

Environmental, Social, And Governance Evaluation

California Water Service Group

Summary

California Water Service Group (the Group), a publicly traded water utility holding company headquartered in San Jose, Calif., serves approximately 2 million people throughout the U.S. through its seven operating subsidiaries across California, Washington, New Mexico, Hawaii, and Texas. In addition to regulated water utility services, the company extends wastewater collection and treatment services to approximately 13,300 customers in select states. With infrastructure comprising over 7,000 miles of pipe, six water treatment plants, and numerous wells and wastewater utility facilities, the Group is the third-largest water utility in the country. In fiscal 2022, the company had revenue of about \$805 million, over \$3.9 billion in assets, and a workforce of over 1,225 professionals.

The Group's ESG Evaluation score of 74 illustrates our assessment of the company's capable management of water services and sewage treatment. The organization demonstrates resilience in its infrastructure and demand-side strategies, boasting low rates of non-revenue water leakage and robust water conservation initiatives. However, its efforts to mitigate water supply risks in its drought-prone regions are still in early stages. Regarding its social performance, the company has a strong record for water quality, while its workforce safety measures are in line with industry standards. Its diversity initiatives and performance are also comparable with U.S.-based peers. Illustrating its strong customer engagement, the Group maintains service shut-off rates well below industry benchmarks and implements a wide array of programs to support disadvantaged customers, resulting in relatively high customer satisfaction. Additionally, it proactively leads public policy initiatives aimed at promoting safe and more equitable access to its water utility services.

Its governance score reflects an effective board structure with a wide array of relevant experience and an expanding focus on diversity among its ranks. The company also maintains a strong commitment to its values and non-financial disclosures, evident in its robust business code of conduct and use of globally recognized reporting frameworks. However, its disclosure of select key standardized metrics for the sector remain in development.

PRIMARY ANALYST

Christina Sewell
San Francisco
+1-415-238-2439
christina.sewell@spglobal.com

SECONDARY ANALYSTS

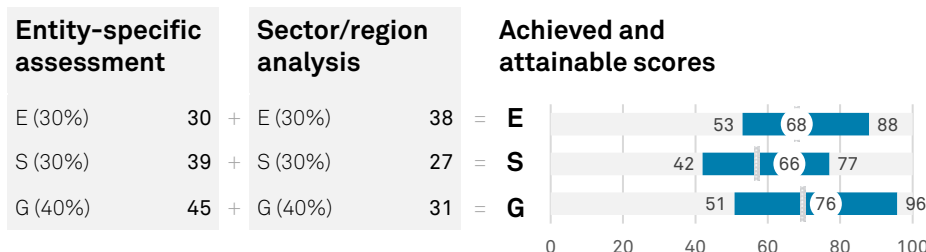
Natalie Wu
San Francisco
+1-415-371-5025
natalie.wu@spglobal.com

Alán Bonilla
San Francisco
+1-415-371-5021
alán.bonilla@spglobal.com

RESEARCH CONTRIBUTOR

Tanmay Kumbharkar
Mumbai, India

ESG Profile Components (figures subject to rounding)



Entity within its primary sector/region

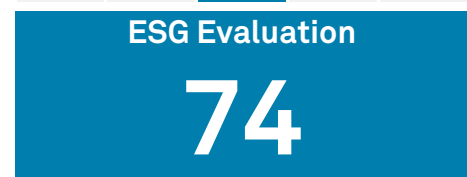
Entity's sectors/ regions versus all sectors/ regions

Min and max scores possible given sectors/regions. The gray line represents performance in line with industry standards.

ESG Profile 71


















Preparedness +3



A higher score indicates better sustainability. Figures subject to rounding.

Component Scores

Environmental Profile			Social Profile			Governance Profile		
Sector/Region Score	38/50		Sector/Region Score	27/50		Sector/Region Score	31/35	
 Greenhouse gas emissions	Good		 Workforce and diversity	Good		 Structure and oversight	Good	
 Waste and pollution	Good		 Safety management	Strong		 Code and values	Strong	
 Water use	Good		 Customer engagement	Strong		 Transparency and reporting	Good	
 Land use and biodiversity	Good		 Communities	Strong		 Financial and operational risks	Neutral	
 General factors (optional)	None		 General factors (optional)	None		 General factors (optional)	3	
Entity-Specific Score	30/50		Entity-Specific Score	39/50		Entity-Specific Score	45/65	
E-Profile (30%)	68/100		S-Profile (30%)	66/100		G-Profile (40%)	76/100	

ESG Profile (including any adjustments)

71/100

Preparedness Summary

Our assessment of the Group's preparedness as adequate illustrates its effective awareness of material disruptors in the industry, strong assessment capabilities, and embedded focus on sustainability throughout its operations and company culture. The company excels in infrastructure resilience and prioritizes capital allocation toward water conservation programs, maintenance of water quality in the face of emerging contaminants, and water affordability initiatives. Its leadership employs scenario analysis for both its climate change and water supply reliability assessments, and it uses internal and external sources to stay informed of key physical and transition risks. We find the Group's demand and supply side assessments of its water systems to be effective, but it is less clear how resilient the company's overall water management strategy is against its heightened exposure to climate variability throughout California.

Preparedness Opinion (Scoring Impact)

Capabilities

Awareness	Good
Assessment	Excellent
Action plan	Good

Embeddedness

Culture	Excellent
Decision-making	Good

Adequate (+3)

ESG Evaluation

74

Note: Figures are subject to rounding.

Environmental Profile

68/100

Sector/Region Score (38/50)

Water utilities encounter moderate exposure to environmental factors, including medium- and long-term water supply and climate impacts. The proper handling and disposal of waste associated with water treatment, along with the management of greenhouse gas (GHG) emissions arising from energy and fuel consumption, are significant concerns within the sector.

Entity-Specific Score (30/50)

Note: Figures are subject to rounding.



The Group’s water use strategy is focused on infrastructure resiliency and conservation, yet high water stress in the region remains a challenge. Leveraging acoustic sensor technology and geographic information system spatial leak dashboards, the Group achieved an impressive leakage rate of 4.7% in 2022, well below the industry average (16%). The company employs inclining block rates for residential customers and invests heavily in its conservation programs to encourage reduced water consumption. These initiatives resulted in 16.5% company-wide water consumption savings in December 2022 compared with December 2020, exceeding the state of California’s conservation target of 15% for that period. Additionally, it is focused on expanding water reuse, with a goal of 5% from 3% recycled water out of total water supply by 2035, surpassing most peers’ performance. Despite its strengths, the Group is confronted with high exposure to water stress in California, representing 90% of its customer base. While the company conducts its own water reliability studies in each of its districts, it is still developing an understanding of precise water stress from its wholesalers (purchased water composes 45% of its supply) and relies on six critically over-drafted groundwater basins. The Group is exploring supply-side options to address these issues such as wastewater treatment for reuse, as well as brackish desalination systems; however, these are early efforts.

The Group’s low waste exposure compared to utilities with larger wastewater operations and its strong sewage management track record are balanced by a limited understanding of its biosolid waste disposal. The company’s sewage management performance leads most peers, with few to no water effluent infractions or sanitary sewage overflows, with the exception of an anomalous year in 2021 after inheriting a less-maintained system in Hawaii. Further, none of the Group’s wastewater facilities are in 100-year flood zones, indicating a lower likelihood of flooding-related contamination. The company is ahead of environmental regulations on the proper disposal of hazardous waste, and looking ahead, the Group is focused on achieving zero environmental violations. Balancing this strong performance, the company lacks tracking mechanisms for its biosolid waste disposal and off-haul destinations, unlike many peers that report beneficial reuse and landfill figures. It has therefore yet to set forward-looking targets. We view such disclosures as essential to understanding the utility’s life cycle impact of waste.

While it is an effective manager of GHG emissions and land use considerations, the Group is still developing forward-looking targets toward carbon neutrality. The company’s Scope 1 and 2 emissions intensity is well below the industry average, in part due to a relatively higher renewables penetration of the California grid and its minimal wastewater operations. The company has also recently begun developing its Scope 3 inventory (roughly 94% of total emissions) in preparation for approaching regulation. Positively, its renewable energy consumption jumped in 2022 from near zero to 10% due to the company’s investments in on-site power generation and electric utility green tariffs, as it aims to invest \$5 million into renewable energy sources by 2032. This includes its plans to purchase only fully electric passenger vehicles from 2035 onward to align with industry-leading California Air Resources Board regulations. While its performance is marginally favorable to global peers, its lack of science-based emissions targets signals a reactive approach compared to some industry peers. Regarding land use, the Group’s sizable footprint in fire-prone areas is well-managed with district-level preparedness plans in coordination with local firefighting entities. It also stays ahead of regulation to protect sensitive species.

Social Profile

66/100

Sector/Region Score (27/50)

The U.S. water utility sector encounters substantial social risks due to the vast geographical reach of water basins and the involvement of diverse stakeholder groups. Customer engagement heavily relies on providing affordable water and minimizing service interruptions. Furthermore, ensuring water quality and safety is crucial to prevent potential health impacts.

Entity-Specific Score (39/50)

Note: Figures are subject to rounding.



Workforce and diversity

Good



Safety management

Strong



Customer engagement

Strong



Communities

Strong



General factors

None

The Group's prioritization of customer affordability through several conservation and affordability programs sets it apart from peers.

By implementing an inclining block rate pay structure, the Group achieved a 20% average bill reduction for residential customers from 2008-2019, and it maintains an average affordability ratio below the U.S. Environmental Protection Agency's benchmark of 2.5% of household income, despite customarily higher water rates in its region. Its Customer Assistance Program (CAP) for eligible lower-income or disadvantaged customers also provides a substantial 50% credit on service charges. Both its CAP and flexible billing options before service disconnection have resulted in an extremely low 0.2% shut-off rate. The Group also maintains higher-than-average customer favorability of 84%. While it has yet to roll out an advanced metering infrastructure dashboard, it maintains customer communication through emails, social media, and webinars.

The Group employs advanced water treatment processes, proactive tackling of emerging contaminants, and robust safety reporting.

Its water treatment methods include granular activated carbon treatment, ion exchange, and reverse osmosis in some cases, illustrating prioritization of water quality and strict adherence to the U.S. Safe Drinking Water Act. The company's sole non-health-related and procedural tier 3 violation in recent years, in addition to its zero boil-water advisories associated with unplanned service disruptions exceeding four hours across its California water systems, surpass peers' performance. Further, it is addressing emerging contaminant levels (including per- and polyfluoroalkyl substances, cyanotoxins, and microplastics) before regulatory requirements come into effect. Regarding workforce safety, it tracks near fatality misses and incidents for both full-time staff and contractors, contributing to a record of zero fatalities since the company began disclosing this data in 2020. The Group attributes a recent uptick in Total Case Incident Rate to post-COVID-19 pandemic challenges and implemented enhanced safety training and a 2023 year-end target of 5% improvement from 2022, which we view positively.

Its community engagement highlights partnerships with local firefighters, broad public policy efforts, and commitment to sustainable business practices.

Importantly, the Group forges partnerships and sponsors grant and scholarship programs with local firefighters and colleges to solidify its role as a leader in emergency preparedness and water utility recruitment. Given its position in wildfire-prone California, the company's support of more than 50 fire departments throughout the state is critical, and it regularly provides emergency on-the-ground coordination and resources. For its public policy efforts, the company's water specialists are embedded within the EPA Taskforce for emerging contaminants, and it is also an active member in relevant Groundwater Sustainability Agency (GSA) boards and committees. In 2022, it also allocated 24% of its total supplier spending on diverse entities, moderately surpassing the industry standard.

The Group's culture fosters a positive, familial work environment that remains challenged by an aging workforce.

In line with industry trends, voluntary turnover has gradually risen as the sector is challenged by an aging workforce, and the company is focused on succession planning and recruitment strategies in an effort to transfer institutional knowledge. In line with peers, the Group also maintains several development and training opportunities for employees, offered internally and through external certifications. Gender and racial diversity are comparable with the industry, but its periodic analysis of gender pay equity and higher-than-average union-represented employees at 61% of the workforce are stronger facets of its performance.

Governance Profile

76/100

Sector/Region Score (31/35)

The governance profile region score is derived from an assessment of the Group’s U.S. headquarters, which we consider in adherence with robust governance standards characterized by a stable political system and a strong commitment to the rule of law.

Entity-Specific Score (45/65)

Note: Figures are subject to rounding.



Structure and oversight

Good



Code and values

Strong



Transparency and reporting

Good



Financial and operational risks

Neutral



General factors

3

The Group’s leadership structure and oversight capabilities align with prevailing industry practices. The ten-member board demonstrates 70% independence by S&P Global Ratings’ methodology, which caps director independence at nine years of service due to exposure to key-person risk and long-term group cohesion. While the combined CEO-board chair position and longer tenures of some of the board committee chairs limits our view of the board’s independence, this risk is somewhat mitigated through use of a lead independent director. The board’s gender and racial diversity are both nominally above industry average at 40% women and 20% people of color, and efforts within its formal succession planning are underway to enhance racial diversity. Exemplifying a diverse skillset relevant to the sector, several board members and executives bring experience in water utility operations, regulatory and legal matters, as well as engineering and sustainability. We view positively the full board’s oversight of the Group’s climate and water resource strategy, including water supply planning, wildfire preparation, and drought response, given the significance of sustainability issues in the sector.

The company’s widely applied business code of conduct, responsible supplier performance, and executive remuneration goals illustrate dedication to its mission. Importantly, its business code of conduct applies to employees, contractors, and suppliers, demonstrating commitment to ethical practices throughout its value chain. Cyber security oversight is ensured by the board, with dedicated senior-level management of the company’s information security strategy and protection of personal and proprietary data. The Group’s CEO compensation ratio to the median employee (30:1) is also the lowest among peers, with the company maintaining a balanced breakdown of fixed and variable compensation. The board’s long- and short-term variable pay parameters also provide incentives for sustainability areas where it aims to enhance performance, including goals around water supply diversification, water quality performance, and renewable energy investment ambition, which help to align executive incentives with the Group’s key sustainability challenges.

The Group demonstrates an increasing commitment to non-financial reporting by aligning its ESG disclosures with globally recognized standards, but is a later adopter of some advanced practices as it continues to improve the integrity of its disclosures. It bases its reporting on the Sustainability Accounting Standards Board/International Sustainability Standards Board, Taskforce on Climate-related Financial Disclosures (TCFD), and Global Reporting Initiative. The company also uses materiality assessments and external ESG ratings to understand and communicate its sustainability efforts to stakeholders and provides detailed remuneration information in proxy statements. Across its non-financial reporting, the Group has recently prioritized data integrity and more robust internal controls to include the use of independent consultants, particularly in the case of its emissions reporting. However, its lack of key metrics such as emission decarbonization targets and water stress figures in its annual reports constrain our view of the Group’s reporting framework. We note that it intends to incorporate these metrics in forthcoming annual disclosures.

A positive adjustment to the Group’s overall governance score reflects its notable strengths across all factor categories, despite certain challenges. In terms of financial and operational risk, the company has no material contingent liabilities or financial health issues.

Preparedness Opinion

Adequate
(+3)

Preparedness

Low

Emerging

Adequate

Strong

Best in class

We assess the Group's preparedness as adequate based on its awareness of emerging disruptors across the water utility landscape and a strong conservation strategy, offset by high exposure to increasing water supply risk in its operating region. The Group's mission is to deliver high-quality and affordable water and wastewater utility services to varied stakeholders over the long term, supported by its sustainability-minded business practices and ethos. This mission is paired with a growth strategy driven by small-scale acquisitions of neighboring undercapitalized community water systems. Conservation and water quality are a key focus of the business, and it leverages customer education, rate structure, and innovation to meet these objectives. However, the Group's heightened exposure to water supply volatility and physical climate risks in California pose long-term challenges for the business, and while we view its assessment of its most material risks as capable, its current water management strategies' resilience against these threats is less clear.

The board is well aware of the risks and trends the company faces, including those related to climate and water supply reliability, and it embeds water quality and supply diversification metrics into its executive remuneration incentive policies, in line with stronger peers in the sector. The board and senior leadership are guided by iterative water supply reliability and climate change risk assessment studies as well as their executive remuneration policies. The latter offers several incentives for enhanced water quality and supply diversification as well as the setting of targets for emissions performance, among other material sustainability factors. These are informed, in part, by leadership's use of scenario planning as well as water balance and gap analyses to evaluate the company's water quality and demand and supply outlook over several decades and increasingly by district. Its prioritization of key adaptation investments is led by its senior-management-level committees, which collaborate with cross-functional working groups throughout the organization before providing recommendations to the board. Notably, its assessment processes include regular discussion with external stakeholders, including utility regulators, GSAs and other water basin groups, and industry associates to prepare for emerging issues such as physical climate impacts, changing customer demand, emerging contaminants, and cyber and physical security.

The company addresses its high exposure to water supply risk by prioritizing conservation efforts and water recycling initiatives paired with other infrastructure improvement and expansion, but the overall resilience of its integrated water management strategy is less evident. Consistent water supply shortages in the West due to diminishing snowpack and groundwater reserves in addition to a growing trend of droughts and wildfires have accelerated the company's infrastructure and related investments, especially given its current sizeable dependence on costly imported water. In 2022, it allocated \$327.8 million in capital expenditures (41% revenue and a roughly 12% year-on-year increase) to projects spanning water main replacements, improved pipeline networks and distribution, and water recycling projects through its own and partner wastewater treatment plants. In the drought-affected Central Valley, it collaborates with municipal partners to bank groundwater and fund recharge initiatives, and it is conducting an exploration of brackish desalination systems, but these are in early stages of development. While its efforts are diverse, in our view, the long-term resilience of the Group's water management strategy remains uncertain as it is still in the initial phases of quantifying its various risks' estimated financial impacts on its operations and developing and stress testing its corresponding adaptation responses.

The Group's familial work culture embeds its values of water quality and accessibility for customers throughout its operations, which we view as an asset in support of long-term sustainability. Its CEO is highly visible in the organization, a key driver in ensuring prioritization of high-quality and accessible services. The full board visits field locations annually across its subsidiaries to gain on-the-ground operational insights of its sites and engage directly with employees. We believe this facilitates feedback from staff and incentivizes innovation in service of the Group's strategic vision. Senior management also maintain close relationships with customers, regulators, and community members. In the last several years, it has prioritized its policy and regulatory working group activity at both the local and national level to ensure that the Group maintains credibility on material ESG issues. We view this holistic incorporation of the company's values in its day-to-day operations to be an effective tool for long-term sustainability.

Climate-Related Financial Disclosure

TCFD Recommendations Alignment Assessment:

Not adopted	Partially adopted	Adopted
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We assessed to what extent the entity has adopted the Financial Stability Board’s TCFD recommendations. We do not opine on the quality of the entity’s disclosure or the climate change scenario assumptions, if any, but rather comment on the number of disclosures made, based on the TCFD’s suggested disclosure list. Based on the entity’s publicly available information, in our opinion California Water Service Group has partially adopted the TCFD recommended disclosures.

The formal structure of ESG and climate oversight at the Group begins with its ESG Working Groups which report quarterly to the ESG Executive Oversight and Strategy and Operating Committees on climate-related issues. These committees are composed of senior managers who report directly to the company’s board of directors, which has oversight of and provides guidance on the objectives, action plans, and practices of the company’s ESG efforts. The board is informed about climate-related risks regularly throughout the year, and progress against goals and targets is tracked in part through executive remuneration policies.

In 2022, the company also carried out scenario analysis to analyze potential climate-related risks and opportunities, using RCPs 4.5 and 8.5, and it qualitatively discloses the potential financial impact of climate-related risks over short-, medium-, and long-term time horizons. Not included in the Group’s disclosures, however, is a description of how these issues will serve as a quantitative input to the company’s financial planning process. While the Group considers existing and emerging regulatory requirements related to climate change and uses materiality analysis to describe the relative significance of climate-related risks, it has yet to communicate how its strategies prepare it to be resilient to the scenario outcomes.

Governance	Strategy	Risk management	Metrics and targets
Description of the board’s oversight of climate-related risks and opportunities.	Description of the climate-related risks and opportunities identified over the short, medium, and long term.	Description of the organization’s processes for identifying and assessing climate-related risks.	Disclosure of the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
Adopted	Partially adopted	Partially adopted	Partially adopted
Description of management’s role in assessing and managing climate-related risks and opportunities.	Description of the impact of climate-related risks and opportunities on the organization’s businesses, strategy and financial planning.	Description of the organization’s processes for managing climate-related risks.	Disclosure of scope 1, 2 and, if appropriate, 3 GHG emissions, and the related risks.
Adopted	Partially adopted	Adopted	Adopted
	Description of the resilience of the organization’s strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Description of how processes for identifying, assessing and managing climate-related risks are integrated into the organization’s overall risk management.	Description the targets used by the organization to manage climate-related risks and opportunities and performance against targets.
	Partially adopted	Adopted	Partially adopted

Sector And Region Risk

Primary sector(s)	Utility Networks
Primary operating region(s)	United States

Sector Risk Summary

Environmental exposure

The regulated utility network sector's exposure to environmental risks stems from its infrastructure assets and exposure to the environmental characteristics of entities across value chains. These networks are generally viewed as having high responsibility for ensuring clean water and air and helping to transition to a lower carbon economy. While electric, gas, and water networks each have unique environmental risk drivers, the most material environmental risks facing these subsectors are the physical effects of climate change and mitigation policies. Each subsector also faces some land-use risk; as they grow they risk encroaching on habitable or undeveloped lands that are more exposed to biodiversity issues in some parts of the world. Electric and gas utilities are exposed to significant energy transition risks, indirectly, through their upstream partners. These risks to networks are moderated, at least financially, by the regulatory support they enjoy and their ability to absorb costs through rate increases. However, less direct reputational effects can be significant given utilities' strong brand recognition. For electric transmission and distribution networks, the physical effects of climate change, including more frequent and severe wildfires, storms, hurricanes, and tornadoes, have the potential to disrupt the functioning of critical equipment and processes. Battery storage has its own set of environmental risks, stemming from mining and end-of-life disposals of materials used in battery units. For natural gas networks, we focus on gas explosions and leaks that emit highly potent greenhouse gases and may adversely affect local biodiversity, leading to costly penalties and reputational damage. For water networks, environmental risks are mainly water quality and availability, sometimes because of inefficient and aging infrastructure. Both water quality and availability--essential for this sector--can be impaired by climate-related factors, including droughts and floods.

Social exposure

The regulated utility network sector plays a crucial community role by providing essential services that must remain affordable and reliable to ensure conciliatory regulatory and customer relationships. This is the essence of utilities' social license to operate. However, as infrastructure ages, utilities must also ensure safety as leaks, explosions and fires can yield very material financial and reputational consequences. Water utilities may also face public health risks if they are unable to avoid drinking water contamination or stop wastewater from polluting supplies. Governments and regulators focusing increasingly on affordability, which we believe could create barriers to regulated networks' cost recovery. This is especially so in areas facing upward cost pressures from ongoing high investments in renewables and grid strengthening. Longer term, increased costs and improved solar and battery technology could result in some downstream residential, commercial, and industrial customers partially defecting from electric utilities. Utilities also face significant workforce issues. Amid an unrelenting energy transition, electric utilities, specifically, must develop employee bases with appropriate skills to operate the grid of the future, as well as retain employees. Given the sector's high unionization, companies have to focus on labor-relations management to avoid labor disruptions and related costs. Given that utilities are local in nature, they play a prominent role in communities and have large numbers of local employees. This can often result in regulatory support, but also carries a responsibility to

contribute to the community and support low income customers, as well as tactfully mitigating disputes around land use as they expand. Finally, given the social responsibility of providing continuous electricity, gas, and water supply, preventing any risk that could lead to a power blackout or water shortage is an important consideration. Cyber-attacks are therefore increased threats for the sector, more so than in many other sectors.

Regional Risk Summary

United States

With robust institutions and rule-of-law standards, the U.S. demonstrates many strong characteristics but lags several other countries with respect to ESG regulations. Governance is characterized by a very stable political system, a strong rule of law, a powerful judiciary, and effective checks and balances. Conditions of doing business are generally very good. The U.S. follows a rules-based approach to corporate governance focused on mandatory compliance with requirements from the major exchanges (NYSE and NASDAQ) as well as legislation. State corporate law is also a key source of corporate governance, particularly Delaware where over half over all U.S. listed companies and close to 70% of Fortune 500 companies are incorporated. Exchanges mandate high standards of corporate governance. The NYSE requires companies listing on its exchange to have boards made up of a majority of independent directors, with separate remuneration and nomination committees. However, formal requirements on ESG reporting are not as established as they are in European countries. While a growing number of companies have an independent chair, the combination of CEO and chair roles is still popular. Remuneration continues to be a contentious point because U.S. executive pay dwarves global pay levels. The U.S. ranks 27 of 180 on Transparency International's 2021 Corruption Perception Index.

Related Research

- [Environmental, Social, And Governance Evaluation: Analytical Approach](#), Sept. 20, 2022
- [The ESG Risk Atlas: Sector And Regional Rationales And Scores](#), July 22, 2020
- [Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide](#), July 22, 2020
- [How We Apply Our ESG Evaluation Analytical Approach: Part 2](#), June 17, 2020

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