

December 10, 2021

## DOGNESS INTERNATIONAL CORP.

### (NasdaqGM: DOGZ)

Dogness was founded in 2003 on the philosophy that pet dogs and cats are important, well-loved family members that should be cared for properly. Backed by more than 200 patents and patents pending, the company's innovative range of high-tech smart products and legacy lease products enhance and enrich pet ownership and lifestyles.

### COMPANY HIGHLIGHTS

- \* DOGZ: A leading developer and manufacturer of a comprehensive line of Dogness-branded, OEM, and private-label pet products, with a record of innovation in the smart tech segment and a strong distribution network.
- \* In our view, Dogness' successful execution of its business plan led the company back to profitability in fiscal 2021, which ended on June 30, 2021. Dogness has benefitted from a surge in demand related to increased pet ownership during the COVID-19 pandemic and increased momentum for its core product line, led by higher-margin smart pet products.
- \* Although near-term product supply has been limited due to global supply-chain issues, we are encouraged by the company's 27% revenue growth in fiscal 2021 and demand trends for the smart product portfolio (where sales increased by 80% and volumes more than doubled). The smart line made up 32.1% of revenues in fiscal 2021, up from just 8% in two years. Given its higher margins compared to the traditional pet product line, fiscal 2021 gross margin rose to 37.6%, levels not seen since 2018.
- \* During fiscal 2021, Dogness expanded availability across multiple sales channels, including online, specialty stores, big box warehouse clubs, and general retail. We expect this momentum to continue, as Dogness has established new and expanding partnerships with leading U.S. retailers including Target, Petco, IKEA, and Walmart, and online platforms including Amazon and Chewy.com, which we think should ease customer concentration risk.

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### PRICE CHART



### KEY STATISTICS

#### Key Stock Statistics

Recent price (12/7/21)	\$5.25
52 week high/low	\$5.71-\$1.30
Shares outstanding (M)	31.8
Market cap (M)	\$167.0
Dividend	Nil
Yield	Nil

#### Sector Overview

Sector	Consumer Discretionary
Sector % of S&P 500	13.2%

#### Financials (\$M)

Cash & Mkt Securities	5.5
Debt	11.4
Working Capital (\$M)	-7.0
Current Ratio	0.7
Total Debt/Equity (%)	17.5%
Payout ratio	NM
Revenue (M) TTM	24.3
Net Income (M) TTM	1.5
Net Margin	6.0%

#### Risk

Beta	-0.42
Inst. ownership	4%

#### Valuation

P/E forward EPS	30.9
Price/Sales (TTM)	6.9
Price/Book (TTM)	2.2

#### Top Holders

Sabby Management, LLC  
Dimensional Fund Advisors, LP  
Two Sigma Securities, LLC

#### Management

CEO	Mr. Silong Chen
CFO	Dr. Yunhao Chen
Company website	www.dogness.com

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- \* Thus, we expect Dogness to continue its evolution into a higher-margin technology-focused pet product company with a diversified global footprint, and to capitalize on favorable long-term global trends in the pet care industry as pet owners return to offices and require mobile pet monitoring and care.
- \* As of June 30, 2021, Dogness had \$5.5 million in cash and short-term investments on its balance sheet. Subsequently, the company raised \$4 million in gross proceeds from an equity offering in July 2021. With its favorable outlook for sustained positive operational cash flow, we believe the company is capitalized sufficiently to execute on its business plan and build value for the company and shareholders.
- \* Although the stock has doubled year-to-date, we do not believe Dogness' current valuation reflects the underlying fundamentals and demand for Dogness products. As such, we view the shares as having upside and, based on our forward P/E analysis, a fair value of \$7.50.

## INVESTMENT THESIS

Dogness International, founded in 2003, is a developer and manufacturer of a comprehensive line of Dogness-branded, OEM and private label pet products. These include smart products, hygiene products, health, and wellness products, and leash products. More recently, growth has been led by the company's expanding suite of smart products that are designed to capitalize on the migration of consumer product trends towards connectivity and remote access. The company has established a record of product innovation and is well positioned, in our view, for long-term growth due to its fully integrated manufacturing chain. It also has established commercial infrastructure in its core China market as well as the United States market. Over the long-term, we expect Dogness benefit from the high level of growth experienced by the broader industry and the recession-resistant nature of the pet industry.

At the end of fiscal 2021, which ended June 30, 2021, products were sold in 35 countries worldwide, though many remain in the early stages of their rollout. During fiscal 2021, sales in China accounted for 56.3% of total revenues, up from 51% for fiscal 2020, closer to fiscal 2019's 57.5% level. In fiscal 2021, U.S. sales represented 24.7% of total revenues, down modestly from 25.7% in fiscal 2020, but still well below approximately one-third of fiscal 2018 sales. We believe that recently announced new and expanded relationships with U.S. retailers should drive renewed growth in this key market.

Dogness' fiscal 2020 financial results were hampered by the COVID-19 pandemic, which originated in China, forced the temporary suspension of manufacturing activities, and slowed the shipping and delivery of completed goods. However, business

activities had returned to a normal pace by the end of Dogness' fiscal year in June 2020, which enabled the return to profitability for fiscal 2021. In our view, Dogness' integrated operations and supply chain capabilities enabled swift adaptation to challenging market conditions, allowing it to meet retail orders and work closely with its customers to maintain sufficient inventory of high demand items.

Despite recent challenges, we believe that Dogness' primary markets continue to show solid trends for long-term growth. The American Pet Products Association recently estimated that there are nearly 85 million U.S. pet-owning families (67% of all households), representing an estimated \$75 billion annual market for spending on pets. Pet ownership has also expanded during the pandemic, as people spend more time at home and own pets for enjoyment and emotional support. In a September 2020 survey by the American Pet Products Association (APPA), 9% of respondents that said they had adopted a pet during the pandemic, up from 6% in just three months prior. In addition, a recent report published by Frost & Sullivan noted that China had approximately 100 million pet owners in 2018, which represented approximately 22% of households in the country. According to trade organization Pet Fair Asia, spending on pets in China totaled approximately \$25 billion in 2019.

In our view, Dogness' long-term growth prospects are supported by its reputation for innovation, product quality and leadership in the faster growing smart pet and pet tech segments. It also has an established commercial infrastructure that includes a retail presence across leading pet-specialty retailers such as PetSmart and Petco, which we estimate collectively account for up to half of the U.S. retail market, as well as online through Chewy.com. In addition, the company's U.S. subsidiary has entered into agreements with large retail and specialty chains in the U.S., Canada and China for the distribution of smart pet products under the company's own brand (rather than just serving as an OEM supplier).

Dogness also sells through mass brick-and-mortar and online retailers such as Walmart and Target, and has recently reported progress in expanding distribution of its smart products online through these vendors, as well as online leader Amazon.com. In November 2020 alone, Dogness announced a new U.S. online distribution deal with Target for its smart pet products, including Smart feeders, water fountains and treat dispensers, and also announced expanded distribution pacts, both in-store and online, with Petco and Chewy.com. Also in November 2020, Dogness announced a new U.S. sales partnership with Costco, which will feature both in-store and online special events to promote its smart product line, and introduce Dogness' products to up to 40 million members. To

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## PEER COMPARISON

Company	Ticker	Recent Price (\$)	52-Week High (\$)	52-Week Low (\$)	Mkt. Cap (\$MIL)	1-yr Price Change (%)	1-yr Rev Growth (%)	1 YR EPS Growth (%)	P/E Ratio	Beta	Yield (%)
DOGNESS INTL CORP.	DOGZ	5.25	5.71	1.30	167	163	27	NA	105.0	-0.42	NA
PETMED EXPRESS INC	PETS	27.34	57.00	24.75	553	-6	9	18	16.0	0.54	4.5
CENTRAL GARDEN AND PET CO	CENT	51.42	62.91	36.53	2629	33	23	25	18.7	0.54	NA
BOQII HOLDING LTD	BQ	1.30	12.84	1.19	117	-78	31	NA	NA	NA	NA

date in 2021, Dogness has received multiple large-scale orders from Petco for its line of pet-feeder products, to be sold at Petco's 1,600 retail locations, and achieved the availability of its products on Home Depot's online platform.

In China, Dogness' products are available on such sites as JD, Tmall and Taobao, and sales have been increasing via platforms across social media channels. We think that online sales should provide a tailwind for commercial growth in China, enhancing customer reach at a lower cost and thus expanding profit margins. In October 2020, Dogness entered into a strategic partnership with Huayuan Pet and Chongai Trading. The former is an established and integrated producer and marketer of pet products on an online platform in China that has 20 brands covering the toiletry, bedding, clothing, toy, staple food, and snack categories. The latter is a leading pet food and supply distributor in China, and an experienced brand promoter. These partnerships contributed to the percentage increase of China-based sales during fiscal 2021.

As part of a strategic shift to diversify its global footprint, Dogness also has established new export markets, as it increased its commercial footprint to 35 countries, from 25 in the prior year. In our view, continued expansion into new markets will help Dogness to diversify its customer mix, as the company's top three customers accounted for 48% of fiscal 2021 revenues, compared with 39% in fiscal 2020, near fiscal 2019 and 2018 levels.

Dogness' product portfolio focuses on connected pet care, to link pets and pet caregivers, and aims to establish a "Smart Pet Ecosystem" into a cohesive, integrated platform that can utilize smart technology for pet owners. The Smart Pet Ecosystem, which was launched in fiscal 2018, has four major areas: smart pet technology, leashes and collars, pet care and pet health and wellness.

Smart products unveiled to date include a pet-food feeder, water fountain, treat dispenser, and smart pet toys and robots. Most of the devices have high-definition cameras that enable pet owners to interact with their pet remotely. Revenues for smart products increased by 80% in fiscal 2021 to \$7.8 million, after more-than doubling in the prior year. The smart-product line accounted for 32.1% of total revenue in fiscal 2021, up from 22.6% in fiscal 2020 and just 8% in fiscal 2019. We expect this trend to continue, and are encouraged by the higher selling prices of these items, which enabled the company to record 27% revenue growth for fiscal 2021. This was despite 2.3% lower total sales volumes across the overall portfolio, which we attribute to lowered production of traditional products. Notably, in March 2021, Dogness launched a new Smart GPS Pet Tracker, featuring next-generation technology for more accurate, real-time pet tracking.

Legacy products include leashes, collars, harnesses, retractable dog leashes, and gift suspenders. The traditional pet product category accounted for 58.9% of fiscal 2021 sales, down from 68.9% in fiscal 2020 and 91.2% in fiscal 2019. Beginning in fiscal 2020, Dogness strategically decreased production of these lower-margin, high raw-material-dependent legacy products, as it shifts focus to its smart product line. This transition contributed to improvements in gross margin, which reached 37.6% in fiscal 2021. Traditional products contributed 33.1%, while smart products contributed 51.2%. As such, we see gross margins increasing over time, as the product mix continues to shift towards smart products.

Dogness' pet care products currently focus on high quality pet shampoos, which launched in 2018 and are focused on and tailored to Chinese market trends. These products are aimed towards dogs and cats, and feature natural plant and amino acid composition. The company has developed breed-specific formulas and a professional line of products for pet groomers.

We also view Dogness' strategy to integrate vertical production as a key competitive advantage. The company manufactures much of its products internally, which promotes better control of cost, quality and delivery time. Dogness' vertical integration and strong retail presence promotes greater efficiency and economies of scale. In 2018, the company acquired a manufacturing plant in Xiamen, China, which will be used to manufacture Dogness' line of traditional pet products, including collars, harnesses, leashes, and lanyards, using new equipment featuring advanced automation components. We expect Dogness to be able to increase its production efficiency significantly, lower its selling price for traditional products, but achieve their margin, which we estimate to have been about 35% prior to the COVID-19 pandemic.

In November 2018, Dogness opened its U.S. corporate headquarters in Plano, Texas. The complex includes a science-based Pet Wellness and Health unit that will research and develop pet supplements and functional pet food, in partnership with a leading U.S. company in this arena. The companies aim to develop and manufacture in the U.S. and sell through the partners' global network, sharing the advancement of the biotechnology in the U.S. with the worldwide pet population. In November 2020, Dogness opened a new China headquarters campus in Dongguan, China, which features state-of-the-art facilities for manufacturing, R&D, sales and marketing, warehousing and logistics, and a showroom to display the full range of Dogness pet products. While products for pets may seem commoditized, Dogness has developed advanced technologies for its products.

As of June 30, 2021, Dogness has obtained 202 patents, including 117 in China. This total is comprised of 30 invention patents, 65 utility patents, and 107 appearance patents. Further, the company has 22 dedicated members in its R&D team and 10 for quality control. Because of its R&D efforts, Dogness became certified as a National High-Tech Enterprise by the State Intellectual Property Office in March 2015, and this certification was renewed in 2019. This certification entitles the company to tax rates of 15%, rather than the unified, uncertified rate of 25%.

## RECENT DEVELOPMENTS

Year-to-date in 2021, DOGZ shares have more than doubled, increasing by 101% compared with a 23% gain for the S&P 500. In 2020, DOGZ's share price increased by 59%, compared with a 16% gain for the S&P 500.

In October 2021, Dogness reported results for fiscal 2021 (ended June 30, 2021), that were highlighted by a 27% revenue increase to \$24.3 million, and EPS of \$0.05 compared with a net loss per share of \$0.33 in fiscal 2020.

In September 2021, Dogness announced that it had increased availability of its intelligent pet-tech products in China, by expanding its portfolio on Boqii, a leading pet-focused platform in China.

In July 2021, Dogness completed a registered direct offering

of nearly 2 million common shares to certain institutional investors, which raised approximately \$4 million in gross proceeds.

In July 2021, Dogness announced a series of market-expanding initiatives, including the availability of its products on HomeDepot.com, and agreement with three new distributors focused on Europe and Asia.

In June 2021, Dogness announced the delivery of large-scale orders to Petco, which expanded availability of Dogness' programmable automatic dog/cat feeders across Petco's 1,600 retail stores.

In December 2020, Dogness announced an OEM order with an international pet specialty retailer for some of its pet products; this order has an expected contract value of \$4 million. In December 2020, Dogness appointed Andy Alfaro, an executive with more than 30 years of sales experience within the Consumer Electronics and Consumer Products channels, as its National Sales Director.

In November 2020, Dogness announced an expansion of its sales activities at numerous leading retailers, both in-store and online. The retailers include Chewy.com, Costco, Petco, and Target.

In October 2020, Dogness completed its new factory near Xiamen, China. The facility will manufacture Dogness' line of traditional pet products, including collars, harnesses, leashes, and lanyards. With new equipment featuring advanced automation components, Dogness expects to double its annual production capabilities for products manufactured at this facility.

## EARNINGS & GROWTH ANALYSIS

We expect fiscal 2022 revenue to increase by 60% to \$39 million, and fiscal 2023 revenue to increase to \$56 million, which would represent 44% growth. In our view, Dogness has navigated challenges successfully, including U.S.-China trade disputes, COVID-19, and resulting global supply-chain issues. Over the course of fiscal 2022, we expect continued sales growth momentum for Dogness' smart-product portfolio, as it further penetrates multiple new retail channels and vendors, including faster-growing and higher-margin online markets, and further optimizes its product and geographic mix.

During fiscal 2021, gross margin improved to 37.6%, a level not seen since fiscal 2018. Dogness' average selling price increased by 28.6% due to the smart portfolio contributing a higher percentage of sales, as well as lower average unit costs due to improved manufacturing. We think that the smart-product line could comprise 50% of sales in the next few years, which meaningfully expand gross margins. Thus, we project gross margins of 40% and 43% in fiscal 2022 and 2023, respectively.

We project EPS of \$0.17 in fiscal 2022 and EPS of \$0.29 in fiscal 2023. We expect latter-period results to benefit from enhanced economies of scale from the integration of new production facilities in China, and the expansion of the global commercial portfolio to include more higher-margin technology-driven and smart products. Our estimates assume 32 million shares outstanding in fiscal 2022 and 33.5 million in fiscal 2023.

## FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Dogness is Medium-Low. As of June 30, 2021, the company had \$5.5 million in cash and short-

term investments. In July 2021, Dogness raised \$4 million in gross proceeds from an equity offering.

During fiscal 2021, net cash provided by operating activities was \$3.7 million, compared with net cash used of \$2.2 million in fiscal 2020. Net cash used in investing activities was \$11.2 million in fiscal 2021, as compared to net cash used of \$2.5 million in fiscal 2020 (which was primarily due purchased machinery and equipment to improve production capacity and construction projects to improve manufacturing facilities and warehouse). Net cash provided by financing activities was approximately \$11.1 million in fiscal 2021, compared with net cash provided of \$3.0 million during fiscal 2020, driven by proceeds of \$6.6 million from equity offerings, \$2.4 million in bank loans, and related party proceeds of approximately \$1.9 million.

As of June 30, 2021, current assets were \$14.3 million, and current liabilities were \$21.3 million, resulting in a current ratio of 0.7X. As of June 30, 2021, Dogness had \$8.1 million in outstanding bank loans (\$1.5 million in current liabilities). In the past, company debts have been guaranteed by related parties, including CEO Silong Chen and his family. We expect that Dogness will be able to repay these loans over the long-term, with positive operating cash flow.

Dogness does not pay a dividend, and we do not expect one to be initiated in the near-term, as it focuses on launching new products and investing in long-term growth initiatives -- including manufacturing and building infrastructure to support its vertically integrated model.

## MANAGEMENT & RISKS

Mr. Silong Chen serves as chairman & CEO. Mr. Chen founded the Chinese subsidiary in 2003 and has more than 15 years of experience in the pet products industry. He created the Dogness brand in 2008. As the sole holder of Class B Common Shares, which hold a three-to-one voting ratio over Class A Common Shares, Mr. Chen controls a majority of the combined voting power. Overall, the company's directors, executive officers, and their affiliates, hold in aggregate approximately 55% of the voting power of the capital stock.

As of June 30, 2021, Dogness had five directors, the majority of whom are independent and non-employee in status.

Risks include the competitive nature of the pet wearable and smart pet product industries. Although we view Dogness' reputation for innovative technology products and robust sales distribution network favorably, its products are not as well known as competing products from the dozen-plus competitors to its smart collar and harness products. We expect the company to face intense competition over the long-term for its home-based smart products, as market trends shift towards products becoming more connected.

Lastly, the company's functional currency is the RMB. But the global sale of its products, half of which occur outside of China, subject the company to financial currency risk which can impact the results in its financial statements that are presented in U.S. dollars.

## COMPANY DESCRIPTION

Dogness was founded in 2003 from the belief that pet dogs and cats are important, well-loved family members. Through its smart

products, leash products, hygiene products and health and wellness products, Dogness is able to simplify pet lifestyles, make them more scientific, and enhance the relationship between pets and pet caregivers. The company targets industry-leading quality through its fully integrated vertical supply chain and research and development capabilities, which resulted in over 200 patents and patents pending. Its products reach families worldwide through global chain stores and distributors, with a network that includes Chewy, Petco, Walmart.com, Target.com, Amazon, Lowes.com, Wayfair.com, Costco and more.

## VALUATION

Despite the stock's doubling in price year-to-date, we think the current valuation does not fully reflect the robust product demand and global retailer network Dogness has assembled to help drive long-term growth. Although we see near-term product availability

dampened modestly by ongoing global supply-chain problems, we are encouraged by the market acceptance of its products and by prospects for enhanced product efficiency, economies of scale, and margin leverage due to investments in production and manufacturing capabilities.

We compare DOGZ to a basket of global animal-care products, for which we estimate an approximate 30-times forward multiple on earnings. In contrast, DOGZ shares are currently trading at 23-times our estimate for fiscal 2022 and 14-times our fiscal 2023 estimate. As we see the potential for fiscal 2022 results to be impacted by transient impacts related to global supply-chain challenges on product availability, we view fiscal 2023 as a more-normalized environment. As such, we apply a 30-times multiple for DOGZ on our fiscal 2023 EPS estimate of \$0.29, discounted back by 1.5 periods at 10% each period, to arrive at a fair value estimate of \$7.50 for the DOGZ shares.

Steve Silver,  
Argus Analyst

**INCOME STATEMENT**

<b>Growth Analysis (\$ML)</b>	<b>FY 2018</b>	<b>FY 2019</b>	<b>FY 2020</b>	<b>FY 2021</b>	<b>1H FY2022E</b>	<b>2H FY2022E</b>	<b>FY 2022E</b>	<b>1H FY2023E</b>	<b>2H FY2023E</b>	<b>FY 2023E</b>
Revenue	30.1	26.2	19.2	24.3	17.5	21.5	39.0	25.0	31.0	56.0
Gross Profit	12.1	9.4	2.4	9.2			15.6			24.1
SG&A	5.6	8.1	8.1	6.8			8.2			11.6
R&D	0.6	0.7	1.5	0.5			0.6			0.8
Operating Income	5.9	0.6	-8.7	1.9			6.9			11.7
Interest Expense	0.0	0.6	0.1	0.3			0.1			0.1
Pretax Income	5.5	1.8	0.2	1.9			7.0			11.8
Tax Rate (%)	17	21	NA	33			17			17
Net income	4.6	1.4	-8.4	1.5			5.6			9.8
Diluted Shares	20.8	25.9	25.9	27.6			32.0			33.5
EPS	0.22	0.05	-0.33	0.05	0.07	0.10	0.17	0.13	0.16	0.29
Dividend	NA	NA	NA	NA			NA			NA
<b>Growth Rates (%)</b>										
Revenue	42	-13	-27	27			60			44
Operating Income	2	-90	NA	NA			263			70
Net Income	-7	-70	NA	NA			273			75
EPS	-33	-77	NA	NA			240			71
<b>Valuation Analysis</b>										
Price (\$): High	6.40	4.45	3.28	4.85			NA			NA
Price (\$):Low	3.55	1.77	0.78	1.03			NA			NA
PE: High	19.4	20.2	65.6	NA			NA			NA
PE: Low	10.8	8.0	15.6	NA			NA			NA
PS: High	4.5	3.1	3.2	6.5			NA			NA
PS: Low	2.5	1.2	0.8	1.4			NA			NA
Yield: High	NA	NA	NA	NA			NA			NA
Yield: Low	NA	NA	NA	NA			NA			NA
<b>Financial &amp; Risk Analysis (\$ML)</b>										
Cash	7.1	2.9	4.8	5.5			NA			NA
Working Capital	37.4	17.9	0.9	-7.0			NA			NA
Current Ratio	5.23	3.2	1.1	0.7			NA			NA
LTDebt/Equity (%)	NA	5	13	11.8			NA			NA
Total Debt/Equity (%)	8	5	13	17.5			NA			NA
<b>Ratio Analysis</b>										
Gross Profit Margin	40.3%	36%	13%	38%			40%			43%
Operating Margin	19.7%	2%	-45%	8%			18%			21%
Net Margin	15.3%	5%	-44%	6%			14%			18%
Return on Assets (%)	8	1	NA	2			NA			NA
Return on Equity (%)	14	2	NA	2			NA			NA
Op Inc/Int Exp	248	1	-87	6			69			117
Div Payout	NA	NA	NA	NA			NA			NA

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