

Hippo Holdings Inc. NYSE:HIPO

FQ1 2024 Earnings Call Transcripts

Thursday, May 2, 2024 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2024-			-FQ2 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(1.15)	(1.16)	NM	(1.12)	(3.01)	NA
Revenue (mm)	72.88	85.10	 16.77	85.28	356.32	NA

Currency: USD
Consensus as of Apr-16-2024 5:56 PM GMT

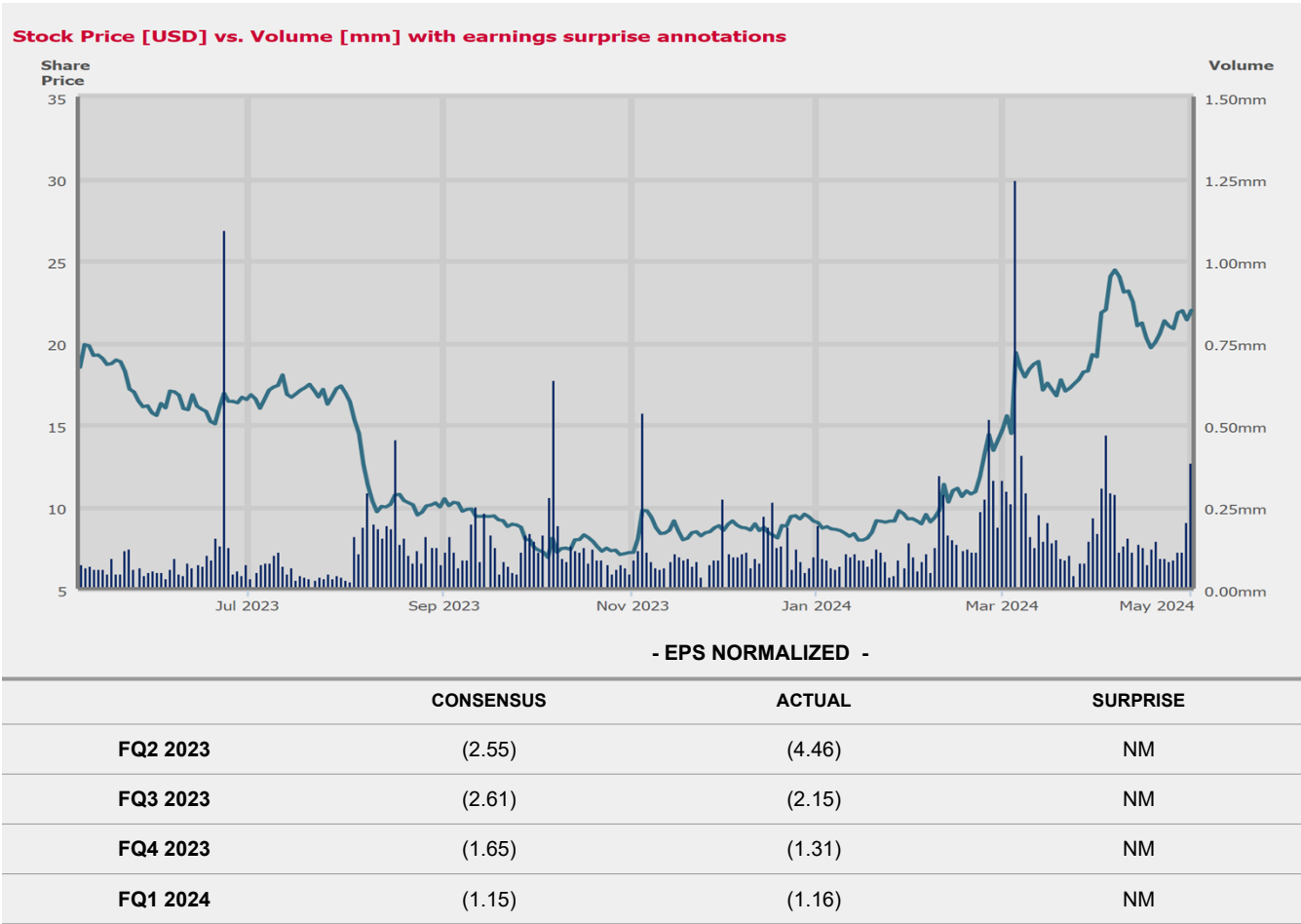


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Call Participants

EXECUTIVES

Mark Olson

Richard Lyn McCathron
President, CEO & Director

Stewart Andrew Ellis
CFO & Treasurer

ANALYSTS

Thomas Patrick McJoynt-Griffith
*Keefe, Bruyette, & Woods, Inc.,
Research Division*

Yaron Joseph Kinar
Jefferies LLC, Research Division

Presentation

Operator

Ladies and gentlemen, welcome to the Hippo Holdings First Quarter Earnings Call. My name is Betsy, and I will be moderating your call today. [Operator Instructions]

I will now hand you over to your host, Mark Olson from Hippo Holdings to begin. Mark, please go ahead.

Mark Olson

Thank you, operator. Good morning, and thank you for joining Hippo's 2024 first quarter earnings call. Earlier today, Hippo issued a shareholder letter announcing its Q1 results, which is available at investors.hippo.com. Leading today's discussion will be Hippo President and Chief Executive Officer, Rick McCathron; and Chief Financial Officer, Stewart Ellis. Following management's prepared remarks, we will open the call to questions.

Before we begin, we'd like to remind you that our discussion will contain predictions, expectations, forward-looking statements and other information about our business that are based on management's current expectations as of the date of this presentation. Forward-looking statements include, but are not limited to, Hippo's expectations or predictions of financial and business performance and conditions, competitive and industry outlook.

Forward-looking statements are subject to risks, uncertainties and other factors that could cause our actual results to differ materially from historical results and/or from our forecast, including those set forth in Hippo's Form 10-Q filed today. For more information, please refer to the risks, uncertainties and other factors discussed in Hippo's SEC filings, in particular the section entitled Risk Factors.

All cautionary statements are applicable to any forward-looking statements we make whenever they appear. You should carefully consider the risks and uncertainties and other factors discussed in Hippo's SEC filings. Do not place undue reliance on forward-looking statements as Hippo's under no obligation and expressly disclaims any responsibility for updating offering or otherwise revising any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

During this conference call, we will refer to non-GAAP financial measures such as total generated premium and adjusted EBITDA. Our GAAP results and description of our non-GAAP financial measures with full reconciliation to GAAP can be found in the first quarter 2024 shareholder letter, which has been furnished to the SEC and is available on our website.

And with that, I'll turn the call over to Rick McCathron, our President and CEO.

Richard Lyn McCathron *President, CEO & Director*

Thank you, Mark, and good morning, everyone. We started off the new year on the right foot, building on the momentum gained during a transformative 2023 and are on track to achieve the 2024 operational and financial goals we discussed last quarter. I'm particularly excited to share that during Q1, we were able to continue reducing our cap exposure and streamlining our operations without sacrificing overall growth.

In fact, we accelerated top line growth compared to last quarter. I mentioned previously that we've been focused on meeting our customers' needs with third-party policies while reducing our Hippo home insurance program exposure in areas where we have a lower risk appetite. Our team's efforts to find the right policy for each customer, regardless of carrier, have allowed us to maintain high retention rates during this effort.

Our success helped drive accelerated total generated premium growth in Q1 relative to last quarter. I expect this growth to accelerate further towards the end of the year as the benefit of reopening certain geographies and the expansion of our builder business overtake the short-term growth impact of reducing cat exposure. Without the effort to rebalance our geographical exposure, our top line could have been even higher, but these efforts are already improving underwriting results and our bottom line. No home insurance company will ever be immune from weather and like others, we experienced losses in March of this year from a large hailstorm that affected Texas and Missouri.

Because of our ongoing efforts to reduce policy counts in these areas and to increase deductibles that further reduce our exposure, we estimate the direct losses from this event will be approximately 43% lower than what we would have experienced if the exact same

event had occurred in March 2023. This is solid progress in a relatively short period of time. And like we discussed last quarter, we feel confident that later this year, after the changes work their way fully through our book. The reduction in expected losses will even be higher.

Finally, towards the end of last year, we took aggressive actions to lower costs and drive efficiency into our operations. We are now realizing the full benefit of these cost reductions in our Q1 financials, and those improvements contributed to our progress in reducing our adjusted EBITDA loss during the quarter. Even though Q1 had a seasonally higher weather-related losses than Q4 last year.

The critical work that started in 2023 has continued into 2024, and our results from Q1 add to the growing evidence of our ability to efficiently grow our business, while marching towards positive adjusted EBITDA. Our teams have worked hard during the quarter. I'm encouraged by the progress and excited to report that there's more to come.

Now I'd like to turn the call over to our Chief Financial Officer, Stewart Ellis, to walk through the highlights of our Q1 2024 financial results as well as our expectations for the future.

Stewart Andrew Ellis
CFO & Treasurer

Thanks, Rick, and good morning, everyone. In Q1, we took another step toward achieving positive adjusted EBITDA later this year, continuing the trends we've been discussing in the past few quarters and showing measurable progress compared to our results from last quarter and to those from a year ago. Before I get into the details of the other line items on the P&L, I'd like to take a minute to highlight how good a quarter it really was for Hippo on the adjusted EBITDA line because it was better than it appears on the surface.

Compared to Q1 of 2023, we improved our adjusted EBITDA loss by \$32.3 million, bringing it down from \$52.1 million a year ago to \$19.8 million in Q1. Compared to last quarter, the improvement was only \$2.5 million, but we need to keep in mind that Q4 is typically our best seasonal quarter in terms of weather losses for the Hippo program. So the \$2.5 million improvement versus last quarter was achieved despite gross losses on the Hippo program being \$19 million higher than they were in the quarter. We were able to accomplish this because of the trends we've been discussing over the past year in each of the major line items on our P&L. So I'll try to highlight those trends as we go through the numbers, and then at the end, discuss how each of them contributed to this result.

So starting with total generated premium. In Q1, TGP grew to \$294 million, a 20% increase year-over-year. As Rick mentioned a few minutes ago, this was an acceleration of growth compared to last quarter, and it is driven primarily by the success we've had offering third-party policy to our customers through our agency and First Connect platforms. Our Insurance-as-a-Service business continued to grow, up 25% year-over-year, while our efforts to reduce cat exposure in our Hippo home insurance program caused TGP from that segment to shrink by 29%.

All of these results were in line with expectations and consistent with the guidance we shared last quarter for the full 2024 calendar year. The parts of our business that are less exposed to underlying weather and underwriting volatility, insurance as a service and services rose as a percentage of our total TGP to 80%, up from 77% last quarter.

As a reminder, we expect these trends to continue over the course of the year with the services and insurance as a Service segments collectively representing 85% of total TGP by Q4 of this year, at which point we should be starting to see TGP from the Hippo Home Insurance Program segment beginning to grow again, especially in the builder channel, which will help bolster our total TGP growth heading into 2025.

Looking at revenue. During the first quarter, we again grew revenue significantly faster than TGP, with it rising 114% year-over-year to \$85 million, up from \$40 million in Q1 2023. As we discussed last quarter, this growth comes from a combination of volume increases at the Services and Insurance-as-a-Service segments as well as significantly higher monetization of our TGP from the Hippo home insurance program. Within HHIP, we were able to retain 58% of gross earned premium, up from 7% a year ago and also benefited from a 33% year-over-year increase in rate on a written basis during the quarter.

Looking at loss and loss adjustment expense. The biggest driver of our consolidated loss and loss adjustment expense, the Hippo Home Insurance Program segment showed strong progress during the quarter. Our HHIP gross loss ratio improved by 21 percentage points to 80% from 101% in Q1 of last year. This portfolio level improvement, combined with the improvements to our reinsurance structure, drove the even larger improvement in our HHIP net loss ratio, which came in at 100% during the quarter, an improvement of 455 percentage points versus Q1 of last year.

As I mentioned earlier, our gross losses at HHIP were \$19 million higher than last quarter because of seasonal weather patterns. But because of the increase in earned premium quarter-over-quarter, we now have the earned premium base to absorb these losses, driven

primarily by the improvements in the Hippo program, our consolidated gross loss ratio improved 17 percentage points year-over-year to 59%, and our consolidated net loss ratio improved 186 percentage points year-over-year to 87%.

We think about fixed expenses and operating leverage. As Rick mentioned earlier, Q1 represents the first quarter where we realized the full benefit of the cost reduction actions and efficiency improvements we implemented late last year. These improvements show the substantial operating leverage we are achieving as we failed. Relative to Q1 of last year, our GAAP sales and marketing, technology and development and general and administrative expenses collectively declined by 87 percentage points of revenue, shrinking from 135% of revenue last year to 48% of revenue this quarter.

Beyond the improvement relative to revenue, each of our sales and marketing, technology and development and general and administrative line items declined in absolute dollar terms during the quarter relative to both Q1 2023 and Q4 2023. Collectively, these improvements drove a year-over-year reduction in expenses of more than \$13 million on a GAAP basis, a decrease of 24% in absolute dollar terms, all while revenue grew 114%.

Turning now to adjusted EBITDA. As I mentioned at the beginning of my remarks, our Q1 adjusted EBITDA loss of \$19.8 million was a \$32.3 million improvement year-over-year and a \$2.5 million improvement quarter-over-quarter. The year-over-year improvement in adjusted EBITDA was driven primarily by a 21 percentage point improvement in our HHIP gross loss ratio. Our improved reinsurance structure, which brings our retained premium more in line with the risk we are retaining, cost-savings initiatives we initiated in Q4 of last year and the growth in our Insurance-as-a-Service and Services segments.

The quarter-over-quarter improvement in adjusted EBITDA was driven primarily by realizing the full benefit of the cost saving initiatives in Q1 versus only a partial benefit last quarter, while the benefit of higher earned premium offset seasonally higher weather-related losses. As a reminder, the definition of adjusted EBITDA that we are using and have used historically excludes net investment income, which amounted to \$5.9 million in Q1.

Looking forward to the full year 2024, we are reiterating the guidance we provided last quarter. As a reminder, 41% of our annual PCS cat load is estimated to occur in Q2. Historically, our highest weather last quarter. When we report Q2 results, we plan to provide updated guidance for the rest of 2024.

And finally, before I close and open the floor for questions, I'd like to point out that Q1 was the first quarter in the company's history where our cash balance increased for reasons other than raising additional capital. Cash equivalents and investments rose by \$6.8 million during the quarter. This increase was a function of some working capital changes and other onetime benefits, so I don't expect that we'll be cash flow positive in every quarter this year, but it is a significant milestone for the company and a reflection that we are getting closer to a point where we expect to generate consistently positive cash flow.

And with that, operator, I'd now like to open the floor to questions.

Question and Answer

Operator

[Operator Instructions] We have our first question coming from Yaron Kinar of Jefferies.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Congrats on achieving the free cash flow milestone. I guess a few questions, if I could. First, on the sales and marketing spend, seem to come in a little bit lighter at least than where I'd expected it to be. Is there a seasonality pattern there or do you think that it will remain at relatively these levels as you continue to achieve this strong level of [B2B] growth?

Stewart Andrew Ellis
CFO & Treasurer

Yaron, this is Stewart. I can take this one. I think I'm expecting our -- not only our sales and marketing, but our other kind of fixed cost line items in the P&L to remain roughly at these levels for a while. I think Q1 is a reasonable proxy for the quarterly run rate of this. I think one of the things that's important to remember about our growth is that not all the dollars of incremental TGP require us to go out and spend money to acquire new customers, especially in insurance at a service segment, a lot of the growth is coming from existing programs. And so we do have an ability to grow efficiently, and I think that we're showing that in the P&L in Q1.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Got it. I'll add one quick thing to what Stewart said. The other aspect to remember is in our services segment, we are doing a better job of cross-selling new policies to existing customers in which you see growth related to those efforts, yet we don't have any incremental marketing spend because they're existing customers.

Stewart Andrew Ellis
CFO & Treasurer

That makes sense. And while we're on services, why was the very strong TGP growth there, like 37%. Why that translates to only 16% revenue growth?

Richard Lyn McCathron
President, CEO & Director

Stewart, I can take this one. I think it's a combination of things. Within the services segment, we do have -- I think as we've talked about in the past, multiple kinds of businesses. So we have our agency where we're selling insurance policies, both homeowners and non-homeowners policies to consumer customers. We also have our First Connected platform where we are helping carriers who are looking for incremental demand for their products and agents who are looking for incremental capacity to sell to their customers.

The First Connect platform is a marketplace. It's a share -- the revenue we have is a share of the commission that is paid from carriers to the independent agents, and it monetizes at a lower percentage of TGP. It's a high variable contribution margin business. But as a percentage of TGP, it's lower. And the First Connect platform is growing incredibly quickly. So there is a mix shift during the quarter to more First Connect premium within that particular segment.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Got it. So it would be reasonable to think of that conversion rate maybe continue to track a bit lower use of the mix shift?

Stewart Andrew Ellis
CFO & Treasurer

I think that's right. I think First Connect, we see as continuing to grow quickly and over time, will become a larger share of the services segment. It is -- we're continuing, as Rick said, within the agency to add new consumer customers and to broaden the share of wallet, if you will, by selling policies more than one policy to consumers through the cross-sell efforts. But First Connect is growing really quickly. And I think you'll see a slow mix shift towards First Connect as it continues to grow.

Richard Lyn McCathron
President, CEO & Director

I will add, this is Rick. I will add, Yaron, over time, as we continue to reopen geographies for our Hippo home insurance program when we acquire customers for that program, we don't always place them with Hippo. We look for the best policy to meet the needs of that particular customer. Therefore, we will continue to grow third-party policies in our agency or our services business that is not part of the First Connect platform over time as we get into the second half of the year. So I would keep that in mind as well.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Okay. That's helpful. And last question for me. In HHIP, we saw the attritional loss ratio improved by a point. I think there's a lot going on underneath that though. You have mix shift away from cat-exposed business, which I would think would drive the attritional loss ratio higher. It seems I have the rate impact and maybe other underwriting actions. Can you maybe help us sort through that, maybe offer some way points in terms of the puts and takes there? What was the good guy? What was the bad guy by what magnitude, just so we have maybe a better sense of what is truly going on under that improvement in the loss ratio?

Stewart Andrew Ellis
CFO & Treasurer

Yes, Yaron, I can take that. I think you're absolutely right that on a like-for-like basis, the attritional loss ratio or the non-PTS loss ratio improved more substantially than 1 point year-over-year. But we do -- as you said, we do have a mix shift away from higher cat geographies within the portfolio. So all things being equal, lowering the amount of premium in the book that is related to higher volatility, weather should see an increase in the attritional loss ratio, just for mix reasons alone. And the fact that we are improving attritional loss ratio despite that headwind on the mix is a testament to the rate that we have earned.

And we've been talking about high 20s and low 30s that we've been able to achieve on a written basis over the past few quarters, and we're starting to see some of that benefit on the earned, which is helping. And we have had in the quarter that we did have some non-weather water issues that contributed to some of the losses there. But I think there -- the variation there is within kind of the normal parameters.

I don't know that I can quantify on this call because I don't think we've really spoken at this level of detail about the puts and takes, but the things that you're highlighting are real. I do think that we will see additional improvements over the course of the rest of the year as we look quarter -- or sorry, year-over-year. We'll continue to see the improving trends on both the PCS and the non-PCS loss ratio.

So yes, the trends there are positive. They're masked a bit by the mix, but especially as we get through project volatility, which is our effort internally to lower our exposure to higher TAD areas. This mix shift effect will come into the background or will fade away, and you'll start to see more substantial improvement in attritional loss as we get toward the end of the year and into 2021.

Richard Lyn McCathron
President, CEO & Director

Yes, Yaron, this is Rick. I just want to emphasize -- thanks for that, Yaron. I just want to emphasize something that Stewart said. We -- although we've been able to keep the attritional loss ratio despite that mix shift relatively flat. And that's a difficult balance to achieve when you're writing less business at higher premiums in cat-exposed areas while the additional premium works itself into the business.

I just want to emphasize that our attritional loss ratio is not where we expect it to be at end of year. We're continuing not only will that mix shift start to fade, as Stewart mentioned, we are continuing our efforts and earning in additional rate and taking other positive actions from an underwriting perspective that we expect that to also improve throughout the end of the year. We're not even close to being done with that improvement.

Operator

We now have our second question coming from Thomas McJoynt of KBW.

Thomas Patrick McJoynt-Griffith
Keefe, Bruyette, & Woods, Inc., Research Division

So you did disclose that the rate increase on a written basis has come in at 33% year-over-year. How far along would you say that you are kind of -- is that 33% relative to what you think that you need over time? And then putting that in the context of the HHIP

program, we've seen the TGP in that business continue to fall for a number of quarters now. Where do you kind of see the trough level of that business kind of falling during the year? It sounds like it's going to hit an inflection point perhaps at the start of next year, but I just kind of wonder where the trough is this year.

Richard Lyn McCathron
President, CEO & Director

Yes. Tommy, this is Rick. I'll go ahead and start and then Stewart can add in on this one. A couple of different things. First, I'll answer your second question first. I think I mentioned this at the end of the earnings call last quarter, we started our, what we call project volatility, which is the cooling or improvement of the existing HHIP business, approximately October of last year. We take the actions at renewals of policies, and we would expect those efforts to be done approximately October of 2024.

And as such, the growth that we get from the non-existing portfolio, the new business we're writing, both in the builder channel and other areas, that's when it will reverse itself. So I think towards the end of this year in Q4, that's when you're going to start seeing growth again in the HHIP channel.

Your first question with some exceptions and the exceptions being geographically or regulatorily based, we think that we have filed and approved the majority of the, what I would call, corrective rate actions to get us to price adequacy. Those need to work their way through the business. However, it's a process that never ends. So we continue to look at trends, both frequency and severity and inflation components, and we expect us to continue to take incremental rate as those trends dictate the need to do so over time. But in terms of what I would consider the heavy lift that's been done, and now it's just working itself into the book with a few geographical exceptions

Thomas Patrick McJoynt-Griffith
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. I appreciate the color there. Switching over, can you give us an overview of the capital and kind of capacity situation and perhaps breaking it down by how much unencumbered capital is currently a holding company? How much capital is at Spinnaker in terms of like what premium leverage that is supporting. Just kind of give us an overview of the capital.

Stewart Andrew Ellis
CFO & Treasurer

Tommy, this is Stuart. I can try to give you a little color. I don't think -- historically, we haven't gotten into the details here. But generally, we have the ability to move capital subject to some restrictions around the organization where we need it. And we always try to think about where can we put capital that will position us to earn the highest return on that capital in any given period.

And so we feel good about the places that we have capital in the broader kind of corporate organization. And we're feeling comfortable that we have the liquidity and the flexibility within our capital structure to be able to continue to invest aggressively in the business, and we're continuing to do that while we converge to adjusted EBITDA positive. So I think from a flexibility and a capital standpoint, I think we've got the flexibility that we need. And we're putting capital where we feel like we can earn the highest return.

Richard Lyn McCathron
President, CEO & Director

One thing I'll add, Tommy, is that from a Spinnaker perspective, our carrier or insurance as a service perspective, we believe it is well capitalized to continue to grow that business with very favorable BCAR score. So we feel very good about -- as Stewart mentioned, we feel very good about not only our flexibility, but our position to continue to invest and grow the business.

Thomas Patrick McJoynt-Griffith
Keefe, Bruyette, & Woods, Inc., Research Division

And then just last one real quick. You gave the disclosure that the sort of the annual cat load breaks down into 41% of it coming through in the second quarter. Do you have what the typical mix is in the other quarters, first, third and fourth, perhaps it's a dynamic question just given the changing book of business, but if you could kind of help us out just with modeling that.

Stewart Andrew Ellis
CFO & Treasurer

Tom, I think I can take this one. We broke that down annually in our last shareholder letter in the guidance that we put out for the year. And let me just see if I can -- it looks -- yes, so, the guidance that we gave for the year, which we've kind of reiterated on this

call is around 29% in the first quarter, 41% in the second quarter, 19% in the third quarter and 11% in the fourth quarter. And that is a cat load that is a function of the geographic exposure of our policies and the nature of the weather that we are exposed to and reflects the changes that we're making during the year related to the exposure concentration in higher cat areas.

Richard Lyn McCathron
President, CEO & Director

Yes, Tommy, I would like to add a couple of things to this -- to Stewart's comment. So first of all, the weather doesn't really look at the calendar. So those numbers are based on historical averages and breakdowns and where we expect the portfolio to be going. I will emphasize that the work that we're doing in our project volatility, that's over a year's time, so October to October.

When we experience or if we experience earlier season events, that will have more of an impact on our portfolio than if the events get pushed later in the season because each month, we're making greater strides on reducing our exposure to volatility. So there is some variation there, but what we're -- what helps our portfolio is if this turns out to be a later season, Q2 as opposed to an earlier season Q2. We don't think it's dramatic, but there is some variation based on that.

Operator

[Operator Instructions] We have another question from Mr. Yaron Kinar from Jefferies.

Yaron Joseph Kinar
Jefferies LLC, Research Division

Just one quick follow-up, Rick, on your last comment on the timing of catastrophe losses. So just given where we are now kind of beginning of May, are you seeing -- I think we've already seen several larger convective storm for over the last couple of weeks. Where would you say we are relatively speaking on that kind of seasonality pattern? Are we early? Are we late? Are you kind of happy with the turn of events and the timing of the storms or a little bit concerned?

Richard Lyn McCathron
President, CEO & Director

Yes, that's -- Yaron, that's a really good question. So a couple of things. One, the more recent events that we've been seeing have been in areas generally, of course, they're widespread. But I think Oklahoma as an example, got hit relatively hard. We don't write business in Oklahoma. So I think where the events happen it does matter. I would say we're now in the, what I would consider traditional or historical second quarter. I think the -- some of the events that we saw in mid-March, I think it was around March 15, the PCS events in March 15, I would have considered that early. But right now, I think we're -- what I would consider, from a calendar perspective and a quarter perspective, we're in line with our expectations as of now.

Operator

We currently have no further questions.

Richard Lyn McCathron
President, CEO & Director

Great. Well, if there's no further questions, we appreciate everybody's time today, and we look forward to speaking with you next quarter. Have a great day.

Operator

Ladies and gentlemen, this concludes today's call. Thank you for joining. You may now disconnect your lines.

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