

Ball Corporation NYSE:BLL

FQ3 2016 Earnings Call Transcripts

Thursday, November 03, 2016 3:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ3 2016-			-FQ4 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.47	0.48	▲2.13	0.42	1.72	2.10
Revenue (mm)	2856.22	2815.00	▼(1.44 %)	2566.80	9213.25	10656.98

Currency: USD

Consensus as of Oct-19-2016 5:08 AM GMT

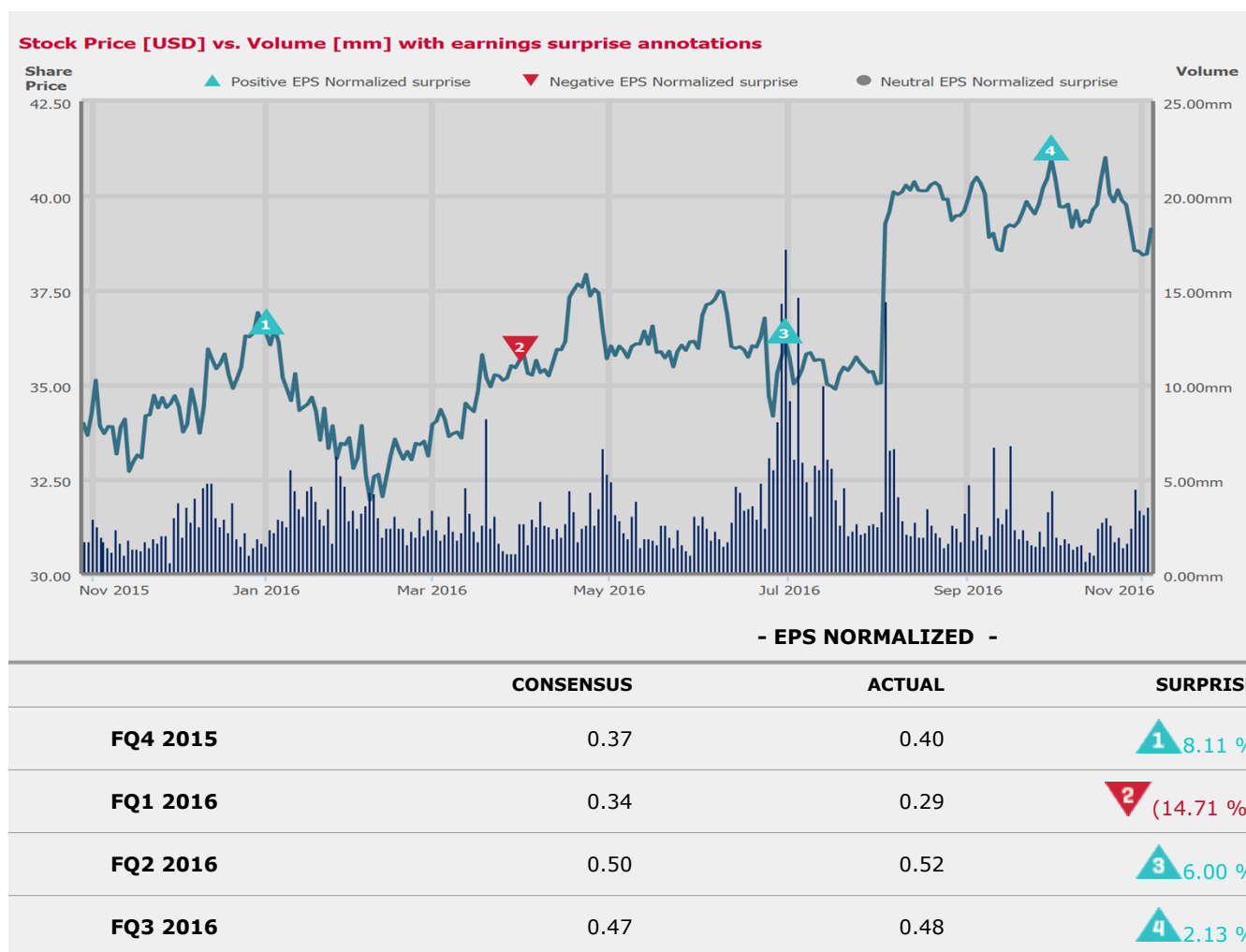


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Scott C. Morrison

Senior VP & CFO

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*Barclays Bank PLC, Research
Division*

Tyler J. Langton

*JP Morgan Chase & Co, Research
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Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Ball Corporation Third Quarter 2016 Earnings Call. [Operator Instructions] As a reminder, the call is being recorded, Thursday, November 3, 2016.

And I'd now like to turn the call over to Chairman, President and Chief Executive Officer, John Hayes. Please proceed.

John A. Hayes

Chairman, President & CEO

Great. Thank you, James, and good morning, everyone. This is Ball Corporation's conference call regarding the company's third quarter 2016 results.

The information provided during this call will contain forward-looking statements. Actual results or outcomes may differ materially from those that may be expressed or implied. Some factors that could cause the results or outcomes to differ are in the company's latest 10-K and in other company SEC filings as well as company news releases. If you don't already have our third quarter earnings release, it's available on our website at ball.com.

Information regarding descriptions are in new segment reporting and the use of non-GAAP financial measures may also be found in the note section of today's earnings release, which includes a simplified table format summarizing business consolidation and other activities as well as a reconciliation of comparable operating earnings and diluted earnings per share calculations.

Joining me on the call today is Scott Morrison, our Senior Vice President and Chief Financial Officer. And if we sound a bit tired, we are. The Chicago Cubs won the World Series, baby. Dreams do come true.

I'll provide a brief overview of the company's performance. Scott will discuss financial and global packaging metrics, and then I'll finish up with comments on our aerospace business and the outlook for the future.

We are pleased with the new combined business as well as our existing businesses are right on track versus our expectations. And the anticipated earnings momentum has continued to materialize, particularly in beverage and aerospace.

Upon the close of the acquisition, we discussed that the second half of 2016 might be a bit choppy from an earnings and cash flow perspective due to one-time integration costs, but that we felt confident as we went into 2017 that we'd be able to generate comparable earnings and cash flow that we discussed for both 2017 and beyond. This is exactly how it is playing out, and we continue to expect to achieve all of the 2017 to 2019 financial metrics and synergy goals we laid out on our prior earnings call.

During our initial review of the new locations, we welcomed our new team members into the Ball culture and experienced a smooth integration to date. Where we have recognized the need for minor changes from a personnel or policy perspective, actions have been taken or are well underway. In the coming months, we will focus on securing the appropriate value for our products while fighting for our proportionate share of the volume. And at the same time, we'll be chasing the value capture opportunities in sourcing, freight, logistics and footprint optimization as well as ongoing cost saving initiatives like the closure of the London and Charlotte offices. Certain work from these locations has already begun to migrate to other Ball locations, and Ball will exit the Millbank office by December 2016 and close the Charlotte office in the first half of 2017. We thank the Millbank and Charlotte teams for their support during this integration. Future announcements regarding other changes will be made when decisions are finalized.

In addition to the complex integration and separation work, during the third quarter, we continued wrapping up line speeds at our new Monterrey, Mexico beverage facility. We shipped and invoiced saleable cans from our new Myanmar facility late in the third quarter. We continued the previously initiated European beverage cost-out initiatives, including the closure of the Berlin, Germany beverage can facility that was announced in December 2015. We achieved solid operational performance in our food and aerosol business despite depressed U.S. food can demand in the period. And we further grew our aerospace contracted backlog to a record \$1.4 billion. It was an incredibly busy and rewarding quarter.

And with that, I'll turn it over to Mr. Morrison. Scott?

Scott C. Morrison

Senior VP & CFO

Thanks, John.

Ball's comparable diluted earnings per share for the third quarter 2016 were \$0.96 versus last year's \$1.10 on a higher share count and a higher year-over-year effective tax rate.

Third quarter comparable diluted earnings per share reflect year-over-year improvement largely due to the beverage can acquisition, solid global beverage can demand and improved aerospace performance, offset by higher corporate costs related to truing up our employee compensation accruals, the extra expense for stock plans due to the run up of our share price as well as some pension expense for inactives not tied to a continuing business segment, higher interest expense related to the timing of the Rexam debt pay off, a higher share count and tax rate.

Our GAAP results in the first 9 months were impacted by transaction-related earnings, hedging, purchase accounting and other customary closing adjustments. Details are provided in the Note 2 of today's earnings release, and additional information will also be provided in our 10-Q, which will be filed next week.

Our beverage packaging North and Central America segment, which comprises 17 legacy Ball facilities plus the 9 acquired facilities, including joint ventures, had comparable operating earnings for third quarter 2016 that were up year-over-year due to the contribution of the recently acquired plants in the U.S. and Mexico and continued specialty can growth. Industry demand across North America grew 1.5% in the third quarter. And on a comparable basis, Ball was in line with the industry during the quarter.

Our new Monterrey, Mexico facility continues to make productions strides, and Mexican domestic and export demand remained strong. Of note, the recently acquired JVs in Guatemala and Panama as well as our legacy Rocky Mountain metal container JV, are not consolidated and therefore, are included in equity earnings of affiliates.

Our beverage packaging South America segment, which consists of the 12 acquired facilities plus 2 legacy Ball facilities, recorded a solid third quarter as can demand in Brazil gained traction in the quarter, in part because of the seasonal summer build. Brazilian market demand as well as our volume in the quarter was relatively flat and down 2% year-to-date. Both Brazilian and Argentine can demand has been impacted by the inflationary environment in those countries. The team in South America is managing the business well, given the current economic and supply/demand conditions in the region.

In the beverage packaging Europe segment results, which include Russia, were up nicely in the quarter due largely to the acquisition and strong can demand in Russia during September. Industry supply/demand remains tight, and specialty demand remains favorable, with a bias towards continued shift into specialty.

As we mentioned in today's release, Ball chose to retain certain volumes in Spain, which will be supplied from a newly constructed plant near Madrid. This investment is supported by a long-term customer contract that was known to all parties prior to the divestment occurring, and the plant will help to provide supply to a region that is experiencing sustainable growth.

Beginning in the third quarter, our new segment reporting incorporates the operating performance of Ball's legacy China Asia business and the acquired EMEA business into other, which also includes the legacy corporate undistributed costs. For clarity and going forward, we will include a footnote in Note 2 of our earnings release financials referencing the amount of corporate undistributed costs included in other.

Of note, the UAC JV 51% investment is consolidated and is also reflected in the other segment, and the 49% outflow is reflected in noncontrolling interest. While I have the opportunity, our team in China is doing everything they can, given the challenges they are faced with. They have met their cost-out goals, and the team in EMEA is fitting right in at Ball. The markets are dynamic like the currency situation in Egypt, and we have great teams in both regions managing the businesses appropriately.

Moving to aerosol. Comparable segment earnings were flat year-over-year due to lower food can volumes, offset by continued growth in global aerosol. Initiatives to further improve production efficiencies are on track and start [ph] to benefit 2017 performance.

In summary, our global packaging businesses posted results that were right on top of our expectations, and the teams continue to be extremely focused on integrating the new assets, achieving their synergy goals and driving EVA dollars from the recent capital and efficiency projects. Thank you again to our global packaging team members as well as the corporate support teams. Their collaboration and dedication is appreciated.

As I mentioned in the second quarter call, we will identify all one-time items impacting free cash flow and operating earnings so that the underlying strength of the business is clear. You will notice that our third quarter net debt, as expected, is about \$400 million higher than the pro forma \$7 billion net debt reflected in our second quarter earnings release.

During the third quarter, we paid out \$110 million in severance and incentives to divested and separated employees; \$90 million to settle Rexam's derivatives; \$65 million in adviser, attorney and banker fees; \$50 million in tax payments; a July 1 \$50 million bond interest payment; and we spent \$125 million in CapEx. Obviously, there were offsets like third quarter EBITDA and the French sale proceeds. We are on target to flow a lot of cash in the fourth quarter, which is typical. We obviously had a working capital build from the acquired locations, and as we said before, it will take time to address how Rexam manages its balance sheet versus how we will manage ours. Regardless, we still see -- we still target year-end net debt in the range of \$7 billion at current FX rates.

As we think about the remainder of 2016, here are some key metrics. We expect full year 2016 comparable operating earnings in the range of \$1 billion, and to be clear, our comparable earnings going forward will exclude the amortization associated with acquired customer intangibles, which should be roughly \$33 million in the fourth quarter.

Since the \$83 million inventory step-up was recognized in the third quarter, I wouldn't expect any additional inventory step-up impact in the fourth quarter. The full year weighted average diluted shares outstanding for 2016 will be in the range of 161 million shares, which reflects the half-year impact of the 32 million shares issued for the acquisition.

For Q4 2016 and full year 2017, weighted average diluted shares outstanding will be roughly 178 million, absent the impact of any share repurchases. Full year 2016 interest expense will be in the range of \$230 million. Given the negative carry associated with the timing of when the acquired credit agreement, private placement and hybrid debt came out, third quarter interest ran about \$8 million higher than it will in the fourth quarter. The full year effective tax rate for 2016 on comparable earnings is expected to be in the range of 28%.

Corporate undistributed is now to be -- expected to be in the range of \$115 million for full year 2016 versus the \$105 million we discussed in the second quarter call. The \$115 million now includes: costs to support the integration from locations such as Millbank and Charlotte as well as a true-up for our employee compensation plan accruals that we'll pay out to current Ball employees in early 2017; and the impact of known pension expense for inactives in the U.S. and abroad, which will migrate to corporate

undistributed in the near term. To be clear, these are not unanticipated costs. It's more about where we have now determined the cost will be reflected from a reporting perspective.

Before I turn it back to John, we have received a few questions to provide a detailed bridge for 2016 to 2017. And we ask that you recall what we said in our second quarter call: we will not be posting a slide every quarter. For now, we just remind you that in 2017, we still expect to be in the range of \$1.3 billion to \$1.4 billion of comparable operating earnings due to value capture savings in the areas of sourcing, manufacturing, logistics and other areas like footprint: 1 billion more of units through our new Monterrey plant, cost-out benefits from the FNA metals service center transition as well as additional global aerosol and specialty beverage can growth. Improvement in aerospace and the full year impacted the acquisition.

And by 2019, we aspire to be generating \$2 billion of comparable EBITDA and generating in excess of \$1 billion of comparable free cash flow. Our December investor field trip will also provide another chance to add to our messaging and engage in Q&A about our progress.

And with that, I'll turn it back to you, John.

John A. Hayes

Chairman, President & CEO

Great. Thanks, Scott.

Our aerospace business reported improved third quarter results driven by solid contract performance. Congratulations to the entire aerospace team. Their hard work paid off.

Our contracted backlog closed the quarter at a record \$1.4 billion, which is 129% increase since the beginning of 2016. As I mentioned last quarter, we're ramping up and staffing up for these new contracts which will benefit the remainder of 2016 and more importantly, beyond.

Now across the company and as we look forward. We are on track to achieve the numbers that Scott just laid out. Every day, we gain even more visibility into the opportunities before us. And while there are always challenges, the team is up for proactively managing these.

In summary, I'm proud of what our team has accomplished so far. Everyone is taking to heart what it means to behave as a true owner. We all know there is much work still to be done, and we are focused on our balance sheet, cost out, footprint, supply/demand balance, supply chain and innovation. Advocating for the beverage can versus other substrates and improving the value generated for the products we sell are things we embrace as an industry leader.

As I mentioned in my introduction, our financial goals and aspirations for 2017 and beyond remain the same. And when our leverage gets to the range of 3x to 3.5x, we will return value to our fellow shareholders in the form of share repurchases and dividends.

And with that, James, we're ready for questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from the line of Anthony Pettinari from Citi.

Anthony James Pettinari

Citigroup Inc, Research Division

Scott, just a couple of questions on guidance. I think you talked about full year operating earnings in the range of \$1 billion. I think previously you'd said just north of \$1 billion. Is it possible to size that delta, if there is one, and what's driving it? And then, apologies if I missed this, but with the previous CapEx guidance of \$500 million or around \$500 million, did that include the Madrid expansion?

Scott C. Morrison

Senior VP & CFO

Sure. On the \$1 billion, it's dynamic, obviously. But if things go well and volumes go well, we could exceed \$1 billion. If things are a little lighter and softer, we'd be -- we might be a little bit short. But I don't think it's a gigantic range. And then as it relates to the capital, yes, one of the things we had planned for some time now is the expansion in Madrid. So in that \$500 million for next year is a good chunk of that to build out Madrid.

Anthony James Pettinari

Citigroup Inc, Research Division

Okay, that's helpful. And then, John, in your comments, you talked about fighting for a proportionate share of volumes. I'm just wondering if you could talk generally about the commercial environment that you've seen since the closure of the merger. Have you seen share shift or a significant change in customer inquiries? If you can just kind of talk generally about the commercial environment.

John A. Hayes

Chairman, President & CEO

Yes, nothing out of the ordinary is what I'd say. As we have moved forward, we've talked about this and before. We have some new muscles in terms of our relative position, and we're developing those and trying to flex them. As I did say in our prepared remarks, we are trying to get value for the products we deliver, and we've had discussions with our customers like we always do. As we mentioned in prior times, we're very much customer-focused. And some of those discussions go easy, some of them are challenging at times, but there's nothing appreciable that's out of the ordinary.

Anthony James Pettinari

Citigroup Inc, Research Division

Okay. And then maybe just one last one. Is it possible to say what level of working capital benefit is baked into the 2017 free cash flow target?

Scott C. Morrison

Senior VP & CFO

There is about \$100 million of working capital benefit for '17 in the numbers we previously gave.

Operator

Our next question is from the line of Adam Josephson for KeyBanc.

Adam Jesse Josephson

KeyBanc Capital Markets Inc., Research Division

Scott, just one more on the 2016 comparable earnings target. It seems like corporate is \$10 million higher than you were expecting before. Is food and aerosol, any lower -- is your expectation any lower now than it was before? And have any other particular buckets changed?

Scott C. Morrison

Senior VP & CFO

Well, I think, to the first point on the corporate undistributed, it's not really that it's higher. It's just in a different bucket than what we had previously had anticipated. What we're going to do with some of the pension costs going forward is if they weren't related, we retain some of the German pensions, for example. And so next year, we'll move some of the German costs for those pensions into corporate undistributed because they really don't relate to the business. So it's really more of just where we're reporting those numbers. It's not really an increase cost. As it relates to the second part, yes, food had a little softer quarter than in the third quarter, but I think the fourth quarter should be okay. And so that plays into the number. I mean, like we said, it's a big business that we're getting our arms around and I think doing really well. We just want to make sure that we're clear. And could there be a little variability to that number? Yes, I think there could.

Adam Jesse Josephson

KeyBanc Capital Markets Inc., Research Division

I think, to be clear -- no. I hear that, Scott. Just to be clear, on a segment basis, have your expectations changed for the full year? [indiscernible]

Scott C. Morrison

Senior VP & CFO

No, not at all. Not for this year and not really for next year. I mean, we're -- if anything, we're 120 days into this. And I think we're more excited about the opportunities that we see in front of us.

Adam Jesse Josephson

KeyBanc Capital Markets Inc., Research Division

And just a couple of others. One on the aforementioned food can business. Can you guys just talk about the volume decline that you experienced and what drove that and to the extent to which you think it's one-time or that it won't recur for several more quarters?

John A. Hayes

Chairman, President & CEO

Yes. Well, as we said, I think, in our earnings release, Adam, it was really just 2 things. Number one, the salmon business. As you know, that has, over time, been a pretty volatile [ph] business, and it was a poor salmon harvest this year. So that was definitely one of them. The other one was just in our existing customer base, the customers, the demand side and the customer didn't perform as well as we had thought. We've talked in the past that we had some share shifts, but that had nothing to do with the -- in the quarter. It was just a little bit softer. Some have bled over into October, but we don't expect October to be meaningfully different than it was last year. And so I just think it was a little bit softer harvest than we had expected.

Adam Jesse Josephson

KeyBanc Capital Markets Inc., Research Division

And just one on South America. You talked about the market being relatively flat. Do you have any reason -- obviously, some of your large customers have expressed disappointment about the market of late. Do you have any reason to expect a change in market demand in the foreseeable future? And relatedly, do you have any thoughts about the potential for additional capacity to be added in that market as demand remains fairly sluggish?

John A. Hayes

Chairman, President & CEO

Well, as you know, the Brazilian economy has been challenged economically. So I'll start with there. I do know the can, however, continues to perform relatively well overall. For example, overall beer volumes were down a couple of percent in the quarter, and the cans were flat, which means it continues to take share from other substrates. I think as we go forward, we continue to expect that. I do think that some of the reforms that Brazil is pushing through gives better confidence over the longer term in terms of the economy approving and the middle-class growing, which is really important, as you know, for overall beverage consumption. There has been discussions about new capacity coming on. It's regionally tight right now. So as I said on the call last quarter, we're certainly aware of that. We don't think there's going to be any appreciable dislocations because Brazil does have a lot of embedded growth. They're just going through some short-term economic pain.

Operator

Our next question is from the line of Tyler Langton from JPMorgan.

Tyler J. Langton

JP Morgan Chase & Co, Research Division

Just had a question in terms of the \$150 million of synergies you're looking for 2017. Do you have a rough sense on how much if the closing of Millbank and then Charlotte would contribute towards that?

John A. Hayes

Chairman, President & CEO

I think what we said in last quarter, nothing really has changed, Millbank -- between those 2 things, we had \$70 million, \$80 million of cost in that range, and we expect to get most of it out. We'll have a little bit because there is some incremental support that's required for all those acquired facilities. But I think what we talked about was kind of \$60 million, \$70 million of total cost that we expect to be able to get out of that.

Tyler J. Langton

JP Morgan Chase & Co, Research Division

Okay. And then just, I guess, with South America sort of the new margins that you reported this quarter were a decent amount above year-ago levels, which [indiscernible] sort of your older assets. And I kind of, in Europe, it's kind of the opposite sort of the margins now with, I guess, the Rexam assets were lower than yours. I mean, could you just talk just high level, what's driving those changes? Is it the businesses or is there any sort of one-time item? Just some color there would be great.

John A. Hayes

Chairman, President & CEO

Yes. First, I caution, not only both of those, but with all of them. The comparability, if you want to call it that, of these segments, is a little apples and oranges. Just because you're comparing our legacy Ball business, much of which what you just described in South America and more importantly in Europe, we divest it. And so that's the apple. And then the pear or the other fruit is what we have going forward. Having said that, I would say in South America, we have -- as we've talked before, it's a good business with a great management team. We got scale, which is really important there. And when you have a footprint that you can leverage in a way much greater than we were able to with kind of 3 facilities, you can see some of the benefit. I do think in Europe, that there is some opportunity. Our business, our legacy business, margins were a little bit better than the business we acquired. We knew that going in. There's no surprises there. And so our opportunity in some of the cost out that I mentioned, whether it's Berlin or whether it's some other things, we think there's opportunity again because of the scale of the businesses. It's a bigger business than we've either had. So over the next couple of years, we expect to drive continued improvement in the European segment.

Tyler J. Langton

JP Morgan Chase & Co, Research Division

Okay. Just last question, again within sort of food and aerosol. I think a couple of quarters ago, you'd commented that it was your goal basically to get EBIT in that segment back to where it had been historically. Is that still the reasonable goal in your view?

John A. Hayes

Chairman, President & CEO

Yes. I think it is a reasonable goal. As I said, we're a little bit softer in the third quarter. But other times, sometimes, we're a little bit stronger. I think as we look forward, what we talked about before in terms of the service center realignment that's going on that we're going to get the benefit of 2017, we're investing in the Czech Republic to grow the impact, the extruded side of that business that's going to come onstream late this year, early next year. We have a new plant in India that really hasn't -- up until recently, really hasn't even been generating anything because it was in start-up mode, and then we've invested in the U.K. in terms of impact extruded. That, combined with just the overall continuative growth of, for example, in our Mexican impact extruded, says that over the next couple of years, we expect to be able to get in the range of where we had been before.

Operator

Our next question is from the line of Scott Gaffner with Barclays.

Scott Louis Gaffner

Barclays Bank PLC, Research Division

Just going back to South America for a couple of minutes, just to clarify a couple of things. John, I realized we're comparing apples and oranges here, but there was a pretty significant delta on the margin in the legacy Ball facility versus what you did acquire, and this is kind of our first look into some of the margins in that market. Maybe is it really just a scale issue? I heard you mention that as being one of the big drivers. Or is there anything else that made the margin between those 2 businesses different?

John A. Hayes

Chairman, President & CEO

No. As I said, scale is really important in this business. And just for example, we have -- we had G&A that supported 3 plants. We don't have that much more appreciable G&A that's supporting 13 plus plants in that region. And so that's just one example of it. There's many others we can give. But scale is important in our business.

Scott C. Morrison

Senior VP & CFO

And also remember, Scott, last year in the third quarter, we had a pretty tough quarter, so you're comparing something that was unusually low, too. So you got to be careful with the comparisons.

Scott Louis Gaffner

Barclays Bank PLC, Research Division

Okay. Yes, that's a fair point, Scott. I appreciate your highlighting that. And then one other on South America. I mean, I -- it sounds like one of your larger customers recently talked about reinvesting in glass bottles for off premise consumption. And I realized the can continues to take market share in the long run. But are you seeing anything in the near term just given the macroenvironment where you're seeing maybe a shift back towards glass in the near term? Is that something you're seeing?

John A. Hayes

Chairman, President & CEO

No. As I said, for example, in the third quarter, can continues to gain share relative to glass and we're entering the summer so and it's still early in the summer season. But so far, so good. But we haven't seen any appreciable change from the trends we've talked about previously.

Scott Louis Gaffner

Barclays Bank PLC, Research Division

Okay. One last one for me, John, you mentioned this a couple of times. You talked about securing appropriate value for the product, and some of that was prefaced on sourcing, freight and logistics. But I got the sense of maybe you feel like maybe it's not been getting full value for the product over the last couple of years maybe because of competitive dynamics or something else in the market. Is that -- how should we read that commentary?

John A. Hayes

Chairman, President & CEO

Read it as exactly what the words that came out of my mouth. We think that the can is -- the beverage can is the most sustainable package from an economic perspective. And while at the same time, we want to make sure we're getting paid for our innovation efforts, and we put a lot of effort and energy into the specialty can size and growth and development of not only the can itself but the market itself. You think about the aluminum bottles, you think about the service that we provide, you think about the quality we provide. And my comments stand on their own 2 feet.

Scott C. Morrison

Senior VP & CFO

And the complexity of the business is way different. We need to make sure that we're getting paid appropriately for that complexity.

John A. Hayes

Chairman, President & CEO

Yes. I mean, another example on that is with the -- given the retail environment, there is a lot of movements and shifts in terms of in and out packages. And so how we've -- when you contract on a standard 12-ounce can basis and you have long runs, it's changing today. And so that's just another example of how we have to modify our muscle memory to reflect the current realities.

Scott Louis Gaffner

Barclays Bank PLC, Research Division

Sure. I really appreciate that. I guess one follow-up on that. I mean, it's -- you can see from some of the customers -- I mean, they're able to significant -- upcharge significantly from a customer perspective with some of these new can sizes, for instance, moving from a 12-ounce to a 7.5-ounce doesn't just get you on the CSD side, doesn't just get you more per ounce from a -- for the beverage guys that actually get you more on the total dollar amount. I mean, is that -- that's all -- did they recognize that value as well or not?

John A. Hayes

Chairman, President & CEO

Yes. Look, let me tackle it a different way. When we're able to help our customers grow their profits and grow their profit pools, there's greater money for -- to go around. Where -- what we try and do is actually make the can the most sustainable package and make it to become the most profitable package for our customer. That's our aspiration because if we can do that, that's what we mean about being the most sustainable package in the beverage world.

Operator

Our next question is from the line of Ghansham Panjabi from Robert W. Baird and Company.

Mehul M. Dalia

Robert W. Baird & Co. Incorporated, Research Division

It's actually Mehul Dalia sitting in for Ghansham. Just piggybacking off of that last question in terms of value capture, is there a particular region where you feel value isn't up to par? Or is it just broad-based across your entire portfolio?

John A. Hayes

Chairman, President & CEO

No, generally speaking, it's broad-based. But specifically when you think about the greatest amount of changes in terms of the package, sizes, shapes, those types of things, I would certainly, say Europe and North America.

Mehul M. Dalia

Robert W. Baird & Co. Incorporated, Research Division

Okay, makes sense. And then can you give us some clarity on your expected synergy run rate by the end of 2016. I know you guys gave a -- you reiterated your 2017 and 2019 target, but just what you guys expect to achieve by 2016 on the run rate.

Scott C. Morrison

Senior VP & CFO

Yes. We never gave a number for 2016. We gave a 2017 number. So we have lots of plans in place. A lot of things that are progressing as we expected. And that's why we're reiterating the number for 2017. It's the same as what we told you a couple of months ago.

John A. Hayes

Chairman, President & CEO

Yes. For 2016, as we said before, the second half of 2016 is as much about getting after from an integration point of view, getting after those cost synergies that we are able to deliver on in 2017. So you shouldn't expect too much into 2016.

Scott C. Morrison

Senior VP & CFO

Yes. There's probably a little bit of drag actually in '16 as we get after some of those stuff.

Mehul M. Dalia

Robert W. Baird & Co. Incorporated, Research Division

Make sense. Just one last one and relatedly, has there been impact on synergies from the recent pound devaluation? And if so, how are you offsetting that to stay at your targets?

Scott C. Morrison

Senior VP & CFO

No, there's not -- yes, our pound business actually isn't that big. And then today, the U.K. court said the vote for Brexit was illegal and the parliament has to vote, so the pound pops. So it's a dynamic world.

John A. Hayes

Chairman, President & CEO

Yes. And remember, the U.K. business, as a percent of our revenues, is south of 5%. So it's not a big driver.

Operator

Our next question is from the line of George Staphos for Bank of America.

George Leon Staphos

BofA Merrill Lynch, Research Division

I guess my first question. Scott, I forget if you mentioned it. The cash cost associated with the integration, has that changed at all? Or is that very much on track with your expectations for both '16 and '17? Has there been any change in the timing thereof?

Scott C. Morrison

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Senior VP & CFO

No. No real change, George. Everything that we expected to happen in the third quarter post-close is exactly what happened at the cost we anticipated. So -- and as we look into '17 and any actions we might take there, none of those costs has changed.

George Leon Staphos

BofA Merrill Lynch, Research Division

Okay. I don't know -- I don't think you could provide a lot of detail and clarity on this for various reasons. But could you give us some qualitative view on how customers specialty did by region within your business?

John A. Hayes

Chairman, President & CEO

I'm sorry. You said specialty?

George Leon Staphos

BofA Merrill Lynch, Research Division

Yes, correct.

John A. Hayes

Chairman, President & CEO

Yes. It's -- yes, let me just quickly try and go through it. I think the overall trends that we've talked about really haven't changed all that much. And what I mean by that, in North America, we continue to see on a pro forma basis -- again, you have to keep that in mind. But we were up high single digits in the United States, in North America, that segment. In Europe, I don't have the numbers off of the top of my head, but as we talked in our prepared remarks, there continues to be a bias toward specialty. And so that's been growing at a faster rate from the standard containers. And then, when you go into other regions, whether it's South America or even Asia, you're continued to seeing specialty can growth higher, and in the case of Asia, much higher, than you are standard containers.

George Leon Staphos

BofA Merrill Lynch, Research Division

Okay, appreciate that, John. One thing I wanted to ask at is the Madrid plant. Can you provide a little bit more color? I think you said it was an existing contract that you had that you elected to keep and you're building this new facility. If there's any more commentary you could share around it. I forget if you said how large the facility was going to be. And then, I had 1 last follow-on before I turn it over.

Scott C. Morrison

Senior VP & CFO

Sure. This is a customer we've been selling to for a while. We were servicing them out of another plant that was outside of Spain in our old -- in the old Ball legacy business. During the process of working with the EC, we kept that particular contract, which was a long multi-year contract, way beyond 5 years, for -- which is the kind of the anchored tenant of all that volume. It'll initially -- the plant will come up in '18 with one line and then another line added after that, and so it's -- a vast majority of it is contracted. And then the Spanish market continues to be one of the better markets across Europe. And so we'll be able to grow with that market.

George Leon Staphos

BofA Merrill Lynch, Research Division

Okay, great. As you think about Mexico, given the potential for various outcomes postelection, is the way you're planning for that business to progress or develop, or for that matter, the way your customers are planning, has any of that changed over the last 6 months relative to where we are right now? And then, I

don't know if you have a quick update on Chinese pricing and the outlook for '17, but I thought I'd throw that in there.

John A. Hayes

Chairman, President & CEO

All right. Why don't I tackle Mexico right now. No. No changes. As you know, we make in Mexico and sell in Mexico. And now the finished product is often exported in the United States, but it really plays into the broader demographics that's going on there. I think you're intimating what happens in the election. I think it's premature to speculate there. But I -- well, it's challenging to think that there's going to be meaningful changes in domestic consumption here in the U.S., given the demographics that have gone on, certainly in the next few years. So we don't see any change based -- relative to where we were 6 months or even a year ago. [indiscernible]

George Leon Staphos

BofA Merrill Lynch, Research Division

But would you consider maybe tightening up the cost structure if currencies further devalue? I guess, that was part of the question.

Scott C. Morrison

Senior VP & CFO

Cost structures really -- we've pretty much inoculated ourselves from Mexican currency swings because it really is a dollar-based business.

John A. Hayes

Chairman, President & CEO

Yes, so no big change. Then in the China market, we're right in the early part of the throes of the annual price negotiations. As you all know, we took a big step down last year. Relative to our expectations, we still think there's oversupply in the market. We still think it's challenging. We also know that a lot of can makers that are publicly traded over there have publicly expressed that they are quite challenged in the market. So I think it's premature to determine exactly what's going to happen. But we've taken a ton of cost out in that business in 2016. We have further plans to do that and we kind of think we've hit a low point, but having said that, it is early November and the pricing discussions haven't been finalized.

Operator

Our next question is from the line of Chip Dillon from Vertical Research Partners.

Clyde Alvin Dillon

Vertical Research Partners, LLC

First question is, I guess the -- we really appreciate the detail. And it's pretty noticeable that if you look at the first half results in Asia, they were -- actually it looks like negative \$13 million and of course, that's just legacy Ball. And then in the third quarter, they shot up to positive \$22 million. As you indicated, interpolating from the other line, of course. And I didn't know if all of that improvement was Rexam or are there other moving parts?

Scott C. Morrison

Senior VP & CFO

No. The -- if you look at the Asia business alone, we took a big hit in the first quarter. We had inventory revaluation down, which was a big impact in the first quarter. So the first quarter was particularly rough. It has progressively gotten better as we've gotten the costs out, too. Remember we had a pretty significant cost out plan, and that has matured through the first quarter into the third quarter. And that's why sequentially, we've gotten better as the year's gone on.

John A. Hayes

Chairman, President & CEO

Yes. But I think in the other -- to answer your other part of the question, the other, remember, also includes EMEA and that is a profitable business. And so we've made a lot of good progress in China. But don't -- I think you're intimating it went from negative 13 in the first half to positive 22. That...

Scott C. Morrison

Senior VP & CFO

No. That is not the case. That's right.

Clyde Alvin Dillon

Vertical Research Partners, LLC

Yes. And it was -- and actually, to be fair, it was positive \$15 million in the first half of '15. So but I appreciate that answer about the first quarter, that's right. And the other thing that's very -- that really sticks out, of course, is the margin that we see in South America and how much better it looks like, at least it appears to be at with the Rexam assets. And of course, that's even with a little bit of hand tied behind your back with a stepped-up depreciation, I'm sure, there's a little bit of that. And is that all of it? Was it just the differential in the businesses you acquired versus what you had before? And I guess, there was a divestiture maybe in there as well. And is this sustainable, the sort of 18% to 19% EBIT multiple we saw in the third quarter?

Scott C. Morrison

Senior VP & CFO

Well, remember, in the third quarter, what you're comparing to was a really soft quarter in our legacy business in the third quarter of last year. So you're really not comparing -- making a fair comparison. But the business that we acquired is a much bigger business that has a lot more scale and is a very well-run business. Where the margins go over time, we'll see. But it's a good business.

John A. Hayes

Chairman, President & CEO

Yes. The other thing, as you all know, we never really talk about margins because metal [indiscernible] are such a big component with aluminum being softer, it makes the margin look higher. We look at the return on capital, and that's another way to be looking at it. So I wouldn't read too much into these margin things that you're mentioning.

Clyde Alvin Dillon

Vertical Research Partners, LLC

Okay. And then, on the plant in Madrid. I mean, as I look at it, looks like you have aluminum aerosol plants starting up in the Czech Republic. And that's basically it until Madrid. And given that you're working hard on all the synergies, I would imagine, I mean, that can change. But that's really the only thing that's out there. And should I assume its like, what, 800 million cans per line and 1 in '18 and 1 in '19, is that a good ballpark?

John A. Hayes

Chairman, President & CEO

It's a good ballpark. It's, like Scott said, we're going to be putting this first line in and then kind of ramping up and building infrastructure for the second line. And so the timing of it is dependent upon how the Spanish market continues to grow. But in terms of your broader question about CapEx, we have been spending a fair amount of money. And you mentioned -- actually, just to be clear, we're not building a new plant in Czech Republic. We're significantly expanding an existing plant. But we continue to make specialty can investments in our business. We talked about in North America on the last conference call that there is some capital that's going to be required to upgrade the facilities we acquired. So there's a whole bunch of distributed things like that. And we stand by what we said in that range of \$500 million for next year.

Clyde Alvin Dillon

Vertical Research Partners, LLC

Okay, okay. And last quick one. I know the depreciation -- this is the first look [ph] we've had with the step up. If you annualize the fourth quarter, I guess it would be what, 456. Is that a good ballpark to be in next year, the 450 range?

Scott C. Morrison

Senior VP & CFO

Yes, that's -- it sounds about right. And then add -- the amortization that we're going to exclude is on top of that, but that's [indiscernible].

Clyde Alvin Dillon

Vertical Research Partners, LLC

Which is 132, give or take?

Scott C. Morrison

Senior VP & CFO

Correct.

Operator

Our next question is from the line of Chris Manuel from Wells Fargo.

Christopher David Manuel

Wells Fargo Securities, LLC, Research Division

Let's see here. So a couple of questions I wanted to ask. I think I understand what's happening in Spain. But I wanted to also dive into the aerospace business a little bit. The backlog's up quite a bit. If we look back historically, '13, '14 -- '12, '13, '14 you've been \$900 million plus of revenue there before. What do think the path is towards monetizing some of that backlog? Should '17, '18 be \$900 million plus revenue kind of numbers? Or what's the path there?

John A. Hayes

Chairman, President & CEO

Yes. I think the path -- I mean, we have record amount of backlog, and it's obviously a very good story there. I think, as time goes on, we're going to be able to surpass what we've done in the past in terms of revenue and in terms of profitability. I mentioned in the last quarter that we had a lot on our plates in terms of 1 not booked and the only -- the biggest surprise that happened in the third quarter for us is, given that the governments pushed out the continuing resolution until after the election, we were pleasantly surprised, and so some of the wins turned into funded wins, which went into our backlog. We're still chasing a variety of things in the aerospace business and even getting back to the capital. I think over the next couple of years, it's not big dollars. But we're going to be investing in that in terms of new chambers, in terms of expanding our manufacturing capability and capacity and building out some of our existing facilities because our backlog is the highest we've ever had, and we were ramping up big-time in terms of hiring people, getting people going and as I mentioned, I think you're going to start see it rollout as early as the fourth quarter of 2016 and then as we go to 2017 and beyond, we feel good about that business. They've been doing a great job.

Christopher David Manuel

Wells Fargo Securities, LLC, Research Division

Okay, that's helpful. And then the second question I had was -- and I fully appreciate you're going to have an analyst day event for us in a few months. But given that the business, particularly in Europe and in South America, is quite different than your historic business or at least the footprint, to an extent, is, help us get a -- give us a sense of what you would anticipate, say, the next 1, 2, 3 years, the organic growth profile of the new Ball business looks like and even in North America, too, given that maybe we've had a bit of an inflection point here.

John A. Hayes

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Chairman, President & CEO

I -- that's a very -- there's a very long answer to that. I would encourage you to come to the investor conference to hear directly from our presidents in that region that can -- that's part of what we're planning on doing, explaining what we see from a demand perspective, a supply perspective, a footprint perspective, a size, shape, a capacity innovation, all those various things at the Investor Day.

Operator

Our next question is from the line of Philip Ng from Jefferies.

Philip H. Ng

Jefferies LLC, Research Division

Sounds like Russia's seeing some increased momentum there. Can you provide some color, what kind of trends you're seeing and how should we think about mix relative to your business in Europe going forward?

John A. Hayes

Chairman, President & CEO

I'm sorry, can you repeat the question? You were breaking in and out.

Philip H. Ng

Jefferies LLC, Research Division

Yes, sure. Russia seems to be gaining a bit of momentum here. Can you talk about what's driving the growth, where you see that market taking off next year and what kind of impact should we think about from a mix standpoint?

Scott C. Morrison

Senior VP & CFO

Yes. The Russian market is good. It's a good business. It's a growing business. The can continues to do well, and we would expect that to continue going forward.

Philip H. Ng

Jefferies LLC, Research Division

Any big delta from a margin standpoint relative to Europe, positive or negative?

John A. Hayes

Chairman, President & CEO

No. Not appreciably, not appreciably. It's -- no, is the short answer.

Philip H. Ng

Jefferies LLC, Research Division

Okay. And I don't know if I missed this. I mean, piggy backing off of Chris' question about the aerospace business, backlogs surprisingly [ph] picked up pretty meaningfully. How quickly of a ramp do we expect to see that flow through your P&L? And are there any start-up costs you would be mindful of in terms of that potentially impacting margins?

John A. Hayes

Chairman, President & CEO

No. No, there aren't no start-up costs. And it's going to be ramped up. As we go and really get going -- it's a difficult question to answer because as we have that we have like -- and every time we have some contracts that are coming off, some contracts that are coming on. I will point out a couple of things, though. The majority of the business we've won is a cost plus business, costs plus fixed fee business. And that usually, from an -- we've talked about this in the past. When you have a fixed price contract, usually

the margins, when you start out, are a bit lower. And then if you execute successfully, your margins will pick up as you deliver those. In a cost-plus environment, it's a little bit more stable, the margin is across. So I don't expect our margin profile, having said that, to change meaningfully as we look forward. I think it's as much about growing the revenues, and some of these programs we've won are multiyear programs. Some of are single year. It's a big mix. But the vast majority of this is cost-plus, which is actually good from an overall profitability perspective.

Daniel T. Schniedwind

AMI Asset Management Corporation

Okay, that's really helpful. And just one last one for me. I know 1 of your partners in Mexico announced they're acquiring a brewery in Mexico. Isn't that an opportunity for you to supply them from an existing facility or through potentially more capacity down the road? Just want to talk about the opportunity down the road.

John A. Hayes

Chairman, President & CEO

Yes. We've got a very good relationship with that customer you mentioned -- mentioning. I think it's premature and it's not fair for us to comment on what some of their plans are. I'll just say that we have a very good relationship with them to supply 100% of their needs in Mexico.

Operator

Our next question is from line of Mark Wilde from BMO.

Mark William Wilde

BMO Capital Markets Equity Research

Just -- actually, following on Mexico. John, is it possible to get some sense of what you're seeing in terms of the can's share of the mix for both domestic and the exported beer out of Mexico?

John A. Hayes

Chairman, President & CEO

Yes. I don't have them off of the top of my head. Some observations. So high level is number one, the can penetration is certainly lower in Mexico than it is in North America. Number two, it has -- and I say that in the beer side that I want to say it's in the 20s versus 50s here in North America. So there's a lot of good runway there. And I think, as a lot of the Mexican beer companies look to develop their brands, they've been -- they recognize they've been under-weighted cans relative to glass and other substrates. And so they've been putting much more emphasis on the can, which I think longer-term and shorter term, is a benefit for us.

Mark William Wilde

BMO Capital Markets Equity Research

Okay. And what about on the export side, do you have any sense of the export mix, how much of that is going in cans and how much is going in bottles and how much that might shift?

John A. Hayes

Chairman, President & CEO

Yes. It's the same trend. It has been... Historically, it had been more weighted towards glass than it had been cans. And I think as you're moving -- as we look now and going forward, we're seeing a greater weight of cans relative to glass for the export.

Mark William Wilde

BMO Capital Markets Equity Research

Okay, right. And I'm just curious. Over the last 90 days, you said no changes to any of your targets. But has there been anything that you would highlight over the last 90 days as you've kind of gotten into Rexam [ph] so much deep that surprised you at all, one way or the other?

John A. Hayes

Chairman, President & CEO

We -- on the conference call 3 months ago, our initial observations was the engagement of the people was awesome, and we've reiterated that. A great bunch of people. We're very excited. And I think as time goes on, we had a management conference, got the top 300-plus people in a room together and really galvanized about who we are, what we're trying to do and how we're going to get there and what each and every person's role is and really just behave like a true owner as I talked about in my opening remarks. That's a positive. I think in terms of -- when you peel away the onion, there's always puts and takes. But as we -- as Scott had mentioned, we see some -- we had to firm these things up, but we see some opportunities on the cost side, whether its footprint, whether it's supply-demand dynamics, whether it's best practice sharing and the manufacturing footprints, all those things. We're getting after it now, and as we kind of dig into it, we're excited.

Mark William Wilde

BMO Capital Markets Equity Research

Okay. And Scott, I'm curious with that Rexam headquarters wind down, is there any potential benefit for you in terms of being able to sell the remaining years on the lease?

Scott C. Morrison

Senior VP & CFO

My experience is there -- we're just -- we're going to try and re-lease the property. We don't own it. There's just not a huge upside. I mean, the market is higher than it was when entered the lease, so maybe there's a little bit, but that's kind of rounding.

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Mark William Wilde

BMO Capital Markets Equity Research

Yes, okay, all right. That's good. And the final question I had, any way to kind of quantify the benefit from the aluminum premiums in the third quarter?

Scott C. Morrison

Senior VP & CFO

No. Nothing for us, really.

Operator

[Operator Instructions] Our next question is from the line of Kyle White from Deutsche Bank.

Kyle White

Deutsche Bank AG, Research Division

A large brewer recently said that they are starting to see some slowdown in the craft beer market. And I'm just curious if you guys are seeing that as well with some of your customers. I know I think last quarter you said it was growing at 30% year-to-date, but just what are you expecting going forward from that?

John A. Hayes

Chairman, President & CEO

No. It's still growing strong. I think what that -- whoever was mentioning that, what you have seen a change, though. I think some of the larger craft brewers have slowed down, the top 10 brands in the craft brewing side has slowed down. But on the other side of the curve, many of the smaller ones, as they continue to grow very strong in the beer -- on the can side because they were in glass historically or they

did not exist. And so we are seeing a -- continue to see a strong uptick in some of the smaller craft beers going into cans.

Kyle White

Deutsche Bank AG, Research Division

Okay, that's helpful. And then sorry go back to the new facility in Spain. I'm just trying to fully understand that it's a customer that you're servicing now. So are you guys seeing kind of increased cost maybe from transportation or whatnot that this kind of new facility is more of a cost saving with some added growth to it? Or how should we think about that?

Scott C. Morrison

Senior VP & CFO

Well, we were servicing out of a facility that we had to divest. So that business will come when we get that plant up and running. And it will be much more -- much more beneficial from a cost standpoint because it will be very closely located to where all that volume's going.

Operator

Our next question is from Chris Manuel from Wells Fargo Securities.

Christopher David Manuel

Wells Fargo Securities, LLC, Research Division

Just one quick follow-up for Scott. And if you have the answer for this handy, that'd be wonderful. If not, you can get back to us. But I wanted to get a sense of the pension, about where we are today, where we are heading into '17. Mainly, what is the liability so that we can try to calculate some sensitivities on what happens with stuff. But your expectations for what the liability is, what the funding level is and how that might play out into '17 as well.

Scott C. Morrison

Senior VP & CFO

Sure. I don't have the exact liability numbers with me right now, but the pension plans that we acquired were actually better funded than the Ball legacy pension plans. So in fact, in the U.K., they have a very sizable pension there. It's actually overfunded by a few hundred million dollars. And in the U.S., it's better-funded than our plans have been. So we don't anticipate a major change in the pension expense going forward. Most of the expense that we'll have will be really related to our U.S. legacy business versus what we acquired. But I can get you some more specific numbers, but big picture it's not going to change.

Christopher David Manuel

Wells Fargo Securities, LLC, Research Division

Okay. And if you can [indiscernible], status will be helpful, too.

Scott C. Morrison

Senior VP & CFO

Sure.

Operator

There are no further questions from the phone lines at this time.

John A. Hayes

Chairman, President & CEO

Okay, great. Well, thank you, James. And we look forward to seeing you all at our upcoming investor conference in December. And if anyone who has not registered, we'd ask you to please reach out to Ann Scott and do so, and look forward to getting into 2017 and delivering on what we expect. Thank you.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines. Thank you.

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