# NXP B.V. and NXP Funding LLC

*Eindhoven, The Netherlands*

## Reference Securities, Ratings & Contacts

| Category | Rating Information |
|---|---|
| Reference Securities: | €1,000,000,000 floating rate Senior Secured Notes due 2013<br>$1,535,000,000 floating rate Senior Secured Notes due 2013<br>$1,026,000,000 77/8% Senior Secured Notes due 2014<br>€525,000,000 85/8% Senior Notes due 2015<br>$1,250,000,000 91/2% Senior Notes due 2015 |
| Source Document: | Offering Memorandum |
| Date of Source Document: | October 5, 2006 |

Legal Jurisdiction: USA
Corporate Family Rating: **Ba3**
Senior Unsecured: **B2**
Ratings Outlook: **Stable**

| Senior Covenant Officer | Phone |
|---|---|
| Alexander Dill, Esq./New York | 1.212.553.1653 |

**Lead Analyst**

Wolfgang Draack/Frankfurt

## Covenant Quality Assessment Matrix

| Key Covenants | CQ-1 Strong | CQ-2 Moderate | CQ-3 Minimal | None | Notes |
|---|---|---|---|---|---|
| **Restricted Payments** | | | X | | Carve-outs > 2% of total assets; headroom under FCCR is < 2.0x |
| **Change of Control** | | X | | | Cash put option @ 101%; 50% voting test; "permitted holder" definition is broad |
| **Merger Restrictions** | | X | | | Pro forma FCCR of the successor company represents 100%+ of the predecessor company or €1 additional debt |
| **Asset Sales/ Conveyance** | | X | | | 18-month effective reinvestment period; 75% cash consideration; broad discretion in asset reinvestment |
| **Limitation on Debt Incurrence** | | | X | | Carve-outs > 2% of total assets; headroom under FCCR is < 2.0x |
| **Negative Pledge/Limitation on Liens** | | X | | | Equal and ratable pledge, carve outs < 15% of net tangible assets |
| **Limitation on Sale/Leaseback** | | | | X | |
| **Limitation on Subsidiary Debt** | | | X | | Debt of restricted subsidiaries is included as part of the limitation on indebtedness |

| Other Important Covenants | Notes |
|---|---|
| **Limitation on Restrictions on Distributions from Restricted Subsidiaries** | Numerous carve-outs weaken protection |
| **Limitation on Affiliate Transactions** | Numerous carve-outs weaken protection |
| **Impairment of Security Interest** | Pledge has no significant carve-outs |

| Other Important Provisions | Present | Not Present | Notes |
|---|---|---|---|
| **Fall-away** | X | | Except for limitation on liens and change of control, all covenants lapse following achievement of IG but are reinstated upon downgrade |
| **Coupon Step-up** | | X | |
| **Financial Reporting** | X | | 120 and 60 days for annual and quarterly, respectively |

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Please also be aware the financial information used in the calculations in this report is based solely on publicly available information. Therefore, the calculations are estimates only and are not intended to be a precise statement of the ratios as defined in the draft indenture.

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Moody's Investors Service
Global Credit Research

## Commentary

The key covenants (of which only the sale/leaseback covenant is absent) are not atypical of a non-investment grade issuer's indenture. Overall the covenant package offers relatively good protection to investors. The restricted payments covenant is scored CQ-3 since carve-outs exceed 2% of the total assets of the company although headroom is less than 2x under the fixed charge coverage ratio test. The importance of the change of control covenant, scored CQ-2, is heightened by the fact that the semiconductor industry is consolidating. A generally stabilizing cash flow generation lends itself well to M&A activity. By itself, however, the covenant provides only modest protection due to the breadth of the "permitted holder" definition. Though ranked CQ-2, the merger covenant would offer limited protection if NXP's controlling shareholders decide to undertake significant re-structuring, the costs of which permitted holders could recoup under the affiliate transactions covenant.

The fall-away provision does not significantly weaken the covenant package. The five key covenants which fall away are reinstated upon a ratings downgrade below investment grade. The liens and change of control covenants are the only covenants that continue to exist if the issuer's rating is upgraded to investment grade.

Moody's expects NXP, as a semiconductor company, to show above-average earnings and cash flow volatility, and to need relatively solid headroom under its financial covenants for continued operating and investment flexibility. The headroom for debt incurence is less than 2x under the fixed charge coverage ratio test calculated on a pro-forma basis for the last twelve months, but NXP, after the recapitalization, held more than €600 million in cash as liquidity cushion. Management expects to buffer this headroom, first, from relatively rapid earnings improvement and, later, debt reduction. Still, given expected earnings volatility and the fact that about half of NXP's long-term debt is floating rate, the 2x fixed charge coverage ratio test could prove to be restrictive and a meaningful early warning sign for bondholders.

The covenant package excludes a significant percentage of NXP's revenue-producing assets. The group of guaranteeing and restricted subsidiaries represents 87% of group assets, but only 55% of group EBITDA calculated pro forma for the first half of 2006. NXP's joint ventures, including 50.5%-owned Systems on Silicon Manufacturing Company (SSMC) of Singapore (NXP subsequently to the bond issue raised its stake in SSMC to 61.2%) and 60%-owned Philips Jilin Semiconductor Company (PJSC) of China as well as other minority-owned, smaller subsidiaries will remain unrestricted, presumably because of part-ownership. Together, this group of companies has contributed a substantial 34% share of EBITDA in first half 2006. NXP can redesignate SSMC (and other unrestricted subsidiaries) as a restricted subsidiary so long as no default would exist and either the €1 debt incurrence test or the pro forma fixed charge coverage test is satisfied.

*Ratio calculations and related items are at Appendix A. Criteria for assigning CQ-1, -2, and -3 scores for the eight standard covenants listed in the covenant quality assessment matrix are at Appendix B. All calculations are based on publicly available information.*

## Synopsis of Key Covenants

### 1. Restricted Payments (CQ-3)

The covenant receives a CQ-3 because, though calculated headroom is less than 2x under the fixed charge coverage ratio, numerous exceptions under the permitted investments definition and basket exceptions exceed 2% of total consolidated assets.

**Covenant Synopsis**

Restricted payments are permitted if EBITDA to fixed charges is at least 2.0 to 1.

**Carve-outs:**

"Permitted payments" (reduce general basket):

- repurchase or loans to purchase of stock of any parent not exceeding (i) €40 million plus (ii) €20 million times no. of years since the issue date plus (iii) net cash proceeds from equity issuance
- aggregate amounts not exceeding €200.0 million.
- dividends and loans to parent to pay distributions on stock following IPO not exceeding greater of (1) 6% of IPO proceeds and (2) 7% of market cap after IPO (subject to formulation including up to 2.75% Consolidated Leverage Ratio test)

"Permitted investments":

- management loans or advances not exceeding €5.0 million
- existing investments not exceeding €5.0 million
- catch-all basket not exceeding €300.0 million
- investments to increase the issuer's ownership in SSMC (subject to the €1 debt test) or SSMC or any other government-financed person not exceeding €300.0 million
- loans to Jilin not exceeding €25 million
- investments in Crolles not exceeding €190.0 million 2 years after the issue date and €50.0 million p.a. thereafter.

**Headroom:**

Calculated headroom is less than 2x the fixed charge coverage ratio test. See Appendix A.

## 2. Change of Control (CQ-2)

This complex change of control covenant is scored CQ-2 due to the broad definition of "permitted holder." It would include any existing or future senior managers who have equity interests in the issuer or parent and any equity share underwriters. A stronger covenant would have restricted ownership to the original buy-out group on the issue date of the Reference Securities. However, one strong feature is that the covenant would grant a put right if the controlling permitted holder sells its shares to another permitted holder, resulting in the second holder owning more than the transferor.

**Covenant Synopsis**

Investors have a 101% put upon a change of control, which occurs upon:

- sale, lease, or transfer of all or substantially all assets to any person other than to permitted holders, or
- acquisition of over 50% of issuer's voting stock by a person other than permitted holders, except that a permitted holder's voting shares will count toward the 50% share test if that holder purchases shares from another permitted holder and holds more shares than the transferor
- after the issuer's IPO, continuing directors cease to be a majority of the board
- change of control does not occur if the issuer becomes a subsidiary of a successor parent

**Definitions:**

"Permitted holders" means (1) the initial investor group in the LBO and any other person whose ownership results in a change of control, (2) senior management of the issuer and its subsidiaries who own or have the right to acquire stock of the issuer or any parent in excess of €250,000, and (3) underwriters in connection with the issuer's or any parent's stock offering.

## 3. Merger Restrictions (CQ-2)

A score of CQ-2 is assigned because the issuer need not satisfy both the €1 debt incurrence test and the pro forma fixed charge coverage test for the existing and successor companies.

**Covenant Synopsis**

No merger or conveyance of all or substantially all assets unless:

- all obligations are assumed and no default exists, and
- pro forma, successor can satisfy the €1 fixed charge coverage ratio test or such ratio of the successor would not be lower than prior to the transaction

## 4. Assets Sales/Conveyance (CQ-2)

A score of CQ-2 is assigned. The covenant is significantly weakened by broad discretion in making asset reinvestments, which may include subsidiary investments as low as 20%, though subject to a "similar business" test, and joint ventures, which are not restricted to a "similar business" test. The time period for reinvestment is effectively 18 months. The most significant carve-out is the temporary, rather than permanent, reduction of the senior credit facility upon debt repayment.

**Covenant Synopsis**

No asset sale is permitted unless:

- at least 75% cash consideration is received
- any debt reduction or reinvestment occurs within 1 year
- any reinvestment occurs within 18 months (a 6-month completion time may be added to a 1 year limit)
- reinvestments are made in "additional assets"

**Carve-outs:**

- All non-guarantor restricted subsidiary debt is permanently reduced but payments on the €500 million senior credit facility are not permanently reduced
- Designated non-cash consideration not exceeding greater of €100 million and 1% of total assets
- Any stock sales with a FMV of less than €30 million
- Sales of assets to outsourcers not exceeding €50 million

**Definitions:**

"Additional assets" means:

- any property or assets used or to be used in any businesses, services, or activities engaged in by the issuer or any subsidiary on the issue date or related, complementary, incidental, ancillary or similar thereto
- any 20%-50% subsidiary investments in entities engaged in the foregoing
- any joint ventures including Crolles (until designated otherwise by the issuer)

## 5. Limitation on Debt Incurrence (CQ-3)

A score of CQ-3 is assigned because carve-outs are far in excess of 2% of total consolidated assets even though headroom is less than 2x the fixed charge coverage ratio test. See Appendix A.

**Covenant Synopsis:**

No debt incurrence is permitted unless fixed charge coverge ratio of 2.0 to 1 is satisfied.

**Carve-outs:**

- Any "credit facility" (which includes, among others, the €500 million senior credit facility, revolving facilities, CP facility, and receivables financing), not exceeding €750 million
- Capitalized lease or purchase money obligations not exceeding the greater of €100 million and 1% of total assets
- Catch-all basket not exceeding €450 million
- Restricted subsidiary debt arising from regulatory restrictions or ordinary-course risk management, not exceeding €350 million
- Ordinary course guarantees by the issuer or restricted subsidiaries in minority-owned companies, not exceeding €15 million

**Headroom:**

- Calculated headroom is less than 2x the fixed charge coverage ratio test for the twelve months ended as of June 30, 2006. See Appendix A.

## 6. Negative Pledge/Limitation on Liens (CQ-2)

A score of CQ-2 is assigned because the carve outs are less than 15% of net tangible assets. See Appendix A.

**Covenant Synopsis:**

The issuer and its restricted subsidiaries are prohibited from incurring a lien on any assets securing any debt unless the unsecured Reference Securities are equally and ratably secured or are secured prior to any subordinated debt.

**Carve-outs:**

- Liens on assets of non-guarantor restricted subsidiaries securing debt of non-guarantor restricted subsidiaries
- Liens securing the €500 million senior credit facility and secured Reference Securities

### 7. Limitations on Sale & Leaseback Transactions (Not Present)

This covenant is not present in the indenture and is not incorporated by way of definition under the asset sale covenant. The phrase "lease (other than an operating lease entered into in the ordinary course of business)" under the definition of "asset disposition" is not sufficiently determinative of a sale/leaseback transaction. In addition, the definition of "Asset Disposition" which is used in the asset sale covenant expressly excludes "customary sale and lease-back transactions."

### 8. Limitation on Subsidiary Debt (CQ-3)

For restricted subsidiaries, the provisions of the covenant "Limitations on Indebtedness" apply. The €350 million carve-out for debt arising from regulatory restrictions or ordinary-course risk management applies specifically to restricted subsidiary debt.

## Synopsis of Other Important Covenants

### 1. Limitation on Dividend and Other Payment Restrictions Affecting Restricted Subsidiaries

This covenant contains numerous, relatively standard exceptions other than the significant exception for all credit facilities.

**Covenant Synopsis**

No restriction or other encumbrance is permitted on the ability of the issuer or any restricted subsidiary to make distributions on its stock or pay debt owed, make loans, or sell or transfer assets, to the issuer or restricted subsidiary.

**Carve-outs:**

- Restrictions pursuant to any credit facility (including the €500 million senior credit facility)

### 2. Limitation on Affiliate Transactions

This covenant would exclude from its restrictions nearly all payments otherwise permissible under the restricted payments covenant. This includes, among other things, ongoing payments and fees in connection with the LBO and numerous investments in specified NXP subsidiaries. The carve-outs are subject to only minor exceptions.

**Covenant Synopsis**

No transaction is permitted with affiliates in excess of €20 million unless it is not materially less favorable or on an arm's-length basis and if the board approves any transaction exceeding €50 million.

**Carve-outs:**

- Restricted payments under the restricted payments covenant (under the general basket test and specific basket exceptions)
- Permitted investments under the restricted payments covenant
- Payments to permitted holders of management, consulting, advisory fees and related expenses
- Payments to permitted holders of financial, advisory, financing, and underwriting services related to acquisitions or divestitures (subject to board approval)

### 3. Impairment of Security Interest

**Covenant Synopsis**

Neither the issuer nor any restricted subsidiary will allow security interests to be materially impaired with respect to collateral securing the secured Reference Securities.

## Synopsis of Other Important Provisions

### 1. Fall-away covenants

Of the key covenants, the restricted payments, debt (and, consequently, the subsidiary debt covenant), asset sales covenants, and the €1 debt and pro forma tests of the merger covenant, and all three covenants summarized in this report as "Other Important Covenants" are suspended with respect to any series of Reference Securities:

- when both rating agencies rate such series investment grade and no default exists

All such covenants again become effective when either of these conditions no longer exists.

### 2. Coupon Step-up (Not Present)

### 3. Financial Reports

- 120 days after each fiscal year, audited financial and unaudited pro forma statements
- 60 days after the end of the first 3 quarters, quarterly reports containing unaudited financial and unaudited pro forma statements
- If unrestricted subsidiaries, taken together, constitute a "significant subsidiary" (i.e., satisfy 10% total assets and income tests), sufficiently detailed annual and quarterly information

# Appendix A

## RATIO CALCULATIONS AND OTHER RELATED INFORMATION

*(Source: Summary Unaudited Pro Forma Condensed Combined Financial Data, NXP Offering Memorandum for Reference Securities, Oct. 5, 2006)*

(Figures are in millions of €)

### RESTRICTED PAYMENTS

- FCCR = EBITDA/Fixed Charges = 1072/366 = 2.92x
- Headroom = 2.92x-2.0 = .92x
- Quantifiable carve-outs

  Permitted Payments (200 + 40) = 240

  Permitted Investments (5+5+300+300+25+190) = 825
  Total carve-outs = 1,065

- Total Assets = 10,275
- Carve-outs as % of Total Assets = 10.4%
- 2% of Total Assets = 205.5

The Restricted Payments carve-outs exceed 2% of Total Assets

### LIMITATION ON DEBT INCURRENCE

- Quantifiable carve-outs (750+100+450+350+15) = 1,665
- Total Assets = 10,275
- 2% of Total Assets = 205.5

Debt incurrence carve-outs exceed 2% of Total Assets

### LIMITATION ON LIENS

- Quantifiable carve-outs = 500
- Net tangible assets
  Total Assets = 10,275
  - (Intangible Assets + Goodwill) = 5,729
- Net tangible assets = 4,546
- 15% of net intangible assets = 681.9

Lien carve-outs are less than 15% of net tangible assets.

Note: Add-backs and other items other than those indicated above could not be quantified and were thus not included in the calculations.

# Appendix B

## Covenant Quality Assessment Matrix

| | Strong ← | Moderate | Minimal → | |
|---|---|---|---|---|
| | **CQ-1** | **CQ-2** | **CQ-3** | **None** |
| **Restricted Payments** | •LTM fixed charge coverage ratio test at least 2.0 times and not to exceed 50% consolidated net income (other ratio tests may apply)<br>•All restricted payments and fixed charges covered by "restricted payments" definition<br>•Carve-outs are less than 2% of total consolidated assets<br>•Headroom under LTM Debt/EBITDA or under fixed charge coverage test is less than 0.5 times | •LTM fixed charge coverage ratio test at least 2.0 times and not to exceed 50% consolidated net income (other ratio tests may apply)<br>•All restricted payments and fixed charges covered by "restricted payments" definition<br>•Moderate carve-outs (equal to or greater than 2% of total consolidated assets)<br>•Headroom under LTM Debt/EBITDA test is equal to or more than 0.5 times and less than 2.0 times or under fixed charge coverage test is less than 2.0 times | •LTM fixed charge coverage ratio test of 2.0 times or less and not to exceed 50% consolidated net income (other ratio tests may apply)<br>•One or more restricted payments or fixed charges not covered by "restricted payments" definition<br>•Excessive carve-outs (greater than 2% of total consolidated assets)<br>•Headroom under LTM Debt/EBITDA test is equal to or greater than 2.0 times or under fixed charge coverage ratio test is equal to or greater than 2.0 times | |
| **Change of Control** | •Cash put option @100 or better if change of control, defined as acquisition of 50% or more of voting rights<br>•Permitted holder definition, if any, triggers change of control upon significant change in ownership | •Cash put option @100 or better if change of control, defined as acquisition of 50% or more of voting rights, and<br>•Negative rating action on, and extending up to 60 days following, public notice of upcoming change of control<br>•Permitted holder definition, if any, does not trigger change of control upon significant change in ownership | •Cash put option @100 or better if change of control, defined as acquisition of 50% or more of voting rights, and<br>•Negative rating action on or up to 60 days following consummation of change of control | |
| **Limitation on Debt Incurrence** | •LTM Debt/EBITDA, fixed charge coverage, or other ratio test<br>•Debt defined broadly<br>•Carve-outs are less than 2% of total consolidated assets<br>•Headroom under LTM Debt/EBITDA or under fixed charge coverage test is less than 0.5 times | •LTM Debt/EBITDA, fixed charge coverage, or other ratio test<br>•Debt defined less broadly<br>•Moderate carve-outs (equal to or greater than 2% of total consolidated assets)<br>•Headroom under LTM Debt/EBITDA test is equal to or more than 0.5 times and less than 2.0 times or under fixed charge coverage test is less than 2.0 times | •LTM Debt/EBITDA, fixed charge coverage, or other ratio test<br>•Debt definition may have material exceptions and may exclude some subsidiaries of credit group<br>•Excessive carve-outs (greater than 2% of total consolidated assets)<br>•Headroom under LTM Debt/EBITDA test is equal to or greater than 2.0 times or under fixed charge coverage ratio test is equal to or greater than 2.0 times | |
| **Limitation on Subsidiary Borrowings** | •Any borrowings by non-guarantor subsidiaries are limited and ordinary course | •Borrowings by non-guarantor subsidiaries permitted under LTM Debt/EBITDA or fixed charge coverage ratio test<br>•Headroom under LTM Debt/EBITDA test is equal to or more than 0.5 times and less than 2.0 times or under fixed charge coverage test is less than 2.0 times | •Borrowings by non-guarantor subsidiaries permitted under LTM Debt/EBITDA or fixed charge coverage ratio test<br>•Headroom under LTM Debt/EBITDA test is equal to or greater than 2.0 times or under fixed charge coverage ratio test is equal to or greater than 2.0 times | |
| **Merger Restrictions** | •No merger unless liabilities assumed by surviving entity<br>•Pro forma fixed charge coverage covenant of successor company represents 100%+ of predecessor company, and<br>•Can incur another $1 of debt under the debt incurrence test | •No merger unless liabilities assumed by surviving entity<br>•Pro forma fixed charge coverage covenant of successor company represents 100%+ of predecessor company, or<br>•Can incur another $1 of debt under the debt incurrence test | •No merger unless liabilities assumed by surviving entity | |
| **Negative Pledge/Limitation on Liens (applies only to Senior Notes)** | •If equally and ratably secured and guaranteed by restricted subsidiaries<br>•Carve-outs are limited and ordinary course | •If equally and ratably secured and guaranteed by restricted subsidiaries<br>•Carve-outs are less than 15% of net tangible assets or tangible net worth, or<br>•Carve-outs limited to working capital and bank debt or subject to a leverage-based calculation | •If equally and ratably secured<br>•Carve-outs equal to or greater than 15% of net tangible assets or tangible net worth, or<br>•Negative pledge is limited to "traded debt." | |
| **Asset Sales/Conveyance** | •100% applied to debt reduction or reinvested in fixed assets<br>•Within 12 months<br>•At least 75% of proceeds in cash or marketable securities | •100% applied to debt reduction or reinvested in fixed assets or asset acquisitions<br>•Within 12 to 24 months<br>•At least 50% of proceeds in cash or marketable securities | •100% applied to debt reduction or reinvested in business, or<br>•Less than 50% cash proceeds or marketable securities, or<br>•No limitation on asset sales unless debt assumed by acquirer | |
| **Limitation on Sale/Leaseback** | •100% applied to debt reduction<br>•Within 12 months | •For other than ordinary course of business, aggregate sale/leasebacks do not exceed 10% of consolidated stockholders equity unless fixed asset re-investment<br>•Within 12 to 24 months | •For other than ordinary course of business, aggregate sale/leasebacks exceed 10% of consolidated stockholders equity; or<br>•Long time frame for re-investment of proceeds | |

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**Author**

*Alexander Dill, Esq.*

**Production Manager**

*William L.Thompson*

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