

Credit Analysis

Moody's Global Sovereign

April 2009

Lebanon

	Foreign Currency	Local Currency
Government Bond Ratings	B2 / STA	B2 / STA
Country Ceilings Bonds	B1 / STA	Ba1
Country Ceilings Deposits	B2 / STA	Ba1

Summary

Lebanon's local and foreign currency government bond ratings are B2 with a stable outlook. Lebanon's sovereign ratings were upgraded in April 2009. The main drivers of the upgrade were the substantial improvement in external liquidity, the proven resistance of the public finances to shocks, and the willingness and ability of the country's resilient banking system to finance fiscal deficits.

Moody's determination of government bond ratings is based on four primary rating factors: Economic Strength, Institutional Strength, Government Financial Strength, and Susceptibility to Event Risk. Moody's step-by-step approach to sovereign ratings, based on these factors, is fully explained in our Rating Methodology entitled Sovereign Bond Ratings published in September 2008 (see link below).

Lebanon's Low Economic Strength balances a moderate level of GDP per capita with the economy's small scale and volatile performance. Its Low Institutional Strength reflects weak government effectiveness but superior financial sector regulation and a proven willingness to repay. A Low score for Government Financial Strength considers the very high public debt and wide fiscal deficit against the government's reliable financing base. Finally, the country's High Susceptibility to Event Risk recognises that a very high risk of adverse events is offset by the proven resilience of the public finances to shocks. These individual factor scores result in a rating range for Lebanon of B1 to B3.

Table of Contents:

Summary	1
Factor 1 – Economic Strength: Low	2
Factor 2 – Institutional Strength: Low	3
Factor 3 – Government Financial Strength: Low	4
Factor 4 – Susceptibility to Event Risk: High	5
Sovereign Rating Mechanics: Lebanon	6
Rating History	7
Annual Statistics	8
Moody's Related Research	10

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Lebanon and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. [Click here to link.](#)

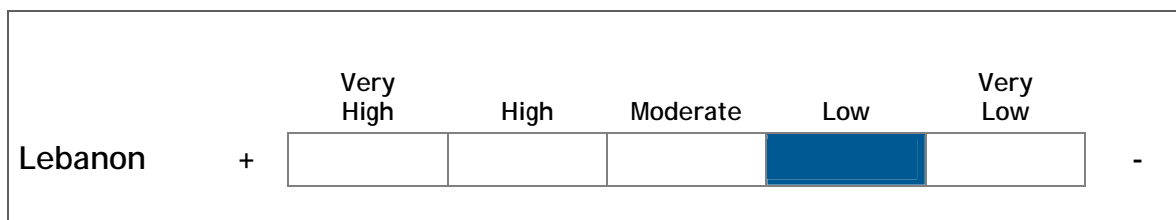


Moody's Investors Service

Lebanon

Low Economic Resiliency imparted by structural impediments and weak government effectiveness

Factor 1 – Economic Strength: Low



Low Economic Strength balances moderate GDP per capita with economy's small scale and volatility

Moody's assesses Lebanon's Economic Strength to be Low, a similar scoring to countries such as Bosnia (B2), Albania (B1), Mongolia (B1), or Bolivia (B3).

GDP per capita tends to be a useful – albeit imperfect – indicator of economic strength, a key parameter used to evaluate capacity and willingness to pay. Over the past five years (2004 to 2008), Lebanon's GDP per capita in purchasing power terms approximated \$11,000 according to the IMF. This placed Lebanon at 64 out of the 181 countries covered by the Fund according to this metric, a moderate level and similar to countries such as Venezuela (B2), Turkey (Ba3), or Uruguay (Ba3).

Lebanon's economy is rather small, however. Scale matters in terms of creditworthiness because the size of an economy tends to be correlated with its ability to withstand shocks. In 2008, Lebanon's nominal GDP amounted to around \$29 billion, close to that of Uruguay or Yemen (not rated). In global terms, Lebanon's economy was the 86th largest of the 181 countries covered by the IMF but generated only 0.05% of the world's GDP (in nominal dollar terms).

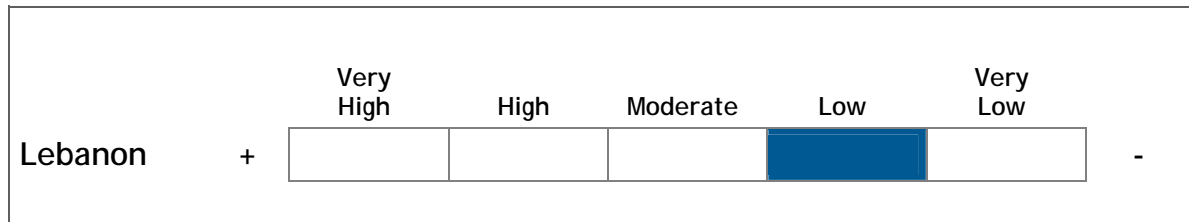
Lebanon's economic performance is also quite volatile. Over the past ten years, Lebanon's real GDP growth rate has displayed a standard deviation of 3.2, a more pronounced degree of volatility than that of most other countries. The wide fluctuations in Lebanon's GDP growth are a reflection of the country's small economic scale. The economy is also quite concentrated, with approximately two-thirds of GDP on services, in particular financial services and tourism.

Lebanon's economy suffers from a number of structural weaknesses. These include a weak basic infrastructure (such as roads, water, electricity and telecommunications), which has been damaged by various conflicts and suffers from under-investment and inefficient management. The government's capital expenditure is very low (it accounted for just over one percent of GDP last year according to Ministry of Finance data), having long been squeezed by the heavy cost of debt servicing, which consumes around half of the government's total revenues.

Lebanon's social indicators tend to be ranked at a moderate level compared to other countries. For example, the UN's latest Human Development Index ranks Lebanon at 78 out of 179 countries covered, a similar level to Turkey or Peru (Ba1). Wealth distribution is relatively skewed, however, and poverty and social deprivation remain significant challenges in many parts of the country. The latest official data indicate an average unemployment rate of 9% in 2007, with a youth unemployment rate of 26.1%. These rates are likely to have climbed since then.

Lebanon

Factor 2 – Institutional Strength: Low



Weak government effectiveness offset by superior financial sector regulation and proven willingness to repay

Moody's scores Lebanon's Institutional Strength at Low, a ranking shared by countries including Ukraine (B1), Dominican Republic (B2), and Honduras (B2).

Analysed in tandem with economic strength, the quality of a country's institutional framework and governance is an important consideration in the rating process. While qualitative in nature, this parameter is correlated with sovereign risk. This factor considers the extent to which a nation's political, social, and legal institutions act as a constraint on sudden and adverse changes in a country's ability and willingness to repay its debt. The stronger the institutions, the greater the constraint.

As a starting point in its assessment of institutional strength, Moody's monitors the World Bank Governance Indicators, which are themselves based on an aggregation of many other opinions and surveys. We particularly focus on those indicators covering Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC). The latest version of these (for 2007) ranks Lebanon between 29 and 48 (on a scale of 0 to 100 with 100 being the strongest) depending on the particular indicator (GE: 29; RQ: 48; RL: 30; CC: 31). Broadly similar scores are recorded for countries such as Fiji (Ba2), Indonesia (Ba3), and Ukraine – also scored at Low for institutional strength.

Transparency International's latest Corruption Perceptions Index ranks Lebanon at 102 out of 180 countries (with 1 being the least corrupt). This is also a similar ranking to other Low institutional strength countries such as Dominican Republic and Mongolia.

The effectiveness of both the executive and legislative branches of government in Lebanon is hampered by the country's long-standing sectarian and political rivalries. For example, the parliament did not sit between November 2006 and May 2008 because it could not muster a quorum of MPs due to bitter political disagreements. The cabinet was also paralysed after a walk-out by opposition ministers in November 2006, who did not return until the formation of a national unity government in July 2008. Such disruptions have prevented the implementation of much-needed economic reforms.

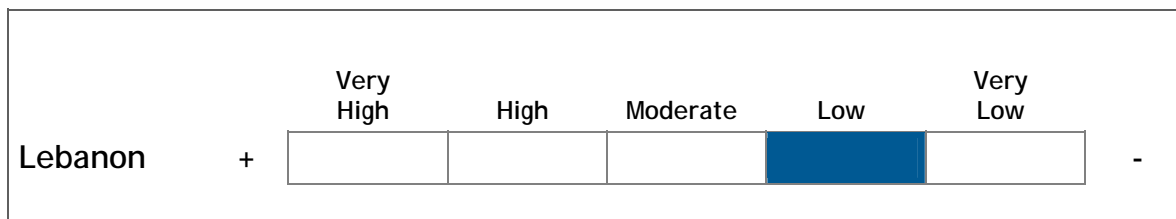
An important factor that supports our assessment of Lebanon's Institutional Strength is the government's proven willingness to repay. The government of Lebanon has never failed to service its debt in a timely manner despite the country suffering many serious political and economic shocks, including a civil war that lasted between 1975 and 1990. Recent traumas include the assassination of the former prime minister in 2005 and the assassinations of many political figures since then, a devastating war between Israel and Hezbollah in 2006, and a brief outbreak of civil conflict in May 2008.

We also recognise the quality of the country's financial sector management and regulation, which is overseen by the central bank. The central bank's personnel tend to be more stable and less politicised than those of other institutions. For example, the current governor of the central bank has been in place since 1993 despite numerous changes of government. His term is not up for renewal until 2011.

Lebanon

Low Financial Robustness caused by stifling public debt and high event risk

Factor 3 – Government Financial Strength: Low



Very high public debt and wide fiscal deficit but reliable and resilient financing base

Moody's ranks Lebanon's Government Financial Strength at Low, the same score as countries such as Belarus (B1), Cambodia (B2), and Paraguay (B3).

Lebanon's headline public finance ratios, despite improvement in recent years, remain among the weakest in the world. In 2008, the general government's gross debt exceeded 150% of GDP or 620% of revenues. Interest payments consumed almost half of the government's total revenues last year. These indicators reflect a very low level of debt affordability, but they are offset to some extent by other factors.

Lebanon accumulated the bulk of its stifling public debt in the 1990's as a means of financing reconstruction following the long civil war. The cost of servicing the debt is now a serious burden that sucks up resources and crowds out more productive forms of public expenditure. Despite running a primary surplus of over one percent of GDP last year, the overall fiscal deficit was around 10% of GDP.

A further drain on the government's resources is the poor financial condition of the state-owned electricity company, EDL, which required a subsidy of around 6% of GDP last year, mainly owing to fuel costs. Efforts to reform EDL, along with other elements of the government's promised reform programme, have been stymied by political infighting for years.

Despite the government's wide deficit, massive debt overhang, and poor track record of fiscal reform, its sources of financing are deep and reliable. The large and resilient domestic banking system is the government's primary creditor and it remains willing and able to purchase and roll over sovereign securities. Lebanon's commercial bank assets amounted to around 330% of GDP at the end of 2008. In general, the banks remain in good health and have not been exposed to toxic financial assets or failed western financial institutions.

Ultimately, the ability of Lebanon's banks to continue financing the government rests on the steady growth of their deposit base. The level of bank deposits has proven remarkably resilient to Lebanon's various shocks in recent years and continues to grow strongly. In the twelve months to January 2009, bank deposits increased by around 14%. These deposits are mainly sourced from Lebanon's wide and loyal diaspora.

The willingness of Lebanon's banks to finance the government is to a large degree explained by the fact that around half of banks' assets are invested with the sovereign (both the government and the central bank). Hence, a default by the government would have a cataclysmic effect on the financial health and profitability of the banking sector. This creates a circularity which is clearly concerning but which nevertheless sustains the government as long as the level of bank deposits continues to increase.

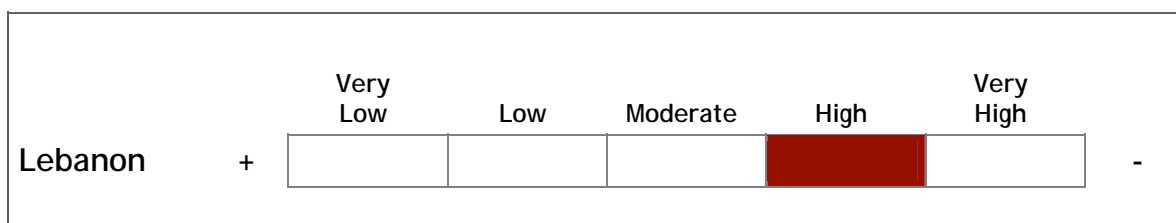
The structure of the government's debt has been improved by a series of liability management operations in recent years. The most recent, in March 2009, exchanged the bulk of the government's Eurobonds maturing in 2009 for longer dated securities. Currently, the government does not face a significant Eurobond principal repayment until March 2010. Around half of the government's gross debt is denominated in foreign currencies.

Lebanon

In 2010 as a whole, the government's Eurobond maturities amount to around \$2 billion. This is easily covered by the central bank's foreign exchange reserves, which approached \$18 billion in January 2009. The commercial banks also have a large capacity to finance the government in foreign currency given their comfortable external liquidity position.

An additional source of financing for the government is external official donors, whose commitment has been tried and tested in recent years. The most recent episode of substantial donor support was the Paris III conference in January 2007 which resulted in pledges of \$7.5 billion in financial assistance for Lebanon. To date, around \$3.1 billion of this amount has been received and disbursements continue.

Factor 4 – Susceptibility to Event Risk: High



Very high risk of adverse events but proven resilience of public finances to shocks

This factor assesses a country's vulnerability to adverse shocks that could materially impact the government's creditworthiness and result in an abrupt, multi-notch downgrade. Such shocks could be financial, economic, or political. Moody's positions Lebanon's Susceptibility to Event Risk at High, along with countries that include Argentina (B3), Pakistan (B3), and Jamaica (B2).

Lebanon has suffered many serious political and economic shocks in recent decades. The country's high event risk mostly stems from its fractious domestic politics and precarious geopolitical location, which has prompted the interference of outside powers. Lebanon has long been a proxy battle ground for regional and international foes, including its immediate neighbours Israel and Syria.

Recent disruptive events include the assassination of the former prime minister, Rafiq Hariri, in February 2005 which was followed by a series of assassinations of other political figures; a destructive war between Israel and Hezbollah in mid-2006; and an internal political crisis which began in November 2006 and culminated in a brief outbreak of civil unrest in May 2008. Relative political calm was only restored by the signature of the Doha agreement later that month.

The country's real growth rate and the level of deposit dollarisation have reflected these events. Real growth plummeted while dollarisation soared in the aftermath of Hariri's assassination in 2005 and then the 2006 bombardment by Israel. Although economic growth recovered quite quickly following the end of hostilities in 2006, boosted in part by the disbursement of financial aid from external donors, the level of deposit dollarisation only began to ease significantly following the signature of the Doha agreement in May 2008.

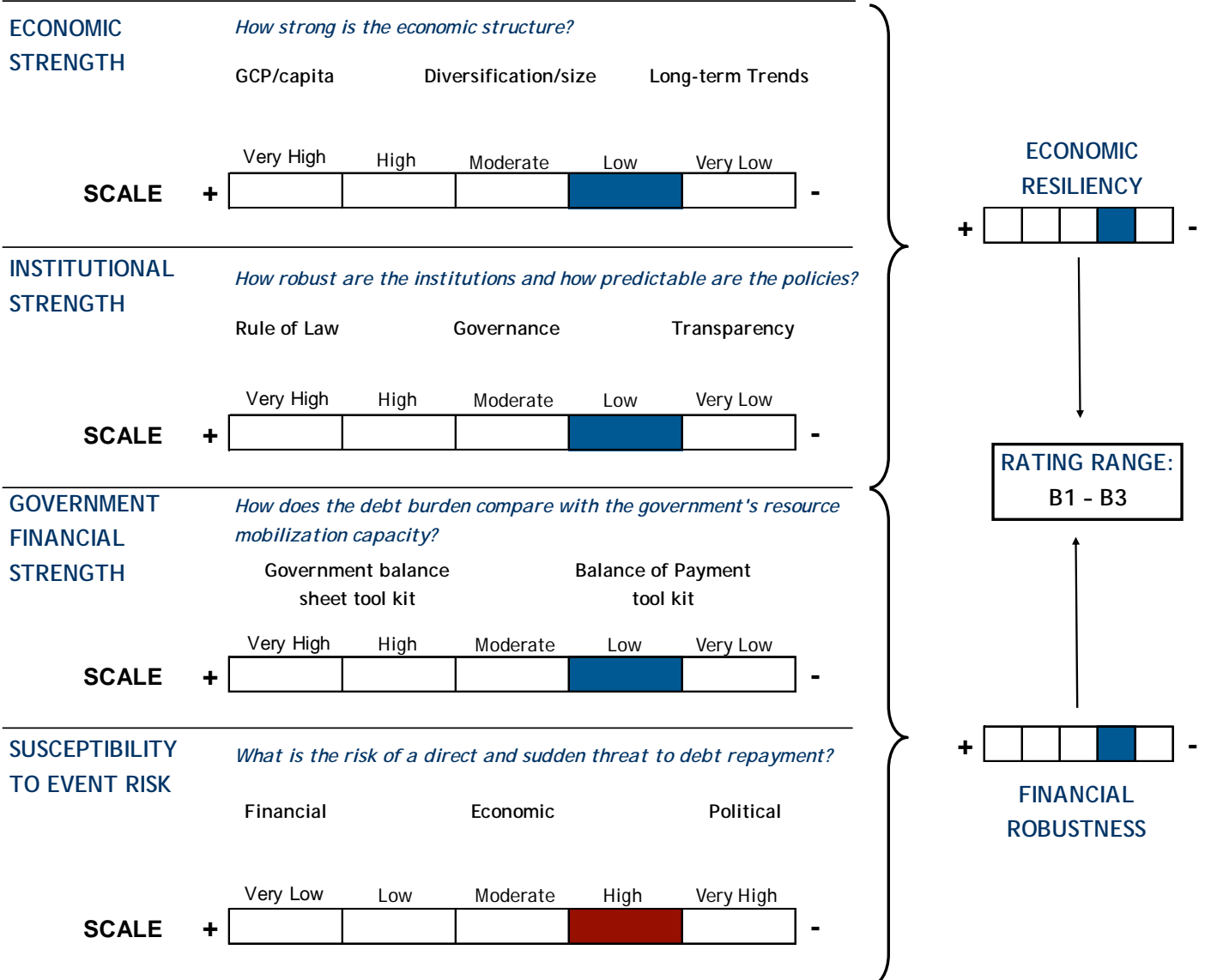
The public finances have shown an impressive level of resilience in the face of such shocks, however, which reduces the likelihood that similar events in the future would lead to a multi-notch downgrade of Lebanon's sovereign ratings or a default. As mentioned above, the government has never failed to service its debt in a timely manner despite numerous disruptive events.

Our assessment of Lebanon's Susceptibility to Event Risk is supported by the government's proven willingness to repay and the substantial buffers which protect the economy and the public finances. These include the central bank's relatively large stock of foreign currency reserves (which shield the balance of payments and bolster confidence in the fixed exchange rate), the sound financial health and comfortable core liquidity of the commercial banks (which continue to attract deposits), and the proven commitment of external donors.

Lebanon

We recognise that the global economic crisis poses risks for Lebanon's own economic outlook. The real sector and the balance of payments are likely to be affected by falling external demand, a more cautious attitude among foreign investors, and a decline in inward worker remittances (especially from the Gulf countries). Yet we believe that these risks are mitigated by the protective buffers outlined above. We also stress that Lebanon's B2 ratings already encapsulate a high level of political and economic vulnerability.

Sovereign Rating Mechanics¹: Lebanon



¹ Link to our Sovereign Bond Rating Methodology

Lebanon

Rating History

Lebanon								
	Foreign Currency Ceilings				Government Bonds		Outlook	Date
	Bonds & Notes		Bank Deposits		Foreign Currency	Local Currency		
	Long-term	Short-term	Long-term	Short-term	Long-term	Long-term		
Rating Raised	B1	--	B2	--	B2	B2	Stable	April-09
Outlook Changed	B2	--	B3	--	B3	B3	Positive	December-08
Outlook Changed	B2	--	B3	--	B3	B3	Stable	March-08
Outlook Changed	B2	--	B3	--	B3	B3	Negative	November-06
Rating Raised	B2	--	--	--	--	--	--	May-06
Rating Lowered	B3	--	B3	--	B3	--	Stable	March-05
Rating Lowered	B2	--	--	--	B2	B3	Negative	July-01
Review for Downgrade	--	--	--	--	--	B1	--	September-00
Outlook Changed	--	--	--	--	--	--	Negative	September-00
Rating Assigned	--	--	--	--	--	B1	--	August-99
Rating Assigned	--	--	B2	NP	--	--	--	May-97
Outlook Assigned	--	--	--	--	--	--	Stable	March-97
Rating Assigned	B1	NP	--	--	B1	--	--	February-97

Lebanon

Annual Statistics

Lebanon

	2001	2002	2003	2004	2005	2006	2007	2008	2009F	2010F
Economic Structure and Performance										
Nominal GDP (US\$ Bil.)	17.21	18.72	19.80	21.47	21.56	22.40	25.00	28.90	30.81	32.69
Population (Mil.)	3.47	3.52	3.56	3.61	3.66	3.70	3.75	3.80	3.85	3.90
GDP per capita (US\$)	4959	5323	5559	5949	5898	6049	6665	7607	8004	8383
GDP per capita (PPP basis, US\$)	8612	8932	9378	10206	10499	10699	11279	12063	-	-
Nominal GDP (% change, local currency)	2.3	8.7	5.8	8.4	0.4	3.9	11.6	15.6	6.6	6.1
Real GDP (% change, local currency)	4.5	3.3	4.1	7.5	1.1	0.6	7.5	8.5	3.0	4.0
Inflation Rate (CPI, % change, dec/dec)	-0.1	3.7	2.2	2.0	0.5	7.2	6.0	6.4	3.9	2.9
Gross Investment/GDP (%)	22.8	18.2	19.2	22.0	21.2	22.7	27.4	21.4	21.1	23.5
Gross Domestic Saving/GDP (%)	-2.5	-1.2	-1.8	-1.8	-0.2	1.2	1.7	-6.6	-3.3	-0.7
Nominal Exports of G & S (% change, US\$ basis)	12.5	9.9	13.0	19.7	7.6	21.8	22.5	14.6	1.3	2.5
Nominal Imports of G & S (% change, US\$ basis)	14.6	-2.3	8.6	21.3	-2.1	12.8	27.6	20.5	-3.2	4.0
Openness of the Economy (%) [1]	40.9	41.3	44.1	48.7	52.2	61.2	67.2	66.6	63.3	61.2
Government Effectiveness	--	-0.35	-0.28	-0.35	-0.33	-0.45	--	--	--	--
Government Finance										
Cen. Gov. Revenue/GDP (%)	17.9	20.7	22.3	23.2	22.8	21.7	23.2	24.2	24.6	23.8
Cen. Gov. Expenditures/GDP (%)	34.2	35.9	35.5	32.6	31.4	35.2	33.4	34.3	37.2	33.9
Cen. Gov. Financial Balance/GDP (%)	-16.3	-15.3	-13.2	-9.4	-8.6	-13.5	-10.2	-10.1	-12.6	-10.1
Cen. Gov. Primary Balance/GDP (%)	0.3	1.1	3.1	3.1	2.3	-0.7	2.3	1.3	0.2	3.0
Gen. Gov. Direct Debt/GDP (%)	152.6	156.1	159.9	160.4	170.9	170.4	155.4	151.1	154.3	155.6
Gen. Gov. Direct Debt/Cen. Gov. Revenue (%)	851.6	755.7	717.1	690.6	750.0	786.5	669.4	623.6	626.7	653.0
Cen. Gov. Int. Pymt/Cen. Gov. Revenue (%)	92.8	79.3	73.2	53.5	47.7	59.2	53.7	47.0	52.0	55.0
Gen. Gov. FC & FC-indexed Debt/Gen. Gov. Debt (%)	36.5	49.9	49.1	53.4	51.9	53.3	54.6	48.4	48.4	48.4
Gen. Gov. Direct Debt (US\$ Bil.)	26.26	29.22	31.66	34.42	36.84	38.17	38.85	43.66	47.54	50.84
GG Direct Debt Owed to Non-residents/GG Direct Debt (%)	14.6	18.2	21.8	20.3	19.9	20.7	21.6	21.6	21.6	21.6

Lebanon

Lebanon

	2001	2002	2003	2004	2005	2006	2007	2008	2009F	2010F
External Payments and Debt										
Current Account Balance (US\$ Bil.)	-3.28	-2.61	-2.62	-3.33	-2.93	-1.25	-1.77	-3.28	-3.19	-3.30
Current Account Balance/GDP (%)	-19.0	-13.9	-13.2	-15.5	-13.6	-5.6	-7.1	-11.4	-10.4	-10.1
External Debt (US\$ Bil.)	14.88	15.24	19.52	22.64	21.99	23.31	25.84	27.78	29.05	30.36
External Debt/GDP (%)	86.4	81.4	98.6	105.5	102.0	104.1	103.4	96.1	94.3	92.9
External Debt/CA Receipts (%) [2]	157.4	153.1	174.8	169.4	163.5	139.1	126.2	119.0	128.5	129.2
Net Foreign Direct Investment/GDP (%)	6.9	7.4	8.7	10.9	12.2	11.9	8.0	7.1	5.5	6.0
Official Forex Reserves (US\$ Bil.)	4.36	5.07	10.20	9.49	9.85	10.21	9.78	17.06	17.59	17.59
Nominal Exchange Rate (local currency/US\$; end-year)	1508	1508	1508	1508	1508	1508	1508	1508	1508	1508
Short-term External Debt/Total External Debt (%)	51.9	47.0	46.7	50.6	49.2	48.7	49.6	48.4	47.4	46.8
Interest Paid on External Debt (US\$ Bil.)	0.68	0.43	0.39	0.59	1.06	1.42	1.54	1.07	0.65	1.16
Amortization Paid on External Debt (US\$ Bil.)	1.21	1.35	1.57	1.74	1.92	2.11	2.31	2.47	2.63	2.83
Net Foreign Assets of Domestic Banks (US\$ Bil.)	1.27	2.14	0.58	1.46	1.63	4.23	7.07	-	-	-
Monetary, Vulnerability and Liquidity Indicators										
Domestic Credit (% change, dec/dec)	11.8	6.4	4.0	9.7	-0.3	10.6	6.6	-	-	-
Domestic Credit/GDP (%)	185.5	181.4	178.3	180.3	179.1	190.7	182.0	-	-	-
M3/Official Forex Reserves (X)	8.0	7.5	4.2	5.0	5.0	5.2	6.1	-	-	-
Debt Service Ratio (%) [3]	20.0	17.9	17.5	17.5	22.2	21.1	18.8	15.2	14.5	17.0
External Vulnerability Indicator (%) [4]	177.2	141.4	89.4	120.6	109.8	111.3	131.0	78.9	78.3	80.7
Liquidity Ratio (%) [5]	21.0	13.3	12.1	14.6	11.8	11.0	13.2	-	-	-
"Dollarization" Ratio (%) [6]	69.0	65.6	60.9	64.9	68.5	72.3	74.0	65.3	-	-
"Dollarization" Vulnerability Indicator (%) [7]	183.3	166.6	126.7	130.0	143.2	141.2	142.0	257.0	-	-
M3 (% change, dec/dec)	7.5	8.1	13.0	10.1	4.5	7.8	12.4	-	-	-
Short-Term Nominal Interest Rate (% dec)	14.6	9.4	8.0	7.9	8.7	8.7	8.7	8.4	-	-
Total External Debt/Forex Reserves (%)	341.1	300.6	191.5	238.4	223.3	228.3	264.2	162.8	165.1	172.6
Total Liabilities due BIS Banks/Total Assets Held in BIS Banks (%)	17.1	14.9	16.4	20.7	16.9	14.7	18.3	-	-	-

Notes:

[1] Sum of Exports and Imports of Goods and Services/GDP (%)

[2] Current Account Receipts

[3] (Interest + Current-Year Repayment of Principal)/Current Account Receipts (%)

[4] (Short-Term External Debt + Currently Maturing Long-Term External Debt)/Official Foreign Exchange Reserves (%)

[5] Liabilities to BIS Banks Falling Due Within One Year/Total Assets Held in BIS Banks (%)

[6] Total Foreign Currency Deposits in the Domestic Banking System/Total Deposits in the Domestic Banking System (%)

[7] Total Foreign Currency Deposits in the Domestic Banking System/(Official Foreign Exchanges Reserves + Foreign Assets of Domestic Banks) (%)

Lebanon

Moody's Related Research

Rating Actions:

- Moody's upgrades Lebanon's sovereign ratings, April 2009
- Moody's changes outlook for Lebanon's sovereign ratings to positive from stable, December 2008

Announcements:

- Moody's: Lebanon's Voluntary Debt Exchange Supports Ratings, March 2009

Banking System Outlook:

- Lebanon, September 2007 (104833)

Statistical Handbook:

- Moody's Country Credit Statistical Handbook, November 2008 (112148)

Rating Methodology:

- Sovereign Bond Ratings, September 2008 (109490)

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Lebanon

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