

## Barry Callebaut AG

**Primary Credit Analyst:**

Silvia Ortolan, London (44) 20-7176-7082; [silvia\\_ortolan@standardandpoors.com](mailto:silvia_ortolan@standardandpoors.com)

**Secondary Credit Analyst:**

Michael Seewald, CFA, Paris (33) 1-4420-6669; [michael\\_seewald@standardandpoors.com](mailto:michael_seewald@standardandpoors.com)

**Recovery Analyst:**

Florence Devevey, Madrid (34) 91-788-7236; [florence\\_devevey@standardandpoors.com](mailto:florence_devevey@standardandpoors.com)

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# Barry Callebaut AG

## Major Rating Factors

### Strengths:

- The leading global chocolate products supplier to the food industry.
- Benefits of the favorable outsourcing trend in the food industry.

### Corporate Credit Rating

BB+/Stable/--

### Weaknesses:

- Exposure to commodity price and foreign exchange risks.
- Political event risk in cocoa sourcing countries.
- Relatively high debt leverage, particularly when considering seasonal working capital fluctuations.

## Rationale

The ratings on Switzerland-based Barry Callebaut AG reflect our view of the company's "aggressive" financial risk profile, offset to some extent by its enhanced position as the world's largest and sole independent global supplier of cocoa and chocolate products to the food industry.

### Key business and profitability developments

Barry Callebaut's sales volume growth, which had fallen behind expectations in the first half of fiscal 2009 (year ended Aug. 31, 2009), picked up again in the second half. Volumes grew by more than 4% and sales revenue of about Swiss franc (CHF) 4.9 billion increased by 8.5% in local currencies, compared with the previous year, or by 1.3% in the company's reporting currency (Swiss francs). This was due to the strengthening of that currency versus most other currencies. Operating profit (EBIT) of about CHF351 million increased by 9.5% in local currencies year-on-year, or up by 2.8% in the reporting currency. This reflects both the company's cost-savings program and its efforts to improve operational performance.

This development contrasts with declining consumption in the global chocolate market, where, according to management, volumes declined by mid-single-digit figures in Western Europe (2%) and the U.S. (8%), driven by destocking and consumer downtrading.

Barry Callebaut's favorable top-line growth is not only due to restocking trends starting up in food manufacturing and retail industries, it also reflects the beneficial effect of the company's long-term supply contracts with leading chocolate producers and its early expansion into emerging and high-growth markets.

In addition to long-term supply contracts and cost-efficiency measures, the company's proven capacity to manage input price volatility should also contribute to protecting its current profitability levels. For 80% of its sales, the company's contract pricing is based on immediately hedged raw material cost. This enables Barry Callebaut to pass on raw material price volatility to its customers. In the other businesses, Barry Callebaut is able to adjust its selling prices about every six months, and raw materials for these businesses are hedged on the basis of planned sales.

### Key cash flow and capital-structure developments

In our view, Barry Callebaut's financial profile is commensurate with the current rating. For the full year ending Aug. 31, 2009, the company's adjusted funds from operations (FFO) to debt was about 22% (against our guidance of 18%) and its adjusted EBITDA fixed-charge coverage about 4.0x (in line with our guidance of 4.0x). The company's reported free operating cash flow (FOCF) turned positive, to about CHF96 million, compared with the previous year (negative by CHF85 million) due to decreased capital expenditures (capex), as the peak of its capacity extension program fell in fiscal 2008. However, Barry Callebaut's business model requires sufficient financial flexibility to finance temporary increases in working capital needs that result from volatile commodity prices.

While the company's business should be resilient enough to maintain its current financial metrics, we see only limited headroom for Barry Callebaut to sustainably reduce debt. Therefore, we believe that the company's debt protection measures are likely to remain stable.

### Liquidity

Barry Callebaut's liquidity position is still adequate for the ratings, in our view, but could come under pressure if commodity price volatility were to lead to increased financial indebtedness and tightening headroom under financial covenants.

The company benefits from a €850 million revolving credit facility (RCF), of which about 83% matures in 2013, and the remainder in 2012. The facility includes financial covenants, with leverage, interest cover, and solvency ratios tested semiannually. At the end of fiscal 2009, the company had CHF36 million of cash and cash equivalents and more than CHF800 million headroom under its RCF, against CHF252 million of short-term debt maturities. The company also raises cash through a trade receivables securitization program, under which about CHF262 million was outstanding at end-August 2009. In addition to revolving credit lines, Barry Callebaut's liquidity profile benefits from its general ability to raise financing against the company's significant cocoa bean inventory. We believe that the company has the necessary financial flexibility to meet upcoming funding requirements and should maintain adequate headroom under the bank loan's financial covenants.

### Recovery analysis

We rate Barry Callebaut's €350 million senior unsecured notes and €850 million senior unsecured bank loan at 'BB+', in line with the corporate credit rating on the parent company. These bonds have a recovery rating of '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default.

For our complete recovery analysis, see "Barry Callebaut AG's Recovery Rating Profile," published April 30, 2009, on RatingsDirect.

### Outlook

The stable outlook reflects our view that Barry Callebaut's strong competitive position in its businesses with food manufacturers and retailers will continue to support its "satisfactory" business risk profile. We could consider a negative rating action if the company's financial metrics were to fall below our guidance of adjusted FFO to debt of 18% and EBITDA interest cover of 4x, or if adverse market developments were to cause the headroom on financial covenants in the company's loan documentation to tighten.

A sustained improvement of the company's financial profile, as reflected in an adjusted FFO-to-debt ratio of about 25% and EBITDA fixed-charge cover of about 5.0x, could trigger a positive rating action.

## Business Description

Barry Callebaut is a vertically integrated and geographically diversified chocolate company (see tables 1 and 2), with operations including the sourcing of cocoa beans and the supply of cocoa-derived products to the food industry. More specifically:

- The cocoa division sources raw materials and supplies the company's other divisions with semifinished products of cocoa liquor and cocoa butter. Some business is with third parties.
- The food manufacturers division supplies industrial chocolate and ready-to-use fillings to food manufacturers.
- The consumer products division sells consumer chocolate to retailers under the group's own brands and private labels. The German market, where the general retailing environment is difficult, makes up about 70% of European sales.
- The gourmet and specialties division supplies premium and specialty products to artisanal users (chocolatiers, pastry chefs, bakeries, restaurants) and vending mixes (chocolate blends used in vending machines).

The company collectively refers to the food manufacturers and cocoa divisions as the industrial business segment, while grouping the consumer and gourmet divisions under the retail and food services business. However, the company still plans to divest its consumer products business.

**Table 1**

<b>Barry Callebaut AG Sales Revenue And Profit By Business Segment</b>				
<b>(Fiscal 2008/2009)</b>				
	<b>Sales revenue (Mil. CHF)</b>	<b>Share of total revenue (%)</b>	<b>Operating profit (Mil. CHF)</b>	<b>Profit margin (%)</b>
Industrial	3,447	71	255	7
Food/service	1,433	29	166	12
Total	4,880	100	421	N/A

CHF--Swiss franc. N/A--Not applicable.

**Table 2**

<b>Barry Callebaut AG Sales Revenue And Profit By Region</b>				
<b>(Fiscal 2008/2009)</b>				
	<b>Sales revenue (Mil. CHF)</b>	<b>Share of total revenue (%)</b>	<b>Operating profit (Mil. CHF)</b>	<b>Profit margin (%)</b>
Europe	3,336	68	296	9
Americas	1,146	24	92	8
Asia-Pacific/RoW	398	8	33	8
Total	4,880	100	421	N/A

CHF--Swiss franc. N/A--Not applicable.

## Business Risk Profile: Satisfactory, And Outpacing Market Growth

Barry Callebaut's "satisfactory" business risk profile reflects our view of the company's market position as the world's leading vertically integrated chocolate producer. The company stands to enhance its market position over time, as it profits from current outsourcing trends in the industry.

### Volatile supply, mature demand in the industry

With a small number of West African countries (mainly Ivory Coast, Ghana, Nigeria, and Cameroon) producing 70% of global cocoa, the cocoa price is highly exposed to political event risk and/or harvest conditions in these countries, which have replaced Latin America as the world's main cocoa producers since the 1980s. A further 15% of global cocoa production comes from Asia (primarily Indonesia), and the remainder from Latin America. The bulk of demand still comes from developed and developing markets, where retail volume growth is about 2%-3% per year generally, with mid-single-digit growth in Eastern Europe and Asia Pacific and about 1%-2% growth in more mature markets in Western Europe and the U.S. in recent years.

Consequently, to be successful, industry players have to protect themselves from shortfalls in raw material supply or volatility while maximizing operating efficiency to support profitability in primarily mature consumer markets. Geographic expansion into developing countries and health- or convenience-related innovations are further ways to increase growth potential.

### Presence along the entire value chain bolsters competitive position

*Cocoa sourcing well diversified.* As the processor of about 15% of the world's cocoa bean production, Barry Callebaut has strong purchasing power. The group's sourcing--about 70% from West Africa, roughly 15% from Asia, and the remainder from Latin America--closely matches worldwide cocoa bean production. This good geographic diversity limits reliance on any given producer, particularly those in politically unstable countries and those with exposure to variation in the quality of crops. In addition, diversified sourcing enables the company to offer a broad range of tastes that appeal to different consumers.

Although cocoa bean prices are very volatile, driven by instability in producing countries and poor harvests, price fluctuations have only a limited impact on Barry Callebaut's profits. This is because some contracts set both cocoa prices and volumes at the same time, so subsequent price movements have no effect. However, price fluctuations do affect the company's working capital requirements. A price movement of £100 per ton (prices are quoted in British pounds) has an impact of about CHF50 million on the company's working capital.

*Cocoa requirements hedged.* Although exposure to cocoa bean price movements is limited for the industrial divisions, the mismatch in retail between when customers commit to orders and when Barry Callebaut sets the price--about every six to 12 months--exposes the group to some commodity price risk. The company consequently hedges all its cocoa bean requirements for six to 12 months ahead. Although the cocoa futures market enables the company to do this, the sector's concentration, in particular the elimination of intermediaries, has substantially reduced the volumes traded, making it harder for companies such as Barry Callebaut to find counterparties matching the volumes and maturities needed for their hedging requirements. The upturn in the group's working capital needs in the first half of fiscal 2008, due to required prepayments of cocoa deliveries, illustrated the difficult cocoa market environment during the period.

Apart from the risk exposure resulting from cocoa price volatility, the company is also exposed to price volatility of

other commodities necessary in the cocoa production process, such as hazelnuts, sugar, and milk. For these commodities, Barry Callebaut conducts back-to-back hedging with suppliers. In our view, Barry Callebaut's substantial risk management experience should continue to offset the company's above-average exposure to foreign exchange and commodity price risks.

***Vertically integrated business model underpinned by grinding operations.*** Cocoa grinding is a concentrated market, with three independent producers--Cargill Inc. (A/Stable/A-1), Archer Daniels Midland Co. (A/Stable/A-1), and Barry Callebaut--accounting for more than 40% of total cocoa volume ground. Barry Callebaut's grinding division is the most integrated, with 75% of volumes supplying the company's other business units. Barry Callebaut sells excess output of semifinished products on the commodity market or to other food manufacturers. Implied processing margins fluctuate widely according to market prices, supply and demand, and capacity utilization in the cocoa-pressing sector.

***Leading market position in chocolate production.*** About 55% of worldwide industrial chocolate production is captive, in other words integrated within large food manufacturers which process their own beans to use in their consumer products. The remaining 45% constitutes the "open" or "free" market. Barry Callebaut's 40% share of the open market makes the company the world's largest producer, with about 18% of global output.

***Industry cooperation enhances customer base.*** Barry Callebaut has a wide client base reflecting its "preferred supplier" position in the industry. The 10 largest customers account for about 30% of sales, and no single customer accounts for more than 8%. Most clients are very large food manufacturers or retailers, which have strong bargaining power but present little credit or payment risk. Since 2007, Barry Callebaut has been further capitalizing on its position to secure outsourcing contracts with the big food manufacturers, while reducing sales of semifinished products.

Many food manufacturers are focusing more on value-generating domains such as branding, and limiting capital-intensive activities such as cocoa processing, which supports the trend toward outsourcing. Increased penetration of customer-label products also supports the trend. Only a large independent manufacturer such as Barry Callebaut has the ability to smooth demand variations by combining the orders of many customers. The arrangements with Nestle S.A. (AA/Stable/A-1+), The Hershey Co. (A/Stable/A-1), and Cadbury PLC (BBB/Positive/A-2) entered into in 2007 reflect Barry Callebaut's unparalleled market position in this field. These contracts accounted for about 75,000 tons of volume growth in fiscal 2008, representing more than 6% of total volume sales.

### **Profitability: Outsourcing trend boosts volume growth**

Barry Callebaut's operating performance should be boosted by the positive impact of price increases and ongoing cost efficiency measures, which underpin management's expectation of stable EBIT per metric tonne in the future. In addition, Barry Callebaut's long-term supply contracts with branded food manufacturers strongly improve the company's transparency on future volume growth. Given that each manufacturer has its own recipes, the costs for manufacturers to switch from one outsourcer to another are high. The enhanced market position stemming from these contracts further curbs the downside for Barry Callebaut's profitability.

## Financial Risk Profile: Aggressive, With Flexibility To Fund Working Capital And Investments

Barry Callebaut's "aggressive" financial risk profile reflects our view of the company's track record of debt-funded expansion, as shown by its current leverage. A mitigating factor is the company's enhanced financial flexibility following its refinancing moves undertaken in summer 2007.

### Accounting: Reporting under IFRS

Barry Callebaut presents its accounts according to International Financial Reporting Standards. Standard & Poor's adjusts the reported numbers for securitized trade receivables, operating lease commitments, post-tax pension liabilities, and share-based compensation expense (see table 1).

**Table 3**

<b>Reconciliation Of Barry Callebaut AG Reported Amounts With Standard &amp; Poor's Adjusted Amounts (Mil. CHF)*</b>									
<b>--Fiscal year ended Aug. 31, 2009--</b>									
<b>Barry Callebaut AG reported amounts</b>									
	<b>Debt</b>	<b>Shareholders' equity</b>	<b>Operating income (before D&amp;A)</b>	<b>Operating income (before D&amp;A)</b>	<b>Operating income (after D&amp;A)</b>	<b>Interest expense</b>	<b>Cash flow from operations</b>	<b>Cash flow from operations</b>	<b>Capital expenditures</b>
Reported	980.5	1,255.6	456.1	456.1	350.8	87.9	240.6	240.6	144.4
<b>Standard &amp; Poor's adjustments</b>									
Trade receivables sold or securitized	262.4	--	--	--	--	7.9	--	--	--
Operating leases	65.2	--	13.9	4.7	4.7	4.7	9.2	9.2	5.1
Postretirement benefit obligations	91.0	(11.5)	5.6	5.6	5.6	5.9	2.2	2.2	--
Share-based compensation expense	--	--	--	11.6	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	4.4	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	2.8	2.8	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	56.7	--
Minority interests	--	0.6	--	--	--	--	--	--	--
Total adjustments	418.6	(10.9)	19.5	21.9	14.7	18.4	14.2	70.9	5.1

Table 3

**Reconciliation Of Barry Callebaut AG Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. CHF)\* (cont.)**

<b>Standard &amp; Poor's adjusted amounts</b>									
	<b>Debt</b>	<b>Equity</b>	<b>Operating income (before D&amp;A)</b>	<b>EBITDA</b>	<b>EBIT</b>	<b>Interest expense</b>	<b>Cash flow from operations</b>	<b>Funds from operations</b>	<b>Capital expenditures</b>
Adjusted	1,399.1	1,244.6	475.7	478.0	365.4	106.4	254.9	311.6	149.6

\*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

The company is the product of a 1996 merger between Barry S.A., a French cocoa bean processor, and Callebaut AG, a Belgian industrial chocolate manufacturer. Standard & Poor's expects potential future add-on acquisitions, if any, to be funded from the company's discretionary free cash flow or divestment proceeds, and debt measures consequently to remain broadly unchanged.

The company's stock has been listed since 1998, but members of the Jacobs family have retained majority control. Jacobs Holding (not rated) controls a 50.2% stake and about 18% is split among other family members. There is only limited information available on the financial conditions of the controlling shareholders, who also hold a 29% interest in Switzerland-based staffing industry player Adecco S.A. (BBB-/Stable/A-3). However, our ratings include the assumption that the financial obligations of Barry Callebaut's controlling shareholders will not have a material adverse effect on the company's dividend policy or its financials.

**Cash flow adequacy: Declining capex contributed to free cash flow turning positive**

Barry Callebaut's debt protection measures are, in our view, commensurate with the rating. In the 12 months to Aug. 31, 2009, adjusted FFO to debt was about 22% (versus our guidance of 18%), a slight improvement compared with the previous year. The impact of efficiently managed working capital needs, offsetting seasonality effects and swings in raw material prices, together with the decrease in capex, contributed to turning Barry Callebaut's FOCF positive.

Working capital requirements, particularly for inventories, are a material part of Barry Callebaut's indebtedness. Variations, particularly those linked to swings in cocoa prices and seasonality, can cause significant temporary changes to indebtedness. The working capital hikes are temporary and tend to normalize as soon as sales price increases feed through. Standard & Poor's does not adjust debt for inventories because the company is fundamentally a cocoa bean processor, not a trader, and therefore needs inventories to operate. We recognize that the inventories give the company some flexibility because financing could be raised against them.

Barry Callebaut's capex needs significantly declined, by about CHF100 million in fiscal year 2009 compared with the previous year, in line with the end of the company's capacity-extension cycle. As we do not expect the group's dividend policy to change, and in the absence of further asset disposals, the company's free cash generation is likely to improve in 2010 as volume-driven sales growth should contribute to higher cash inflows and capex needs should decline further.

**Capital structure/Asset protection: Enhanced financial flexibility through 2007 refinancing**

Barry Callebaut's debt leverage improved to 3.0x in fiscal 2009 from 3.4x the previous year. The lower financial indebtedness is the result of positive foreign currency impacts. We do not expect this stable trend to change materially in the current fiscal year, unless unforeseen working-capital-related increases in short-term financing have a negative effect on group debt.

Barry Callebaut anticipated the financing needs for its current capex program and refinanced its debt in summer 2007, resulting in extended maturities and improved financial flexibility. The company's €350 million, 10-year senior unsecured notes maturing in 2017 and the €850 million unsecured syndicated credit facility, maturing in 2013, are rated 'BB+', the same as the corporate credit rating, reflecting the low level of priority obligations. Both financings are guaranteed by the parent and by operating subsidiaries that comprise at least 65% of Barry Callebaut's tangible assets and 70% of EBITDA.

**Table 4**

<b>Barry Callebaut AG Peer Comparison*</b>			
	<b>Barry Callebaut AG</b>	<b>Tate &amp; Lyle PLC</b>	<b>Suedzucker AG</b>
Rating as of Feb. 26, 2010	BB+/Stable/--	BBB-/Negative/A-3	BBB/Negative/A-3
	<b>--Fiscal year ended Aug. 31, 2009--</b>	<b>--Fiscal year ended March 31, 2009--</b>	<b>--Fiscal year ended Feb. 28, 2009--</b>
<b>(Mil. €)</b>			
Revenues	3,217.3	3,835.8	5,871.3
EBITDA	315.0	464.4	472.7
Net income from continuing operations	149.6	96.1	162.2
Funds from operations (FFO)	205.2	417.3	498.3
Cash flow from operations	167.8	434.6	308.2
Capital expenditures	101.3	239.4	412.8
Free operating cash flow	66.6	195.2	(104.7)
Debt	922.4	1,687.4	2,544.7
Equity	820.5	1,093.6	2,875.2
<b>Adjusted ratios</b>			
EBITDA/revenues (%)	9.8	12.1	8.1
Operating income (before D&A)/revenues (%)	9.7	12.6	8.4
EBIT interest coverage (x)	3.4	2.1	1.8
EBITDA interest coverage (x)	4.5	4.5	3.1
Return on capital (%)	13.1	8.0	5.0
FFO/debt (%)	22.3	24.6	19.6
Cash flow from operations/debt	18.2	25.6	12.1
Free operating cash flow/debt (%)	7.5	9.7	(4.1)
Debt/EBITDA (x)	2.9	3.6	5.4

\*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

Table 5

<b>Barry Callebaut AG Financial Summary*</b>					
<b>--Fiscal year ended Aug. 31--</b>					
	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Rating history	BB+/Stable/--	BB+/Stable/--	BB+/Stable/--	BB+/Stable/--	BB+/Stable/--
<b>(Mil. CHF)</b>					
Revenues	4,880.2	4,815.4	4,106.8	4,261.9	4,061.1
EBITDA	478.0	470.1	455.7	411.0	309.1
Net income from continuing operations	226.9	208.2	207.0	183.0	68.3
Funds from operations (FFO)	311.6	334.4	286.6	222.6	220.8
Capital expenditures	149.6	267.7	175.1	91.8	121.6
Free operating cash flow	105.3	(85.1)	73.1	133.9	90.2
Debt	1,399.1	1,607.9	1,505.2	1,415.6	1,363.8
Equity	1,244.6	1,176.8	1,066.4	994.1	827.0
<b>Adjusted ratios</b>					
EBITDA/revenues (%)	9.8	9.8	11.1	9.6	7.6
Operating income (before D&A)/revenues (%)	9.7	9.6	11.1	9.6	7.7
EBIT interest coverage (x)	3.4	3.0	3.3	2.8	1.5
EBITDA interest coverage (x)	4.5	4.0	4.5	3.9	2.9
Return on capital (%)	13.1	12.9	13.2	12.5	7.1
FFO/debt (%)	22.3	20.8	19.0	15.7	16.2
Cash flow from operations/debt	18.2	11.4	16.5	15.9	15.5
Free operating cash flow/debt (%)	7.5	(5.3)	4.9	9.5	6.6
Debt/EBITDA (x)	2.9	3.4	3.3	3.4	4.4

\*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

### Ratings Detail (As Of February 26, 2010)\*

#### Barry Callebaut AG

Corporate Credit Rating	BB+/Stable/--
Senior Unsecured (2 Issues)	BB+

#### Corporate Credit Ratings History

28-Feb-2003	BB+/Stable/--
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#### Business Risk Profile

Satisfactory

#### Financial Risk Profile

Aggressive

#### Debt Maturities

On Aug. 31, 2009:\*  
 2010: CHF3 million  
 2011: CHF3 million  
 2012: CHF197 million  
 2013: CHF4 million  
 Thereafter: CHF521 million  
 \*All years to Aug. 31.

#### Related Entities

##### Barry Callebaut Services N.V.

Issuer Credit Rating	BB+/Stable/--
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**Ratings Detail** (As Of February 26, 2010)\* **(cont.)**

Senior Unsecured (1 Issue)	BB+
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\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

**Additional Contact:**

Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

**Additional Contact:**

Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

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