

## LCI Industries (LCII) EQ Review

<u>Current EQ Rating*</u>	<u>Previous EQ Rating</u>
3+	NA

\*For an explanation of the EQ Review Rating scale, please refer to the end of this report

### **We initiate earnings quality coverage of LCII with a rating of 3+ (Minor Concern).**

This is a good example of a company that flags on several negative items such as growth through acquisition, cash flow insufficient to cover its dividend and share repurchases and working capital items related to inventories. On closer examination, many of these items can be explained, are one-time in nature, and may be about to improve. It is a company going through some transition to lessen its dependence on the RV and Fifth-Wheel Trailer business. We are assigning it a 3+ EQ rating initially.

The primary reasons for the 3+ rating is debt increased following a string of acquisitions and both the company and the auditor KPMG excluded the 2018 acquisitions from their assessments and evaluations of the company's internal control over financial reporting.

- Growth through Acquisition is part of the business model. LCI has completed 32 deals in the last 9 years and has seen one-third of growth come from acquisition, one-third from organic growth, and the rest due to the industry ups and downs. Many times acquisitions are red flags – in this case, we are not seeing many of the typical warning signs. (neutral)
- LCI is not overpaying for deals in our view. It is routinely paying a lower multiple of sales than LCI trades for and it is buying companies that are growing. The fact that

margins and the 20%+ ROI remain at historic levels after years of deals is a good sign that the deals are working. (positive)

- Deal structures are conservative. With only one exception in 2018, LCI is paying for deals with cash. It has not borrowed or issued stock to complete deals. Cash flow is covering both capital spending and acquisitions except in 2018 when both were elevated to invest in additional margin and growth areas. (neutral – with debt rising in 2018).
- Deals are also not being allocated mostly to goodwill. Most of these deals have 25%-50% going to goodwill and the rest as PP&E or intangibles that are amortized over time. The result should be a falling carrying value of these acquisitions. The lower value and the 22% ROI make it less likely to suffer an impairment. Moreover, LCI didn't do one major acquisition and is counting on cost-cutting and synergies to make it work. The large portfolio of acquisitions at low prices also reduces impairment risk. (positive)
- One Red Flag that remains – the auditor noted that management excluded 2018's acquisitions from its assessment of the effectiveness of internal controls. The auditor excluded that analysis too for 2018. The company has a lawsuit against a former president who left in late 2018 and had invested in an acquisition target company. (negative)
- Inventory Flag with DSI rising over 13 days in 4Q18 and 12 days in 3Q18 has some explanation. Inventory build-up is normal at the end of 4Q to serve the stronger quarters of customers in 1Q and 2Q. Rising raw material costs drove down margins and boosted inventory levels as well – running DSI on inflated period-end figures against the cost of goods sold that rose over the period – effectively makes the denominator lower and boosts DSI. LCI sees that situation as improving in 2019. Inventory doesn't spoil here and there are contracts that allow LCI to pass through more raw material cost increases. They could enter a period where sales rise and cost of goods flatten out more. FIFO accounting should also help in more mild inflation. (negative – we can see why the inventory jumped, but it still rose higher than raw material costs should have moved it alone)
- Cash flow and the dividend are flagging for 2018 as well. LCI saw cash flow headwinds from rising inventory and falling payables. It also was hurt by the margin squeeze from higher raw materials of over 200bp. That cut cash from operations to

\$157 million and it could bounce back above \$200 million before growth. Capital spending was unusually high in 2018 and is expected to decline by \$55 million. With those changes, the dividend coverage returns. (positive)

## Growth Through Acquisition Is Part of the Business Model

LCI has continually bought up smaller companies to add to sales, boost its market share, and diversify into new areas for sales. It has made 32 deals between 2010-2018. In looking at total sales growth from 2013-2019, which rose from \$1.0 billion to \$2.5 billion – acquisitions accounted for one-third of that growth. The split is \$480 million from deals, \$510 million from organic growth (taking market share and pricing), and the remaining \$470 million from higher industry sales of RV's and Trailers.

We will discuss some of the cyclicity of the industry later in this report, but the company reports that acquisitions completed in 2018 were 10.8% of the reported 15.3% total sales gains:

	2018	2017	2016
Total Sales Growth	\$328.0	\$468.9	\$272.8
Sales Growth %	15.3%	27.9%	19.7%
Acquisitions %	10.8%	2.5%	4.6%

This understates the impact of acquisitions as it only reports sales gains achieved in the year of acquisition. In 2018, there were deals completed in June and November. In 2017, there were deals in May and June. That means total acquisitions reflected partial years and were not called out as acquisition-related in the next year.

A big reason behind the many acquisitions is to add new products to existing divisions and expand into areas beyond RV's and Trailers. To be sure, there are products that were at LCI that are expanding their distribution without acquisition. For example, they have built mattresses for RV's and Fifth Wheel Trailers for years and now are selling them also for dorm rooms. That would be driving adjacent industry sales growth organically. Or, an innovation could push pricing up with a new edition of an existing trailer accessory and that would show up in higher content per unit. But, we do think acquisitions also would be a heavy influence on content per unit sales growth and adjacent industry sales growth:

Fifth Wheels	2018	2017	2016
% Total LCI Sales	58%	65%	66%
Sales Growth	2.5%	27.8%	17.2%
Content per Unit Growth	5.7%	8.0%	1.2%

In 2018, higher sales per vehicle outpaced total sales. That was due to negative industry unit growth. In 2017, the content figure rose much higher than the acquisition growth figure in the prior table.

Motorhome Sales	2018	2017	2016
% Total LCI Sales	8%	7%	7%
Sales Growth	17.5%	37.2%	34.3%
Content per Unit Growth	12.3%	10.3%	n/a

Adjacent Ind.	2018	2017	2016
% Total LCI Sales	25%	19%	20%
Adjacent Sales Growth	49.5%	23.9%	20.8%

The Motorhomes and Adjacent Industries are smaller parts of the total company, but both are seeing much higher growth than the overall company. We can see content per unit for RVs looks larger than what the gross acquisition figure supports in the first figure. We think that is due to the timing of deals.

Clearly, this is a part of the company's business model and it believes it can continue to make more deals and boost market share. The goal is also to reduce reliance on the Fifth Wheel and RV market to 40% of sales from 63% last year and nearly 90% a few years ago. Given the heavy cyclical in that industry, that may be a positive. There actually are not too many red flags here.

## It Does Not Appear that LCI Is Overpaying for Acquisitions

Many of the deals are small private firms that LCI is buying. LCI gives very good detail on price paid and trailing sales figures. However, it does not disclose EBITDA or operating margins. Given that the businesses being acquired are very similar to LCI's business model – making parts for installation in motor homes, towable fifth-wheels, other trailers for boats, modular homes, etc. we think price to sales may be a reasonable multiple to look at. LCI is trading for 0.9x sales. With only two exceptions, the last several deals were all done at or below that level:

Acquired Company	Date	Price	Sales	Multiple
Taylor Made	Jan 18	\$90.4	\$150	0.6
Hehr Intl.	Feb 18	\$51.5	\$55	0.9
STLA S.r.l.	Jun 18	\$14.9	\$21	0.7
Smoker Craft	Nov 18	\$28.1	\$35	0.8
SessaKlein	Feb 17	\$6.5	\$11	0.6
Lexington	May 17	\$40.1	\$60	0.7
Metallarte	Jun 17	\$13.5	\$12	1.1
Highwater	Jan 16	\$10.0	\$35	0.3
Flair Interiors	Feb 16	\$8.1	\$25	0.3
Project 2000	May 16	\$16.6	\$10	1.7
Atwood Mobile	Nov 16	\$12.5	\$30	0.4

Many of these deals would be accretive to LCI's valuation even if sales stayed flat simply giving the sales LCI's multiple of 0.9x. The customer list is fairly small for some of these products and we think a company like Thor would have more confidence relying on a larger supplier such as LCI to produce more of its parts than a smaller supplier. Simply adding that smaller supplier to LCI may help boost sales of the acquired product line. We think that is where some of LCI's growing content per unit comes from but is not fully showing up when LCI simply calls out sales from acquisitions from date of purchase to year end for the first few months of ownership. The company called out an example of this on the 4Q18 call noting that sales of Taylor Made are now up to about \$170 million annual run-rate.

The idea that LCI is not overpaying or buying much lower margin businesses is supported by margins and ROI not eroding. If they were adding many 3% margin businesses to a base of 8% margin – there should be solid evidence of decay and there is not:

	2018	2017	2016	2015	2014	2013
LCI Op. Margin	8.0%	10.0%	12.0%	8.3%	8.0%	7.7%
Return on Avg. Cap.	22.0%	34.0%	41.0%	25.0%	26.0%	28.0%

This is still a heavily cyclical industry and 2016 saw a surge in RV unit sales of 15% combined with lower steel and aluminum costs. That allowed LCI to run factories at higher utilization rates over fixed costs, take pricing and enjoy lower costs. Every 100bp of higher margin added 3.5% to ROI. We would argue that the 41% ROI figure was carried above 30% by these short-lived tailwinds. In 2017, unit sales remained strong up 18%, but higher steel and aluminum cut ROI by 700bp from 2016. In 2018, the industry saw a -3% change in units sold in the industry and higher raw materials and LCI still posted a 22% ROI. We

would argue that long-term ROI here is above 20% and margins adjusted for raw materials are closer to 9%.

We would need to see a trend in paying multiples higher than LCI as a whole to have a red flag on the company's acquisition strategy. Moreover, we would need to see a trend that the acquisitions are diluting margins and ROI. If over time, LCI can make several deals in a cyclical industry, grow market share, grow sales, and base ROI is still above 20%, it's tough to knock that.

## Deal Structures Are Conservative Too

First, LCI is paying for the bulk of deals out of operating cash flow and not diluting shareholders or issuing significant debt.

	2018	2017	2016	2015	2014
Operating Cash Flow	\$156.6	\$152.7	\$201.7	\$95.0	\$107.0
Capital Spending	\$119.8	\$87.2	\$44.7	\$29.0	\$42.5
Acquisitions	\$184.8	\$60.6	\$48.7	\$41.1	\$106.8
Free Cash Flow	-\$148.0	\$4.9	\$108.3	\$24.9	-\$42.3
Total Debt	\$294.1	\$49.9	\$49.9	\$50.0	\$15.7
Shares Outstanding	25.5	25.4	24.9	24.7	24.3

In 2018, the Taylor Made deal was \$90 million. That was much larger than what LCI had been buying and the cash cost exceeded the cash from operations, and it raised borrowing. Given that the multiple paid was only 0.6x and the company has already grown sales there significantly, this is not a red flag in our view. Moreover, it still did not dilute shareholders and debt to EBITDA is now only 1.1x. We would also expect that cash flow going forward should improve.

The company has been investing more heavily on capital spending to install more automation in production lines. The goal is to use less labor, have the ability to stop and start production more easily in response to changing order rates, and further integrate the acquisitions. 2018 included \$25 million in spending for that area and \$50 million in new capacity. In 2019, capital spending is expected to return to more normal levels and come in about \$65 million. That's \$55 million in improved cash flow right there.

Also, working capital was a sizeable headwind in 2018. We would expect a company showing growing volumes to have a rising working capital investment that consumes cash

flow. However, 2018 saw RV unit sales decline 3% vs. up 18% in 2017 and up 15% in 2016. We'll discuss this more with inventory issues, but look at the headwind to cash flow from working capital:

	2018	2017	2016	2015	2014
Operating Cash Flow	\$156.6	\$152.7	\$201.7	\$95.0	\$107.0
Working Capital Chg.	-\$87.4	-\$66.2	-\$11.4	-\$37.4	\$4.1

Even before growth, having some negative lag related to working capital catch up and the lower capital spending, 2019 may see a \$90-\$100 million positive swing in free cash flow. That should make funding any 2019 deals reflect the company's normal method of paying for deals from current cash flow.

**We would be concerned if debt to EBITDA rose above 2x. We do think the company will see EBITDA increase and perhaps even pay down debt to reduce the current 1.1x ratio.**

LCI is also not putting all the value of acquisitions to unamortizing goodwill:

	Price	PP&E	Other Intg	Goodwill	GW %
Taylor Made	\$90.4	\$45.3	\$22.7	\$22.4	24.8%
Hehr Intl.	\$51.5	\$12.0	\$21.5	\$18.0	35.0%
STLA S.r.l.	\$14.9	\$0.3	\$7.0	\$7.5	50.3%
Smoker Craft	\$28.1	\$1.4	\$18.5	\$8.2	29.2%
SessaKlein	\$6.5	\$0.4	\$2.3	\$7.7	118.5%
Lexington	\$40.1	\$4.9	\$18.7	\$16.4	40.9%
Metallarte	\$13.5	\$0.0	\$8.9	\$6.9	51.1%
Highwater	\$10.0	\$1.3	\$8.1	\$0.6	6.0%
Flair Interiors	\$8.1	\$2.4	\$3.7	\$2.0	24.7%
Project 2000	\$16.6	\$0.0	\$12.4	\$5.6	33.7%
Atwood Mobile	\$12.5	\$10.9	\$1.5	\$0.0	0.0%

The PP&E is being depreciated. The other intangible assets are largely customer relationships being amortized over 15 years and patents being amortized over 3-19 years. With the exception of the very small SessaKlein deal, generally only 25%-50% of these acquisitions have been assigned to goodwill with assets that amortize being larger than the goodwill figure.

The company reviews goodwill and intangibles for impairment. We believe when PP&E will be depreciated and intangibles amortized the lower carrying value of the acquisition makes an impairment less likely going forward. That is especially true when a smaller percentage of the total deal was assigned to goodwill in the first place. It is also true when the price paid was not a premium to the acquiring company's valuation and the ROI is above 20%.

So, while LCI flags on screens for being a growth through acquisition story which normally entails many red flags – LCI has avoided the bulk of those traditional negatives. It is paying low prices for deals. The companies being acquired are similar to LCI's focus and are growing. LCI is not wrecking the balance sheet to make deals and is not diluting shareholders. The acquisitions are not hurting margins or ROI. LCI is buying many small deals rather than one big one that is often the case in growth through acquisition so the risk of any one deal is also small. It is not buying companies that need a new product line, new staff, or other large transformations. LCI also has a history of producing as much organic growth as it does acquired growth. So, it is not masking decay in the base business with deals.

We have one potential red flag – internal controls over recent deals:

## Both LCI and Auditor Singled Out Internal Control Measures on Recent Deals as Areas Not under Full Scope of Examinations

From the 2018 Auditor Report:

*“The Company acquired Taylor Made Group, LLC (“Taylor Made”), Hehr International Inc. (“Hehr”), ST.LA. S.r.l. (“STLA”), and Smoker Craft Inc. (“Smoker Craft”) during 2018, and management excluded from its assessment of the effectiveness of the Company’s internal control over financial reporting as of December 31, 2018, the acquired companies’ internal control over financial reporting associated with total assets of \$190.5 million and total revenues of \$211.2 million included in the consolidated financial statements of the Company as of and for the year ended December 31, 2018. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of Taylor Made, Hehr, STLA, and Smoker Craft.”*

The prior year did not include similar language about excluding recent acquisitions from the review and evaluation of internal controls.



Also, the former President Scott Mereness left LCI in late 2018 after 24 years. He is now being sued by LCI as of January 2019. The company disclosed that:

*“The Complaint alleges that Mereness used LCI’s confidential information to usurp a corporate opportunity. The suit claims Mereness, after actively pursuing an acquisition target on behalf of LCI as an LCI employee, personally invested in the target company for his own benefit.”*

We have no further information to comment, but the statement about internal controls on 2018 acquisitions and a lawsuit against a former executive who invested in a target company may be related.

## LCI Also Flags on Inventory Levels, Which Ripples Throughout the Financial Statements

In 2018, Days Sales Inventory jumped noticeably.

DSI	4Q	3Q	2Q	1Q
2018	71.5	62.0	55.2	57.8
2017	58.1	48.2	44.3	45.9
2016	56.3	47.8	41.9	47.8

At the same time, sales growth slowed:

Y/Y Sales Chg.	4Q	3Q	2Q	1Q
2018	-1.9%	8.9%	25.0%	30.5%
2017	35.8%	34.5%	24.2%	17.9%

We noted earlier that the sales of fifth-wheels and motor homes are 66% of sales at LCI and unit growth in the industry slowed from 18% to -3% from 2017 to 2018. That clearly accounts for some of the inventory surge. However, sales for RVs are seasonally focused on 1Q and 2Q. As a result, LCI normally carries higher inventory in 4Q to serve the forward demand.

One of the issues investors have to be willing to accept in owning LCI is it can see larger swings in sales because it has two channels that get filled. It sells to the RV maker, who in turn sells to dealers, who in turn sell to retail customers. If retail is strong, the dealers

boost inventories, the RV maker sees higher future sales and buys more inventory from LCI. But, that works in reverse also. If retail falters, the dealers buy less and work down inventories. That lack of orders from dealers causes the RV maker to work off its own inventories. The result is LCI can see a more pronounced move up or down based on this multiplier effect. It grows faster than the industry in up times and falls faster than the industry in down times. It feels the impact first and gets the impact of recovery last as the two channels in front of it work with their own inventories. This is why LCI is making acquisitions to diversify away from this market being 90% of its business a few years ago vs. 66% now and ultimately the goal is 40%. It is also why it seeks to use acquisitions to add more content per RV. Thus, if the market declines 10% but LCI goes from selling \$2,000 per unit to \$2,500 per unit – that also shaves some of the pain of the down cycle off.

The 71.5 DSI is a red flag. It is up over 13 days and unit sales growth of 18% seems unlikely after two very strong years in 2016 and 2017 and only a minor decline in 2018. However, there are some mitigating issues that may point to results improving despite the high inventory figure.

First, the company's raw materials are 45% steel and 15% aluminum. Prices were volatile in 2016, but steel prices fell that year. In 2017, both steel and aluminum were up in price. In 2018, those costs rose further even though sales growth started to drop. This is the largest area called out for recent margin pressure:

**February 2019 conference call:**

*“The good news is that steel and aluminum prices seem to be leveling off and even falling in places over the last couple of months. As a result, we believe some of these commodity headwinds should start to turn into tailwinds in Q2 and should put us in a much less constrained position with respect to raw material pressure on margins.”*

**In the 2018 commentary on results:**

“The cost of aluminum and steel used in certain of the Company's manufactured components increased throughout 2018 from lows in 2016 and 2015, having a large impact on operating profits. Raw material costs continue to fluctuate and are expected to remain volatile.” The company called the impact for 2018 as 220bp on operating margins.

**In the 2017 commentary on results:**

*“The cost of aluminum and steel used in certain of the Company’s manufactured components increased throughout 2017 from recent lows in 2016 and 2015. Raw material costs continue to fluctuate and are expected to remain volatile.”*

Gross Margin was clearly helped and then hurt by these moves in raw materials:

Gross Margin	4Q	3Q	2Q	1Q
2018	19.2%	20.8%	22.0%	21.6%
2017	21.3%	21.8%	23.9%	24.9%
2016	24.3%	25.6%	26.5%	25.6%

The company believes 150bp in 4Q18 was due to higher raw material costs and 100bp of 3Q18 from the same. However, IF the rate of increase is leveling off, margin could bounce back. LCI has some contracts that allow it to push through cost increases in raw materials and other contracts can get some pricing adjustment on a 6-18 month lag:

From the 10-K:

*“The Company has several supply agreements or other arrangements with certain of its customers that provide for prices of various products to be fixed for periods generally not in excess of eighteen months; however, in certain cases the Company has the right to renegotiate the prices on sixty-days’ notice. The Company has agreements with certain customers that indexes their pricing to select commodities.”*

In addition, LCI uses FIFO accounting. As the rate of increase stalls and it takes pricing – the inventory moving through behind that will be of lower cost steel. The company believes it could see 200-300bp of gross margin improvement in 1Q19 and 2Q19 as it recovers some of the lost margin from 2018.

Essentially, with inflation, FIFO should help margins. With rapid inflation and FIFO, pricing may not be able to adjust rapidly enough to offset the margin squeeze, but it should catch up eventually. In deflation, FIFO poses a problem as pricing is more likely to fall sooner rather than later and the inventory that rolls through will be of higher cost. Right now, LCI seems to be catching up from rapid inflation.

Also, keep in mind that inventory at LCI does not spoil nor is it a warehouses of winter coats as summer approaches. It has a few very large customers who are actually having LCI

provide more content to its products. For example, \$850 million (31%) of LCI's sales are to Thor Industries who had \$6.2 billion in Cost of Goods Sold for 12 months ended in January 2019. LCI is a big part of Thor's business and it's not selling them a commodity they can get from many other places in quantity. It is possible LCI gets some push-back on pricing but it seems unlikely that incremental inventory will need to be sold for 30-cents on the dollar to lower the inventory investment at LCI.

Our conclusion on the inventory red-flag is it is not as severe as it would be at other companies. The DSI is up 13.5 days y/y. We estimate that 3-4 days of that is due to the ending inventory representing higher priced raw materials than that the cost of goods sold represents during a period of rising costs. That still leaves 9-10 days growth and part of that was due to orders coming in weaker than forecast and LCI adjusted production down. Thus, some of that will be worked off in the seasonally stronger 1Q. Also, guidance is for the lagging impact of pricing vs. cost increases to take hold in 1Q and 2Q so the company does not appear to be marking product down. In fact, it is forecasting that margins will recover.

## Cash Flow and Dividend

LCI also flags on its dividend and with good reason – it spends heavily on acquisitions and leaves less Free Cash Flow for the dividend:

	2018	2017	2016	2015	2014
Operating Cash Flow	\$156.6	\$152.7	\$201.7	\$95.0	\$107.0
Capital Spending	\$119.8	\$87.2	\$44.7	\$29.0	\$42.5
Acquisitions	<u>\$184.8</u>	<u>\$60.6</u>	<u>\$48.7</u>	<u>\$41.1</u>	<u>\$106.8</u>
Free Cash Flow	-\$148.0	\$4.9	\$108.3	\$24.9	-\$42.3
Dividend	\$59.3	\$51.1	\$34.4	\$48.2	\$46.7

We have discussed that operating margins are down due to rising raw materials prices and that is expected to result in better pricing in 2019 and costs are leveling off. The company also believes its automation investments will pay off with better margins as well. Every 100bp of improved gross margin is about \$20 million in cash flow.

We noted that that working capital was a significant headwind in 2018 too with inventories increasing while payables and accrued expenses actually declined. We believe that working capital overall could grow in 2019, but those two headwinds may reverse. Together, they

were \$58.3 million of the \$87.4 million headwind in working capital. Another \$20 million of cash flow relief may not be a stretch.

The company expects to be able to leverage SG&A also with other growth that comes through in 2019. It seems like Cash from Operations could rise to \$200 million before growth or additional acquisitions. LCI already said that the high level of capital spending would retreat to under \$65 million. That would leave \$135 million to cover the dividend and acquisitions. If LCI completes a historically normal level of acquisitions in the \$50-\$60 million range, then the dividend is covered.

## Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recent reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

### Key Points to Understand About the EQ Score

**The EQ Review Rating is much more than a blind, quantitative scoring method.** While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

**The EQ Review Rating is not comparable to a traditional buy/sell rating.** The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

## Disclosure

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