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Viavi Solutions Inc.

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Earnings Call

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Presentation

Operator

Hello, everyone. My name is Alexis. Welcome to Viavi Solutions, First Quarter Full Year 2024 Earnings Conference Call. [Operator Instructions] I'll now turn the line over to Pam Avent with Viavi Solutions Interim CFO. Please go ahead.

Pamela Avent

Global Controller & Interim CFO

Thank you, Alexis. Welcome to Viavi Solutions, First Quarter Fiscal Year 2024 Earnings Call. My name is Pam Avent, Viavi Solutions Interim CFO. Also joining me on today's call is Oleg Khaykin, our President and CEO.

Please note, this call will include forward-looking statements about the company's financial performance. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our current expectations and estimations. We encourage you to review our most recent annual report and SEC filings, particularly the risk factors described in those filings. The forward-looking statements, including guidance we provide during this call are valid only as of today. Viavi undertakes no obligation to update these statements.

Please also note that unless we state otherwise, all results except revenue are non-GAAP. We reconcile these non-GAAP results to our preliminary financial, GAAP financials and discuss their usefulness and limitations in today's earnings release. The release, plus our supplemental earnings slides, which include historical financial tables, are available on Viavi Solutions website at www.investor.viavisolutions.com. Finally, we are recording today's call and will make the recording available by 4:30 p.m. Pacific Time this evening on our website.

Let's start with our quarterly financial results. Fiscal Q1 revenue came in at \$247.9 million, slightly below the midpoint of our guidance range of \$240 million to \$260 million. Revenue was down sequentially 6% and down 20.1% on a year-over-year basis. Operating profit margin of 12.4% was slightly below our guidance range of 12.7% to 14.2%, up by 70 basis points from the prior quarter and down 930 basis points from the prior year. EPS at \$0.09 and at the low end of our guidance range of \$0.09 to \$0.11, down \$0.01 sequentially and down \$0.14 year-over-year. The current fully diluted share count was 224.2 million shares during the quarter, down from 230.4 million shares in the prior year. Cash flow from operations for our first quarter was \$50.3 million versus \$26.6 million a year ago.

Now, moving to our quarterly results by business segment for Q1. Starting with NSE. NSE revenue came in at \$170.4 million, above the low end of our guidance range of \$167 million to \$183 million and down 22.2% year-over-year, primarily as a result of weaker spend in the service provider market. NE revenue at \$150 million declined 23.7% year-over-year.

SE revenue at \$20.4 million declined 8.9% from last year. NSE gross profit margin at 63.6% increased 150 basis points sequentially and decreased by 110 basis points year-over-year.

Within NSE, NE gross profit margin at 63.1% decreased 140 basis points from the prior year, primarily due to a combination of lower volume and product mix. SE gross profit margin at 67.2% increased 110 basis points from last year, driven by richer product mix.

NSE's operating profit margin at 0.9% came in below our guidance range of 3% to 5% as a result of lower volume and less favorable product mix. Now turning to OSP. Driven by higher demand for the anti-counterfeiting and 3D sensing products, first quarter revenue came in \$77.5 million, slightly above the high end of our guidance range of \$73 million to \$77 million and was down 15.1% year-over-year.

Gross profit margin at 52.5% declined 420 basis points year-over-year. Operating margin at 37.8% also exceeded the high end of our guidance range and declined 450 basis points year-over-year.

Now, turning to the balance sheet. The ending balance of our total cash and short-term investments was \$544.5 million, up \$27.4 million compared to the prior year. As previously mentioned, operating cash flow for the quarter was \$50.3 million, an increase of \$26.8 million from the prior quarter and an increase of \$23.7 million year-over-year. In addition, capital expenditures during the quarter of \$6.7 million were down from the \$14.8 million in the prior year when we were completing construction of our new facility in Chandler.

In addition, during fiscal Q1, we repurchased 1 million shares of our common stock for \$10 million. As you may recall, in September of last year, we announced a new common stock repurchase program for up to \$300 billion. At the end of fiscal Q1 2024, we had \$224.8 million available into this program.

Now on to guidance. We expect our fiscal second quarter 2024 revenue to be in the range of \$240 million to \$260 million. Operating profit margin is expected to be 11.2% plus or minus 160 basis points and EPS to be \$0.06 to \$0.10. We expect NSE revenue to be approximately \$177 million, plus or minus \$8 million, with an operating profit margin of 2% plus or minus 200 basis points.

OSP revenue is expected to be approximately \$73 million, plus or minus \$2 million, with an operating profit margin of 33.5%, plus or minus 100 basis points. Our tax expense is expected to be around \$8 million, plus or minus \$0.5 million for the second quarter as a result of jurisdictional mix.

We expect other income and expenses to be a net expense of approximately \$3 million, and the share count is expected to be around 222 million shares. With that, I will turn the call over to Oleg.

Oleg Khaykin

President, CEO & Director

Thank you, Pam. During the September quarter, our end market spend environment continued to be challenging, particularly with the service providers in North America. In view of these continued headwinds, our revenue came in slightly below the midpoint of our guidance, with stronger OSP demand, helping to offset weaker telecom service provider revenues.

Our EPS came in at the low end of our guidance range, driven by lower volume and higher taxes due to less favorable geographic revenue mix. With NSE, we saw a mixed performance. The demand for our field fiber, cable, service enablement and wireless lab products taming weaker than expected due to tight spend and CapEx environment at Tier 1 service providers.

The demand for lab fiber, avionics and Ofcom products was robust and continue to see good momentum. The net result was NSE revenue coming in slightly below the midpoint of our guidance.

Now turning to OSP. OSP business segment results came in slightly better than expected, with both revenue and profitability exceeding our expectations. The results were driven by stronger-than-expected demand for both anti-counterfeiting and 3D sensing products.

Looking ahead at the December quarter, we expect revenue to be seasonally down primarily due to lower anti-counterfeiting demand as our customers work to adjust their year-end inventories. We're also seeing slightly softer 3D sensing demand after strong Q1 orders.

Looking into early calendar 2024, we expect the following demand dynamics for our major product areas. First is continued slow recovery in service provider spend impacting our field instruments business.

The second, continued weaker demand for our anti-counterfeiting products a tight fiscal policy slowed down the inventory consumption by major customers. Third, beginning of recovery of wireless lab products as major wireless NAMs continued 5G product development and increased 6G investment.

The fourth, accelerated the recovery in our fiber lab and production product demand, driven by strong optical demand by data center, optical NAMs, optical module and semiconductor customers.

Fifth, growing service enablement product demand as our new architecture gain struction and acceptance with major customers. And last but not the least, growing demand for our avionics Mil/Aero and resilient P&C products.

Despite the near-term macroeconomic headwinds, our long-term growth strategy thesis built around 5G and 6G wireless, fiber, new service enablement product portfolio, 3D sensing and emerging resilient P&T technology remains intact.

In conclusion, I would like to thank my Viavi team for managing in this challenging environment and express my appreciation to our employees, customers and shareholders for their support. With that, I will now turn it over to Operator for Q&A.

Question and Answer

Operator

We will now begin the question-and-answer session. [Operator instructions] The first question comes from the line of Mehdi Hosseini with SIG.

Mehdi Hosseini

Susquehanna Financial Group, LLLP, Research Division

Yes. Oleg, do you have any plans to take additional cost out of OpEx? And if not, how do you see near term with last earnings call was under one question that your customers, at least on a wireline may be bottoming, but it seems like demand has weakened, and just want to get a feel for how you're looking at the end market demand user a smartphone?

Oleg Khaykin

President, CEO & Director

Sure. Thanks. We have taken out -- I'm not a believer of death by thousand cuts taking out a little bit at a time. We have taken a major step earlier in the year, we've taken out around \$30 million in OpEx. And we have just completed, I would say, there's maybe a little bit left, but most of it has already been factored in. And in terms of the outlook, we actually see -- while the service provider still continues to be a bit anemic. We're actually seeing it stabilizing and our lab and production test business is actually starting to recover. So, with that, I think we are good for now with any further OpEx reductions.

The area where we have a bit of a challenge is clearly our OSP business unit. That's the area where we have factories with a lot of fixed assets. So clearly, lower loadings lead to a bit more underutilization and as a result, a bit lower margins, which puts the pressure on the overall margins. But we are working diligently to bring the inventories under control as our customers and ourselves try to adjust inventories to the new equilibrium.

We think we are in a pretty good position in managing a soft landing, so to say, and to start the recovery. So the short answer, we're not planning any further OpEx reductions. I think we've implemented all the changes we need to implement. We have a little bit more remaining to be implemented from the original plan, but that's about it for now.

Operator

The next question comes from the line of Michael Genovese with Rosenblatt Securities Inc.

Michael Edward Genovese

Rosenblatt Securities Inc., Research Division

All right. Oleg, can you talk about linearity sort of from service provider orders in the quarter and particularly how things looked late in the quarter and as you talked about early October?

Oleg Khaykin

President, CEO & Director

Sure. I think if anything, linear is pretty good. Nobody has been recommitting. I mean, I would say, converting orders into bookings is taking a bit longer, but that does the lower demand before you could get things within a quarter and now it takes you a bit more than a quarter. But with that said, I think nobody has been canceling, nobody's been pulling back. I mean, once they place the orders, they take the orders. And we are seeing actually -- we're not expecting usually in the December quarter, you always have some budget flush. I don't think we're seeing any of it this year.

But on the positive side, we are seeing a probably stronger than seasonal demand into the March quarter. Things are being a lot more linear than kind of a strong June kind of December quarter, week September

March quarter. So I think there's less I would say, kind of budget flushing or trying to use it or lose it going on. It's people ordering equipment just as they needed kind of real time, just in time.

And I think the initial shock in the restructuring has been kind of worked out, and everybody is getting back to within the new operating environment, deciding what they need and placing orders as necessary. I think I'll say the first 2 quarters of fiscal -- I mean, if I look at the December kind of March quarter of this fiscal year, a year ago, there was a lot of order cancellation as many service providers were trying to get their CapEx under control.

Now that they were able to cancel and push out big-ticket items, with various NAMs, they're getting back to operational optimization, and we're actually seeing more willingness to spend money on getting more out of what they've got versus just coming down completely.

Michael Edward Genovese

Rosenblatt Securities Inc., Research Division

Okay. Great. I appreciate that color. I guess our second question is, you talked about the lab business already starting to recover. Could you give more color on what's driving that? And is the newer higher speed like very high-speed data center business, part of that lab that you're talking about?

Oleg Khaykin

President, CEO & Director

Yes. So I'd say it's a story of 2 different labs. So if you look at the wireless space, clearly, we are seeing the results of major wireless NAMs. I'd say there is still a very tight environment, but we do expect the demand to start coming back early next calendar year because in the end, everybody still got a lot of 5G and 6G products that they are working on and will be placing orders.

So in that area, we've seen weakness. The second area of weakness has been in, I'd say, in the last 2 quarters, is anything related to storage, also source both semiconductor and despite our providers kind of pulled back on some of the investments, but we expect that to be coming back as well as the next-generation products needs to be launched.

The area that's been pretty strong and actually has been up year-on-year is the very high speed. So about a quarter ago, people asked me about do I see any demand related to the hyperscale data center for AI. And at that point, we didn't really see it. We're actually starting to see that coming down. And that's why I said, between the time people talk about it and the time they start placing orders, there's always some lag.

So that piece of business for us is actually doing very well, and we are seeing a robust demand from the system providers, the data center operators and the semiconductor companies that play in that space. So, I mean, I say about level production, it's much stronger on high-speed optical transport and a bit weaker in storage and wireless. But we think storage and wireless will be coming back in the March quarter.

Michael Edward Genovese

Rosenblatt Securities Inc., Research Division

Super helpful. And I look forward to following more on that offline. I guess my last question for you would be about, you already mentioned the March quarter maybe being a little bit more linear and less seasonal with December. But can you talk just about the second half of the year because you're pretty bullish on the second half of the year and making comparisons to early '23 or '24? And how do you feel about that now? Because it seems like things are a little bit weaker on the telecom side.

Oleg Khaykin

President, CEO & Director

Well, I mean, remember, telecom's side weakness is relative. We were the first ones to see everything go tight, which was in September and December of last year. A lot of the NAMs didn't see it happening until June and, let's say, September quarter because they have non-cancelable, nonrefundable orders so, while the service providers were working to cancel or push out a lot of the equipment spend, the first thing they

did is they really tightened up on operating expenses. Now that the big-ticket items has been canceled or pushed out, it's kind of going getting back to business and trying to get more with what they've got.

So in that respect, the dialogue we are seeing is much more constructive in that area. In particular, we are expecting to see some reasonable spend in the cable deployment and network upgrade. And I think the initial revenue will start flowing in the March quarter. So in that respect, the MSOs are moving forward with their network upgrades.

I think the big service providers in North America are still a bit anemic. But in Europe and Asia, I mean we're seeing a bit better environment. So obviously, it's not as good as it was, I'd say, 1 year, 1.5 years ago, but it's from where I'm sitting, it's a better situation than it was a year ago, where for 6 months, it was crickets. Nobody was doing anything. So at least we have the dialogue and things are moving forward. And I think the initial shock for a lot of 1 production, the semi companies, module companies, system companies that kind of took a pull back, reassessed their budgets, they are CapEx and now they're coming back. And we think the areas in the high-speed optical and Ethernet is going to be quite strong in there, we expect to be quite strong in the first half calendar year.

The wireless, we expect it to start recovering and coming back. And on the service enablement our software business, we're actually feeling pretty good. We're getting very good traction for our new architecture and a very nice design win in some of the most challenging areas against truly who's who in the space. So I think in this particular space, we think we're going to pick up our share in the coming years. So, overall, where I'm sitting on the NSE side, I think the worst is behind it is now we just need to determine how is it going to be kind of gradual recovery, a little bit stronger recovery in some areas, weaker than the others, it remains to be seen.

On the OSP side, we saw very strong demand on 3D sensing in the September quarter. I think it's too early to tell how the December is going to come in. I think our major customer is probably going to look at, see how well they're selling their products. If the sales are very strong, particularly in Asia, we may see more upside to the December and March quarter. At this point, it's too early to tell.

And on the anti-counterfeiting, I think between the inventory builds during COVID and tighter fiscal environment, I think the inventories are unwinding slower. So we expect to see a weaker demand and has a greater level of underutilization and some gross margin pressure in that business unit in the coming 6 months.

Operator

The next question comes from the line of Tim Savageaux with Northland Capital Markets.

Timothy Paul Savageaux

Northland Capital Markets, Research Division

A quick question on the kind of outlook you mentioned something about March being less seasonal. And I'm not sure how the magnitude of some of the businesses, the lab businesses that you're seeing growth in, clearly, you're going to have some headwinds seasonally on 3D sensing. And it sounds like on the currency side, but at this point, you mean to talk about March being less seasonal? Could March be up given some of the dynamics that you're seeing?

Oleg Khaykin

President, CEO & Director

I think it's a bit early, so, I think in the NSE, there's a chance that March will be flat to up. I mean, as I said, we expect some pretty strong cable demand to come in, in March quarter. And we do think we're going to see some loving production recovery. But I think at this point, it's too early to tell. But the mere fact that, normally, you see quite a bit of orders being pulled in into December quarter because of budget flush. We're not seeing that as a result, people are just placing orders to when they need the product versus when they have the money to spend. And in that respect, we think the general strength that we see in December, which results in a bit weaker March, I think, is largely absent.

So, the March bookings are already in. And there's still obviously a lot of work to be done, but there is a good chance that March will be flat, maybe even slightly up on NSE side. On the OSP side, I think it will be slightly down because that's usually the weaker quarter for 3D sensing, and we continue to expect more anemic demand on anti-counterfeiting. But obviously, I've been surprised in the past, I mean, we don't get much visibility from central banks around the world. And I mean, at least our operating assumption right now is that our OSP business will be slightly down from the December quarter, and the NSE business maybe conversely slightly up. So net-net, roughly flattish March quarter is the early expectation. But I think it's too early to truly call it.

Timothy Paul Savageaux

Northland Capital Markets, Research Division

Understood. Now I appreciate the color. Following up on the network enablement side, given some of the trends you've noted in terms of service provider spending weakness, it would seem to follow that, and I know you've broken this down from time-to-time over time about lab versus field split. But it would seem that you're more lab heavy these days given that field weakness. Would you say that's right? Can you give us kind of a current estimate of where that breakdown stands? And of that lab business, how material is your 800 gig high-speed optical stuff relative to that total?

Oleg Khaykin

President, CEO & Director

So I think in general, we used to be like significantly more present in the service provider. We have obviously grown our lab business a lot more in the last 6 years. So I mean, while we are still not quite there, I would say the field instruments as, let me just kind of do a quick math here. It's probably more like 60-40, maybe 55-40. It's still about maybe 60-40, 65-45 split between the field instruments being a little bit bigger and left being smaller. That's a big change from about 70-30 that we had a few years back.

The other thing is I mentioned earlier about how we think about March quarter some of the -- when you look at our EPS range for this quarter, that assumes higher commissions because our current booking velocities, we are expecting much stronger bookings in this quarter. So we pay, this will reserve commissions in the quarter of bookings. And that obviously, as the bookings come in much stronger than the revenue, some of it carries over as the saving backlog into the next quarter that gives us a little bit more comfort to the March quarter. But that's response to your question.

Operator

The next question comes from the line of Alex Henderson with Needham.

Alexander Henderson

Needham & Company, LLC, Research Division

Great. So, we could start off with a little bit of a sense of what the break is between 3D and non-3D OSP. I'm assuming that it's somewhere around \$20 million, \$21 million in the September quarter for 3D. Is that in the ballpark?

Oleg Khaykin

President, CEO & Director

It's a little bit higher -- it's closer to \$24 million.

Alexander Henderson

Needham & Company, LLC, Research Division

\$24 million. Okay. Great. Thanks.

Oleg Khaykin

President, CEO & Director

A little over \$24 million.

Alexander Henderson*Needham & Company, LLC, Research Division*

Normally, that declined sequentially. It's a little stronger. What gives you the confidence that it's not going to decline more sequentially?

Oleg Khaykin*President, CEO & Director*

So we are expecting some decline into this quarter. But in the near term, I mean, looking at our current forecast, we are seeing a revenue to be around maybe \$3 million, \$4 million down for the total OSP. And that's largely some of it coming from the anti-counterfeiting and some of the other is coming out of the 3D sensing. But there's other elements of 3D sensing market that are playing into it. And we are already 1 month into December quarter. So yes, we're already on marketing to December --

Alexander Henderson*Needham & Company, LLC, Research Division*

Is there another piece of the business that's kicking in other than the standard customer?

Oleg Khaykin*President, CEO & Director*

Well, I mean, is the standard customer, there's also some industrial customers in that space. But I'd say the main customer is the main customer.

Alexander Henderson*Needham & Company, LLC, Research Division*

Yes. If we can go to the income statement, you talked about the \$30 million in cost savings coming out earlier in the year as we look at the \$118 million in OpEx in the quarter, is that the right level that we should be anticipating in the December quarter? Or will it step up because of commissions? And if it's not going to have a seasonal decline in the March quarter, is that again, the right level for the March quarter?

Oleg Khaykin*President, CEO & Director*

So this 118 is about on the lower end side. So in the December quarter, as I said, call it's one of these things you don't get the revenue, you get bookings. So there is a significant step up in bookings. So a big chunk of that \$4 million increased guidance for December quarter is the commissions on bookings on the revenue that will likely land in the March quarter. And in the March quarter, it will be roughly, we expect to be about the same level as December but for different reasons. It's more of a statutory accrual that you do beginning of the year, the FICA and all that stuff. And then by the June quarter, we expect it to come down a bit somewhat. So I'd say during the year, you're kind of looking between 118 to 122 is the range depending on the quarter.

Operator

The next question comes from the line of Meta Marshall with Morgan Stanley.

Karan Juvekar*Morgan Stanley, Research Division*

This is Karan on for Meta. I guess just on the telecom side and service provider side, just regionally, I know you mentioned that North America is weaker and areas like Europe is a little bit stronger. Is there anything you'd call out on this quarter in terms of trends beyond that? And I guess, do you expect sort of Europe to revert back to North American trends? Or do you expect them to continue to outgrow and outperform?

Oleg Khaykin*President, CEO & Director*

Well, I mean, I'd say telecom globally is weaker, but the difference is, are you on life support or you're working with it. And I would say, relatively speaking, Europe is doing probably the best. Latin America actually continues to be fairly resilient. Asia is doing pretty well. North America is really the area that's struggling quite a bit and I think a lot of it is driven by the heavy debt load that North American service providers are carrying. But generally, we've seen pullback across the world, less the least in Europe than I would say, Asia than Latin America, roughly on par and then North America is the most impacted.

Karan Juvekar

Morgan Stanley, Research Division

Okay. That makes sense. And then sort of on the currency side of your business, just given sort of the headwinds you outlined, are there any changes to maybe high level, how you look at the run rate of that business? Has that come down a little bit? Or do you sort of expect it to revert back as sort of demand normalizes?

Oleg Khaykin

President, CEO & Director

I think we expect the core business to be on the lower end of the \$50 million range per quarter.

Operator

[Operator instructions] There are currently no further questions in queue. So I'll now turn the line back to the team for any closing or additional remarks.

Pamela Avent

Global Controller & Interim CFO

Thank you. That concludes the conference call.

Operator

That concludes the conference call. Thank you for your participation. You may now disconnect your lines.

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