

April 13, 2023

BUILD-A-BEAR WORKSHOP, INC.

(NYSE: BBW)

Based in St. Louis, Missouri, Build-A-Bear Workshop, Inc. is a global brand that develops and markets a wide array of consumer-focused toys and experiences through nearly 500 interactive brick-and-mortar locations, as well as e-commerce/digital channels. The company also offers products at wholesale and in non-plush consumer categories via licensing agreements with leading manufacturers, and is expanding its brand beyond retail by creating engaging content through social media channels.

COMPANY HIGHLIGHTS

- * BBW: Leading Omni-Channel Consumer Experience Retailer
- * Build-A-Bear Workshop is a global brand that creates long-term personalized relationships with its customers by marketing a wide array of plush toys, accessories and consumer experiences. Historically, sales were driven by a retail mall-based footprint, but the company has diversified its operating model to leverage the power of its Build-A-Bear brand and include e-commerce, third-party retail, licensing, and franchise operations.
- * In our view, Build-A-Bear Workshop provides a unique customer experience and its prime retail thrust drives traffic to its mall locations. The company has successfully expanded its customer reach to include adults and collectors, and has leveraged its loyalty database to drive repeat customer visits, resulting in consistent sales and profit growth. We view the recent resumption of parties at its retail locations as a tailwind to its near-term growth profile.
- * In our view, the company's digital transformation has enabled omnichannel capabilities that drive increased consumer traffic across multiple channels. Recently, Build-A-Bear Workshop has been successfully driving increased visibility and organic growth through the creation of proprietary products and content, which are complemented by a strong licensing partnership with over 75 world-class col-

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KEY STATISTICS

Key Stock Statistics	
Recent price (4/12/23)	\$25.26
Fair Value Estimate	\$45.00
52 week high/low	\$26.87-\$12.47
Shares outstanding (M)	14.8
Market cap (M)	\$373.8
Dividend	Nil
Yield	Nil

Sector Overview

Sector	Consumer Discretionary
Sector % of S&P 500	10.1%

Financials (\$M, as of 1/28/23)

Cash & Mkt Securities	42.2
Debt/Lease Liabilities	86.5
Working Capital (\$M)	46.2
Current Ratio	1.5
Total Debt/Equity (%)	72.6%
Payout ratio	NM
Revenue (\$M, TTM)	467.9
Adjusted Net Income (\$M, TTM)	47.0
Net Margin (TTM)	10.0%

Risk

Beta	1.92
Inst. ownership	72%

Valuation

P/E Forward EPS	7.3
Price/Sales (TTM)	0.8
Price/Book	3.0

Top Holders

Cannell Capital LLC
Dimensional Fund Advisors LP
BlackRock, Inc.

Management

President/CEO	Ms. Sharon Price John
CFO	Mr. Voin Todorovic
COO	Mr. Christopher Hurt
Company website	www.buildabear.com

PRICE CHART



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laborators. In diversifying its revenue streams, the company has continued to maintain strong control over its inventory, which we see driving operating results that can continue to return increased value to its shareholders through special dividends and share repurchases.

- * As of January 28, 2023, Build-A-Bear Workshop had cash and cash equivalents of \$42.2 million compared to \$32.8 million at the end of fiscal 2021 with no borrowings on its revolving credit facility.
- * The company has repurchased more than 10% of its stock since 2021, and has shown a commitment to returning capital to its shareholders. Including a special dividend paid in April 2023, Build-A-Bear Workshop has returned more than \$70 million to its shareholders in the form of stock repurchases and dividends during the past two years.
- * Build-A-Bear's stock has recovered nicely from its lows at the onset of the COVID-19 pandemic, but remains considerably below our view of its strong fundamentals and prospects for continued growth. Based on our P/E analysis, we arrive at a fair value estimate of \$45, well above current levels.

INVESTMENT THESIS

Build-A-Bear Workshop was founded in 1997 as a mall-based vertical retailer and has become a globally recognized brand delivering positive customer experiences through its sale of over 225 million teddy bear and animal friends and the associated store experiences.

As of January 28, 2023, the company had 488 global locations, up nine from the prior year. It operates through a combination of corporately-managed, (direct-to-consumer, 350), third-party retail, (wholesale, 70) and international franchise (royalty, 68) models. All of these entities operate under the Build-A-Bear Workshop brand. In addition to stores, its products are sold on the company's e-commerce sites, third-party marketplaces and franchisee sites and through retailers' wholesale agreements. In our view, the Build-A-Bear experience is unique and supportive of its premium market position, in that customers can create their own products to feature customized sounds, scents, accessories and names, each with a product birth certificate. Furthermore, in-store products are stuffed in front of the customer, creating a very personalized experience that we think represents significant barriers to entry for potential competitors. We believe these features differentiate Build-A-Bear products from peers including Vermont Teddy Bear and Funko, as well as more general toy manufacturers including Ty, Mattel, Hasbro, Lego, Ganz, and Steiff.

Importantly, the Build-A-Bear Workshop experience is atypical among retailers, as it tends to be a driver of mall traffic, rather than being reliant upon it for its sales. According to company exit surveys, it estimates that up to 80% of its store visits are planned as a special trip rather than being a by-product of a typical trip to the mall. For fiscal 2022 that which ended January 28, 2023, the company stated that nearly all of its retail stores in North America were profitable, with an average contribution margin over 25%, which has more than doubled since 2012.

Over time, the company has improved its footprint to optimize its locations, thus achieving superior sales per square foot that have doubled since coming out of the COVID-19 pandemic, and which increased nearly 20% in fiscal 2022 over the prior year. In fiscal 2022, average net retail sales per store were \$1.1 million, up from \$1.0 million and \$0.6 million in fiscal 2021 and 2020, respectively. Also, the company is successfully diversifying its revenue base with the emergence of new channels, including e-commerce, third-party, and franchising retailers, which has resulted in around 35% of its locations being located outside of traditional malls. We think these factors will provide leverage in negotiating favorable lease terms with mall operators, since company locations tend to drive traffic to other stores in the malls in which they operate.

In recent years, Build-A-Bear Workshop has also diversified through its use of data and technology to provide customers with value-added sales channels, new products and media content distribution. In our view, this digital transformation has enabled the company to broaden its consumer base beyond the traditional children's demographic, to be more multi-generational and achieve penetration among teens and adults as well, which currently represent approximately 40% of its end users. This user base has been expanded to include collectible enthusiasts, corporate gifting and brand building, among other groups.

In our view, this diversification has been boosted by Build-A-Bear's emergence as a co-brand, with a strong licensing portfolio of more than 75 world-class collaborators and licensees, many of which are pop culture icons such as Harry Potter, Pokemon, Star Wars and more recently, TV show Ted Lasso. Importantly, these relationships and co-branded products retain the essence of the Build-A-Bear brand while appealing to the licensor's fans who tend to be in an older targeted demographic. We estimate that licensing activity impacts more than one-third of its total business. We also see licensing supporting a premium pricing model that enables Build-A-Bear Workshop to maintain, and in some cases, expand its product gross margin,

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PEER COMPARISON

Company	Ticker	Recent Price (\$)	52-Week High (\$)	52-Week Low (\$)	Mkt. Cap (\$ML)	1-yr Price Change (%)	1-yr Rev Growth (%)	1 YR EPS Growth (%)	P/E Ratio	Beta	Yield (%)
BUILD-A-BEAR WORKSHOP INC	NYSE: BBW	25.26	26.87	12.47	374	37	14	30	8.2	1.92	NA
HASBRO INC	NASDAQ: HAS	51.3	94.22	45.75	7110	-39	NM	NM	35.1	0.72	5.5
MATTEL INC	NASDAQ: MAT	17.43	26.99	15.36	6170	-22	0	NM	15.8	1.17	NA
1-800-FLOWERS.COM INC	NASDAQ: FLWS	11.61	14.93	5.82	752	-15	4	NM	25.8	1.68	NA

In addition, Build-A-Bear Workshop's co-developed product tie-ins enhance the customer experience, and additionally contribute to higher overall transaction values and monetization of its inventory. Between fiscal 2012 and 2021, the company saw an approximately 50% increase in its average dollar per transaction to over \$53 from \$35, with increases in unit sales per transaction supporting strong pricing power. We note that the company tends to realize swift redemptions of gift cards, with many customers spending more than the value of the redeemed gift card. In addition, it sees below industry-average product returns, given the ubiquitous sizing of many of its items. We believe these trends contribute to effective inventory management.

Overall, we think that the company's inventory management is an under-appreciated aspect of its broader execution, as its vertical retail model provides flexibility in its inventory management to help drive higher margins. Build-A-Bear Workshop is able to test new products in various channels, including e-commerce, before introducing them to its physical store locations. The company is also diversifying its sourcing factory footprint and ships product directly from its stores, leveraging its store fixed costs to serve as distribution centers for online orders, while utilizing technology to determine optimized shipping routes.

We see such factors as having contributed to solid financial results for fiscal 2022, which was highlighted by nearly 14% revenue growth, despite a temporary dip in e-commerce revenues due to a revamping of its website, which has since been completed, and consumers returning to physical stores following pandemic-related restrictions. Still, we note that website sales are significantly above pre-pandemic levels.

In fiscal 2022, total revenues and pre-tax income represented the highest levels since the company's inception. Adjusted net income increased 30% to \$3.08 per diluted share from \$2.37 in fiscal 2021. We view the 2022 results, which superseded 2021 as the company's most profitable year to date, as impressive, due to the disruption to its business by the pandemic.

In our view, Build-A-Bear Workshop is poised to sustain growth over the coming years, as its store traffic has outperformed a market that has seen inflation and supply chain issues across the retail segment. In addition, we see its re-opening of in-store parties, which resumed during the second quarter of 2022, and that historically has accounted for around 5% of sales, as a key-long term value driver to its in-store productivity and transactional metrics.

In addition to the favorable in-store operating metrics, we believe that Build-A-Bear Workshop remains in the early-stages of driving additional organic revenue growth through its emerging digital and omnichannel approach. In recent years, the company has made significant investments in its IT infrastructure, including its e-commerce capabilities, which currently generates approximately 20% of its business. Importantly, e-commerce has also played a strategic role in the business' growth, as it has been responsible for appealing to an older customer base beyond the traditional children's market. This has enabled the company to easily reach a new demographic of customers seeking an experience for various holidays and occasions without requiring a trip to a store.

In addition to e-commerce, Build-A-Bear Workshop has embraced the use of data across its business to drive enhanced

consumer interactions. The company captures first-party data on its customer base through its relationship with Salesforce that help to inform marketing and promotional campaigns, as well as drive product development. Among the information the company is able to capture and leverage is customer demographics, ages and transaction values. The company cites more than 12 million opted-in first party data contacts, including more than 10 million active Build-A-Bear Bonus Club members, through which it saw an increase in transactions of approximately 25% in fiscal 2022. In our view, this robust loyalty program, which can begin capturing customer information as early as 1 year old under the loyalty Club's Count Your Candles program, serves as a customer acquisition tool and positions Build-A-Bear Workshop to create customer stickiness for repeated transactions and drive traffic through its various channels.

Another aspect of Build-A-Bear Workshop's digital infrastructure is designed to utilize social media to communicate with its consumers to help drive traffic and overall engagement. The company has access to over 20 million social media followers, including its loyalty members and first-party data contacts, that generate approximately 10 billion incremental annual media impressions over the past few years, including its After Dark program and Baby Yoda (Star Wars) program, each of which generated up to one billion impressions alone. Additionally, the company has driven viewership and interest through digital content, including the production of films that can be streamed on Netflix, new digital games on leading social platforms such as Roblox, and other properties, including collectible non-fungible tokens (NFT's), documentaries and other-movie tie-ins based on its intellectual property.

Through its third-party retail model, there were 70 stores in operation at the end of fiscal 2022. Under this model, partner companies bear the cost of workshop build out and operation, and Build-A-Bear Workshop sells them inventory on a wholesale basis. Revenue from the commercial segment increased approximately 60% in fiscal 2022.

We are encouraged by the strategic partnerships in this segment to date, with such leading hospitality vendors as Carnival Cruise Line, Great Wolf Lodge Resorts and Six Flags. These relationships enable Build-A-Bear to drive engagement in additional markets, particularly among tourists. We view positively the feedback that suggests that guests that are introduced to Build-A-Bear during a tourist activity are more likely to drive traditional in-store traffic upon their return home.

Lastly, the company is at an early-stage of penetrating additional global markets under a franchising model. To date, it has entered fewer than 10 countries, including China and India. However, Build-A-Bear Workshop has not yet entered many high-growth markets in Europe, which we see as potential growth drivers to the international franchise segment over time.

RECENT DEVELOPMENTS

Build-A-Bear Workshop shares are listed on the New York Stock Exchange (NYSE) under the symbol "BBW". In 2022, the stock rose by 30% versus a decline of 19% for the S&P 500. Year-to-date in 2023, the stock has increased by 3%, versus an increase of 7% for the S&P 500.

In March 2023, Build-A-Bear Workshop reported financial results for the fiscal year ended January 28, 2023, highlighted by roughly 14% revenue growth to \$468 million and adjusted net income of \$3.08 per share, which represented a 30% increase from \$2.37 in the prior year.

In April 2023, Build-A-Bear Workshop paid a special cash dividend of \$1.50 per share. In January 2023, the company announced the hiring of Dara Meath as senior vice president, chief technology officer and a member of the company's Senior Leadership Committee, reflecting its commitment to its digital transformation and expanded technical capabilities. Ms. Meath brings more than 20 years of experience in various technologic leadership roles to Build-A-Bear Workshop.

In December 2022, Build-A-Bear Workshop announced the release of a new virtual community space, "Build-A-Bear Tycoon", over popular global online platform Roblox. The offering represents the next launch into the Metaverse in partnership with Gamefam and enables users to build their own fantastical Build-A-Bear universe and experience the brand in a new way.

In September 2022, the company announced its new website design, offering improvements that provide an updated digital space for guests to engage with the brand in a manner similar to their in-store experience.

In July 2022, Build-A-Bear Workshop was recognized as one of Newsweek's 'America's Best Retailers of 2022' as well as being named on Newsweek's list of 'America's Fastest Growing Online Shops 2022'.

EARNINGS & GROWTH ANALYSIS

We forecast fiscal 2023 revenues of \$500 million and fiscal 2024 revenues of \$530 million, which would represent 7% growth and 6% growth respectively. We expect growth across all three of its operating segments, driven by organic growth from its existing store base as well as contributions from new entities that we expect to consist of 20 to 30 locations, including corporate-managed and third-party sites, which we see back-end loaded to the second half of the year. We also see fiscal 2023 results benefitting from an extra week compared with fiscal 2022, thus contributing an additional \$7 million in revenues.

In our view, the company is well positioned to maintain its gross margins above 50%, compared with 40%-45% prior to the COVID-19 pandemic, as it has realized efficiencies in its retail footprint, and leveraged its fixed occupancy costs across an expanding revenue and merchandise margin base. In addition, fiscal 2022 results began to see the normalization of freight-related costs and supply chain expenses following the pandemic. We note that Build-A-Bear also has flexibility in managing its promotional spending, which can further expand its margins over time. Thus, we forecast gross margins of 53% in fiscal 2023 and 2024, above fiscal 2022's 52.5% level, with the fourth quarter yielding the highest margin due to the seasonality of holiday shopping and a stronger revenue contribution.

We forecast adjusted earnings per share (EPS) of \$3.48 in fiscal 2023 and \$3.90 for fiscal 2024. Despite some variability, we forecast a normalized tax rate around 25%. With fewer than 15 million shares currently outstanding, we see Build-A-Bear Workshop shares having inherent earnings growth leverage.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Build-A-Bear Workshop is High. At January 28, 2023, the company had \$42.2 million in cash and equivalents, compared with \$32.8 million at the end of the prior fiscal year, and a working capital surplus of \$46.2 million. Importantly, it has no borrowings outstanding on its revolving credit facility.

At the end of fiscal 2022, inventory was \$70.5 million, having declined by \$1.3 million from fiscal 2021, which we view as strong inventory management, as it has over 75 licensing partnerships and distributes its products across its store-based and e-commerce platforms. In fiscal 2022, capital expenditures were \$13.6 million and depreciation and amortization was \$12.5 million. In our view, Build-A-Bear Workshop is in elevated capital expenditure phase as it grows its business. The company expects approximately \$15-\$20 million in required capital expenditures, more than half of which is growth and technology oriented, rather than aimed at store maintenance. We also anticipate approximately \$13-\$14 million in depreciation and amortization for fiscal 2023.

In fiscal 2022, net cash provided by operating activities was \$3.5 million (\$39.8 million provided in fiscal 2021, \$59.5 million used in fiscal 2020). Cash provided by financing activities in fiscal 2022 was \$26.4 million (\$6.9 million used in fiscal 2021, \$30.2 million provided in fiscal 2020). Cash used in investing activities in fiscal 2022 was \$60.1 million (\$27.4 million in fiscal 2021 and \$18.1 million in fiscal 2020). We view Build-A-Bear Workshop as well positioned to achieve robust free cash flow that should enable continued investments and distributions to its shareholders.

To that end, the company has been committed to returning capital to its investors with more than \$70 million returned over the past two years. During fiscal 2022, it utilized \$24.1 million in cash to repurchase approximately 1.54 million shares of its common stock. As of January 28, 2023, it had \$46.5 million available under a \$50 million stock repurchase program that was authorized by its board, upon the completion of a previous \$25 million program. With fewer than 15 million shares outstanding, we note that the company has repurchased nearly 10% of its outstanding shares since the end of fiscal 2021.

Build-A-Bear Workshop does not pay a regular cash dividend, but issued a special one-time dividend in each of the past two years - \$1.25 per share in fiscal 2021 and \$1.50 at the end of fiscal 2022, which was paid in April 2023. We see the potential for the initiation of a regular dividend program over time.

MANAGEMENT

Sharon Price John has served as Build-A-Bear's president and CEO since March 2016, and was appointed to the Board of Directors in June 2013. Previously, Ms. John served as president of children footwear designer and marketer Stride Rite Children's Group. Earlier in her career, Ms. John held various roles of increasing responsibility at multi-national toy company Hasbro, Inc. and Mattel Inc, and founded and served as CEO of Checkerboard Toys and as vice president of the U.S. toy division at VTech Industries, Inc. She also serves on the Board of Directors of Jack in the Box Inc., a publicly traded restaurant company.

Voin Todorovic has served as Build-A-Bear Workshop's CFO since September 2014. Previously, Mr. Todorovic served as the head of finance and operations for the Lifestyle Group of global footwear and apparel company Wolverine Worldwide, Inc. His experience also includes executive leadership roles at brands such as Stride Rite, Collective Brands, Inc. and Payless ShoeSource.

Build-A-Bear's board of directors includes six independent directors of the seven total members.

RISKS

Risks for an investment in Build-A-Bear Workshop include its sensitivity to discretionary spending by consumers, which can be affected by economic conditions including inflation, levels of employment and consumer confidence; profitability that can be impacted by supply chain issues such as freight costs and inventory transportation availability; demand from and continuity in relationships with brand licensors for its co-branded products and experiences; and reliance upon maintaining an available e-commerce platform to test various products and direct consumer traffic. Lastly, we note that Build-A-Bear Workshop does not own or operate its production factories and that the company has purchased up to 75% of its merchandise from four vendors, which represents some concentration risk. Although most of its merchandise had been produced in China prior to 2020, the company has since significantly diversified production into Vietnam.

COMPANY DESCRIPTION

Based in St. Louis, Missouri, Build-A-Bear Workshop, Inc. is a global brand that develops and markets a wide array of consumer-focused toys and experiences through nearly 500 interactive brick-and-mortar locations as well as e-commerce/digital channels. The company also offers products at wholesale and in non-plush consumer categories via licensing agreements with leading man-

ufacturers, and has recently begun to expand its brand beyond retail by creating engaging content through social media channels.

VALUATION

Since 2022, Build-A-Bear Workshop shares have traded in a range between \$12.47 and \$26.87 and are currently trading near the upper end of that range. While the stock has recovered significantly from its lows below \$2 at the onset of the COVID-19 retailer shutdowns in early 2020, the shares have traded sharply below a basket of leisure product peer companies that includes toy makers Mattel and Hasbro among others, on various metrics including forward P/E (~7-times vs 15-times) and Enterprise Value-to-Revenues (below 1-times vs 1.5-times).

In our view, the current valuation does not appropriately reflect Build-A-Bear Workshop's organic revenue growth, margin expansion, proprietary media creation, superior inventory management, strong balance sheet, and commitment to returning capital to its investors. Additionally, we think that the company is poised to continue expanding its footprint, with additional store openings planned, -- further supporting its revenue growth prospects

We acknowledge that its business is volatile in nature, as it is tied to broader measures of consumer sentiment and macro-economic factors. However, we note that its fiscal 2021 and 2022 results, which represented its best two years since inception, occurred during periods of elevated inflation, supply chain issues that significantly impacted costs including freight, and pressure on U.K. derived revenues due to a stronger U.S. dollar. While we expect these challenges to continue over the near-term, we expect the labor market to remain tight and for the company to continue to leverage its premium market reputation, which we believe warrants a valuation closer to this market peer group.

Thus, we apply a 13-times multiple to our 2023 adjusted EPS estimate of \$3.48 to arrive at a fair value of \$45, well above current levels above \$25.00.

Steve Silver,
Argus Research Analyst

INCOME STATEMENT

Growth Analysis (\$MIL)	FY 2021	FY 2022	Q1 2023E	Q2 2023E	Q3 2023E	Q4 2023E	2023E	Q1 2024E	Q2 2024E	Q3 2024E	Q4 2024E	2024E
Revenue	411.5	467.9	124.7	106.3	112.2	156.8	500.0	133.7	114.0	120.3	162.0	530.0
Gross Profit	218.0	245.9					264.5					281.2
SG&A	167.7	183.9					198.2					206.7
R&D	0.0	0.0					0.0					0.0
Operating Income	50.3	61.9					66.3					74.5
Interest Expense	0.0	0.0					0.0					0.0
Pretax Income	49.4	61.9					67.9					75.5
Tax Rate (%)	23	24					25					25
Adjusted Net Income	38.3	47.0					50.7					56.6
Adjusted EPS	2.37	3.08	0.88	0.58	0.65	1.37	3.48	0.99	0.76	0.80	1.35	3.90
Diluted Shares	16.1	15.2					14.5					14.5
Dividend	NA	NA					NA					NA
Growth Rates (%)												
Revenue	61	14					7					6
Operating Income	NM	23					7					12
Net Income	NM	30					8					12
EPS	NM	23					13					12
Valuation Analysis												
Price (\$): High	23.50	26.87					NA					NA
Price (\$): Low	4.65	12.47					NA					NA
PE: High	NA	11.3					NA					NA
PE: Low	NA	5.3					NA					NA
PS: High	1.5	1.0					NA					NA
PS: Low	0.3	0.5					NA					NA
Yield: High	NA	NA					NA					NA
Yield: Low	NA	NA					NA					NA
Financial & Risk Analysis (\$MIL)												
Cash	32.8	42.2					NA					NA
Working Capital	32.6	46.2					NA					NA
Current Ratio	1.3	1.5					NA					NA
LTDebt/Equity (%)	78.3	49.6					NA					NA
Total Debt/Equity (%)	105.2	72.6					NA					NA
Ratio Analysis												
Gross Profit Margin	53%	53%					53%					53%
Operating Margin	12%	13%					13%					14%
Net Margin	9%	10%					10%					11%
Return on Assets	11.9%	14.2%					NA					NA
Return on Equity	58.7%	45.1%					NA					NA
Op Inc/Int Exp	NA	NA					NA					NA
Div Payout	NA	NA					NA					NA

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