

Statkraft AS

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Statkraft AS

Major Rating Factors

Strengths:

- Strong market position as competitive low-cost generator of electricity.
- Prudent trading and hedging strategies.
- Ongoing support and potential extraordinary support from the Norwegian state as the sole shareholder.

Corporate Credit Rating

A-/Stable/A-2

Weaknesses:

- Exposure to competitive markets and volatile electricity prices.
- Weather-exposed generation profile because generation fleet is largely hydro based.
- Significant investment program, partly weighted toward high-risk markets.
- Aggressive dividend policy and a high effective tax rate.

Rationale

The ratings on Norwegian state-owned utility Statkraft AS, the third-largest Nordic power generator, reflect Standard & Poor's Ratings Services' assessment of the group's stand-alone credit profile (SACP) at 'bbb', which is based on a "strong" business risk profile and a "significant" financial risk profile. They further reflect our opinion that there is a "moderately high" likelihood that the Norwegian government would provide timely and sufficient extraordinary support in the event of financial distress. This results in the ratings benefiting from two notches of uplift from the SACP.

Statkraft's business risk profile is underpinned by the group's dominant market position in Norway and leading position in the Nordics, its competitive and flexible hydropower generation asset base, and its prudent strategy of selling forward its electricity generation output. These strengths, in combination with our expectation of continued steady electricity demand in the Nordics, are likely to support healthy profit margins over the foreseeable future, in our opinion. Moderating factors, in our view, include the inherent volatility of Statkraft's earnings generation as a result of its exposure to weather dependent hydropower, volatile wholesale power prices, and potential chronic oversupply of power in the Nordic region over the medium term, as well as a significant investment program that is partly weighted toward higher risk emerging markets.

The group's financial risk profile is primarily constrained by what we view as an aggressive dividend policy and our expectation of negative free operating cash flow (FOCF) in the next few years owing to a large investment program. These weaknesses are partly mitigated by our expectation of ongoing financial support from its 100%-owner, the Norwegian state, and strong financial flexibility through the 4.17% shareholding in E.ON AG (A/Negative/A-1). We also recognize that the group's investment plans are flexible, and that it could postpone growth-related investments during difficult times.

Statkraft is 100% state owned. We believe that there is a "moderately high" likelihood that the Norwegian government will provide timely and sufficient extraordinary support to Statkraft in the event of financial distress. This is based on our assessment of Statkraft's important role and strong link to the government.

S&P base-case operating scenario

In our base-case assessment, we anticipate that Statkraft's reported EBITDA will decline from the record Norwegian krone (NOK) 16 billion (€2.1 billion) achieved in 2010, to about NOK11 billion-NOK12 billion in 2011. The decline is primarily based on our expectation of lower achieved prices in the first and last quarters of 2011 compared with those in the corresponding periods of 2010. As is often the case, Nordic power prices were high in the first and fourth quarters of 2010, for example averaging €62 megawatt per hour (MWh) in the fourth quarter versus the spot price of about €40/MWh in the beginning of December 2011.

The lower prices in 2011 are primarily a result of milder weather, higher hydro reserves, better availability of nuclear base-load capacity, and pressure on carbon dioxide prices. These factors are likely to continue to pressure power prices in the near term. As hydro reservoir capacity has recovered and is currently above its long-term median level, we believe it is likely that Statkraft will generate normal hydropower volumes in the near term. We further believe that Statkraft's position as a flexible low-cost power producer will support solid profitability with an EBITDA margin in the 45%-50% range over the near to medium term.

Statkraft has embarked on an ambitious capital expenditure program where it aims to invest NOK70 billion-NOK80 billion between 2011 and 2015. Up to 50% of these investments are directed toward hydropower projects in emerging markets, mainly in Southeastern Europe, but also in Asia and South America (through its 60%-owned subsidiary SN Power [not rated]). Although these investments carry project risks, they are nevertheless partly mitigated by Statkraft's extensive use of local partners in the investment phase.

S&P base-case cash flow and capital-structure scenario

In 2011, we forecast that Statkraft will reach a Standard & Poor's-adjusted ratio of funds from operations (FFO) to debt of about 25%, which we regard as comfortably in line with the ratings. Underpinning this analysis is our assumption of adjusted FFO of about NOK9.0 billion and capital expenditures (including investments in associates) of NOK10 billion-NOK11 billion for 2011. We assume that reported debt will stay largely unchanged at about NOK40 billion compared with the level at year-end 2010.

For 2012 and onwards, we anticipate that Statkraft's large investment program, together with high dividend payments and pressure on Nordic power prices, will lead to large negative discretionary cash flows. We think this deficit is likely to be financed by additional debt because the government is unlikely to increase additional equity in the short term--although we do not exclude such an action over the medium to long term. As a result, debt could significantly increase over the next few years, although we think the magnitude would depend on Statkraft managing to fully execute its investment plan. Nevertheless, we expect the group will be able to maintain an adjusted FFO-to-debt ratio of between 18%-20% throughout the forecast period. This ratio, which has been revised from the previous 15%-20%, reflects the fact that we will start adjusting Statkraft's reported debt for surplus cash (see Financial Statistics/Analytical Adjustments section for more details).

Liquidity

The short-term rating is 'A-2'. We consider Statkraft's liquidity to be strong under our criteria, supported by our view that Statkraft's liquidity sources will exceed its funding needs by more than 1.5x in the next 24 months.

As of Sept. 30, 2011, we estimate Statkraft's liquidity sources to be in excess of NOK30 billion. These include:

- Cash balances of NOK15 billion. This amount is unusually high due to a NOK14 billion equity injection, which was from the government received in late 2010;

- An unused committed multicurrency facility of NOK12 billion maturing in 2016; and
- Annual FFO in excess of NOK8 billion.

We estimate Statkraft's liquidity needs over the next 12 months to be about NOK20 billion, including:

- Significant capital expenditures (including investment in associates) of more than NOK10 billion annually in the next three years;
- Dividends of about NOK5.5 billion-NOK6.0 billion annually, which are in line with the Norwegian government's aggressive dividend policy of 75%-100% of reported net profit; and
- Debt maturities of NOK4 billion.

Furthermore, financial flexibility is supported by the minority share in E.ON AG, which is listed on the Frankfurt stock exchange. At the beginning of December 2011, the stake was valued at about €1.5 billion (NOK11.4 billion) based on the E.ON share price.

Covenants attached to Statkraft's borrowing arrangements relate mainly to restrictions regarding indebtedness at material group subsidiaries and government ownership.

Outlook

The stable outlook reflects our expectation that Statkraft's financial risk profile will remain in line with our expectations for the ratings and that the group will actively manage its investment levels in order to protect its credit measures. Taking into account the ongoing support from the government, we consider a ratio of FFO to debt of 18%-20% to be consistent with the current ratings.

The ratings could come under pressure as a result of concerns over a gradual deterioration of Statkraft's business risk profile over the longer term, which could result from the group's significant investment program and the attached execution risks. In addition, we note that the program will be partly implemented in what we regard as high-risk countries.

We could also lower the ratings if a lengthy period of low electricity wholesale prices or poor hydro-availability resulted in a weaker-than-expected earnings performance, or if we see that the likelihood of government support is decreasing. The latter could result from a significant dilution of state ownership--a possibility that we view as unlikely, even over the long term.

Ratings upside could materialize if there is an unexpected change to the group's financial strategies and targets, which would include a focus on maintaining higher credit metrics than those currently factored into the ratings. We would consider a ratio of adjusted FFO to debt of more than 25% on a sustainable basis as commensurate with a higher stand-alone credit profile.

Business Description: Europe's Largest Renewable Energy Producer

With total installed capacity of 16,010 megawatts as of Dec. 31, 2010, Statkraft is the third-largest electricity generator in the Nordic region and the largest renewable energy producer in Europe. Statkraft owns and operates hydropower plants, mainly in Norway but also across the Nordic region. Statkraft is also expanding the proportion of gas-fired generated capacity, currently amounting to about 2,200 megawatts located in Norway and in Germany,

as well as making investments in wind power. Through its majority-owned venture, SN Power, Statkraft makes hydropower investments in emerging markets. Statkraft owns shares in several regional utilities in Norway, with downstream operations including electricity distribution, retail sales, and district heating.

The Norwegian government's ownership of Statkraft is managed by the Ministry of Trade and Industry. Restructured in 2004, Statkraft became a limited-liability company owning the majority of the group's assets and liabilities. The group's ultimate parent company, Statkraft SF (A-/Stable/A-2), maintains direct liability for all sovereign-guaranteed debt, and ownership of some Norwegian hydropower plants and one of Statkraft's overseas hydropower projects. Statkraft Energi AS (A-/Stable/A-2), 100% owned by Statkraft AS, is the core member in the Statkraft group, comprising the majority-owned Norwegian hydropower plants and the group's Nordic trading and wholesale operations.

Government support and GRE methodology impact

We believe that there is a "moderately high" likelihood that the Norwegian government will provide timely and sufficient extraordinary support to Statkraft in the event of financial distress. This is based on our assessment of Statkraft's:

- "Important" role, in light of its vast domestic hydropower resources, which we view as highly strategic to Norway's power supply. Another strategic objective for Statkraft is to secure and develop Norway's competencies within the renewable energy sector; and
- "Strong" link based on full state ownership and our belief that the risk of privatization is remote. Although Statkraft's board of directors is formally independent, and management is relatively autonomous, we believe the government retains a strong influence over high-level strategic decision making.

Any privatization of Statkraft would require parliamentary approval and would likely be a politically sensitive issue. Furthermore, in Norway, hydropower assets are subject to a legal requirement (hjemfallsretten) under which power plants that are more than one-third owned by private owners must be returned to the state at no cost after 60 years. Public owners such as Statkraft face no such limitations. The concession legislation restricts private ownership in publicly-owned power assets to no more than one-third, effectively preventing full privatization of Statkraft.

Government guarantee status has been abolished for liabilities incurred on or after Jan. 1, 2003. All remaining debt carrying state guarantees (NOK1.1 billion as of Sept. 30, 2011) resides within Statkraft SF. This debt is protected by a back-to-back lending arrangement between Statkraft SF and Statkraft, and ranks pari passu with Statkraft's other debt obligations.

Business Risk Profile: Strong; Hydropower Portfolio And Leading Market Positions Moderated By Volatile And Competitive Markets

Statkraft's "strong" business risk profile is underpinned by its:

- Highly competitive generation asset base. Statkraft's electricity generation mainly consists of low cost hydropower plants, representing 84% of electricity generation in 2010. In 2010, Statkraft's average production cost was NOK0.0712 per kilowatt hour (about €9/MWh). This, in combination with the flexible and zero-carbon emission profile of its significant hydropower assets, supports the ratings. We view the large number of hydropower stations and huge reservoirs as offsetting the weather-related risk (low precipitation) of hydropower

production. Although we view gas-fired generation as carrying higher business risk than hydropower, Statkraft's gas-fired generation plants are largely regarded as modern and efficient. We expect the group's proportion of gas-fired generation to decrease slightly over the medium term because investments will primarily be directed toward hydropower and wind parks.

- Dominant domestic market position in Norway and leading position in the Nordic region as the third-largest electricity generator. Statkraft is also Europe's largest renewable power generator, and it compares favorably with rated peers that have more carbon-intensive generation portfolios. Statkraft's business risk profile is underpinned by the economically stable and developed Nordic market, which is characterized by high per capita electricity demand.
- Prudent strategy of selling forward its electricity generation output. Statkraft systematically sells forward the bulk of its projected near-term output, either through long-term contracts with industrial clients or through hedging arrangements. This reduces near-term earnings volatility. The main offtake market for Statkraft's electricity hedging is the Nord Pool power exchange.

These strengths are partly offset by Statkraft's:

- Exposure to competitive and volatile wholesale electricity markets. Statkraft operates in the fully deregulated Nordic electricity market and the continental European electricity and gas wholesale markets. Although the group's consistent use of hedging instruments should offer protection against near- and medium-term price fluctuations, a prolonged period of low power prices or poor hydrological conditions could have a significant impact on Statkraft's earnings performance.
- Significant investment program, partly directed toward higher-risk countries and including project-related risks. We believe Statkraft will upsize its investment spending over the coming five years. We also believe a greater part of this investment will be directed into renewable energy sources, including hydropower and on/offshore wind parks. Furthermore, we believe that a majority of investments will be executed outside Norway: Statkraft is likely to pursue an international growth strategy, primarily targeting hydropower investments in Southeastern Europe, as well as in certain emerging markets outside of Europe, through the majority-owned SN Power AS.

Financial Risk Profile: Significant; Aggressive Dividend Policy And Weakening Credit Metrics Partly Offset By Financial Flexibility And Ongoing Owner Support

The main weaknesses of Statkraft's "significant" financial risk profile are:

- An aggressive dividend policy. We view the current dividend requirements on Statkraft, defined by the government as 75%-100% of reported net profit, as aggressive. This policy continues to constrain the ratings in our opinion.
- Cash flow-based debt protection that is somewhat volatile. Furthermore, this has periodically been weak following significant swings in power prices. Historically, this effect has been amplified by low-price statutory sales contracts whereby Statkraft sold power to companies at a price close to the production cost.
- Our expectations of negative FOCF in the next few years. This is due to the group's aggressive investment program.

These weaknesses are offset by:

- Strong financial flexibility. We view the 4.17% holding in E.ON AG, received by Statkraft under a swap

agreement, as a financial investment that could be divested in the event of financial distress. This stake is valued at around NOK11 billion and could we believe be sold with relative ease on the stock markets.

- Evidence of ongoing support from the Norwegian government. We believe that the NOK14 billion capital injection by the Norwegian government helped Statkraft to implement an augmented investment program without damaging the latter's financial risk profile. This, in our view, supports the group's credit risk profile.
- Flexible capital spending. We believe that Statkraft has the willingness and ability to adjust its growth-related capital expenditure budget according to demand. We understand that expansionary investments occur only if economically justified. For this reason, we assume lower spending and more conservative management of cash flow during difficult times.

Financial Statistics/Adjustments

Statkraft adopted International Financial Reporting Standards on Jan. 1, 2007. We make a number of analytical adjustments to Statkraft's accounts (see table 1) of which the more notable include the addition of post-retirement obligations, capitalization of operating leases, and the reversal of unrealized changes in the value of energy contracts from operating income.

In addition, we will start adjusting Statkraft's reported debt for surplus cash, as we believe that the group will maintain a cash balance that could be partly used for reducing debt. We will however not deduct what we view as restricted cash, such as collateral for margin calls. We estimate that restricted cash normally is about NOK1.0 billion. If applied to the group's 2010 financial numbers, the surplus cash adjustment would have amounted to about NOK19 billion, which is unusually high owing to the NOK14 billion capital injection in December 2010. Consequently, the ratio of adjusted FFO to debt would have been about 58%, which we however think is unrepresentative of the group's likely future credit measures.

Table 1

Reconciliation Of Statkraft AS Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. NOK)								
--Fiscal year ended Dec. 31, 2010--								
Statkraft AS reported amounts								
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	40,486.0	68,018.0	15,956.0	12,751.0	1,607.0	13,577.0	13,577.0	2,852.0
Standard & Poor's adjustments								
Operating leases	980.7	--	48.1	48.1	48.1	59.4	59.4	271.2
Postretirement benefit obligations	1,501.0	--	(243.0)	(243.0)	55.0	(53.0)	(53.0)	--
Capitalized interest	--	--	--	--	9.0	(9.0)	(9.0)	(9.0)
Reclassification of nonoperating income (expenses)	--	--	--	2,057.0	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	497.0	--
Minority interests	--	7,284.0	--	--	--	--	--	--
EBITDA*	--	--	(586.0)	(586.0)	--	--	--	--
D&A (impairments)	--	--	--	661.0	--	--	--	--

Table 1

Reconciliation Of Statkraft AS Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. NOK) (cont.)								
Total adjustments	2,481.7	7,284.0	(780.9)	1,937.1	112.1	(2.6)	494.4	262.2
Standard & Poor's adjusted amounts								
	Debt	Equity	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	42,967.7	75,302.0	15,175.1	14,688.1	1,719.1	13,574.4	14,071.4	3,114.2

*Gain on sale of assets and unrealized changes in value of energy contracts. NOK--Norwegian krone.

Table 2

Statkraft AS -- Peer Comparison						
	Statkraft AS*	EnBW Energie Baden-Wuerttemberg AG	Fortum Oyj	Vattenfall AB	Verbund AG	
Rating as of Dec. 16, 2011	A-/Stable/A-2	A-/Stable/A-2	A/Negative/A-1	A-/Stable/A-2	A-/Stable/--	
Stand-alone credit profile	bbb	bbb+	a-	bbb+	bbb+	
Business risk profile	Strong	Strong	Strong	Strong	Strong	
Financial risk profile	Significant	Significant	Intermediate	Significant	Significant	
GRE qualifier	Moderately high	Moderate	Moderate	Moderate	Moderate	
Installed capacity end-2010 (GW)	16.0	15.5	14.1	39.8	8.6	
Electricity production 2010 (TWh)	57.4	66.7	69.8	172.5	31.1	
Of which hydro (%)	87	11	32	21	86	
Of which nuclear (%)	0	51	32	25	0	
Of which renewables (%)	1	0	0	2	0	
Of which thermal (%)	11	35	37	52	14	
Gas sales 2010 (TWh; excl. trading)	N/A	54	N/A	64	N/A	
Heat sales 2010 (TWh)	1.1	5.3	26.1	44.5	N/A	
Regulated income 2010 (% of EBIT)	4	25	17	16	5	
--Fiscal year ended Dec. 31, 2010--						
(Mil. €)						
Revenues	3,750.0	18,406.2	6,296.0	23,682.8	3,307.9	
EBITDA	1,945.2	2,855.5	2,408.4	6,592.7	1,085.9	
Net income from cont. oper.	909.4	1,170.5	1,300.0	1,441.2	400.8	
Funds from operations (FFO)	1,803.6	2,297.1	1,388.0	4,392.0	788.0	
Capital expenditures	404.8	1,496.0	1,193.9	4,415.7	661.2	
Free operating cash flow	1,335.1	841.6	232.2	100.8	118.3	
Cash dividends paid	1,020.9	419.2	888.0	616.8	455.3	
Discretionary cash flow	314.2	422.4	(655.8)	(516.0)	(337.0)	
Debt	5,508.1	8,655.7	8,349.2	19,895.2	4,365.8	
Equity	9,653.1	7,509.5	8,689.5	15,164.1	4,782.2	
Adjusted ratios						
EBITDA margin (%)	51.9	15.5	38.3	27.8	32.8	
EBIT interest coverage (x)	8.5	2.4	7.3	4.1	3.4	

Table 2

Statkraft AS -- Peer Comparison (cont.)					
EBITDA interest coverage (x)	8.8	3.1	8.8	6.0	4.0
Return on capital (%)	11.8	12.0	10.9	10.8	10.4
FFO/debt (%)	32.7	26.5	16.6	22.1	18.0
FFO/Debt (%) Expectation	18-20	20	25	20	20
Net cash flow / capex (%)	196.1	125.5	41.9	86.7	50.3
Free operating cash flow/debt (%)	24.3	9.7	2.8	0.8	2.7
Common dividend payout ratio (un-adj.) (%)	112.3	31.9	68.3	50.0	47.7
Debt/EBITDA (x)	2.8	3.0	3.5	3.0	4.0
Total debt/debt plus equity (%)	36.3	53.5	49.0	56.7	47.7

N/A--Not applicable. N.A.--Not available. *Debt not adjusted for surplus cash. †2009 generation. ‡Including renewables.

Table 3

Statkraft AS -- Financial Summary*					
--Fiscal year ended Dec. 31--					
	2010	2009	2008	2007	2006
Rating history	A-/Stable/A-2	A-/Negative/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2
(Mil. NOK)					
Revenues	29,253.0	25,675.0	25,061.0	17,600.0	16,054.0
EBITDA	15,175.1	12,678.9	13,965.3	9,673.3	11,270.5
EBIT	14,688.1	12,708.9	13,826.3	10,986.3	12,022.5
Interest Expense	1,719.1	2,340.9	2,339.3	1,817.3	1,372.5
Net income from continuing operations	7,094.0	7,532.0	33,012.0	6,466.0	7,348.0
Funds from operations (FFO)	14,071.4	8,631.6	14,602.2	6,969.7	8,474.1
Capital expenditures	3,114.2	3,815.4	2,207.4	1,902.0	3,611.3
Free operating cash flow	10,460.2	5,721.2	9,275.7	5,745.7	2,936.8
Dividends paid	7,964.0	10,260.0	8,396.0	7,895.0	4,990.0
Discretionary cash flow	2,496.2	(4,538.8)	879.7	(2,149.3)	(2,053.2)
Debt	42,967.7	47,933.8	43,205.0	38,934.8	33,607.2
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	75,302.0	64,901.0	72,324.0	44,380.0	44,565.0
Debt and equity	118,269.7	112,834.8	115,529.0	83,314.8	78,172.2
Adjusted ratios					
EBITDA margin (%)	51.9	49.4	55.7	55.0	70.2
EBIT interest coverage (x)	8.5	5.4	5.9	6.0	8.8
FFO int. cov. (x)	9.1	4.4	7.2	4.8	7.1
FFO/debt (%)	32.7	18.0	33.8	17.9	25.2
Discretionary cash flow/debt (%)	5.8	(9.5)	2.0	(5.5)	(6.1)
Net Cash Flow / Capex (%)	196.1	(42.7)	281.1	(48.6)	96.5
Debt/EBITDA (x)	2.8	3.8	3.1	4.0	3.0
Debt/debt and equity (%)	36.3	42.5	37.4	46.7	43.0
Return on capital (%)	11.8	10.5	13.1	12.5	14.7

Table 3

Statkraft AS -- Financial Summary* (cont.)					
Return on common equity (%)	11.3	11.8	59.4	15.3	18.7
Common dividend payout ratio (un-adj.) (%)	112.3	98.5	30.3	105.7	76.2

*Debt not adjusted for surplus cash. NOK--Norwegian krone.

Ratings Detail (As Of December 16, 2011)	
Statkraft AS	
Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured (11 Issues)	A-
Corporate Credit Ratings History	
30-Nov-2010	A-/Stable/A-2
22-Oct-2009	A-/Negative/A-2
30-Jun-2009	BBB+/Watch Pos/A-2
Business Risk Profile	
	Strong
Financial Risk Profile	
	Significant
Debt Maturities	
(as of Sept. 30, 2011)	
2011: NOK1,353 mil. (of which NOK653 mil. relates to loans raised at Statkraft SF)	
2012: NOK3,201 mil.	
2013: NOK3,888 mil.	
2014: NOK4,125 mil.	
2015: and beyond: NOK23,331 mil. (of which NOK400 mil. relates to loans raised at Statkraft SF)	
Related Entities	
Statkraft Energi AS	
Issuer Credit Rating	A-/Stable/A-2
Statkraft SF	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured (2 Issues)	A-

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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