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Cresco Labs Inc. CNSX:CL

Earnings Call

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Call Participants

EXECUTIVES

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Co-Founder, CEO & Director

Gregory Butler
President & Chief Transformation Officer

Sharon Schuler
Chief Financial Officer

TJ Cole

ANALYSTS

Aaron Thomas Grey
Alliance Global Partners, Research Division

Brenna Cunnington

Jesse Pytlak
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Unknown Analyst

Presentation

Operator

Good day, and welcome to Cresco Labs Second Quarter 2025 Earnings Conference Call. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the call over to TJ Cole, Senior Vice President, Corporate Development and Investor Relations for Cresco Labs. Please go ahead.

TJ Cole

Thank you. Good morning, and welcome to Cresco Labs Second Quarter 2025 Earnings Conference Call. On the call today, we have Chief Executive Officer and Co-Founder, Charles Bachtell; Chief Financial Officer, Sharon Schuler; and President, Greg Butler, who will be available for the Q&A.

Prior to this call, we issued our second quarter earnings press release, which has been filed on SEDAR and is available on our Investor Relations website. These preliminary results for the second quarter are provided prior to completion of all internal and external reviews and therefore, are subject to adjustment until the filing of our company's quarterly financial statements. We plan to file our corresponding financial statements and MD&A for the quarter ended June 30, 2025, on SEDAR and EDGAR later today.

Before we begin, I want to remind you that statements made in today's call may contain forward-looking information. Actual results may differ materially. The risks, uncertainties and other factors that could influence actual results are described in our earnings press release and in the most recent annual information form and MD&A filed with the securities regulators. This call also contains non-GAAP measures also outlined in our earnings press release and in the MD&A filed with the securities regulators. Please also note that all financial information on today's call is presented in U.S. dollars, and all interim financial information is unaudited.

With that, I'll turn the call over to Charlie.

Charles Bachtell

Co-Founder, CEO & Director

Good morning, everybody, and thank you for joining us on our Q2 earnings call. We're pleased to be here and share the strategic steps we're taking to position Cresco Labs for this next phase of the cannabis industry, where consolidation is inevitable and the winning operators have the balance sheet, cash flow and capabilities to capitalize on the moment. Q2 was a steady and productive quarter for Cresco.

Operationally, we maintained our momentum and defended our retail and wholesale market shares in what remains an incredibly competitive environment. Strategically, we made critical decisions to reinforce our balance sheet, free up capital and hone in on new paths to growth. In Q2, we delivered \$164 million in revenue, in line with guidance and consistent with Q1 levels, reflecting our ability to counteract price compression through increased unit volumes in both retail and wholesale segments.

We generated \$83 million in adjusted gross profit and \$41 million in adjusted EBITDA as we continue to stack efficiency gains. Our second quarter cash flow from operations was \$9 million. The cannabis sector is approaching an inflection point. The operating and regulatory environments are pushing many operators to downsize significantly, particularly those lacking scale or carrying excessive debt. This means we're seeing a growing number of distressed assets, receiverships and consolidation opportunities across the industry.

We've been talking about this likely outcome for several quarters, and the trend will only accelerate from here. We see this as an incredible opportunity for Cresco. We remain committed to profitability and cash flow, but Q2 and Q3 also marked a step change in preparing Cresco Labs to be the partner of choice for industry consolidation. The shift is proving even more important as competition in our core footprint increases, and we set our sights on new expansion markets.

Now I'll walk through how we're thinking about this next phase. First and foremost, our #1 priority continues to be maintaining a solid balance sheet with a strong cash position. To that end, I'm thrilled to announce we signed a letter of commitment to refinance our debt and we'll be closing on or around August 13. We've opted to refinance \$325 million of our debt while paying down the remaining \$35 million. This pushes our maturity date out to August of 2030.

We're proud that we secured such favorable terms because they're a direct result of the discipline we've infused in every part of our business over the past 2 years. We've streamlined operations, made difficult calls like tightening credit sales and embedded a cash flow first mindset in every part of the organization. Beyond refinancing, we're continuing to strengthen our balance sheet and improve cash flow through ongoing AR management and restructuring initiatives.

One of these initiatives is our plan to exit the California market. While we're grateful for everything our California team has given Cresco Labs, including the FloraCal brand and our quality-at-scale approach to cultivation, but the state's structural challenges have made it too difficult to generate sustainable profits. Stepping away will strengthen our margin profile, unlock resources that can be funneled into new growth and bring our footprint in line with our long-term strategic direction.

Second, our focused footprint uniquely positions us to win with organic growth from our core markets and growth potential from target expansion markets. Everything we're doing is aimed at building the most productive, profitable and cash-generating footprint possible, one that can seamlessly integrate new states and assets. As previously stated, we will be opportunistic while being patient and disciplined in our capital allocation, prioritizing high-return organic growth and M&A opportunities.

We have ample organic growth opportunities materializing in the quarters ahead. For example, in Ohio, we're on track to open three new dispensaries before the end of Q1 '26, the first of which opens in early fall, building on our #1 retail share and #3 branded product share in the state. In Kentucky, as a first mover, we're making great progress on our cultivation build-out. This quarter, we executed an MSA with a Kentucky processing partner, an exciting milestone that will enable us to bring our full suite of branded products to patients. We're on track to have our first product in market in early 2026.

In Pennsylvania, we're building on the strength of our #1 branded share and fourth largest retail footprint ahead of adult-use conversion in this \$2 billion market. We opened our 18th dispensary in the state in May, and we recently turned on our Mount Joy cultivation facility. With this added capacity, we're positioned to lead on pricing, drive volume growth and capture additional market share regardless of the adult-use time line.

With organic growth in hand, we've been waiting patiently for the right opportunities to take on capital-efficient M&A. As expected, we're seeing more distressed assets for sale across the target markets such as New Jersey and Maryland. We're one of the few operators without overlapping operations and license cap constraints in these markets, giving us a competitive and compelling long-term growth story.

Importantly, we know that once we acquire assets, we accelerate their performance. Take Pennsylvania, where we acquired a small dispensary group in 2024, we added them to our loyalty program, and we increased shelf space for our house of brands. Together, this drove a 77% increase in year-over-year quarterly sales and over 200% increase in year-over-year EBITDA, a testament to the Cresco consolidation playbook in action.

And lastly, our proven retail and wholesale capabilities will keep enabling us to outperform the market. Our operational strength across every part of the supply chain is a key differentiator that allows us to outperform in nearly every market we operate in, and our execution is getting tighter at every turn. We've maintained #1 market share positions in Illinois and Pennsylvania, along with top 5 market shares in all of our limited licensed wholesale markets.

We rely on a disciplined consumer-focused approach to both wholesale and retail, paired with exceptional execution across cultivation, manufacturing and production. In wholesale, as we previously mentioned on our Q4 call, we are ramping up production of premium flower and manufactured products in our Kankakee, Illinois and Mount Joy, Pennsylvania facilities. This added cultivation capacity now gives us depth and

the ability to flex up when the market calls for it, meeting the growing demand that price compression encourages.

In retail, Sunnyside continues to outperform in an extremely competitive and fluid retail landscape by establishing customer loyalty, increasing basket sizes and delivering stronger unit sales year-over-year. Our dispensaries generate approximately 20% more revenue per store than state averages, a testament to our operational strength and careful attention to shopper experience. Competition is fierce in licensed capped markets where operators have identical store counts, yet our ability to consistently outperform peers underscores the strength of our retail model.

According to Hoodie data, we hold the #1 retail share in both Illinois and Ohio, where store counts are tightly regulated. We're also gaining share in markets where we have smaller footprints. In Florida, we're sixth in market share while ranking only eighth in store count. We're leaning into our expertise and repeatedly proving that we can win in both growth and margin-constrained environments. In closing, Cresco is ready for cannabis' next chapter.

In Q2, we delivered solid performance in line with guidance, maintained our market share in a highly competitive environment, continued to drive cash flow through operational discipline and signed a commitment letter to refinance our debt, which reduces the total facility size by 10% and extends the maturity date to 2030.

This milestone reinforces our balance sheet, preserves our equity value and creates financial flexibility for the years to come, giving us an even stronger foundation to execute against both near-term priorities and long-term growth opportunities. We've been playing the long game to create scalable, stable growth.

With our debt refinancing behind us, we're on the offense, executing on organic initiatives while building a targeted pipeline of M&A opportunities in profitable strategic markets. That strategy is supported by a meaningful white space in our footprint with several high-priority states still untapped, giving us a long runway for expansion. With that, I'll turn it over to Sharon to walk you through our Q2 performance in more detail.

Sharon Schuler

Chief Financial Officer

Thank you, Charlie, and good morning, everyone. As Charlie mentioned, this was a steady quarter operationally. We remain focused on cash flow over top line growth in our decision-making. As a result, we reported \$164 million in revenue, representing a 1% sequential decline from Q1. This modest decrease was primarily due to continued price compression in our Illinois retail operations. Wholesale revenue was flat as we stayed disciplined in our AR strategy, prioritizing creditworthy accounts and foregoing sales that carried repayment risk.

We delivered strong margins and cost performance this quarter, supported in part by a couple of favorable items that reflected great execution but are not expected to repeat going forward. Adjusted gross margin came in just shy of 51%, up 124 basis points sequentially. We benefited from selling through lower cost of goods product in Illinois, driven by stronger yields in prior quarters.

On the cost side, our team continued to execute well and made progress across multiple areas. Notably, we recovered approximately \$1 million in previously reserved bad debt, which contributed to the \$3 million sequential reduction in adjusted SG&A, bringing the total to \$50 million. Our accounts receivable balance is down 23% since the start of the year, a clear sign of our policy around credit risk and that much higher yields of connectivity we've created between sales and finance teams.

Across the business, we continue identifying and capturing small operational efficiencies. In addition, strong execution this quarter led to a few unique wins that [indiscernible] expected to reoccur, contributed meaningfully to our bottom line. Together, these factors supported \$41 million in adjusted EBITDA, representing 25% of revenue. In Q2, we generated \$9 million in operating cash flow and invested \$13 million in capital expenditures. We ended the quarter with a cash balance of \$147 million.

As Charlie mentioned, the most significant milestone is, we've signed a commitment letter to refinance our debt. We replaced our prior loan with a new \$325 million senior secured term loan maturing in 2030 at a 12.5% interest rate. This refinancing provides enhanced financial flexibility with favorable terms, including the option to prepay up to \$125 million, and it comes at a time when access to capital in the U.S. cannabis sector remains highly constrained.

In an environment marked by tightening credit and over \$2 billion in industry debt maturities on the horizon, our ability to secure long-term financing without equity dilution reinforces the strength of our business model and balance sheet. Completing this refinancing allows us to shift fully on to offense and take advantage of the consolidation opportunities ahead.

You can expect us to take a balanced approach, investing in smart CapEx, pursuing accretive M&A and continuing to drive operational efficiencies and disciplined growth, all while maintaining a strong balance sheet. Looking ahead to Q3, we expect revenue to remain roughly in line with Q2. Increased cultivation capacity in Illinois will help offset price compression across several of our markets. Further out, new dispensary openings in Ohio and expanded production in Pennsylvania are expected to provide additional tailwinds for revenue growth.

As the additional cultivation capacity we brought online in the first half ramps up, they will support our efforts to defend gross margin in a challenging price environment. However, in the near term, we expect some margin drag in Q3 and Q4, as we sell through initial harvest, which typically come with lower yields and lower utilization. Our focus remains on optimizing output from our fixed asset base to preserve as much gross profit as possible.

On the expense side, our commitment to continuous improvement is driving real results. We're consistently capturing small efficiencies that compound over time and help fund strategic investments for growth. We're excited to enter the back half of 2025 and push into 2026 with more flexibility as we find new growth while keeping focus on profitability and cash generation.

With that, I'll pass it back to Charlie.

Charles Bachtell

Co-Founder, CEO & Director

Thank you, Sharon. The cannabis industry is entering a new phase, defined by consolidation and rationalization. We anticipated this shift where many operators are being forced to scale back or exit and more M&A opportunities exist than ever. With our proven operating model, focused in productive footprint and clean capital structure, we're built for this moment, and we're well positioned to be the company of choice as this industry consolidates.

I want to thank the Cresco Labs team for their passion and continued commitment to grind, drive cash flow and capturing high-margin growth. Thank you for your time today. We look forward to sharing our continued progress in the quarters ahead.

Question and Answer

Operator

[Operator Instructions] Our first question today comes from Aaron Grey with AGP.

Aaron Thomas Grey

Alliance Global Partners, Research Division

Congrats first and foremost, on the debt refinancing. I know you guys put a lot of work into that. So you've done well in terms of optimizing the portfolio as demonstrated by the healthy margins with a rationalized footprint. And with the debt refinancing now behind -- you're better positioned to capitalize on growth opportunities as you outlined, getting more on the offensive -- just maybe some more color in terms of the M&A opportunities that you've mentioned. You made it clear that they're going to be prudent and strategic in that.

So without tipping the hat too much, maybe some color in terms of where you're seeing some of those attractive opportunities today, and are you seeing it more so in terms of deepening within some of the existing markets, we don't have the ceiling, as you mentioned, or in new markets that you're not currently in right now. So any color that you're seeing there would be helpful.

Charles Bachtell

Co-Founder, CEO & Director

Look, our footprint, we've discussed it over the past few calls. Our footprint has some great white space opportunities for us to get into markets that we are not in, that most, if not all of our peers are already in. And you could look at Maryland, you could look at New Jersey, you could look at Connecticut. There's just some really good opportunities for us to expand the footprint into states that have good regulatory structures that also create good economic profiles. And so we've worked real hard to put ourselves in a position to have the resources to be acquisitive, while at the same time, definitely challenging ourselves to be patient and disciplined as we evaluate those with the sort of the recent -- more recent struggles that some of our colleagues in the industry have had that it is increasing the number of assets that are going to be available in some of those markets, and we look forward to evaluating them and making some good strategic decisions.

Aaron Thomas Grey

Alliance Global Partners, Research Division

Appreciate that color there, Charlie. Second question for me, just in terms of broader for the category. Volumes remain healthy, pricing pressure continues to offset that, not flowing through to sales. Are you starting to see any signs of stabilization or maybe acceleration in the pricing pressure? And do you see any risk of that worsening as operators have debt coming due and may not have the same ability to successfully refinance? So any color or commentary you're seeing on volumes and how you're expecting pricing pressure moving forward?

Charles Bachtell

Co-Founder, CEO & Director

Yes. We think pricing pressure is a reality of the industry that we're in, especially as we also have competition and it is state by state. So whether or not there's a more aggressive priced state nearby that becomes an alternative for a consumer or as you look at THC-based chem products, there's competition that's come into this industry that's enhanced and really increased the pricing pressure.

We're operating the organization in a way that is preparing ourselves to be competitive in the event that, that continues. We're not banking on there being a change there. So we're taking the steps that we need to on the cost side of our business to make sure that we can stay competitive and maintain those market shares and that productivity. We definitely also, again, look at it on a state-by-state basis. So there's differences as you look across markets. Greg, any additional color?

Gregory Butler*President & Chief Transformation Officer*

No, I'd say to answer one of your questions, Aaron, we are -- prices are still seeing declines. I would say the rate of decline, though, has started to flatten in most of our core markets. So we're down quarter-to-quarter year-over-year. But from a rate perspective, that had slowed down. So maybe that's one encouraging thing. You're not on this negative slope.

The second thing that we're seeing is, yes, there's price compression, but a lot of retailers, including ourselves, have been able to pull up price compression because we've been able to keep our baskets -- larger baskets at a lower price per unit and overall holding pricing. Now that comes a little bit at the expense of trips because people are loading up on products and they're having them homes, so we're seeing less trips.

So really, that strategy continue to work for us as long as these lower prices bring shoppers into the stores. And as you mentioned, consumption is up. So people are consuming more cannabis than we've seen before. But really, the future outlook is at these lower prices, can this help entice more shoppers to come in. And if we're successful at doing that, to Charlie's earlier comments, we'll be able to really hold at these lower prices.

Operator

Our next question comes from Brenna Cunnington with ATB Capital Markets.

Brenna Cunnington

This is Brenna on for Frederico. Congrats on the results this quarter. Just looking at the margins, good to see some sequential improvements there. But you mentioned a margin drag is expected in the second half of the year. And it sounds like this may be temporary. So could you just provide some additional color on this?

Charles Bachtell*Co-Founder, CEO & Director*

Sure. This is Charlie. I'll start it off and then hand it to Sharon for some more detail. But -- yes, we're proud of the team for finding really operationally -- operational execution-based good guys in Q2. It's nice to see. It's great execution.

But as we had mentioned in the back half of the year, one of the impacts of the strategic decisions we made to bring on more capacity in markets like Illinois and Pennsylvania is that we've got this additional capacity now that's the initial yields that come out of any facility, are not optimized that, that cost comes in Q3 and Q4 as we sell through the product before it tends to normalize in the future quarters. Any additional color there, Sharon?

Sharon Schuler*Chief Financial Officer*

Yes. I mean just to kind of elaborate on that. I mean, as we sell through that product, right, it will be a bit of a drag on some of the margin going forward. Obviously, we'll continue to look for operational efficiencies to try to counter that, but it's just a reality we'll be facing in the back half.

Brenna Cunnington

Okay. Understood. And then regarding the Florida market share improvements, yes, we've been seeing that in the weekly state data, so good job on that. But looking at the underpinning drivers behind those improvements, could you provide a little bit more color on that? And if there's the potential for further improvements in the near term?

Charles Bachtell*Co-Founder, CEO & Director*

Sure, Greg will lead this.

Gregory Butler

President & Chief Transformation Officer

So we're really pleased with what we're seeing in Florida. Really, what helped us drive that is the quality of the products that our teams are able to get out of our facility in the state. And we are now -- even with a full outdoor greenhouse facility, we are holding some great quality products that are very competitive in that market, competing against indoor products and high-quality products in the state.

So it was a big recognition for the hard work that our team is doing in that state, which has gotten us to where we are. And we think we're looking at our Q2 yields. We are encouraged by what we're seeing in Q2. So it will help us in Q3, and we think that we are putting ourselves in that state in a very competitive assortment position. And because it is a full vertical state, obviously, it is based on the quality that our teams can bring to market is what drives the assortment in our stores, and that quality is continuing to show momentum.

Operator

[Operator Instructions] Our next question comes from Pablo Zuanic with Zuanic Associates.

Unknown Analyst

This is Rahul on for Pablo. We have two questions. First, I know you touched on this just a little bit, but with the potential for adult-use sales in Pennsylvania, can you talk about any changes you've made in that state in terms of cultivation capacity, product assortment expansions or store relocations and refurbishing? And the second question would be, of all the states where you sell wholesale, which are the two states where you have had to cut back on wholesaling due to worsening credit quality among third-party retailers?

Charles Bachtell

Co-Founder, CEO & Director

Absolutely. So as we look at the potential for AU and PA, I will -- I'll try to hit on them in the order that you asked them, but changes in capacity, we addressed. We brought on a secondary facility that we've had and that we did not need the production out of until recently. So we've turned that on in 1H, and that will be fully utilized as we enter the back half of the year here.

Assortment strategy, we've constantly -- and I'd say, in general, across the footprint, always focused on innovation and bringing products to market that the consumer wants. So it's no different in Pennsylvania. It's fair to note, though, that without an AU law being passed yet, there's still the same restrictions that apply to the product types that are available in the medical program there.

From a store location standpoint, I can tell you that the -- as far as new openings -- new store openings, I'd say we've been focused on the potential for adult-use in Pennsylvania for the last 18 months, 24 months. So new stores that we've brought online organically over that period of time have always had a focus on what would be not only useful in the medical program, but also in an adult-use scenario. Greg, anything else there?

Gregory Butler

President & Chief Transformation Officer

No, I would say what we're just seeing is, in Pennsylvania, you have a lot of players and operators ramping up their production ahead of adult-use. So you are seeing a competitive -- more competitive medical market. But as Charlie mentioned, with our supply coming online, it will give us an opportunity to continue to lean in on our pricing a bit today with the inventory to back it up to really be competitive and move products in the state.

Charles Bachtell

Co-Founder, CEO & Director

Second question was states, where we have significant wholesale presence and whether or not we've just had to turn off?

Gregory Butler

President & Chief Transformation Officer

Why don't I continue with that?

Charles Bachtell

Co-Founder, CEO & Director

Yes.

Gregory Butler

President & Chief Transformation Officer

It really comes down to two states that are major for us, we're watching. Massachusetts, as you might expect, any states that have a significant penetration of MSOs and independents increases your risk. Massachusetts continues to be a tough market from an AR perspective. I think it's why you're seeing other operators start to pull out of the states.

But we have really -- and kudos to our team brought that state in line and resegmented all of our customers to make sure that we're putting products in customer stores that are good payers. But we are also seeing it in states like Illinois, where you had some increased activity, whether it's due to financial struggles of some major outlets in the state, but that has also -- our decision to not sell to those customers may have impacted revenue, but we think it's the right thing to do.

Operator

Our next question comes from Jesse Pytlak with Cormark.

Jesse Pytlak

Cormark Securities Inc., Research Division

Just a single question for me. Having just gone through the debt refinancing process, can you speak to how lenders are reviewing the [indiscernible] liability and getting comfortable with it?

Charles Bachtell

Co-Founder, CEO & Director

Sure, Sharon, do you want to hit this one?

Sharon Schuler

Chief Financial Officer

Yes. I mean -- so it's obviously something that we have included, right, when we're looking at our different ratios with the lenders. But I think there's also a comfort there that we're -- our balance is not as high as some of our competitors. We also have been very clear about what that number would look like over time. So I think in the end, it is something that they all were very comfortable with knowing where we were on our position and feeling very strongly that, that would be one we handle.

Operator

At this time, we have no further questions. And so I'll hand the call back to Charlie for closing comments.

Charles Bachtell

Co-Founder, CEO & Director

Great. Just again, I really want to thank the broader Cresco team for the execution in the quarter, especially the team that was front and center on getting the refinance across the finish line. It really does put us in a great position for the go forward here. Like I said on the prepared remarks, we're built for this. Thanks, everybody, for joining the call today, and we'll talk to you next quarter. Bye-bye.

Operator

Thank you, everyone, for joining us today. This concludes our call, and you may now disconnect your lines.

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