



## COMPANY UPDATE / ESTIMATE CHANGE / TARGET CHANGE

### Key Metrics

AAPL - NASDAQ - as of	9/12/17	\$160.86
Price Target		\$182.00
52-Week Range	\$104.08 -	\$164.94
Diluted Shares Outstanding (mil.)		5165.2
Market Cap. (\$mm)		\$830,878.6
1-Mo. Average Daily Volume		29,422,763
Institutional Ownership		63%
Debt/Total Capital (net)	FQ3'17	0%
ROE		36.0%
Book Value / Share	FQ3'17	\$25.49
Price / Book Value		6.3x
Indicated Dividend / Yield	\$2.52	1.6%
LTM EBITDA Margin		31.0%

### GAAP EPS FY 9/30

	Prior	Current		Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$3.28	\$3.36	A	\$3.72	\$3.74
2Q	\$1.90	\$2.10	A	\$2.55	\$2.57
3Q	\$1.42	\$1.67	A	\$1.99	\$1.98
4Q	\$1.67	\$1.97	\$1.95	\$2.18	\$2.19
Year	\$8.27	\$9.09	\$9.07	\$10.45	\$10.48
P/E	19.5x	17.7x			15.3x

### Revenue (\$BN)

	Prior	Current		Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$75.8	\$78.3	A	\$83.4	\$84.6
2Q	\$50.5	\$52.9	A	\$61.6	\$62.3
3Q	\$42.3	\$45.4	A	\$51.4	\$51.4
4Q	\$46.9	\$52.2	\$51.8	\$54.9	\$55.9
Year	\$215.6	\$228.8	\$228.5	\$251.5	\$254.3

**Company Description:** Apple Inc. designs, manufactures and markets hardware including the Mac, iPhone, iPad, iPod, Apple Watch, TV and Beats headphones. Apple also develops software, the Mac OS X operating system and the iOS mobile operating system, along with other consumer and professional software applications and services including Maps and Apple Pay. Third-party digital content is sold through iTunes and the App Store. The company sells its products globally through Apple retail stores, an online store and other traditional retail chains. The company is headquartered in Cupertino, California.

## Technology

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## Apple Inc.

### AAPL - NASDAQ – Long term Buy -1 Apple Product Launch Highlights

- Highlights.** Yesterday, Apple introduced the iPhone 8, 8 Plus, and the iPhone X (10). The iPhone 8 and 8 Plus will be priced starting at the typical \$699 and \$799 price points and go on sale as customary on Sept. 22. The iPhone X will retail starting at \$999, in line with our prior view. Its launch date was set for Nov. 3, a few weeks later than our initial forecast. Apple also launched the Apple Watch Series 3 featuring LTE connectivity running new WatchOS 4 software. The Series 3 Watch will start selling at \$399 which is positive and much lower than our initial expectation, while high end Edition models will escalate in price to \$1,399. Apple also launched a 4K HDR Apple TV that will go on sale Sept. 22 and a wireless charging mat dubbed, AirPower, with an expected availability date early next year. Apple will release iOS 11 to all Apple users on Sept. 19. Much of what Apple announced yesterday was in line with our expectations.
- Guidance.** Apple's initial fiscal Q4 guidance was maintained and notably excludes sales of the iPhone X.
- Outlook.** We make some slight adjustments to our outlook. Our FQ4'17 EPS estimate decreases to \$1.95 from \$1.97 on gross margin conservatism vs. our prior view. In parallel, our FY'17 EPS estimate is adjusted to \$9.07 from \$9.09. We make more meaningful adjustments to our FY'18 & '19 outlooks. Our FY'18 EPS estimate increases to \$10.48 from \$10.45, while our FY'19 EPS forecast increases to \$11.39 from \$11.25. Our updated outlook assumes higher average selling prices for iPhones and the Apple Watch through our investment timeframe, which we offset to a degree with some gross margin conservatism due to new product launch constraints. We also note the U.S. Dollar Index has declined 10% year-to-date which has the potential to boost overseas demand.
- Opinion.** We increase our FYE'19 price target to \$182 from \$180 and maintain our Long-term Buy rating.

**Note Important Disclosures on Pages 7-8  
Note Analyst Certification on Page 7**

**ADDITIONAL DISCUSSION**

Much of what Apple announced yesterday was in line with our expectations. The company introduced the iPhone 8, 8 Plus, and the iPhone X (10). The iPhone 8 and 8 Plus models have a similar design as the iPhone 7, while the iPhone X features an edge-to-edge OLED display. While the iPhone X is similar in size to the iPhone 8, its display is larger at 5.8 inches compared to Plus models at 5.4. The iPhone X features Face ID vs. Touch ID while doing away with the home button altogether allowing for the larger display. The OLED display has richer color quality and improves battery life by over 2 hours per charge. We believe the average consumer may find the facial scanning technology disturbing, an issue Google has dealt with on numerous occasions. We also note Face ID failed during the presentation. The new phone lineup will include a retro glass back and include wireless charging, new camera array, and run the new iOS 11 operating system. Apple updated its CPU to the A11 Bionic chip, a 6 core CPU and included an Apple designed GPU that is 30% faster, designed for running Metal 2, machine learning processes, and augmented reality apps. Augmented reality features were showcased with animojis and new game play which we expect to become a significant boost to Apple's services revenue and potentially lead to new hardware devices.

The iPhone 8 and 8 Plus will go on sale as usual on Sept. 22. The iPhone X will retail for \$999, while the launch date was pushed back to Nov. 3<sup>rd</sup> which could weigh on initial iPhone demand as consumers will want to experience the new device before they decide which version they prefer, in our opinion. We also believe Apple may have a supply/demand issue depending on consumer demand with the addition of a new line of phones.

Apple also launched the Apple Watch Series 3 featuring faster processors and LTE connectivity running new WatchOS 4 software. The Watch will sell for \$399 which is positive and much lower than our initial expectation. Apple also launched a 4K HDR Apple TV that will go on sale Sept. 22 and a wireless charging mat dubbed, AirPower, with expected availability early next year. Overall, we believe it was a positive event that should continue Apple's multi-year success going forward.

**OUTLOOK**

Apple's prior guidance, listed below, was noted to exclude iPhone X.

- Revenue between \$49 billion and \$52 billion
- Gross margin between 37.5% and 38%
- Operating expenses between \$6.7 billion and \$6.8 billion
- Other income of \$500 million
- Tax rate of 25.5%

We expect the Nov. 3 launch date to have a limited impact on current quarter results, however we expect it to negatively impact our fiscal Q1 estimates as consumers wait to examine the new iPhone X before deciding which phone to purchase, potentially causing a supply/demand issue in the first month of the holiday quarter. We are also concerned initial supply may be constrained for the holiday season or a mismatch in supply and demand among iPhone models could create a double negative hit to results. Having listed several of our concerns, we believe many consumers will choose to upgrade to the higher priced iPhone X, especially considering the interest free and low initial cash outlay iPhone upgrade program many consumers are adopting. We also expect carriers and retailers to offer discounts to lure in shoppers. Lastly, we note the U.S. Dollar Index has decreased 10% year-to-date which to international consumers is a significant price cut and may boost demand over last holiday season.

We lower our FQ4'17 EPS estimate to \$1.95 from \$1.97 on gross margin conservatism. In parallel, our FY'17 EPS estimate is adjusted to \$9.07 from \$9.09. We make more meaningful adjustments to our FY'18

revenue estimate of \$254.3 billion vs. \$251.5 billion and our EPS estimate which increases to \$10.48 from \$10.45. Our FY'19 EPS forecast increases to \$11.39 vs. \$11.25. Broadly, our updated outlook assumes higher average selling prices for iPhones and the Apple Watch, which we offset to a degree with some gross margin conservatism due to new product launch constraints.

## VALUATION & OPINION

**We increase our FYE'19 price target to \$182 from \$180 and reiterate our Long-term Buy rating.** Our updated price target reflects adjustments made to our fiscal 2019 EPS estimate. We maintain our forward P/E multiple of 16x despite our expectation that EPS will rise 36% through FY'19 vs. '16. This is currently being anticipated by the market, in our opinion, as AAPL shares currently trade at nearly an 18x forward multiple. Our 16x forward multiple reflects a full business cycle, encompassing full cycle growth, not the current peak iPhone super cycle earnings expansion. We believe our price target is a conservative valuation as we do not include Apple's cash balance of \$261.5 billion, which could ultimately be repatriated at a lower tax rate to further boost our growth outlook. We believe AAPL shares remain a core holding for investors seeking capital appreciation and a growing income stream. We expect AAPL shares to be volatile in coming days, weeks, and months depending on initial supply constraints and/or if consumers overwhelmingly choose one phone model over others, which may differ from what Apple is currently anticipating.

## SUITABILITY

We assign shares of AAPL a suitability rating of 1 on our scale of 1-4 (1 = most conservative, 4 = most aggressive). Our rating is based on Apple's long and reputable history as a public consumer electronics company. While a majority of revenue is derived solely from iPhone sales, we believe Apple has the ability to expand its services offering and continue to introduce new products over time. We also take into consideration the company's large cash balance and significant free cash flow generating ability. We believe a suitability rating of 1 incorporates these attributes. We believe AAPL shares remain a core holding for investors seeking capital appreciation and a growing income stream.

## RISKS & CONSIDERATIONS

Risks to our valuation include but are not limited to:

- Uncertainty regarding potential court proceedings with Qualcomm, which could produce unintended consequences.
- Potential health risks, including brain cancer, caused by wireless device usage. Apple recommends users carry iPhones at least 5 millimeters away from the body. Regulators may begin to require a warning vs. the current recommendation, which could impact future sales.
- Management's ability to secure and retain top talent
- Possible risks from changes in the smartphone selling model.
- Piracy issues: Apple's ability to protect intellectual property rights against global competitors, including software and brand piracy
- Macroeconomic issues, including higher future international tax rates or tariffs, a decline in consumer spending, or changes in consumer behavior/willingness to continue purchasing devices rather than fully functional PCs
- Lack of innovation due to a "closed-ecosystem" versus competitors' "open-ecosystem" architecture
- The risk of excessive spending due to rapid technological advances. Apple must ensure a timely flow of competitive products and services to compete
- Increased competition from global competitors, particularly low cost Asian manufacturers
- The International Trade Commission's ability to ensure Apple's patents, trademarks, copyrights and licenses are enforced and upheld. Continued legal disputes involving patent infringement

lawsuits and federal government inquiries into anti-competitive business practices, health and environmental concerns

- Component shortages or pricing risk due to single source availability. Also, future supply disruptions resulting from situations involving natural disaster, geopolitical events, etc.
- A large percentage of future growth expectations tied to emerging market economies which may choose to block certain products or services
- Internally generated product growth outside of the iPhone business could take a significant amount of time to ramp into a meaningful contribution to revenue whether a hardware or service related offering.

*Additional information is available upon request.*

Apple Inc. - Consolidated Statement of Operations (in millions except per share data and percentages)

	FY'07	FY'08	FY'09	FY'10	FY'11	FY'12	FY'13	FY'14	FY'15	FY'16	12/31/2016	3/31/2017	6/30/2017	09/30/2017E	FY'17E	FY'18E	FY'19E
Net Sales	\$ 24,006	\$ 37,491	\$ 42,905	\$ 65,225	\$ 108,249	\$ 156,508	\$ 170,910	\$ 182,795	\$ 233,715	\$ 215,639	\$ 78,351	\$ 52,896	\$ 45,408	\$ 51,795	\$ 228,450	\$ 254,298	\$ 261,227
Cost of Sales	15,852	24,294	25,683	39,541	64,431	87,846	106,606	112,258	140,089	131,376	48,175	32,305	27,920	32,165	140,565	156,708	160,010
Gross Profit	8,154.00	13,197	17,222	25,684	43,818	68,662	64,304	70,537	93,626	84,263	30,176	20,591	17,488	19,630	87,885	97,589	101,218
<b>Operating expenses:</b>																	
Research and Development	782	1,109	1,333	1,782	2,429	3,381	4,475	6,041	8,067	10,045	2,871	2,776	2,937	2,926	11,510	12,277	12,578
Selling, general and admin.	2,963	3,761	4,149	5,517	7,599	10,040	10,830	11,993	14,329	14,194	3,946	3,718	3,783	3,786	15,233	16,800	17,133
Total operating expenses	3,745	4,870	5,482	7,299	10,028	13,421	15,305	18,034	22,396	24,239	6,817	6,494	6,720	6,713	26,744	29,077	29,711
Operating income	4,409	8,327	11,740	18,385	33,790	55,241	48,999	52,503	71,230	60,024	23,359	14,097	10,768	12,918	61,142	68,512	71,506
Other income and expense	599	620	326	155	415	522	1,156	980	1,285	1,348	821	587	540	585	2,533	2,375	2,750
Income before provision for income taxes	5,008	8,947	12,066	18,540	34,205	55,763	50,155	53,483	72,515	61,372	24,180	14,684	11,308	13,503	63,675	70,887	74,256
Provision for income taxes	1,512	2,828	3,831	4,527	8,283	14,030	13,118	13,973	19,121	15,685	6,289	3,655	2,591	3,416	15,951	17,722	18,564
Net Income	\$ 3,496	\$ 6,119	\$ 8,235	\$ 14,013	\$ 25,922	\$ 41,733	\$ 37,037	\$ 39,510	\$ 53,394	\$ 45,687	\$ 17,891	\$ 11,029	\$ 8,717	\$ 10,086	\$ 47,723	\$ 53,165	\$ 55,692
Dividends						\$ 0.38	\$ 1.63	\$ 1.81	\$ 1.98	\$ 2.18	\$ 0.57	\$ 0.57	\$ 0.63	\$ 0.63	\$ 2.40	\$ 2.66	\$ 2.88
<b>GAAP Earnings per share:</b>																	
Diluted	\$ 0.56	\$ 0.97	\$ 1.30	\$ 2.16	\$ 3.95	\$ 6.31	\$ 5.68	\$ 6.43	\$ 9.20	\$ 8.27	\$ 3.36	\$ 2.10	\$ 1.67	\$ 1.95	\$ 9.07	\$ 10.48	\$ 11.39
<b>Shares outstanding:</b> (in millions)																	
Diluted	6,225	6,315	6,349	6,473	6,557	6,617	6,522	6,145	5,805	5,500	5,328	5,262	5,233	5,167	5,247	5,062	4,881
<b>Year/Year Growth Rate:</b>																	
Net Sales	24.3%	56.2%	14.4%	52.0%	66.0%	44.6%	9.2%	7.0%	27.9%	-7.7%	3.3%	4.6%	7.2%	10.6%	5.9%	11.3%	2.7%
Gross Profit	45.7%	61.8%	30.5%	49.1%	70.6%	56.7%	-6.3%	9.7%	32.7%	-10.0%	-0.8%	3.4%	8.6%	10.2%	4.3%	11.0%	3.7%
Operating Income	79.7%	88.9%	41.0%	56.6%	83.8%	63.5%	-11.3%	7.2%	35.7%	-15.7%	-3.4%	0.8%	6.6%	9.8%	1.9%	12.1%	4.4%
Net Income	75.8%	75.0%	34.6%	70.2%	85.0%	61.0%	-11.3%	6.7%	35.1%	-14.4%	-2.6%	4.9%	11.8%	11.9%	4.5%	11.4%	4.8%
EPS			33.9%	66.9%	82.6%	59.5%	-9.9%	13.2%	43.1%	-10.1%	2.3%	10.4%	16.9%	16.8%	9.7%	15.5%	8.7%
Diluted Shares Outstanding	1.34%	1.44%	0.5%	2.0%	1.3%	0.9%	-1.4%	-5.8%	-5.5%	-5.2%	-4.8%	-5.0%	-4.4%	-4.2%	-4.6%	-3.5%	-3.6%
<b>% of Net Sales:</b>																	
Cost of sales	66.0%	64.8%	59.9%	60.6%	59.5%	56.1%	62.4%	61.4%	59.9%	60.9%	61.5%	61.1%	61.5%	62.1%	61.5%	61.6%	61.3%
Gross Profit	34.0%	35.2%	40.1%	39.4%	40.5%	43.9%	37.6%	38.6%	40.1%	39.1%	38.5%	38.9%	38.5%	37.9%	38.5%	38.4%	38.7%
R&D expense	3.3%	3.0%	3.1%	2.7%	2.2%	2.2%	2.6%	3.3%	3.5%	4.7%	3.7%	5.2%	6.5%	5.7%	5.0%	4.8%	4.8%
SG&A expense	12.3%	10.0%	9.7%	8.5%	7.0%	6.4%	6.3%	6.6%	6.1%	6.6%	5.0%	7.0%	8.3%	6.7%	6.6%	6.6%	6.8%
Total operating expense	15.6%	13.0%	12.8%	11.2%	9.3%	8.6%	9.0%	9.9%	9.6%	11.2%	8.7%	12.3%	14.8%	13.0%	11.7%	11.4%	11.4%
Operating Income	18.4%	22.2%	27.4%	28.2%	31.2%	35.3%	28.7%	28.7%	30.5%	27.8%	29.8%	26.7%	23.7%	24.9%	26.8%	26.9%	27.4%
Net Income	14.6%	16.3%	19.2%	21.5%	23.9%	26.7%	21.7%	21.6%	22.8%	21.2%	22.8%	20.9%	19.2%	19.5%	20.9%	20.9%	21.3%

Source: Company reports and Hilliard Lyons estimates

## Apple Inc. - Consolidated Balance Sheet (in millions except per share data and percentages)

	FY'06	FY'07	FY'08	FY'09	FY'10	FY'11	FY'12	FY'13	FY'14	FY'15	FY'16	12/31/2016	3/31/2017	6/30/2017
<b>Current assets:</b>														
Cash and Cash Equivalents	\$ 6,392	\$ 9,352	\$ 11,875	\$ 5,263	\$ 11,261	\$ 9,815	\$ 10,746	\$ 14,259	\$ 13,844	\$ 21,120	\$ 20,484	\$ 16,371	\$ 15,157	\$ 18,571
Short-Term Marketable Securities	3,718	6,034	10,236	18,201	14,359	16,137	18,383	26,287	11,233	20,481	46,671	44,081	51,944	58,188
Accounts receivables	1,252	1,637	2,422	3,361	5,510	5,369	10,930	13,102	17,460	16,849	15,754	14,057	11,579	12,399
Inventories	270	346	509	455	1,051	776	791	1,764	2,111	2,349	2,132	2,712	2,910	3,146
Deferred tax assets	607	782	1,447	2,101	1,636	2,014	2,583	3,453	4,318	5,546	-	-	-	-
Vendor non-trade receivables					4,414	6,348	7,762	7,539	9,759	13,494	13,545	13,920	9,033	10,233
Other current assets	2,270	3,805	5,822	6,884	3,447	4,529	6,458	6,882	9,806	9,539	8,283	12,191	11,367	10,338
Total current assets	14,509	21,956	32,311	36,265	41,678	44,988	57,653	73,286	68,531	89,378	106,869	103,332	101,990	112,875
Long-term marketable securities			2,379	10,528	25,391	55,618	92,122	106,215	130,162	164,065	170,430	185,638	189,740	184,757
Property, plant and equipment	1,281	1,832	2,455	2,954	4,768	7,777	15,452	16,597	20,624	22,471	27,010	26,510	27,163	29,286
Goodwill	38	38	207	206	741	896	1,135	1,577	4,616	5,116	5,414	5,423	5,473	5,661
Acquired intangible assets	139	299	285	247	342	3,536	4,224	4,179	4,142	3,893	3,206	2,848	2,617	2,444
Other assets	1,238	1,222	1,935	3,651	2,263	3,556	5,478	5,146	3,764	5,556	8,757	7,390	7,549	10,150
Total assets	17,205	25,347	39,572	53,851	75,183	116,371	176,064	207,000	231,839	290,479	321,686	331,141	334,532	345,173
<b>Current liabilities:</b>														
Accounts payable	3,390	4,970	5,520	5,601	12,015	14,632	21,175	22,367	30,196	35,490	37,294	38,510	28,573	31,915
Accrued expenses	3,053	4,310	3,719	3,376	5,723	9,247	11,414	13,856	18,453	25,181	22,027	23,739	23,096	23,304
Deferred revenue		-	4,853	10,305	2,984	4,091	5,953	7,435	8,491	8,940	8,080	7,889	7,682	7,608
Commercial paper									6,308	8,499	8,105	10,493	9,992	11,980
Current portion of long term debt										2,500	3,500	3,499	3,999	6,495
Total current liabilities	6,443	9,280	14,092	19,282	20,722	27,970	38,542	43,658	63,448	80,610	79,006	84,130	73,342	81,302
Deferred revenue-non-current	778	1,535	3,029	4,485	1,139	1,686	2,648	2,625	3,031	3,624	2,930	3,163	3,107	2,984
Long term debt								16,960	28,987	53,463	75,427	73,557	84,531	89,864
Other non-current liabilities	-	-	1,421	2,252	5,531	10,100	16,664	20,208	24,826	33,427	36,074	37,901	39,470	38,598
Total liabilities	7,221	10,815	18,542	26,019	27,392	39,756	57,854	83,451	120,292	171,124	193,437	198,751	200,450	212,748
<b>Shareholders' Equity:</b>														
Common Stock	4,355	5,368	7,177	8,210	10,668	13,331	16,422	19,764	23,313	27,416	31,251	32,144	33,579	34,445
Retained earnings	5,607	9,101	13,845	19,538	37,169	62,841	101,289	104,256	87,152	92,284	96,364	100,001	100,925	98,525
Accumulated other comprehensive income	22	63	8	84	(46)	443	499	(471)	1,082	(345)	634	245	(422)	(545)
Total shareholders equity	9,984	14,532	21,030	27,832	47,791	76,615	118,210	123,549	111,547	119,355	128,249	132,390	134,082	132,425
Total liabilities and shareholders equity	17,205	25,347	39,572	53,851	75,183	116,371	176,064	207,000	231,839	290,479	321,686	331,141	334,532	345,173

Source: Company reports

Other stocks mentioned: Qualcomm Inc. (QCOM-\$50.90), and Alphabet (GOOGL-\$946.65 -Neutral)

### **Analyst Certification**

I, Stephen Turner, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### **Important Disclosures**

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

The author of this report or members of his household have a long position in the common stock of Apple Inc., but may not engage in buying or selling contrary to our recommendation.

### **Suitability Ratings**

- 1** - A large cap, core holding with a solid history
- 2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
- 3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
- 4** - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

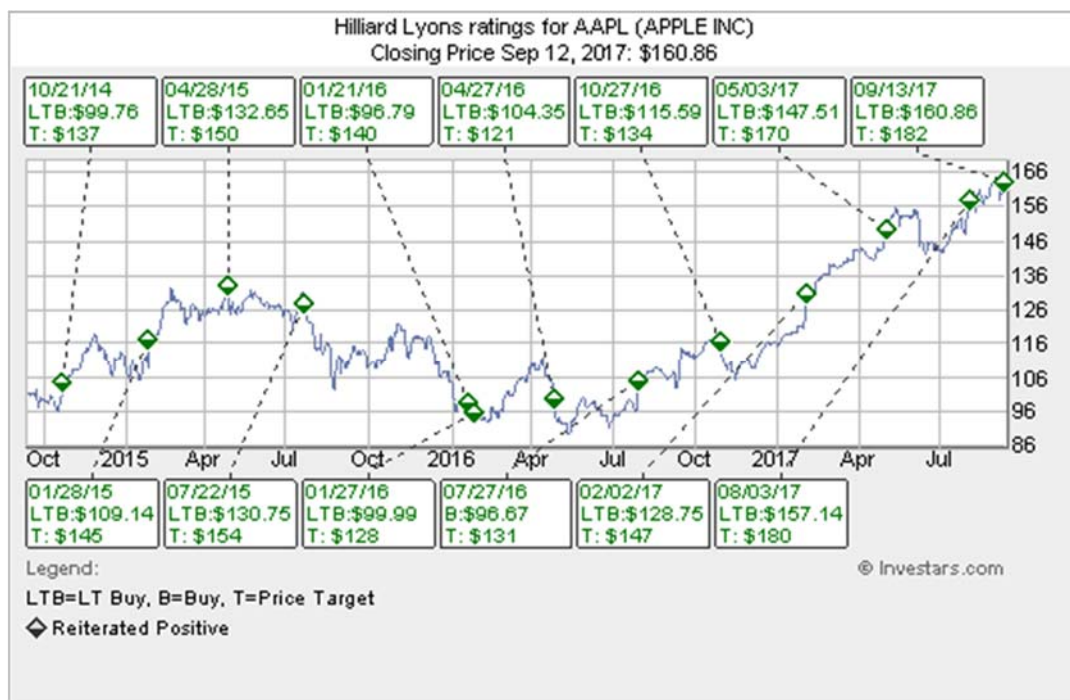
### **Investment Ratings**

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price setback in the next 12 months.



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings generally reflect a two to three year time period.

Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	40	32%	10%	90%
Hold/Neutral	77	62%	8%	92%
Sell	8	6%	0%	100%

As of 6 September 2017

**Other Disclosures**

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