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Earnings Call

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Call Participants

EXECUTIVES

Linda A. Findley

President, CEO & Director

Robert P. Ryder

Interim Chief Financial Officer

ANALYSTS

Bradley Bingham Thomas

*KeyBanc Capital Markets Inc.,
Research Division*

Daniel Arnold Silverstein

*UBS Investment Bank, Research
Division*

Peter Jacob Keith

*Piper Sandler & Co., Research
Division*

Robert Kenneth Griffin

*Raymond James & Associates,
Inc., Research Division*

Presentation

Operator

Thank you for standing by, and welcome to the Sleep Number's Second Quarter 2025 Earnings Conference Call. [Operator Instructions] As a reminder, this call is being recorded today, Wednesday, July 30, 2025. This conference call will be available on the company's website, ir.sleepnumber.com. please refer to today's news release to access the replay.

On today's call, we have Linda Findley, President CEO; and Bob Ryder, Interim Chief Financial Officer of Sleep Number.

Before handing the call over to the company, we will review the safe harbor statement. The primary purpose of this call is to discuss the results of the fiscal period ending on June 28, 2025. Commentary and responses to questions may include certain forward-looking statements. These forward-looking statements are subject to a number of risks and uncertainties outlined in the company's earnings news release and discussed in some detail in the annual report on Form 10-K and other periodic filings with the SEC.

The company's actual future results may vary materially. In addition, any forward-looking statements represent the company's views only as of today and should not be relied upon as representing its views as of any subsequent date. The company specifically disclaims any obligation to update these statements. Please also refer to the company's news release and SEC filings for a reconciliation of certain non-GAAP financial measures and supplemental financial information included in the news release or that may be discussed on this call.

I will now turn the call over to Linda Findley, Sleep Number's CEO. Ma'am, please go ahead.

Linda A. Findley

President, CEO & Director

Thank you, Janine, and thank you to everyone for joining today's call. I'll start first by welcoming Bob Ryder, our Interim CFO. Bob joins us with extensive experience in public company turnarounds, which will be invaluable to us as we continue to focus on driving shareholder value. He is acclimating quickly. I'm confident that it will be a great partner to our executive team as we navigate the work ahead. I'd also like to thank Francis for his contribution to Sleep Number over the past 2 years.

We wish him the best in his future endeavors. When I joined Sleep Number in April, I challenged our team to question assumptions and think critically about every aspect of our business from the products we sell to the ways we sell them. My goal was to push for bold and rapid action, and I'm happy with the progress. When I started, I immediately took a look at what was and wasn't working.

Marketing spend was outsized and highly inefficient, particularly in Q1. So we took the necessary actions to reset the marketing program with a 30% cut to Q2 year-over-year marketing spend. This was a big part of the drop in Q2 revenue. We brought in new marketing leadership and started building back from there. The changes are starting to work as expected.

We've already seen the efficiency of our marketing programs grow in Q2 and continue into the start of Q3. We were able to move fast to reposition the business and drive future better performance because of the organizational realignment we did in Q2. The current team is focused on creating a more cost-effective business that will change the trajectory of the top line in the coming quarters.

It will take time, but I'm confident we'll get there. To start, we are focused on controlling costs and building an ongoing discipline of cost management into everything we do. We originally targeted \$80 million to \$100 million in annualized cost savings. We now expect to remove over \$130 million in operating expenses in 2025 compared to 2024, exceeding the plan we shared last quarter.

The reductions have been deep and broad across the entire organization because, frankly, they needed to be. We have streamlined G&A and R&D by reducing redundancy and layers without compromising on our

innovation. Additionally, we reduced our full year selling expenses as well as marketing spend that allowed for investment in the back half of the year to support our 2025 plan. Reducing expenses is not the limit of our ambitions, nor is it our only lever to increase profitability.

I'll focus on 3 initiatives: optimizing our product portfolio value and distribution; enhancing the efficiency and effectiveness of our marketing; and managing our capital structure. Let's start with products.

We are rethinking our position, price and distribution. People love Sleep Number beds for their comfort and adjustability. However, the process of selecting and purchasing our beds is a bit more complicated than it should be. While many customers value choice, it's not always clear how our products are distinct from one another or how our different technologies translated to benefits for our customers.

We are refining the experience by leveraging data to better understand consumer needs and what drives them to buy a Sleep Member beds. As part of this, we'll be enhancing the product line to meet a broader customer base. This will include new price points, new features that drive comfort and durability and simpler selection to help people find the right Sleep Number beds for them. You'll start seeing the results of these changes in 2026.

In parallel, we are considering new distribution channels, including digital first, retail partnerships and emerging platforms while continuously evaluating our existing retail footprint to ensure that we have the right format in the right locations. As I mentioned in our first quarter earnings call, everything is on the table. Our goal is to build on the vertical model that we have and make every channel work harder together for the customer. As we pursue these changes, we are moving even faster on our marketing approach with a focus on efficiency and impact. We cut deeply and quickly in Q2 to reset the inefficient marketing strategy of the past.

While we saw lower revenue in the quarter because of that shift, we use this moment to adjust and rebuild our approach. We are sharpening our positioning and messaging with a focus on relevance and strengthening the connection with today's consumer. Importantly, we are opening new marketing channels that we were not leveraging in the past to reach more customers with a shopper value proposition.

We are also improving how our potential customers can find us through AI and other technical implementations. We know what we need to do to get the next customer, and we're building the programs, infrastructure and creative content that will set us up for strength in the future. So far, it's working. We're seeing early signs of significant improvements in cost per acquisition, including a 24% increase in conversion year-over-year in Q2.

These metrics continue to improve through July, a trend we anticipate to carry on as we roll out new marketing programs. In short, we are resetting the business. We are moving these initiatives quickly while maintaining compliance with our debt covenants. That said, the pace at which we can move is somewhat limited and shaped by our capital structure. To get more flexibility and enable us to move even faster, we are in active dialogue with our lenders.

Those conversations have been constructive, and we hope to have more news to share on that front in the near future. Regardless, we remain focused on managing our debt structure in a way that supports the business and shareholder value creation. To be clear, we are acting with urgency and discipline.

As Bob will discuss further in detail, we are expecting roughly the same revenue in the second half as we saw in the first half adjusted for the 53rd week this year. We're spending slightly less marketing in the second half based on the efficiency gains we've seen. This, combined with improved ARUs, we are seeing from product mix and promotional optimization drives our forecast for the balance of the year. Sleep Number remains a powerful brand with loyal customers and proprietary technology.

When I joined the company, we needed to make dramatic and decisive changes a reinvigorated our commercial and product strategies. We're implementing those plans now. With improved focus and by operating with greater simplicity, we will deliver against our goals and create value for our shareholders, our customers and our team members.

Before I turn the call over to Bob, I want to thank our team members for their continued focus during this period of change. Their commitment to our customers and to doing the hard work required to reset our business is what makes our progress possible.

With that, I will now turn the call over to Bob.

Robert P. Ryder

Interim Chief Financial Officer

Thanks, Linda, for the warm work, and good morning, everyone. I want to start off by thanking everyone at Sleep Number. In my first week here, everyone has been incredibly gracious, professional and helpful. I can also say that from my short time at Sleep Number, our team members are passionate about the company and are working diligently to improve the business. As the newest member of the team, I bring fresh eyes and an added perspective. I look forward to working with them along with our other stakeholders to drive shareholder value.

As Linda shared, we're taking decisive actions to reset the business for long-term profitable growth. That reset is well underway. We're focused on commercial and product improvement, continued cost discipline and better cash flow management. I'll walk through the company's Q2 financial performance and then speak about our progress on our cost structure, liquidity management and expectations for the future. Let's start at the top of the P&L.

Net sales for the second quarter were \$328 million, down 19.7% from the prior year. As Linda noted, we cut marketing spend significantly in Q2, which partly drove the sales decline in the quarter. As we implemented our new marketing strategy throughout the quarter, we saw increased conversion, which has continued to improve into July. This is why we have confidence in our sales forecast for the second half of the year, which I'll touch on a little bit later.

Gross profit margin was 59.1%, flat versus the prior year. Continued reduction in material costs and manufacturing efficiencies were offset by unit volume deleverage and a mix shift towards lower-priced products as consumers prioritized value. That said, our gross margin profile remains strong relative to historical levels and is indicative of our underlying brand strength. Over the past several years, we've steadily expanded gross margin through product cost reductions, innovation and operational efficiencies.

This will remain a focus as we move forward. Let's turn to costs. Operating expenses were \$185 million before restructuring and nonrecurring costs, down 21% and year-over-year and \$51 million lower than the prior quarter. These reductions are the result of our organizational redesign and cost saving initiatives implemented in the first half and reflect more savings than we shared on our last call.

We recorded \$8 million in restructuring costs in the quarter and expect approximately \$8 million of additional restructuring costs to be incurred in the second half of the year. Adjusted EBITDA was \$23.6 million, down \$4.7 million from the prior year. Adjusted EBITDA margin was 7.2%, 30 basis points higher than the prior year. This margin rate expansion was driven by disciplined cost management partially offset by the sales decline. Our leverage ratio on a trailing 12-month basis was 4.56x EBITDAR at the end of the second quarter, within the 4.75x covenant maximum.

I want to briefly share an update on 3 key items. First, cost savings. We fundamentally reshaping our cost base. As you know, the company reduced costs significantly in 2023 and 2024. Since Linda joined, we have identified \$130 million of cost reductions for the full year 2025 as compared to the full year 2024. This surpasses our original annualized target of \$80 million to \$100 million. These reductions are the result of streamlining leadership layers, improving marketing efficiency simplifying operations and narrowing R&D to core platforms without compromising innovation. These changes contributed directly to the \$51 million or 22% Q2 operating expense reduction as compared to Q1. And we're definitely not done.

We will continue to look at the business to reduce costs, increase efficiency and improve profitability and cash flow generation. While Q2 results are below where we want them to be, they reflect intentional strategic decisions as part of the reset. The pullback in marketing while deliberate and necessary weighed on demand in the early part of the quarter. However, the positive response during Memorial Day reinforces our strategy, and we're seeing signals that our revised approach is working. We acknowledge

our sales results are not yet in line with the industry, but more recent trends are encouraging and give us confidence that we are on the right path. Second, we are acting with urgency to address our capital structure. We're actively engaged with our lenders in productive conversations. In parallel, we're exploring refinancing and other non-dilutive options that will provide us with more flexibility and allow us to reinvest in growth.

In the meantime, we have improved our processes around working capital and capital expenditures. Importantly, our reset is expected to deliver breakeven cash flow in the second half. Our first priority for any positive operating cash flow is to pay down debt. Lastly, we do not want to provide some visibility and we do want to provide some visibility into our expectations.

As mentioned, we're managing the business to stay within our existing covenants as we engage with our lenders. We expect to see full year net sales of approximately \$1.45 billion, representing a 14% year-over-year decline. Second half sales will be roughly comparable to first half sales. This anticipates second half moderation of our year-over-year sales rate declined to 9%. This percentage change is partly driven by softer year-over-year comparisons plus the 53rd work week in 2025. We believe our top line expectations are supported by, first, reduced marketing spend in Q2 had a negative impact on sales.

With our new strategy, we are already seeing improved cost of acquisition and conversion in Q2 with continued improvements through today. Our total marketing spend as a percentage of revenue in the second half will be slightly up when compared to the second quarter. Second, the promotional strategies we have implemented are driving a higher ARU while also improving our product mix, which also supports net sales.

We see evidence of this improvement in July and expect those outcomes to continue for the balance of the year. Turning to gross profit margin. We have seen positive trends for the past several quarters and we expect to deliver gross profit margin of approximately 61% for the second half of the year, including mitigation of the impact of tariffs. We've also talked a lot about operating expenses, something that is under our control. We now expect full year 2025 operating expenses, excluding restructuring and other nonrecurring costs, to be approximately \$830 million, which is \$130 million less than 2024.

With these anticipated outcomes, we expect to be in compliance with our debt covenants. In closing, we are doing the hard work, and we are committed to making changes necessary to ensure the company performs regardless of the consumer environment. With significant progress against our cost structure, we are actively resetting our strategy to drive demand. Our top priority remains the generation of cash to pay down debt. We have and will continue to make bold moves to reposition the company to create shareholder value.

With that, I'll turn it back to the operator for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Dan Silverstein from UBS.

Daniel Arnold Silverstein

UBS Investment Bank, Research Division

Is just outside of the changes to the marketing model? Can you break down the composition of the additional cost savings you expect to harvest this year where are these coming from? And how are you balancing the longer-term impacts of these actions given the cumulative number of cost savings over the last 3 years is just very large?

Linda A. Findley

President, CEO & Director

Absolutely, Dan. And also congratulations on your new role. We are -- when you look at the breakdown of the \$130 million of the cost savings, we're not giving an exact breakdown on this call. However, it roughly follows the same percentages that we announced for the \$80 million to \$100 million before. .

So we're very focused on making sure that we're making structural changes to how we operate primarily through reductions in G&A and R&D to make sure that, that scales effectively as we grow the business in the future. Specifically, when you look at the marketing cost savings, a lot of those are structural changes. So while we did a hard reset in Q2 based on trying to reset the efficiency of marketing and reset the strategy there.

A lot of those changes can bring scale through the efficiency that we're actually seeing going forward. So we anticipate that any future reinvestment in marketing would be done at a much higher efficiency level than in the past. But right now, we think we're focused mostly on structurally how do we redirect those dollars into more effective programs, more effective channels, many of which, frankly, are already industry proven long term. So a lot of what we're doing in the early days isn't necessarily rocket science. It's kind of -- it's a lot of just opportunities that we can drive for the business going forward while layering some more strategic marketing on top of that. Hopefully, that answers your question.

Daniel Arnold Silverstein

UBS Investment Bank, Research Division

Very helpful. And then maybe just looking forward, you mentioned 1 lever to gain momentum into next year. We'll be exploring digital-first retail partnerships and some other partnerships. How do you think about the consideration set and kind of the alignment or economic terms you'd be looking for in these type of endeavors? .

Linda A. Findley

President, CEO & Director

Sure. So first, I think it's important to note that our vertically integrated model is one of our biggest assets. And so our intent is to build on top of that not necessarily replace or change that. And the way that we see it is we can enhance both distribution long term by looking at other models that allow us to take advantage of broader distribution, but still maintain a strong margin profile while also raising awareness for leads that would actually come into the stores as well.

So we see opportunities to think about distribution more holistically and think about how the different channels in an ecosystem approach would actually impact each other still maintaining the strong margin profile that we've already enjoyed to date.

Operator

Our next question comes from the line of Brad Thomas from KeyBanc.

Bradley Bingham Thomas*KeyBanc Capital Markets Inc., Research Division*

A lot of really interesting things here that you're working on. The one that I'm most interested in is probably the changes to the product assortment and pricing. And I was wondering if you could share a little bit more about how you're going to come up with that strategy, how you might be able to test it, if at all, before you put it into place. And what the timing might look like for the refresh?

Linda A. Findley*President, CEO & Director*

Sure. So I'll try to give you as much detail as I can. Obviously, we want to be cautious about revealing too much too early. But we've been doing a significant amount of consumer research to really understand the specific needs that our customers have, the benefits they're looking for, what they optimize for a purchase, which I think is important to do ongoing research on just because that constantly changes as you see macroeconomic environments as well as personal preferences change. .

But we have a huge amount of data already, plus we're pretty lucky in that we have 30 billion-plus hours of sleep data from our existing customers already. so we can really understand more about what they're optimizing for, what benefits them when it comes to sleep quality and sleep improvement.

And we can combine all of that together. Also, while we've done a lot of cost refinements on our R&D and G&A, as we mentioned before, we do have that entire history of R&D already that we can work on and implement some of the knowledge that we gained from that work in the past as well. And we can leverage that at a pretty great cost base because we already have it in the company. I guess in short, I would say that the most important thing we're doing in product is listening to the consumer. And we luckily have both a history of doing that and currently are conducting a lot of that work with our existing and potential consumer base to think about how we reach a broader TAM of consumers in the process of developing new products.

We'll start rolling out some of this material in the beginning of 2026. So that's really where we are. We are moving very quickly in the physical product world, things usually move pretty slowly, but that's actually pretty fast.

And so we're aggressively thinking about how we look at the assets we already have, the benefits of the product and how we can get that into the hands of customers. On the promotional and pricing side, I just want to emphasize that we have an incredibly valuable product and an incredibly differentiated product. And so really, that's just thinking about the structure of how we talk about the product, how we set the margin profile and how we bring value to the customer going forward in both price and promotion.

Bradley Bingham Thomas*KeyBanc Capital Markets Inc., Research Division*

That's really helpful. And if I could follow up on the wholesale comments. I think that's very interesting. We've seen many new direct sales get into wholesale. There's obviously -- it can greatly expand the addressable market with more distribution points. But the other -- on the other hand, it does come with lower margins. I guess could you share any more about where you are in that journey of reexploring that opportunity for the company?

Linda A. Findley*President, CEO & Director*

I can't share details at this stage about where we're looking. What I would like to do is when I said before in the previous earnings call and say it now of everything being on the table.

I think it's both wholesale but also other direct-to-consumer channels that have strong margin profiles beyond what would be considered traditional wholesale. So we're really thinking about everything holistically across the board, but with a focus and priority of maintaining the strength of our vertical model and our margin profile. So that's really the optimization that we're looking at when we think about distribution.

Operator

Our next question comes from the line of Bobby Griffin from Raymond James.

Robert Kenneth Griffin

Raymond James & Associates, Inc., Research Division

Linda, first, I wanted to dive a little bit further kind of into the rebuild of the advertising strategy. I don't know if there's any more details you can offer. But I guess -- what I'm looking at like historically, this business was 13%, 14% of sales spent on ad. When you think about what a goal would be for the business on a go-forward basis with the dollars going the way you and the team feel they're most efficient. How do you think about that level and something for us to kind of greater look towards as we build out maybe what a new model for Sleep Number would look like? .

Linda A. Findley

President, CEO & Director

So I think it's a really interesting question. And I think the way that we're approaching marketing as a percentage of sales is I think we look at industry best practices, and we want to continue to optimize in order to drive towards industry best practices. So what you're going to see probably is some volatility in marketing as a percentage of sales as we sort of work into this new efficiency that we're gaining and the new programs that we're gaining because again, it takes time for these things to take hold.

But -- so you'll see some volatility, and you'll see some continued investment in the right way with efficient dollars based on driving our top line. But my intent would be that our percentage of marketing spend to sales should get more efficient and lower and more in line with industry expectations in the future. Again, you'll see some volatility in the near term, which is intentional of that percentage. But long term, I think it has a huge amount of opportunity based on what we're already seeing even into July to become a lower percentage of sales but far more effective.

Robert Kenneth Griffin

Raymond James & Associates, Inc., Research Division

Okay. And I guess, secondly, on the selling process comment, interesting comment because if you do look at moving into other distribution, that probably does have to be a little bit quicker of a process to kind of compete on the different floors, but are you currently testing new different selling process? Is that more to come maybe in '26? Just curious how you and the team are looking at kind of flexing that differently over the next couple of quarters. .

Linda A. Findley

President, CEO & Director

Yes. So I think that's more something that we'll start talking to you about in 2026, and we can give more details then.

Operator

Our last question comes from the line of Peter Keith from Piper Sandler.

Peter Jacob Keith

Piper Sandler & Co., Research Division

I was just looking at some of the guidance metrics that you provided, I guess you're moving towards now guiding for gross margin expansion in the back half. And I do think you have a little bit of tariff pressure. Maybe could you help us unpack the drivers that you expect and maybe reframe where the tariff pressure would stand in the back half?

Linda A. Findley

President, CEO & Director

Sure. So our guide really -- and again, part of the reason that when we put our outlook forward, we were really focused on trying to be as clear as possible with the dollar amount because with the 53rd week and the year-over-year comparisons, percentages are a little bit sort of different than what you might expect based on expecting the same revenue roughly in the second half of the year versus the first half of the year. .

So we feel pretty confident in our plan going forward based on our marketing efficiencies based on what we're seeing in ARU as far as strength of mix and strength of profitability going into the third quarter. So all of that is a good foundation. I think that for us, specifically, when we look at tariffs through previous pricing changes that were made in the business, we've been able to completely mitigate tariffs within our margin structure and continue to find more opportunities for material cost reductions as well as optimizations based on our promotional strategy and based on how we're approaching the business.

So we've been able to actually mitigate those tariffs through both negotiations with our suppliers and also through some previous pricing actions that we were able to apply to this pretty effectively, especially considering the new moderated plans of tariffs that we've seen to date. Obviously, that consistently changes. But at this point, it's no impact.

Robert P. Ryder

Interim Chief Financial Officer

Yes. I'll just follow up on Linda. Look, we -- as everyone knows, we've done a very good job on cost reduction, frankly, coming in from the outside, it's quite amazing, right? Even seeing for the quarter, sales down what they were and seeing an expansion to the gross profit margin. I mean that's in my experience, like shockingly good, right, that you were able to take those costs to offset the impact of these reduced sales. So I think within the company, we're pretty confident around our control and our ability to control costs in the gross profit margin.

I think the thing we're all focused on as we get out of the costs -- we have to continue the cost cycle, but eventually, you run out of cost savings, right? So what we're really focused on -- or what Linda is going after the commercial side, right? How do we make product more relevant to the consumer, make the buying experience easier, right, and reduce complexity for the consumer and for the company and how do we have the marketing strategies that again, resonate better with the consumer and increased activation and make marketing drive more sales growth.

And we are seeing some positives. And it's -- again, from the outside, it's incredible how quickly this new team has worked to reinvigorate both to take all the costs out and to reinvigorate and really change the whole go-to-market from a product and marketing perspective. So I look forward to being part of it as we go forward and seeing the positive results of all that work.

Peter Jacob Keith

Piper Sandler & Co., Research Division

Okay. And encouraging to hear on the improved marketing spend and the efficiencies. Obviously, Labor Day is coming up, and that's a big holiday weekend. The sales guidance is helpful, but there's kind of a lot of moving pieces with store closures and you get the extra week. Maybe could you frame up a ballpark of what same-store sales than in the back half? And then what that extra week contribution will be to Q4?

Robert P. Ryder

Interim Chief Financial Officer

Yes. I don't think we're going to get into the extra week. Obviously, it helps. And one of the chances when Linda and I joined that it's the 53rd week year, right, which I was at a -- one of my former employers also had a 53rd week a year and it just -- it sends the whole place into a fluid because it just complicates everything. But I think we provided the sales. I mean the good thing is we're at the halfway point and provided the full year forecast. So you guys can figure out the growth for the first half and the back half, and we're just focused on executing against that sales forecast.

Linda A. Findley

President, CEO & Director

Yes. And just to build on that a little bit more. We're not specifically discussing same-store sales on this call at this point. But as we continue to always look at our store portfolio, et cetera, we will continue to make smart decisions about where our stores are, what the footprint is, et cetera. But we are putting forward this approach, assuming roughly the same-store footprint. And again, with some puts and takes to the business than to what we've had in the first half of the year. .

Operator

This concludes our question-and-answer session. I will now turn the call over to our CEO, Ms. Linda Findley for closing remarks.

Linda A. Findley

President, CEO & Director

Thank you, everyone, for your time today. We're energized by the work ahead, and I look forward to updating you on our progress in the coming months and quarters. In the meantime, if you have any additional questions, please don't hesitate to reach out to us directly. Thank you.

Operator

Thank you for joining today. You may now disconnect.

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