

# Hanmi Financial Corporation

## NasdaqGS:HAFC

### FQ3 2019 Earnings Call Transcripts

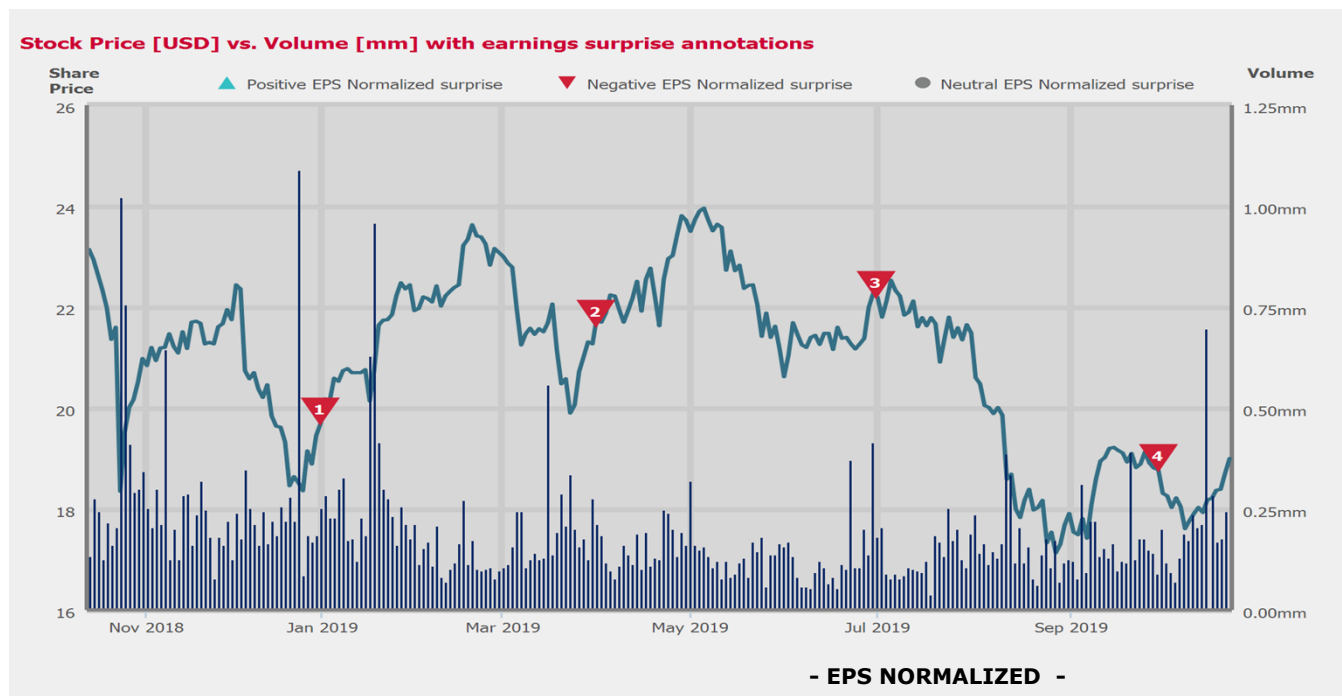
Tuesday, October 22, 2019 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2019-			-FQ4 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.47	0.40	▼ (14.89 %)	0.47	1.47	1.84
<b>Revenue (mm)</b>	50.88	50.92	▲ 0.08	51.20	203.05	207.82

Currency: USD

Consensus as of Oct-11-2019 10:43 AM GMT



	CONSENSUS	ACTUAL	SURPRISE
<b>FQ4 2018</b>	0.51	0.46	▼ <sup>1</sup> (9.80 %)
<b>FQ1 2019</b>	0.47	0.46	▼ <sup>2</sup> (2.13 %)
<b>FQ2 2019</b>	0.10	0.07	▼ <sup>3</sup> (30.00 %)
<b>FQ3 2019</b>	0.47	0.40	▼ <sup>4</sup> (14.89 %)

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# Call Participants

## EXECUTIVES

**Bonita I. Lee**

*President, CEO & Director*

**Romolo C. Santarosa**

*Senior EVP & CFO*

## ANALYSTS

**Donald Allen Worthington**

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

**Gary Peter Tenner**

*D.A. Davidson & Co., Research  
Division*

**Kelly Ann Motta**

*Keefe, Bruyette, & Woods, Inc.,  
Research Division*

**Matthew Timothy Clark**

*Piper Jaffray Companies, Research  
Division*

## ATTENDEES

**Lasse Glassen**

*ADDO Investor Relations*

# Presentation

## Operator

Ladies and gentlemen, welcome to the Hanmi Financial Corporation's Third Quarter 2019 Conference Call. As a reminder, today's call is being recorded for replay purposes [Operator Instructions] I would now like to introduce Mr. Lasse Glassen, Managing Director at ADDO Investor Relations. Please go ahead.

## Lasse Glassen

*ADDO Investor Relations*

Thank you, operator, and good afternoon and thank you for joining us today. With me to discuss Hanmi Financial's Third Quarter 2019 Earnings are Bonnie Lee, President and Chief Executive Officer; and Ron Santarosa, Chief Financial Officer. Ms. Lee will begin with an overview of the quarter, and Mr. Santarosa will then provide more details on our operating performance. At the conclusion of the prepared remarks, we will open the session for questions.

In today's call, we may include comments and forward-looking statements based on current plans, expectations, events and financial industry trends that may affect the company's future operating results and financial position. Our actual results could be different from those expressed or implied by our forward-looking statements, which involve risks and uncertainties. The speakers on this call claim the protection of the safe harbor provisions contained in the Securities Litigation Reform Act of 1995. For some factors that may cause our results to differ from our expectations, please refer to our SEC filings, including our most recent Form 10-K and Form 10-Qs. In particular, we direct you to the discussion in our Form 10-K of certain risk factors affecting our business. This afternoon, Hanmi Financial issued a news release outlining our financial results for the third quarter of 2019, which can be found on our website at [hanmi.com](http://hanmi.com).

I will now turn the call over to Bonnie Lee. Bonnie?

## Bonita I. Lee

*President, CEO & Director*

Thank you, Lasse. Good afternoon, everyone. Thank you for joining us today to discuss Hanmi's 2019 third quarter results. Hanmi's third quarter performance reflects the continuation of our strategy to protect net interest margin with a moderate growth in loans and leases.

The following are some of the key financials and operational highlights from this past quarter. Net income per diluted share increased significantly from the prior quarter, which included a \$15.7 million allowance relating to our troubled \$40 million loan relationship. Earnings in the quarter benefited from a 6 basis points increase in net interest margin resulting from a decline in cost of deposits and an improvement in the yields on interest-earning assets. As a result, net interest income was up 2.5% from the prior quarter, however, these gains are partially offset by elevated noninterest expense arising in part from the aforementioned troubled loans as well as other charges. By design, we were selective in our loan and lease production in the quarter and total loan and lease balances increased modestly from the prior quarter while average loans and leases increased 2.5% in the quarter on an annualized basis.

Importantly, we believe our keen focus on high-quality, bulk price loans and leases will serve our shareholders well in these increasingly volatile and uncertain times. Although total deposits decreased slightly in the quarter, cost of deposits were lower, driven by a favorable mix of the lower time deposits and growth in noninterest-bearing demand deposits, reflecting our efforts to increase core deposit relationships and respond to the recent declines in the general level of interest rates.

And finally, Hanmi remains very well capitalized. The bank's regulatory capital ratios remain very strong, and we are well positioned to continue growing in a safe and sound manner.

Our second quarter results were greatly affected by a single loan relationship consisting of a land loan and a business loan. After considering the approaching the year-end maturities of both loans, the project

status of the land loan and the timeliness of a certain liquidity event of the guarantor, we placed the entire relationship on nonaccrual status. Although both loans were current, we established a specific allowance of a \$15.7 million. We have and continued to work closely with the borrowers to achieve a positive resolution to the loans. Notwithstanding this particular loan relationship, we believe our overall asset quality remains strong.

Looking in more detail at our third quarter results. We reported net income of \$12.4 million or \$0.40 per diluted share. On a linked quarter basis, net income per share increased by \$0.31 compared to the second quarter of 2019.

Turning to loans and leases receivable. Our portfolio balance has held steady at approximately \$4.6 billion over the last 12 months. This coincided with strategic decisions to protect the net interest margin as much as possible, which as a consequence lead to more measured loan growth for the second half of 2018 and with a slow economic growth and uncertain times moderated our loan growth expectations for 2019. Third quarter loan and lease production of \$217.5 million declined from the \$252.4 million posted in the previous quarter.

Our third quarter production activity continued to reflect our strategic shift towards the higher-yielding categories such as equipment leases. At the same time, we continued to reduce our portfolio of a lower yielding single-family residential loans. Due in part to the strength of our commercial equipment leasing division and strong C&I loan production, the diversification of our portfolio continues to improve.

CRE loans comprise of 70.2% of our portfolio at the end of the third quarter compared with 74.1% 2 years ago. Third quarter production consisted of a \$78 million of commercial real estate loans, \$34 million of SBA loans and \$51 million of C&I loans. We also originated \$52 million of commercial equipment leases.

Newly generated loans and leases for the quarter had a weighted average yield of 5.54%, down 23 basis points from the previous quarter's weighted average yield on a new production of 5.77%, however, average loans and lease yields with the portfolio of 5.08% held steady quarter-over-quarter as the average yields on new loans and lease production in the third quarter exceeded the average yield on loans that paid off in the quarter by 9 -- 39 basis points.

Looking ahead to the fourth quarter in 2019. Our loan and lease pipeline has improved modestly, and we anticipate moderate growth of loans and leases for the full year.

Now turning to deposits. We continue to operate in a highly competitive Asian-American banking landscape for deposit gathering activities. Total deposits at the end of the third quarter of \$4.69 billion decreased 1.5% or approximately \$72 million on a linked quarter basis but expanded 1.6% or nearly \$76 million from a year ago. Importantly, the mix of deposits has improved. Noninterest demand deposits increased 5.8% over the prior quarter while time deposits decreased by 11.6%, which resulted in the cost of deposits declining by 4 basis points in the quarter.

Looking at asset quality. Aside from the troubled loan relationship identified last quarter, overall, the key metrics remained stable. Net charge-offs held relatively steady at \$276,000 or 2 basis points for the third quarter. We recorded a \$1.6 million loan loss provision in the quarter and allowance for loan and lease losses increased slightly to 111 basis points of loans and leases at quarter end.

Furthermore, we continued to maintain conservative and disciplined underwriting standards on new loan originations. For the third quarter of 2019, the weighted average loan-to-value and debt coverage ratio on new commercial real estate loan originations were 54.2% and 1.7x, respectively. For the entire commercial real estate portfolio, the weighted average loan-to-value and weighted average debt coverage ratios as of the end of the third quarter were 48.6% and 2.1x, respectively.

I would now like to provide a quick update on our key initiatives for 2019, which are focused on being more selective on new loan production, protecting net interest margin as much as possible and careful expense management. With our loan and lease balance holding steady through the first quarter -- first 3 quarters of the year, as I noted earlier, we now anticipate full year 2019 loan and lease growth to be modest. We continue to emphasize areas of growth where we can achieve a higher spread such

as equipment leases. The commercial equipment leasing division as a percentage of our overall loan production has increased significantly during 2019 and we expect this trend to continue.

I would also like to provide an update on our efforts to reduce costs and to improve operational efficiencies. A significant portion of this effort has been the successful branch consolidation initiative, which was completed earlier in the year and included the closure of [ 5 branch ] or about 10% of our branch network. We are also making investment in technology and systems to achieve cost reductions through improvements in operational efficiencies. This includes centralizing and streamlining certain back-office activities through improved processing speed along with enhanced consistency across the enterprise in sourcing, underwriting and administrating credit.

With that, I would now like to turn the call over to Ron Santarosa, our Chief Financial Officer, for additional details on our third quarter financial results. Ron?

**Romolo C. Santarosa**  
*Senior EVP & CFO*

Thank you, Bonnie, and good afternoon, all. Looking at our top line revenue results, net interest income for the third quarter was \$44.1 million, up from \$43 million for the second quarter, reflecting an improved margin and 1 extra day in the period. Overall, yields improved during the quarter, and mixed with higher average balances, led to a 1.1% sequential increase in interest income.

Further benefiting our net interest income was a 2% decrease in total interest expense to \$18.1 million, mostly driven by a 4.4% decrease in interest on deposits.

Net interest margin for the quarter was 3.36%, up 6 basis points from 3.3% in the linked quarter. The cost of deposits fell 4 basis points to 1.37%, mostly due to the decline of higher-costing time deposits. In addition to lower funding costs, we realized a 2 basis point increase in average yield on our interest-earning assets to 4.74%. Although individual yields mostly remained flat quarter-over-quarter, we saw a mix shift in average balances out of lower-yielding interest-bearing deposits with other banks and it's higher-yielding loans and leases.

Turning to noninterest income, we had an 11.2% decrease from the second quarter to \$6.9 million. In the second quarter, we had a \$1.2 million gain from the sale of a branch building. In addition, we sold the remaining position in our tax-exempt municipal securities portfolio in the second quarter. The absence of the building sale gain and the securities gain account for a large part of the decline in noninterest income on a linked quarter basis. Gains from the sales of SBA loans, however, increased to \$1.8 million from \$1.1 million last quarter. SBA trading premiums were very favorable in the third quarter, averaging 9.15%, up from 8.6% for the prior quarter. The volume of loans sold also increased 58% in the quarter to \$24.3 million from \$15.4 million.

Noninterest expenses increased by \$2.5 million to \$3.26 million for the linked quarter due to several items. There was a \$1.1 million increase in occupancy and equipment costs, driven mainly by the reassessment and reduction of personal property tax expense in the second quarter. We also saw an increase in professional fees relating to a \$600,000 of charges realized in connection with the reporting delay, and also there were about \$200,000 legal fees from the year ago terminated merger transaction and our CECL efforts added an additional \$300,000 in the period. Increased headcount and incentives in part from added SBA staff contributed to a \$600,000 increase in salaries and benefits.

Partially offsetting these increases was a \$400,000 FDIC insurance credit. Increased expenses this quarter, mixed with a slight increase in revenue, drove our efficiency ratio to 64.04% from 59.44% in the prior quarter.

Return on average assets for the third quarter increased to 0.9% from 0.19% last quarter while return on average equity increased sequentially to 8.67% from 1.87%. Our tangible book value increased by \$0.22 to \$18.05 per share from the second quarter, and our tangible common equity ratio remains strong at 10.2%.

With that, I'll turn it back to Bonnie.

**Bonita I. Lee**

*President, CEO & Director*

Thank you, Ron. As we look ahead for the fourth quarter, we continue to see headwinds from the persistently competitive market for loans and deposits. However, our recent success in shifting towards a higher-yielding assets and lower cost of deposits gives me confidence that we can meet challenges ahead. Hanmi is poised for a strong finish in 2019 while generating solid returns for our shareholders. I look forward to sharing our continued progress with you next quarter.

**Lasse Glassen**

*ADDO Investor Relations*

Operator, that concludes our prepared marks. You can now open the call to -- for questions.

# Question and Answer

## Operator

[Operator Instructions] Our first question is from Matthew Clark, Piper Jaffray.

### **Matthew Timothy Clark**

*Piper Jaffray Companies, Research Division*

First one for me just wanted to know how much prepay penalty income may have contributed to the margin this quarter and last quarter as well?

### **Romolo C. Santarosa**

*Senior EVP & CFO*

Matthew, this is Ron. Very slight, about \$300,000 in the third quarter and about \$100,000 in the second quarter.

### **Matthew Timothy Clark**

*Piper Jaffray Companies, Research Division*

Okay. Okay, great. And then the -- was there tax benefit this quarter that contributed to lower tax rate as well that you could quantify?

### **Romolo C. Santarosa**

*Senior EVP & CFO*

No, actually, I would just observe, in the first quarter, our tax rate was particularly high because of some matters bearing in the first quarter. As I have mentioned, we would probably have an effective tax rate for the year of about 29%. We're still headed towards that, and so the subsequent quarters would naturally have to be below that mark to get to the 29% for the year.

### **Matthew Timothy Clark**

*Piper Jaffray Companies, Research Division*

Okay. And then honing in on the commercial real estate portfolio that's kind of drifted lower here year-to-date, should we not expect that portfolio to grow as we look out in the next year as you get more selective and maybe rework some of the portfolio? Or should we expect some net growth?

### **Bonita I. Lee**

*President, CEO & Director*

I think we would expect moderate growth. Growth of the portfolio is the function of not only the new production but, of course, the payoffs and some of the payoffs are -- come in unexpectedly and we are not really in control of when the payoffs are happening. So -- but I do hope that to have a little bit of a modest growth in the portfolio.

### **Matthew Timothy Clark**

*Piper Jaffray Companies, Research Division*

Okay. And then just last one from me on the leasing portfolio. You guys wanted to continue to grow that portfolio. I know it comes at higher yield. I guess how should we think about kind of loss content or charge-offs on that portfolio as it seasons?

### **Bonita I. Lee**

*President, CEO & Director*

So leasing portfolio has performed actually fairly well, and we expected about 1% loss when we actually first started the business, but I think it's actually -- the actual loss is coming much lower than that 1% target we originally expected.



**Operator**

Our next question is from Gary Tenner, D.A. Davidson & Company.

**Gary Peter Tenner**

*D.A. Davidson & Co., Research Division*

Question around -- on the [indiscernible] credit. How much of that is left or rather just how long should that continue to be a positive driver for expenses?

**Romolo C. Santarosa**

*Senior EVP & CFO*

I believe that would just be for this quarter unless the agency does another reassessment.

**Gary Peter Tenner**

*D.A. Davidson & Co., Research Division*

Okay. There are some banks that are -- suggesting it goes into the even first quarter of next year. So I don't know, it probably depends on the pace of recognizing that credit. And then I wonder just on the expense -- or rather as you go back to kind of the troubled loan issue in the second quarter and your comments in the queue about kind of efforts to remediate some of those issues, what is involved there? Is it technology, is it processes, is it headcount in any particular business lines?

**Romolo C. Santarosa**

*Senior EVP & CFO*

I'm sorry, Gary, can you repeat the question? Are you talking about the resolution efforts to the troubled loan or the charge?

**Gary Peter Tenner**

*D.A. Davidson & Co., Research Division*

I think -- in the Q, I think the commentary suggested that there were some weaknesses that you needed to address internally.

**Romolo C. Santarosa**

*Senior EVP & CFO*

Yes.

**Gary Peter Tenner**

*D.A. Davidson & Co., Research Division*

So I'm just wondering what's involved from expense or investment or action in terms of that activity?

**Romolo C. Santarosa**

*Senior EVP & CFO*

I understand now, thank you. So the material weakness that we cited in the filing of our second quarter Form 10-Q that will continue again for the third quarter. Remediation efforts are underway. It will not command an unreasonable amount of effort on our part or additional resources. That's something that we can resolve pretty much with what we have. So I don't anticipate any real charges coming from the remediation efforts.

**Operator**

[Operator Instructions] Our next question is from Matthew Clark, Piper Jaffray.

**Matthew Timothy Clark**

*Piper Jaffray Companies, Research Division*

The outlook on the loan yields given the repricing within your portfolio and again the increased contribution from leasing, I haven't made the adjustment yet on kind of core loan yield ex the recoveries -- or not the recoveries, but the prepay income, but it was fairly steady. I guess how do you -- I know a lot of new business came in, but I guess how do you feel about that loan yield relative to the recent Fed cuts and what you're putting on?

**Romolo C. Santarosa**

*Senior EVP & CFO*

So Matthew, this is Ron. So in the quarter, as we mentioned, our loan yields came in favorable, particularly relative to the yields that left us through payoffs. If that were to repeat again for the fourth quarter, I think we should be able to see our yields basically holding. We do have the repricing that occurred late in the third quarter, however, when we look at the loan book that will be maturing in the fourth quarter, which came on about 4 to 5 years ago, the distance between what those loans came on back in '14, '15 to what we might be experiencing here in '19 isn't all that great. So there is an opportunity that the loan yield could stay at that 5 level, it could also dip below in trend of 4 handle, but it would be a combination of those ideas manifesting in the fourth quarter.

**Matthew Timothy Clark**

*Piper Jaffray Companies, Research Division*

Okay. And then just on the increase in criticized loans. I know it wasn't that substantial, but just I was wondering what was behind that increase?

**Bonita I. Lee**

*President, CEO & Director*

So in the criticized and classified category, we have in each category -- respective category we have 3 loans. And those loans are actually paying and -- but there is a sign of stress. So we have downgraded the loans and then we looked at the supporting collaterals and we don't expect any loss from any of those credits.

**Matthew Timothy Clark**

*Piper Jaffray Companies, Research Division*

Can you just give us a little more color on what types of industries those are or types of customers?

**Bonita I. Lee**

*President, CEO & Director*

It's a pretty broad-based. There are some real estate loans, there are small C&I loans. So in terms of size, it ranges from less than \$1 million to the \$3 million.

**Operator**

Our next question is from Kelly Motta, Keefe, Bruyette, & Woods, Inc.

**Kelly Ann Motta**

*Keefe, Bruyette, & Woods, Inc., Research Division*

My first thing I wanted to ask, I wanted to circle back to expenses. I believe Ron, in prepared remarks, you mentioned there were some elevated expenses related to CECL, some related to the workout. Just wondering what in there could potentially go away on a go-forward basis? And how we should be thinking about modeling it going forward?

**Romolo C. Santarosa**

*Senior EVP & CFO*

The CECL element will come to a close here in the fourth quarter and so -- in large part, there will be a piece that will continue on into 2020, but I expect that in aggregate we probably would be down about \$1

million from the third quarter, taking a look at the troubled loan from the delay, the legal matters and the CECL. So I would guess about \$1 million.

**Kelly Ann Motta**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Great. And then onto another question on loan growth. You mentioned that you expect loans fee modestly up, that implies a bit stronger in Q4. I was wondering what gives you the confidence of that kind of boost back up? And how you are also thinking about loan purchases, which is something you had been doing a couple of quarters before, before pausing it, that was something you were looking into getting into again?

**Bonita I. Lee**

*President, CEO & Director*

So in terms of our loan purchases, we haven't had any purchases done for last couple of quarters and we don't intend to have any purchases within the coming quarters. And what was the first part of the question?

**Kelly Ann Motta**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Just where -- what gives you the confidence that loan growth is going to kind of boost back up after the first 3 quarters of this year? What drives that?

**Bonita I. Lee**

*President, CEO & Director*

Looking into -- going into the fourth quarter, looking at the pipeline, we have somewhat increase in the pipeline compared to the third quarter, but as I had mentioned previously, net expansion of the loan portfolio is the function of the production as well as the payoffs. We have been ranging the last couple of quarters in terms of payoffs anywhere from \$80 million to \$90 million, up to \$130 million. So whether we're actually going to have net expansion of the portfolio is to be determined by those loans. But in summary, I think the pipeline going into fourth quarter is stronger than the third quarter or other periods.

**Operator**

Our next question is from Don Worthington, Raymond James.

**Donald Allen Worthington**

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

Just to touch on loan sales. Looks like you had a pretty good quarter this quarter versus last as the SBA premium holding up this quarter. Where you might expect the gain on sale to run going forward?

**Bonita I. Lee**

*President, CEO & Director*

So in terms of the premiums on the SBA loans, in the third quarter we saw the premium rates coming in around 9%, but I think this quarter we may see a little bit of reduction in that, maybe to about 8% level in terms of overall premium levels.

**Donald Allen Worthington**

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

Okay. And it sounds like the volumes are kind of holding where they have been in terms of originations with SBA.

**Bonita I. Lee**

*President, CEO & Director*

We had a pretty good production. This is actually the highest production within the last 8 quarters.

**Donald Allen Worthington**

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

Okay. And then on provisioning, you're basically just looking to cover any charge-offs you might have and maybe some for loan growth?

**Bonita I. Lee**

*President, CEO & Director*

Yes. I mean we'll have to see how they -- both numbers coming along in the fourth Q. So we'll provide the results accordingly.

**Operator**

We have reached the end of the question-and-answer session. And I will now turn the call back over to Lasse Glassen for closing remarks.

**Lasse Glassen**

*ADDO Investor Relations*

Thank you for listening to Hanmi's Third Quarter 2019 Results Conference Call. We look forward to speaking with you again next quarter.

**Operator**

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time, and thank you for your participation.

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