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EXECUTIVES

Matt Anderson

Head of Finance & Strategy

Michael Doyle

CFO

Sarah Friar

CEO

ANALYSTS

Eric Sheridan

Goldman Sachs

Jocelyn Hu

Evercore

Robert Zeller

Truist

Presentation

Operator

Good afternoon, and thank you for attending today's Nextdoor Q1 2023 Earnings Call. My name is Jason, and I'll be the moderator for today's call. [Operator Instructions].

I would now like to pass the conference over to our host, Matt Anderson, Head of Investor Relations.

Matt Anderson

Head of Finance & Strategy

Thank you, Jason. Good afternoon, and thank you for joining us today to review Nextdoor's First quarter 2023 financial results. With us on the call today are Sarah Friar, Chief Executive Officer; and Mike Doyle, Chief Financial Officer. During this call, we may make statements related to our business that are forward-looking statements under federal securities laws. These statements are not guarantees of future performance. They are subject to a variety of risks and uncertainties.

Our actual results could differ materially from expectations reflected in any forward-looking statements. For a discussion of the material risks and other important factors that could affect our actual results, please refer to our SEC filings available on the SEC's website and in the Investor Relations section of our website as well as the risks and other important factors discussed in today's earnings release. Additionally, non-GAAP financial measures will be discussed on today's conference call. A reconciliation of these measures to their most directly comparable GAAP financial measures can be found in the Q1 2023 shareholder letter released today.

With that, I'd like to turn the call over to Sarah.

Sarah J. Friar

CEO

Thank you, Matt, and hello everyone. We started 2023 with a strong quarter and we're seeing meaningful progress across a range of business outcomes. Starting with neighbors, WAU grew 16% year-over-year and 6% sequentially in Q1, demonstrating healthy and growing engagement. This growth was led by neighbors in the U.S. where we added over 2 million net WAU quarter over quarter. Over 80 million Verified Neighbors come to Nextdoor with high intent to join, connect, contribute, and transact, thus finding unique value from the utility and the community offered on the platform.

In 2023 we have been building product momentum focusing on growing the base of neighbors and organizations on Nextdoor through work on invites and content sharing. We've been deepening engagement and driving kind conversation through better Feed and Discover personalization and new content types such as Events. Finally, we are making progress on our local ad platform for businesses of all sizes to benefit from Nextdoor's high-intent audience and the ability to target neighborhoods everywhere.

Our investments in AI, including ML, have seen strong returns, particularly in deepening engagement. In Q1, this is the leading driver of WAU growth. We continue to personalize Notifications to be relevant and timely to each neighbor. We're making the Newsfeed more personal, a focus area in 2023, by enabling content to be more widely acceptable based on the use case. For example, a neighbor may want a broader view when looking for a service provider or something to do locally over the weekend but a much narrower view when searching for a lost pet. This unlocks greater growth on the platform and is important to neighbors who increasingly see Nextdoor as *the* local network that allows you to connect to the neighborhoods that matter to you.

AI is already an integral part of product experiences at Nextdoor and we've only scratched the surface of its potential use across WAU and revenue outcome. We are excited to explore the possibilities for generative AI applications on our platform, built on the foundation of our unique local knowledge graph and content that is often already labeled by neighbors. For example, this post is a recommendation,

this post is a lost and found item, this is content that potentially needs moderating, and so on. Leveraging the ChatGPT API offered by OpenAI, in April, we launched an "Assistant" feature that helps neighbors write posts that are more engaging, kind, and constructive. This is based on our data of what works well on Nextdoor to achieve the outcomes that neighbors are looking for.

For example, making a recommendation about a beloved local business that needs help getting a word out or finding the best park to delight younger kids or helping the neighbor entice a group to come together for our local community garden build. We'll continue to share updates here in the coming quarters. In Q1, we also launched several other product features to deepen engagement through driving kind conversations and the volume and diversity of content. For example, we launched the ability for organizations to access all format types including events, calls, and videos. This has increased posting from businesses and agencies, helping connect them with high-intent nearby audiences and creating a better local experience for neighbors.

We also launched our ShareKit, which places Nextdoor's logo on partner sites like GoFundMe and Patch so users of external sites can post directly to Nextdoor. This is another important step in our shift from a private to a local network. These initiatives have driven more posting and posters across more areas of the platform.

We've made progress introducing new viral growth loops. Verified neighbors added organically in the US grew at 24% year-over-year in Q1. We bring new neighbors and organizations to Nextdoor through invites and content sharing. Today features like Contact Sync help neighbors invite each other to our platform. In Q1, we booked features for businesses to invite neighbors, and we're seeing positive traction with the number of business inviters growing by 34% since the features were introduced in January of this year. In the coming quarters, we plan to launch new partners with our updated content API so the content that is flagged as "anyone" content can be shared to other platforms. This content can then be picked up by SEO which raises our brand awareness and draws in more neighbors as they discover the specific use cases of our local platform.

We also continue to make progress on our ad platform. In Q1, we completed the majority of the work on our unified platform offerings for advertisers of all sizes. For SMBs, we will be maintaining the simplicity of the original self-serve experience while also adding advanced tools and reporting capabilities that were not previously available, such as a more flexible location targeting. For larger advertisers, Nextdoor Ads Manager will reduce the time it takes to onboard Nextdoor and to create and launch an ad.

Let me give you an example of the success of the platform for an international beauty retailer who ran a campaign to drive neighbors to shop its products in local stores. We leveraged predictive intent targeting to reach beauty shoppers when they were most interested and engaged on Nextdoor in order to drive them from the app into the local store. Our Foursquare study found the campaign was so successful that it resulted in an approximately 52x return on ad spend. Another study by Oracle Moat analytics found that the campaign also far exceeded industry benchmark in attention related performance categories like interaction rate and hover rates. The brand has continued to spend on Nextdoor, partnering with us for spring and summer campaigns.

In closing, we started 2023 on a strong note and we are excited to continue executing on our top three priorities: growing our base of neighbors and organizations, deepening engagement, and driving revenue growth by enabling better advertiser outcomes on our proprietary ad platform. We remain confident that our efforts will enable us to return to sustained revenue growth and margin improvement in 2023.

I'll turn it over now to Mike for more details on our financials.

Michael Doyle
CFO

Thank you, Sarah, and good afternoon, everyone.

Q1 revenue of \$50 million came in 7% above the midpoint of our guidance range and represented progress in the sequential growth rate. Despite a 2% year-over-year decline, Q1 revenue demonstrated an upward trajectory in the quarter. We expect year-over-year revenue comparisons to ease as we move through 2023.

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We saw several areas of revenue growth in Q1. Mid-market continued to be an area of strength, with average spend per customer growing as we build relationships with and demonstrated value for customers. We are also seeing success from our strategy of building relationships with advertising agencies, which allows us to increase revenue diversity and retention and to more efficiently activate new logos, a top priority in 2023. Several of our large advertisers from the quarter were brought on board through agency relationships.

We've also shifted our sales strategy to focus more on recession-resilient verticals and customers, and we are seeing benefits in verticals like healthcare. International was another area of strength with U.K. revenue growing year-over-year as we expanded our presence in the market and reached an all-time high of total weekly active users in Q1.

We saw a healthy mix of spend across both top and the bottom of the funnel ad campaign objectives with a continuing trend towards direct response-focused campaigns, which accounted for more than 60% of managed spend in the quarter.

Q1 ARPU of \$1.17 declined 16% year-over-year, the result of progress made in growing WAU, which outpaced the advertiser demand in the period. Q1 adjusted EBITDA loss was \$22 million, representing a negative 44% margin. The year-over-year decrease in adjusted EBITDA margin primarily reflects deleveraging from the reduction in revenue, combined with growth in personnel costs and hosting costs as neighbor engagement grows. Our operating cash burn of \$14 million was better than adjusted EBITDA loss as we benefited from positive working capital dynamics and interest income.

In Q1, we continued our close focus on operational efficiency, holding total operating expenses largely stable over the past three quarters. We held our year-over-year operating expense growth rate at just 5%, primarily through increased customer acquisition efficiencies. We will continue to balance expense management with ensuring that we are resourced to deliver on our long-term product and go-to-market initiatives.

We ended Q1 with \$575 million in cash, cash equivalents, and marketable securities. We will continue to evaluate our capital allocation opportunities looking forward.

I'll close with our outlook. Our Q2 2023 revenue guidance is \$53 million to \$54 million, a year-over-year growth rate of (2%) at the midpoint of the range. While revenue trends are improving, we continue to see some uncertainty with some advertiser budgets in April. Based on progress to date, we expect to return to year-over-year revenue growth in 2023.

Turning to adjusted EBITDA. We expect Q2 adjusted EBITDA loss to be minus \$24 million to minus \$23 million. At the midpoint of the range, this implies an adjusted EBITDA margin that is approximately flat sequentially. As we look to the second half of 2023, we expect improvements in year-on-year EBITDA margins.

We remain highly focused on driving sustained WAU and revenue growth, and we are pleased with our Q1 progress.

Thank you for joining our earnings call today. With that, I'll turn it over to the operator for Q&A.

Question and Answer

Operator

[Operator Instructions] Our first question is from Eric Sheridan with Goldman Sachs.

Eric Sheridan
Goldman Sachs

Thanks so much for taking the question. I want to come back to both your comments with respect to the ad platform and maybe ask a multi-parter. Can you give us an update in terms of the timeline where the ad platform will be fully deployed between either now and the end of the year as we move out of '23 and into '24? And based on what you've learned on the rollout of the ad platform, how should we be thinking about that informing mix of advertisers either by advertiser type and/or promoting further advertiser diversity and driving new verticals, as Mike pointed out, like the healthcare vertical, in particular, to think about density as a driver of monetization, not only in '23, but over the medium to long term.

Sarah Friar
CEO

Great. Eric appreciate it. So just finding our legs on the ad platform itself, really good momentum in Q1, and that's the reason why you see the revenue doing as well as it is relative to how we guided. On the Nextdoor Ad Manager itself, we continue to iterate on that self-serve, easy-to-use, intuitive platform. And in Q1, we unified that, so that now every customer of any size is working off of the same platform. And so by creating one self-serve option, that just simplifies products all around.

If you look at what that meant, if you are a small business, it keeps the same self-serve, easy-to-use element, but it is also adding on new facets like, for example, some of the performance targeting and so on that I talked about in my prepared remarks. If you're a larger enterprise and mid-market, all the way up to large, even an ad agency, it now means that there's a place that you can create a self-service ad as long as doing something that is more managed.

On the back end, the Nextdoor ad server, that's where we are unlocking our ability to better use our first-party data. And that will help advertisers understand their audiences better, optimize ad targeting and delivery, and increase ad relevance. So the right ad, the right person at the right time with great content and a high-intent platform like Nextdoor that's very high on utility, but it's also great for the advertiser. It's very, very, very efficient.

So in terms of where we are in Q1, we're continuing to move forward on that. We're pleased with the progress. So as we look towards the back half of the year, our goal is to have our SMBs all up and on the platform and then slowly moving towards mid-market, ultimately into the large enterprise. We're going to do this wisely because we don't want to expect to, in any way, upset our current momentum on the revenue front. So we'll do it with a lot of tests and iterations. Of course, it's not just about that ad platform itself. It's also about things like measurement. As an example, we do have first party measurement with our own Pixel, but we also continued to add new third parties into the mix - folks like Neustar, Oracle Moat, Lucid, Foursquare, Thesis, and so on because the more that we can show advertisers that the performance that Nextdoor can give them, the more likely they are to stick around. That's one of the reasons why our retention rates have been so high across the platform.

In terms of the mix of adds of customers by type and by vertical, last year, as we headed into kind of a tougher time in the ad market, we were definitely quite exposed to verticals like financial services, real estate that have done phenomenally well on Nextdoor because they often are targeting in a hyper-local way. Those advertisers will come back when the environment improves. So we think there's a lot of pent-up demand in those verticals. That said, we pivoted and went to places where we could see opportunity. So for example, more recession-resilient verticals like government and healthcare. We have continued to invest in areas like tech and telco that did really well for us in Q1.

And then we continue to build out our mid-market sales team. So now we're able to go after not just really large advertisers or the smallest SMBs, but more of that kind of torso, the mid-market, they're

often not per se national, but they're often multi-state. And then finally, in terms of the type of ad being served, Mike talked about the fact that we work across the funnel, all the way from brand to consideration into direct response. Clearly, because of the environment, we are tending more towards direct response, but I'd expect that balance to come back to be more balanced, frankly, as the ad environment improves.

We know there's a lot of debate with CMOs right now about the power of brand marketing. They just want to be able to put numbers behind it. And so being able to utilize the digital platform allows you to put a lot of numbers behind what you're doing, why you're doing it, and why it's effective. Do you want to -- anything you want to add on the density? Or are we good?

Michael Doyle
CFO

Yes. I'd maybe just connect the opportunity with the new ad platform with your question specifically about the impact on each of those segments. And we do feel like the ad platform has a huge benefit for all of the segments, and given where we are in our penetration of the advertisers and retail segments, I don't expect a large change in composition because there's so much opportunity in each one. So thinking about for enterprise to mid-market to SMBs, the ability to use first-party data to improve targeting, to have self-serve access to campaigns to be able to experiment and shift budgets between campaign objectives, testing creatives across different target audiences. Those are all benefits that will accrue to each segment of the business, and we think we'll accelerate growth in all three segments.

Operator

Our next question comes from Youssef Squali with Truist.

Robert Zeller
Truist

Hi. This is Robert on for Youssef. Thanks for taking the question. I just wanted to ask a couple of questions in regard to AI. So it seems you're investing more heavily now in AI. So is that what explains the step up in R&D versus prior periods? Or is it a much larger investment than that? And then my second question is in relation to increasing the radius of neighborhoods and showing content from nearby neighborhoods. How far did you expand the neighborhood distance for content that you show now? Curious what it was previously and what it is now?

Sarah Friar
CEO

Okay. So why don't I start -- thank you. First of all, why don't I start talking about our investment in AI, I'll talk about the radius question, and then I'm going to flip the R&D cost question back to Mike. So from an AI perspective, we definitely want to make sure you're hearing the message loud and clear that we've been investing here for multiple years. So it's not a new thing for Nextdoor. And one of the reasons I came to Nextdoor is because of the data sets that we have.

Super unique, right? We own the local knowledge graph, and we do see that neighbors are effectively labeling that data for us, which is really interesting. In 2022, that was a really big year for the build-out of our AI team. It was our fastest-growing team. And with that, we have invested in areas like Notifications, making the Newsfeed more personal, and so that's why you're seeing that great growth in WAU that we've shown, right, the ninth consecutive quarter of growth, in fact. And we're definitely excited to continue to explore more possibilities. For example, how do we use AI to drive more new neighbors coming to the platform. Maybe it's helping with better invitations, neighbor-to-neighbor, or a new investment for us, which is having businesses invite neighbors to the platform. How do we use data to close that loop.

In the quarter, most recently, we've talked about generative AI. So last Tuesday, we made our announcement about the launch of our assistant feature and then also the addition of generative AI into some of our vitality areas as well. We are in the business of user-generated content. And so therefore using anything that is generative, has a very natural fit here. What gets me super excited about the AI

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"Assistant" is we're really helping neighbors get done the thing they're coming to the platform to do, but hopefully helping them do it even more effectively. So we're training that model from OpenAI, on Nextdoor data.

So it's giving the neighbor a response that is related to our platform and what works on our platform. So as they're posting and asking for help, maybe they're giving a recommendation, maybe they're trying to aggregate their neighbors, as I talked about, to build that community garden, we're helping them create a post that is in of itself much more engaging for the Nextdoor platform. And I've really enjoyed myself getting to use it because it's right there. It's easy to see what is core, but it puts a lot of control into the hands of the users.

And then on the vitality side, this is a place where I feel we have been really leading edge even relative to other really large platforms in the social media space. We were the first to implement a Kindness Reminder back I think in 2017 that slowed people down and reminds them to be more constructive. But up to this point, we've really just given the option to edit their posts. Now we can ask them to edit or we can even offer a suggestion of how to be more constructive. And I think that just continues in that same vein of how do we increase the vitality overall of Nextdoor because we know that helps create better neighborhoods, helps customers get things done that they want to get done.

On the radius of neighborhoods, if you recall, I think back at the end of 2021, we shifted to something called "anyone" content. And so this is the first time we allowed neighbors to tag their content and say, I'm fine with this content going to anyone depending on how useful it is. So sometimes you want to make a post that's really better off just in the neighborhood like you've lost a pest -- but sometimes you want to post about something much bigger, right? On a personal note, living here on the West Coast when fires were happening, I wanted to know what was going on even if those fires were maybe hundreds of miles away from them because I wanted to be able to help neighbors immediately, sometimes because I wanted to know what was going on, but that content that we want to let move to the extent it is still interesting and this is a place where AI comes to play again because it's not about setting hard and fast, rigid boundaries and saying this content can only travel this distance. Instead, it's much more about asking the question: is the content still interesting to this person? And making it very personalized.

For some people, they may only want to see things that are literally in their building. And for others, they might care about seeing something across the whole county, maybe even across the state line. And so this is where the data itself starts to become very powerful when we marry it to AI to allow the user to personalize what that Feed will look like. Okay, Mike on the R&D cost?

Michael Doyle
CFO

Yes, Robert, I want to pick up there on AI and then just operating expense management more generally. So certainly, we are investing deeply in this area of the business, just given the potential for impact, and that is true in R&D generally. We have managed costs very tightly over the last several quarters, we're seeing basically flat sequential OpEx growth over the last three quarters. That's true as well within the R&D line and thinking about headcount. Going forward, in the rest of the year, we are selectively adding to our product development team. It will include investments in AI capabilities, and you'll see a little bit of that in the quarters to come. But we really are leaning in on performance management and really being very targeted in where we are with incremental resources.

The other area where AI impacts our P&L is worth calling out is in gross margin. And first, I just wanted to call out the fact that we have very high gross margins by industry standards. We finished the quarter at 80% gross margin this quarter, down just a point seasonally. And it remains a great tailwind in the business. The most important cost in cost of revenue driving gross margin is our hosting cost. And AI compute costs are included here. We think these are very worthwhile investments to be making for us to be unlocking additional engagement and learning more about the impact that AI can have on the business.

Operator

Our next question is from Jocelyn Hu with Evercore.

Jocelyn Hu
Evercore

Hi, this is Jocelyn asking a question for Mark. Maybe first, could you give us an update on neighbor and advertiser retention rates? I think probably one year or several quarters ago, there were some disclosure around three months retention about 75% and then six months, 65%. And then last earnings call, you mentioned you retained 90% of your top 50 advertisers. So just wondering is there anything you can share on that front?

Sarah Friar
CEO

Yes. I appreciate the question. I think the TLDR I want to give you is that we continue to see really strong durability in the business, and there's been no meaningful change to our retention rate from a neighbor perspective, it is still incredibly high, I would say best in class in the industry. A fast way that I think about it is 50-50-50. So of our Verified Neighbors, 50% return on a weekly basis. Internationally that's actually more than 50%. And then all the folks who come back weekly, they come back on average about four times a week. That's actually a little bit over 50% from our WAU to our DAU. And then the third stat is the one that we gave you way back at our Investor Day in 2021 where we continue to see 50% of neighbors engaged after two years.

And so that indicates the enduring retention that we see on Nextdoor because of what we're bringing to neighbors. Great utility in the neighborhood and a great way to build community. On the advertiser side, last quarter we told you that 90% of our top 50 advertisers in 2022 had been retained. So again, speaking to the fact that advertisers are coming to the platform, finding value, and staying with us, and there has been no change in the LTM of that trend. It's remained in and around about 90%. Again it's something we're very proud of because we think that builds a great base for revenue growth because if we can keep the advertisers we have, we're continuing to build out how we're going to market.

I talked about pivoting towards recession-resilient vertical, pivoting towards the mid-market, building deeper relationships with ad agencies. All of that should then be additive on top of the advertisers we already have, the net new logos that are coming, and then of course we'll continue to go deeper within each of those customers. We typically find once we get a foothold, our ability to grow revenue in the hundreds of percent is quite high. Great example is the tech and telco provider that we look to here in Q1 of '23. Their spend has grown 300% since Q1 of 2022 as an example. So, we feel very good about retention rates on both sides of our marketplace.

Jocelyn Hu

Thank you. And then just one quick follow-up on the session growth rate. Is there anything you can provide, especially comparing versus WAU growth?

Sarah Friar
CEO

The session growth rate continues to grow faster than the WAU growth. And again, if you were kind of asking why is that happening? So we're bringing people back to the platform, but then we're giving them reasons to go deeper. Why are they going deeper? Number one is because we're personalizing the Feed. The more you're using your Newsfeed, the more you're seeing content that is really relevant to you. So you're finding if you're someone who loves a local business, you're probably seeing more recommendations of local businesses. If you're a new mover, you are maybe seeing some examples of places -- things to do in your neighborhood that you might not yet know about.

If you're a millennial parent, a key demographic for Nextdoor, you might be seeing more things to do with kids, especially now as we head into the summer, I'm seeing a lot of stuff in my Feed around things like local summer camps, as an example. So why that's important is if we bring those neighbors back, and I talked about the 50-50-50 durability, we help them to go deeper in the Newsfeed and in other surfaces like Discover -- that is just creating more impressions that we can ultimately sell to

advertisers, which increases our revenue. But it should all be done in a loop where it feels really high value to that high-intent audience coming to Nextdoor to get things done.

Operator

[Operator Instructions] There are no questions. So I'll pass the call back over to Sarah Friar with closing remarks.

Sarah Friar
CEO

Great. Thank you so much. As ever, we appreciate your time and support of everyone dialing in for this call. The analysts, who are asking great questions, but we also know we have a lot of investors and other stakeholders on the line. As you can tell from our quarter, we're really pleased with how we've entered 2023. We continue to control what we can control. So first and foremost, we are driving more neighbors to the platform, WAU growth up 16% year-over-year and continuing to see progress on both revenue and margin improvement. Sessions growth, as I just talked about to Jocelyn, again, continues to show that users are finding real value on Nextdoor. And because of that, they're also joining more organically. Over 70% of our U.S. Verified Neighbors came organically to the platform in Q1.

We're continuing to see strength in revenue: areas like the mid-market, tech and telco and our ad agency partnerships -- and we're optimistic that once verticals like financial services and real estate return to spending, they will perform well again for us.

We're investing in AI. This is a place where Nextdoor should absolutely thrive because of our local knowledge graph, because of that labeled data, and because we're creating products that are actually helping neighbors get done what they need to get done on Nextdoor. We're laser-focused on growing WAU and revenue, and you'll continue to hear us talk about that, whether it's driving invitations, top of funnel growth, whether it's driving new content types or better Discover and Feed relevance and then, of course, continuing to build out our proprietary ad tech stack.

And then finally, we're on track to return to revenue growth and margin improvement in 2023 while also investing in the long-term opportunity that we have. Everyone's a neighbor, and we're really excited to bring Nextdoor to them. So with that, thank you so much for your time today, and we look forward to talking to you through the quarter.

Operator

That concludes the conference call. Thank you for your participation. You may now disconnect your lines.

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