

loanDepot, Inc. NYSE:LDI

FQ4 2022 Earnings Call Transcripts

Wednesday, March 08, 2023 10:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2022-			-FQ1 2023-	-FY 2022-			-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	(0.27)	(0.35)	NM	(0.14)	(1.45)	(1.49)	NM	(0.32)
Revenue (mm)	196.11	169.66	▼ (13.49 %)	193.96	1271.21	1255.80	▼ (1.21 %)	1020.34

Currency: USD

Consensus as of Feb-28-2023 4:19 AM GMT

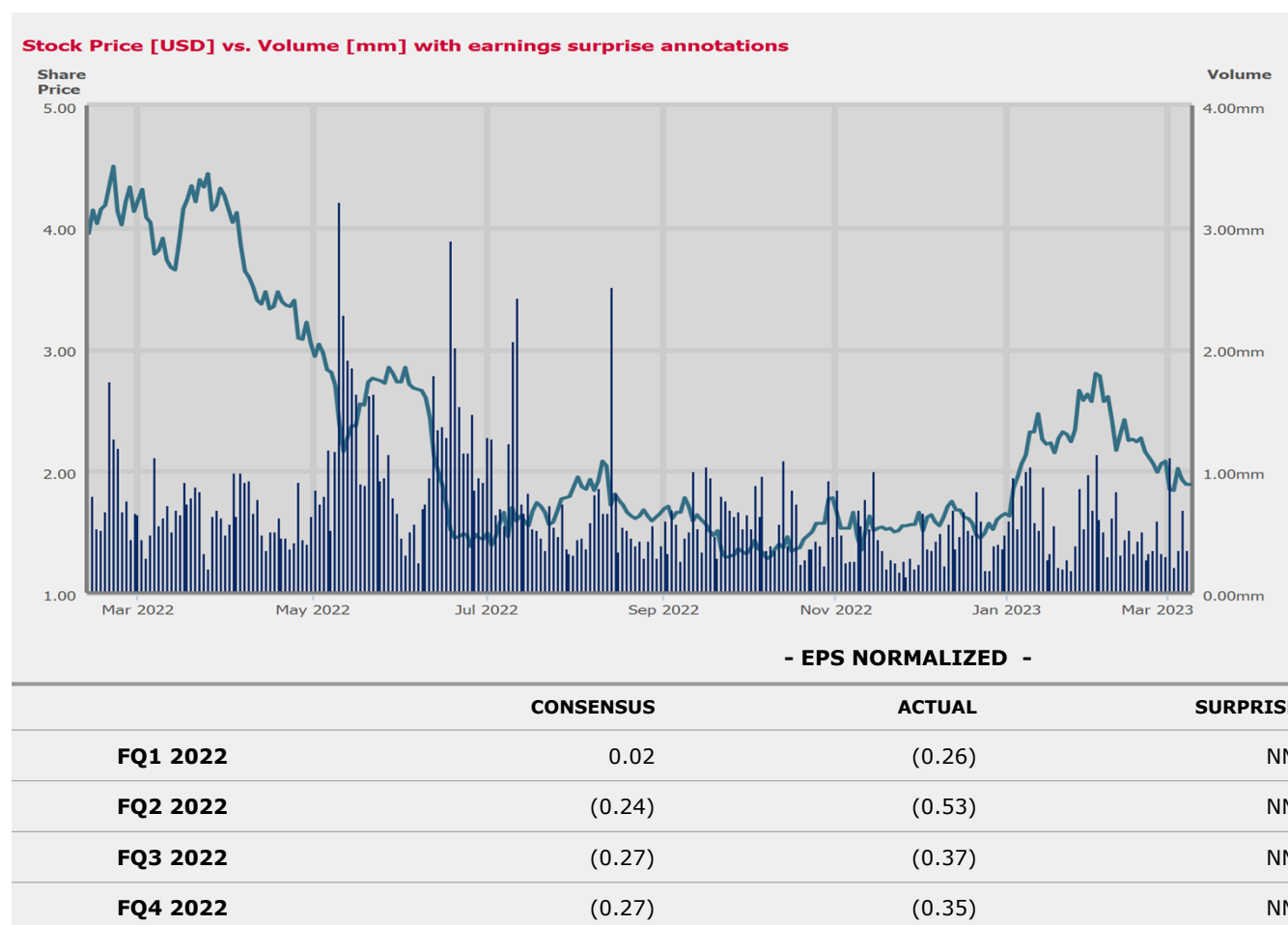


Table of Contents

Call Participants		3
Presentation		4
Question and Answer		8

Call Participants

EXECUTIVES

Frank D. Martell

CEO, President & Director

Gerhard Erdelji

Senior Vice President of Investor Relations

Jeff Alexander Walsh

President of LDI Mortgage

Jeffrey Michael DerGurahian

Chief Investment Officer & Head Economist

Nicole M. Carrillo

Executive VP & Chief Accounting Officer

Patrick J. Flanagan

Chief Financial Officer

Taylor DeBey

*Raymond James & Associates, Inc.,
Research Division*

ANALYSTS

Blake Netter

Morgan Stanley, Research Division

Bradley Michael Capuzzi

*Piper Sandler & Co., Research
Division*

Douglas Michael Harter

*Crédit Suisse AG, Research
Division*

Kyle Joseph

Jefferies LLC, Research Division

Robert Paul Napoli

*William Blair & Company L.L.C.,
Research Division*

Presentation

Operator

Good afternoon, and welcome to loanDepot's Year-end and Fourth Quarter 2022 Conference Call. [Operator Instructions] I would now like to turn the call over to Gerhard Erdelji, Senior Vice President, Investor Relations. Please go ahead.

Gerhard Erdelji

Senior Vice President of Investor Relations

Thank you. Good afternoon, everyone, and thank you for joining our call. I'm Gerhard Erdelji, Investor Relations Officer at loanDepot.

Today, we'll discuss loanDepot's year-end and fourth quarter 2022 results. Before we begin, I would like to remind everyone that this conference call may include forward-looking statements regarding the company's operating and financial performance in future periods. All statements other than statements of historical fact, are statements that could be deemed forward-looking statements, including, but not limited to, guidance to our pull-through weighted rate lock volume, origination volume, pull-through weighted gain on sale margin and expenses. These statements are based on the company's current expectations and available information. Actual results for future periods may differ materially from these forward-looking statements due to risks or other factors that are described in the Risk Factors section of our filings with the SEC.

A webcast and a transcript of this call will be posted on the company's Investor Relations website at investor.loandepot.com under the Events and Presentations tab. On today's call, we have loanDepot President and Chief Executive Officer, Frank Martell; and Chief Financial Officer, Patrick Flanagan, to provide an overview of our quarter as well as our financial and operational results, outlook and to answer your questions. We are also joined by our Chief Investment Officer, Jeff DerGurahian; and LDI Mortgage President, Jeff Walsh, to help address any questions you might have after our prepared remarks. Please note that we will not be taking any questions regarding Anthony Hsieh submission of a nomination notice.

And with that, I'll turn things over to Frank to get it started. Frank?

Frank D. Martell

CEO, President & Director

Thank you, Gerhard, and thank you all for joining us today. I look forward to sharing my perspectives on market conditions, our results, and our outlook.

As all of you know, 2022 was a year of dramatic volatility and extreme challenge for the mortgage and broader housing markets. Virtually no part of the housing ecosystem was left unaffected as participants in the housing market grappled with substantial and rapid increases in home -- in the cost of home loans. This was compounded by the cumulative impact of significant home price appreciation over the last 4 to 5 years, driven by structural supply-demand imbalances as well as the depressive impact of high inflation on available household incomes.

The impact of this once-in-a-generation downshift was magnified by the fact that most industry participants had greatly expanded their operations to accommodate historically high levels of activity in 2020 and 2021. To address the short- to medium-term impacts of lower market activity, as well as to position loanDepot to capitalize on longer-term opportunities inherent in shifting home buyer demographics, technology enhancements and process optimization, we announced the launch of our Vision 2025 strategic plan in July of 2022.

As you may recall, Vision 2025 has 4 pillars. Pillar I focuses on transforming our originations business to drive purchase money transactions with expanded emphasis on first-time homebuyers and serving diverse communities. Pillar II calls for aggressively rightsizing our cost structure in line with current and anticipated market conditions as well as to achieve internal operating performance targets. Pillar III covers

selectively investing in profitable growth-generating initiatives as well as critical business platforms and processes to support operating leverage and exceptional quality and delivery. And finally, Pillar IV relates to optimizing our organizational structure.

I intend to focus the balance of my prepared remarks today on significant progress we've made in actioning our Vision 2025 pillars in 2022 as well as provide some comments on the market and our focus areas in 2023. Pat will provide additional context and financial details in his remarks.

Regarding our revenues, Vision 2025 focuses on creating long-term shareholder value through a unique purpose-driven and durable mortgage origination footprint focused on first-time homebuyers and serving diverse communities. We believe that a laser focus around putting first-time homebuyers into homes positions loanDepot to be a customer's trusted resource when making key home ownership and other financial decisions.

We unified the leadership of our origination channels and continue to centralize operational functions to sharpen our focus and accelerate the implementation of Vision 2025. In addition to centralizing and simplifying our organization, we also focused on growing revenue-generating opportunities, which fit the strategic imperatives outlined in Vision 2025. Examples of this include the launch of our new HELOC solution during the fourth quarter as well as the formation of our most recent builder joint venture.

Our joint venture channel is a unique business that generates very high-quality customers. We're going to continue to invest in growing it. During the fourth quarter, our JV team demonstrated the benefits of our investment in this differentiated channel by delivering strong year-end volume.

In addition to driving profitable growth, loanDepot also made important and significant investments in its quality, delivery, compliance, and risk management capabilities over the course of 2022. In this regard, we recently completed the process of bringing our mortgage loan servicing portfolio onto our in-house platform, which we expect to drive higher levels of customer satisfaction at lower costs. We also announced our investment in a new loan origination platform, which we expect to deliver operational efficiency and state-of-the-art technology and workflow processes.

Finally, we added new leadership to help optimize our risk management capabilities and drive quality and compliance initiatives. As I mentioned at the start of my remarks, 2022 was a year of dramatic volatility and extreme change for the mortgage market. Like every other participant loanDepot had to reset its cost structure. When we announced Vision 2025, we established the goal of reducing our expenses by an annualized amount of \$375 million to \$400 million.

Lower costs were expected to come from rightsizing our staffing levels, shrinking our real estate footprint, reducing marketing costs, consolidating operations, investing in operating efficiencies and realizing synergies from bringing our servicing portfolio in-house. The size of our targeted reductions and the bias for speed of implementation reflect just how unique and sizable this market downturn has been.

Today, I can confirm that our team has overachieved against our Vision 2025 expense reduction goal. Pat will go over our results in more detail in a minute, but the non-volume-related expenses are down \$130 million since the second quarter of 2022 or over \$500 million annualized.

We believe that the mortgage market will remain challenged in 2023 and we must remain vigilant to respond quickly as conditions evolve. We plan to continue to reduce our costs and optimize our operating model. With a sizable cash balance, we believe we are well positioned to continue to invest in our people and our platforms as well as to benefit from ongoing industry consolidation.

I want to conclude my prepared remarks today by thanking Team loanDepot and other key stakeholders for their support. 2022 was challenging no doubt, but it was also a very important period of change and progress for the company. Against the backdrop of one of the most difficult housing markets in a generation, we have very significantly reset our cost structure, which has resulted in a progressive narrowing of our operating losses. We have also aggressively shifted our revenue profile towards purchase transactions, launched our HELOC solution and our most recent builder joint ventures.

With over \$860 million in cash on hand, approximately \$520 million in run rate cost reductions identified so far, and several new growth vectors in flight, we believe we are positioned to navigate through the current market downturn and emerge a stronger and more valuable company.

With that, I will turn the call over to Pat, who will take us through the company's Q4 and full year financial results in more detail.

Patrick J. Flanagan
Chief Financial Officer

Thanks, Frank, and good afternoon, everyone.

During the fourth quarter, loan origination volume was \$6 billion, a decrease of 35% from the third quarter of 2022. This was near the high end of the guidance we issued last quarter of between \$4 billion and \$7 billion. Fourth quarter volumes consisted of just under \$5 billion in purchase transactions and \$1.5 billion in refinance loans, primarily cash-out refinances.

Our pull through weighted rate lock volume of \$4 billion for the fourth quarter resulted in total revenue of \$170 million, which represented a 38% decrease from the third quarter. Rate lock volume also came in within the guidance we issued last quarter of \$3 billion to \$6 billion. The decrease in revenue is primarily a result of lower pull through weighted rate lock volume quarter-over-quarter driven by ongoing volatility in the interest rate markets, year-end seasonality and the completion of our decision to exit from the wholesale channel. Our pull through weighted gain on sale margin for the fourth quarter came in at 221 basis points, also within the guidance we provided.

Turning now to our servicing portfolio. Customer retention and revenue diversification remain key areas of focus. As of last month, we achieved our goal to bring our portfolio of agency and Ginnie Mae loan servicing to our in-house platform. This transition, which began in early 2021, enhances our operational efficiency and allows the company to diversify revenue streams. With the transition complete, we will continue to invest in our in-house servicing business, complementing our origination strategy to serve customers through the entire journey mortgage -- entire mortgage journey.

This enables us to capture additional revenue opportunities over time by leveraging our marketing and customer acquisition expenses across a diverse set of products and services.

The unpaid principal balance of our servicing portfolio increased to \$141 billion as of December 31, 2022, compared to \$140 billion as of September 30, 2022. This increase was primarily due to net additions during the quarter. We did not have any bulk sales from the portfolio during the quarter.

Despite the larger portfolio, servicing fee income decreased from \$114 million in the third quarter of 2022 to \$107 million in the fourth quarter of 2022. This was due to higher average balance of the portfolio during the third quarter compared to the fourth quarter. If you recall, we had a bulk sale of MSRs early in the third quarter of last year. We hedge our servicing portfolio, so we do not record the full impact of changes in fair value and the results of operations. We believe this strategy protects against volatility in our earnings and liquidity. Our strategy for hedging the servicing portfolio is dynamic and we adjust our hedge positions in reaction to changing interest rate environments.

We believe our servicing portfolio is well protected against potential rising defaults in the marketplace. As of the end of December, the average loan age was only 19 months, the average FICO score was 737. The weighted average coupon was 3.1% and the weighted average loan-to-value at origination was 71%. These characteristics contributed to a low delinquency rate with only 80 basis points of the portfolio more than 90 days past due at year-end and should generate reliable, ongoing revenue during these uncertain economic times.

A major component of our Vision 2025 plan was to align our expense base with our expectations for lower origination volume and create efficiencies we believe will result in improved operating leverage and financial performance over time. We believe that the mortgage market will total approximately \$1.5 trillion in 2023, and we've been shrinking our expense base for this much smaller market.

Our total expenses for the fourth quarter of 2022 decreased by \$91 million or 21% from the prior quarter, driven primarily by lower personnel expenses including both salaries and volume-based commissions, lower G&A and lower marketing expenses. Our total expense reduction since announcing Vision 2025 consisted of \$130 million of non-volume-related expenses and \$87 million of volume-related expenses in the form of lower commissions and direct origination expenses. One of the goals of the Vision 2025 plan was to reduce nonvolume-related expenses by an annualized \$375 million to \$400 million for the second half of 2022.

Thanks to the hard work of our entire team, we exceeded that goal by reducing nonvolume-related expenses by an annualized \$519 million. The fourth quarter included Vision 2025 related charges totaling \$12 million, including \$6 million of real estate exit costs, \$3 million of personnel-related charges and \$2 million of Vision 2025 related professional fees. Vision 2025 expenses incurred in the third quarter of 2022 totaled \$36 million.

While we achieved our Vision 2025 expense reduction target, we will continue reducing expenses with some additional headcount reductions, primarily in the form of attrition and additional consolidation of redundant operational functions and reducing real estate costs and other third-party charges. Total expenses for the first quarter should continue to fall primarily reflecting the full benefits of lower personnel costs due to our lower headcount. We expect the first quarter expenses will mark the low point for 2023, reflecting the full benefits of our expense reduction efforts and shrinking Vision 2025 related expenses.

Looking forward past the first quarter, we expect increased expenses primarily driven by higher volume-related commissions and other origination expenses, reflecting the traditional seasonal increase in home buying activity. Looking ahead to the first quarter volumes and margins, we expect origination volume of between \$3 billion and \$5 billion. We expect pull through weighted lock volume of between \$4 billion and \$6 billion and we expect our first quarter pull through weighted gain on sale margin of between 180 and 220 basis points.

In light of current market conditions, our balance sheet management strategy will keep in place our various forms of capital, preserve cash until operating losses are reduced and industry-wide gain on sale margins normalize. We entered 2023 financially sound with \$921 million of tangible equity, \$864 million of unrestricted cash and what we believe are excellent relationships and the support of our financing partners the agencies and our other investors.

With that, we're ready to turn it back to the operator for questions and answers. Operator?

Question and Answer

Operator

[Operator Instructions] We'll go first to Doug Harter, Credit Suisse.

Douglas Michael Harter

Crédit Suisse AG, Research Division

I was hoping you'll talk a little bit about your gain on sale margin [indiscernible] around 200 basis points for that's basically at all...

Nicole M. Carrillo

Executive VP & Chief Accounting Officer

I'm sorry. Lisa, we're not able to hear the question.

Operator

Just one moment, Ma'am, I don't think he can hear us. Mr. Harter, unfortunately, we cannot hear you.

Douglas Michael Harter

Crédit Suisse AG, Research Division

Sorry about that. Can you hear me now?

Frank D. Martell

CEO, President & Director

Yes.

Douglas Michael Harter

Crédit Suisse AG, Research Division

So yes, just hoping for more detail around the gain on sale margin, the midpoint around 200 basis points for business exiting the wholesale, I guess, it seems like some peers in the retail are higher. So just hoping you could help put a little more context around that gain on sale margin and where that might ultimately settle out.

Patrick J. Flanagan

Chief Financial Officer

Thanks, Doug. Yes, so I think that our gain on sale margin reflects the activity in the market for the loan origination profile of customers that we're originating and expect, as we said, for that to remain pretty steady in the first quarter. I think the differences are largely origination mix and geographic concentration of where others are in the marketplace.

Douglas Michael Harter

Crédit Suisse AG, Research Division

Okay. And then I think in your comments, you talked about kind of leaving the liquidity structure kind of in place. I guess, is that to mean that you're going to probably continue to run kind of high levels of cash kind of in the near term?

Patrick J. Flanagan

Chief Financial Officer

Yes. I think our balance sheet management strategy will remain the same as it has been for the last few quarters.

Douglas Michael Harter

Crédit Suisse AG, Research Division

Okay. And what about the thoughts around sales of additional MSR or now that you brought it all in-house, would you look to kind of try to grow that portfolio?

Patrick J. Flanagan

Chief Financial Officer

Yes. The MSR and the servicing business are important assets to us, and we don't expect to reduce that portfolio, and we'll look to selectively increase it as the economics of the business allow us to do so.

Operator

Your next question comes from Kevin Barker, Piper Sandler.

Bradley Michael Capuzzi

Piper Sandler & Co., Research Division

This is Brad Capuzzi on for Kevin Barker. Given the significant cost reduction, do you have a view on when you'll be able to achieve profitability? And then do you feel comfortable you'll be able to scale up on the other side of the cycle?

Frank D. Martell

CEO, President & Director

Yes. This is Frank. I think -- first of all, I think that, as I said, the team did a great job, and we reduced our expense structure significantly. I think are we confident that we can grow out of the cycle? Yes. I think absolutely. I think we anticipate, as I said, a very challenging 2023. So we remain very focused on the market and where the market goes, and we have actions that can address market downsides, but also we are committed to investing. We have certain in-flight investments that we're making that will help us when the market returns to grow efficiently and effectively.

Operator

Next question comes from Kyle Joseph, Jefferies.

Kyle Joseph

Jefferies LLC, Research Division

Just high level, obviously, demand for mortgages, we know what that's done just from your perspective, in the industry. Has supply caught up with that? Or would you need rates really to stabilize for supply to catch up with demand?

Frank D. Martell

CEO, President & Director

Yes. I don't think we've seen capacity come out quite as quickly as we would have thought. I think that's occurring now. But still going forward, there's room for reduced capacity in our view. And I think we're prepared hopefully would be a beneficiary of that reduced capacity when it happens.

Kyle Joseph

Jefferies LLC, Research Division

Got it. And then just 1 quick follow-up or clarification now that servicing in in-house, just looking at the loan you guys sold \$6.8 billion of loans in the quarter and released \$2.6 billion of that -- of the servicing type of those loans. What do you think that mix looks like going forward?

Patrick J. Flanagan

Chief Financial Officer

I think that servicing sale you're referencing was a third quarter event. There were no bulk sales of servicing in the fourth quarter.

Operator

Your next question comes from John Davis, Raymond James.

Taylor DeBey

Raymond James & Associates, Inc., Research Division

This is Taylor on for JD. Just maybe to start on the HELOC launch. Can you just talk about the feedback you've gotten so far and how the launch has gone versus your expectations when you first rolled it out?

Jeff Alexander Walsh

President of LDI Mortgage

Yes. This is Jeff Walsh. The launch is going well. We're now in kind of 80% of the market in terms of the opportunity. We've been expanding the product offering, and we see becoming a more and more meaningful part of our business going forward, not just the volume and revenue in the short term, but also the kind of the long-term customer opportunities that get created from having those consumers in the portfolio.

Taylor DeBey

Raymond James & Associates, Inc., Research Division

Great. Maybe just one more. It's good to see your Vision 2025 cost cuts are ahead of schedule. As you've gone through the exercise of restructuring your cost structure, have you found any additional opportunities to reduce costs in any particular area?

Frank D. Martell

CEO, President & Director

Yes. I think -- look, I think there's always opportunity to reduce cost, and we continue every day to get more efficient. I think some are short term in nature and some are longer term. I think the cost-cutting that we're doing right now mirrors what was going on in 2022. I think longer term, though, we're really excited about the new LOS platform that was announced recently. We think that over the medium to longer term, that's going to generate significant cost reduction and efficiency, but also quality and other opportunities for us.

So that's just one example of investments we're making, there's many others. So I think we will continue to look at what's important, I think, is the market and how the market evolves and make cost actions and cost plans accordingly. But we think that we have really good momentum right now coming out of last year and feel good about where we are right now.

Operator

Next question comes from James Faucette, Morgan Stanley.

Blake Netter

Morgan Stanley, Research Division

This is Blake Netter on the line for James. So in the fourth quarter, cash out refi was about 30% of your volumes. I'm wondering how has that been trending so far during the first quarter and what kind of assumptions are you baking into your outlook for cash out refi given your renewed focus on the purchase market and you recently launched HELOC product?

Patrick J. Flanagan

Chief Financial Officer

Yes. So this is Pat. The HELOC product is inclusive or included in that cash out refinance total. And I would expect that the origination mix remains pretty steady through the fourth quarter going forward. And we're finding that customers that are benefiting from cash out refinances is significantly less sort of rate dependent as many of that -- many of those are cash out in debt consolidation. So I would expect it to remain about steady mix for the rest of the year.

Blake Netter*Morgan Stanley, Research Division*

Got it. And as a quick follow-up to that. Industry-wide, it looks like average FICO scores and cash out refi loans have been declining quite materially over the past year, while on purchased loans have remained relatively flat, so some people are interpreting that to mean the lenders have already finished cashing out the easiest borrower, so to speak and are kind of moving down to like lower credit quality parts of the spectrum. I'm wondering how does that impact your cash out refi outlook? And are you seeing any less opportunity in this space going forward because of that?

Jeffrey Michael DerGurahian*Chief Investment Officer & Head Economist*

I think -- this is Jeff DerGurahian. And I think the HELOC product is meant to serve some of those higher FICO borrowers that maybe have sticker shock when they see some of the current rates. I think going forward, consumers are continually adding to their debt stack, which are at higher rates than even current mortgage rates. So we expect this to continue to see borrowers come to us for that consolidation option, whether it's HELOC or first lien cash out.

Operator

The next question is Bob Napoli, William Blair.

Robert Paul Napoli*William Blair & Company L.L.C., Research Division*

I guess trying to get a little more color. I think the most important thing here is to maintain your liquidity and protect as much book value as you can until the market turns. Now it looks like the market is going to be rough for longer. I mean higher interest rates for longer, we may not get a rebound in the mortgage market until, I don't know, 2025. I mean, you have to be prepared. How are you thinking about that? How much cash do you expect -- I mean, at this market, you have to get a way, you have to get to profitability or 0 cash burn, so you're around for the other side. So what are your thoughts on that? How much room do you have?

And how -- I mean, you've done -- it's a really tough question and tough market, and you've done a great job reducing expenses. But it seems like more has to be done to get to where you can generate at least flat free cash flow in this market. So I mean I think some color on how much room you have when -- how you can do that in this kind of a market, so you get the benefits when all these high interest rate mortgages are refied a couple of years from now?

Patrick J. Flanagan*Chief Financial Officer*

It's a good question, Bob. This is Pat. I think the first thing to recognize is that our sort of prediction of a \$1.5 trillion market is probably significantly lower than most other forecast for the year. So we've already started that thought process of building our expense base to be able to get back to profitability in a much smaller market than even we had last year. And we'll -- and we do -- are starting to see some seasonal pickup in home purchase activity, and we'll have to watch very closely to see if that materializes through the spring.

I think the other -- we are carrying significantly higher cash balance as a percent of total assets than we would normally in a more stabilized market. We'll continue to protect liquidity. We have a significant amount of unlevered equity in the MSRs and will -- and so that allows us access to additional capital should we need it. But I think we've demonstrated over the last year that we have the ability to focus on market conditions and adjust our out performance of expense cuts of more than \$400 million to \$519 million is representative of that.

Our original view is that the market size would be close to \$2 trillion. We adjusted down to \$1.5 trillion and made the necessary expense cuts along the way. And so I think we'll continue that focus on the business, and we have that discipline to adjust to market cycles. And as in my remarks earlier, we would

say we're going to keep our current balance sheet management strategy and focus on maintaining liquidity.

Robert Paul Napoli

William Blair & Company L.L.C., Research Division

Can you get to breakeven from a financials in a net income perspective in this market over the next year?

Frank D. Martell

CEO, President & Director

Yes. Look, I think as we stated, we will continue to drive toward cash flow neutrality and operating profitability in any market. And as Pat said, I think we planned this year on a \$1.5 trillion, which is a very low market volume. And I don't think we have a certain answer nor anybody does, but I think we're taking -- as you pointed out, we're taking the right actions. And as I said in my prepared remarks, we're prepared to adjust our planning depending on market conditions. And we're hopeful we'll see a solid uptick in the selling season in the spring.

If that doesn't materialize, we'll be looking at continued cost management activity -- aggressive cost management activity. But getting to a run rate profitability continues to be a North Star under the Vision 2025. It's just a function of the market and managing through the market, and it's certainly the roughest market in the generation for sure. But I think we have liquidity, and we have a very sound and prudent capital management strategy that will see us through this cycle.

Operator

That does conclude the question-and-answer session. Frank Martell, I'll turn the call back over to you for any additional or closing remarks.

Frank D. Martell

CEO, President & Director

Thanks, Lisa. So look, thanks, everybody, for joining us today. We really appreciate the insightful questions and your time today. On behalf of Jeff, and Jeff and Pat, and really the rest of the team will indeed, well, want to thank everybody for your support and your continued interest in the company, and we'll continue to keep you all apprised of our continuing progress, both on a short term and -- but a longer-term shareholder value creation plan that we believe is encapsulated in Vision 2025. So again, thanks very much, and have a great day.

Operator

And this concludes today's conference call. You may now disconnect.

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