

February 23, 2024

## TH INTERNATIONAL LIMITED

(NasdaqCM: THCH)

TH International Limited (“Tims China”, or “THCH”, or “the company”) is the parent company of the exclusive master franchisee of Tim Hortons coffee shops for Restaurant Brands International Inc. in mainland China, Hong Kong and Macau, as well as Popeyes restaurants in mainland China and Macau. THCH offers freshly brewed coffee, tea and other beverages, bakery and sides, as well as sandwiches. The company launched its first coffee shop in China in February 2019 and had grown to more than 900 stores by the end of 2023. The company utilizes an operating model that includes company-owned stores and franchise operated locations, of various location size formats.

### COMPANY HIGHLIGHTS

- \* **White Space for Growth:** THCH has been expanding in China’s Fast Growing Coffee Market since 2019. We see the market for coffee consumption in China as still in the early-stages of a generational category shift from a previously tea drinking culture.
- \* **Adding Locations:** In our view, THCH is executing a strategic plan that aims to expand to over 2,700 locations in 2026, nearly tripling from its current footprint.
- \* **Investment Phase Largely Completed:** THCH has completed much of its investment towards building an infrastructure, including a scalable supply chain and technology system that can support the target footprint.
- \* **Differentiated Product Offering:** We think that Tims China is well positioned to fill the role of a differentiated player in the Chinese market; by providing value on price compared with entrenched market leaders, while still offering a locally adapted food menu. Thus, we expect Tims China to grow without needing to displace or take share from other entrenched players.
- \* **Expanding Margins:** We are encouraged by several operating trends in Tims China’s business, including store EBITDA margin expansion to 7.5% in the third quarter of 2023, up from 5% in the previous quarter, and growth in its loyalty

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### KEY STATISTICS

#### Key Stock Statistics

Recent price (2/22/24)	\$1.22
Fair Value Estimate	\$4.00
52 week high/low	\$5.54-\$1.11
Shares outstanding (M)	157.5
Market cap (\$)	\$192.2
Dividend	NA
Yield	NA

#### Sector Overview

Sector	Consumer Discretionary
Sector % of S&P 500	10.3%

#### Financials (as of 9/30/23, RMB)

Cash & Mkt Securities (M)	461.8
Debt (M)	1,072.1
Working Capital (M)	-786.4
Current Ratio	0.5
Total Debt/Equity (%)	NM
Payout ratio	NA
Revenue (M, TTM)	1,486.1
Net Income (M)	NM
Net Margin (%)	NM

#### Risk

Beta	0.47
Inst. ownership	74%

#### Valuation

P/E forward EPS	NA
Price/Sales (TTM)	0.9
Price/Book (TTM)	NM

#### Top Holders

Cartesian Capital Group LLC  
Tencent Holdings Limited  
Sequoia Capital Operations LLC

#### Management

CEO	Mr. Yongchen Lu
Chairman	Mr. Peter Yu
CFO	Mr. Dong Li
Company website	<a href="https://ir.timschina.com">https://ir.timschina.com</a>

### PRICE CHART



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program base to over 18 million (up more than 90% over the same period of 2022), which accounts for about 80% of its transactions, the majority of which are conducted online.

- \* **Solid Financial Position:** As of September 30, 2023, THCH had RMB 461.9 million (\$64.9 million USD) in cash, and net debt of RMB 1.07 billion (\$85 million USD). We expect continued improvement in corporate level EBITDA to improve its balance sheet over time.
- \* **Fair Value:** Based on our EV/Revenue analysis, we see a fair value of \$4.00 per share.

## COMPANY/INDUSTRY BACKGROUND

THCH is the parent company of the master franchisee of, and licensed operator of Tim Hortons coffee shops, one of the largest coffee, donut, and tea restaurant chains in the world, in mainland China, Hong Kong and Macau. In March 2023, the company also became the exclusive operator and developer of the Popeyes® brand in mainland China. Since opening its first coffee shop in February 2019, the company has expanded to a total store count of 910 locations at the end of 2023, consisting of company-owned/operated and franchised Tims China stores, and 10 company-owned Popeyes locations at present.

Tims China has targeted a total footprint of more than 2,700 profitable stores in 2026. Consistent with trends since inception, we expect the fourth quarter to be the most active one for new store openings.

In our view, underpinning the opportunity for THCH is a market that is undergoing a generational shift in consumer preferences to coffee drinking, from what was historically only a tea drinking culture. According to the United States Department of Agriculture Foreign Agricultural Service, per capita annual consumption of coffee in China in 2020 was only 19 cups, compared to 628 cups in the United States and 494 cups in Japan. Subsequently, in 2021, according to China Briefing, China’s coffee market grew by 31% in 2021, which compares favorably to a mature international growth rate of only 2%.

Despite this growth, we see the market as still being in its early stages of development and offering lots of white space for future growth. We are encouraged by initiatives of the Chinese government to support this expanding development. In October 2022, coffee cultivation and production were included in the government’s Catalogue of Encouraged Industries for Foreign Investment. Starbucks entered the Chinese market in 1999, and currently has approximately 6,500 locations in the country, mostly in larger formats. Over the past decade, Luckin Coffee has surpassed Starbucks, with more than 12,000 stores as of mid-2023.

In March 2023, THCH obtained a license to bring the Popeyes brand fried chicken stores to China. The first location opened in August 2023 and its 10<sup>th</sup> restaurant opened at the beginning of 2024. In our view, fried chicken is a robust growth food category in China, as leading western brand KFC has over 10,000 locations in the country, nearly double the number of McDonalds stores, the next largest western QSR brand. We are encouraged by the opening trends reported by THCH since inception, including the fact that the Popeyes store network is already store-level EBITDA positive. We expect Popeyes to expand across China over the coming years and are encouraged by the company’s plans for 500 new store openings over the next five years and 1,700 over the next decade.

## INVESTMENT THESIS

In our view, the company has completed much of its investment towards building an infrastructure that can support the targeted footprint. Over the past few years, it has established the Tims China brand through the opening of a base of primarily large-scale, company-owned stores, as well as by building out a scalable supply chain and technology system that can accommodate store growth. In addition, the company has already begun to add new brands, such as Popeyes in 2023. We view positively that THCH’s supply chain focuses on sourcing fresh ingredients from suppliers that have a Global Food Safety Initiative (GFSI) certificate, a widely recognized food safety standard.

We see the company executing on a high Return on Investment (ROI) strategy building upon investments already made. We expect the focus of future store growth to center around densification of established areas, both through sub-franchising and smaller format locations. We view this strategy favorably, given the limited capital investment required and enhanced profitability due to the scalability and higher margin of the franchising model.

We note that leading franchise partners include leading convenience store chain Easy Joy (a subsidiary of oil and gas company SINOPEC) and real estate company Century 21, which are already well established and vetted, thus lowering THCH’s execution risks. We expect many new store locations in high-traffic locations including gas station convenience stores, subway stations and others that can accommodate smaller formats, all of which will utilize THCH’s supply chain, technology systems and menu boards, and benefit from lower labor burdens.

For both the Tims and Popeyes brands, we see THCH benefiting from investments in developing locally relevant and product-tested menus, which we believe have been key for western brands to achieve success in China. These menus also focus on

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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 (%)
TH INTERNATIONAL LTD	NasdaqCM: THCH	1.22	5.54	1.11	192	-76	57	NM	NM	0.47	NA
STARBUCKS CORP	NasdaqGS: SBUX	95.78	115.48	89.21	108,444	-7	12	27	26.8	0.99	2.4
LUCKIN COFFEE INC	OTCPK: LKNCY	24.00	38.88	17.77	6,622	-23	67	NM	114.3	-0.59	NA
YUM CHINA HOLDINGS INC	NYSE: YUMC	41.76	64.70	33.55	16,806	-31	15	89	21.2	0.42	1.5

innovation, as THCH has announced a goal of a new beverage or food product every 2-3 weeks, having launched 21 new beverages and 11 new food products in the third quarter of 2023. Although coffee is the largest revenue driver at Tims China locations, we are encouraged by the growth in food-included orders, which reached approximately 50% of all orders in the third quarter of 2023. We think this has also contributed to improving store operating margins that reached 7.5% in the third quarter of 2023, up from 5.0% in the year-earlier period, which we estimate had around 40% of transactions that included food purchases.

We note that freshly prepared food on the menu represents another area of differentiation compared with its peers. In addition, we see the variety of store formats enabling smaller locations with varied food and seating options, in contrast to chains such as Starbucks, which is largely concentrated in larger store footprints.

We also view THCH's use of mobile and digital technologies as supporting its growth amid China's use of mobile devices in daily routines. Since 2020, digital ordering has increased from 64% to over 80% of all transactions, including delivery and mobile ordering for self-pickup. In addition, the Tims app is prominently featured across the digital ecosystem to facilitate digital ordering and marketing, on vertical service platforms including Eleme and Tmall, and social media platforms, including WeChat, Weibo, Weixin, Xiaohongshu and TikTok. In December 2023, the company's loyalty program had expanded to over 18 million members, up from just 2 million at the end of 2020.

## RECENT DEVELOPMENTS

Tims China shares trade on the Nasdaq Capital Market under symbol "THCH". In 2023, THCH shares declined by 37%, compared with a 24% increase for the S&P 500. Year-to-date in 2024, the shares have fallen 29% compared with a 7% increase for the S&P 500.

In November 2023, THCH reported third-quarter 2023 results, a period that was highlighted by 43% revenue growth and an adjusted store EBITDA margin of 7.5%, up from 5.0% in the prior year period. Total store count increased by 57% compared with the same period in 2022.

In January 2024, THCH announced the opening of the first seven Tims China stores in Shanghai Metro stations. This partnership will be expanded to include more Tims China coffee shops in "Line 14" stations.

In January 2024, THCH announced the opening of its 10th Popeyes store in Shanghai. The company launched its first Popeyes location in mainland China in August 2023.

In July 2023, THCH announced the opening of its 700<sup>th</sup> coffee shop and expanded into China's Northwest as part of its broader growth plans.

In June 2023, THCH completed a financing offer that resulted in the issuance of 5.42 million common shares in exchange for all 17,250,000 outstanding public warrants and all 5,650,000 outstanding private placement warrants.

On May 31, 2023, THCH announced that it was added to the MSCI China All Shares Small Cap Index.

In March 2023, THCH announced that it acquired PLKC International Limited ("Popeyes China"), which holds the ex-

clusive rights to develop and sub-franchise the Popeyes brand in mainland China and Macau. The share-based transaction included \$30 million in cash to support the brand's launch, and the company planned to earmark an additional \$60 million to develop the Popeyes China business over the coming years.

## EARNINGS & GROWTH ANALYSIS

We forecast that THCH will post revenues of RMB 1.64 billion for 2023 (approximately \$230 million) and RMB 2.02 billion (\$283 million) for 2024, which would represent 62% and 23% growth, respectively.

The company ended 2023 with more than 900 stores. As of the third quarter of 2023, the stores were approximately 77% company owned and operated. Over the next two-to-three years, we forecast approximately 500 new store openings per year, predominantly franchised, and expect that franchised locations will surpass company-owned stores, as the company executes its strategic expansion program.

Thus, we see this shift slowing the rate of top-line growth, but enabling an accelerated path to profitability, as the company will receive a largely expense-free percentage of gross revenues of franchised units in perpetuity. To date, approximately 90% of company revenues have come from the operation of company-owned stores, which we expect to decline to approximately 75% by 2025.

In terms of operating margins, we are encouraged by prospects for THCH to reduce its cost burden as a percentage of revenues moving forward, as costs shift to franchisees, as well as smaller format locations, which can generate favorable growth and profitability from inception. We believe this trend is evident in the improvement in store-level EBITDA, which had increased to 7.5% in the third quarter of 2023 from 5% in the third quarter of 2022. While we expect these results to be somewhat variable, we anticipate more modest pre-store opening expenses contributing to adjusted EBITDA margin expansion to 6.5% for 2023 and 14% in 2024, from a negative margin for 2022, which was hampered by COVID-related lockdowns. Corporate-wide, we project adjusted EBITDA of approximately -15% for 2023 and turning positive during the second half of 2024.

We project adjusted basic and diluted net loss per share of RMB 4.45 (\$0.62) in 2023 and RMB 1.45 (\$0.20) in 2024, using a recent RMB to USD exchange rate of 0.14.

## FINANCIAL STRENGTH & DIVIDENDS

Our financial strength rating for THCH is Medium. As of September 30, 2023, the company had cash of RMB 461.8 million (approximately \$65 million USD), down from RMB 611.5 million (\$86 million) at the end of 2022, primarily due to the expansion of its business and store network, partially offset by an increase in bank borrowings. Cash use also included a true-up payment to investors under a previous Equity Support Agreement (ESA).

As of September 30, 2023, THCH had a negative working capital position of RMB 786.4 million (\$110 million), which translates into a current ratio of 0.5. The company has approximately RMB 1.07 billion (around \$150 million) in debt, consisting of approximately 65% short-term borrowings and 35% from long-term convertible notes that mature in December 2026. We expect its

balance sheet to improve over the coming years, as corporate-level EBITDA turns positive and operational cash flows begin to reflect the leveraging of its supply chain across a store base that shifts to new franchised store locations. Such operations carry little investment requirement and expense exposure, while providing a percentage of those restaurant's gross sales to the company.

Net cash used in operating activities in 2022 was RMB286.9 million (US\$41.6 million), up 17% from 2021 levels, due to the expansion of the corporate store footprint. In the nine months ended September 30, 2023, net cash used in operating activities was RMB 115.6 million (\$15.8 million), down 40% from RMB 190.8 million in the prior year period.

In 2022, net cash used in investing activities was RMB 705.2 million (US\$102.2 million), up approximately 110% from 2021 due to the Collateral Account balance invested in U.S. treasury bonds through an Equity Support Agreement (ESA) collateral account that holds the underlying assets. For the nine months ended September 30, 2023, net cash provided by investing activities totaled RMB 128.0 million (\$17.5 million), compared with net cash used of RMB 611.4 million.

Net cash provided by financing activities in 2022 was RMB 827.2 million (US\$121.0 million), compared with net cash provided in 2021 of RMB 798 million, primarily attributable to net proceeds from ESA Investors, private investment in public equity (PIPE) investors and bank loan drawdowns. For the nine months ended September 30, 2023, net cash provided by financing activities totaled RMB 200.4 million (\$27.5 million), compared with RMB 790.1 million for the same period in 2022.

In September 2022, in connection with its IPO, THCH issued 22.9 million warrants, consisting of 17,250,000 Public Warrants (at a strike price \$11.50), and 5.65 million private placement warrants. In June 2023, the company completed an exchange of all of these public and private warrants in exchange for 5.42 million common shares.

THCH does not pay a dividend and we do not expect the company to initiate such a program in the foreseeable future.

## MANAGEMENT

Mr. Yongchen Lu has been THCH's Chief Executive Officer since its 2018 inception, and a director since September 2022. Previously, Mr. Lu served as the Chief Financial Officer of Burger King China from November 2012 to April 2018 and previously was China representative for Cartesian Capital Group, LLC. Mr. Lu is a certified Six Sigma Black Belt and holds a bachelor's degree in international finance from Shanghai Jiaotong University and an MBA from Tuck School of Business at Dartmouth College.

Mr. Peter Yu has been THCH's Chairman since its 2018 inception, and is a Managing Partner of Cartesian Capital Group, LLC, a global private equity firm. He was previously the Founder, President and CEO of private equity firm AIG Capital Partners, Inc. (AIGCP), which became a leading international private equity firm, with more than \$4.5 billion in committed capital, under his leadership. Prior to founding AIGCP, Mr. Yu served President Clinton as director to the National Economic Council, the White House office responsible for developing and coordinating economic policy. Mr. Yu is a graduate of Harvard Law school, and served

as President of the Harvard Law Review and as a law clerk on the U.S. Supreme Court.

As of September 30, 2023, affiliates of Cartesian Capital Group owned approximately 51% of the outstanding ordinary shares. Other prominent investors include Tencent Holdings (12%), Sequoia Capital China (8%) and Restaurant Brands Inc, the brand owner of Tim Horton's and Popeyes.

As of September 30, 2023, THCH's Board of Directors consisted of nine members.

## RISKS

Risks to an investment in THCH include intense competition in China's coffee shop and food and beverage industries; sensitivity of inflation rates to the prices of commodity inputs to its products, labor, and transportation; reliance on continued favorable macro-economic trends towards consumer discretionary spending on the out-of-home coffee and food categories; the need to continually develop new products that are accepted by its customers, as well as disruptions to its supply chain and technology systems.

## VALUATION

With a recent stock price below \$2 per share and a market capitalization around \$200 million, we do not see THCH's valuation accurately reflecting its growth potential in China's coffee market that we view as in the early stages of a generational shift in consumer preferences, and its entry into an established high growth market for fried chicken that has not seen a new entrant from an international brand in years. We think that robust growth trends, including improving store-level EBITDA growth, increases in food ordering and technology driven transactions under a rapidly expanding loyalty program, are all underappreciated by investors.

While the company has achieved robust revenue growth over the past few years, we note that it remains unprofitable due to investments in building its infrastructure, including its supply chain and technology systems, while incurring elevated costs from the rental of large-scale locations to help establish the Tims brand in China.

Over the next few years, we expect the company's growing operational footprint to shift towards franchising, which should significantly reduce its cost structure, while enhancing its profitability. We expect the company to add approximately 500 new locations over the next three years to achieve its target for more than 2,700 locations in 2026, most of which are expected to be franchised through established groups, and smaller in format, which should promote strong store launches in high traffic locations.

Moving forward, although we see revenue growth moderating due in part to the increased contribution of franchised locations compared with company owned locations, we expect operating margins to improve in lock-step, thus enabling the company to approach corporate-level EBITDA profitability in 2024. In addition, we expect improving cash flows to ease an overhang due to the company's balance sheet and working capital needs.

We value THCH in comparison to the leading coffee and fried chicken companies operating in China, and a basket of global restaurant companies. Starbucks (current EV/Revenue of 3.3-times on consensus 2024 revenues), Luckin Coffee (1.3-times) and Yum China (1.4-times), which averages 2.0-times as a group, and while

profitable, are likely to grow at a slower rate than THCH, in our view.

Thus, we apply a modest premium multiple of 2.50-times our 2024 revenue estimate of RMB 2.02 billion (\$283 million, at

current exchange rates), which is closer to the 2.6 multiple for a basket of global restaurant companies, and adjust for current net debt of approximately \$85 million to arrive at an EV/Revenue derived fair value of \$4.00 per share.

Steve Silver,  
Argus Research Analyst

**INCOME STATEMENT**

<b>Growth Analysis (MIL, RMB)</b>	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023E	2023E	Q1 2024E	Q2 2024E	Q3 2024E	Q4 2024E	2024E
Revenue	643.4	1011.1	336.5	411.7	436.4	455.2	1639.8	471.5	494.3	518.0	536.4	2020.2
Operating Costs	1020.7	1602.8					2214.4					2248.1
Operating Income	-377.3	-591.7					-574.6					-228.0
Other Expense	8.5	163.5					93.7					4.0
Pretax Income	-385.8	-755.2					-668.3					-232.0
Tax Rate (%)	NA	NA					NA					NA
Net Income	-384.6	-753.1					-671.7					-236.0
Weighted Diluted Shares	121.60	128.1					152.7					164.0
EPS (RMB)	-3.16	-5.90	-1.27	-1.52	-1.03	-0.63	-4.45	-0.47	-0.43	-0.31	-0.24	-1.45
EPS (USD)	-0.44	-0.83	-0.18	-0.21	-0.14	-0.09	-0.62	-0.07	-0.06	-0.04	-0.03	-0.20
Dividend	NA	NA					NA					NA
<b>Growth Rates (%)</b>												
Revenue	NA	57					62%					23%
Operating Income	NA	NM					NM					NM
Net Income	NA	NM					NM					NM
EPS	NA	NM					NM					NM
<b>Valuation Analysis</b>												
Price (\$): High	10.78	10.55					6.72					NA
Price (\$):Low	9.56	2.54					1.43					NA
PE: High	NA	NA					NA					NA
PE: Low	NA	NA					NA					NA
PS: High	NA	NA					NA					NA
PS: Low	NA	NA					NA					NA
Yield: High	NA	NA					NA					NA
Yield: Low	NA	NA					NA					NA
<b>Financial &amp; Risk Analysis (MIL, RMB)</b>												
Cash & Securities	395	614.9					NA					NA
Working Capital	18.7	-521.5					NA					NA
Current Ratio	1.0	0.6					NA					NA
LTDebt/Equity (%)	97.4	1072.6					NA					NA
Total Debt/Equity (%)	154.1	1605.9					NA					NA
<b>Ratio Analysis</b>												
Store Level Adjusted EBITDA	3.2%	-4.3%					6.5%					14.1%
Corporate Adjusted EBITDA	-29.5%	-31.4%					-14.8%					-1.6%
Adjusted EPS	-2.16	-3.57					-2.67					-1.22
Return on Assets (%)	NM	NM					NM					NM
Return on Equity (%)	NM	NM					NM					NM
Op Inc/Int Exp	NM	NM					NM					NM
Div Payout	NA	NA					NA					NA

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