

Hanmi Financial Corporation

NasdaqGS:HAFC

FQ4 2019 Earnings Call Transcripts

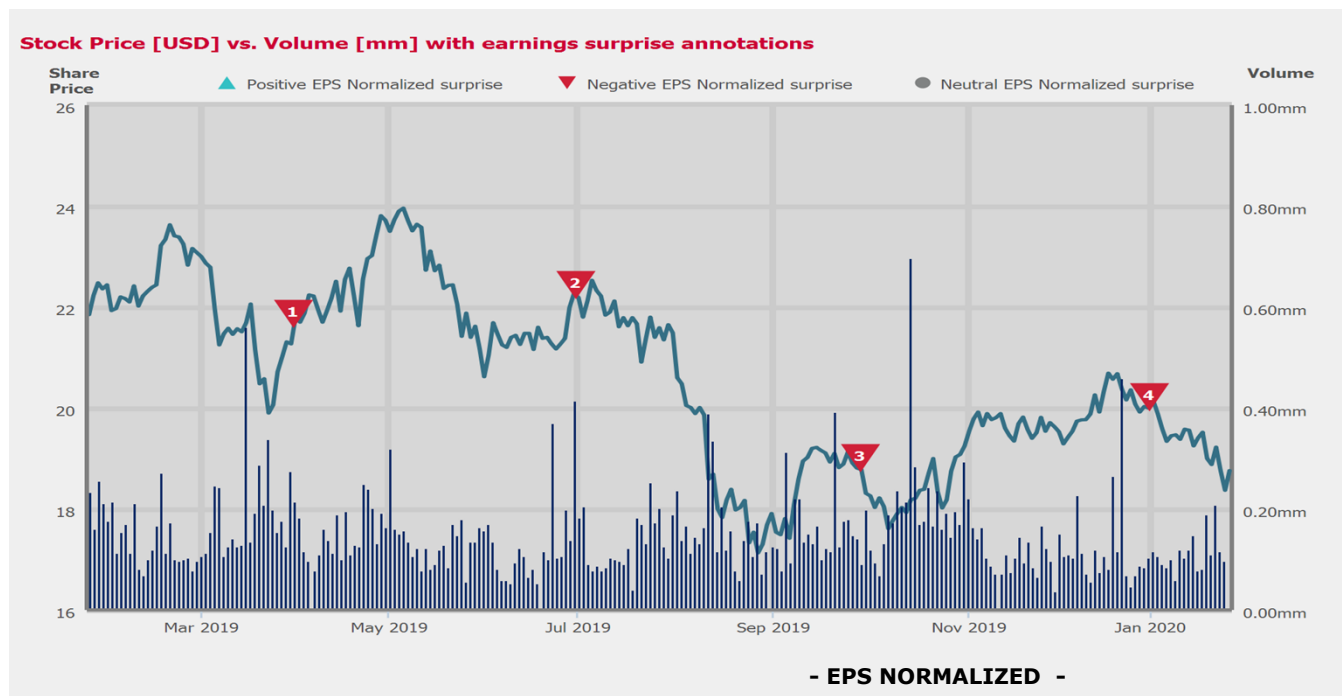
Tuesday, January 28, 2020 10:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2019-			-FQ1 2020-	-FY 2019-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.44	0.10	▼ (77.27 %)	0.41	1.36	1.04
Revenue (mm)	51.28	50.64	▼ (1.23 %)	50.58	203.20	203.42

Currency: USD

Consensus as of Dec-09-2019 9:27 PM GMT



	CONSENSUS	ACTUAL	SURPRISE
FQ1 2019	0.47	0.46	▼ ¹ (2.13 %)
FQ2 2019	0.10	0.07	▼ ² (30.00 %)
FQ3 2019	0.47	0.40	▼ ³ (14.89 %)
FQ4 2019	0.44	0.10	▼ ⁴ (77.27 %)

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Call Participants

EXECUTIVES

Anthony Kim

*Chief Lending Officer & Executive
VP*

Bonita I. Lee

President, CEO & Director

Romolo C. Santarosa

Senior EVP & CFO

ANALYSTS

Gary Peter Tenner

*D.A. Davidson & Co., Research
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Kelly Ann Motta

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

Matthew Timothy Clark

*Piper Sandler & Co., Research
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Timothy Norton Coffey

*Janney Montgomery Scott LLC,
Research Division*

ATTENDEES

Lasse Glassen

ADDO Investor Relations

Presentation

Operator

Ladies and gentlemen, welcome to the Hanmi Financial Corporation's Fourth Quarter and Full Year 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 thank you all for joining us today. With me to discuss Hanmi Financial's Fourth Quarter and Full Year 2019 Earnings are Bonnie Lee, President and Chief Executive Officer; Anthony Kim, Chief Banking Officer; and Ron Santarosa, Chief Financial Officer. Ms. Lee will begin with an overview of the quarter. Mr. Kim will discuss loan and deposit activities, and Mr. Santarosa will then provide more details on our operating performance. At the conclusion of our 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 these expectations, please refer to our SEC filings, including our most recent forms 10-K and Form 10-Q. 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 fourth quarter and full year 2019, which can be found on our website at 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 Fourth Quarter and Full Year Results. While Hanmi's fourth quarter included some extraordinary items that impacted our financial results in the period, I believe, our underlying performance was solid, and we continued to benefit from our strategic focus on a higher-yielding assets and lower deposit costs.

So following are some of the key financial and operational highlights from this past quarter and full year. Loan and lease production was at the highest level since 2015, helping to more than offset extremely elevated levels of loan payoffs in the quarter and resulting in fourth quarter growth in loans and leases receivable of 3.6% on an annualized basis. Net interest income before the loan and lease loss provision was relatively consistent quarter-over-quarter, but a higher loss provision stemming from the previously disclosed troubled loan relationship along with the some nonrecurring expenses impacted fourth quarter net income. Deposit gathering activities remained strong as we achieved 8.3% increase in noninterest-bearing deposits for the full year.

Throughout the year, we benefited from a favorable mix of a lower time deposits and growth in noninterest-bearing demand deposits, reflecting our effort to increase core deposit relationship. The lower cost of deposits helped to mitigate pressure on net interest margin, which declined just 4 basis points during the quarter. We also invested in Hanmi common stock during the quarter under our current authorized 1.5 million shares repurchase program. Notwithstanding the one troubled loan relationship, overall credit quality metrics remain stable. And finally, the bank remains very well capitalized. Hanmi's

regulatory capital ratios remain very strong, and we are well positioned to continue to grow -- continue to growing in a safe and sound manner.

Looking in more detail at our fourth quarter results. We reported net income of \$3.1 million or \$0.10 per diluted share. Net income in fourth quarter was significantly affected by the troubled loan relationship, consisting of a \$27.2 million land loan and a \$12.5 million business loan. While the borrower had continued to make payments and we have incurred no charge-offs, with the loans maturing at year-end, we commissioned a current appraisal on the personal property securing the relationship. As a result, we increased the specific allowance by \$6.9 million in the fourth quarter, which places the total allowance at \$22.6 million. We will continue to work closely with the borrower to achieve a positive resolution to this loan.

In addition, fourth quarter noninterest expense included the recognition of a \$1.7 million impairment loss on a former bank premises that are currently being held for sale. This extraordinary item, along with the specific allowance for the aforementioned loan relationship, reduced the pretax income by \$8.6 million or approximately \$0.23 per diluted share.

Looking at asset quality. Aside from the troubled loan relationship, overall, the key metrics remain relatively stable. Nonperforming loans were \$63.8 million or 138 basis points of loans at quarter end, representing sequential improvement of 1.9% from third quarter nonperforming loans of \$64.7 million or 143 basis points of loans. The fourth quarter also included nominal net charge-off of \$50,000.

Importantly, even in today's highly competitive market for loan and leases, we've continued to maintain our commitment to conservative, disciplined credit underwriting.

For the fourth quarter of 2019, consistent with the asset quality data from prior quarters, the weighted average loan-to-value and debt coverage ratio on new commercial real estate loan originations were 53.7% and 1.7x, respectively. For the entire commercial real estate portfolio, the weighted average loan-to-value and weighted average debt coverage ratio, as of the end of the fourth quarter, were 48.2% and 2.0x, respectively.

As you may recall, earlier in 2019, Hanmi announced that its Board of Directors authorized a stock repurchase program of up to 5% or 1.5 million shares of our outstanding common stock. During the fourth quarter, Hanmi made initial purchases under this authorization and invested approximately \$7.4 million to repurchase 375,000 shares at an average price of \$19.63 per share. Even after the share repurchase, Hanmi's tangible common equity ratio remained strong at 9.98% as do all of our regulatory capital ratios.

Today, approximately 1.1 million shares remain available for repurchase under this current authorization, and we expect to continue to support the stock with additional purchases as market conditions allow. We believe the current share price is not indicative of Hanmi's long-term intrinsic value. The repurchase of our stock highlights our confidence in the Hanmi franchise. And we see it as both a timely and appropriate use of our capital resources.

I would now like to provide quick update on our key initiatives, which are focused on being selective in new loan production, protecting net interest margin as much as possible and careful expense management with our total loan and lease balance increasing modestly during the course of this past year. Looking ahead, we anticipate low to mid-single-digit growth in loans and leases during the full year in 2020. We continue to emphasize areas of growth where we can achieve higher spreads such as equipment leases as well as a C&I loan.

During 2019, production of C&I loans increased nearly 55%, while production of equipment leases expanded more than 11% year-over-year, and we expect to continue to emphasize these categories as we move forward in 2020. I am also pleased with the early results achieved by our Corporate Korea Initiative. Here, we are focusing on developing and expanding relationships within Korean companies domiciled in the U.S. We have launched a corporate Korea test in 7 strategically located branches throughout the United States. While still in its early days, the corporate Korea program contributed to new loan productions and new deposit relationships in 2019.

Throughout 2019, we made good progress on various initiatives designed to reduce noninterest expense and improve operational efficiency. A significant portion of this effort has been the successful branch consolidation initiative, which was completed during 2019 and included a closure of 5 branches or approximately 10% of our branch network. We also continue to make investment in technology and systems to achieve cost reduction through improvements in operational efficiency. This includes centralizing and streamlining certain back-office activities to improve processing speed along with enhanced consistency across the enterprise in sourcing, underwriting and administering credit.

With that, I would like to turn the call over to Anthony Kim, our Chief Banking Officer, to discuss the fourth quarter loan and lease production results and deposit gathering activities. Anthony?

Anthony Kim

Chief Lending Officer & Executive VP

Thank you, Bonnie. I will discuss loan and lease production and deposit gathering activities and then turn it over to Ron Santarosa for additional details on our fourth quarter financial results. During the quarter, loan and lease production totaled \$381.4 million, which increased 75% over the prior quarter and nearly 55% from the fourth quarter in 2018. However, due to elevated levels of payoffs as well as higher amortization during the quarter, our portfolio of loans and leases expanded by just 3.6% on an annualized basis, and the portfolio grew modestly for the full year.

Production in the fourth quarter was up year-over-year in every major category of loans and leases. Production activity throughout 2019 reflected our shifting emphasis towards higher-yielding categories with a strong asset quality, such as C&I loans as well as equipment leases, while we reduced our exposure to lower-yielding asset classes, such as single-family residential loans. In line with our longer-term objective to diversify our loan and lease portfolio, C&I loans comprised 70.0% of our portfolio at the end of 2019, compared with the 70.8% at the end of 2018 and 76.5% 3 years ago.

Fourth quarter production consisted primarily of \$185.1 million of commercial real estate loans, \$33.6 million of SBA loans and \$95.3 million of C&I loans. We also originated \$65.5 million of commercial equipment leases. Of note, C&I loan originations in the fourth quarter were nearly 87% higher than the previous quarter, while equipment lease production remained consistently strong throughout the year. Newly generated loans and leases for the quarter had a weighted average yield of 5.08%, down 45 basis points from the previous quarter's weighted average yield on new production of 5.53%. However, average loan and lease yields for the portfolio of 4.97% was down just 11 basis points quarter-over-quarter as the average yield on new loan and lease production in the third quarter exceeds the average yield on loans that were paid off in the quarter by 7 basis points.

Looking ahead in the first quarter of 2020, our pipeline remains healthy and supports the annual growth objective range in the low to mid-single digits that Bonnie noted in her comments.

Moving on to deposits. We continue to operate in a highly competitive Asian-American banking landscape for deposit gathering activities. Total deposits of \$4.70 billion increased nearly 1% during the fourth quarter on an annualized basis, but declined 1% from a year ago. For the full year, we benefited from a favorable shift in deposit mix that included an 8.3% increase in noninterest-bearing demand deposits, along with 13.6% reduction in higher cost time deposits. As a result of fourth quarter loan production and deposit gathering activities, our loan-to-deposit ratio for the fourth quarter was 98%, compared with the 97% in the fourth quarter last year.

I'd now like to turn the call over to Ron Santarosa, our Chief Financial Officer. Ron?

Romolo C. Santarosa

Senior EVP & CFO

Thank you, Anthony, and good afternoon, all. Starting with net interest income. We posted \$43.9 million, down slightly from \$44.1 million for the prior quarter, due mostly to a 2.9% decrease in income from loans and leases receivable on lower average yields for the portfolio. Overall, yields decreased during the quarter, reflecting the decline in the general level of interest rates from -- earlier in the quarter and mix was slightly lower, average loan and lease balances led to a 2.4% sequential decrease in interest income.

Partially offsetting the decrease in net interest income was a 7.5% decrease in total interest expense to \$16.8 million, mostly driven by an 8.1% decrease in interest on deposits. Net interest margin for the quarter was 3.32%, down 4 basis points from 3.36% in the third quarter. The average yield on interest-earning assets fell by 15 basis points to 4.59% with a commensurate 15 basis points decrease in cost for interest-bearing liabilities to 1.89%.

The cost of deposits fell 12 basis points to 1.25% due to a decline of higher rate time deposits and an increase in lower costing money market and savings deposits. Time deposits now make up 33% of total deposits, down from 35% in the linked quarter. This mix shift in our interest-bearing deposits from time deposits into money market and savings were the main drivers of the decrease in interest on deposits.

Looking at noninterest income, we had a 2.2% decrease from the third quarter to \$6.7 million. Income from service charges on deposit accounts and trade finance and other service charges and fees increased by 2.8% and 6.8%, respectively. However, this was offset by a decrease in gains from the sales of SBA loans, falling 15.2% to \$1.5 million. SBA loan sales volume increased to \$25.1 million in the quarter from \$24.3 million.

However, trade premiums fell during the fourth quarter, averaging 7.6%, down from 9.15% for the prior quarter. Noninterest expenses increased by \$1.5 million to \$34.1 million from the third quarter, driven mostly by the \$1.7 million impairment loss, which Bonnie mentioned earlier. In addition, the provision for off-balance sheet items increased to \$646,000 from an increase in outstanding commitments as well as an increase in estimated loss factors.

Last, the 2019 third quarter included charges for an SBA guarantee repair that's not present in the fourth quarter. For the 4.5% increase in noninterest expense this quarter combined with the decline in revenue caused our efficiency ratio to increase to 67.31% from 64% in the linked quarter. Return on average assets for the fourth quarter decreased to 0.22% from 0.90% last quarter, while return on average equity experienced a similar sequential decrease to 2.15% from 8.67%. Our tangible book value at year-end declined by \$0.15 to \$17.9 per share, and our tangible common equity ratio was strong at 9.98%.

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

Bonita I. Lee

President, CEO & Director

Thank you, Ron. While some extraordinary items impacted our profitability in the quarter, Hanmi delivered a solid overall performance to wrap up 2019. As we look ahead to 2020, given our strong deposit franchise and loan and lease pipeline, I am confident in our ability to deliver profitable growth throughout the year. I look forward to sharing our continued progress with you when we report our first quarter 2020 results in April.

Lasse Glassen

ADDO Investor Relations

Operator, that concludes our prepared remarks. We would now like to open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Gary Tenner, D.A. Davidson & Company.

Gary Peter Tenner

D.A. Davidson & Co., Research Division

I had a couple of questions on credit. In terms of the large credit, the increase in the specific reserve and the current valuation, which, I think, is \$22.5 million, when was the most prior appraisal to the updated one that you mentioned in the press release?

Bonita I. Lee

President, CEO & Director

So we obtained the most recent one within the last month or so. The prior one was within the last -- second half of the last year -- mid-second half of the last year.

Romolo C. Santarosa

Senior EVP & CFO

So Gary, this is Ron. So the real estate side of life, that was a year ago second quarter. On the personal property, we had one, of course, at inception. We had one in the second quarter, which gave rise to the question about how we should view it, et cetera. So we commissioned us another one here at -- as we got into the fourth quarter.

Gary Peter Tenner

D.A. Davidson & Co., Research Division

Got it. Okay. And then I'm curious about the provision over and above the specific provision for that credit, it would be around \$4 million on basically \$40 million of net loan growth sequentially. So can you talk about what drove that? I mean there was the increase in classified loans related to another construction credit. But maybe just talk broadly about the magnitude of the provision increase over and above the large credit issue?

Romolo C. Santarosa

Senior EVP & CFO

Sure. So as you noted, classified loans did increase. And as we go through our quarterly analysis to determine the allowance, we look at trends, we look at concentrations, we look at recent experiences. And with that, we've increased our estimated loss factors. So that's part of the reason for the increase. And of course, the other side of the equation, we just have a higher level of loans than we had in the past period.

Gary Peter Tenner

D.A. Davidson & Co., Research Division

Okay. And if I could just ask one last question here. Any projections or outlook with regard to CECL in terms of the day 1 adjustment?

Romolo C. Santarosa

Senior EVP & CFO

Not at this time. We're working with our auditors and advisers. So we'll be prepared for that idea when we publish our 10-K, I think, March 1 and March 2.

Operator

Our next question is from Matthew Clark, Piper Jaffray.

Matthew Timothy Clark

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Piper Sandler & Co., Research Division

Just wanted to get the rate on new production and the rate on the loans that were paid off. I think you've mentioned that the differential was 7 basis points. So I was just looking for those yields.

Romolo C. Santarosa
Senior EVP & CFO

So Gary, this is Ron. So I think I have 5.08% in my mind, but our average production was 5.01%, would have been the payout -- would have been the average rate on the loans that were paid off.

Bonita I. Lee
President, CEO & Director

New loan came in, in the quarter at 5.08% and then payoff rate was 5.0% -- the new loan was 5.08% and then payoff was 5.01%.

Romolo C. Santarosa
Senior EVP & CFO

As I think we have talked about before, Matthew, and whether with you or with others, we cannot predict and have been fortunate or fortuitous in the average rate of the loans that we've been paying off. And so far, for most of '19, we've been in a net accretive mode when you look at the portfolio. That was one of the elements of why the -- our net interest margin was able to kind of stay within a fairly narrow corridor.

Matthew Timothy Clark
Piper Sandler & Co., Research Division

Okay. And then prepayment income this quarter within the margin?

Romolo C. Santarosa
Senior EVP & CFO

\$700,000.

Matthew Timothy Clark
Piper Sandler & Co., Research Division

Okay. And then I think last quarter you talked about \$1 million of that might come out of the run rate of expense related to the reporting delay, CECL, legal, the FDIC credit assessment and maybe some occupancy and equipment. Can you update us there and whether or not that came out or whether or not that's still in there or some portion?

Romolo C. Santarosa
Senior EVP & CFO

So we did see the decline in professional and data processing and I'll say the other category. Then there were some offsets to those ideas that came about. We have a seasonal increase of spend in some of our marketing, and we had some increase in our salaries and benefits. So the FDIC notion, insurance notion is pretty well flat quarter-to-quarter. We did get the third quarter had a charge in it relating to an SBA guarantee repair for an old SBA loan. So we did see the reduction. But as we tried to point out then we had the increase because of the increase in the off-balance sheet provision, stemming, again, from just larger unused commitments as well as increased loss factors, which are consistent with the other part of the allowance and the impairment loss on the properties.

Matthew Timothy Clark
Piper Sandler & Co., Research Division

Okay. And then I guess how much in the way of reserve did you set aside for that loan that migrated into classified, the \$11 million credit?

Romolo C. Santarosa

Senior EVP & CFO

That would be no specific allowance. So that's just part of...

Bonita I. Lee

President, CEO & Director

I think it's about \$0.5 million.

Romolo C. Santarosa

Senior EVP & CFO

Yes, of general allowance.

Bonita I. Lee

President, CEO & Director

Yes.

Matthew Timothy Clark

Piper Sandler & Co., Research Division

Okay. Okay. And then the tax rate outlook, a little higher this quarter, but I assume that will normalize?

Romolo C. Santarosa

Senior EVP & CFO

Yes. I think for 2020, we may be able to post kind of mid-29s. But if I would use a sum measure, I'd probably would use 30% and then look forward to trying to drift down slightly.

Operator

Our next question is from Timothy Coffey, Janney Montgomery Scott.

Timothy Norton Coffey

Janney Montgomery Scott LLC, Research Division

Looking at kind of your loan growth outlook, does that include payoffs that we saw at the level in the fourth quarter or kind of what we saw throughout the rest of 2019?

Bonita I. Lee

President, CEO & Director

So in terms of a payoff, which is hard to predict, but I think just looking at 2019, I think, the average payoffs in a given quarter ranges from -- anywhere from \$100 million to obviously to \$200 million in the 4Q, which is elevated from overall average payoffs in the 2018 period. So -- but still, I think the message is that our production is holding up fairly nicely. So assuming just the average payoff of about \$100 million \$130 million, we think that we can grow to single- to mid-digit loan growth.

Timothy Norton Coffey

Janney Montgomery Scott LLC, Research Division

Okay. And then what -- how does that kind of impact the trends within your margin given that there is that kind of slow churn into the deposit portfolio that could give you tailwinds through year-end in terms of lower deposit costs, but not necessarily in the beginning of the year.

Romolo C. Santarosa

Senior EVP & CFO

So on the deposit costs, again, if you think of our time deposits, most of those mature approximately 25% a quarter, give or take, 5%. So we should see a little bit more reduction in the first quarter, albeit at a lower rate. And by the time we get to second quarter, we probably have now stepped into or legged into the rate environment we're currently expect -- that we're currently experiencing. On the loan side, a large

part of the shift away from the residential into the higher-yielding equipment and C&I has occurred. So we would continue to see some decline in the resi, but probably not as much as we experienced in 2019. So that said, I would think we would continue to see margin kind of play within this corridor of 3.30%-ish. And as long as there's -- Fed stays where, I think, Fed will be staying or most people expect Fed to stay and barring headline news and unusual prepay, we'll -- that, I think, is how we could probably think about 2020.

Operator

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

Kelly Ann Motta

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

Maybe staying on the margin and kind of the balance sheet a bit, it looks like cash was elevated this quarter. Wondering what the dynamics were going on there? And if you expect to kind of get more back to the level you're at in the third quarter?

Romolo C. Santarosa

Senior EVP & CFO

Yes. So production by month can sometimes be uneven. And so the cash balances that you saw, at least, on an average basis, were -- most of the production happened as we went into December with not much for October, November. And so that will vary from quarter-to-quarter.

Kelly Ann Motta

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

Got it. And securities, kind of, building off this level and growing with the overall balance sheet. Is that the right way to think about it?

Romolo C. Santarosa

Senior EVP & CFO

Yes. So most of -- securities would represent kind of a regular ratable growth where the cash, as I would call that overnight, that will fluctuate depending on where we are with cash inflows from the portfolio versus fundings.

Kelly Ann Motta

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

Great. Turning back to expenses. You said that the compensation line went up a bit this quarter. I was wondering, with adding people -- if you're adding talent, if it's back office or if you're adding to the front line, and if that's kind of supporting your strong production you have?

Bonita I. Lee

President, CEO & Director

We have an ongoing talent recruitment process. So we did bring in some of the relationship manager type of employees, so that may have contributed.

Operator

We have no further questions in the queue at this time.

Lasse Glassen

ADDO Investor Relations

Please continue. Thank you for listening to Hanmi Financial's Fourth Quarter and Full Year 2019 Results Conference Call. We look forward to speaking with you, again, in the quarterly results next quarter.

Operator

Thank you. 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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