

FIGURE 1: TRADING BONDS

Instrument	Issue date	Maturity Date	Coupon	Amount outstanding (USDm)	Price	Yield (%)	Z-spread (bps)	ISIN
USD 1.25bn unsecured bond	30-Jul-15	30-Jul-27	8.97%	1,250	56.57	22.56	2,234	US988895AF56
USD 1bn senior unsecured bond	14-Apr-14	14-Apr-24	8.50%	748	55.77	28.74	2,853	US988895AE81
USD 750m unsecured bond	20-Sep-12	20-Sep-22	5.375%	750	55.64	37.71	3,759	US988895AA69
Total Eurobond debt				2,748				

Sources: Debtwire, Markit for bond prices as at 10-Aug-20

ZAMBIA ON ROAD TO DEBT RESTRUCTURING; HIRES ADVISORS

For over a decade, Zambia has focused on stepping up public investment to address its infrastructure issues. However, this has strained the fiscal budget and widened the deficit to 8.2% in FY19 (FY18: 7.6%, FY10: 3.0%), largely on account of accelerated interest payments. In December 2019, the country failed to repay loans borrowed from African Development Bank (AfDB) and was thus placed under sanctions. The sanction was lifted, after Zambia repaid the outstanding due. To address the distress, the government hired advisors in May 2020, expecting to restructure debt and strengthen liquidity. In FY19, Zambia reported Gross Domestic Product (GDP) growth of 1.5%, a significant fall from 4% in FY18 (FY17: 3.5%). In the wake of the coronavirus (COVID-19) crisis, the International Monetary Fund (IMF) revised its estimates on Zambia's GDP, which is now expected to fall by 4.9% in FY20 against c.3% growth expected previously.

Economic outlook: even before the pandemic hit the landlocked country, the economy was sluggish. This is largely attributable to US-China tensions; weakness in manufacturing activities; and adverse weather, which affected the mining (c.11% of total GDP) and agriculture (c.10%) sectors. Inflation jumped to 9.8% in FY19 from 7% in FY18, driven by the acceleration in prices of food and fuel; and 23.4% year-on-year (YoY) depreciation of Zambian kwacha (ZMW) against the USD. Note that the local currency also depreciated against other major currencies, largely on account of higher imports of petroleum products, electricity and agriculture inputs. The impact was intensified by downgrade of the sovereign rating by major rating agencies. In April 2020, Fitch and Moody's both downgraded Zambia to CC and Ca from CCC and Caa2, respectively. However, Moody's changed the outlook from negative to stable.

Zambia's external debt swelled to USD 11.2bn in FY19 (FY18: USD 10bn) from USD 1.7m in 2010. Likewise, the share of external debt to

GDP jumped to 40.7% in FY19 from 37.6% in FY18. Thus, cost of external debt service surged to USD 1.2bn in FY19 from USD 0.98bn in FY18 (FY17: USD 0.7bn), which eroded international reserves to USD 1.4bn (equivalent to c. 2.1 months of import cover) in FY19 from USD 1.6bn in FY18. According to Bank of Zambia (BoZ), external debt service accounts for 85% of the country's gross international reserves. However, according to Fitch, Zambia's external debt service is 105% of the current international reserves. Moreover, Moody's expects the debt to GDP ratio to push above 110% this year.

Mounting debt and Chinese debt diplomacy:

Zambia's debt was in check until 2010; however, external borrowing surged since The Patriotic Front (PF) assumed power in 2011. The PF has borrowed heavily for infrastructure and civil service (see [figure 10](#) for government expenditure breakdown). Debt levels increased further after the current President, Edgar Lungu, was elected in 2015. Subsequently, the country's external debt-to-GDP ratio soared to 31.7% in 2015 from 17.4% in 2014. Rather than borrowing from the IMF and The World Bank, which provide loans at low rates, Zambia turned towards China and other unconventional sources.

There are reports of loans borrowed by the country but not recorded in the official numbers. According to [The Economist](#), these unaccounted loans could add up to USD 10bn as of April 2019. Most of such loans are owed to China, for various infrastructure projects, and are likely to be collateralized by the underlying project assets (see [figure 7](#)). Therefore, there is a growing speculation that in case Zambia restructures Chinese debt, China could take control of the projects, which include roads, airports and mines amongst others. China is known to lend funds to developing countries, as part of its debt diplomacy. If the borrowing nation is unable to repay the debt, China tends to seek concession or other advantages in exchange. Sri Lanka's Hambantota Port serves as a good example. In 2017, when the Sri Lankan government was unable to pay its USD 1bn debt linked to a port, it had to relinquish the right of operating the port to China under a 99-year lease. In Zambia, there are concerns over a similar takeover of

ZESCO, the state-owned power company, due to USD 1.5bn being financed by China Exim Bank and International Commercial Bank of China for construction of Kafue Gorge Lower Hydro Power Station. In May 2020, ZESCO signed a USD 548m contract with Power China to develop 60 MV grid connected Solar PV Power Plant. Many such ZESCO projects have been financed by China, (see [figure 6.7 and 8](#)), however, ZESCO provides limited disclosure on the same.

Unconventional debt structure: we have divided Zambia's reported loans into three categories: i) Eurobonds; ii) multilateral organisations; and (ii) China and other unconventional sources. To date, Zambia has USD 3bn outstanding under the Eurobonds. The multilateral loans, provided by organisations such as The World Bank, are relatively stable and carry a low rate of interest with an extended maturity. We note a steady rise in borrowing from China and other unconventional sources such as bilateral government loans, loans from fuel suppliers,

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and loans from AfDB. According to the 2019 budget book published by The Ministry of Finance of Zambia, debt service is composed of 37% loans from multilateral organisations; 33.3% from commercial and non-Paris club; and the remaining from Chinese creditors (31.1%).

In the sovereign debt basket, the maturity of the Eurobonds is drawing close, with the first bond due to mature in September 2022. Zambia was supposed to create a sinking fund for the timely repayment of debt. However, so far, the country has not been able to build the fund. Considering the weakening economic indicators, looming maturities and no clear indication of repayment, the market has already priced Zambian bonds at distressed levels. The 2022 Eurobond, as of 10 August 2020, is priced at USD 55.64, while yielding 37.71% (see [figure 5](#)). Interest payments on each of the Eurobonds are to be paid semi-annually and are next due on: (i) September for 2022s; (ii) October for 2024s; and (iii) July for 2027s.

The restructuring process: on 28 May 2020, the Zambian government hired Lazard, a financial advisor, to advise on restructuring of debt, as reported by [Debtwire](#). It also hired White & Case as legal advisors on 23 June, for liability management of the portfolio. In December 2019, the Zambian cabinet decided to engage with advisors, to enhance liquidity. The government is also trying to pull back from USD 3.1bn of contracted debt, which is not yet received.

On 23 June 2020, Zambia's bondholder committee appointed Newstate Partners as a financial advisor, as reported by [Debtwire](#). The committee consists of 10 international financial institutions: Greylock Capital, Amia Capital, Global Evolution, BlackRock, Fidelity International, NN Group, Candriam, JPMorgan Asset Management, Alliance Bernstein, UBS AG, Pictet and Ashmore Group, holds 35% of outstanding sovereign Eurobonds. According to the [Debtwire](#) report, the committee is in close contact with other holders representing additional 30% of Zambia's outstanding Eurobonds. Moreover, many of these holders are also significant investors in the government bonds issued on the domestic market. It was further reported by [Debtwire](#), that several real money funds holding Zambian bonds are reluctant to participate in the committee but are actively involved in discussions. The bondholders are also concerned over Zambia's plan of approaching the IMF.

It should be noted that Zambia's 2022 and 2024 Eurobonds lack the collective action clauses (CAC), which are a part of the 2027 bond series. CACs can make it easier for countries to proceed with orderly debt restructuring, by enabling majority of creditors

to modify the payment terms or otherwise restructure debt, thus overcoming any obstacle presented by minority creditors that favour holding out for legal recourse. In case of Zambia, it is possible for the minority bondholders of the abovementioned instruments to block the resolution on restructuring, if there is any.

Deficit financing: a rise in external debt service led to a preliminary fiscal deficit of 8.2% in FY19, which exceeded the government's target of 6.5% (FY18: 7.6%). Interest payment accounted for 13% of total expenditure in FY19, up from 11% in FY18. Increased expenditure offset the 11.9% YoY growth in government revenue, which was supported by dividend, fees and charges and extraction royalties.

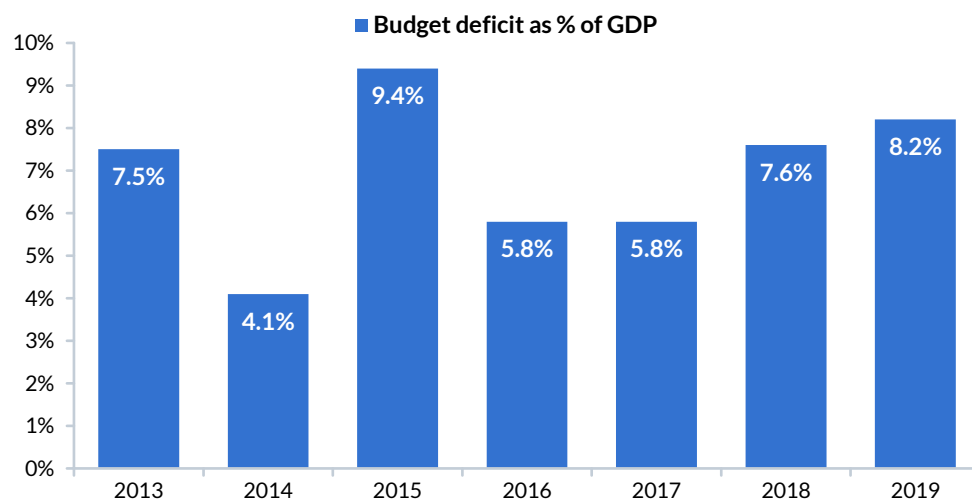
The mining trouble: Zambia's copper exports contributed c.69% to export revenue in FY19. However, in FY19, copper exports dropped 25% YoY, on the back of 20.4% YoY lower volume and a c.6% YoY reduction in average realised prices. The plunge in volumes resulted from lower imports of copper ore and concentrates, temporary shutdown of smelters for refurbishment and low mineral ore grades at some of the country's major mining entities. Amid the pandemic, copper price fell by 15.9% in April from December 2019 levels. However, according to Ministry of Finance, copper prices have already begun to recover gradually.

Despite being a critical sector, taxes on mining business in Zambia are amongst the highest in the world. In 2019, the country proposed tax changes to extract more revenue from the sector. It hiked royalty rates to around 5.5%-7.5% from 4%-6%. Apart from this, the Zambian government has taken a tough stand against miners. It initiated liquidation

proceedings against Konkola Copper Mines (KCM), which is largely owned by Vedanta Resources, an India-based mining enterprise, and Zambian State Mining Company, which held c.20% stake as of April 2019. The government accused KCM of breaching the terms of the mining license. It has been over a year since the liquidation, but the government is yet to secure a buyer for KCM. Although some Turkish and Chinese entities expressed interest in purchasing the mines, the ongoing arbitration was a roadblock. In April 2020, Glencore, a British mining enterprise, announced its intention to shut the Mopani Copper Mines (MCM), a Zambian subsidiary of Glencore, in view of the weakness in commodity prices and the economic implications of the pandemic. The Zambian government responded by announcing plans to revoke Glencore's operating permits for the Nkana and Mufulira mines unless the intended closure was justified. The authorities detained the CEO of MCM, Nathan Bullock as he attempted to leave the country. We note that these efforts hint at the government's intention to seek a more active role in the mining sector rather than being a minority shareholder. ZCCM- Investment Holding (ZCCM-IH), a state-owned mining company, has already begun exploration, while commissioning new mines for gold and manganese. The ongoing intervention of the government has intensified worries about the investment climate in the country.

Covid-19 impact: In a recent speech delivered by the Minister of Finance of Zambia, Dr Bwalya K E Ng'andu, the IMF has revised the country's FY20 GDP growth rate to negative 4.9% from c.3%. This could be the first recession for Zambia in the past 25 years, according to The World Bank. The pandemic

FIGURE 2: BUDGET DEFICIT AS A % of GDP



Source: Debtwire, Bank of Zambia

has affected travel, tourism, manufacturing, and trade activities, thus dampening the demand for goods and services. As a result, the ZMW depreciated by 26% against the USD, propelling inflation to 16.6% and 15.9% in May and June 2020, respectively.

There is a funding gap of ZMW 26.9bn to be expected in FY20. The government expects revenue to fall short of ZMW 17.2bn of the approved budgeted expenditure for FY20. The shortfall is attributable to COVID-linked tax relief and the cancellation of c. ZMW 4.35bn of external financing. Domestic revenue could be 17.8% short of the budgeted target for FY20, while tax revenue could fall by 12.7% from the initial expectations. However, the non-tax revenue is expected to outperform the budget by 7.3%, largely on account of receipts from dividends and on-lending activities. The government believes spending will increase by ZMW 9.7bn, primarily on account of COVID-linked relief funds; rise in foreign currency spending on account of currency depreciation; and increase in repayment of external debt. In FY20, external debt service is expected to increase by ZMW 2.2bn to ZMW 3.4bn versus ZMW 1.2bn in FY19.

Relief measures amidst coronavirus crisis: the government has decided to issue a COVID-19 mitigation bond, which targets to raise up to ZMW 8bn from the banking sector and pension funds. Until July 2020, Zambia managed to raise ZMW 6.8bn. The issue proceeds will be solely used for domestic expenditure, especially for small and medium enterprises (SME). The bond proceeds will be allocated as follows: (i) ZMW 3.185bn to the Presidential Covid-19 Economic Recovery Fund; (ii) ZMW 1.315bn for third-parties payments (mainly to microfinance institutions); (iii) ZMW 1bn for drug debt and equipment procurement; (iv) ZMW 1.7bn for grain purchases; and (v) ZMW 0.8bn for other purposes.

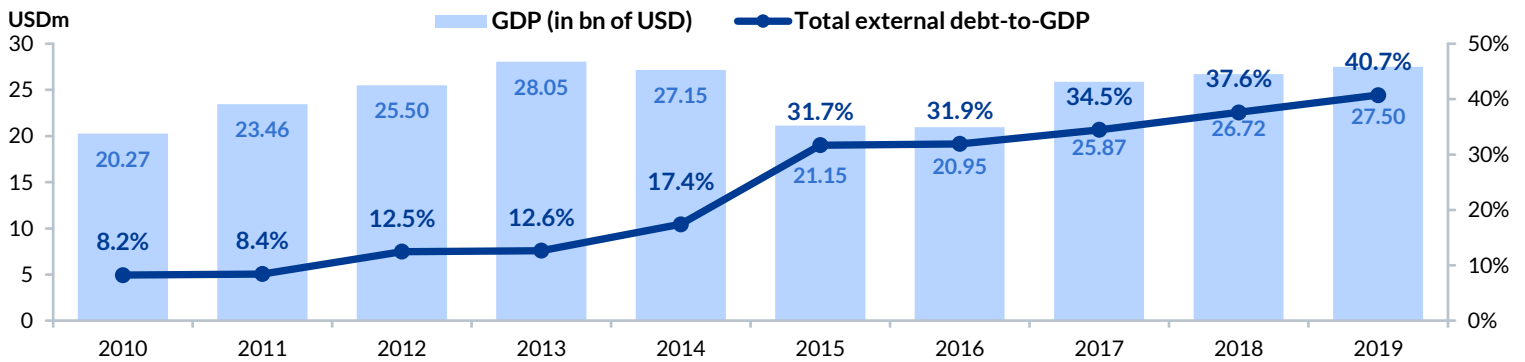
In the banking system, BoZ has eased liquidity through a ZMW 10bn medium-term refinancing facility, which is available to eligible commercial banks and non-bank financial institutions. Funds from the facility would be used to restructure, refinance or extend credit (at favourable terms) to businesses and households impacted by COVID-19. As on 13 July, 11 banks and 12 non-financial institutions applied for ZMW 4.8bn of funding, of which

ZMW 3.9bn is approved. In view of the COVID-19 crisis, on 15 June, BoZ directed the Paris Club to suspend the payment of principal and interest to some official creditors, for the period beginning 1 May 2020 until December 2020. Additionally, President Lungu has requested his Chinese counterpart to consider debt relief and cancellation. This comes after the Chinese ambassador to Zambia expressed the country's intention (on 7 July) to consider cancelling interest on debt and extending the repayment period.

The government also announced various relief measures, including: i) ZMW 500m to Public Services Pensions Fund to pay over 1,500 retirees or their beneficiaries; ii) ZMW 170m to banks for clearing third-party arrears; iii) ZMW 140m to road contractors; and iv) ZMW 950m to suppliers of goods and services.

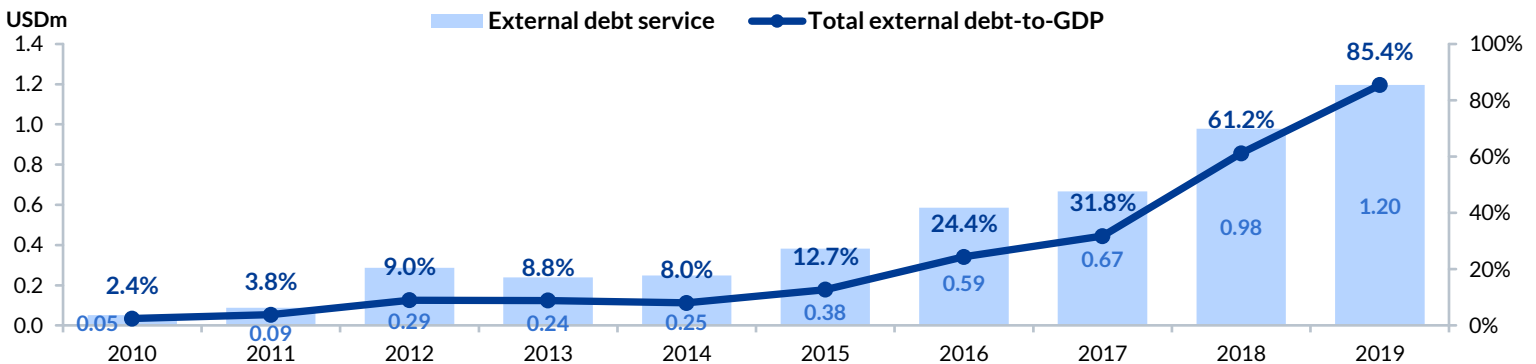
Conclusion: even before the onslaught of the pandemic, Zambia was in troubled waters, and eventually hit the COVID-19 iceberg. The debt-ridden country is heavily reliant on relief from China. Although it has approached the IMF for emergency support, the IMF believes that Zambia has not set its policy priorities, according to [Debtwire](#).

FIGURE 3: TOTAL EXTERNAL DEBT/GDP RATIO



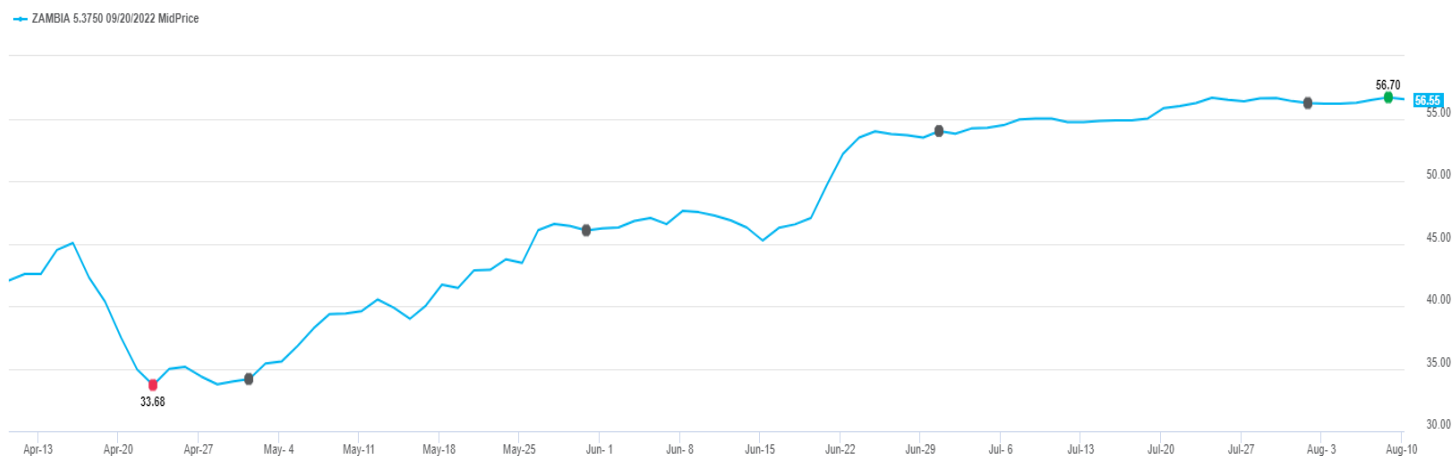
Source: Debtwire, IMF

FIGURE 4: TOTAL EXTERNAL DEBT SERVICE/INTERNATIONAL RESERVES (USDbn)



Source: Debtwire, IMF

FIGURE 5: EUROBOND PRICE



Source: Debtwire, Markit as at 10-Aug-20

FIGURE 6: PROJECT FINANCING PIPELINE (4Q18-1Q20)

Borrower	Countries	Sector	Instrument	Currency	Size (USDm-equiv)	Date	Expected/estimated time line	Hyperlink
Zambia (Gov't of)	Zambia	Government	Project finance	USD	20	11-Oct-18	2019	Source
Zambia (Gov't of)	Zambia	Government	Project finance	USD	5	16-Oct-18	2019	Source
Zambia (Gov't of)	Zambia	Energy	Project Finance	USD	4000	18-Dec-18	2019	Source
Zambia Airports Corporation Limited (Government of Zambia)	Zambia	Transportation	Project Finance	USD	150	8-Mar-19	end-2019	Source
Industrial Development Corporation	Zambia	Government	Project finance	USD	250	12-Aug-19	2019-2Q20	Source
Zambia National Building Society	Zambia	Financial services	Project finance	USD	15	19-Aug-19	2019-20	Source
ZESCO	Zambia	Energy	Project finance	USD	26	28-Jun-19	2019-20	Source
Rural Electrification Authority	Zambia	Energy	Project finance	USD	150	14-Nov-19	2020	Source
Zambia (Gov't of)	Zambia	Government	Project finance	USD	180	3-Dec-19	4Q20	Source
Zambia (Gov't of)	Zambia	Government	Project finance	USD	35.5	3-Dec-19	2020	Source
Zambia National Broadcasting Corporation	Zambia	Government	Loan	USD	220	20-Nov-19	2020	Source
Zambia (Gov't of)	Zambia	Government	Project finance	USD	20	31-Jan-20	2020	Source
Zambia (Gov't of)	Zambia	Government	Loan	USD	5	17-Jan-20	2020	Source
Zambia (Gov't of)	Zambia	Government	Project finance	USD	300	6-Feb-20	2020	Source
ZESCO	Zambia	Energy	Project Finance	USD	548	22-May-20	-	Source

Sources: Debtwire

FIGURE 7: EXTERNAL LOANS

Project pipeline	Issuer	Issue date	Amount	Amt (USDm)
Kenneth Kaunda International airport loan	EXIM bank of China	2014	USD 360m	360
Kaufe Gorge Lower	EXIM bank of China	2015	USD 1,500m	1,500
	Commercial Bank of China			
Kariba North Bank Power Plant Expansion	EXIM bank of China	2014	USD 430m	430
Zambia L400 road		2013	USD 240m	
Copperbelt International Airport		2017	USD 400m	400
Lusaka De-congestion	Government of India	2017	USD 286m	286
Telecommunication loans	EXIM bank of China	2017	USD 280m	280
Copperbelt C400 project	China Development Bank	2015	USD 418m	418
Mongu-Kalabo Road	EXIM bank of China	2011	USD 287m	287
Zambian military home	Industrial and Commercial Bank of Zambia	2017	USD 157m	157
Mansa-Luwingi Road				
Water and sanitation project	Nordea Bank of Denmark	2014	USD 70.1m	70.1
Hereos National Stadium	EXIM bank of China	2011	USD 94m	94
Levy Mwanawasa General Hospital	Chinese Government	2015	USD 90m	90
Kafulafuta Dam Project	China Complete Corporation	2018	USD 450m	450
Construction of houses	Chinese Government	2015	USD 275m	275

Sources: Debtwire

FIGURE 8: 2019 Budget Yellow Book: Debt service (interest payments + amortisation)

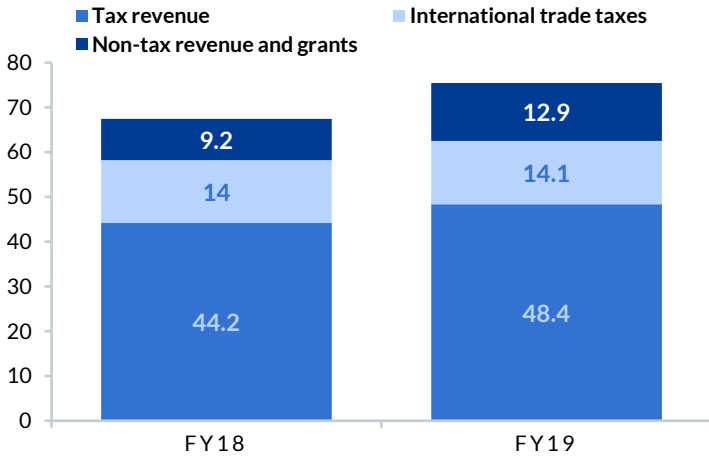
Particulars	Creditor type	2018 (ZMW)	2019 (ZMW)	2018 (USDm) ⁽¹⁾	2019 (USDm) ⁽¹⁾
China - Catic	Bilateral/ commercial/ non-Paris Club	24,77,15,060	26,32,81,062	26.08	25.07
China - Exim Bank	Bilateral/ commercial/ non-Paris Club	1,24,40,52,470	2,28,84,60,727	130.95	217.95
India Exim Bank	Bilateral/ commercial/ non-Paris Club	5,36,53,040	15,50,39,519	5.65	14.77
Kuwait - Fund for Arab Economic Development	Bilateral/ commercial/ non-Paris Club	2,62,74,730	2,22,78,698	2.77	2.12
China - AVIC	Bilateral/ commercial/ non-Paris Club	6,44,08,360	-	6.78	
Polytechnology	Bilateral/ commercial/ non-Paris Club	39,66,10,760	49,03,42,413	41.75	46.70
Abu Dhabi Fund	Bilateral/ commercial/ non-Paris Club	14,25,190	85,49,914	0.15	0.81
China Development Bank	Bilateral/ commercial/ non-Paris Club	41,66,81,040	87,17,07,245	43.86	83.02
Nordea	Bilateral/ commercial/ non-Paris Club	6,81,48,450	7,51,37,925	7.17	7.16
Industrial Commercial Bank of China	Bilateral/ commercial/ non-Paris Club	19,60,42,610	81,35,44,763	20.64	77.48
Paramount Group	Bilateral/ commercial/ non-Paris Club	6,36,27,590	7,03,25,226	6.70	6.70
Standard Chartered Bank	Bilateral/ commercial/ non-Paris Club	40,34,68,230	2,13,63,95,985	42.47	203.47
Investec	Bilateral/ commercial/ non-Paris Club	14,95,72,140	21,64,29,676	15.74	20.61
CitiBank UK	Bilateral/ commercial/ non-Paris Club	10,60,50,980	36,65,74,546	11.16	34.91
Exim Bank of Korea	Bilateral/ commercial/ non-Paris Club	-	23,189		0.00
Other External Debt Interest	Bilateral/ commercial/ non-Paris Club	-	62,60,00,000		59.62
EXIM US	Bilateral/ commercial/ non-Paris Club	7,02,12,470	10,79,21,850	7.39	10.28
China Minsheng Bank	Bilateral/ commercial/ non-Paris Club	3,57,91,350	30,63,77,999	3.77	29.18
Star Times	Bilateral/ commercial/ non-Paris Club	97,37,350	2,15,10,900	1.02	2.05
Bank Hapoalin	Bilateral/ commercial/ non-Paris Club	66,35,810	2,88,85,467	0.70	2.75
Israel Discount Bank	Bilateral/ commercial/ non-Paris Club	3,79,56,090	37,46,25,656	4.00	35.68
Citibank Zambia	Bilateral/ commercial/ non-Paris Club	4,74,17,850	1,18,99,765	4.99	1.13
Nedbank	Bilateral/ commercial/ non-Paris Club	-	12,67,34,516		12.07
Credit Suisse	Bilateral/ commercial/ non-Paris Club	-	13,23,50,563		12.60
Total	Bilateral/ commercial/ non-Paris Club	3,64,54,81,570	9,51,43,97,604	384	906
International Fund for Agriculture	Multilateral	4,03,68,259	4,60,53,369	4.25	4.39
OPEC Fund	Multilateral	3,62,24,580	4,63,36,553	3.81	4.41
World Bank	Multilateral	17,61,20,520	23,48,83,126	18.54	22.37
AfDB	Multilateral	1,35,39,560	2,55,91,711	1.43	2.44
Asian Dev Bank	Multilateral	21,66,000	62,52,645	0.23	0.60
EIB	Multilateral	6,36,80,390	5,86,53,821	6.70	5.59
Dev Bank SA	Multilateral	22,48,50,270	24,06,90,094	23.67	22.92
African Development Fund	Multilateral	5,02,11,100	6,57,27,404	5.29	6.26
Nordic Dev Fund	Multilateral	77,06,690	95,08,128	0.81	0.91
Saudi Fund for Development	Multilateral	96,64,220	2,64,66,113	1.02	2.52
Eurobond 24s	Multilateral	80,75,00,000	89,25,00,000	85.00	85.00
Eurobond 22s	Multilateral	38,29,68,750	42,32,81,250	40.31	40.31
Eurobond 27s	Multilateral	1,06,51,87,500	1,17,73,12,500	112.13	112.13
Sinking Fund for Eurobonds	Multilateral	10,00,00,000	-	10.53	
Trade and Development Bank	Multilateral	42,59,80,000	2,01,88,09,037	44.84	192.27
Total	Multilateral	3,40,61,67,839	5,27,20,65,751	359	502
Grand Total		7,05,16,49,409	14,78,64,63,355	742	1,408
Of which Chinese		2,22,10,64,050	4,59,37,68,163	31.5%	31.1%
Of which multilateral		3,40,61,67,839	5,27,20,65,751	48.3%	35.7%
Of which other commercial/ non-Paris Club		1,42,44,17,520	4,92,06,29,441	20.2%	33.3%

Sources: Debtwire; Ministry of Finance, Zambia;

1) 2018: ZMW 1 = USD 9.5; 2019: ZMW 1 = USD 10.5

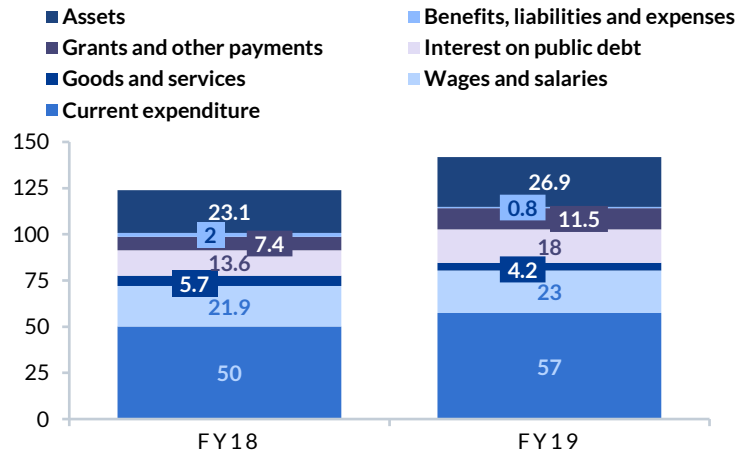
2) Eurobond outstanding does not match with figure 1, which as reported by Markit

FIGURE 9: GOVERNMENT REVENUE BREAKDOWN (ZMWbn)



Source: Debtwire, Ministry of Finance, Zambia

FIGURE 10: GOVERNMENT EXPENDITURE BREAKDOWN (ZMWbn)



Source: Debtwire, Ministry of Finance, Zambia

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