	(3.5)	(3.9)	(0.4)
DCF/debt (%)	2.5	(27.1)	(8.4)	(10.0)	(3.2)

Business Risk: Excellent

NIE Networks' business risk profile reflects the stability and predictability of its regulated revenues from transmission system ownership and distribution system ownership and operation in its monopoly service area of Northern Ireland. The current 6.5-year price control period (RP6) in Northern Ireland follows the key principles of the regulatory frameworks applicable to U.K. regulated utility businesses, which we assess as credit supportive. These strengths are partially offset by the most recent regulatory determination, which we see as tough and as having one of the lowest WACCs we have seen (3.18%). However, the price control includes an adjustment mechanism to WACC for new debt raised during RP6 to reference the market rate prevailing at the time of issuance.

NIE Networks' current regulatory period runs from Oct. 1, 2017, to March 31, 2024. So far, the company has performed well under the challenging circumstances with strong regulatory indicators, and has facilitated the opening of the Connections market to competition.

RP6 will be dominated by a few key themes including implementing cost-efficiency plans to address the gap in RP6 allowances; meeting higher customer service standards; and securing regulatory funding for growth projects and innovation.

Our assessment of ESB's business risk profile as strong is underpinned by the company's leading position in the Irish electricity market and the stable and predictable cash flow from its low-risk regulated electricity transmission and distribution network operations. These operations contributed roughly two-thirds of consolidated EBITDA in 2020. ESB also has well-balanced power generation and supply operations.

Financial Risk: Significant

Our assessment of NIE Networks' financial risk reflects that adjusted FFO to debt will likely fall to 14%-15% over the three-year outlook horizon, slightly below the 2020 level, because of increased debt from major capex spending. The utility derives the majority of its earnings under a regulatory regime we view as low risk.

We base our forecast on the final determination for the current regulatory period, RP6. Although there was quite a gap between NIE's business plan and the final determination, we believe the utility will achieve satisfactory ratios due to its cost-efficiency and stable capex plans.

At year-end 2020, the company was on track with its investment program for RP6, having achieved 54% of RP6

outputs and 48% of capex investment. As well as having installed 38,000 meters, connected 1.7 gigawatts of renewable energy to the grid, and achieved a record low number of customer minutes lost. NIE Networks has partially funded the RP6 investment program through the issuance of a £350 million bond (maturity due 2025) and expects to fund the remainder of the program via a new bond issuance in due course. It also has a £400 million bond in place (maturity due 2026). NIE Networks pays up to a maximum of 60% profit after tax (as per revised dividend policy)

Financial summary

Table 2

Northern Ireland Electricity Networks Ltd.--Financial Summary					
Industry sector: Electric					
	--Fiscal year ended Dec. 31--				
	2020	2019	2018	2017	2016
(Mil. £)					
Revenue	282.2	258.4	258.8	245.6	232.3
EBITDA	198.8	175.7	176.5	156.0	146.5
Funds from operations (FFO)	146.8	130.0	127.7	111.0	102.0
Interest expense	36.8	37.4	40.6	42.0	41.7
Cash interest paid	34.9	35.7	39.9	39.1	38.6
Cash flow from operations	135.3	114.3	92.6	48.4	93.2
Capital expenditure	96.9	114.1	108.8	121.5	102.9
Free operating cash flow (FOCF)	38.4	0.2	(16.2)	(73.1)	(9.7)
Discretionary cash flow (DCF)	20.4	(23.5)	(38.2)	(91.1)	(25.7)
Cash and short-term investments	21.5	9.0	30.4	11.2	9.3
Gross available cash	21.5	9.0	30.4	11.2	9.3
Debt	823.0	841.3	808.3	812.8	735.6
Equity	425.0	390.7	373.6	327.4	293.9
Adjusted ratios					
EBITDA margin (%)	70.4	68.0	68.2	63.5	63.0
Return on capital (%)	9.0	7.8	8.7	7.7	7.9
EBITDA interest coverage (x)	5.4	4.7	4.3	3.7	3.5
FFO cash interest coverage (x)	5.2	4.6	4.2	3.8	3.6
Debt/EBITDA (x)	4.1	4.8	4.6	5.2	5.0
FFO/debt (%)	17.8	15.5	15.8	13.7	13.9
Cash flow from operations/debt (%)	16.4	13.6	11.5	6.0	12.7
FOCF/debt (%)	4.7	0.0	(2.0)	(9.0)	(1.3)
DCF/debt (%)	2.5	(2.8)	(4.7)	(11.2)	(3.5)

Reconciliation

Table 3

Northern Ireland Electricity Networks Ltd.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. £)							
--Fiscal year ended Dec. 31, 2020--							
Northern Ireland Electricity Networks Ltd. reported amounts							
	Debt	Revenue	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Capital expenditure
Reported	747.6	302.2	217.7	129.7	35.0	198.8	122.5
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	(17.1)	--
Cash interest paid	--	--	--	--	--	(34.9)	--
Reported lease liabilities	11.9	--	--	--	--	--	--
Postemployment benefit obligations/ deferred compensation	85.0	--	1.1	1.1	1.8	--	--
Accessible cash and liquid investments	(21.5)	--	--	--	--	--	--
Nonoperating income (expense)	--	--	--	0.6	--	--	--
Revenue: Other	--	(20.0)	(20.0)	(20.0)	--	--	--
Capital expenditure: Customer contributions	--	--	--	--	--	--	(25.6)
Total adjustments	75.4	(20.0)	(18.9)	(18.3)	1.8	(52.0)	(25.6)
S&P Global Ratings' adjusted amounts							
	Debt	Revenue	EBITDA	EBIT	Interest expense	Funds from operations	Capital expenditure
Adjusted	823.0	282.2	198.8	111.4	36.8	146.8	96.9

Liquidity: Strong

We assess NIE's liquidity position as strong, supported by our view that liquidity sources will exceed funding needs by more than 1.5x in the next 12 months and 1.0x in the next 24 months. Our assessment is further supported by the ESB group's ongoing and proactive liquidity and debt management, and ample and proven access to capital markets, even under challenging market conditions. We also view positively the revolving credit facility from ESB.

Principal Liquidity Sources	Principal Liquidity Uses
<p>For the 12 months from June 30, 2021, we estimate that NIE Networks' liquidity sources will be:</p> <ul style="list-style-type: none"> • A cash balance of about £20 million; • A committed undrawn facility of £200 million, 	<p>Over the same period, we estimate liquidity uses of:</p> <ul style="list-style-type: none"> • A dividend payment of about £25 million; • A working capital outflow of roughly £16 million; and

- maturing in December 2023; and
- Annual FFO of about £135 million.

- Capex of about £170 million.

Environmental, Social, And Governance

NIE's environmental policy commits to protecting the environment and mitigating the impact of its activities on the environment. The utility has connected 1,683 MW of renewable generation to the grid as of end-2020. It expects to evolve from a distribution network operator to a distribution system operator, encompassing the incorporation of advanced technologies in the network and capacity for the two-way transfer of electricity, all of which will facilitate transition to a low carbon network for Northern Ireland. The company also has a continued reduction in energy usage across its operational sites.

NIE Networks provides an important social service as the operator of the distribution network. It must maintain high quality networks as set by the regulator at an affordable level.

Group Influence

We view NIE Networks as a core entity within the ESB group because its activities are aligned with the group's strategic focus on regulated networks. Although we assess NIE's SACP at 'a-', we do not consider it insulated from the credit quality of ESB because of the high integration and financing dependencies between the parent and subsidiary. Therefore, we rate NIE Networks at the level of ESB's unsupported GCP. We continue to assess ESB's GCP at 'bbb+', based on the consolidated cash flows and debt at the ESB level. We don't expect the Irish government to extend support to NIE, so the rating on NIE Networks is capped at the SACP of ESB.

Issue Ratings - Subordination Risk Analysis

Capital structure

NIE Networks' debt structure consists of senior unsecured debt issued by NIE Finance PLC.

Analytical conclusions

We rate the debt 'BBB+', the same as the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Excellent

- **Country risk:** Low
- **Industry risk:** Very low
- **Competitive position:** Excellent

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: a-

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 : a-

- **Group credit profile:** bbb+
- **Entity status within group:** Core (-1 notch from SACP)

Related Criteria

- 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
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- 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
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011

Business And Financial Risk Matrix

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

Ratings Detail (As Of July 30, 2021)*

Northern Ireland Electricity Networks Ltd.

Issuer Credit Rating

BBB+/Stable/A-2

Issuer Credit Ratings History

13-Feb-2013

BBB+/Stable/A-2

17-Jan-2012

BBB+/Negative/A-2

08-Dec-2011

BBB+/Watch Neg/A-2

Related Entities

Electricity Supply Board

Issuer Credit Rating

A-/Stable/A-2

*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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