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Bakkt Holdings, Inc.

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Earnings Call

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Call Participants

EXECUTIVES

Andrew A. Main

President, CEO & Director

Karen J. Alexander

CFO & Principal Financial Officer

Olivia Keavey

Ray Kamrath

*Chief Commercial Officer of crypto
Business.*

ANALYSTS

Spencer Brolley James

Jefferies LLC, Research Division

Presentation

Operator

Greetings, and welcome to the Bakkt Second Quarter 2024 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I will now turn over to Olivia Keavey, Senior Lead of Communications at Bakkt.

Olivia Keavey

Good morning, and thank you for joining Bakkt's second quarter earnings call. Joining me on today's call are Andy Main, Bakkt's Chief Executive Officer; Ray Kamrath, Chief Commercial Officer for our crypto business; and Karen Alexander, Chief Financial Officer. Andy will provide a high level overview of Q2 results, the current crypto currency macro landscape and our operational progress during the quarter. Ray will provide an update on strategic initiatives and partnerships. And Karen will cover Bakkt's detailed financial results. After the prepared remarks, we will answer questions we received from our investors through the Stay Technologies platform and any questions from the analyst community.

As a reminder, today's earnings call includes a separate supplemental presentation that can be found at our Investor Relations website at www.investor.bakkt.com. During today's call, we may make certain forward-looking statements. These statements are based on management's current expectations and are subject to risks and uncertainties, which may cause actual results to differ materially from those expressed or implied in such forward-looking statements. For a more complete discussion on forward-looking statements and the risks and uncertainties related to Bakkt's business, please refer to its filings with the Securities and Exchange Commission.

Further, in addition to discussing results that are calculated in accordance with generally accepted accounting principles, we'll also make references to certain non-GAAP financial measures. For more detailed information on our non-GAAP financial disclosures, please refer to our earnings release, which can be found on our Investor Relations website. Thanks.

And I'll now turn the call over to Andy.

Andrew A. Main

President, CEO & Director

Thank you, Olivia, and good morning, everyone. Thank you for joining Bakkt's second quarter 2024 earnings call. It's great to speak to you all again. I'd like to start today by providing a high-level overview of our business performance, then dive into specific updates from our crypto and loyalty businesses. As we cover strategic initiatives and partnerships, I'm delighted that Ray Kamrath, our Chief Commercial Officer, is with us today. Ray is going to provide an update on some significant news for our crypto business.

Turning to Page 3 of our presentation, let's start with highlights of our Q2 financial performance. Q2 crypto and loyalty services revenue net of crypto costs and execution and clearing and brokerage fees was \$14.8 million, up approximately 9% from Q2 last year, but down 30% sequentially. Office \$14.8 million, \$12.8 million came from our loyalty business, which improved 4% year-over-year and decreased 3% sequentially. The remaining \$2 million was generated from crypto services revenue, which increased 35% year-over-year, but declined 46% sequentially. This was due to the downward trend in prices and notional crypto volume that followed the significant spike in March after the Bitcoin spot ETF approval, which had driven broader institutional interest.

OpEx, excluding crypto cost and execution and clearing and brokerage fees were \$36.8 million, down approximately 43% year-over-year and 25% sequentially as a result of our Q1 cost restructuring initiatives. Year-over-year, revenue growth and significantly lower costs improved our net loss by 30% year-over-year and our adjusted EBITDA loss by approximately 27% year-over-year.

Diving into our crypto business, let's start with our assets under custody. At the end of the second quarter, our assets under custody stood at \$975 million, down from \$1.233 billion at the end of Q1, but up significantly from \$660 million in the same quarter last year. This was driven by stronger trading volumes across the entire market, including our platform.

I'd also like to touch on some of the major changes in the regulatory landscape since our last call that we believe will provide tailwinds for our industry in the second half and beyond. On July 22, the SEC gave final approval for the spot Ethereum exchange traded funds or ETFs. This approval is yet another positive indication of the improving regulatory landscape and bipartisan support for our industry. Similar to the Bitcoin spot ETF earlier in the year, we believe approval of the ETH spot ETF provides further clarity and will likely act as another catalyst for continued mainstream adoption and investment going forward. With these regulatory advancements in mind, we remain extremely confident in our overall strategic direction to advance our institutional offerings and remain laser focused on scaling strategic partnerships, which I will cover next.

In terms of our crypto business operations, we continue to double down on our commitment to expand our institutional crypto business, and here's a few highlights. In June, BakktX, our electronic communications network, executed its first trade between Bakkt Crypto Solutions and DV Chain, the first of many new liquidity providers that we're working to add to the platform. This milestone demonstrates our ability to bring offers rapidly to market, and in this case, offering seamless, efficient crypto trading solutions.

Additionally, we recently announced that we significantly enhanced our BakktX institutional capabilities with a licensing agreement with Crossover Markets. This collaboration powers BakktX with Crossover's high-performance tech, providing institutional and professional traders with sub-10 microsecond matching latency, customizable and tailored liquidity streams and significantly lower trading costs than incumbent crypto brokers and exchanges. BakktX will be available to Bakkt's liquidity providers and a group of early adopters in the coming months. Users will benefit from Bakkt's prioritization of risk management, reliability and compliance alongside capital markets friendly workflows for digital assets trading. We will share more regarding the expected launch date in the very near future.

At the end of May, we appointed Ray Kamrath as Bakkt's Chief Commercial Officer for our crypto business. I'm now delighted to introduce you to Ray. Ray is a Wall Street veteran with 30 years of experience in capital markets where he served as Global Head of Foreign Exchange and Prime Brokerage at Jefferies and Managing Director in Foreign Exchange, Sales and Global Electronic Trading at Goldman Sachs. We are extremely delighted to have someone Ray's caliber to help us scale our crypto business.

With that, I'm happy to hand it over to Ray to share what we've accomplished recently in the market in terms of our strategic initiatives and partnerships.

Ray Kamrath

Chief Commercial Officer of crypto Business.

Thanks, Andy. Turning to Slide 4. As we've discussed in prior earnings calls, we are laser-focused on building the Bakkt ecosystem. I'm excited to share that we've continued to execute on that mission and are creating marketplace partnerships to make us stand out as an industry leader. This leadership is demonstrated by our prioritization of regulatory compliance at our comprehensive crypto solutions ecosystem.

For institutions, we're building out our solution, BakktX, and this is where I'd like to tell you about our significant news. To scale BakktX on August 11, we entered into a letter of intent with Hidden Road, signaling our mutual intent that Hidden Road will provide platform services, including real-time risk management and back office functionality to the forthcoming BakktX Electronic Communication Network, the ECN. Hidden Road is an important player in credit intermediation, providing prime brokerage and clearing solutions in FX, listed derivatives, OTC swaps, digital assets and soon fixed income. When agreed, we expect this will enhance our ability to minimize counterparty and credit risk for institutional clients using BakktX through Hidden Road's real-time risk management platform.

We believe that Bakkt partnering with Hidden Road and Crossover Markets is a winning combination. Our customers will benefit from Crossover's high-performance technology with sub-10 microsecond matching latency, high order throughput capability, customizable and tailored liquidity streams and low trading costs. This is matched with Hidden Road's enablement of a quicker, wider distribution channel for institutional market participants, while introducing new operational risk management and capital efficiencies. This is all powered by Bakkt's unwavering commitment to security and compliance as well as our deep network of liquidity relationships and understanding of institutional liquidity requirements in the digital asset marketplace. We are positioning ourselves as an ideal partner for institutions seeking a professional, high-performance trading venue.

On the client side, our relationship with partner Blockchain.com recently grew. Just this month, we expanded our services together into New York, helping them reach a wider audience in all 50 states. This expansion demonstrates our commitment to providing top-tier services and being our clients' partner in growth. These strategic alliances enhance our competitive advantage, positioning us to better serve our diverse client base and drive future growth.

I'll now turn it back over to Andy who will discuss our international strategy.

Andrew A. Main

President, CEO & Director

Thank you, Ray. Turning to Slide 5, I'd like to give an update on our international strategy. We are seeing growing interest from non-U.S. based companies looking to establish a presence in the U.S.A. As such, we are shifting our strategy to provide these clients with the necessary infrastructure and regulatory support to enter the U.S. market seamlessly. We are among a select few with a BitLicense and [indiscernible] in all U.S. states to support their business. This positions us well to capitalize on evolving market dynamics to drive future growth. Karen will discuss how this affects our guidance. And we believe this change will yield a higher ROI for us and our clients.

Turning to Slide 6, I'd like to dive into our loyalty business. As a reminder, we leverage our deep expertise in loyalty solutions to cater to major credit card and incentive programs in North America. If you wish to take a closer look at it yourself, our recent updates to the corporate website have boosted the brand visibility of Bakkt loyalty. So I encourage you to take a look.

Our loyalty business continues to perform with our sales volume numbers at \$341.2 million year-to-date, looking on track to hit our full year forecast. Our loyalty business operates at scale, as demonstrated by our consumer-facing rewards store fronts, attracting over 7 million visitors to date. It also operates with excellent performance with a 12% conversion rate. To add some context, in comparison to travel and retail websites, a conversion rate of 2% puts you among the top 20% in the industry. A rate between 3% to 4% puts you in the top 10%. With Bakkt loyalty achieving a 12% conversion rate, this underscores and demonstrates Bakkt's exceptional performance in converting customers to purchase.

Our loyalty business is poised for growth by taking advantage of consumer needs who want to maximize the value of earned loyalty points through various services and products as well as valuing loyalty points as an alternative currency given broader macroeconomic pressures on cash value. We remain excited about the loyalty business and the growth opportunities it presents for Bakkt and our clients.

We continue to invest in Bakkt loyalty. For example, we recently refreshed our loyalty program, offering higher quality benefits to our customers and improving delivery times, customer support and retention for managing costs effectively. We invested in transitioning our technology to a leading cloud provider, which has consequently enhanced operational efficiency, security and customer insights. We also invested in recertifying PCI and SOC 2 standards and improved mobile device management security to further strengthen our operational stability and client trust.

Finally, investments in product enhancements, including our switch to a holistic travel platform and expanded Apple Storefront offerings expect to increase our market competitiveness and profitability. On the expense side, we have reduced our direct expenses leading to significant improvements, which we

expect to demonstrate in the second half of the year. Overall, Bakkt Loyalty Solutions is on track to deliver within the given guidance range of \$53 million to \$57 million in revenue for 2024.

Turning to Page 7 and to wrap up. We continue to make solid progress across the entire business for our 2024 strategic priorities. We've laid out these priorities in prior earnings calls. As you have heard today, we are growing our client network and deepening our existing client relationships. Secondly, we are expanding our product solutions and extending the Bakkt ecosystem. And third, we are realigning our costs and prudently managing expenses. We will continue to be laser-focused on our 3 priorities.

Through the second quarter, we have reduced operating expenses and enhanced capital efficiencies from the integration of our regulated entities. Moving forward, we anticipate further improvements in our cash burn as we execute our strategic initiatives and lap some of the one-time restructuring costs. We haven't included any of these new business lines in our current guidance, but certainly, we aim to improve overall company ROI with these new ventures.

In conclusion, we are confident that our strategic focus on broadening our client network, expanding our product and solution offerings and improving cost structures will drive us towards sustainable growth and profitability. We are well positioned to capitalize on the growing market and deliver value to our shareholders. I want to express my gratitude to our dedicated team for their hard work and commitment, which are driving our success and positioning Bakkt as a leader in the retail and institutional crypto markets as well as the loyalty industry. Thank you for your continued support.

I'll now turn it over to Karen to walk us through the financials. Karen?

Karen J. Alexander

CFO & Principal Financial Officer

Thanks, Andy. I'll now walk you through our second quarter KPIs and financial results. A quick reminder, that in accordance with GAAP, we present crypto services revenue in crypto costs and execution, clearing and brokerage fees on a gross basis as we are a principal in the crypto services we provide our customers. By contrast, we are an agent in the loyalty redemption services we provide our loyalty customers. Therefore, our loyalty revenue is presented on a one line net basis.

Starting on Slide 9, we have our Q2 KPIs, which provide a snapshot of the underlying trends driving our business. We ended the second quarter with \$6.4 million of crypto-enabled accounts, reflecting a steady increase over the past 12 months. This growth underscores the increasing adoption and trust in our platform. Next, we have our transacting accounts broken down into crypto and loyalty accounts. There were 719,281 transacting accounts in the second quarter, of which 461,000 were for loyalty redemption and 258,000 were for crypto trades.

Total notional traded volume was \$672 million with \$494 million attributable to crypto and \$178 million to loyalty redemptions. Crypto notional traded volume was down 42% sequentially, but was up 48% year-over-year. Assets under custody were \$975 million, down from the previous quarter high of \$1,233 million, driven by a settling of crypto prices compared to March 2024 highs.

On Slide 10, we show our total revenue broken out between our crypto and loyalty products. Total revenue for the second quarter of 2024 was \$510 million. Gross crypto services revenue for the quarter was \$497 million, an increase of 48% from the same quarter last year. This growth trended with the overall market as overall crypto interest has increased since last year. Our net loyalty revenues were \$12.8 million, up 4% year-over-year, driven by \$1.1 million increase in subscription and services revenue, partially offset by a \$700,000 reduction in transaction revenue. Approximately half of the increase in subscription and service revenue was driven by an adjustment to the remaining life of one of our service contracts.

Moving on to Slide 11, we have our total operating expenses. Total expenses for the quarter were \$531.9 million, including \$495.1 million of crypto costs in ECB, driven by trading volumes. SG&A expenses were \$5.5 million, down 29.5% from Q1 2024, reflecting our ongoing efforts to maintain a disciplined expense structure. Total compensation expense was \$22.4 million, a 17% decrease compared to the second quarter of 2023 due to lower headcount and a decrease in incentive bonuses and benefits. This reflects our commitment to maintaining a disciplined expense management.

On Slide 12, we have our EBITDA and adjusted EBITDA for the second quarter of 2024. Adjusted EBITDA reflects adjustments for non-cash restructuring and acquisition-related items that impacted period. EBITDA and adjusted EBITDA for the quarter were losses of \$36.6 million and \$17.9 million respectively. Adjusted EBITDA loss for the 3 months ended June 30, 2024 decreased by \$6.6 million or 26.9% as compared to the 3 months ended June 30, 2023. The decreased loss was primarily due to the contribution of increased revenues, a \$4.7 million decrease in compensation and benefits expense and a \$2.1 million decrease in selling, general and administrative expenses.

Turning to Slide 13, we present our condensed profit and loss statement. Net loss for the quarter was \$35.5 million, of which \$19.1 million was allocated to the non-controlling interest in the operating company and \$16.4 million is attributable to Bakkt Holdings, resulting in a diluted loss of \$2.67 per share on an average diluted share base of 6.2 million shares for both basic and diluted.

On Slide 14, we have our condensed balance sheet as of June 30, 2024. We ended the quarter with \$60.7 million in cash, cash equivalents and available for sale securities. After consideration of \$7.4 million of net proceeds from the second funding of the registered direct offering proceeds in April and \$10 million of restricted cash reductions driven by surety bond collateral releases, we utilized \$31.3 million of our cash, cash equivalents and available for sale securities in the second quarter of 2024.

Included in this utilization was \$3.1 million of severance payments and \$1.1 million for litigation settlement as well as approximately \$7 million of working capital utilization related to loyalty business that we anticipate to reverse in Q3. Excluding some of these lumpier items, we are continuing to see improvements in our cash utilization run rate from a lower operating expense base, which we will cover more in the guidance slide.

Additionally, we disclosed in our 10-Q filed this morning that we have entered into a line of credit agreement with the Intercontinental Exchange Incorporated, our former parent company and our largest shareholder. This agreement provides access to up to \$40 million of additional cash during 2025 and will serve as an additional liquidity source to our current cash position, enabling us to continue focusing on near-term growth opportunities and delivering for our clients.

Moving on to Slide 15. We have updated our 2024 full year outlook. We have fine-tuned our expectations for 2024 revenue based on observed engagement metrics and updates to our go-to-market strategy. We have not adjusted our expectation for net loyalty revenues of \$53 million to \$57 million consistent with the performance of that business in 2023. We have adjusted our expected gross crypto revenue range to \$2,550 million to \$2,770 million and the associated crypto costs in ECB to \$2,505 million to 2,755 million. When crypto costs from ECB are deducted from the expected gross crypto revenue, this implies a net revenue contribution from crypto trading of \$10 million to \$15 million as compared to the \$15 million to \$25 million range guided in May. This guidance does not include any revenue projections from BakktX.

There are several factors that drove the adjustment of our expected net revenue contribution from crypto trading. First, we continue to consider a range of potential trading engagement metrics based on observed trading engagement in Q2 2024. Our expected revenue range for the full year 2024 considers an expectation that engagement metrics will continue at the levels observed in June 2024. Secondly, we have updated the range of possible scenarios for the activation of new clients currently in our pipeline. We have lowered our expectation for new client activations as we pivot our international strategy from a land and expand strategy to one of enabling non-U.S. crypto natives to establish U.S. market presence.

Based on our current view of pipeline and current client growth, we have reduced our expectation for crypto trading account growth relative to the guidance I provided in May. We expect total operating expenses of \$157 million to \$162 million. We have reduced the upper end of our expected total operating expense range as we continue to see execution of our expense reduction initiatives. Similar to the May guidance, this guidance does not anticipate any acquisition or inorganic transaction expenses like the acquisition expenses we incurred in 2023 related to the acquisition of Bakkt Crypto.

The net of our operating expenses and non-cash expenses represent our expected cash operating expenses for 2024. Expected operating cash flow usage of \$72 million to \$79 million reflects both expected revenue and expense ranges that I have gone through. The low end of the expected operating

cash leases range has increased relative to the guidance I provided in May due to the reduction in the net revenue contribution from crypto. Free cash flow, which is a non-GAAP metric, is expected to be a usage between \$79 million to \$86 million. We expect to end the year with \$35 million to \$42 million of available cash, cash equivalents and available for sale securities. The upper end of our forecasted end of year balance decreased in line with our updated expectations for crypto revenue.

We continue to believe that we have sufficient cash to fund our operations in 2024. As you will note from this range, we expect our cash utilization to reduce over the course of 2024 as we achieve our revenue growth and expense reduction targets. While our cash utilization is subject to timing differences on a monthly basis, our expectation for end of year available cash, cash equivalents and available for sale securities implies an average monthly cash utilization for approximately \$3.0 million to \$4.3 million a month. This expectation assumes that the approximately \$7 million of loyalty working capital utilization that we observed at June 30, 2024 does not reoccur at December 31, 2024.

Thanks, everyone. That concludes the prepared remarks section of our Q2 '24 earnings call. I'll now pass it back to Olivia for the Q&A session.

Question and Answer

Olivia Keavey

Thanks, Karen. Next, we'll move over to a couple of questions from the investor community. After that, we'll turn to live questions from the analyst community. Our first question from the investor community comes from Sayeed H. When do you expect to reach profitability? Please provide a realistic timeframe and provide the actions you will take to achieve this? How will BakktX help in achieving profitability sooner?

Andy, can you share your perspective here?

Andrew A. Main

President, CEO & Director

Thank you, Sayeed, for your question and to being a fellow stockholder of Bakkt. We do anticipate reaching profitability, but cannot give specific timelines and guidance beyond what we already provided on the call. It is largely contingent on the successful execution of our strategic priorities, which we remain laser-focused on, expanding our client network, broadening our product offerings, particularly our BakktX ECN, and new partnerships we have in place and in our pipeline and enhancing our cost management strategies.

Of these, BakktX plays a crucial role here as it's designed to enhance our institutional offerings, providing a high-performance trading venue with lower costs and faster execution times. This platform will attract more institutional clients and drive higher volumes and revenues, which are key to achieving our profitability goals.

Olivia Keavey

Next question from Matthew M. and [indiscernible] which is on the topic of stock splits. How do you plan on maintaining investor appetite for long-term investors after the loss and overall value from the 1 to 25 stock split? Furthermore, why was the decision made to perform a stock split of that severity? Are you planning on splitting the stock again?

Karen, can you take this one?

Karen J. Alexander

CFO & Principal Financial Officer

Certainly. Our decision to execute the 1 to 25 stock split was primarily driven by the need to meet the NICE's minimum price requirements and maintain our stock listing. This action was crucial to ensure the stability and credibility of our stock in the market. It has allowed us to attract institutional investors who have minimum price thresholds for their investments.

It's important to clarify that stock splits or reverse stock split, like the one we conducted, does not change the underlying value of the company or the value of our company's shares. Fundamentally, a stock split changes the number of shares you own, but it also adjusts the price per share proportionately. The total value of your investment remains the same. While we understand that this move might have been challenging to long-term investors, it was necessary to protect and enhance the long-term value of Bakkt. At this time, we have no plans for another reverse stock split. Instead, our focus is on driving growth and increasing our stocks' intrinsic value through strong operational performance and strategic initiatives.

Olivia Keavey

And with that, I would now like to turn the call back over to the operator to open up the phone line to take questions from the analyst community.

Operator

[Operator Instructions] Our first question today comes from Trevor Williams from Jefferies.

Spencer Brolley James

Jefferies LLC, Research Division

This is Spencer James on for Trevor. I wanted to ask on BakktX. Could you provide more color on how customer conversations are progressing? And maybe comments on which customer segments BakktX will be best positioned to address at launch in coming months?

Andrew A. Main

President, CEO & Director

Yes, super question. Thanks for asking. It seems Ray is on. Ray, why don't you take that one?

Ray Kamrath

Chief Commercial Officer of crypto Business.

Sure. Thank you for the question. The industry in the United States has -- there's considerable demand for institutional market participants seeking high-performance, low-cost trading experiences. Right now, most of the trading venues in the United States are geared more towards retail. And BakktX is an institutional focused trading venue that is geared towards that. So with that in mind, the market structure, which is more of an ECM and less of a central limit order book is particularly attractive to institutional investors and we're seeing a high demand in our presales efforts and our conversations with clients.

Operator

We have no further questions in the queue today. So I'll hand back over to the management team for closing remarks.

Olivia Keavey

Thank you everyone for attending our earnings call this morning. We look forward to connecting with you again soon.

Operator

That concludes today's call. You may now disconnect your lines.

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