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Earnings Call

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Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to CPI Card Group's Third Quarter 2025 Earnings Call. My name is Janine, and I will be your operator for today. [Operator Instructions] And now I would like to turn the call over to Michael Salop, CPI's Head of Investor Relations. Sir, please go ahead.

Michael A. Salop

Head of Investor Relations

Thanks, operator, and welcome to the CPI Card Group Third Quarter 2025 Earnings Webcast and Conference Call. Today's date is November 4, 2025. And on the call today from CPI Card Group are John Lowe, President and Chief Executive Officer; and Jeff Hochstadt, Chief Financial Officer. Before we begin, I'd like to remind everyone that this call may contain forward-looking statements as they are defined under the Private Securities Litigation Reform Act of 1995. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements.

For a discussion of such risks and uncertainties, please see CPI Card Group's most recent filings with the SEC. All forward-looking statements made today reflect our current expectations only, and we undertake no obligation to update any statement to reflect the events that occur after this call. Also, during the course of today's call, the company will be discussing one or more non-GAAP financial measures, including, but not limited to, EBITDA, adjusted EBITDA, adjusted EBITDA margin, net leverage ratio, free cash flow and net sales growth, excluding the impact of the accounting change implemented in the second quarter. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are included in the press release and slide presentation we issued this morning.

Copies of today's press release as well as the presentation that accompanies this conference call are accessible on CPI's Investor Relations website, investor.cpicardgroup.com. In addition, CPI's Form 10-Q for the third quarter will be available on CPI's Investor Relations website. For today's call, all growth rates refer to comparisons with the prior year period unless otherwise noted. The agenda for today's call can be found on Slide 3. After our remarks, we will open the call for questions. We can start on Slide 4, and I'll turn the call over to John.

John D. Lowe

President, CEO & Director

Thanks, Mike, and good morning, everyone. As we come closer to wrapping up the year, I'm going to spend some time updating you on our strategic initiatives, where we are making great progress growing our core businesses and diversified, including in our digital solutions. But first, let me touch on the highlights of our third quarter performance. Overall, the third quarter results were largely in line with our expectations. Our Software-as-a-Service instant issuance business once again delivered strong growth and Arroweye continued to perform well.

In our Debit and Credit segment, we believe we gained market share as contactless card volumes increased nicely. Card revenue, though, was impacted by a mix shift to higher volume orders and lower average selling prices. This mix, combined with tariff impacts and other in-year investments has continued to impact margins. Overall, sales increased 11% for the quarter due to the addition of Arroweye compared to a very strong level in the prior year, which benefited from strong growth across our portfolio. Adjusted EBITDA decreased 7% in the quarter, primarily due to the unfavorable sales mix and tariff expenses. We continue to work on various initiatives to counter these margin pressures in 2026 and beyond, including key supplier negotiations, driving automation and operational efficiencies in production, achieving Arroweye synergies and general overhead cost management.

We have already obtained future savings on key components in our supply chain and our new Indiana facility is now fully operational with all work moved over from the previous facility, which should aid

efficiencies in 2026. For 2025, we have updated our full year outlook to low double-digit to low teens net sales growth and flat to low single-digit adjusted EBITDA growth as we expect margin impacts in debit and credit to continue in the fourth quarter, and we anticipate certain prepaid orders may move into 2026. Our prepaid business remains a clear market leader. And as the pace of package innovation rises to combat fraud, order timing has been a bit uneven. That said, more prepaid complexity, including the potential for the use of chip technology is a positive over the long term as this increases values and demand for our solutions.

We still expect strong year-on-year growth in the fourth quarter for both net sales and adjusted EBITDA with levels significantly higher than the third quarter. Jeff will give you more details on the quarter and our outlook in a few minutes. But first, I want to update you on our strategy execution. Our vision and strategy can be seen on Slide 5. With everything we do, our organization is focused on the customer, quality and efficiency, innovation and diversification and our people and culture as we strive to be the most trusted partner for innovative payment technology solutions. We have made great progress on multiple strategy initiatives in 2025, including our efforts to expand our addressable markets to enhance growth for the future, and I'll highlight some of the most recent developments on Slide 6.

We are starting to provide tours to customers in our new Indiana production facility, and we believe we should be able to leverage our innovation and automation investments across our debit and credit portfolio to drive share gains and do so even more efficiently. We are continuing to expand and cross-sell our Arroweye solutions and are very excited about the initial progress and interest from new and existing customers. We believe our Software-as-a-Service instant issuance business is headed to a record year with growth in new verticals and from additional financial institution penetration. The value proposition of our integrations into the U.S. payments ecosystem continues to drive our share growth and is starting to show realization in our other digital solutions, too.

Although revenue in our other digital solutions is small today and will still take time to build, we continue to sign more issuers and build out even more integrations to broaden our addressable market. When we provide our full year 2025 results, we look forward to sharing more on our higher-margin digital solutions performance. Health care payment card expansion is also progressing with share gains of additional programs with existing customers and advances into new areas. Our value-based metal card offerings are also generating good interest with incremental sales again in the third quarter. In closed-loop prepaid, we are now in production and expect shipments in the fourth quarter. We've also invested in go-to-market for the space to expand beyond existing program managers we work with for open loop and are in discussions with several potential new customers.

As I mentioned before, complexity continues to rise for open loop packages, which not only further solidifies our position as a market leader, but also benefits our go-to-market plans for closed loop. And our most recent expansion initiative builds on this growth in prepaid complexity as we have entered into a strategic relationship with Karta, an Australia-based prepaid program manager and digital technology provider. We will be Karta's exclusive U.S. supplier of its digital card validation solution, producing contactless prepaid cards with chip technology embedding Karta's SafeToBuy [applet]. Karta's solution eliminates the need for data to be printed on cards, significantly reducing the risk of prepaid fraud.

As a reminder, prevention of prepaid gift card fraud can be accomplished through more complexity in packaging or through the adoption of chip technology and prepaid gift cards. CPI is uniquely positioned in our markets with deep expertise in both areas, we believe this can be a great complement to our secure prepaid solutions and will provide more choice for prepaid customers in the market. We are already piloting the solution with a large national retailer in the U.S. and look forward to further developing our relationship with Karta.

Many of these growth initiatives are starting to yield tangible results, and we look forward to continuing to update you on the progress as we move forward. I will now turn the call over to Jeff to cover the third quarter results and 2025 outlook in more detail. Jeff?

Jeffrey A. Hochstadt
Chief Financial Officer

Thanks, John, and good morning, everyone. Let's start on Slide 8 with the third quarter results. Third quarter net sales increased 11%, which was primarily driven by the addition of Arroweye and growth in our instant issuance business, partially offset by a decline in prepaid sales. Debit and Credit segment sales increased 16% as Arroweye contributed \$15 million of sales and our Card@Once instant issuance business delivered strong growth, led by solution sales. Contactless card sales were flat in the quarter compared to a very strong prior year sales level, which includes some large eco-focused card orders. Contactless volumes increased, but average selling prices were down due to sales mix.

Personalization services were also flat in the quarter, an improvement from the first half trend. Prepaid sales declined 7%, largely due to timing and comparisons to large sales in the prior year period. Similar to the second quarter, gross profit margin in the third quarter decreased from 35.8% in the prior year to 29.7%, driven by unfavorable sales mix resulting in lower average selling prices and increased production costs. Production costs in the quarter included \$1.6 million of tariff expenses and \$1.7 million of increased depreciation, which was primarily related to the Arroweye acquisition as well as the new Indiana production facility. SG&A expenses in the third quarter, including depreciation and amortization, increased approximately \$1 million from the prior year, primarily due to acquisition and integration costs of \$1.8 million and the inclusion of Arroweye operating expenses, partially offset by reduced employee performance-based incentive compensation and lower severance costs.

Our tax rate for the quarter was 38%, which brought our year-to-date rate to 34%, higher than anticipated coming into the year due primarily to nondeductible expenses related to the Arroweye acquisition. For the full year, we expect an effective rate between 30% and 35%. Net income increased 78% in the quarter as the prior year quarter included debt retirement costs related to the full redemption of our previous senior notes and replacement of our previous ABL revolving credit facility. Third quarter adjusted EBITDA decreased 7% to \$23.4 million and margins declined from 20.1% to 17.0% as the impact of higher sales was offset by unfavorable sales mix and tariffs. Year-to-date results and variance explanations can be found on Slide 9. Year-to-date variances generally reflect the same factors that impacted the third quarter with year-to-date reported sales also negatively impacted by the revenue recognition change implemented in the second quarter, which primarily affected the prepaid segment.

Prepaid sales decreased 5% through the first 9 months on a reported basis, but increased 8%, excluding the accounting change. A reconciliation of the accounting change impact on sales can be found in the exhibits of our earnings press release. Turning to segment results on Slide 10. Income from operations for the Debit and Credit segment decreased for the quarter and year-to-date as sales growth, including the addition of Arroweye, was offset by lower gross margins and increased SG&A expenses, including the impact of additional headcount from the Arroweye acquisition. Debit and credit gross margins were impacted by sales mix and higher production costs, including tariffs, which primarily impact the debit and credit segment and increased depreciation related to Arroweye, the new Indiana production facility and other capital equipment purchases.

Prepaid debit segment income from operations decreased in the quarter and year-to-date due to decreased net sales. On a year-to-date basis, the decline was a direct result of the revenue recognition accounting change. Turning to the balance sheet, liquidity and cash flow on Slide 11. Our cash flow generated from operating activities for the first 9 months increased from \$16.7 million last year to \$19.9 million in the current year, driven by lower working capital usage. As we have discussed previously, 2025 has been a major investment year, including spending for our new Indiana production facility and other advanced machinery to support operating efficiency, capacity expansion and new capabilities such as closed-loop prepaid. Year-to-date, our capital spending has increased almost \$10 million compared to prior year, resulting in free cash flow of \$6.1 million in the first 9 months of this year, down from \$12.5 million in the prior year.

Following the third quarter, as John mentioned, we finalized a strategic relationship with the Australian prepaid technology firm, Karta. This relationship also included an equity investment of \$10 million to acquire 20% of the company, which is also backed by the Commonwealth Bank of Australia. For the investment, we paid \$2.5 million in upfront cash with the remaining \$7.5 million expected to be settled through performance of commercial arrangements as we work together to bring new digital technology to prepaid cards in the U.S. market. Turning to the balance sheet. At quarter end, we had \$16 million of

cash, \$47 million of borrowings on our ABL revolver and \$265 million of senior notes outstanding. As we mentioned last quarter, in July, we exercised an optional redemption feature on our 10% coupon senior notes and retired \$20 million of notes at a redemption price of 103% of par value.

We have utilized our \$100 million ABL facility to help fund the Arroweye acquisition and the senior notes redemption and plan to pay down borrowings over time as we generate cash flow. Our net leverage ratio at quarter end was 3.6x, which we also plan to work down as cash flow is generated. Before we move on to our 2025 outlook, we have provided the latest U.S. cards and circulation trends from Visa and Mastercard on Slide 12. For the 3 years ended June 30, cards in circulation in the U.S. increased at a 7% CAGR. Large issuers have continued to report card and account growth in their latest earnings reports, which indicate card issuance remains healthy.

I will now turn to our 2025 outlook on Slide 13. We have updated our 2025 outlook to reflect sales mix in our debit and credit segment and timing of orders in our prepaid segment. Our net sales outlook is now low double-digit to low teens growth, which compares to low double-digit to mid-teens growth in our prior outlook. Adjusted EBITDA outlook is now flat to low single-digit growth, down from our previous range of mid- to high single digits due to the margin impact of sales mix trends. Our current outlook reflects existing tariff rates and does not reflect potential impacts from the proposed semiconductor chip tariffs, which have not been enacted and details on implementation timing and exemption criteria remain unclear. I'll now turn the call back to John for some closing remarks.

John D. Lowe

President, CEO & Director

Thanks, Jeff. Turning to Slide 14 to summarize before we open the call for Q&A. The third quarter was largely what we expected with good sales contribution from Arroweye and good demand from our core solutions, while we still face margin pressures, which we are working to counter. We have updated our outlook, and we expect strong sales and adjusted EBITDA growth in the fourth quarter. We continue to execute our strategy and are pleased to have transitioned our new Indiana production facility and advanced multiple long-term growth initiatives, including entry into closed-loop prepaid and our agreement to bring new prepaid chip-enabled technology solutions to the U.S. prepaid market with Karta. We have faced many challenges this year, but we are confident in our core business growth moving forward and are excited to see many of our growth initiatives begin to yield results. Operator, we will now open the call up for any questions.

Question and Answer

Operator

[Operator Instructions] Our question comes from the line of Andrew Scutt from ROTH Capital Partners.

Andrew Scutt

ROTH Capital Partners, LLC, Research Division

First one for me is just if you could provide some more details around the impact of tariffs. I know this is kind of tough for you guys to parse out. But following your previous call, you guys said you expected around \$5 million in charges on the year. I believe it was a \$1 million headwind to EBITDA in the second quarter. So any further details around that in the third quarter would be great.

John D. Lowe

President, CEO & Director

Andrew, I'll let Jeff cover that.

Jeffrey A. Hochstadt

Chief Financial Officer

Andrew, yes, we said \$1 million, you're right in Q2 -- in Q3, we mentioned about \$1.6 million of tariffs. So -- and we did think in Q2, it's going to be closer to \$5 million. China -- we did get a reduction in the China rate to 45% recently. And just -- we're still trying to push back every single day on our suppliers to some of that tariff impact. So we're actually thinking more in the range of \$4 million to \$5 million now. We're hoping it's closer to \$4 million. But every day, we're trying to push back on our suppliers to try to reduce the impact to us. And then I would just say that started in April. I'm not -- we're not giving color for next year, but obviously, that would probably grow a little bit into 2026 just because you got a full year impact next year.

Andrew Scutt

ROTH Capital Partners, LLC, Research Division

Yes. Understood. And I appreciate the color. Second one for me, and then I'll hop back in the queue. Your prepaid segment, you guys have added a bunch of additional programs now, health care, some payroll cards and whatnot. So previously, kind of analyzing the segment, it was just gift cards. So can you kind of give us the puts and takes in prepaid among your kind of different sales verticals?

John D. Lowe

President, CEO & Director

Yes. Let me cover the kind of overview of what we're doing in prepaid because it has changed a little bit, and Jeff can give any color on the numbers for Q3 and the rest of the year. Our prepaid business, just as a reminder, we're the market leader in prepaid packaging solutions in the United States. And so as fraud rises within the prepaid market, the complexity of what our customers are asking for, what we're innovating with our customers continues to rise. That's actually created lumpiness in orders, I would say, for this year within our open loop packages. But that's a good thing. It creates kind of greater value over the longer term of what we're producing. And then we're also investing in closed loop, which is operational. We expect to have orders shipping in Q4. And that's again because fraud impacts are bleeding into the closed loop side of the prepaid market.

But additionally, I think you saw the announcement a couple of days ago, we issued a press release. We talked about it this morning on the call. We invested in a kind of innovative technology company based in Australia. They're a program manager. They're backed by the largest bank in Australia as well. That's another one of their big investors. And they've got unique technology that we're working with our program managers to actually chip-enabled payment cards in the prepaid space. We're already piloting that with a large national retailer in the U.S. So you look at the prepaid space, you look at our unique position to both lead in the packaging side, lead in our unique chip capabilities. And we believe our strategic initiatives

entering into closed loop as well as expanding our capabilities in the open loop side are going to benefit us over the longer term. So we're happy about the prepaid performance, but definitely this year, a little bit lumpy on the revenue side.

Jeffrey A. Hochstadt

Chief Financial Officer

Yes. And Andrew, I'll just add a little bit color on the revenue side. Last year, there was a lot of -- our clients were looking to increase the security of the packaging. So we did a lot of innovation. We actually rolled out some new security measures, fraud prevention packaging last year, and you saw a pretty really strong growth here last year, especially in the second half. So as John said, it can be a little bit lumpy, but we do have pretty strong comps to grow over this year. I mean we still feel really good with the prepaid business that does, especially in the second half, have some strong comps year-over-year.

Operator

[Operator Instructions] We have a question from Jacob Stephan from Lake Street Capital Markets.

Jacob Michael Stephan

Lake Street Capital Markets, LLC, Research Division

First, I just wanted to ask on the Visa and Mastercard data. Obviously, the graph in your chart or in your presentation shows prepaid actually decreasing but credit being up. And most recent guidance here talks about timing of prepaid shipments. I guess maybe kind of help us think through what the timing in prepaid, what that portion of guidance was? And maybe do you expect that in 2026? Or are these pushed out indefinitely?

John D. Lowe

President, CEO & Director

Jacob, let me comment on that first, and then I'll let Jeff add color. The credit side actually went up quarter-to-quarter. The debit side, not prepaid actually reduced a little bit. That said, it's 1 quarter. You look back over the last 3 years, your CAGR is still 7%. What we're seeing within our markets, what we're hearing from banks opening new accounts, we continue to see growth. So we're pretty confident on card growth and what we hear from our customers, we're still seeing growth in new programs coming on board. This year, our card volumes are actually up, so we're winning share. So winning share in a growing market, we're happy about it.

Jeffrey A. Hochstadt

Chief Financial Officer

Yes. And I would just say I don't think that is correlated necessarily to delay in orders. Just as John mentioned, the prepaid ordering can be lumpy at times. And if something does get pushed off to early 2026, it would be more delayed to early 2026, not necessarily going away. So it's really -- we're just talking about the timing. Is it going to hit really in December? Is it going to hit in January, February? That's kind of more of what we're talking about.

Jacob Michael Stephan

Lake Street Capital Markets, LLC, Research Division

Okay. That's helpful. And then also wanted to touch on Karta a little bit. I guess my perception of them is that they're kind of a credit card provider. I know they have kind of a travel -- a premium travel card launch, but help us kind of think through the safe to buy technology. What -- overall, I know fraud preventative packaging has been a big growth driver for you. But what is adding the chip capability to -- for you in prepaid along with the fraud preventative packaging?

John D. Lowe

President, CEO & Director

Well, let me cover the first part. I think you're mixing them up with another company that has a similar name based in Southern Florida. That's a different company than we're investing in. This company is based in Australia. They're a prepaid program manager there. But just to touch on why the capability is unique and why it will benefit our markets as well as our company over the long term. They have the ability to essentially enable chips in a payment card and create a payment card where [the PAN], the 16-digit number is constantly changing. So your fraud and ability to kind of pull that 16-digit number off of the card, deal it, if you will, significantly reduced through putting their technology onto a chip into a payment card.

Why that's good for a market is because the fraud volumes, the amount of fraud has significantly increased in the prepaid market, it hurts the reputation of our customers, hurts the reputation of those retailers out there, the 100,000-plus points of distribution that have to deal with it every day. But additionally, if you think about our debit and credit market and you think about the transition in our debit and credit market from mag stripe to chip-enabled cards and now fully to contactless, the value grows. And that's exactly what we're starting to see hints of in the prepaid market, and we want to be on the front end of it. So that's why we made this investment. We have a right to buy a majority share of the company if we choose to. They're great partners of ours. And like I said, we're already piloting this with a large national retailer. So to the extent that this is successful and to the extent that the market moves more towards chips and prepaid payment cards, not only does it help our customers, help our market, but it also rises the value of what we're selling into that prepaid market and benefits our prepaid business.

Jacob Michael Stephan

Lake Street Capital Markets, LLC, Research Division

Very helpful. Maybe just kind of a quick last one. Adding the chip to prepaid, how significantly does that change kind of the ASP?

John D. Lowe

President, CEO & Director

Yes, I wouldn't comment on the exact ASPs, but just for context, if you're on the debit and credit side, mag stripe card versus a chip-enabled card, I mean, the chip-enabled card is generally more than 2x the cost. It's a little bit different on the prepaid side, but the price is higher. We'll try to put more pen to paper and give more color as we give more color on how the pilot is going when we released in March.

Operator

Our last question comes from the line of Peter Heckmann from D.A. Davidson.

Peter James Heckmann

D.A. Davidson & Co., Research Division

I had some follow-ups. In terms of thinking about the potential for tariffs on semiconductors and thinking about your suppliers and whether or not they have manufacturing facilities in the U.S. I guess any additional thoughts and then how you're positioned, how you might be positioning inventories ahead of this? And potentially, depending upon the timing and whether it's retroactive or a date in the future, do you think there's the potential to pull forward some larger projects ahead of a tariff implementation?

Jeffrey A. Hochstadt

Chief Financial Officer

Yes. Fair question. Everything we hear today in the market about semiconductor, we thought we would hear something late summer. It hasn't happened. The administration really hasn't come out with anything new in the last several months that we've been aware of. Our providers are pretty confident that if there was a tariff that they would be exempt just because of their -- like you said, their production facilities in the U.S. and their investment in the U.S. No one can be certain at this point. We also know if semiconductor tariffs do go into effect, it's going to affect the entire industry equally. So we're aware of that. We're really hoping either they're exempt or it doesn't impact the industry. But we'll just see. We're just waiting like everyone else. So we don't really have any more color than we did 3 months ago.

But with that said, if you look at our balance sheet, we did we did have a high inventory balance. So we've been buying chips at a little bit higher rate than we normally would have, just knowing what could potentially happen. I mean that could help us for a little bit of time if we had a higher balance of inventory. It's not completely sustainable, but it would help us in the short term. So we have been purchasing chips at a higher rate so far this year. We do expect just the timing of chips, that inventory balance may come down a little bit in Q4. But we do have a higher-than-average amount of chips on hand right now. So we've been taking a little bit aggressive approach on keeping that balance relatively high.

Peter James Heckmann

D.A. Davidson & Co., Research Division

Sorry, yes, I was on mute. I was going to say just as regards to the instant issuance business, in terms of thinking about other use cases there outside of the financial institution channel, you talked about a public sector customer last quarter. Any additional thoughts there in terms of opportunities to roll that out? And remind us, that subset of revenue for 2025, would you expect Card@Once grows faster than the overall company?

John D. Lowe

President, CEO & Director

Yes. Card@Once, our instant issuance business is growing faster. Just as a reminder, Pete, it's a higher-margin business than the rest of our business. It goes hand-in-hand with our other digital solutions. And the value proposition there is really the solution, the technology and the fact that we're integrated to most all processors and cores that support banks across the payments ecosystem. That's the exact same value proposition that we're using to win with our other digital solutions where we've been signing a number of issuers and growing, again, with higher-margin products, but our other digital solutions are fairly small right now.

That said, our instant issuance business, we're on track to have a record year. You're exactly right, there's a value proposition not only in the [FI space], but in any location where you'd want to issue a payment card on spot. And so we are continuing to kind of push to expand that market and diversify. And we're happy with our instant issuance business performance. They've done a great job this year, and we expect them to have a record year and then look forward to what they're going to do in coming years.

And just as a reminder, we said this in the call, our instant issuance business historically has been roughly 10% of the business. That's a little bit more now. Our digital solutions that we're adding continue to add to kind of our broader digital solution suite, if you will. And so we plan more on the performance, more metrics, if you will, when we release in March going into next year. So I look forward to sharing more on those businesses and especially given the value they create for CPIs [indiscernible].

Operator

As there are no further questions in the queue, I would now like to turn the call over back to John Lowe for closing remarks.

John D. Lowe

President, CEO & Director

Thanks, operator. As we head into the holiday season, I want to thank all of our CPI employees for their contributions and dedication to the company and our customers and wish everyone a safe and happy holiday. Thank you all for joining our call this morning, and we hope you have a great day.

Operator

Thank you for joining the call today. You may now disconnect.

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