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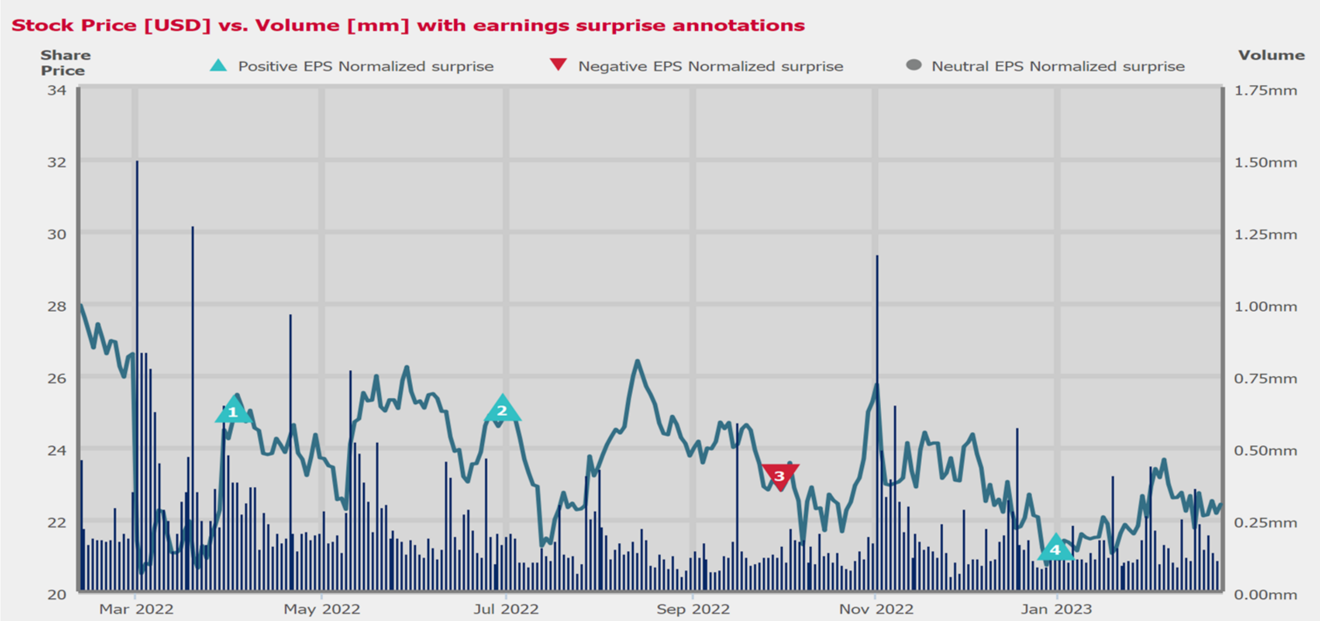
James River Group Holdings, Ltd.
NasdaqGS:JRVR
FQ4 2022 Earnings Call Transcripts

Tuesday, February 28, 2023 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2022-			-FQ1 2023-	-FY 2022-			-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.52	0.53	▲1.92	0.58	1.81	1.85	▲2.21	2.50
Revenue (mm)	212.47	225.71	▲6.23	212.30	800.46	813.70	▲1.65	862.45

Currency: USD
Consensus as of Feb-28-2023 2:15 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2022	0.26	0.37	▲42.31 %
FQ2 2022	0.50	0.52	▲4.00 %
FQ3 2022	0.45	0.41	▼(8.89 %)
FQ4 2022	0.52	0.53	▲1.92 %

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Table of Contents

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Presentation

Operator

Thank you for standing by, and welcome to the James River Group Fourth Quarter 2022 Conference Call. [Operator Instructions] I would now like to turn the conference over to Brett Shirreffs, Head of Investor Relations. Mr. Shirreffs, please go ahead.

Brett Shirreffs
Senior VP of Finance, Investments & Head of Investor Relations

Good morning, everyone, and welcome to the James River Group Fourth Quarter 2022 Earnings Conference Call. During the call, we will be making forward-looking statements. These statements are based on current beliefs, intentions, expectations and assumptions that are subject to various risks and uncertainties, which may cause actual results to differ materially. For a discussion of such risks and uncertainties, please see the cautionary language regarding forward-looking statements in yesterday's earnings release and the risk factors of our most recent Form 10-K and Form 10-Qs and other reports and filings we have made with the Securities and Exchange Commission.

We do not undertake any duty to update any forward-looking statements. In addition, during this presentation, we may reference non-GAAP financial measures such as adjusted net operating income and adjusted net operating return on tangible common equity. Please refer to our earnings press release for a reconciliation of these GAAP -- numbers to GAAP.

Lastly, unless otherwise specified for the reasons described in our earnings press release, all underwriting performance ratios referred to are our business that is not subject to retroactive reinsurance accounting for loss portfolio transfers.

I will now turn the call over to Frank D'Orazio, Chief Executive Officer of James River Group.

Frank N. D’Orazio
CEO & Director

Thank you for that introduction, Brett. Good morning, and welcome to everyone on the call. I'm pleased to be joining you today to provide additional color on our fourth quarter and full year 2022 results, while also offering commentary on market conditions as well as our company's continued repositioning for the future. As evidenced by the results we released last night, this was a very strong quarter for James River across a number of financial metrics in a year in which we demonstrated the meaningful progress that we've made as an organization.

We are now 2 years into what has been a significant turnaround at James River. We've repaired the balance sheet, returned to profitability and are now actively repositioning the organization around its core strengths, while continuing to gain scale in our insurance operations.

Before drilling down into each segment's performance, I'd like to take a few moments to share some of the highlights of our achievements over the past 12 months. For the full year 2022, we produced a combined ratio of 93.5% and underwriting income of $49.6 million, a record for the company. The combined ratio represents our best underwriting performance since 2014 and our first sub-100 combined ratio since 2018. We continue to focus on growing our most profitable segments and in E&S we achieved a 10.5% gross premium growth rate and 17.5% net premium growth for the full year, while also approaching $1 billion in written premiums for the segment.

Our core E&S business has now increased over 70% since year-end 2019. Additionally, we grew our investment income 25% to $71 million in 2022 and reported our highest ever quarterly investment income total during the fourth quarter. When taken in concert, the sum of these accomplishments resulted in an adjusted net operating return on average tangible common equity of 17.4% for 2022 and 23.5% annualized for the fourth quarter, simply outstanding results that directly support the narrative that our strategic actions over the last 2 years would unburden the earnings power of the organization.

Beyond the financial metrics that I've shared with you, we continue to take the necessary actions to make James River an even better company. And our progress is notable whether pointing to investments in actuarial resources, employee engagement, enterprise risk management, technology or underwriting oversight. Responding to shareholder feedback, we have also made a number of positive governance changes that have resonated well with investors.

These initiatives have all been aimed at creating shareholder value while driving new levels of engagement and ownership throughout our organization and shareholder base. Now turning more specifically to market conditions and our progress in each of our segments.

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In our E&S segment, during the fourth quarter, the platform increased gross premiums by 11.3% and 20.5% on a net basis. I believe we are carrying tremendous momentum to the first quarter as we have now experienced 24 consecutive quarters of positive rate increases, compounding to 64.2% over that period.

The environment remains very robust with renewal rates up 6.5% during the fourth quarter and up nearly 10% for all of 2022, remaining in excess of our view of loss cost trend and our own expectations for the year. While our composite effective rate change data will vary from quarter-to-quarter, our firm belief is that underwriting conditions will continue to remain quite favorable throughout 2023 and quite possibly longer. And although we have had a limited sample size for the new year, thus far, I'm pleased that we have seen renewal rate increases, in line with what we accomplished over the full year of 2022.

In terms of submission activity, we continue to experience steady growth in renewal submissions where we maintain a high conversion ratio on the business that we know the best, helping us to continue to increase our policy count growth in our targeted SME business classes where average premiums are approximately $24,000 per policy. The combination of these factors aided the segment in generating $23 million in underwriting income for the fourth quarter.

For the full year, the E&S platform produced an 85.1% combined ratio and $83 million of underwriting income, the highest level of underwriting income for the segment in the company's history and all told, an excellent year for our E&S platform. Moving to Specialty Admitted. This segment also contributed favorably for the quarter, producing an 86.8% combined ratio, while growing the nonworkers' compensation business by 7.5%. Overall, this segment was able to achieve modest premium growth despite a combined 8% reduction of premium in our individual risk workers' compensation business and workers' compensation focused program.

For the full year, the combined ratio was 94.3%, and we grew fee income by 4.3%. As we've reported for the last several years, the workers' compensation market remains very competitive. We have proactively reduced our new and renewal premium production for this line of business as our team remains disciplined and also diligently reflecting the rate declines in our accident year loss ratios. We again experienced favorable development in this segment, largely driven by the 2017 and 2018 accident years. We have also continued to grow the breadth and depth of our fronting and program business. So we have added new programs during 2022 and see a healthy pipeline of new opportunities as we look forward.

Turning to the Casualty Reinsurance segment. For the fourth quarter, gross written premiums declined by 76.8% and for the full year, premium declined by $97 million or 53.2%. This reduction in written premium directly aligns with our previously announced plans to significantly shrink top line writings for the segment in 2022. During the fourth quarter, we also experienced an unexpected increase in claims activity, both on treaty subject to the Fortitude Re loss portfolio transfer as well as select treaties not subject to the Legacy transaction.

Development on treaties subject to the LPT totaled $6.1 million and was driven primarily by construction defect claims on treaties underwritten in 2012 to 2015. The $6.1 million was fully covered by the limit we purchased in the LPT. Reserve development on treaties not subject to the LPT totaled $6.6 million during the fourth quarter, driven primarily by general liability losses and 1 large liquor liability claim from treaties underwritten between 2015 and 2020, including 2 separate clash losses that impacted the portfolio.

Historically, clash losses have been rare occurrences in this segment, and we do not necessarily view this development as an indication of broader trends related to the business. As a result of this claims activity, the segment recorded a combined ratio for the fourth quarter of 107.9%. As I have stated previously, we are a bottom line-focused organization, and we'll continue to deploy our capital where we have the most confidence in generating consistent profitability and attractive returns for shareholders.

Since my arrival at James River, I believe we have repeatedly demonstrated this commitment through the targeted underwriting actions that we took earlier in the year in our E&S segment as well as the reductions in workers' compensation that I alluded to in our Specialty Admitted platform, and most notably, the decision that we made to drastically reduce our casualty reinsurance writings in 2022. All of these actions have impacted our top line results, but we believe they will lead to stronger future profitability and less prospective volatility.

Prudent portfolio management is a continuous process, irrespective of market conditions or prior profitability. In keeping with that theme, we have decided to suspend writing business in our Casualty Reinsurance segment, as we allocate our capital to the areas where we believe we have meaningful scale and can drive better, higher returns for the organization and for our shareholders.

To summarize, I believe our fourth quarter and full year 2022 results represent a major step forward, demonstrating the strength and earnings potential of our franchise and underwriting culture. I'm very pleased with our performance and execution on strategic initiatives throughout 2022 and feel we have now repositioned the company around our core strengths. I'm confident in the strength of the E&S market and fee income opportunities presented by the fronting marketplace and feel we are well positioned to capture value and deliver very compelling returns to shareholders as we focus our capital and resources on these attractive markets.

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And with that, let me turn the call over to Sarah.

Sarah Casey Doran
Chief Financial Officer

Thanks very much, Frank, and good morning to everyone. Thanks for joining us today. James River is reporting another solid quarter, a continuation of our powerful momentum all year. This year concluded with fourth quarter adjusted net operating income of $0.53 per share for an annualized net operating return on tangible common equity of 23.5%. Tangible book value per common share increased 8.5% in the quarter to $9.51, carrying strong momentum into 2023. As Frank highlighted, we've made appreciable progress in moving the organization forward and believe the group is executing at a very high level. I'm going to spend a minute on an overview of the performance of the quarter and the year and also provide some commentary around our outlook for 2023.

First, the quarter and the year. We are delivering $20.2 million of adjusted net operating income this quarter, which includes $16.6 million of underwriting profit and $22.8 million of net investment income each on a pretax basis. For the full year, adjusted net operating return on tangible common equity was 17.4%, not only a significant improvement from the last few years, but the highest for the company's history in an annual period. Our competitive expense ratio of 23.9% for the quarter continues to be a meaningful advantage we enjoy as compared to our peers and the sector generally.

Our expense ratio for the quarter and year are higher from a year ago for 2 primary reasons. First, last year, we had a meaningful offset from sliding scale commissions in our Casualty Reinsurance segment, and second, we reduced incentive compensation expenses given the company's performance last year. Taken together, these items reduced last year's annual group expense ratio by about 2.5 points. As mentioned earlier, investment income was $22.8 million this quarter. It grew 32% from the sequential quarter and 88% from the prior year quarter. Reinvestment rates moved higher with interest rates. We've had strong cash flow and we also benefited from the opportunistic sale of a portion of the renewable energy portfolio.

Approximately $1 million of our net investment income is related to the sale of 2 of our renewable energy investments above carrying value. Cash flow from operations continued to be very strong at $54 million this quarter and about $222 million for the full year. This is by far our strongest annual operating cash flow figure since 2019. Reinvestment yields in the core fixed income portfolio averaged 5.3% during the quarter, although they've moved back a bit to 4.75% quarter so far this year.

The combination of our growing base of invested assets, natural portfolio turnover in a rising rate environment and exposure to floating rate assets positions us well to continue to deliver an increasing level of net investment income.

Next, I wanted to speak a little bit about 2023. We believe we're well positioned to drive a mid-teen return on tangible common equity, excluding AOCI. We expect to continue to benefit from robust conditions in the E&S market, in particular, which should drive profitable growth for that segment.

We expect similar conditions for the fronting business within Specialty Admitted. As Frank mentioned, we're suspending underwriting activities in the Casualty Reinsurance segment, but given the nature of the business, we still expect to earn about half as much premium as we did during 2022. We expect the accident year combined ratio in this segment to break even or make a small profit. And our team in Bermuda is fairly lean, so we do not expect much in the way of expense savings from the move to suspend underwriting operations due to the support needed to manage the liabilities going forward.

Overall, we see opportunities that will enable us to grow our total gross premium written during the year despite the suspension of underwriting activities in 1 segment. And moving on to our group expense ratio, we expect it to be closer to 28% in 2023 due to our business mix and our change in retention strategy, as we've mentioned. As we mentioned for the past few quarters, we've increased our underwriting retention in E&S in particular, given our desire to keep more of our underwriting profit. This has had the impact of reducing the ceding commitment we received as seen in the E&S segment expense ratio, which is up about 2.5 points from the prior quarter.

We firmly believe that this change in retention strategy will yield higher benefits in the years ahead. And finally, with regard to 2023, we expect our tax rate to approximate the U.S. statutory rate of 21%. The results we produced this year across our operations were achieved through a thoughtful and deliberate execution of our prudent underwriting strategy, by allocating capital to the most profitable businesses where we have a scale advantage and by focused expense and risk management.
We're off to a great start in 2023 and continue to see very attractive opportunities to invest and scale our company. And so with that, let me turn it back to the moderator to open the line for questions.

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Question and Answer

Operator

[Operator Instructions] Mark Hughes with Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Sarah, your guidance of mid-teen return on tangible in your fourth quarter, I think it was 23.5%, full year, 17%, these mid-teens. Does that reflect some different view on the market? You seem to be pretty upbeat. Is that -- should we think of that as the low end of the range?

Sarah Casey Doran
Chief Financial Officer

No. I called out, Mark, that, that excludes AOCI. So our full year numbers obviously wouldn't be inclusive of AOCI. I'm trying to back that out to make it a little bit more easy to follow. So I think on one hand, it's a fairly down the middle assumption with regard to guidance, but also I would point out that the delta between those numbers is the inclusion and the exclusion of AOCI.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Okay. Good. Thank you for that clarification. Frank, the different lines that you may think look good at this point. I don't think you've mentioned any specifics, but I'm sort of curious your thoughts on the property market, whether that's something you might lean into here and also how Excess is looking these days?

Frank N. D’Orazio
CEO & Director

Sure. So it's never -- as you know, Mark, it's never been our ambition to be a major property cat player, and I would suggest that the weather-related cat losses in the last couple of years, probably not tempting us to change our risk appetite, all that much. So it is our Excess property cat portfolio is about 6% of our E&S portfolio. I don't see major changes there. I mean just even looking at how that business has kind of moved just year-over-year, fairly similar in terms of average attachment point and gross limit. We are seeing significant rate there. But again, we are focused as an organization on consistency in earnings and not necessarily tempted by the volatility that, that line of business presents. More broadly, though, just in terms of the quarter, we saw healthy growth opportunities across, I would say, most of our E&S platform during the fourth quarter. The majority of the underwriting divisions reported solid growth, positive renewal rate changes, continue to see strong growth in renewal submissions as much as, I think, up 8% in the quarter.

We'd expect to continue to see these trends well into 2023. But in terms of your question relative to underwriting divisions, I think we saw double-digit premium increases from Excess Casualty and healthy rate there as well as general casualty, and again, both double-digit premium increases during the fourth quarter. And I don't really think we've seen any significant changes in the opportunity set for our E&S business. I noted some of the discrete actions that we took last quarter on the portfolio, which impacted our growth results in the third quarter. But as I look back at our results for all of 2022, what I see is very healthy growth across the overall portfolio.

Operator

Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Frank, just quickly, and Sarah, on the decision to cease underwriting on the casualty reinsurance. Any thoughts of maybe actually going out and finding an ADC on that book or some type of a LPT? Just to make sure we don't see any more noise going forward just from the runoff because I know a lot of times when things go in to run off, you get adverse development.

Frank N. D’Orazio
CEO & Director

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Yes. So right now, we are primarily focused on servicing the in-force portfolio, meeting our regulatory requirements, keeping the staff and infrastructure in place, I think we're confident in our reserve position overall but always open to options consider to bolster our balance sheet if they present themselves.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then, sorry, I just wanted to clarify, did you say that the expense ratio in the casualty reinsurance business should be relatively flat on a year-over-year basis or total expenses?

Sarah Casey Doran
Chief Financial Officer

I said total expenses. So the expense ratio will be up slightly, Brian, to get to the 28% overall.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. Okay. That's helpful. And then lastly, Frank, I am wondering if you could just comment a little bit more on kind of where is pricing relative to loss trends in the E&S business? I know you don't write a whole lot of professional liability business, which is 1 area where I know we're seeing pressure, particularly on the D&O side. Are there other areas that maybe you're seeing some pressure on?

Frank N. D’Orazio
CEO & Director

We are still, I think, at a good place just relative to the rate environment. I mean, if you looked at our fourth quarter results and the rate we produce there, the positive rate, you may see a little bit of deceleration from the third quarter. But really, I think our history has proven that rates jump around for our E&S segment from quarter-to-quarter. So we like to look at it really at a couple of quarters at a time or on an annual basis. And so for the year, we produced 10% after producing 13%, both in '21 and '20. I think there's still a great opportunity to actually push rate. I know you mentioned seeing some lines of business where you're seeing some rate pressure. I mean I'm seeing really between the uncertainty relative to inflation, maybe some overhang from property cat losses and also a tightening reinsurance marketplace, which is broader than just property, certainly tied to some of the overhang of the last years of the soft market, I see opportunities to continue to push rate.

Now I do want to comment on our view just broadly speaking, relative to loss cost trend as we see it for the coming year. And we analyze and discuss loss trends on a quarterly basis, I think our actuaries do a good job of constantly analyzing rate movement and loss cost trends and the duration of our liabilities. Looking to the year ahead, we slightly raised our view of loss cost trend closer to a high single-digit viewpoint, which feels, again, prudent just given the uncertainty and the inflationary environment and the nature of our business.

You may recall that on the overall portfolio, we were closer to a mid-single-digit view of loss trend with some product lines coming in higher by as many as a couple of hundred basis points from the average of the portfolio. And that gap still exists, but out of caution and conservatism, we've moved up our view on the overall portfolio for the coming year. But to be clear, we've also slightly adjusted our view of exposure or premium trend. And we believe rate change continues to compare favorably to net trend or loss cost trend, less exposure trend, even after taking this more conservative view on loss costs.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. So we shouldn't expect underlying loss ratios and actually to moving up, they're kind of stable-ish given the exposures you're also getting to?

Frank N. D’Orazio
CEO & Director

No, that's about right.

Operator

Meyer Shields with KBW.

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

A couple of quick numbers questions, if I can. First, Sarah, you mentioned that we should expect maybe half of the level of Casualty Re earned premium in 2023. Is there anything material in 2024 or should we be done with the under premium overhang by then?

Sarah Casey Doran
Chief Financial Officer

Thanks, Meyer, for the question. I think there'll be a little bit in '24, but it's not going to be material relative to the balance of the total group top line.

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

Okay. That's helpful. And when you talk about a 28% expense ratio, that, that the corresponding number in 2022 was [25%], right? I just want to make sure I'm starting from the right side.

Sarah Casey Doran
Chief Financial Officer

That's correct. Yes, that's correct. With the biggest delta due to little bit less business in Casualty Re, right, earning through. But more so, the change in the retention strategy in E&S is what's causing the delta there, the biggest piece of it.

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

Okay. And then, I guess, a philosophical question on the reserves. I completely understand the unusual nature of the clash losses in the quarter. When you establish reserves at this point in time, is the goal to have it incorporate this sort of unusual items? Or when this happens, should we expect a little bit of adverse development periodically?

Frank N. D’Orazio
CEO & Director

Well, Meyer, let me first just start by kind of defining how odd this kind of scenario is. So they are rare. I think that's how I described them. They're not nonexistent, though. So I think in the history of writing reinsurance in this segment, I think you can count the amount of times that we've seen clash losses on 1, maybe 2 hands. And obviously, we had 2 in the quarter 1 coming out of the GL space and involve multiple insurers and then one, again, a liquor liability claim that involved multiple insureds in the cedings underlying business. So they're fairly rare, I would say, generally speaking, I don't think you're expecting the variety where you have as many as a handful of insureds involved in a single individual occurrence.

Operator

[Operator Instructions] Tracy Benguigui.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Just a few follow-up questions on questions already asked. So at inception, just a year ago, the Casualty Re LPT transaction represented the bulk, about $335 million but not the entire reserve balance of $450 million, and those are accident years 2011 to 2020. Can you share those reserve balances now? And can you frame what type of businesses are part of the casualty re reserves that are out of scope of your LPT and what that duration is of those liabilities.

Sarah Casey Doran
Chief Financial Officer

Sure. So thanks for the question, Tracy. When we put the LPT together, we did it in a very, very quick time line and wanted to focus on what we saw with the -- let's call it, the riskiest part of our portfolio where we could get it down to, I would say, a reasonably sized number of contracts. We've got over 400 contracts in the business, having been writing the business since 2008, 2009. So it's going to be impossible to really put the whole segment into any LPT with the way these work. So when we design this, we put the majority of the reserves in it. We also put the majority of our construction risk in it and are, again, kind of our longer tail trickier lines, so to speak.

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So that remains within that portfolio, which is why the losses that we've seen this quarter outside of the portfolio, the $6.6 million characterized by clash, i.e., bodily injury risks that didn't go into that portfolio. So that remains the case. So now we've moved from $335 million to $341 million of reserves with the additional $6.1 million that are in there. That still remains the bulk of our reserve balance in the portfolio. And again, would still have the majority of our construction and longer tail business in there. By definition, those reserves are going to be paid out over a slightly longer time frame than the rest of the reserve balance there. So we would expect that to be upwards of, let's call it, 3 to 5 years, perhaps as long as 7 years as well. So the tail is going to be a little bit longer there as well.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. Great. Last year, you were targeting a low double-digit ROE. This year your targeting mid-teen ROE. I'll just point out that your target expense ratio is up 3 points from how you ended the year. I'm wondering if you could share the contribution from that investment income under mid-teen ROE target.

Sarah Casey Doran
Chief Financial Officer

Yes. Well, we expect our NII this quarter to be pretty commensurate of how it would look over the '23 year absent that $1 million, let's call it, a gain that's rolling through NII. So if you take that out, I would think that would be a pretty reasonable run rate upwards of $20 million a quarter. So that's a good contributor there.

Operator

There are no further questions at this time. I now turn the call back over to the presenters for closing comments.

Frank N. D'Orazio
CEO & Director

Okay. I want to thank everyone listening on the call for their time today and for the questions we received this morning. I'd also like to acknowledge the employees of James River for a job well done in delivering our 2022 results. We look forward to speaking with you again in just a few months to discuss our Q1 results. Thank you and enjoy your day.

Operator
This concludes today's call. We thank you for your participation. Participants may now disconnect.

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