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## Jernhusen AB

**Primary Credit Analyst:**

Gustav Liedgren, Stockholm (46) 8-440-5916; [gustav.liedgren@spglobal.com](mailto:gustav.liedgren@spglobal.com)

**Secondary Contact:**

Franck Delage, Paris (33) 1-4420-6778; [franck.delage@spglobal.com](mailto:franck.delage@spglobal.com)

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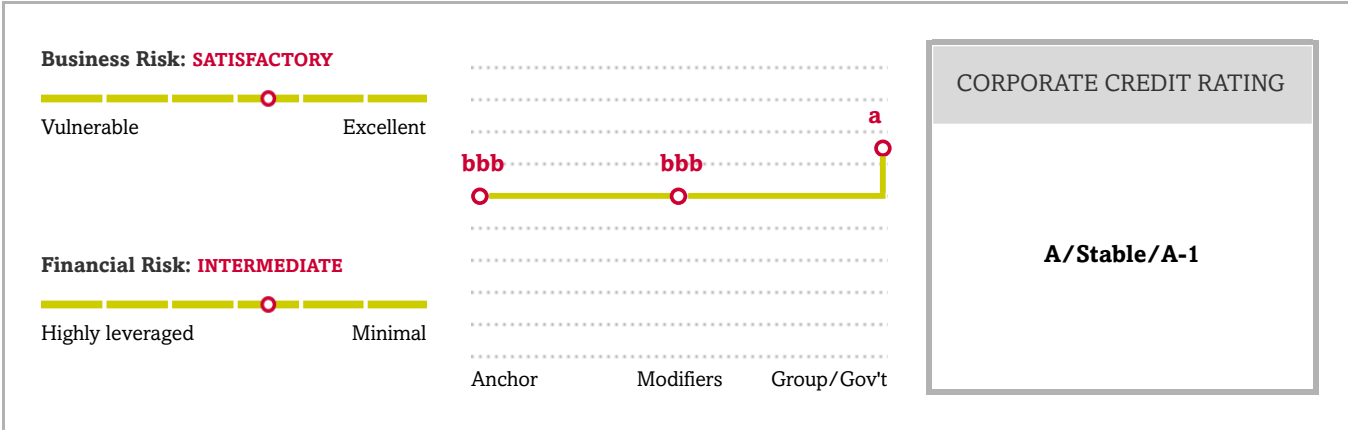
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# Jernhusen AB



## Rationale

| Business Risk: Satisfactory   | Financial Risk: Intermediate  |
|---|---|
| <ul style="list-style-type: none"> <li>• High-quality property portfolio, with assets located around the Swedish railway system.</li> <li>• Ownership of unique assets, such as the Stockholm central station and depots close to the main cities.</li> <li>• Relatively low tenant risk, due to favorable property locations.</li> <li>• A degree of exposure to higher-risk development activities.</li> <li>• Relatively small size and limited geographic diversity compared with other rated real estate companies.</li> </ul> | <ul style="list-style-type: none"> <li>• Moderate debt leverage, with debt to capital of about 50%.</li> <li>• Strong interest coverage, due to favorable borrowing costs and strong standing in local credit markets.</li> <li>• A financial policy that allows higher debt leverage.</li> <li>• An ambitious investment plan, which could result in weakening credit ratios.</li> </ul> |

**Outlook: Stable**

S&P Global Ratings' stable outlook on Swedish real estate company Jernhusen AB reflects our expectation that Jernhusen's properties will continue to benefit from strong economic fundamentals in Sweden, and favorable demand trends for rail traveling. We expect the company will maintain ample headroom to its stated financial policy, and that any unforeseen drops in the market value of its portfolio could be counterbalanced by the sale of development rights, or lower investment levels. We also expect that management will continue to closely monitor risks in the development portfolio. For the current rating level, we expect the company to maintain a ratio of debt-to-debt-plus-equity of about 50%, and EBITDA interest coverage of at least 3.0x.

**Upside scenario**

We could raise the rating if we thought that Jernhusen's financial risk tolerance had decreased to such an extent that it would maintain a debt-to-debt-plus-equity ratio of less than 40% on a sustainable basis. We view this as unlikely in the coming two years, due to Jernhusen's ambitious investment plan, and our view that this would follow a shift in the company's publicly stated financial policy to ensure lower financial risk through the cycle.

**Downside scenario**

We could lower the rating if financial risk increased, for example due to a yield increase, which would lead to a drop in property values, and hence a weakened debt-to-debt-plus-equity ratio. We would view a debt-to-debt-plus-equity ratio above 55% for a prolonged period as inconsistent with the current rating. In addition, we could also lower the rating if Jernhusen's EBITDA interest coverage ratio fell well below 3.0x for a prolonged period, for example due to markedly higher borrowing costs.

We could also lower the rating on Jernhusen if we considered that the likelihood of government support had weakened, which could, for example, be the result of an announcement of a partial privatization, although we consider this highly unlikely at the moment.

**Our Base-Case Scenario**

| Assumptions  | Key Metrics                  |              |              |              |
|--|------------------------------|--------------|--------------|--------------|
| <ul style="list-style-type: none"> <li>Real GDP growth in Sweden of 2.5% in 2017 and 2.2% in 2018, and the unemployment rate remaining at about 6.7%. Economic growth in combination with ongoing urbanization trends and a strong labor market in Stockholm will result in an increasing number of passengers on the railway system, and hence people passing through Jernhusen's stations.</li> <li>Rental income growth to increase by 3%-5% per year in 2017-2019, supported by the finalization of new developments in Stockholm, Uppsala, and Malmö, as well as contract renegotiations in the depot segment.</li> <li>Portfolio growth of about 5% in 2017, driven by increasing net rental income, investments, and slight yield compression; and 0%-5% in 2018, depending on yield development.</li> <li>Investments in 2017 of about SEK800 million, rising to SEK1.0 billion-SEK1.5 billion in 2018 and 2019, depending on the timing of large development projects.</li> <li>Disposals of about SEK200 million in 2017 (e.g., the Sundsvall station) and additional disposals in coming years as Jernhusen sells off property development rights at land areas close to central stations.</li> </ul> |                              | <b>2016a</b> | <b>2017e</b> | <b>2018e</b> |
|  | EBITDA margin (%)            | 45.7         | 46-47        | 49-50        |
|  | EBITDA interest coverage (x) | 4.7          | 4.1-4.3      | 4.4-4.6      |
|  | Debt to debt plus equity (%) | 51.3         | 48-50        | 48-50        |
| Adjusted by S&P Global Ratings. a--Actual.<br>e--Estimate.   |                              |              |              |              |

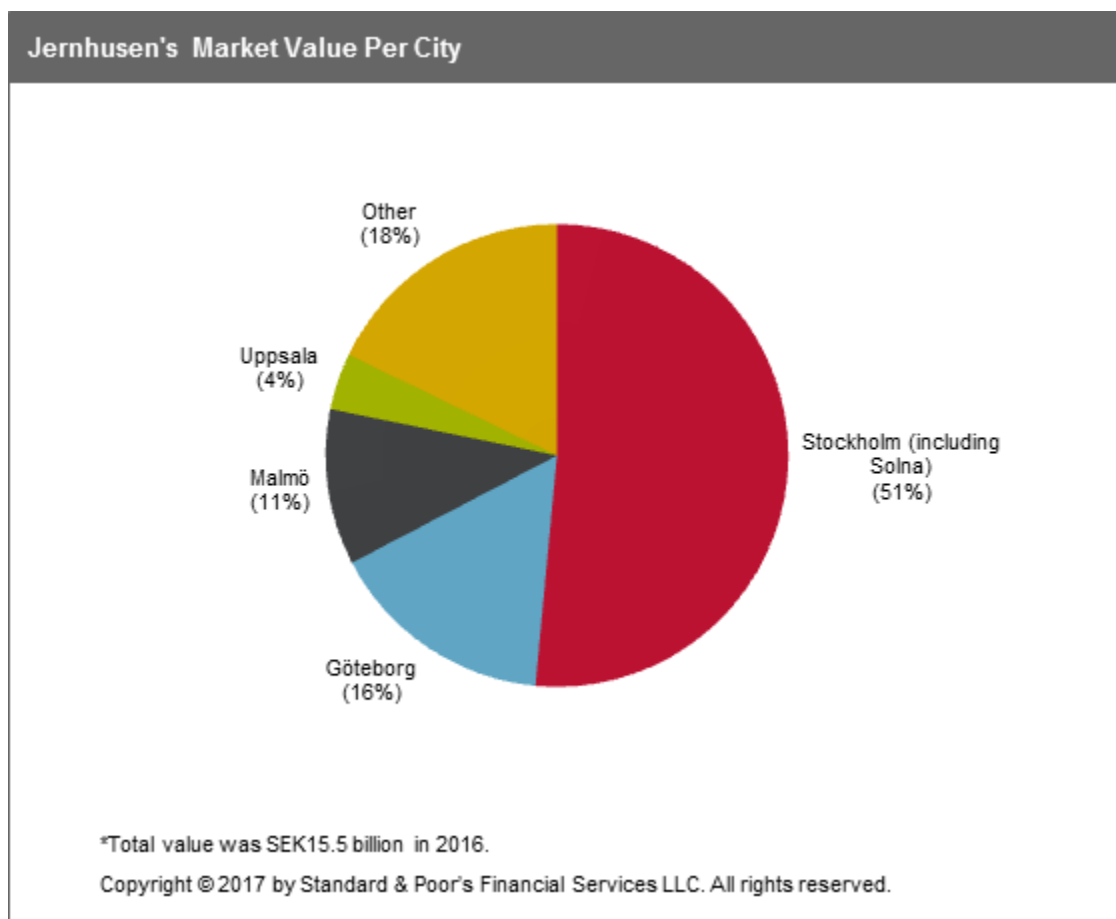
## Company Description

Jernhusen is a Swedish real estate company in the transport sector that owns, manages, and develops properties located in connection with the Swedish railway system. Jernhusen's purpose is to enable more people to travel by rail and thereby contribute to a more environmental-friendly transport system. Holdings include the main railway stations, station areas, maintenance depots and freight terminals along the railway network. The company was founded in 2001 and is 100%-owned by the Swedish state. At year-end 2016, the properties were valued at SEK15.5 billion (about €1.6 billion) and it had 647,000 square meters of rentable area.

**Table 1**

| Jernhusen 2016 Property Details |                      |                   |               |                 |
|---------------------------------|----------------------|-------------------|---------------|-----------------|
|                                 | Number of properties | % of market value | % of revenues | % of net profit |
| Stations                        | 67                   | 44                | 47            | 24              |
| City projects                   | 31                   | 25                | 9             | 39              |
| Depos                           | 54                   | 25                | 38            | 33              |
| Freight terminals               | 15                   | 6                 | 6             | 4               |

Chart 1



## Business Risk: Satisfactory

We think that Jernhusen's business risk is supported by its unique property portfolio, which mainly consists of railway stations (44% of value and 47% of revenues) and depots (25% of value and 38% of revenues) in the largest cities in Sweden. Every day about 500,000 passengers pass through its stations, 250,000 of which pass through Stockholm central station. Traveling by rail is essential for daily commuters and widely supported by parties across the political spectrum. This ensures a strong flow of passengers that is relatively insulated from economic downturns, and hence supports high rent levels and low vacancy risk at the stations. We also view positively Jernhusen's ownership of railway depots close to main cities, since these are essential infrastructure for ongoing maintenance of the trains. Although Jernhusen's tenants for its depots are mainly private maintenance companies, we view the tenant risk as very low, since a defaulting tenant would most likely be replaced by another very quickly to avoid disruptions to the railway system. We view its urban development business segment as somewhat more risky due to the nature of development activities, but recognize that Jernhusen's developable land has favorable geographic characteristics and that the company has built up a track record of these activities over the past 10 years. Jernhusen's relatively small portfolio and geographic concentration, compared to rated real estate companies like Akelius Residential Properties, and Balder, are

constraining factors to business risk, in our view. However, we recognize that passenger volumes at the stations have been very stable historically and relatively unaffected by economic downturns, such as the one in 2009.

## Peer comparison

**Table 2**

| <b>Jernhusen AB -- Peer Comparison</b>                          |                     |  |                             |                    |
|---|---------------------|--|-----------------------------|--------------------|
| <b>Industry Sector: Real Estate Investment Trust or Company</b> |                     |  |                             |                    |
|   | <b>Jernhusen AB</b> | <b>Akelius Residential Property AB</b> | <b>Fastighets AB Balder</b> | <b>Citycon Oyj</b> |
| Ratings as of Aug. 29, 2017                                     | A/Stable/A-1        | BBB-/Positive/A-3                      | BBB/Stable/--               | BBB/Stable/A-2     |
| <b>--Average of past three fiscal years--</b>                   |                     |  |                             |                    |
| <b>(Mil. SEK)</b>   |                     |  |                             |                    |
| Revenues  | 1,274               | 4,138                                  | 3,536                       | 2,737              |
| EBITDA  | 561                 | 2,040                                  | 2,237                       | 1,656              |
| Funds from operations (FFO)                                     | 415                 | 547                                    | 1,274                       | 1,164              |
| Net income from continued operations                            | 877                 | 5,915                                  | 4,506                       | 1,112              |
| Cash flow from operations                                       | 256                 | 620                                    | 1,469                       | 947                |
| Capital expenditures  | 1,038               | 2,362                                  | 6,655                       | 1,566              |
| Free operating cash flow  | (782)               | (1,742)                                | (5,186)                     | (619)              |
| Discretionary cash flow   | (1,020)             | (4,891)                                | (5,222)                     | (1,521)            |
| Cash and short-term investments                                 | 185                 | 218                                    | 990                         | 245                |
| Debt  | 6,761               | 38,840                                 | 39,932                      | 17,011             |
| Equity  | 6,125               | 27,168                                 | 21,387                      | 19,464             |
| Valuation of investment property                                | 14,043              | 70,778                                 | 64,005                      | 35,050             |
| <b>Adjusted ratios</b>  |                     |  |                             |                    |
| EBITDA margin (%)   | 44.0                | 49.3                                   | 63.3                        | 60.5               |
| Return on capital (%)   | 9.7                 | 3.2                                    | 5.2                         | 5.2                |
| EBITDA interest coverage (x)                                    | 3.9                 | 1.4                                    | 2.3                         | 3.0                |
| FFO cash interest coverage (x)                                  | 3.9                 | 1.5                                    | 2.4                         | 2.6                |
| Debt/EBITDA (x)   | 12.1                | 19.0                                   | 17.9                        | 10.3               |
| FFO/debt (%)  | 6.1                 | 1.4                                    | 3.2                         | 6.8                |
| Cash flow from operations/debt (%)                              | 3.8                 | 1.6                                    | 3.7                         | 5.6                |
| Free operating cash flow/debt (%)                               | (11.6)              | (4.5)                                  | (13.0)                      | (3.7)              |
| Discretionary cash flow/debt (%)                                | (15.1)              | (12.6)                                 | (13.1)                      | (8.9)              |
| Total debt/debt plus equity (%)                                 | 52.5                | 58.8                                   | 65.1                        | 46.6               |

SEK--Swedish krona.

## Financial Risk: Intermediate

Jernhusen's financial risk profile is supported by moderate debt leverage, in our view, with a debt-to-debt-plus-equity ratio currently at about 50%, and consistently been below 55% over the past five years. It is also supported by a strong interest coverage ratio, which was 4.7x at end-2016 (our ratio is lower than the company-reported interest coverage ratio of 7.0x, since our calculation of interest includes SEK44.1 million of capitalized interest). We acknowledge that

the company's financial policy allows for higher leverage, since it stipulates a minimum solidity ratio of 35% (versus 42.5% for 2016), which corresponds to a debt-to-debt-plus-equity ratio of approximately 60%. However, we think that the company will maintain ample headroom to this ratio in the coming five years. We recognize that Jernhusen's financial ratios are sensitive to any changes in yield and the general interest rate environment, since its debt maturity profile is relatively short, with 34% of borrowings coming from its commercial paper program. However, we think that Jernhusen has some flexibility to adjust its ambitious investment plan should ratios weaken. In addition, we view positively Jernhusen's hedging strategy to manage its interest rate exposure.

## Financial summary

Table 3

| Jernhusen AB -- Financial Summary                        |        |         |        |         |         |
|--|--------|---------|--------|---------|---------|
| Industry Sector: Real Estate Investment Trust or Company |        |         |        |         |         |
| --Fiscal year ended Dec. 31--                            |        |         |        |         |         |
| (Mil. SEK)   | 2012   | 2013    | 2014   | 2015    | 2016    |
| Revenues   | 1,161  | 1,104   | 1,181  | 1,273   | 1,368   |
| EBITDA   | 459    | 394     | 481    | 562     | 640     |
| Funds from operations (FFO)                              | 276    | 222     | 312    | 429     | 503     |
| Net income from continuing operations                    | 564    | 513     | 389    | 984     | 1,259   |
| Cash flow from operations                                | 343    | 360     | 362    | 496     | (91)    |
| Capital expenditures                                     | 1,004  | 1,277   | 1,138  | 1,401   | 574     |
| Free operating cash flow                                 | (661)  | (918)   | (776)  | (904)   | (665)   |
| Discretionary cash flow                                  | (761)  | (1,018) | (876)  | (1,017) | (1,165) |
| Cash and short-term investments                          | 93     | 0       | 101    | 283     | 170     |
| Debt   | 4,915  | 5,746   | 6,112  | 6,832   | 7,340   |
| Equity   | 4,555  | 4,973   | 5,262  | 6,158   | 6,956   |
| Debt and equity  | 9,469  | 10,719  | 11,374 | 12,990  | 14,295  |
| Valuation of investment property                         | 9,896  | 11,327  | 12,164 | 14,417  | 15,547  |
| <b>Adjusted ratios</b>                                   |        |         |        |         |         |
| EBITDA margin (%)  | 39.6   | 35.7    | 40.7   | 44.2    | 46.8    |
| Return on capital (%)                                    | 5.4    | 6.1     | 6.2    | 10.4    | 11.9    |
| EBITDA interest coverage (x)                             | 2.5    | 2.3     | 2.9    | 4.3     | 4.7     |
| FFO cash interest coverage (x)                           | 2.5    | 2.3     | 3.0    | 4.2     | 4.7     |
| Debt/EBITDA (x)  | 10.7   | 14.6    | 12.7   | 12.2    | 11.5    |
| FFO/debt (%)   | 5.6    | 3.9     | 5.1    | 6.3     | 6.8     |
| Cash flow from operations/debt (%)                       | 7.0    | 6.3     | 5.9    | 7.3     | (1.2)   |
| Free operating cash flow/debt (%)                        | (13.4) | (16.0)  | (12.7) | (13.2)  | (9.1)   |
| Discretionary cash flow/debt (%)                         | (15.5) | (17.7)  | (14.3) | (14.9)  | (15.9)  |
| Debt/debt and equity (%)                                 | 51.9   | 53.6    | 53.7   | 52.6    | 51.3    |

SEK--Swedish krona.

## Liquidity: Adequate

Our assessment of Jernhusen's liquidity profile as adequate is supported by its ample access to committed bank lines and to multiple funding sources, such as bank loans, commercial papers, and bonds. We view positively that Jernhusen covers its full commercial paper program of SEK3 billion with long-dated committed bank lines, currently maturing in May 2019. We recognize that the company faces large maturities in April 2018 of SEK1.3 billion, but think it will address those maturities well in time, as it has done historically. We note that Jernhusen has had satisfactory access to credit markets for more than 10 years, and that it established its current medium-term notes program in 2013. We also view positively Jernhusen's diverse banking group, since it has relations with the large Swedish banks, all of which we rate in the 'A' category or above.

| Principal Liquidity Sources  | Principal Liquidity Uses   |
|--|--|
| <ul style="list-style-type: none"> <li>• Cash and equivalents of SEK128 million;</li> <li>• Access to SEK5.4 billion of committed bank lines maturing in May 2019;</li> <li>• Expected funds from operations of about SEK600 million in 2017; and</li> <li>• An expected working capital inflow of about SEK500 million in 2017, relating to a receivable with Stockholm Continental.</li> </ul> | <ul style="list-style-type: none"> <li>• Investments of about SEK800 million in 2017 and about SEK1.2 billion in 2018;</li> <li>• Short-term debt of SEK4.2 billion, of which SEK2.6 billion relates to commercial paper utilization, which we expect to be rolled over; and</li> <li>• Annual dividend payments, which we expect to be about SEK200 million.</li> </ul> |

### Debt maturities

Table 4

| Jernhusen AB -- Debt Maturities |       |
|---------------------------------|-------|
| (SEK Mil.)                      | Debt  |
| 2017                            | 2,851 |
| 2018                            | 1,760 |
| 2019                            | 1,550 |
| 2020                            | 300   |
| 2021                            | 200   |
| 2022                            | 600   |
| 2023                            | 200   |

## Government Influence

Jernhusen is 100% owned by the Swedish government and managed by the Ministry of Enterprise and therefore we classify Jernhusen as a government-related entity (GRE). We consider that there is a high likelihood of government support to Jernhusen from Sweden (AAA/Stable/A-1+), and therefore apply three notches uplift to our assessment of its 'bbb' stand-alone credit profile. Our assessment of government support is based on our view of Jernhusen's:

- Important role for the Swedish government due to its unique real estate holdings, which are essential for the



Swedish railway network. We think that Jernhusen plays an important role in meeting political objectives when it comes to public transport. Although we think that part of Jernhusen's activities could be managed by private real estate companies, we view it as highly unlikely that the large central stations (e.g., Stockholm, Göteborg, and Malmö) and depots would be disposed to private owners due to their vital functions in the railway system.

- Very strong link with the Swedish government, which is actively involved in defining the company's strategy, appoints its board, and has a long-term commitment to the company. We view it as unlikely that the government would consider privatizing part of Jernhusen, since it owns critical real estate assets tied to the Swedish railway sector. This assessment is also supported by an ownership clause in the company's debt documentation that stipulates that the company should remain 100%-owned by the state. In addition, the Swedish government has a track record of supporting the GRE sector, and any unremedied financial distress at the company would pose significant reputational risk for the government.

## Ratings Score Snapshot

### Corporate Credit Rating

A/Stable/A-1

### Business risk: Satisfactory

- **Country risk:** Very low
- **Industry risk:** Low
- **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:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Related government rating:** AAA
- **Likelihood of government support:** High (+3 notches from SACP)

## Reconciliation

Table 5

**Reconciliation Of Jernhusen AB Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. SEK)**
**--Fiscal year ended Dec. 31, 2016--**

| <b>Jernhusen AB reported amounts</b>                 |             |               |                         |                         |                              |
|--|-------------|---------------|-------------------------|-------------------------|------------------------------|
|  | <b>Debt</b> | <b>EBITDA</b> | <b>Operating income</b> | <b>Interest expense</b> | <b>EBITDA</b>                |
| Reported   | 7,896.6     | 625.8         | 1,724.8                 | 93.0                    | 625.8                        |
| <b>S&amp;P Global Ratings' adjustments</b>           |             |               |                         |                         |                              |
| Interest expense (reported)                          | --          | --            | --                      | --                      | (93.0)                       |
| Interest income (reported)                           | --          | --            | --                      | --                      | --                           |
| Current tax expense (reported)                       | --          | --            | --                      | --                      | (0.5)                        |
| Surplus cash   | (170.1)     | --            | --                      | --                      | --                           |
| Capitalized interest                                 | --          | --            | --                      | 44.1                    | (44.1)                       |
| Nonoperating income (expense)                        | --          | --            | 1.5                     | --                      | --                           |
| Debt--Derivatives                                    | (387.0)     | --            | --                      | --                      | --                           |
| EBITDA--Income (expense) of unconsolidated companies | --          | 14.4          | 14.4                    | --                      | 14.4                         |
| EBIT--Income (expense) of unconsolidated companies   | --          | --            | (14.4)                  | --                      | --                           |
| Total adjustments                                    | (557.1)     | 14.4          | 1.5                     | 44.1                    | (123.2)                      |
| <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> |
| Adjusted   | 7,339.5     | 640.2         | 1,726.3                 | 137.1                   | 502.6                        |

SEK--Swedish krona.

## Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, 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

## Related Research

- Sweden-Based Real Estate Co. Jernhusen AB Rated 'A/A-1'; Outlook Stable, Aug. 29, 2017

## 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 August 29, 2017)

### Jernhusen AB

Corporate Credit Rating

A/Stable/A-1

### Corporate Credit Ratings History

29-Aug-2017

A/Stable/A-1

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### Additional Contact:

Industrial Ratings Europe; Corporate\_Admin\_London@spglobal.com

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