

Rite Aid Corporation NYSE:RAD

FQ3 2022 Earnings Call Transcripts

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S&P Global Market Intelligence Estimates

	-FQ3 2022-			-FQ4 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.18)	0.15	NM	(0.42)	(0.76)	(0.24)
Revenue (mm)	6280.00	6228.88	▼ (0.81 %)	6355.79	24970.21	25655.75

Currency: USD

Consensus as of Dec-21-2021 1:05 PM GMT

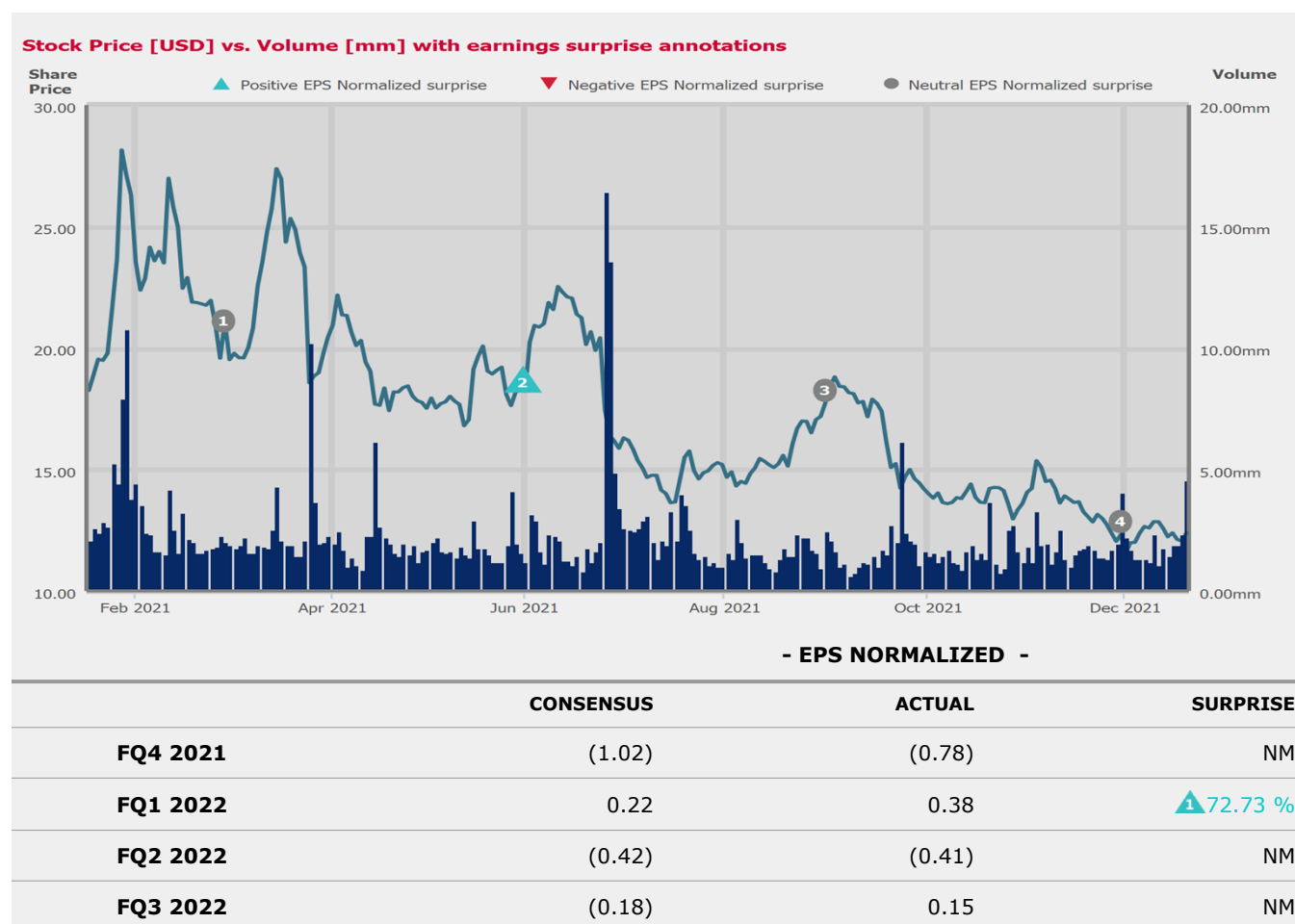


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Call Participants

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Presentation

Operator

Good day, and thank you for standing by. Welcome to the Rite Aid Corporation Fiscal Year '22 Q3 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Trent Kruse. Please go ahead, sir.

Trent Kruse

Senior Vice President of Investor Relations & Treasury

All right. Thank you, Deshondra, and good morning, everyone. We welcome you to our Fiscal 2022 Third Quarter Earnings Conference Call. On the call with me this morning are Heyward Donigan, Jim Peters and Matthew Schroeder.

As we mentioned in our release, we are providing slides related to the material we will be discussing today. These slides are provided on our website, investor.riteaid.com. While management will not be speaking directly to the slides, these slides are meant to facilitate your review of the company's results and to be used as a reference document following the call.

Before we start, I'd like to remind you that today's conference call includes certain forward-looking statements. These forward-looking statements are presented in the context of certain risks and uncertainties that can cause actual results to differ. These risks and uncertainties are described in our press release in Item 1A of our most recent annual report on Form 10-K and in other documents that we file or furnish to the SEC.

Also, we will be using certain non-GAAP measures in our release and in the accompanying slides. The definition of the non-GAAP measures, along with the reconciliation to the related GAAP measure, are described in our press release and slides.

And with that, let me turn the call over to Heyward. Heyward?

Heyward Rutledge Donigan

President CEO & Director

Thanks, Trent, and good morning, everyone. I'm pleased with our third quarter performance as we grew our revenue and increased adjusted EBITDA by nearly 13%.

Now before I turn the call over to Jim and Matt to talk through our quarterly results and updated guidance, I wanted to spend some time discussing the very bright future we see ahead for Rite Aid. As we move forward, we are unleashing the next evolution of our strategy, and we are laser-focused on an evolved view of the pharmacy of the future.

What that really means is a pharmacy business that's not limited to what we usually think about, a traditional in-store definition of pharmacy. Rather, our efforts, and we've been talking about this for a couple of years, are centered on an expanded view of pharmacy and what we've been calling internally our omnipharmacy strategy. That is our RxEvolution is driving our transition from a company with numerous loosely tied pharmacy parts to an omnipharmacy business whose value and relevance as a whole is far greater than the sum of its individual parts.

To be clear, we are going after the digital, retail PBM, specialty and mail order pharmacy markets that will allow us also to expand beyond our 17-state footprint to be a national provider of pharmacy in an omnichannel way, not in a brick-and-mortar way, just the way we are today.

Rite Aid is in a really strong position to be a pure-play omnipharmacy company that serves consumers and enterprise customers, utilizing a full suite of pharmacy services including thousands of retail pharmacies with hundreds of millions of trusted customer touch points, engaging with consumers on their whole

health and well-being as no one else can; our own specialty pharmacy through which we currently distribute and manage pharmacy and medical benefits for specialty pharmaceuticals, which is core to our growth strategy.

Our own mail order pharmacy with a 50-state license and leading NPS scores, which position us well for traditional PBM clients and other fulfillment opportunities; our own pharmacy benefit management company, Elixir, that is large enough to scale and small enough to be nimble, more on that in a little while; our modernized Laker platform, a best-in-class claims adjudication platform that powers PBMs across the country; our virtual pharmacist chat capabilities that connect the consumers -- connect consumers to pharmacies online as they seek to get more than just in-person pharmacy touch points; and our central fill operations that offer compliance packaging solutions that help individuals receive personalized weekly packages of their medications that are neatly organized and by time of day; and an exciting soon-to-be-announced direct-to-consumer digital offerings. We look forward to sharing more about this initiative in the near future.

Our strategy also continues to focus on utilizing pharmacists to engage as every day care connectors to ensure our customers get and stay on the traditional medication and alternative remedies that they need to stay healthy. And we can deliver these medications to our customers in ways that suit them best, through the mail, same-day courier, in-store, via your smartphone and, as I just mentioned, via modern direct-to-consumer digital offering in the near future.

That's what we mean by omnipharmacy, and we are energized by the potential of the omni-pharmacy market, which is significant in size, with a total addressable market of approximately \$1 trillion, yes, that's with a T, and growing.

And while there is much more to do to advance our omni-pharmacy strategy, we're also focused on using the power of our pharmacists to help our health plan partners achieve superior member health outcomes, lower overall health care costs and maximize health plan revenue.

When we launched our RxEvolution strategy back in March of last year, it was with a conviction that pharmacy has a critical role to play in health care. And we all see that today as recently as in yesterday's Wall Street Journal how the event of the last almost 2 years have highlighted, and yes, stress the pharmacy system, but highlighted the role that pharmacists play, one that we probably couldn't even imagine when we first started talking about this. We're really excited now even more so than we were about the future of the Rite Aid enterprise as we further leverage all of our strategic pharmacy assets to be a leader in omnipharmacy in America.

Now let me provide an update on Elixir. I want to acknowledge that we have not yet made the progress on the PBM membership growth in the time frame we previously expected. Even though we have strong network economics and robust clinical offerings, we were unable to be competitive on rebates. As announced today, we've taken steps to address our rebate economics by partnering with Prime Therapeutics, who will be able to help us significantly increase our rebate value given their membership in the Ascent GPO. This new rebate aggregation agreement will deliver significant value to Elixir and to our clients as well as make us more price competitive in the market.

Now with our strong rebate and network economics, we can point to recent signs of success that lead us to be optimistic that the upcoming selling season will be telling. So far, in the last couple of months, we've seen 10 new customer wins in recent -- I'm sorry, 10 new customer wins, and we're getting to the final round 20% more often than last year, and we're closing 50% of the business when we get to the final lap. This shows that when we have the economics to get to the final lap stage, our suite of assets provides a very compelling value proposition.

In addition, we have received 80% more RFPs in the last 2 months than we received during the same period last year. So there will be no shortage of opportunities for us to win.

On the Elixir insurance side of the business, our Part D business that we own, our results have been disappointing primarily due to the deterioration of the medical loss ratio. We continue to look to ways to

reduce our exposure to our Medicare Part D business, Elixir Insurance, and look forward to sharing more on our go-forward plans here on the coming months as well.

As we move forward, we're focusing on optimizing the many assets we have. Modernizing Laker, which is our adjudication platform, leveraging our mail order on specialty pharmacies and continuing the strong growth of our cash card business, all of which produce economics and growth in ways beyond pure-play membership increases.

In addition to this growth, Elixir continues to build on its PBM operational capabilities to drive improved efficiencies, great service and analytics to our customers. On the leadership front, we continue to bring in top talent. Last quarter, we noted that Lance Neill has joined the team as Elixir's Chief Operating Officer. For personal reasons, Lance was with us only briefly. We were able to quickly move forward, and I'm happy to announce that Chris DuPaul has joined our team as our new COO. And Chris is on the phone with us today.

Chris comes to us with many years of experience, particularly at CVS, where he led the \$4.5 billion clinical products and services business. He also led the development and management of health care products and services across the CVS retail pharmacy and PBM business units. We're very excited to add Chris to the Elixir team.

In addition to Chris, we've recently recruited seasoned health care executives across key functional areas within Elixir and brought on a new CFO, who has significant health care experience. And we have recently assembled a very strong seasoned sales team aligned to all of our key target market segments. These new hires are critical to Elixir. However, we are maintaining our synergies across the organization from our prior integrations in HR, IT, legal and within the finance organization.

And we are continuing our focus on driving lean and process synergies and principles across the enterprise. We have seen measurable results in several areas, including implementations and customer care and we are now institutionalizing our lean efforts as we continue to focus on expense management.

Lastly, we have a formal rollout of a more targeted go-to-market strategy for market segments where we have a right to win, particularly in the health plan, health systems, employer groups over 1,000 lives, labor and public sector lines of business. We're encouraged by our recent momentum and believe Elixir can win its fair share of business during the 2023 selling season and in the years to come. But the proof will be in the pudding, so to speak. I remain optimistic.

So overall, for our business, we are relentlessly focused on 3 things: growing our business, reducing costs and improving our leverage ratio, all of which we believe will drive shareholder value. To that end, and as we announced this morning, we are rigorously assessing our store base and executing a store closure plan to reduce costs, drive improved profitability, ensure we have a healthy foundation to grow our omnipharmacy from, including the right stores in the right locations for the communities we serve and for our businesses.

We've identified 63 stores for closure that we expect to provide an annual EBITDA benefit of approximately \$25 million. This review will continue, and we would anticipate this closure number and related EBITDA benefit to grow as we finalize these efforts over the next several months.

The decision to close the stores is one we take very seriously as we evaluate the impact on our associates, our customers and our communities. First and foremost, we work hard to ensure the transfer of prescriptions is automatic and seamless for our customers and that all their prescription needs are met. Importantly, associates impacted by the store closures are being offered the opportunity to transfer to another store. These tough decisions allow us to ensure our company continues to thrive and provides us the opportunity to continue to invest in and drive our omnipharmacy strategy.

And now I'll turn it over to Jim for some comments on our Retail Pharmacy segment. Jim?

James Joseph Peters
Chief Operating Officer

Thank you, Heyward, and good morning, everyone.

As Heyward noted, we are driving the next evolution of our strategy to truly bring our omnipharmacy capabilities to life. We also continue to prepare and adapt to the changing needs of our customers and communities and at the same time, focus on delivering strong results for our shareholders.

And before I jump into our quarterly results, I would like to also recognize the incredible and tireless work of all our associates and, in particular, our frontline teams and pharmacists who are working around the clock to provide the care and support our communities desperately need.

Now let me talk through our solid third quarter results. We grew our business, including 7.9% growth at Retail and increased our adjusted EBITDA by 12.7%. During the quarter, we administered nearly 4 million COVID vaccines, and we conducted over 1.1 million COVID tests. This brings our total vaccines delivered since we began administering COVID vaccines to nearly 11.6 million and the total tests administered to over 4.5 million as of the end of the third quarter. As a result of our COVID vaccine program, we have successfully converted nearly 300,000 new customers who are now filling approximately 800,000 new prescriptions at Rite Aid.

As we look at our pharmacy results overall, we grew our 30-day adjusted comp scripts by 7.9% in the quarter. In addition, maintenance scripts grew approximately 1.7% for the quarter. And when excluding vaccines, we saw acute scripts increase 3.9%. During the quarter, we administered 2.1 million flu shots. In addition, we administered nearly 278,000 ancillary vaccines for a 43% sequential increase versus our last quarter.

Our pharmacists and store teams did an incredible job in meeting an over 40% increase in pharmacy services this quarter due to the unprecedented demand for all vaccines and COVID testing. The ability to meet this incredible surge in pharmacy services in such a challenged labor market clearly demonstrates our work in lean principles to free up their time is paying off. Looking ahead, we will continue to enhance our efforts around adherence through programs like first fill, courtesy refills, 90-day conversion and compliance packaging.

Each of these programs have historically shown the potential to deliver meaningful improvement in adherence rates with increases ranging from 9% to over 24%. We have an opportunity to improve our overall levels of adherence. And this is particularly exciting as a 1% overall improvement in our adherence rates is worth over \$20 million in pharmacy gross profit. We are excited to continue our efforts to truly unlock our pharmacists' full potential to drive increased productivity and meaningfully improve the profitability of our stores.

Now let me turn to our retail and digital results. For the quarter, our front-end comps, excluding tobacco, were up 1%. We saw a continued strength in our health categories, including upper respiratory, pain care, vitamins and diagnostics driven by take-home COVID tests. We also experienced growth in the beauty department, in particular, makeup and cosmetics as well as personal care.

As we all know, we are operating in a high inflation environment. As we've seen a number of our manufacturing partners increased their cost of goods to us, we strategically adjusted our pricing, applying learnings from our partnership with dunhumby to identify which products and price points are crucial to driving customer loyalty and profitable growth and always with a focus on ensuring that we maintain a competitive position in the marketplace. We continue to experience ongoing supply challenges that are impacting our in-stock rates, and we are working to adjust as needed to mitigate any meaningful risks.

In addition, the labor market continues to be pressured as well. As we have stated previously, we are addressing these challenges by investing in wages for associates while also launching a new digitally enabled recruiting platform. But important to note, it's more than just wages. We're also providing enhanced training and differentiated career development opportunities for our associates.

Finally, on the front end, we continue to see improvement in our inventory turns with another quarter of 7% growth. We are also continuing to make exciting progress on our digital initiatives with total digital revenue growing 75% versus last year, including 253% growth in our marketplace and delivery

businesses. We expanded with Uber Eats and Postmates this quarter and saw express delivery transactions grow nearly 900%.

In addition, the teams completed our national rollout of buy online, pick up at store in October as part of our plan to evolve the digital channel to meet our customers' ever-changing needs through enhanced convenience. Collectively, this has led to a 10% quarter-over-quarter increase in the number of known customers who interacted with us digitally in the quarter.

We continue to expect our digital enhancements to have a halo effect across the rest of our business, attracting new customers, driving bigger basket sizes, increasing product availability, enhancing overall consumer experience and improving sales across our chain.

In closing, we delivered a strong quarter and increased profitability that beat expectations. Thanks to the energy, passion and commitment of our teams, we are confident that we can continue to deliver on our strategy, build relevance and gain market share both today and in the future. Thank you.

And with that, I'd like to turn it over to Matt for some comments on our financial performance. Matt?

Matthew C. Schroeder
CFO & Executive VP

Thanks, Jim, and good morning, everyone.

Looking at our quarterly results, revenues were up \$111.8 million or 1.8% from the prior year's third quarter driven by growth at the Retail Pharmacy segment partially offset by a decline at the Pharmacy Services segment. Third quarter net loss was \$36.1 million or \$0.67 per share compared to last year's third quarter net income of \$4.3 million or \$0.08 per share. Current year's net loss was significantly impacted by a noncash facility exit and impairment charge of \$47.5 million driven primarily by our store closure decisions.

Adjusted net income was \$8.2 million or \$0.15 per share versus an adjusted net income of \$21.6 million or \$0.40 per share for the prior year's quarter. Adjusted EBITDA for the quarter was \$154.8 million, an increase of \$17.4 million or 12.7% over the prior year's results of \$137.4 million. Retail EBITDA increased \$37.3 million due to increased script count offset somewhat by increases in SG&A to support that script count growth. Pharmacy Services segment adjusted EBITDA decreased \$19.9 million due to a reduction in revenues and gross margin rate.

Now let's discuss the key drivers of operating results in our business segments. Retail Pharmacy segment revenue for the quarter was \$4.4 billion, which was \$322.9 million higher or an increase of 7.9% over last year's third quarter due to an increase in same-store sales and the inclusion of the newly acquired Bartell stores. Retail Pharmacy same-store sales increased 4.4% with same-store prescription count up 7.9%. Our prescription count increase was driven by the administration of 4 million COVID vaccines slightly offset by a reduction in flu immunizations.

Front-end same-store sales, excluding cigarettes and tobacco products, increased 1%. The increase in front-end same-store sales was driven by good performance in our health categories, including upper respiratory, take-home COVID tests and vitamins somewhat offset by a reduction in alcohol sales during the quarter.

Third quarter Retail Pharmacy segment adjusted EBITDA was \$125.9 million or 2.8% of revenues compared to last year's third quarter adjusted EBITDA of \$88.6 million or 2.2% of revenues. Retail gross profit on an adjusted EBITDA basis was \$172 million higher and 198 basis points better as a percent of sales. COVID vaccination and testing demand was the main driver of the variance, aided by an improvement in front-end margin due to good markdown management. This increase was partially offset by reimbursement rate pressure.

Retail Pharmacy expense and adjusted SG&A EBITDA basis was \$134.8 million higher and 130 basis points higher than last year's third quarter. The increase in SG&A dollars is primarily due to incremental payroll costs to support COVID immunization, increases in bonus expense for store field and corporate associates,

increases in workers' compensation costs, cycling the benefit from the prior year change to modernize our associate TTO plans and the inclusion of the Bartell-related expenses.

I'll now shift to our Pharmacy Services segment, Elixir. For the third quarter, Elixir saw revenues decline \$226 million or 10.8% to \$1.9 billion due to a planned reduction in our Elixir Insurance membership, a decline in member utilization in the Elixir Insurance business and a previously announced client loss.

Elixir's third quarter adjusted EBITDA was \$28.9 million or 1.6% of revenues, a decrease over last year's third quarter adjusted EBITDA of \$48.8 million or 2.3% of revenues. The decrease in adjusted EBITDA is a result of the loss in lives and related earned rebates and an increase in the medical loss ratio. SG&A expense improved due to a reduction in payroll costs.

I'll now turn to our cash flows. Our cash flow statement for the quarter shows a use of cash from operating activities of \$3 million compared to a source of \$223 million last year. The difference is primarily due to an increase in our CMS receivable of \$168 million over the last year's third quarter end and a \$140 million increase in receivables related to COVID vaccines and testing. We've had some differences in the timing of our CMS receivable sale program in the current year, but expect to sell the remainder of the 2021 CMS receivable before the end of our fiscal year.

In addition, we still expect to generate an approximately \$80 million working capital benefit in fiscal 2022 from continued inventory reduction initiatives. We are tracking ahead of our initiatives to reduce front-end inventory but has seen a slight pickup in pharmacy inventory or a slight increase in pharmacy inventory as prescription demand has picked up.

Cash used in investing activities was \$20.7 million for the quarter. We completed 9 store sale leaseback transactions that generated total proceeds of \$25.6 million in the quarter. We currently own 111 of our stores, some of which are candidates for additional sale leaseback transactions.

Our net debt balance was \$3 billion at the end of the quarter, and we have \$1.6 billion in liquidity. We expect our leverage ratio to be around 5.5x at fiscal year-end when we cycle the impact of prior year's fourth quarter on the leverage ratio calculation.

Now before turning to our updated guidance, I'll quickly comment on the universal shelf filing that we made during the quarter. We filed a new shelf registration statement with the SEC to provide us with the flexibility to access the capital markets if and when we desire. Most public companies have an effective shelf registration for this very purpose, and our previous shelf registration statement had expired. If we were to conduct an offering pursuant to the registration statement, we will file a prospectus supplement for that transaction.

Now let's turn to our updated guidance for fiscal 2022. As a result of the momentum we're seeing in our third quarter and our expectation for an increase in demand for COVID vaccines and testing versus our prior expectations, we are raising our adjusted EBITDA guidance. Adjusted EBITDA is expected to be between \$500 million and \$520 million for fiscal 2022 compared to our previous guidance of between \$460 million and \$500 million. We are lowering our revenue guidance driven by expected results in our pharmacy services segment. This guidance change is driven by reductions in our Part D revenues for calendar 2022 and the loss of a health plan client effective January 1, 2022.

Total revenues are expected to be between \$24.4 billion and \$24.7 billion in fiscal 2022. Pharmacy Services segment revenue is expected to be between \$7.1 billion and \$7.2 billion. Net loss is expected to be between \$189 million and \$230 million, and capital expenditures are expected to be approximately \$275 million with a focus on investments in our store base, file buy purchases, digital, and technology initiatives at both Rite Aid and Elixir.

Finally, while we plan to share more details with you during our fourth quarter earnings call, I want to provide some initial thoughts regarding fiscal 2023. Currently, we expect benefits from COVID vaccines next year, however at a reduced level, about 40% of current year levels. We also expect some modest benefit from COVID testing but less than what we've seen in the current year.

We recognize the headwind that the expected reduction in COVID-related benefits is to fiscal 2023. We expect benefits from several areas to offset this gap, including: cost reductions from our store closure program, which we expect to contribute benefits in excess of the \$25 million run rate benefit that we will get from the 63 closures already approved; improvements in front-end margin from the launch of a new loyalty program and expansion of our own brands; improved PBM margins from our new rebate aggregation agreement; progression toward more normalized levels of acute script activity in the pharmacy; and operating expense efficiencies from further back office consolidation in our retail and pharmacy businesses and continuing to leverage lean.

While we are still in the process of finalizing our detailed fiscal 2023 plan, we expect these initiatives to result in fiscal 2023 adjusted EBITDA that is significantly above current analyst average estimates of \$430 million. We will provide further details and formal fiscal 2023 guidance during our fourth quarter earnings call in April.

This completes our prepared remarks, Deshondra, could you please open the phone lines for questions?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of George Hill with Deutsche Bank.

George Robert Hill

Deutsche Bank AG, Research Division

Yes, thanks for taking the questions and Matt, I'm probably going to pepper you with a couple. I guess the first one is you talked about the store closures, which seem to be an immediate near-term opportunity for RAD's financial performance. I guess can you talk about what other stuff that you see that's really kind of -- is really able to be pulled forward especially as we can get to fiscal '23 as it relates to improving the company's near-term financial performance?

Heyward Rutledge Donigan

President CEO & Director

Matt, I'll let you take that.

Matthew C. Schroeder

CFO & Executive VP

Yes, sure. And George, I think -- appreciate the question and touched on some of these in the script. I'll just repeat them again for emphasis. But certainly, the store closure program is a bit -- is one of the drivers, and 63 is the number we've agreed on, we've announced so far. Still don't have a full number that will result from the program. We do expect probably some more closures to come and some more benefit from that.

On the PBM side, this -- the rebate agreement that we've got with Prime is really going to enable us to not only deliver more value for our clients, which is the most important thing, but it is going to enable us to expand our margins at the PBM.

We do -- in the front-end, really have, I think, some really good opportunities on the front-end margin side as well as the front-end sales increase side around continued -- the changes we're going to make to our loyalty program as well as continue to own brand penetration. And then the final thing I would highlight is just really going to be taking a hard look at some of our back office expenses and continue to drive some additional operational efficiencies. And I think all that kind of sets us up for additional value drivers in 2023 and kind of in addition to some of the omnipharmacy initiatives that Heyward talked about in her opening.

George Robert Hill

Deutsche Bank AG, Research Division

Okay. And then I guess a couple more quickly. I guess, number one is, can you talk about what is in the assumptions as it relates to COVID for fiscal Q4? And then my follow-on for that would be it looks like if you back out the kind of the COVID contribution for calendar '21, it looks like the company's run rate of the core business is, call it, \$275 million to \$325-ish million. I would love if you could kind of outline in broad strokes kind of -- you laid out the pieces but would love you to kind of rank order or if you can kind of broad stroke kind of that \$325-ish million number to the \$430-ish million number would be super helpful.

Matthew C. Schroeder

CFO & Executive VP

Well, let me kind of, I guess, start with your second question and I'll get to the Q4 assumptions.

First of all, the math you're doing, I think the one thing you've got to keep in mind there is that -- and as we said this before, the COVID vaccine has clearly been a benefit. We're still not seeing acute scripts

at the level that we saw pre pandemic. And so when I think about the run rate of the business, I think about needing to kind of getting back to a level where we're really getting acute to where they were pre pandemic.

I think the second thing is I don't think we see a world without COVID vaccines. This is going to become another immunization and other clinical support function that our pharmacies give. And so as we said in -- I said in the comments, that's why we would expect the COVID vaccines next year to be at a 40% level of this year not going to like a 0 level. So I think that's another really important thing to think about, George.

As far as kind of ranking the items for 2023, I think more to come on that with the guidance in April. I don't want to get too far ahead of getting our formal guidance out there. The other thing, just to clarify, is you mentioned the \$430 million number. That's where analyst estimates are today. Just to be clear, we expect our numbers next year to be significantly above that \$430 million number for fiscal '23.

The last question I'll get to is you asked about COVID assumptions for the fourth quarter. We are expecting continued demand for booster shots but I would say at a level that is less than what we saw in Q3.

Heyward Rutledge Donigan

President CEO & Director

The one thing I will comment on is -- and thanks, George, is that as a reminder, we were in the market that got shut down in the early days of COVID, and that's when we saw the significant cording of front-end, and that's when we saw the drop to 0 on acute. And it's also when we started very intensely and on the forefront of most of the country doing vaccines and testing. And what we're seeing right now in New York City is all of the above. People are still going to the doctors, and they're now wanting to get booster shots and they are getting tested like crazy.

So there continues to be a scenario where this really does go on for quite a long period of time. And the thing that we are encouraged about is that we don't think that people will stop going to the doctor again or stop going to school again, at least on a regular basis, especially for the younger kids who really are the super spreaders of cough, cold and flu. And we are seeing so much activity around the non-COVID viruses going on as well.

Operator

Your next question comes from the line of Lisa Gill of JPMorgan.

Lisa Christine Gill

JPMorgan Chase & Co, Research Division

Just to go back to that comment, Heyward, around acute prescriptions and your thoughts that you and Matt both kind of highlighted that we're not back to pre-pandemic levels. How do we think about profitability for an acute script versus a COVID vaccine? I mean just based on the numbers that you've talked about, it seems that the COVID vaccines are actually more profitable than the acute scripts. So will it really be a one-for-one offset if we do see scripts come back in 2022?

Matthew C. Schroeder

CFO & Executive VP

Yes. Lisa, I'll jump in and start. And thanks for the question. No, I don't think it's a one-for-one offset, and I apologize if my answer implied that. What I -- the reason I bring up the acute scripts are still at kind of depressed level is just the idea of when people try to do their math around whatever a pre-COVID run rate or without COVID run rate ends up being, which again, I think the math really needs to be around what does -- what do things look like when you get more to an endemic level as opposed to thinking kind of with and without COVID altogether.

Now what I would say about acute scripts is that their profitability is less than immunizations. But it's better than maintenance scripts because acute scripts typically tend to track more generic, which are more profitable as well. So there is a -- when you kind of pull out all the immunization activity and look at the

business from a maintenance versus acute scripts, the more you skew maintenance, typically, the less you get kind -- the less profitability you get because the maintenance scripts tend to skew a little bit more brand and the COVID skew a little bit more generic.

Heyward Rutledge Donigan

President CEO & Director

Yes. I think that -- I'm sorry, I think that they're very likely to forever in our lifetime us to be happening once or twice a year, COVID vaccines. So I think that is the future. And there's a future where we do an off [indiscernible] COVID vaccine. And just like flu shots, we're probably going to get 1 or 2 -- I think 2 a year. The margins are not likely to be as high as they are right now because the government's funding now. But they -- it is good business. And then when you put it back to where we think it will go on a normal basis, which helps us with the balance of profitability on the medication side of the business, and just what I would call a much more intense awareness around both testing and prevention now. I just don't think it will ever go back to the way it was. So that's the modeling that we're submitting through.

Lisa Christine Gill

JPMorgan Chase & Co, Research Division

Sadly, Heyward, I think you're probably right. There has been talk about some kind of combination vaccine, right. So maybe it's not 2 COVID vaccines plus a flu vaccine but maybe something more along the lines of combining them. So we'll have to watch and see what happens there.

But I really want to ask a question around the PBM side. So you talked about the new relationship with Prime and you talked about the rebate aggregation. Just really a couple of questions for me. One would be why not go to Express Scripts directly? Why go through Prime? And then secondly, when we think about the relationship with Prime, do you see incremental opportunities to work together beyond what you're doing on rebate aggregations?

Heyward Rutledge Donigan

President CEO & Director

Well, first, we actually took the entire book of business out to bid for all of the rebate aggregators that were -- that are in the market. So that included ESI, that included others that you would expect to be included. So it's a fulsome RFP, and Prime was the most competitive of all. So that's why we chose Prime. We also -- I also really did -- and we have great relationships with ESI and others as well. But this was a competitive environment, and Prime has the most fulsome deal for us.

And I do think that there are some very interesting opportunities. The CEO of Prime and I have discussed this to further partner in some very interesting ways, which I can't get into now. But I do think when you look at all the PBM relationships, they are complicated and they are also fulsome. And I do think that there -- we continue to have opportunities to partner with other PBMs. And I think we also would look to have an expanded relationship with some over time.

Lisa Christine Gill

JPMorgan Chase & Co, Research Division

Great. And then my last question just on the PBM would be can you give us any indication as we think about calendar '22 around membership, whether addition of Medicare Part D lives. I know you've talked about shedding some membership, but how do we think about how you did in this year's selling season and for Medicare Part D?

Heyward Rutledge Donigan

President CEO & Director

Well, are you talking about our Elixir Insurance business?

Lisa Christine Gill

JPMorgan Chase & Co, Research Division

Yes. Yes.

Heyward Rutledge Donigan

President CEO & Director

Yes. Well, we purposefully shrunk that business due to the medical loss ratio issues that we're having. So Matt, you can comment on the specifics because they're included for 1/1 results.

Matthew C. Schroeder

CFO & Executive VP

Yes. Lisa, the expectation for next year is that our revenues in lives are going to be down from this year. It's a combination of, as Heyward said, bidding in a different way for '22 and really trying to continue to hone in our focus on Med D lives where we think we can be most profitable. And I think we did -- we are...

Heyward Rutledge Donigan

President CEO & Director

Matt, let me just jump in for a second. Most profitable is probably not the term that we should use. We are running so hot on the medical loss ratio. This business is a very tough business. If you aren't in this business as a Medicare Advantage player or MAPD player, the economics of this business is very constrained. The government is hardly even funding the premiums anymore. Someone wants to ask why this is even called the government program anymore.

So it is not a good business for us. We are -- we've learned a lot from actually managing this business, and we've been able to really support our health plan clients who have Medicare programs become 5-star programs. We do an excellent job of managing cost and clinical for our Part D customers.

The own insurance business where we are taking the risk is the one that we're struggling with, Elixir Insurance. And we are purposefully shrinking both the revenue and the membership on this business to try to see if we can get into a cycle where we're not running so hot on the MLR. But I am -- I remain not optimistic about that. And so we are looking at some alternatives for the '23 cycle. What we really want to do is grow our PBM core business. Sorry, go ahead.

Operator

Your next question comes from the line of Eduardo Ron of Evercore.

Eduardo Ron

I guess maybe if you could just speak a little bit to the full year guide, the reduced PBM revenue. I mean clearly indicates about a step-down of \$300 million to maybe \$400 million into Q4, and obviously you have January and February there. So maybe just how we should think about the loss of this health plan contract and maybe should we run rate that into '23? And then also, how you would think about I guess, the EBITDA contribution as we think about the benefit of the Prime Therapeutics relationship and how that ramps from Q4 to the full year of '23.

Heyward Rutledge Donigan

President CEO & Director

Well, let me just start by saying that we have -- as I mentioned earlier, we are purposefully shrinking our Elixir Insurance Medicare Part D membership. Therefore, we are also purposefully shrinking that revenue because that revenue is not adding to our bottom line in a meaningful way.

The second thing, and this is unfortunate, is that one of our health plan clients, who was growing very rapidly, got merged with another health plan and they did a roll-up RFP that we -- they went with the other incumbent, which is one of the risks that we have when we get these health plan clients because so many of these health plans are getting rolled up right now, especially in the government programs business.

So we are -- the rebate contract is going to help us offset the economics from that lost contract. But I wouldn't really so much, and I can let Matt comment, focus on the rest of the revenue loss because that's tied to a piece of business that is essentially running at a very high medical loss ratio. But Matt, you can clarify.

Matthew C. Schroeder

CFO & Executive VP

Yes. No, Heyward, I think you touched on all the key points there. I think when we get to the fourth quarter guidance, we'll give some more specifics about the puts and takes and kind of some more specific numbers around the PBM. But I do expect the -- we do expect the improved margin from the additional rebate contract to largely offset the impact of the loss of lives in the Med D and with the health plan client that we lost.

Heyward Rutledge Donigan

President CEO & Director

And then the focus, of course, is now the business that we're quoting on that I mentioned where we've got 80% more RFPs in the last 2 months than we got in the last 2 months of last year. That's the business that we're starting to be successful with. And that business will largely be coming onboard during calendar year '23 or for January 1, 2024. So you're going to see the dip and then we are hoping that we will continue to see strong momentum and start to see the business growing again outside of the Part D business, the Elixir Insurance business. So I would really put these two in your minds because one is one that we're shrinking and one side of the business is one that we're hoping to grow but later in the year.

Eduardo Ron

Okay. That's helpful. And maybe as we think about the store closures and the \$25 million of the annualized benefit. Would -- I mean, I'm assuming that \$25 million doesn't benefit all of '23, it would be more staggered?

Matthew C. Schroeder

CFO & Executive VP

It's going to be largely in '23. I mean we're actually -- these 63 stores or stores that we've made the decision on, the process that actually started and will be completed over the next several months. So that benefit should largely be all of it in 2023.

Eduardo Ron

Okay. And is that what's driving the reduction in your CapEx, \$300 million to \$275 million?

Matthew C. Schroeder

CFO & Executive VP

No, I don't think there's a correlation there. There's plenty of stores left that we had to do CapEx work on, and I think more to come in our '23 guidance about how we're going to think about staggering our remodels to the rest of the fleet. That's not really the reason. I think the reduction in CapEx is more just around kind of timing of some of our technology spend. And if I'd have my way, we'd be spending more money on file buys, which is a very competitive kind of file buy by market out there right now.

Operator

Your next question comes from the line of Jenna Giannelli of Goldman Sachs.

Jenna Loren Giannelli

Goldman Sachs Group, Inc., Research Division

When you talked about some of the puts and takes as we look into 2023, I didn't hear much mention of the potential mix benefits from just a recovery in cough, cold and flu and higher elective procedures. Is the right way to think about it that this should all come back and kind of plus keeping some vaccine

upside? I mean, I think the question is really is can we get back to peak EBITDA ex COVID? And what do we need to see to get there?

Heyward Rutledge Donigan

President CEO & Director

Well, I think the first thing is there -- is I really, really strongly believe is there's no ex COVID. And so there -- and we can all debate this. But there is no short time. I don't think there's any time in the next 3 to 4 years if we're lucky that there is no COVID. So that's number one. So the question is what do we think, what do you think in terms of how you model that. Because as Lisa Gill said, even if there's not 3 COVID shots a year, there's at least going to be 1. And so that's number one. And I think COVID testing is here to stay as well.

We're having very strong results on our health side of our business, whether it be OTC and the testing itself. And we are seeing a nice ramp back up in terms of acute. So I'll let Jim and Matt talk about the specifics in terms of how you model that out.

James Joseph Peters

Chief Operating Officer

Yes. I'll just add a little bit to what, Heyward, you said. Thanks, Jenna.

On the cold, cough and flu within health, but we just look at upper respiratory, which includes that and allergies, we're up 34% Q3 year-over-year, which I think signals a strong pathway back to levels that we saw pre COVID in 2020. That correlates -- that's over the counter. That correlates as well on the script side for cough, cold and flu where we've also seen a strong return, not all the way back, but a strong trend to get us much closer to where we had been in 2020 -- fiscal year '20. So I think that's all positive signs that give us comfort that what we expect in the guidance range that Matt provided for earlier is certainly achievable.

We also have diagnostics, which is an emerging category for us. But given the advent of COVID and the need for home diagnostic tests, I mean, we've been up 100% just year-over-year when these kits did exist. So I do think that, to your specific question, we are on the return, and we think that trajectory will continue.

Heyward Rutledge Donigan

President CEO & Director

Yes. And I think the other thing is that you guys -- anyone who's got kids or friends with kids or even my own husband, there is a horrible respiratory virus going around and there's a very bad cold going around. My husband is hacking away as we speak, and he's been sick for like 9 days. So there -- it's not just COVID that's circulating right now. It's these other viruses. And so we are seeing people really go back out, go back to school, and then they're becoming the super spreaders of this other stuff, which does really generate a great business for us.

Jenna Loren Giannelli

Goldman Sachs Group, Inc., Research Division

That's helpful. Heyward, we're seeing the same thing. My kids are super germ spreaders as well.

Heyward Rutledge Donigan

President CEO & Director

Yes. I know. Just for the kids to be back at school, it's also good for our business.

Jenna Loren Giannelli

Goldman Sachs Group, Inc., Research Division

I just -- I have one more, if I can. I guess just on, Heyward, the strategic priorities that we are growing the business, reducing costs and improving leverage. I guess, on that third point with the goal of reducing

leverage, any sort of parameters or more parameters you could hit around that, whether a target, a time frame and kind of the key tools you have to get there at this point? And that's it for me.

Heyward Rutledge Donigan

President CEO & Director

Yes. I mean, I -- one of the things when I came to this company, and I said to the Board was one of the most important things for us to do with the company is to reduce leverage because that will give us the ultimate freedom. And so you can see that we've taken significant steps over the last 2 years to do so, whether it be securitizing the CMS receivable on the Elixir Insurance business or sale leaseback and just all the good work that Matt and his team have done to push out the debt and to buy back some bonds at a discount and everything that we did, including reducing about \$280 million in working capital tied to inventory. So we've made meaningful progress.

Now we took a step back on it because we got so hard hit by the pandemic last year in the fourth quarter. That has impacted our EBITDA. But we're back on track, and I'm feeling good about it. And I think what we're building out is a plan to continue to incrementally pay down debt, to improve our EBITDA and to use every opportunity we can to reduce working capital. We still have a big target to do so this year and to also take opportunities like sale leaseback. But it will be incremental. And I think it's the combination of all those tools. It's not one big thing that we can do at this point because I am committed to keeping Rite Aid, keeping Elixir and growing that business organically as much as we can.

Matthew C. Schroeder

CFO & Executive VP

Yes. Jenna, the one thing I would add is I think that the fact that we don't have any debt due until 2025, gives us the opportunity to find that right balance between generating some free cash flow to pay down debt but also make any investments that we need to grow this business because that's really the key to getting the leverage ratio down is driving our EBITDA growth here in the outer years.

Operator

Your next question comes from the line of William Reuter of Bank of America.

William Michael Reuter

BofA Securities, Research Division

I just have 2. So the first is on the store closure plan, it sounds -- did you choose 63 because that was what seemed like a manageable number to go after right now? And I guess if we were to look at the remainder of the stores, how many are losing money? And what would be the EBITDA drag that the other unprofitable stores represent?

Matthew C. Schroeder

CFO & Executive VP

Bill, I'll answer -- Bill, thanks for your question. Let me jump in first. I'll answer the second part of your question first. We're still kind of looking through the portfolio. I think it's more to come -- sorry about that. That was me. I think more to come in the fourth quarter on kind of the total scope of this. We're still working through our assessment. So I think more to come on the full dollar value and the full amount.

James Joseph Peters

Chief Operating Officer

The only thing I'd add is, I just want to be clear, when our new leadership team, not so new anymore, but when we came together at Rite Aid just over 2 years ago, we committed to strategically assessing the whole store base market by market and store by store. We bought Bartell's in the Seattle market. We invested in remodels across Boise and the Virginia Beach markets. And after careful and very thoughtful analysis, we're very excited to actually enter into the execution phase of the strategic store closure program. We certainly expect it will increase the vitality and strength of our core base of our stores. And it

allows us, frankly, to concentrate investments in stores and markets that are poised for growth. So more to come, but this is something that we believe is very strategic in nature.

Heyward Rutledge Donigan

President CEO & Director

And there is some level of just how much store do you need if you're an omnipharmacy. So for example, in New York City, just to use New York City example, you have a company like Capsule who has a virtual pharmacy and those stores just delivers the drugs all over the city. So we do that ourselves. We don't promote that. We don't think about that. Maybe people don't think about that for us. But from every pharmacy that we have in New York City, we can deliver to you in any of the 5 boroughs and you can order a prescription from us digitally on our app.

So the notion of omnipharmacy, that's what we're really getting at, doesn't require that you have as much real estate. We do want to continue to have stores because people do want -- many people do want to go to a store to engage with a pharmacist and to pick up other items. But we have seen so much growth in our delivery service that, that leads us to believe this is really a great opportunity.

William Michael Reuter

BofA Securities, Research Division

Okay. And then there's been a lot of discussion around potential reduction in COVID vaccine administration that's going to hurt profitability. That should be offset, I guess, with increased cough and cold. As that dynamic plays out over the next year or so, do you think that the sum of the profitability or the reduction in vaccinations will be offset more or less by the increase in sales of cough and cold?

Heyward Rutledge Donigan

President CEO & Director

Matt?

Matthew C. Schroeder

CFO & Executive VP

Yes. No, I wouldn't make a direct link between cough and cold being a direct offset for COVID vaccines. The COVID vaccines are pretty profitable. But I think what we try to get across in our discussion about kind of an initial glimpse into '23 is there's a lot of other factors in the business that are playing in the '23 that we think kind of help us offset what we think is going to be the reduction of benefit in COVID vaccines next year.

Operator

Your next question comes from Karru Martinson of Jefferies.

Karru Martinson

Jefferies LLC, Research Division

Glad to hear that you guys deliver here in New York City. I guess that raises the question though. If you have the omnichannel pharmacy capabilities and the consumer doesn't know about them, what do you need to do and what spend do you need to do to kind of take advantage of your 50 state license?

Heyward Rutledge Donigan

President CEO & Director

Well, we have -- first, let me say that it's too bad but people don't know that we do deliver. And we actually have done a significant amount of advertising around our delivery service, and that's why we've seen a 900% increase in some of like the Uber Eats and Postmates. And we do use ScriptDrop for pharmacy delivery. I personally use it all the time and love it and use the digital app and get everything paid for and delivered and I don't have to talk to anyone. But I go in store to talk to the pharmacist when I have a concern, and that's when I like to engage.

So we have done a significant amount of advertising. We do have to continue to build awareness. And you will hear a lot more about this in the coming months as we launch this new program and also, we'll be able to access all 50 states, which, by the way, we do with our mail order facility now. We do ship medications to all 50 states to our Elixir members.

Now we're going to come up with a direct-to-consumer offering that we will share with you more about, the economics of which are included in the comments that Matt made about next year.

Karru Martinson

Jefferies LLC, Research Division

Okay. But the infrastructure behind it is in place. This is more of a question of getting the word out, right?

Heyward Rutledge Donigan

President CEO & Director

Yes. It's all in place. The mail order facility, the specialty pharmacy and all of our digital omnichannel delivery is all in place and has been up and running for over a year.

Karru Martinson

Jefferies LLC, Research Division

Okay. And then when we look at the store closures, are they geographically centered? Are you targeting certain markets? We've heard a lot about stores pulling back from, say, San Francisco and others. Or is this just a broad-based overhaul?

Heyward Rutledge Donigan

President CEO & Director

Jim, why don't you comment on that?

James Joseph Peters

Chief Operating Officer

As I mentioned earlier, we are looking at both. We're looking at a full fleet of stores, and you can imagine the ways that we may rank those in terms of where we focus first. We also look at market to market because market dynamics are obviously important as well as it relates to reimbursement, the presence of regional health plans, competitive environment, et cetera. So our goal is really to maintain access in our communities and make sure that we're not overstored.

And look, I think the benefit that we had as we came in as a new leadership team is to recognize that we did have an opportunity to rationalize the fleet in a way that provided a much stronger base from which we can grow.

Karru Martinson

Jefferies LLC, Research Division

Okay. And just lastly, looking at your guidance, sequentially, certainly down in the fourth quarter from third quarter. Can you talk to what you're seeing in terms of the seasonality that you guys normally have in the fourth quarter and help explain some of the variance there between third quarter to fourth quarter?

Matthew C. Schroeder

CFO & Executive VP

Yes, Karru. It's Matt. I mean the variance for the third to fourth quarter is largely driven around COVID vaccination assumptions. We don't expect to do as many vaccinations in the fourth quarter as we do in the third. I think from a seasonality standpoint, we're actually expecting a pretty solid cough, cold and flu season, probably not as good as it was 2 years ago but certainly a lot better than last year.

Operator

We have time for one more question. Your next question comes from the line of Carla Casella of JPMorgan.

Carla Casella

JPMorgan Chase & Co, Research Division

Just a couple of follow-ups on prior questions. So is the full charge for the store closures, is that taken in the fourth quarter? Or will there be -- I'm sorry, in third quarter? Will there be additional charges in fourth? And will some of them tail in the first quarter next year?

Matthew C. Schroeder

CFO & Executive VP

So Carla, the charges for the 63 stores that we announced are included in this quarter.

Carla Casella

JPMorgan Chase & Co, Research Division

Okay. And did you say how much is cash versus noncash?

Matthew C. Schroeder

CFO & Executive VP

Well, the charge is all noncash. What will happen is that is -- that there'll be a reserve set up for that charge and then there will be an increase in basically our debt rent charge -- debt rent addback cash outflow that will occur. This 63 will have a pretty nominal impact on that.

Carla Casella

JPMorgan Chase & Co, Research Division

Okay. And then the CapEx reduction, is that a better run rate to use going forward? Or is that something you would scale as you grow EBITDA? And is it a pullback on wellness plus remodels?

Matthew C. Schroeder

CFO & Executive VP

Yes. The reduction is really more about just kind of timing of what we can spend this year, and I would not use -- say that is definitely the run rate. I mean I think in an ideal kind of CapEx spend, Carla, I think we'd like to see the number closer to around \$300 million. Some of it gets to what can we -- what's priorities, what are we staffing for, what do we -- how do we kind of manage CapEx and manage to a free cash flow number so we can pay down some debt. But as we grow EBITDA, I think a better run rate number to use is probably a starting point of \$300 million.

Carla Casella

JPMorgan Chase & Co, Research Division

Okay. And then just on the PBM. The full year guide implies fourth quarter revenue for the PBM down about 20%. What's driving it in that quarter specific? Or is there something timing-related driving that quarter specifically?

Heyward Rutledge Donigan

President CEO & Director

No, the PBM runs on a 1/1 to December 31 cycle. The vast majority of the business renews on 1/1. As we mentioned earlier, our Elixir Insurance business, the Part D business, renewed on 1/1. We purposefully significantly reduced the membership in that business, and that is one key driver. And the second key driver is the commercial health plan client on the PBM that I talked about earlier that got rolled up into another PBM.

Carla Casella

JPMorgan Chase & Co, Research Division

Okay. Great. And then just one last follow-up. The Bartell, was that included the full quarter?

Matthew C. Schroeder

CFO & Executive VP

I'm sorry, what was that, Carla? I apologize.

Carla Casella

JPMorgan Chase & Co, Research Division

Was Bartell included for the full quarter? I just...

Matthew C. Schroeder

CFO & Executive VP

Yes, we bought Bartell -- we closed on Bartell in mid-December of last year. So it's in this year's full quarter, not in any of last year's quarter. Going forward, it's going to be in the numbers for both years.

Operator

This concludes today's conference call as far as the question remarks. I will now turn the call back over to Heyward.

Heyward Rutledge Donigan

President CEO & Director

Thank you. Thanks, everyone, for your questions. Very exciting, and we're so pleased with the quarter and so enthusiastic about our future.

As we close the call, I do -- I know everyone says this, but I really do want to acknowledge these incredible associates, especially the ones that are working in the stores and the distribution centers because of the incredible impact that not just the COVID pandemic has had. But frankly, what's happening now is we have so much volume because it's front-end volume. It is tied to cough, cold. It's tied to tests. It's tied to doing and administering our tests. It's tied to administering not only flu vaccines, but COVID vaccines and boosters and other vaccines and now people are getting their medications. So our volumes are up 40%, and we're in the biggest labor market crisis since probably World War II. As we all know, that affects everyone in retail and in health care.

And I just want to acknowledge how hard this work has been and also have purpose-driven this work has been because we know that our associates are among today's health care heroes. So it is my greatest privilege to work along this tremendous team and the team at Elixir as well and our corporate associates. And I'm forever grateful for their passion and commitment to our company, our customers and each other. It's been an unbelievable 2 years.

I'm thrilled to be launching the next evolution of our strategy in the fourth quarter, and we're looking forward to a strong quarter and speaking with you all again during the next earnings call.

And I want to wish all of you a very safe, maybe not so healthy, just kidding, and happy holiday season. It's going to be quite a holiday season. So get your tests, get your home tests. Keep a supply at home; I do. Make sure you use Rite Aid for all of your over-the-counter needs, prescriptions. If you want them delivered, you just go on to our app, and you can get that done, and we thank you all for your support. Have a great holiday.

Operator

Thank you for participating in today's conference call. You may now disconnect.

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