

April 19, 2022

COOTEK INC. (NYSE: CTK)

CooTek is an internet company that offers mobile applications in three categories: online literature, casual games, and scenario-based content. CooTek aims to deliver its content seamlessly, and uses a data-driven approach to develop content that can attract both mobile internet users and advertisers.

COMPANY HIGHLIGHTS

- * CTK: A developer of user-focused and technology-driven mobile internet content
- * CooTek is developing a robust ecosystem for delivering mobile internet content that, in our opinion, can generate substantial advertising revenue over time. Using its AI and big data capabilities, the company has built online literature and gaming platforms over the past two years, and has developed capabilities to merge content across the two platforms. CooTek also plans to launch a metaverse offering with tokenized capabilities that can integrate and leverage its proprietary content.
- * Across 2021, CooTek implemented a portfolio restructuring aimed at mitigating the impacts of a soft environment for advertising spending in the domestic China market. The company has positioned its platform apps to generate more-attractive returns on investment, which resulted in contraction of daily and monthly active users and their associated revenue streams, but accelerated its path back to profitability. We expect revenue growth in 2022, and forecast profitability for the full-year.
- * As of December 31, 2021, CooTek had \$18.4 million in cash, short-term investments, and restricted cash on its balance sheet, down from \$49.6 million as of the end of 2020. In 2021, the company issued convertible notes that yielded proceeds of \$27 million, and has access to up to \$20 million in capital through an institutional equity purchase agreement. As such, we believe that it has sufficient capital to execute its business plan.
- * The CTK ADSs rose above \$7 in February 2021, but have since fallen below \$1, which we attribute to several factors that we expect to be transient. These include contraction in its user base and revenues, a soft advertising market in China, and poor investor sentiment towards companies based and operating in China, amid economic and regulatory concerns.

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PRICE CHART



KEY STATISTICS

Key Stock Statistics

Recent price (4/14/22)	\$0.21
Fair Value Estimate	\$3.00
52 week high/low	\$2.50-\$0.19
Shares outstanding (M)	66.5
Market cap (M)	\$14
Dividend	Nil
Yield	Nil

Sector Overview

Sector	Information Technology
Sector % of S&P 500	27.9%

Financials (\$M, as of 12/31/21)

Cash & Mkt Securities	18.4
Debt	19.2
Working Capital (\$M)	-11.2
Current Ratio	0.8
Total Debt/Equity (%)	NM
Payout ratio	NM
Revenue (M) TTM	272.1
Net Income (M) TTM	NM
Net Margin	NM

Risk

Beta	0.44
Inst. ownership	5%

Valuation

P/E forward EPS	2.1
Price/Sales (TTM)	0.1
Price/Book (TTM)	NM

Top Holders

Qiming Weichuang Venture Capital
Sequoia China Investment Management
SIG Asia Investments

Management

Chairman	Mr. Karl Kan Zhang
CEO	Mr. Michael Jialiang Wang
CFO	Mr. Robert Yi Cui
Company website	www.cootek.com

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* That said, we believe that CTK's current enterprise value of approximately \$20 million, or less than 0.1-times our 2022 revenue estimate, does not fairly reflect the company's improving fundamentals and prospects for achieving sustainable profitability, beginning in 2022. We think that the achievement of positive adjusted net income for the final three quarters of 2021 has been overlooked by investors. Based on our forward P/E analysis, we see a fair value estimate for CTK of \$3 per ADS, well above current levels.

INVESTMENT THESIS

CooTek is an internet company that offers a portfolio of content-rich mobile applications supported by big data analytics. The company leverages the insights gained from its users to deliver targeted advertisements through these applications.

The company has gained user insights from its legacy TouchPal Smart Input mobile app, an adaptive, multilingual tool that helps users to communicate more efficiently by offering next-word prediction, mistyping correction, and auto spelling correction on mobile devices, among other features. The app uses big data analytics to improve its language model continually, and provides users with a customized experience over time. The app, which was launched initially in 2010, had nearly 93 million daily active users (123 million on a monthly basis) in more than 200 countries, as of the end of 2021.

In early 2019, CooTek launched an internally developed advertising platform, supported by big data capabilities, serving advertising customers directly or through ad agencies. This system allows advertisers to create and manage advertising campaigns and budgets, and to place advertisements into CooTek's portfolio applications, under an optimized In-App Advertisement (IAA) model that integrates various monetization tools, including ad-bidding mechanisms.

Also in 2019, CooTek launched online literature and gaming products, which helped to boost revenue by 259% in 2019 and 148% in 2020. By December 2020, its daily and monthly active user base had increased to 27.8 million and 85.8 million, respectively. However, due to high user-acquisition costs and headwinds from emerging weakness in the online advertising market in China, CooTek's net losses in 2019 and 2020 were \$36.8 million and \$47.4 million, respectively.

Across 2021, CooTek implemented a strategy to restructure its product portfolio and reduce its marketing costs, focusing on higher ROI products and higher frequency and duration users that could accelerate its path to profitability. While most of its advertising revenue had come from the Chinese market, CooTek has made significant progress towards diversifying its revenue mix. Overseas

revenues increased throughout the year and represented more than 20% of total revenues by the end of 2021. We expect this trend to continue, as CooTek invests in its global reach, particularly in its mobile games segment -- which has emerged as a primary revenue driver.

In 2021, online literature accounted for 39% of advertising revenue, mobile games 52%, and scenario-based content apps 8%.

As of December 31, 2021, the company had 18.5 million daily active users (DAUs) for its portfolio products, which represents a 33% decline from the 27.8 million peak, achieved in the December 2020 quarter-end. Similarly, monthly active users (MAUs) were 62.6 million, a 27% decline from 85.8 million in December 2020. Importantly, the company achieved positive adjusted net income for the last three quarters of 2021 and its monthly active user count increased by 9% in the fourth quarter of 2021, on a sequential basis.

CooTek's online literature app in China is Fengdu Novel, which provides users with a large library of free online novels across more than 35 genres. Users can search this library using keywords to find titles that match their interests. Fengdu Novel has multiple collaboration agreements with Chinese publishers, and has more than 4,000 authors in its "ecosystem," more than doubling since October 2020.

Fengdu Novel includes a data feedback loop that can help authors better understand readers' preferences, while also improving engagement and generating enhanced ad activity. In turn, readers receive new book recommendations based on their ratings and feedback. Across 2021, CooTek began to monetize the intellectual property (IP) around these works by securing corporate partners, and utilizing social media and other channels throughout the content chain to maximize their influence. The revenues derived from such initiatives more than doubled on a sequential basis, between the second and third quarters of 2021.

Despite the contraction of its daily average user (DAU) base to 4.2 million at the end of 2021, compared with a peak of 10.2 million, CooTek's average daily reading times on Fengdu Novel increased across 2021, to 179 minutes by year-end, up from 153 over the previous two quarters. We think this underscores the potential to drive advertising revenues from a more-targeted user base. We see the more-engaged user base, and improving average revenue per user (ARPU), as driving greater operational efficiency and enhanced monetization over time. Similarly, CooTek has been developing a comparable product for the overseas market, called Readict, which the company expects will become profitable during the second quarter of 2022.

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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 (TTM) Growth (%)	1 YR EPS (TTM) Growth (%)	PE Ratio (TTM)	Beta	Yield (%)
COOTEK INC.	NYSE: CTK	0.21	2.50	0.19	14	-90	-38	NM	NM	0.44	NA
CHEETAH MOBILE INC.	NYSE: CMCM	0.99	2.90	0.65	139	-52	-54	-80	11.0	1.22	NA
PHOENIX NEW MEDIA LTD.	NYSE: FENG	0.58	1.86	0.44	42	-63	-15	NM	NM	1.73	NA
HELLO GROUP INC.	NASDAQ: MOMO	4.88	16.33	4.47	964	-67	-3	NM	NM	1.34	NA

We see additional opportunities for growth in the online literature platform, as it's the library is expanded with different media formats, including audio, film, and live streaming. In addition, we expect adoption across the online literature category to benefit from social media, key opinion-leader interactions, and targeted audience engagement. This should provide a foundation for user base expansion at enhanced monetization and lower user acquisition costs compared with its initial launch.

In the mobile games segment, CooTek launched its first internally developed game in the second half of 2019, and has subsequently built a global product pipeline that has more than 10 million users. We think this should help sustain the group's momentum. Initial casual games included simulation games Farm Hero and Idle Land King Tycoon. In 2021, the unit released Catwalk Beauty, which topped the iOS charts in the U.S., and achieved success on a global scale, reaching top-status in 58 total global markets. Other recently released casual titles, such as Truth Runner, Hotties Up, and matching game Love Fantasy, were developed by studios in which CooTek has invested and achieved top-status in the U.S. within days of their respective launches.

As mentioned above, mobile games generated more than 50% of revenues in 2021. CooTek launched more than 30 new games in second half of 2021, most of which were in overseas markets. During the fourth quarter of 2021, mobile games in the overseas market accounted for more than 20% of revenues. We expect this momentum to continue as CooTek works with more than 20 third parties on its gaming business. To help drive this business, CooTek has developed a game publishing software as a service (SaaS) platform, based on its data-driven content model and designed to support its content-producing partners and optimize monetization.

As a key initiative in its growth strategy, CooTek is leveraging its content from the online literature category to develop new titles for its mobile games segment. A validating example for this approach was recent hit title Love Fantasy, a matching game that combined interactive storylines taken from an online novel. The title is consistent with the company's stated goal of developing content for the female user base, which historically has been underserved in terms of targeted content. The title was the most downloaded iOS Chinese overseas game title in December 2021, and was second on Google Play. The title contributed 60% of profits for the entire mobile games segment in the fourth quarter of 2021. As such, we expect the gaming segment to complement the online literature segment and contribute to CooTek's growth over the long term.

CooTek also offers a scenario-based mobile app portfolio, including apps for sports, health, and fitness. Within this category, users can watch videos from professional fitness trainers, follow workout programs and customize workout schedules, and track progress toward their fitness goals. Other apps count steps when walking or jogging, or remind users to drink enough water. Despite relatively modest growth and revenue generation, the scenario-based apps have provided stable revenue that has supported the company's investments in other areas. In December 2021, CooTek announced plans to launch a "metaverse" offering to integrate and leverage its online literature and gaming businesses. This new platform will enable users to interact with characters

from online literature content and with other readers in the form of games whose storylines are based on literature content. The metaverse will also allow users to acquire virtual items that can be tokenized and be taken into other story worlds, or collected and traded, both within and outside of the apps.

We see intense competition in emerging metaverse market, with many global tech companies announcing plans to establish such immersive offerings (most notably Facebook's recent name change to Meta Platforms). But we think CooTek's installed user base, which nearly reached 30 million at peak in 2020, combined with its proprietary content, should provide a solid base to establish a presence in this emerging category. In addition, we are also encouraged by the modest R&D costs associated with developing the platform, as compared to developing the core online literature and gaming business models.

We like CooTek's plan to focus its metaverse products to include female users, who represent more than 1 billion game players (nearly half the global market). In May 2021, CooTek invested in game studio Lejiu, which plans to introduce female-targeted games that will allow users to upload their own works as home decoration into the games, which will be traded as non-fungible tokens (NFTs), and which can earn real money by developing co-branding goods and products with other merchants. In our view, such initiatives should complement the content provided by Fengdu Novel, which has generated strong usage among female users.

In our view, CooTek is well positioned to maintain a strong market presence by developing its data-driven technology. More than half of the company's employees are software engineers and product designers. The company also has an active IP strategy, with a growing number of patents, trademarks, copyrights and website domains, both in and outside China.

RECENT DEVELOPMENTS

In 2021, CTK ADSs declined by 78%, compared to a 27% gain for the S&P 500. Year-to-date in 2022, the ADS's have declined by 66%, compared with an 8% decline for the S&P 500.

In March 2022, CooTek reported full-year 2021 results. Revenue declined 38% to \$272.1 million and net loss per ADS was \$0.25, compared with a net loss per ADS of \$1.00 in 2020. However, the company achieved adjusted net income for the last three quarters of 2021, and expects meaningful net income for the full-year 2022.

In December 2021, CooTek announced plans to launch an immersive "metaverse" offering that could integrate and leverage the content from its online literature and mobile gaming platforms to provide original content and capabilities to tokenize virtual items from these experiences.

In August 2021, CooTek's Fengdu Novel online literature mobile app announced significant progress in leveraging social media channels to provide a novel approach to reach targeted readers and to develop a new business model that can support company revenue growth.

In June 2021, Fengdu Novel's literature platform achieved first place on the Tencent GuangDianTong's rising popularity list of novels, driven by strategic cooperation with leading social media channels to promote original platform content actively.

In May 2021, CooTek announced that its internally developed game Catwalk Beauty reached number 1 on the iOS App Store and Google Play games sites in the United States and 57 other countries and regions.

In January 2021, CooTek announced collaboration agreements between Fengdu Novel and several well-known online publishers in China, including Tadu Literature, Heiyan.com, and BoYiChuangWei, that should help to expand its online offerings. In January, the company also added short videos and audiobooks to Fengdu Novel in response to growing demand.

EARNINGS & GROWTH ANALYSIS

In 2020, revenues increased 148% to \$442 million, despite continued weakness in the global advertising industry. CooTek benefited from an increase in its user base as COVID-19 lockdowns led to more time spent at home and on mobile devices. However, as a result of high user-acquisition and marketing costs, CooTek initiated a restructuring of its product portfolio to drive higher ROI content, which resulted in the contraction of its user base. Still, we are encouraged by the company's strong user retention among newer users and increased usage trends. Thus, we expect a new revenue and profitability growth cycle to begin in 2022, driven by growth in overseas activities and supported by enhanced monetization efforts in the domestic China market.

We forecast 2022 revenue of \$286 million, implying 5% growth over 2021, and 2023 revenue of \$355 million, which would represent 24% growth. We anticipate investments in ecosystem content and the recent portfolio restructuring will drive a return to revenue growth in 2022. We expect the mobile games and online literature categories to be key growth drivers, as CooTek makes continued progress towards integrating and monetizing its content across multiple channels.

We forecast gross margins of 89% for 2022 and 90% in 2023, below the 94% in 2020, as CooTek invests in the development of revenue-generating content across its mobile app ecosystem. Conversely, we project a decline in sales and marketing expenses (the company's largest expense) as a percentage of revenues, to around 70% in 2022 and 66% in 2023, down from 98% as recently as 2020. This reflects lower customer-acquisition costs and increased user retention as CooTek expands its offerings on Fengdu Novel and introduces new casual games. In 2022, we forecast operating margin of 2%, and longer-term, we project operating margins to expand to 5%-10% of revenues.

We project earnings per ADS of \$0.10 in 2022 and \$0.25 per ADS in 2023. We note that CooTek achieved positive net income on a quarterly basis (on an adjusted basis, excluding stock-based compensation expense) over the last three quarters of 2021, and we anticipate more-meaningful growth across 2022.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on CooTek is Medium. As of December 31, 2021, the company's cash, cash equivalents, and restricted cash were \$18.4 million, down from \$49.6 million at the end of 2020. Across 2021, CooTek issued convertible notes that yielded proceeds of approximately \$27 million. The company also has a financing package with Yorkville Advisor Global, consisting of a security

purchase agreement, whereby CooTek can sell, at its request, up to \$20 million of its ADSs to Yorkville over a 36-month period.

Although it had a working capital deficit of \$11.2 million and a current ratio of 0.8 at the end of 2021, we expect the company to generate positive cash flow from operations in 2022. This should ease a financing overhang on the ADS's. In addition, we expect the company to retain its NYSE stock listing, and note that the company will have until July 2023 to regain compliance over its stock price and market-capitalization requirements.

Despite the operational challenges and resulting restructuring, and the protracted weakness in CooTek's stock price, we are encouraged by the stabilizing of its operations that occurred over the last nine months of 2021. Further, we view positively the company's March 2022 announcement that Chairman/CTO Karl Kan Zhang planned to purchase up to \$3 million of the company's ADSs, as a signal of confidence in its long-term prospects. In May 2020, the company authorized the repurchase of up to \$20 million of its ADSs through May 2021. At the program's expiration in May 2021, CooTek had purchased 1.4 million ADSs for \$6.0 million.

In 2021, the net cash outflow from operating activities was \$51.0 million, compared to a net outflow of \$0.9 million in 2020. The net cash outflow from investing activities in 2021 was \$1.8 million, compared to \$2.6 million in 2020. The net cash generated from financing activities was \$20.9 million in 2021, compared to \$8.5 million used in 2020.

CooTek does not pay a dividend, and we do not expect it to pay one in the near term as it invests in the business.

MANAGEMENT

Karl Kan Zhang co-founded the company in 2008, and has served as chairman since 2012 and chief technology officer since 2020. Mr. Zhang also served as chief architect from 2008 to 2020. Prior to founding CooTek, Mr. Zhang was a research and development manager at the Microsoft Advanced Technology Center and a software engineer at Intel China. He received his bachelor's degree in mechanical and electronic engineering from Shanghai University in 2002.

Michael Jialing Wang is the company's other co-founder and has served as CEO since its inception. He was previously a product manager at Microsoft R&D Group in China. Mr. Wang received his bachelor's and master's degrees in electronic engineering from Shanghai Jiao Tong University in 2002 and 2005, respectively.

As of December 31, 2021, CooTek's board had eight directors. Importantly, independent directors lead both the Audit and Compensation committees, and are members of the Nominating and Corporate Governance committee.

RISKS

Risks include CooTek's classification as a "controlled company" by the New York Stock Exchange due to Chairman Zhang's 68% voting power. The company also faces customer concentration risk, in our view, as four advertising customers each accounted for more than 10% of 2020 revenue. In addition, the mobile app software industry is intensely competitive, and CooTek will need to retain advertisers and expand consumer usage to reach sustainable profitability.

COMPANY DESCRIPTION

CooTek is an internet company that offers mobile applications in three categories: online literature, scenario-based content, and casual games. CooTek aims to deliver its content seamlessly, and uses a data-driven approach to develop content that can attract both mobile internet users and advertisers.

VALUATION

CTK shares have been extremely volatile over the past two years. Over the past 52-weeks, the ADS's have traded a range between \$2.50 and \$0.19, and traded as high as \$7 in February 2021. Although the ADSs have traded below \$1.00 since November 2021, the valuation, in our view, does not fully reflect the underlying strength of the company's mobile applications or prospects for reaching sustainable profitability beginning in the current fiscal year.

We see the stock price being impacted by some external factors. These include the soft advertising market in China and a lack of investor appetite for companies based in China due to political and economic concerns, which we think CooTek is navigating successfully. We expect that progress on recently announced goals and a return to positive cash flow will drive renewed investor interest and support a continued NYSE listing.

Despite these overhangs, CooTek has made strategic decisions to restructure its portfolio and user base, and to focus on assets with the highest ROI and profitability potential. As well, it has prioritized its mobile games unit for overseas markets. We view these moves as prudent, given strong results in multiple product titles over the past year that topped both iOS and Google Play download charts in 2021.

We expect CooTek to continue investing in its online literature (with a focus on domestic China) and mobile games (with a focus on overseas markets). We are encouraged by the retention rates and enhanced monetization among new users in 2021. We see such investments in these primary businesses providing a strong content foundation for the launch of new offerings, and integration of content across its platforms.

We are encouraged by CooTek's positive adjusted net income over the final three quarters of 2021, and we project full-year profitability in 2022. We apply a P/E of 30 on our 2022 earnings per ADS estimate of \$0.10. We think this is appropriate for high-growth technology companies but still reflects a meaningful discount to a peer average over 48-times for a basket of global application software companies due to the near-term overhangs. Thus, we arrive at a fair value estimate for CTK of \$3 per ADS.

Steve Silver,
Argus Analyst

INCOME STATEMENT

Growth Analysis (\$ML)	2019	2020	2021	Q1 2022E	Q2 2022E	Q3 2022E	Q4 2022E	2022E	Q1 2023E	Q2 2023E	Q3 2023E	Q4 2023E	2023E
Revenue	177.9	441.5	272.1	61.0	69.0	76.0	80.0	286.0	84.0	86.5	90.0	94.5	355.0
Gross Profit	162.6	417.4	239.3					255.8					318.2
Selling & Marketing	173.3	433.3	218.1					213.2					254.3
R&D	26.9	29.7	34.3					30.0					35.5
Operating Income	-36.8	-47.8	-8.7					8.6					23.1
Interest Expense	NA	NA	-5.7					-2.0					-2.4
Pretax Income	-36.8	-47.4	-13.6					6.6					20.7
Tax Rate (%)	NA	NA	NA					NA					20
Net income	-36.8	-47.4	-13.9					6.6					16.6
Diluted Shares	63.1	61.6	66.1					66.2					66.2
EPS	-0.58	-0.77	-0.25	0.00	0.02	0.03	0.05	0.10	0.06	0.06	0.06	0.07	0.25
Dividend	NA	NA	NA					NA					NA
Growth Rates (%)													
Revenue	33	148	-38					5					24
Operating Income	NA	NM	NA					NA					169%
Net Income	NA	NM	NA					NA					152%
EPS	NA	NM	NA					NA					150%
Valuation Analysis													
Price (\$): High	13.30	7.45	7.20					NA					NA
Price (\$):Low	4.55	2.61	0.44					NA					NA
PE: High	88.7	NA	NA					NA					NA
PE: Low	30.3	NA	NA					NA					NA
PS: High	6.3	2.6	NA					NA					NA
PS: Low	2.1	0.9	NA					NA					NA
Yield: High	NA	NA	NA					NA					NA
Yield: Low	NA	NA	NA					NA					NA
Financial & Risk Analysis (\$ML)													
Cash/Restricted Cash	60.5	49.6	18.4					NA					NA
Working Capital	33.3	-42.0	-11.2					NA					NA
Current Ratio	1.5	0.6	0.8					NA					NA
LTDebt/Equity (%)	NA	NA	NA					NA					NA
Total Debt/Equity (%)	NA	NA	NA					NA					NA
Ratio Analysis													
Gross Profit Margin	91%	95%	88%					89%					90%
Operating Margin	NA	NA	NA					3%					7%
Net Margin	NA	NA	NA					2%					5%
Return on Assets (%)	NA	NA	NA					NA					NA
Return on Equity (%)	NA	NA	NA					NA					NA
Op Inc/Int Exp	NA	NA	NA					NA					NA
Div Payout	NA	NA	NA					NA					NA

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