



COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

Key Metrics

SJM - NYSE (as of 11/16/17)	\$116.65
Two Year Price Target	\$140.00
52-Week Range	\$99.57 - \$143.68
Shares Outstanding-Basic (mil.)	113.6
Market Cap. (\$ mil.)	\$13,251
3-Mo. Average Daily Volume	1,350,000
Institutional Ownership	80%
Total Debt/Total Capital (10/17)	43%
ROE (TTM ended 10/17)	12%
Book Value/Share (10/17)	\$61.94
Price/Book Value	1.9x
Annual Dividend & Yield	\$3.12 2.7%
EBITDA Margin (TTM ended 10/17)	21%

Adjusted EPS FY 4/30 (excludes nonrecurring items and amort.)

	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	\$1.86		\$1.51	A	
2Q	\$2.05		\$2.02	A	
3Q	\$2.00	\$2.24	\$2.14		
4Q	\$1.80	\$2.15	\$2.16		
Year	\$7.72	\$7.79	\$7.83	\$8.25	\$8.26
P/E	15.1x		14.9x		14.1x

Note: EPS figures exclude nonrecurring items and amortization expense.
Quarterly figures may not add to annual figure due to rounding.

Revenue (\$ mil)

	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	\$1,816		\$1,749	A	
2Q	\$1,914		\$1,924	A	
3Q	\$1,879	\$1,886	\$1,885		
4Q	\$1,784	\$1,815	\$1,817		
Year	\$7,392	\$7,350	\$7,375	\$7,500	\$7,520

Company Description: Established in 1897, The J.M. Smucker Company is a leading marketer and manufacturer of consumer foods, beverage products, and pet food/snacks in North America. Its portfolio of food & beverage brands includes Smucker's, Folgers, Dunkin' Donuts (packaged coffee), Jif, Crisco, Pillsbury, R.W. Knudsen, Hungry Jack, Café Bustelo, Martha White, Sahale Snacks, and Bick's. The Pet food/snack portfolio of brands (from the purchase of Big Heart Pet Brands in March 2015) includes Meow Mix, Milk-Bone, Kibbles 'n Bits, and 9Lives.

The J.M. Smucker Company

SJM — NYSE — Long-term Buy-2

Encouraging 2Q Results; Raising Price Target

- **Fiscal 2Q results were above expectations.** Net sales for the quarter ended 10/31/17 rose 1% to \$1.924 billion, better than the street consensus expectation for a slight decline. Each of the three main segments—coffee, consumer foods, pet foods—produced a positive surprise with either sales or profit. Adjusted gross margin declined but to a much smaller degree than the preceding quarter (1Q FY18). Adjusted earnings per share, excluding amortization, were \$2.02 compared to \$2.05 in the year ago period. The street consensus expectation was \$1.90 and our estimate was \$1.89.
- **We found net positives with each segment.** The coffee segment surprised us with a slight sales gain, though *Folgers* was down and commodity costs were higher. The consumer foods business had positive net price realization and reduced marketing expenses, leading to a 10% jump in profit. The pet foods segment had higher volume and higher profit, representing a considerable improvement from the previous quarter.
- **We expect double-digit earnings growth in the 2H of FY18.** This is based on projected gross margin improvement as the year unfolds due in part to lower coffee costs, and continued cost containment. We have also slightly raised our FY18 financial outlook.
- **We have a more favorable view of FY19 and beyond.** Although we view SJM's business segments as highly competitive, we consider the company well-positioned with a strong portfolio of brands, a focus on product innovation, and the financial wherewithal to invest in those brands to grow market share over time.
- **We are raising our two-year price target by \$10 to \$140 per share.** This increase is the result of a slightly higher assumption of forward EPS in two years and a slightly higher valuation. These changes are based on what we consider recently improved fundamentals. Implied total return potential is over 12% annualized. Our Suitability rating remains 2.

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

Exhibit 1**Consolidated Statements of Operations** (figures in millions except percentages and per share data)

	Three Months Ended			Six Months Ended		
	10/31/17	10/31/16	% chg.	10/31/17	10/31/16	% chg.
U.S. Retail - Coffee	\$552.7	\$551.8	0.2%	\$1,033.5	\$1,065.1	(3.0%)
U.S. Retail - Consumer Foods	531.5	557.3	(4.6%)	1,023.9	1,094.3	(6.4%)
U.S. Retail - Pet Foods	552.1	531.0	4.0%	1,073.8	1,050.5	2.2%
Int'l & Away From Home	287.3	273.8	4.9%	541.3	519.8	4.1%
Total Net Sales	<u>1,923.6</u>	<u>1,913.9</u>	0.5%	<u>3,672.5</u>	<u>3,729.7</u>	(1.5%)
Cost of Products Sold	<u>1,168.6</u>	<u>1,171.0</u>	(0.2%)	<u>2,255.4</u>	<u>2,264.1</u>	(0.4%)
Gross Profit	755.0	742.9	1.6%	1,417.1	1,465.6	(3.3%)
Selling, Distrib. & Admin. Exp.	360.9	363.1	(0.6%)	711.1	719.1	(1.1%)
Amortization	51.6	51.8	(0.4%)	103.1	103.5	(0.4%)
Special Project Costs	9.7	26.6	(63.5%)	36.8	48.8	(24.6%)
Other Operating Exp. (Inc.)	2.1	(1.9)		1.6	(2.9)	
Operating Income	330.7	303.3	9.0%	564.5	597.1	(5.5%)
Interest Expense, net	(41.6)	(41.0)	1.5%	(83.6)	(82.5)	1.3%
Other Income (Expense)	2.7	3.2		(0.1)	4.3	
Earnings Before Taxes	291.8	265.5	9.9%	480.8	518.9	(7.3%)
Taxes (Benefit)	97.2	88.2	10.2%	159.4	171.6	(7.1%)
GAAP Net Income	<u>\$194.6</u>	<u>\$177.3</u>	9.8%	<u>\$321.4</u>	<u>\$347.3</u>	(7.5%)
GAAP Diluted EPS	\$1.71	\$1.52	12.7%	\$2.83	\$2.98	(5.1%)
Reconciliation to Non-GAAP N.I.:						
Income Taxes	97.2	88.2		159.4	171.6	
Amortization	51.6	51.8		103.1	103.5	
Unalloc. Derivative (Gain) Loss	(9.7)	14.2		(22.3)	6.5	
Cost of Prod. Sold - Special Projects	0.9	0.3		1.6	4.3	
Other Special Project Costs	9.7	26.6		36.8	48.8	
Pretax Income, exclud. Special Items	344.3	358.4	(3.9%)	600.0	682.0	(12.0%)
Adj. Taxes (Benefit)	114.8	119.2	(3.7%)	198.9	225.6	(11.8%)
Non-GAAP Net Income	<u>\$229.5</u>	<u>\$239.2</u>	(4.1%)	<u>\$401.1</u>	<u>\$456.4</u>	(12.1%)
Non-GAAP Diluted EPS	\$2.02	\$2.05	(1.5%)	\$3.53	\$3.92	(9.9%)
Avg. Diluted Shares Outst.	113.6	116.6	(2.6%)	113.6	116.5	(2.5%)
As a % of Net Sales:			bp. chg.			bp. chg.
Gross Profit	39.25%	38.82%	43	38.59%	39.30%	(71)
Selling, Distrib. & Admin. Exp.	18.76%	18.97%	(21)	19.36%	19.28%	8
Operating Income	17.19%	15.85%	134	15.37%	16.01%	(64)
Earnings Before Taxes	15.17%	13.87%	130	13.09%	13.91%	(82)
GAAP Net Income	10.12%	9.26%	85	8.75%	9.31%	(56)
Non-GAAP Net Income	11.93%	12.50%	(57)	10.92%	12.24%	(132)
Segment Profit Margins:						
U.S. Retail - Coffee	27.61%	33.80%	(619)	26.74%	33.83%	(708)
U.S. Retail - Consumer Foods	24.63%	21.34%	329	23.62%	21.05%	257
U.S. Retail - Pet Foods	22.26%	21.56%	70	20.60%	22.53%	(193)
Int'l & Away From Home	18.69%	18.88%	(19)	17.00%	17.55%	(55)
Total Segment Profit Margin	23.92%	24.64%	(72)	22.64%	24.63%	(199)

Source: Company reports and Hilliard Lyons estimates

Note: April fiscal year

2Q FY18 results. The U.S. Retail Coffee segment faced challenges in the quarter, as expected. 2Q sales were up negligibly (better than we expected) while profits dropped 18% (also better than we anticipated and lower than the 29% drop in the preceding quarter). This reflected lower volume from *Folgers* but higher volume from the *Dunkin' Donuts* and *Café Bustelo* brands. Commodity costs were significantly higher, leading to a 620 basis point decline in segment profit margin for the quarter.

The U.S. Retail Consumer Foods segment posted a 5% sales decline yet a 10% increase in profits. This reflected lower volume (including the *Crisco* and *Pillsbury* brands), but beneficial impacts of reduced marketing expenses and higher net pricing (particularly with the *Jif* and *Smucker's* brands). Segment profit margin rose about 330 basis points.

In the U.S. Retail Pet Foods segment, sales were up 4% from the year ago figure, while profit increased 7%. This reflected higher volume (especially the *Nature's Recipe* and *Meow Mix* brands), slightly higher net price realization, and cost savings initiatives. Segment profit margin for the quarter was up roughly 70 basis points.

Sales from the smaller International and Away From Home (formerly titled Foodservice) segment increased 5% and profits rose 4%. The sales gain reflected favorable foreign currency exchange and higher volume. Segment profit margin declined 20 basis points compared to a year ago, reflective of some incremental expenses related to construction of a production facility for the *Uncrustables* product line.

Share repurchases over the past year helped the EPS calculation. Non-GAAP net income fell 4%, while EPS dropped just 1.5% due to an approximate 3% decline in the weighted average share count compared to one year ago.

Financial condition. The company's balance sheet is solid, in our view. As of October 31, 2017, total cash and equivalents were \$180 million. Receivables and inventories were at sufficient levels, in our view. Total debt was \$5.257 billion, or 43% of total capitalization. Gross debt divided by EBITDA (earnings before interest, taxes, depreciation & amortization) was 3.4x. We consider this an adequate level and reflective of past acquisitions, namely the \$6 billion purchase of the Big Heart pet food business in March 2015. Shareholders' equity at the recent quarter end was \$7.036 billion.

Wesson oil to join the portfolio. On 5/30/17, SJM announced an agreement to acquire the *Wesson* oil brand from Conagra Brands. The *Wesson* brand is considered a complement to SJM's *Crisco* brand. SJM management expects *Wesson* to add about \$230 million in annual sales, \$30 million in EBITDA, and \$0.10 in EPS in the first full year under SJM ownership. The \$285 million purchase price represents 9.5x EBITDA prior to the tax benefit. Including that benefit, and expected synergies, the multiple is expected to drop to about 5.0x. The deal is subject to customary closing conditions and regulatory approvals. We will incorporate *Wesson* in our financial model for SJM when the transaction becomes official.

Outlook. Management made modest revisions to its FY18 financial guidance, which is still based on lower net price realization in the coffee segment, continued cost containment, and 2H gross margin improvement. Annual guidance includes sales being flat to slightly down (versus previous guidance of down), adjusted gross margin improvement of 60 basis points (narrowing the previous range of 50-75 basis points), and higher operating margin after the impact of synergies and cost reduction initiatives. Non-GAAP EPS are expected at \$7.75-\$7.90, representing a reduction of \$0.05 to the upper end of the range.

We have updated our FY18 outlook. Our net sales estimate is \$7.375 billion, up \$25 million from our previous figure. After updates to various line items and our share count assumption, our non-GAAP EPS estimate is \$7.83, or \$0.04 above our previous figure of \$7.79. After planned capital expenditures of about \$310 million (above FY17's figure of \$192 million), FY18 free cash flow is still projected at \$775 million. In FY17, free cash flow was \$867 million. We have modestly increased our FY19 estimates, based on what we consider slight improvements in fundamentals.

Our presentation of EPS is consistent with the methodology used by the company, that is, excluding amortization expense. However, for valuation purposes, we also consider the more conservative approach of including amortization expense (mostly related to the acquisition of Big Heart Pet Brands in March 2015). Our new FY18 EPS estimate of \$7.83 equates to roughly \$6.65 including amortization expense, reflective of about \$1.18 per share in amortization expense.

Valuation. SJM shares are down approximately 9% for the calendar YTD period. Based on the current price, the shares are trading at 14.9x our FY18 adjusted EPS estimate of \$7.83 and 14.4x our estimate of forward twelve-month EPS, both figures excluding amortization expense.

Including amortization expense of about \$1.18 per share (most earnings figures from our covered companies include amortization expense), the current stock price represents 17.5x an estimated FY18 EPS figure of \$6.65 and 16.9x an estimated forward EPS figure.

We believe comparing SJM's commonly presented and discussed price/earnings multiples to historical figures has some limitations due to changing methodologies behind EPS figures (perhaps a mix of the two methodologies—with and without amortization expense). However, we note the following:

- The 14.4x multiple on our projection of forward EPS excluding amortization expense is below the mid-point of an historical range we estimate at 12x-19x (adjusting past EPS figures to exclude amortization expense).
- The 16.9x multiple on our forward EPS estimate including amortization expense compares to forward multiples of 18.4x for the S&P 500 and 19.5x for the S&P Consumer Staples sector.
- On an Enterprise Value/EBITDA basis, SJM is trading at approximately 10.5x our estimate of forward adjusted EBITDA. This compares to a five-year historical range we estimate at 9x-13x.

Opinion. We like SJM's extensive operating history, diverse product portfolio, and seasoned management team. We like the numerous brands and believe market share and product innovation initiatives are positives.

The coffee business is a good cash flow generator, in our view, but profits can be volatile over the short-term due to fluctuations in commodity costs and pricing decisions implemented by SJM management. It is also quite competitive at this time. However, we like the combination of a mainstream brand (*Folgers*) and smaller growth-oriented brands (*Café Bustelo* and *Dunkin' Donuts*). Additionally, we believe industry growth in K-Cup servings bode well for SJM. The consumer foods business provided perhaps our favorite aspect to fiscal 2Q results, with a 10% increase in segment profit and a 330 basis point gain in profit margin. Positive net price realization for the *Jif* and *Smucker's* brands is noteworthy, in our view.

We believe the Big Heart pet food business is starting to show signs of improvement after a sluggish start following the 2015 acquisition, and believe it can be a meaningful cash flow generator, particularly with some improved industry dynamics, greater distribution, and fully realized synergies. In addition, a new manufacturing facility is planned for the fast-growing *Uncrustables* frozen sandwich line, which could double its sales potential. Finally, we would not be surprised to see one or more acquisitions over the next few years.

We are also mindful of the “investment year” represented by FY18, as the company injects money back into the business to boost innovation, add capacity in certain product lines, and improve its overall competitive position. This had a limiting impact on 1H profits (adjusted EPS down 10%), in our view, with the 2H outlook notably better (projected EPS increase of 13%). Beyond that, we continue to feel good about the company's prospects in FY19 and beyond.

Longer term, earnings growth could potentially come from factors such as improved volumes, market share gains, product development/brand extensions, operating margin improvement, debt reduction (lower interest expense), and share repurchases. Also, we expect annual dividend increases, with declarations around July of each year (a 4% raise was announced in July 2017). We consider the balance sheet solid and note management's recent comment that it was "aggressively pursuing a variety of growth opportunities." We project long-term annual EPS growth in the upper single digit percentages.

Rating and price target. We rate SJM shares Long-term Buy. We consider the company a high achiever, with notable histories of both organic and external growth. Given current earnings pressure but a more favorable outlook over the next few years, we believe our Long-term Buy rating is most appropriate. Our two year price target is \$140 per share, an increase of \$10 from our previous figure. This new target is the same as our original target when we upgraded SJM to Long-term Buy from Neutral in July 2017. Our target raise reflects a slightly higher estimate of forward EPS and a slightly higher multiple assumption compared to our previous view. These increases reflect what we consider improving fundamentals, including areas such as demand, pricing power, market share, product portfolio, and innovation initiatives.

Our \$140 price target is based on forward EPS excluding amortization of approximately \$9.00 two years from now and a 15.5x price/earnings multiple. This latter figure compares to the 14.4x multiple on our current estimate of forward EPS. We are comfortable with our higher valuation assumption, and note this revised figure is roughly the mid-point of the aforementioned estimated historical range of 12x-19x.

Suitability. Our Suitability rating on SJM is 2 on a 1 (most conservative) to 4 (most aggressive) scale. Contributing factors in determining our Suitability rating include the company's debt level (particularly following the March 2015 acquisition of Big Heart Pet Brands), market capitalization, liquidity/trading volume, diversity of revenues, the industry in which the company operates, the company's competitive position within the industry, and the company's long-term earnings and dividend history.

Risks. There are numerous factors that could affect operations of The J.M. Smucker Company. A recent factor is the company's relationship with its retail partners (in a dynamic food retailing industry) as it relates to unit volumes and pricing. Other factors include changes in consumer demand for the company's products; product competition, including private-label; price competition; volatility of commodity markets (green coffee beans, wheat, soybean oil, milk, peanuts, sugar, etc.); labor relations; extreme weather conditions or occurrences; crude oil price trends and the resulting impact on transportation, energy, and packaging costs; the ability to implement price changes in response to rising input costs; the success and costs of introducing new products; the impact of potential food safety concerns; risks associated with potential growth of international operations such as exchange rate fluctuations and geopolitical risks; potential future acquisitions; and the global economy.

Labor contracts are another consideration. Recently, about 27% of SJM's employees were covered by union contracts at 11 facilities. The company has five contracts expiring in FY18, representing about 8% of SJM's total employees.

There were recently just under 114 million common shares outstanding and there is only one class of stock. Shareholders are typically entitled to one vote per share held; however, shareholders who have owned the stock for approximately four years are entitled to ten votes per share held on certain matters, including major issues such as a potential merger, consolidation, or liquidation of the company.

Exhibit 2**Consolidated Statements of Income**

(figures in millions except percentages and per share data)

	FY19E	% chg.	FY18E	% chg.	FY17	% chg.	FY16
U.S. Retail - Coffee	\$2,108	2.2%	\$2,062	(2.2%)	\$2,109	(5.8%)	\$2,239
U.S. Retail - Consumer Foods	2,079	2.4%	2,031	(2.6%)	2,085	(8.1%)	2,270
U.S. Retail - Pet Foods	2,200	1.3%	2,171	1.6%	2,136	(5.1%)	2,250
International & A Way From Home	<u>1,133</u>	2.0%	<u>1,111</u>	4.6%	<u>1,062</u>	1.0%	<u>1,052</u>
Total Net Sales	7,520	2.0%	7,375	(0.2%)	7,392	(5.4%)	7,811
Costs of Products Sold	<u>4,571</u>	1.6%	<u>4,500</u>	(1.3%)	<u>4,557</u>	(5.9%)	<u>4,843</u>
Gross Profit	2,949	2.6%	2,875	1.4%	2,835	(4.5%)	2,968
Selling, Distrib. & Admin. Exp.	1,425	3.3%	1,380	(0.8%)	1,391	(7.9%)	1,510
Amortization	210	2.4%	205	(1.1%)	207	(0.3%)	208
Impairment Charge	0		0		133		0
Special Project Costs	25		50		77		136
Other Operating Exp. (Inc.)	<u>(3)</u>		<u>(2)</u>		<u>(4)</u>		<u>(32)</u>
Operating Income	1,292	4.0%	1,242	20.4%	1,032	(9.9%)	1,145
Interest Expense, net	(162)	(1.8%)	(165)	1.2%	(163)	(4.6%)	(171)
Other Income (Expense)	<u>4</u>		<u>3</u>		<u>10</u>		<u>4</u>
Earnings Before Taxes	1,134	5.0%	1,080	23.0%	878	(10.2%)	978
Taxes	<u>371</u>	5.0%	<u>354</u>	23.6%	<u>286</u>	(1.1%)	<u>289</u>
GAAP-based Net Income	<u>\$763</u>	5.0%	<u>\$726</u>	22.6%	<u>\$592</u>	(14.0%)	<u>\$689</u>
Non-GAAP Adjustments:							
Income Tax Expense	371		354		286		289
Amortization	210		205		207		208
Unallocated Derivative Loss (Gain)	0		(22)		27		(12)
Impairment Charge	0		0		133		0
Costs of Products Sold - Special Costs	0		2		6		12
Other Special Project Costs	<u>25</u>		<u>50</u>		<u>77</u>		<u>136</u>
Pre-tax Income, Adjusted	1,369	4.1%	1,315	(1.0%)	1,329	0.5%	1,322
Income Tax Expense, Adjusted	<u>448</u>		<u>431</u>		<u>433</u>		<u>391</u>
Net Income, Adjusted	<u>\$921</u>	4.1%	<u>\$884</u>	(1.3%)	<u>\$896</u>	(3.8%)	<u>\$931</u>
Avg. Diluted Shares Outst.	111.5	(1.3%)	113.0	(2.7%)	116.1	(2.8%)	119.5
Non-GAAP EPS, diluted, as reported	<u>\$8.26</u>	5.5%	<u>\$7.83</u>	1.4%	<u>\$7.72</u>	(1.0%)	<u>\$7.79</u>
As a % of Net Sales:		bp. chg.		bp. chg.		bp. chg.	
Gross Profit	39.22%	23	38.98%	63	38.35%	36	37.99%
Selling, Distrib. & Admin. Exp.	18.95%	24	18.71%	(10)	18.81%	(52)	19.34%
Operating Income, GAAP-based	17.18%	34	16.84%	289	13.95%	(71)	14.66%
Net Income, GAAP-based	10.14%	29	9.85%	184	8.01%	(80)	8.82%
Net Income, Adjusted	12.24%	25	11.99%	(13)	12.12%	20	11.92%
Tax Rate, Adjusted	32.75%	0	32.75%	18	32.57%	299	29.58%
Dividend Data:	FY19E		FY18E		FY17		FY16
Dividends Paid During FY	\$3.28		\$3.08		\$2.92		\$2.65
Dividend Payout Ratio	40%		39%		38%		34%

Note: Non-GAAP EPS figures exclude amortization expense

Source: Company reports and Hilliard Lyons estimates

Note: April fiscal year

Additional information is available upon request.

Prices of other stocks mentioned: Dunkin Brands Group - DNKN - \$57.64
Conagra Brands Inc. - CAG - \$35.62

Analyst Certification

I, Jeffrey S. Thomison, 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.

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 set back in the next 12 months.

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 revenue, volatility, low trading volume or a narrow customer or product base

Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	32	29%	13%	88%
Hold/Neutral	73	65%	7%	93%
Sell	7	6%	0%	100%

As of 8 November 2017



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

Other Disclosures

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