

**The Scotts Miracle-Gro Company**  
**NYSE:SMG**  
**Company Conference**  
**Presentation**

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# Call Participants

## EXECUTIVES

### **Cory T. Miller**

*Senior VP & Interim CFO*

### **James D. King**

*Chief Communications Officer &  
Executive VP*

## ANALYSTS

### **Jon Robert Andersen**

*William Blair & Company L.L.C.,  
Research Division*

# Presentation

## **Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

Good morning, everybody. My name is Jon Anderson. I'm the analyst at William Blair that covers Scotts-Miracle Gro. I welcome you to our Growth Stock Conference and more specific, our webinar today with Scotts' Interim Chief Financial Officer, Cory Miller; and Scotts' EVP of Corporate Affairs, Jim King.

Before beginning, I need to inform you that a complete list of research disclosures and potential conflicts of interest can be found on our website at [www.williamblair.com](http://www.williamblair.com). We're going to begin with some introductory comments by Cory, and then we're going to transition into a fireside chat, which I'll help host. I do invite participants to submit questions to me, and I will attempt to include them in our discussion today.

So with that, I'm going to turn it over to Cory to get started.

## **Cory T. Miller**

*Senior VP & Interim CFO*

Thank you, Jon, and thank you for having Jim and I be part of your conference today. Despite starting our fiscal year out in the middle of global pandemic, record February ice storms in Texas, late April snow in Ohio and one of the coldest Memorial day weekends in the last 100 years. We're having a hell of a year.

The lawn and garden category is not for the faint at heart, and this year is proving it once again. Even with these events in our rearview mirror, we are still raising our guidance again today on sales in both the U.S. Consumer business and in Hawthorne. We now expect growth of 7% to 9% in the U.S. Consumer business versus a previous guidance range of 4% to 6%.

In Hawthorne, we now expect growth of 40% to 45% versus a previous range of 30% to 40%. Expectations for gross margin are unchanged at a decline of 175 to 225 basis points versus the previous year. These inputs then take our earnings per share expectation to a range of \$9 to \$9.30 per share compared to a previous range of \$8.60 to \$9 per share.

As we look at the capital markets to date, what remains over the back half of the year, we feel pressure against delivering the \$250 million of cash flow this year. While sales continue to be a good story, it does require us to continue investing in the business. This investment is both in infrastructure to keep the volume moving and in additional inventory, which is at a higher cost right now. Doing what is right for the business will require more cash than previously planned, and we're going to focus on setting up 2022 to be another great year.

With the table set, I think we're ready to jump into Q&A.

# Question and Answer

## **Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

Cory, thanks for the update, and we appreciate you seems every year at our conference, you provide an update on the full year. So we appreciate that, again, you making news here.

I think I'll start by asking you a little bit about the news you made yesterday with the guidance revisions. I think talking about the U.S. Consumer portion of the business, core lawn and garden, you had been pretty clear, I think, in signaling that there was some upside, perhaps, to your full year expectations just based on the level of consumer engagement you've seen early in the season.

What ultimately led you to kind of pulling the trigger on the guidance raise that we got yesterday? I know that May was a month where you had a more challenging comparison. You must have come through that fairly well to allow you to do that. But what are some of the specific indicators you're seeing in the consumer and retail level that allowed you again to kind of step up the full year outlook for the U.S. Consumer portion of the business?

## **Cory T. Miller**

*Senior VP & Interim CFO*

Yes, good question. As we entered the year -- at the beginning of the year, we thought our sales might be negative for the year. And then as Q1 started, our load in was really strong. We started to see that upside. We pulled our numbers up. And the last time we gave guidance on a range of 4% to 6%, we had kind of a number in mind that we expected for May.

We did expect that number to go backwards a little bit. And because of the strong May last year, our performance this year in May, while negative, was kind of in line with our expectations, and it gave us line of sight to get to a full year number that was higher than our previous guidance that came out.

We're still up against challenging comps. The growth of 7% to 9% in the U.S. Consumer business, we still have to work hard to get there. But we feel, given where May landed, we can get to a spot that allows that growth to happen somewhere in that range. And I'd be -- I'm saying that, that's kind of the guardrails that we have, 7% to 9%, it's possible that we go above that. I'm not as confident in going above that as I was in our old range. So I feel like the range we're putting out there is a pretty fair range. And I'd say just POS during the month of May was the leading indicator and the ability that the retailers are having. As they lean into our business, that gives us some ability to understand what their plans are, the ability to meet the demand and get a little forward insight on their buying patterns, and those have remained strong during the month of May as well.

## **Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

That's helpful. Maybe you can talk a little bit about what happened in May because I recall, entering May, your point-of-sale was up 25% season to date. Exiting May or entering June, as you just reported, you were up 10%. So to your point, you gave some of that point-of-sale back. I think that was very much in line with your plan. And reflected the comparison. But how do you -- at this point, the comparisons, I believe, stay pretty challenging through the second half of the year, what is your expectation at this point with respect to full year point of sale? Do you think you'll give some more point-of-sale back as you move through the second half of the year? And then second, is there a divergence that you're seeing in terms of dollar point-of-sale and volume point-of-sale? And does that have the implications on your shipments?

Because I know that, that was something where there was divergence last year due to some of the pricing and promotional changes in the marketplace. How has that kind of evolved this year? And talk about the implications on your shipments?

## **Cory T. Miller**

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*Senior VP & Interim CFO*

I'll answer the last part first. The -- if you look at last year, the dollar shipments that we were looking at for -- or the dollar POS that we were seeing was higher than our unit POS because the promotional activity was lower. So that lack of promotional activity caused every sale that went out the retailer door to be at a higher price. It drove our dollar POS ahead of our unit POS. This year, it's actually the reverse of that. Our unit POS is higher than our dollar POS. So we're moving a lot of units right now, but the promotional activity that's happening at retail is causing our dollar POS to be a little lower.

So we're really happy with the units that are going out and it's equating to dollar POS that makes us feel comfortable as well. If you look at the back part of the year and what we think is going to happen, I think we'll give a little bit back. We're up against large comps for the remainder of the year. My estimate would be flat to down a little. And that down a little will cause our full year POS to be just a little lower than it is coming out of May.

I will say that given the retailers' thoughts around inventory levels that they need to have and how they want to end our fiscal year. Our shipments could outpace our POS a little bit to get them back in an inventory position that makes sense for them going into the calendar Q4. And as we look at the violent peak that we had this year during our key shipping times, we see next year as being no different. So we want them to carry that inventory. We want our fiscal Q1 of '22 to be another strong shipment period to allow the retailers to have inventory as the POS starts to happen, that allows them to have some holding power. And with that, we can fulfill their needs a little easier than if we wait too long to try to deliver during that spike period.

**James D. King***Chief Communications Officer & Executive VP*

And Jon, just a bit of color on the issue of promotions, so people who may not follow us every single day kind of understand the difference between what we're seeing this year and last year. Obviously, April and May are the 2 biggest months of the year for us, historically, both about 20% of total year POS. Last April, at kind of the -- when COVID was just really impacting the retail market, home centers, in particular, really scaled back their promotional activity, actually trying aggressively to not drive foot traffic into the store because they were trying to moderate foot traffic at the time.

When the category finally took off in May and they were bringing people into the stores again, they didn't need to promote as much as they did because there was such huge demand in the category. This year, we expected retailers to promote more than they did a year ago, which they are, but not as much as they were promoting a couple of years ago, which they're not, okay? So I think they found this really good balance where they have been able to keep their margins healthy as well, find the right cadence in terms of promotional activity to pull some consumers in, but not do promotional activity every weekend. So the retailers are behaving just as we thought they would, which is why we're seeing this difference in units in dollars right now.

**Jon Robert Andersen***William Blair & Company L.L.C., Research Division*

Okay. That's helpful. As we think -- it's very difficult, I know, at this point in the year to think about 2022. I think my question -- the question here that I have, and I think a lot of investors have is, you've had a succession now of years of really above trend growth. 2020, obviously, driven by the pandemic, to some degree. But 2019 was a very strong year. This is going to be another very strong year with tough comparisons. As you look forward and you think about the consumers that you've acquired or the households that you've acquired, what is your update on the level of household acquisition, you're feeling about to what extent you can retain those households as we move into, let's call it, a more normal year in 2022?

And what are some of the activities that you kind of have to get right from a product innovation, from a marketing, from a merchandising perspective, in order to retain as many of those consumers that you've

acquired over the past 12 to 24 months to, again, kind of establish this as the new base level of sales for the U.S. Consumer business as opposed to maybe kind of going backwards in a given year.

**Cory T. Miller**

*Senior VP & Interim CFO*

Yes. Good question, Jon. We talked about the 20 million consumers that came in last year. Our goal was to hold on to them. Part of holding on to them was why we came out with the Super Bowl ad early on. We tried to hit everybody early while there's a lot of eyes viewing it. The Super Bowl ad had a sweepstakes element that kept people engaged and kept them coming back. Our original research was saying that about 80% of those new consumers would stick. And and they're also looking to spend more this year.

So it feels like we're close to that with POS growth that we've seen. We're going to continue talking to the consumers a lot in as many ways as we can by being on social media more often, trying to speak with the consumers on a full year basis, not just the peak season basis that we've done in the past with TV. We're going to keep working with our R&D department and drive innovation. And we're coming out with some new products here, if you think about rapid grass, triple action fertilizer, extending our groundclear lineup. Those are all areas where we're innovating in the space and allowing us to reach those new consumers or solidify the consumers we have in place. And we're going outside of our core lineup as well with Miracle-Gro branded flowers instead, which is a natural lawn subscription program that you'll see a promotion effort around and a Greendigs in online indoor plant marketplace. So it's a little bit out of our core, but we're trying to reach consumers where they're at and speaking to them in ways that we haven't in the past and just making sure that we're kind of on with them all year.

**James D. King**

*Chief Communications Officer & Executive VP*

Jon, the other tailwind here for us, we think going forward for quite a long time, is demographics as well. Consumer goods companies have been talking about millennials for years, okay? We haven't because typically, people don't participate in the lawn and garden category until they own a lawn or garden. That makes sense, which means typically when they own a home. And it's only been the last couple of years where millennials have actually become a significant percentage of the homeownership base in the United States. In fact, are now the largest participants in the overall market and more millennials are coming into the market every year and replacing baby boomers.

What we're seeing in terms of participation levels is that millennials participate in the category about 20 percentage points higher than baby boomers do. So we're seeing a higher level of engagement. It's mostly on the gardening side of the business. But we're really bullish on what the demographics for this category look like for the next many years. And part of the reason that we invested so hard in marketing over the last couple of years is not just to drive the category this year or this season, but to build that level of awareness of lawn and garden to talk about the emotional elements of it to kind of get embedded with that consumer base. And bring them back year after year after year. And that's a big part of the investment again this year.

**Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

Very helpful. Do you, before we leave U.S. Consumer, I want to ask the question, is -- I think of lawn and garden as having a heavy, heavy experiential component to it. It's not like buying most consumer products. Is that something that your research also shows? In other words, the kind of the experiential aspect of working in the yard, the development of a garden or maintenance of your lawn is not just a 1 season thing because once you engage in it, you're kind of committed to it as both an activity, which you drive pleasure from, but also is something you want to upkeep from year-to-year.

And I'm wondering if that's another reason why we might expect this -- the acquisition aspect that's been helping drive sales be stickier than it might be for other consumer products companies. Is that something your research kind of shows as where -- as well?

**Cory T. Miller**

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*Senior VP & Interim CFO*

Yes, it's an emotional category. I mean, gardner's garden. And people who have put raised beds in their backyards last year, guess what they have in their backyard this year? Raised beds. Guess what they're going to have in their backyard next year? Raised beds. And so gardening kind of begets gardening. And a big part of how you talk to people in this environment is not just about -- so if you look at a lot of our really successful marketing over the last couple of years, Jon, it has not been brand focused at all. It's been experiential.

It's about being home, about being in the backyard, what the backyard is all about. Even if you look at the Super Bowl commercial, [indiscernible] expensive, lots of celebrity participating. All the celebrities were doing something different in their backyard. And it wasn't necessarily gardening with the exception of Martha Stewart. They were just doing things in their backyard, exercising, grilling, whatever. And that's part of the experience here, and it is sticky. It is stickier than most categories. You're right.

**Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

Let's shift over to Hawthorne because 1 thing that was surprising about the update yesterday is that you we feel confident enough to take the Hawthorne sales outlook up. That was a little surprising to us, just in the sense that it was, I think, 4 weeks ago that you had guided numbers higher in that business. So tell us a little bit about what you've seen over the past 4 weeks or so that, again, is giving you a comfort level to move that expectation up for the year?

And just kind of the overall backdrop, where are you seeing that particular strength? Is it in a type of state, i.e., a legacy state or a set of newer states, newer legal states. Is it in certain product categories? Or is it just kind of an across-the-board phenomenon right now?

**Cory T. Miller**

*Senior VP & Interim CFO*

Yes. Hawthorne continues to be a great story. Sales continue to be strong. If you think of what's happened in the last 3 months, our fiscal months are kind of 4 week, 4 week, 5 week. And if you go back to March, March was a 5-week month, a record 5-week month. So that's kind of our record month, that being a 5-week month, means it's tough for a 4-week month to compare to it. But following March up, which was a record. We then had April.

April was a 4-week record. So the biggest 4-week month we ever had. And then we follow that up with May, which was another record. And you go back to 2020, and we're kind of in the same trap to where we continue to raise guidance during the year. And I'd say that growing at 60% last year and 60% this year to date and then getting to a spot where we're at a 40% to 45% call for the full year means that we're growing and showing each month will kind of be a record month. And we want to make sure that we can deliver on sales at that level before calling the year up and banking on that for all the remaining months.

But we continue to raise that bar up and show that we can deliver more than we previously expected. And part of that is due to the investment we're putting in the business, we're investing a lot of dollars and time and effort into our distribution centers on the Hawthorne business. We're investing a lot of dollars in our inventory levels. We're up about 50% in inventory. And all of this allows us to meet the demands of the customers in a way that we weren't able to a year ago or 2 years ago because we simply could not get that level of volume out. And so that's kind of the key to it is we're seeing the volume in the volume patterns going forward are such that we're going to be at these kind of levels that we're talking about here for April and May for the remainder of the year.

But if you break down the sales and you think about where the volume is coming from? It's all over the board. And the growth pattern, if you think before COVID, the deepest areas of the lack -- the deepest time period of the lockdowns. And then now that it's eased a little bit, it's all high volume. And -- so I don't know that the time period or covet is driving it up. I'd say that we have strong sales before, during and kind of as we enter the after period now. Lighting and dehumidification have been the categories



where we're seeing the most growth. Certainly, our lighting innovation that we've put out has been successful. And it's allowed a lot of that growth to happen.

Orders and shipments continue to happen at that pace on our lighting SKUs in particular. You look at nutrients and growing media, and we're seeing the largest shift into our signature brands in those areas. So nutrients continue to have a total growth that is very strong, but the shift into our signature brands is what makes us feel really good about those 2 categories. If you think about the state level, California is by far our largest state, but it's also a really high-growth percentage. So the growth percentage on a strong state is really helpful to us.

But then you can also think about states that were smaller a year ago that had really high growth, like Oklahoma is 1 that comes up as an example. You'd have 300% growth, but it was a pretty small base. While you do that for a couple of years, and now it's turning into a large dollar state as well. So the growth rates that we have, while not quite as high as they were a couple of years ago when Oklahoma kind of turned on, they're still very high, and it's on a base that is continuing to grow. So I'd say kind of across the board, we're seeing wins. And I'd say that the category is seeing those wins as well. If you look at key competitors, they're growing at a pretty good rate as well.

I would say that us being at a base last year of about \$1 billion, growing at the rate we have been lot harder to sustain than a company that's kind of 20%, 25% of the size, growing at a similar rate. So just the sheer dollars involved makes it tough for us to sustain this growth. But that's what the investment is for. That's what the Hawthorne team goes in every day thinking about how can we drive more product into the DC to be ready and have that holding power to ship that product out as the consumer demand comes in.

**Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

And as I think -- I think about the performance of the business over the past few years now, to your point, Cory, 65% last year, 65% year-to-date, calling 45% for the full year. And then I kind of -- you juxtapose that against some of the more recent developments in state legislation, where we -- as recently as November had for new states, legalized, adult use, we've had New York subsequent to that through legislative action approved and you start to look at the population base in the U.S., moving from perhaps 30% of the population living in states where adult-use cannabis is legal to something more like 40% today.

Now those newer states haven't gone live as of yet. And I'm not sure probably haven't really contributed to your business as of yet, but will over the next couple of years, for sure. It makes me think that we should be growing at these kind of -- at an elevated rate, 20, 30-plus percent for the foreseeable future. Is that kind of a realistic expectation because I know that's a little bit different than what you said historically, where you've kind of committed more to 10% to 15% growth. But again, it seems like the stars have kind of aligned here in a way you could see a situation where the growth rate comes in significantly better than that over the next several years. Is that consistent with your hypothesis?

**Cory T. Miller**

*Senior VP & Interim CFO*

Well, I can -- I think it kind of depends on what's happening in our -- kind of the historical state. So if you think of the West Coast states, California, like I said, is huge. It's up over 80% versus prior year, Oregon, Washington, are up kind of 50% over prior year. Those are the states that are driving our total results. The newer states that come on, like I said, they have large percentages for that individual state. But it's how the existing states, kind of those West Coast states grow that really determines our total number. And I completely agree that as more states legalize they will come into our business and become a larger part. It is going to take some time.

So if you think about a state that goes legal today, it's a ramp-up of about 18 months before we start to notice a real difference in volume in those states. And then because they started at a lower base, the large percentage increase in those states just don't give us the volume to take our total business up in a drastic

way for some time until they get a little more established and things start to happen. There could be a shift of end consumer demand from some of the existing states into the new Eastern Coast states that have legalization. We haven't seen a lot of that yet. We haven't seen a fall-off in the West Coast. I still look at the run rate on this business as being positive. And I'm also still going to be conservative about what we call. And I was around in the Hawthorne business, working at the heart of the Hawthorne business in 2018, we were kind of -- we had the negative side when California became legalized?

**Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

I was there with you.

**Cory T. Miller**

*Senior VP & Interim CFO*

Yes, I don't think we're going to feel that again because the size of the states that are becoming legal, just aren't the same as California. but I am still going to be conservative about what we call going forward. I think the double-digit growth that we've talked about, 10% to 15%, I want that to be conservative. I'm still probably going to hang out down around that level. But certainly, if I were in your position, I'd be asking the same question and I'm going to be driving the business to get to a growth rate that's much higher than that.

**Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

So we're winding down on time. I have a couple of questions, 1 on investments and 1 on use of cash.

So part of the sales upside that you kind of communicated yesterday and here today will be reinvested. Can you talk about some of the investments you're making, both on the U.S. Consumer side of the business to kind of try and maintain the momentum into 2022, and maybe investments you plan on making in Hawthorne, capability investments? You've probably touched on the some of them already in terms of maintaining or improving your service levels.

Does it change your position on pricing -- your stance on pricing at all? So some of the investments you plan to make, given kind of the particularly strong top line? And then the second question is just on the balance sheet, and your thoughts on use of cash or priorities for use of cash going forward in balancing that. And then we'll wrap up with those.

**Cory T. Miller**

*Senior VP & Interim CFO*

Yes. Starting with the investments. All the volume is great. Both sides of the business, we love having the volume. On the U.S. Consumer business, that volume has taken us to a spot where our excess capacity is definitely minimized. And we need to build more capacity into our manufacturing and distribution model to continue with this growth. And even if sales stay flat, we are working so hard to keep up with the volume that's out there. We're going to have to have some investment in our production capabilities to keep this volume level that we're at today.

And that varies by product. If you think about the different products that we have, whether it be grass seed, fertilizer, liquids, growing media facilities. Each 1 of them feels different pressure. And each 1 of the products has different options on how we could fulfill that need, whether it's external, going out and finding capacity somewhere else or whether it's internal and it's capacity that we need to build. If you think about products where what we deliver is a specific product like all-in-one fertilizer or EZ Seed or growing media close to the consumers, those are things that we have to do, and that's capacity that we need to build, and we need to invest in those areas.

Other areas of the business might be a little more generic in nature, and we can go find some capacity and do some things that don't require us to build it in-house. So we continue to look at each of the products and prioritize the need on capital spend in a way that will help us kind of monitor the amount of

capital that goes into these areas to meet financial goals and make sure that we're investing in increasing our capacity.

If you think of the Hawthorne business, you have the same thing. I'd say the pinch that we have in the Hawthorne business is more on the distribution side. So the ability to hold enough inventory to react to customer demand and get those shipments out in a timely fashion is the largest pinch that we feel today. We're kind of on a plan to double our footprint in our distribution centers. And holding the amount of inventory that we want, would say that we even need to go a little higher than that. So we're going to continue looking at growing our distribution footprint being closer to the consumers and closer to where those sales are going to happen. And that's where our key focus will be on the Hawthorne business moving forward.

I think second part of the question on the balance sheet, kind of where we're at. The investments in inventory and capital will continue to be needed. If you think of our debt levels and what we see as our way to finance those activities, debt is kind of cheap now. We want to make sure that we're maximizing the debt that we can go after and we'll likely be seeing some additional debt as we look to have this finance -- as we look to finance the capital investments, and we look to finance M&A activity that happens. It's a pipeline that's full now with M&A. Capital is pulling on us hard, and we want to fund all of this. So we'll be weighing the different options and making sure that we're using that incremental debt in a way that advances both the existing business today to keep that train rolling as well as looking to invest in new opportunities that can be the next big growth item for us.

**Jon Robert Andersen**

*William Blair & Company L.L.C., Research Division*

I want to wrap it there. And I want to thank you very much, Cory and Jim, for participating in the conference today. Very illuminating 35 minutes here, and we look forward to being in touch soon. Thanks.

**James D. King**

*Chief Communications Officer & Executive VP*

Jon, thanks, as always.

**Cory T. Miller**

*Senior VP & Interim CFO*

Thank you, Jon.

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