



**STANDARD  
& POOR'S**

# FULL ANALYSIS

## CenturyTel Inc.

### Corporate Credit Rating

BBB/Negative/A-3

### Primary Credit Analysts:

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### Major Rating Factors

#### Strengths:

- Relative stability of cash flows from CenturyTel's rural local exchange carrier (RLEC) business, which still has a dominant position in its markets.
- Some insulation from cable telephony competition due to the rural nature of its markets.
- Healthy growth of digital subscriber lines (DSL).
- Geographically clustered markets.
- Intermediate financial risk profile, including low leverage and solid liquidity.

#### Weaknesses:

- Increasing competitive pressures from wireless substitution and cable telephony have resulted in deteriorating access-line trends.
- Stagnant revenue and cash flow growth.
- Lack of a facilities-based video or wireless product to combat competitive pressures.

### Rationale

The ratings on Monroe, La.-based CenturyTel Inc. reflect the company's still-dominant position as a RLEC and the accompanying stable, predictable discretionary cash flow generated by its 2.1 million access-line base. The ratings also reflect a business that is less exposed to cable telephony competition than many of its peers for the foreseeable future, significant growth in digital subscriber line customers, geographically clustered markets, and an intermediate financial risk profile, including low leverage and solid liquidity. Tempering factors include the increasingly competitive challenges from wireless substitution and cable telephony to CenturyTel's core local exchange carrier business, which accounts for roughly 95% of revenue and EBITDA, stagnant revenue growth, and deteriorating margins. Another

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*CenturyTel Inc. Report Title*

weakness is the lack of a facilities-based video or wireless product, which would better enable CenturyTel to combat the triple play offering of cable operators. Annual access-line losses of 5.4% have accelerated over the last couple of years and Standard & Poor's Ratings Services expects this trend to continue in 2007 as cable operators deploy Internet Protocol (IP) telephony in CenturyTel's markets.

Historically, the low density and rural nature of CenturyTel's markets have helped insulate the company from competition. However, over the past couple of years, CenturyTel's core telephone operations have experienced increased competition, mainly from wireless substitution and, more recently, from telephony service provided by cable operators. In fact, cable telephony exposure increased to 29% at year-end 2006 from around 12% in 2005 and could grow to around 50% over the next couple of years. Nevertheless, competition from cable telephony will be somewhat more subdued longer term than in urban markets.

CenturyTel has taken steps to mitigate longer-term competitive risks by bundling services, increasing DSL penetration, entering into an agreement to resell wireless services of various carriers, and forming a partnership with EchoStar Communications Corp. to market direct-to-home (DTH) satellite TV services in CenturyTel's markets. The company is also offering IP TV on a trial basis, using ADSL 2+ and VDSL2 technology in a couple of markets. Nevertheless, costs, including set-top boxes, are still an issue. As a result, a mass-market deployment of video service is not expected in the intermediate term.

CenturyTel is acquiring Madison River Communications Corp., which will add about 176,000 access lines to CenturyTel's base in Alabama, Georgia, Illinois, and North Carolina, an increase of 8%. The transaction is expected to close in the second quarter of 2007. Despite Madison River's rural operations, the company does have significant cable competition, overlapping with Time Warner Cable, Comcast, Mediacom, and Insight, all of which are deploying IP telephony. Nevertheless, CenturyTel will benefit from Madison River's above-average DSL penetration and its DSL capabilities, which covers virtually all of Madison River's access-line base. Additionally, Madison River's rate of access-line erosion is somewhat lower than CenturyTel's and universal service fund (USF) receipts, which are subject to regulatory uncertainty longer-term, account for only small portion of revenue.

CenturyTel's revenue in the fourth quarter of 2006 declined 2% year-over-year due to fewer access lines and lower USF receipts. These factors were partially offset by growth in lower-margin DSL services and the company's fiber transport and competitive local exchange carrier (CLEC) businesses. We expect this revenue trend to continue over the next year. While the combination of limited competition and cost controls historically has allowed CenturyTel's RLEC business to maintain an EBITDA margin in the mid-50% area, Standard & Poor's expects margins to weaken modestly due to declining RLEC revenue, coupled with greater contributions from lower-margin services. Pro forma leverage of about 2.6x adjusted for unfunded pension and other postemployment benefit obligations is at the high end for the rating level.

***Short-term credit factors***

Our short-term rating on CenturyTel is 'A-3'. CenturyTel has solid liquidity, primarily derived from \$26 million in cash as of Dec. 31, 2006, and discretionary cash flow, which we expect will be in the \$500 million range in 2007. The company also has access to borrowings under its \$1.5 billion commercial paper program. However, borrowings are limited to available committed credit facilities, which totaled about \$727 million at Dec. 31, 2006. At year-end 2006, the company completed \$800 million of its \$1 billion authorized stock repurchase program, which ends June 30, 2007. CenturyTel's

discretionary cash flow generation should be sufficient to cover its remaining stock buyback program. The company does not have any significant debt maturities until 2010 for \$514 million.

### ***Outlook***

The outlook is negative. CenturyTel's core local exchange business will face increasing competition over the next couple of years, which will result in pricing pressure and access-line losses. An acceleration of line losses, deteriorating margins, and reduced discretionary cash flow generation, which prevents CenturyTel from maintaining leverage in the mid-2x area, could trigger a downgrade. Additionally, execution missteps from the integration of Madison River, a more-aggressive shareholder financial policy, or a significant debt-financed acquisition could result in a downgrade. Although less likely, the outlook could be revised to stable if the company is able to stem access-line losses in the face of increasing competition from wireless and cable telephony while maintaining a prudent financial policy.

### ***Business Description***

CenturyTel is an incumbent local exchange carrier in rural markets in 21 states, mostly in the Midwest and the South. The company provides local, long distance, private line, and DSL services. Approximately 70% of its 2.1 million access lines are concentrated in Missouri, Wisconsin, Alabama, and Arkansas. The company operates under a mixture of rate of return and price cap regulation, at both the federal and state levels. Consistent with its status as a RLEC, CenturyTel serves on average 12 access lines per square mile in its markets, compared with a nationwide average of around 50 access lines. A small competitive local exchange carrier and fiber transport business account for roughly 6% of total sales. Network access is an important source of revenue for CenturyTel, representing about 36% of total revenue in 2006.

### ***Business Risk Profile***

CenturyTel still enjoys a relatively good competitive position in its markets. Rural markets are generally more costly to serve due to the low access-line density and long average loop lengths, which make it more difficult for other providers to compete. Competition from cable telephony is somewhat less pronounced than in urban markets where cable operators have upgraded their plants to two-way capability and are aggressively marketing telephony services. Over the last few years, line losses were mainly attributable to wireless substitution. However, cable telephony competition in rural markets has been increasing and as a result, CenturyTel and other RLECs have experienced an acceleration of access-line losses. At present, approximately two-thirds of CenturyTel's markets overlap with cable and 29% of the company's access lines are exposed to cable telephony competition, up significantly from 12% at year-end 2005. Cable competition in CenturyTel's markets include Charter Communications, Time Warner, Comcast, and Mediacom.

### ***Regulation***

At the federal level, approximately 70% of the company's access lines operate under rate of return regulation where service rates are adjusted periodically. The remaining lines are subject to price cap regulation. At the state level, roughly 40% are subject to rate of return regulation and the other 60%

are subject to price cap regulation, which provides CenturyTel with greater freedom to establish local service rates.

CenturyTel is dependent on universal service funds, which together with other federal and state programs, account for roughly 14% of total revenue. Given the increased number of wireless and other telecommunications providers filing for USF support and higher nationwide average loop costs, CenturyTel has been receiving a lower amount of USF and related subsidies.

### ***High-speed data***

CenturyTel offers DSL services to about 79% of its access lines, which will likely remain at that level given the distance limitations of DSL. The company continued to experience healthy growth in DSL subscribers, up 48% in 2006 to 369,000. Penetration of addressable lines is in line with CenturyTel's peers at about 22%.

### ***Video***

CenturyTel partners with DTH provider EchoStar to sell DISH service as part of a bundle. However, the company still lacks a facilities-based video strategy and will need to develop a longer-term solution to compete more effectively with cable operators. CenturyTel began offering IP TV service over ADSL2+ in Lacrosse, Wis., a year ago and has had moderate success to date. However, given current loop lengths, ADSL2+ technology is only sufficient for 10 to 15Mb of capacity, which is enough for standard definition television and broadband service. CenturyTel is also trialing IP TV using VDSL2 technology with shorter loop lengths in Columbia, Mo., which should address capacity limitations. Nevertheless, a mass market launch of video is unlikely in the near term, given relatively high costs for customer premise equipment.

### ***Fiber transport and CLEC***

CenturyTel's fiber transport and CLEC business account for about 6% of total revenue, up from 4.5% in 2005. Revenue contributions from these businesses are likely to increase over time as these segments grow and core RLEC revenue declines. Both of these businesses have a high degree of business risk and margins are lower at around 30%-35%.

### ***Profitability***

Total sales declined 1.4% to \$2.4 billion in 2006. Access-line losses and lower USF and access revenue were partially offset by continued growth in DSL and increased sales in the fiber transport and CLEC businesses. CenturyTel's EBITDA margins are comparable to its peers at about 49%, but have contracted over the past few years from the mid-50% area as a result of increasing contributions from lower-margin businesses as well as fewer access lines.

### ***Financial Risk Profile***

#### ***Accounting***

CenturyTel files access tariffs, which are deemed "lawful" if certain criteria are met. For tariffs that have yet to be deemed lawful, the company initially records earnings in excess of the authorized rate of return as a liability and then recognizes as revenue some or all amounts at the end of the settlement

period. CenturyTel recorded \$35.9 million in revenue true-ups during the third quarter of 2005 for the settlement period related to 2001-2002. The company recorded \$43 million as a liability at Dec. 31, 2006, for the 2003-2004 period, which lapses in September 2007.

At Dec. 31, 2006, CenturyTel had outstanding four fair value interest-rate hedges associated with the \$500 million aggregate principal amount of its Series L 7.875% senior notes due 2012. These hedges are "fixed-to-variable" interest-rate swaps that convert fixed-rate interest payment obligations under these notes into obligations to pay rates ranging from the six-month LIBOR plus 3.229% to the six-month LIBOR plus 3.67%, with settlements being paid and rates being reset in arrears every six months through the expiration of the hedges in August 2012. During 2006, CenturyTel realized an average rate under these hedges of 9.03%; interest expense increased \$5.8 million. The aggregate fair market value of these hedges was \$20.6 million at Dec. 31, 2006, and is reflected both as a liability and as a decrease in the company's underlying long-term debt.

CenturyTel's pension and postemployment benefit obligations were \$349 million unfunded at year-end 2006, a modest improvement from an unfunded \$378 million at year-end 2005. Our tax-effected adjustments for these unfunded obligations have a negligible effect on CenturyTel's credit measures.

**Cash flow adequacy**

CenturyTel has historically generated a healthy amount of annual free operating cash flow in the \$500 million to \$600 million range. The company has a low dividend payout and is likely to use future excess cash flows for share repurchases. Funds from operations to total debt has remained stable in the low-30% area in the past three years.

**Capital structure/Asset protection**

In March 2007, CenturyTel issued \$750 million of senior unsecured notes to largely fund the acquisition of Madison River. Share repurchase activity has kept leverage in the low- to mid-2x area although pro forma leverage of about 2.6x, including pension adjustments, is at the high end of what we consider acceptable for the current rating.

Table 1

**CenturyTel Inc.—Peer Comparison\* (cont. 'd)**

**Industry Sector: Telecommunications**

|                              | —Fiscal year ended Dec. 31, 2006— |                             |                  |                 |
|------------------------------|-----------------------------------|-----------------------------|------------------|-----------------|
|                              | CenturyTel Inc.                   | Citizens Communications Co. | Windstream Corp. | Embarq Corp.    |
| Rating as of April 27, 2007  | BBB-/Negative/A-3                 | BB+/-Negative/—             | BB+/-Negative/—  | BBB-/Negative/— |
| <b>(Mil. \$)</b>             |                                   |                             |                  |                 |
| Revenues                     | 2,447.7                           | 2,025.4                     | 3,033.3          | 6,363.0         |
| EBITDA                       | 1,226.6                           | 1,141.8                     | 1,416.0          | 2,633.3         |
| Operating income (after D&A) | 691.2                             | 655.0                       | 966.4            | 1,553.3         |
| Net income from cont. oper.  | 370.0                             | 254.0                       | 445.6            | 784.0           |
| Funds from operations (FFO)  | 776.4                             | 838.9                       | 1,036.1          | 1,877.8         |
| Cash flow from operations    | 848.2                             | 849.0                       | 1,160.0          | 2,080.8         |
| Capital expenditures         | 314.1                             | 266.7                       | 433.4            | 986.1           |

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Table 1

| <b>CenturyTel Inc.—Peer Comparison* (cont. 'd)</b> |         |         |           |         |
|--|---------|---------|-----------|---------|
| Free operating cash flow                           | 534.1   | 582.3   | 726.6     | 1,094.7 |
| Discretionary cash flow                            | 504.9   | 258.6   | (1,749.7) | 750.7   |
| Cash and investments                               | 25.7    | 1,041.1 | 386.8     | 53.0    |
| Debt   | 2,817.9 | 4,654.4 | 5,701.8   | 6,932.9 |
| Preferred stock                                    | 7.5     | 0.0     | 0.0       | 0.0     |
| Common equity                                      | 3,183.5 | 1,058.0 | 469.8     | (468.0) |
| Total capital                                      | 6,018.1 | 5,712.4 | 6,171.6   | 6,464.9 |
|  | 0.0     | 0.0     | 0.0       | 0.0     |
| <b>Adjusted ratios</b>                             |         |         |           |         |
| EBITDA/sales (%)                                   | 50.1    | 56.4    | 46.7      | 41.4    |
| Oper. income/sales (%)                             | 49.6    | 56.5    | 47.0      | 40.8    |
| EBIT interest coverage (x)                         | 4.0     | 2.1     | 4.7       | 4.7     |
| EBIT interest coverage (x)¶                        | 4.1     | 2.1     | 4.7       | 4.7     |
| EBITDA interest coverage (x)                       | 6.0     | 3.3     | 6.6       | 8.0     |
| Return on capital (%)                              | 12.0    | 12.3    | 17.3      | 20.6    |
| FFO/debt (%)                                       | 27.6    | 18.0    | 18.2      | 27.1    |
| FFO/debt (%)¶                                      | 27.9    | 18.0    | 18.7      | 27.9    |
| Cash flow from operations/debt (%)                 | 30.1    | 18.2    | 20.3      | 30.0    |
| Free operating cash flow/debt (%)                  | 19.0    | 12.5    | 12.7      | 15.8    |
| Discretionary cash flow/debt (%)                   | 17.9    | 5.6     | (30.7)    | 10.8    |
| Discretionary cash flow/EBITDA (%)                 | 41.2    | 22.6    | (123.6)   | 28.5    |
| Debt/EBITDA (x)                                    | 2.3     | 4.1     | 4.0       | 2.6     |
| Debt/total capital (%)                             | 46.8    | 81.5    | 92.4      | 107.2   |

\*Fully adjusted, including postretirement obligations. ¶Postretirement obligations using actual returns. N.M.—Not meaningful.

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Table 2

**CenturyTel Inc.—Financial Summary\* (cont. 'd)**

**Industry Sector: Telecommunications**

|                                       | —Fiscal year ended Dec. 31— |                   |                 |                 |                 |
|---------------------------------------|-----------------------------|-------------------|-----------------|-----------------|-----------------|
|                                       | 2006                        | 2005              | 2004            | 2003            | 2002            |
| Rating history                        | BBB/Negative/A-3            | BBB+/Negative/A-2 | BBB+/Stable/A-2 | BBB+/Stable/A-2 | BBB+/Stable/A-2 |
| <b>(Mil. \$)</b>                      |                             |                   |                 |                 |                 |
| Revenues                              | 2,447.7                     | 2,479.3           | 2,407.4         | 2,379.2         | 1,979.6         |
| EBITDA                                | 1,226.6                     | 1,285.0           | 1,271.8         | 1,248.6         | 1,029.6         |
| Operating income (after D&A)          | 691.2                       | 753.1             | 770.9           | 778.0           | 618.0           |
| Net income from continuing operations | 370.0                       | 334.5             | 337.2           | 344.7           | 189.9           |
| Funds from operations (FFO)           | 776.4                       | 1,018.3           | 924.9           | 1,010.1         | 767.6           |
| Cash flow from operations             | 848.2                       | 982.5             | 948.2           | 1,083.7         | 796.0           |
| Capital expenditures                  | 314.1                       | 414.9             | 385.3           | 377.9           | 386.3           |

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Table 2

| <b>CenturyTel Inc.—Financial Summary* (cont. 'd)</b>            |         |         |         |         |         |
|---|---------|---------|---------|---------|---------|
| Free operating cash flow  | 534.1   | 567.6   | 562.9   | 705.8   | 409.7   |
| Discretionary cash flow   | 504.9   | 535.8   | 531.1   | 673.8   | 379.5   |
| Cash and investments  | 25.7    | 158.8   | 167.2   | 203.2   | 3.7     |
| Debt  | 2,817.9 | 2,898.3 | 3,226.6 | 3,392.4 | 3,831.8 |
| Preferred stock   | 7.5     | 7.9     | 8.0     | 8.0     | 8.0     |
| Common equity   | 3,183.5 | 3,323.9 | 3,164.2 | 3,221.5 | 2,879.4 |
| Total capital   | 6,018.1 | 6,238.3 | 6,406.3 | 6,629.1 | 6,745.2 |
| <b>Adjusted ratios</b>  |         |         |         |         |         |
| EBITDA/sales (%)  | 50.1    | 51.8    | 52.8    | 52.5    | 52.0    |
| Oper. income/sales (bef. D&A) (%)                               | 49.6    | 51.8    | 52.8    | 52.5    | 52.0    |
| EBIT interest coverage (x)                                      | 4.0     | 3.6     | 3.5     | 3.3     | 2.7     |
| EBIT interest coverage (x)¶                                     | 4.1     | 3.5     | 3.6     | 3.6     | 2.0     |
| EBITDA interest coverage (x)                                    | 6.0     | 6.1     | 5.8     | 5.3     | 4.6     |
| Return on capital (%)   | 12.0    | 10.9    | 10.9    | 11.0    | 9.6     |
| FFO/debt (%)  | 27.6    | 35.1    | 28.7    | 29.8    | 20.0    |
| FFO/debt (%)¶   | 27.9    | 35.0    | 28.8    | 30.4    | 18.7    |
| Cash flow from operations/debt (%)                              | 30.1    | 33.9    | 29.4    | 31.9    | 20.8    |
| Free operating cash flow/debt (%)                               | 19.0    | 19.6    | 17.4    | 20.8    | 10.7    |
| Discretionary cash flow/debt (%)                                | 17.9    | 18.5    | 16.5    | 19.9    | 9.9     |
| Discretionary cash flow/EBITDA (%)                              | 41.2    | 41.7    | 41.8    | 54.0    | 36.9    |
| Debt/EBITDA (x)   | 2.3     | 2.3     | 2.5     | 2.7     | 3.7     |
| Debt/total capital (%)  | 46.8    | 46.5    | 50.4    | 51.2    | 56.8    |
| <b>Ratios before adjustments for postretirement obligations</b> |         |         |         |         |         |
| Oper. income/sales (bef. D&A) (%)                               | 48.6    | 51.2    | 52.1    | 51.4    | 51.7    |
| EBIT interest coverage (x)                                      | 4.0     | 3.7     | 3.6     | 3.5     | 2.8     |
| FFO/debt (%)  | 29.7    | 37.7    | 31.0    | 31.3    | 21.0    |
| Debt/EBITDA (x)   | 2.2     | 2.1     | 2.4     | 2.6     | 3.6     |
| Debt/total capital (%)  | 44.7    | 42.3    | 46.8    | 47.7    | 54.0    |

\*Fully adjusted, including postretirement obligations. ¶Postretirement obligations using actual returns.

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Table 3

**Reconciliation Of CenturyTel Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)\* (cont. 'd)**

—Fiscal year ended Dec. 31, 2006—

**CenturyTel Inc. reported amounts**

|          | Debt    | Shareholders' | Operating    | Operating    | Operating   | Interest | Cash flow  | Cash flow  |
|----------|---------|---------------|--------------|--------------|-------------|----------|------------|------------|
|          |         | equity        | income       | income       | income      | expense  | from       | from       |
|          |         |               | (before D&A) | (before D&A) | (after D&A) |          | operations | operations |
| Reported | 2,590.9 | 3,191.0       | 1,189.0      | 1,189.0      | 665.5       | 196.0    | 840.7      | 840.7      |

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Table 3

**Reconciliation Of CenturyTel Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)\***  
(cont. d)

—Fiscal year ended Dec. 31, 2006—

**Standard & Poor's adjustments**

|   |       |     |      |      |       |     |     |         |
|---|-------|-----|------|------|-------|-----|-----|---------|
| Postretirement benefit obligations                    | 227.1 | —   | 25.7 | 25.7 | 25.7  | 9.8 | 7.4 | 7.4     |
| Share-based compensation expense                      | —     | —   | —    | 11.9 | —     | —   | —   | —       |
| Reclassification of nonoperating income (expenses)    | —     | —   | —    | —    | 121.6 | —   | —   | —       |
| Reclassification of working-capital cash flow changes | —     | —   | —    | —    | —     | —   | —   | (71.75) |
| Minority interest                                     | —     | 9.2 | —    | —    | —     | —   | —   | —       |
| Total adjustments                                     | 227.1 | 9.2 | 25.7 | 37.6 | 147.2 | 9.8 | 7.4 | (64.3)  |

**Standard & Poor's adjusted amounts**

|          | Debt    | Equity  | Operating income (before D&A) | EBITDA  | EBIT  | Interest expense | Cash flow from operations | Funds from operations |
|----------|---------|---------|-------------------------------|---------|-------|------------------|---------------------------|-----------------------|
| Adjusted | 2,817.9 | 3,200.2 | 1,214.7                       | 1,226.6 | 812.8 | 205.7            | 848.2                     | 776.4                 |

\*CenturyTel Inc. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

**Ratings Detail (As Of 27-Apr-2007)\***

**CenturyTel Inc.**

|                         |                  |
|-------------------------|------------------|
| Corporate Credit Rating | BBB/Negative/A-3 |
| Commercial Paper        |                  |
| Local Currency          | A-3              |
| Senior Unsecured        |                  |
| Local Currency          | BBB              |

**Corporate Credit Ratings History**

|             |                    |
|-------------|--------------------|
| 04-May-2006 | BBB/Negative/A-3   |
| 13-Jan-2006 | BBB+/Watch Neg/A-2 |
| 11-Aug-2005 | BBB+/Negative/A-2  |
| 01-May-2002 | BBB+/Stable/A-2    |

**Business Risk Profile**

Satisfactory

**Financial Risk Profile**

Intermediate

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.



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