**Industry Update**

LONGBOW Research
Tactical advantage through independent research

**February 8, 2013**

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Industry: **CONSTRUCTION MATERIALS**

Coverage:

| Ticker | Rating | Price |
|---|---|---|
| CRH | NEUTRAL | $20.64 |
| CX | NEUTRAL | $10.37 |
| EXP | NEUTRAL | $64.30 |
| MLM | BUY | $97.37 |
| OC | BUY | $42.23 |
| PNR | BUY | $50.53 |
| SSD | NEUTRAL | $31.79 |
| TXI | NEUTRAL | $55.48 |
| USG | NEUTRAL | $27.96 |
| VMC | NEUTRAL | $55.41 |
| WTS | NEUTRAL | $45.27 |

# Aggregate News



***IMPORTANT DISCLOSURES ARE LOCATED IN THE APPENDIX.***

## COMPANY NEWS

**Owens Corning: Upgrading Shares to BUY, $54 Price Target on Accelerating Building Products Earnings -** We are raising our forecasts and are upgrading OC to a BUY, $54 12-month target price as we think that stronger than expected roofing demand in 4Q will lead to near term earnings upside and that accelerating FY13 building products earnings provides cushion to what we think will be a still sluggish near term composites environment. We are raising 4Q12E to $0.17 (+$0.07) and FY13E to $2.30 (+$0.32). We see significant upside to Consensus FY13E of $2.11. According to the American Roofing Manufacturers Association, 4Q roofing demand came in well ahead of our expectations. 4Q volume growth of +2% was much, much stronger than our -12% expectation as stronger organic demand and a prebuy ahead of the February price increase drove demand. We see potential upside to OC's 4Q12E based on stronger roofing demand – a driver that was the wildcard in the company's wide $280-$310M FY12 guidance range. Our channel contacts indicate that the February 10% roofing price increase will likely hold although the full benefit will not be felt until March. We are also hearing positive developments on a December insulation price increase and expect 4-5% to stick. We expect composites trends to remain soft in the near term and are conservatively modeling $30M y/y EBIT growth in FY13 vs. management's $60M guidance. That said, we think buying OC ahead of the composites turn makes sense as when the segment gets close to double digit margins again, or at least provides some line of sight that this target is again reasonable, it will likely be a strong catalyst to the shares, especially as building products growth will likely provide a near term offset and catalyst.
*Source: Longbow Research*

*LBR Note: Beacon Roofing (BECN, NR) reported $0.37 1Q13 vs. the Street $0.41. OC investors looking for takeaways should note: BECN says manufacturers are optimistic the increases will hold and that indications are the prebuy was not as high as a year ago. This confirms our research. The Company said that spring will be the real test for pricing given seasonal demand is more important here. Given the inventory build, the company said it doesn't expect to re-load inventory until April, but it is hearing that some distributors are already committed to paying the price increase at this time. However, management said that they're confident they will be able to pass along higher prices as necessary. Lastly, against tough comps (+47% in 1/12), January sales were flat like for like which management said is encouraging especially as November and December 2012 were down y/y.*

**USG Corp.: Downgrading to NEUTRAL after 4Q Margin Expectation Reset -** USG reported 4Q adjusted EBIT of $5M vs. our $20M forecast and consensus of $21M. $7M in higher corporate and elimination costs relative to our forecast, $5M in lower Ceilings EBIT and $2M in lower NA Gypsum and L&W EBIT contributed to the lower consolidated EBIT. Wallboard volumes increased 12% vs. our 10% forecast. USG's ASPs were flat. However, wallboard EBIT of $28M was below our $30M forecast and incremental margin was softer than anticipated. Ceilings sales were flat y/y on a like for like basis and beat our -4% forecast. However, EBIT of $14M was below our $19M forecast from weaker U.S. margins. Management indicated seasonality and negative mix away from higher margin office work contributed to the shortfall. L&W sales increased 7%, generally in line with our expectations. That said, we view L&W's performance as directionally OK but that the segment will need much stronger volume growth to turn profitable. We see this as a 2014 event given the exposure to commercial construction the segment has. We are downgrading USG to NEUTRAL from BUY as after the 4Q disappointment, we see limited near to medium term catalysts as well as a stock that appears fairly valued. We see an improvement in commercial construction and higher wallboard volumes as potential FY14 catalysts but think that 2013 catalysts are more unclear as incremental margins have downside risk as expectations re-set following 4Q and the likelihood that ceilings and L&W growth will remain choppy. Last, we now think the 25-30% January 2013 price increase is being fully discounted by investors.
*Source: Longbow Research*

**CEMEX 4Q Solid Quarter But Expectations Ran Too High -** CX reported 4Q12 EBITDA of $611M which was slightly below our $619M forecast. Strength in Central and South America was more than offset by slightly lower EBITDA in the US and Mexico. Net sales were flat y/y, in line with our expectations but consolidated EBITDA margins of 16.5% were 30bp below our view. That said, EBITDA was up 13% y/y off flat sales, so CX is making progress on its cost savings program. Consolidated cement volumes declined 2% y/y and varied considerably by region. Volumes were up most notably in the U.S. and Central and South America and partially offset declines in Europe and Mexico. US Volumes were up 9% and the company is guiding to high teens growth again in 2013. Prices were up 5% y/y on a like-for-like basis in cement. Other product categories also had price improvement. Looking to 2013, we expect the US to outperform most markets while South and Central America remain strong as well. We think CX's focus on price improvement could offer a positive offset to earnings especially as European trends remain soft. Overall, CX is seeing mixed demand conditions in its geographic footprint with a slowly improving US, solid Latin America and Central Europe offsetting weak Mediterranean fundamentals. Overall, we expect ~$375M in EBITDA growth in FY13 as CX's cost savings program should help drive y/y improvement. We remain NEUTRAL rated as we believe the stock is fairly valued when a) considering normalized earnings of ~$4.1B in FY15 and b) pending additional confidence that US EBITDA will accelerate beyond our $730M FY15 expectations especially after an in-line performance in 4Q12.
*Source: Longbow Research*

**EXP: Solid Quarter When Excluding One-Time Items But Not Strong Enough** - EXP reported adjusted 3Q13 of $0.43 which came in below our $0.45 forecast and consensus of $0.44. Excluding higher costs associated with purchase accounting and unplanned downtime at its NV cement plant, EXP likely would have beat by ~$0.02.Given the shares had such a strong run of late and that the quarter was generally in line, directionally, we believe investors took profits on a strong but not strong enough print. Wallboard volumes increased 23% y/y vs. our +10% forecast. Management was bullish on the January price increase and indicated, consistent with our view that end market demand remains strong and the distributor inventory build won't take long to work down. Paperboard EBIT margin of 41% was stronger than our 37% forecast. Volumes increased 14% vs. our 1% forecast as EXP continues to see a positive mix shift towards higher margin gypsum liner paper. We expect this segment to hold low 40%+ EBIT margins going forward vs. our 36% expectation previously on stronger volumes and mix. In general, EXP continues to execute well on all fronts, however, we think most of the near to medium term catalysts are baked into the shares. While the recent pullback could provide a buying opportunity for long term focused investors, we'd like more visibility on the timing of EXP's fracking sand oil well cement expansion projects before we get comfortable with additional upside to our $2.95 FY14E and $4.90 normalized EPS forecast. On these estimates, we believe the shares have some but not great upside when considering fair value of ~$75.
*Source: Longbow Research*

**Simpson Manufacturing 4Q; Starting to Think Gross Margin In Structural Decline -** SSD reported 4Q EPS of $0.12. However, excluding a $6.8M tax benefit and $2.3M goodwill impairment, EPS was $0.02/share. Results were weaker than our $0.07 EPS forecast which was in line with consensus. Net sales increased 11% y/y and were 210bp ahead of our forecast. Approximately 2/3 of the sales increase was driven by acquisitions with the rest from organic demand, although sales in France and the UK remain weak. The miss was driven by weaker gross margin. Corporate costs which have weighed on prior quarters, up $3M y/y were flat q/q. Gross margin of 38.2% was below our 40.8% forecast and down from 42% in 4Q12.The company cited a higher mix of lower-margin concrete construction sales (vs. higher-margin wood construction products), price competition, higher material costs, factory overhead, and shipping costs as weighing on gross profit. We're concerned that gross margin will continue to decline from negative mix as well as pricing pressure. As the company expects rising input costs in FY13, we have a hard time seeing how pricing at this point will be able to offset. North American sales increased 10% but gross margin fell 380bp to 38.2%. European sales increased 13% y/y but gross profit fell from 31.4% to 21.2% but most of the decline was associated with severance costs and the loss on sale of inventory related to the Liebig plant closure and exit of the mechanical anchor market. While SSD is slowly starting to see the sales benefit associated with the rebound in US construction, it continues to see pricing pressure as well margin pressure from mix and price. It's unclear when the company will start to see stability in these areas.
*Source: Longbow Research*

**Italcementi Says European Decline Offset By Asia** - Italcementi's group cement shipments in 2012 saw a decline of 6.6% with cement volumes being down in Europe and in the Middle East, but improving elsewhere. Group sales declined by 3.8%. In concrete and aggregates, revenues fell by 7.8% to €1280.3m as shipments of aggregates fell by 10.8% to 34Mt and ready-mixed concrete deliveries were also down by 10.8% to 12.9Mm³. Western European revenues were down by 9.8% to €2417.9m as cement and clinker volumes fell by 16.1% to 16.0Mt. Italian cement shipments were down by around a quarter, or by 2.2Mt to 6.7Mt. Italian prices, however, continued to recover. Revenues from the Mediterranean and Black Sea regions were off by a marginal 0.1% to €1008.7m, with Egypt being the one negative factor. Cement and clinker shipments were off by 4.5% to 14.9Mt on the back of lower Egyptian sales. Aggregates volumes were boosted by a 7.1% volume increase in Morocco and improved by 6.6% overall to 1.8Mt. Asian revenues rose by 14.2% to €520.9m, with cement deliveries being 8.8% higher at 10.1Mt, boosted by good volume increases in Thailand and India that rose by 10.3% and 9.7% respectively. The Asian downstream activities remain modest in group terms and are dominated by Thailand. North American revenues rose by a further 8.5% to €439.5m, helped by a stronger US dollar. Cement deliveries were just 0.3% higher at 4.2Mt, but ready-mixed concrete deliveries were 3.4 % higher at 0.8Mm³. Sales of aggregates showed the strongest advance and deliveries rose by 11.5% to 1.6Mt, on top of the 40.7% jump seen in the previous year.
*Source: Aggregate Research*

**HeidelbergCement Reports 8% Year-On-Year Revenue Rise -** The German multinational cement giant HeidelbergCement has announced preliminary financial results for the fourth quarter of 2012 and for the full year. In the fourth quarter it saw its revenue rise by 6.5% year-over-year, its operating income before depreciation increased by 8.2%. The improvements reflect the continuing positive development in HeidelbergCement's growth markets and the ongoing recovery in North America. Sales volumes and result declined in Europe, mainly as a result of government budget constraints in some countries, which led to significant reductions in infrastructure spending. In western and northern Europe the business development was not supported by mild weather at the beginning and the end of the year, which had been the case in 2011. Nevertheless, demand for construction materials remained stable in HeidelbergCement's native Germany and northern Europe, driven by positive economic development. In contrast, construction activity in the UK and the Netherlands weakened noticeably, mainly as a result of lower infrastructure spending in the UK due to budget consolidation and the decline in residential construction in the Netherlands following the end of housing subsidy programs. While cement sales volumes and prices developed positively in Russia and Central Asia, the demand for construction materials declined significantly in Poland, Hungary and the Czech Republic as a result of budget consolidation measures in these countries and the completion of construction projects related to the 2012 European Football Championship in Poland and Ukraine. In North America demand for cement and ready-mixed concrete continued its recovery in 2012, driven especially by an increase in residential construction. Cement, clinker and GGBFS sales volumes recorded growth of 11.7%, rising to 11.7Mt. However, the group's result in the fourth quarter of 2012 was affected by Hurricane Sandy and an early winter start in Canada. In this region its revenue came to €3.44bn, a 13.4% increase year-on-year. In the group's Asia-Pacific region, Demand for all of its products remained very strong due to construction activities that were supported by economic growth across the region. As a consequence, revenue showed growth of 17.6% for the full year and 12.8% for the fourth quarter. This rose to €3.48bn for the whole of 2012. Meanwhile, cement, clinker and GGBFS sales rose by 3.9% to 30.0Mt. In HeidelbergCement's Africa-Mediterranean Basin region, cement, clinker and GGBFS sales were up by 0.9% to 9.2Mt. Revenues increased by 11% year-on-year to €1.135bn. The group noted particular improvements in its key markets of Ghana and Tanzania. With regards to its progress in 2013, HeidelbergCement cited the IMF's expectations for slightly improved global economic growth, presumably linking this directly to demand for building materials. It cautioned that this growth was dependent on the continued focus of North America and Europe on their respective debt crises. There are still risks for the global economy from armed conflicts in the Middle East. In North America, the company expects a continuing economic recovery and consequently a further increased demand for building materials, especially from residential construction and the raw materials industry. In Europe and Central Asia, HeidelbergCement anticipates divided development. While markets in Germany, Northern Europe, Russia and Central Asia should remain stable or continue to grow, weak economic development and low demand for building materials is expected in all other regions. In Asia and Africa, the company expects sustained demand.
*Source: Globalcement.com*

## CONSTRUCTION MATERIALS INDUSTRY NEWS

**VA House Scraps Tolls, Senate Gets New Roads Plan -** Gov. Bob McDonnell's plan for funding transportation is taking a detour through the General Assembly that would, among other things, avoid tolls. The House of Delegates voted Monday to prohibit tolls on Interstate 95 south of Fredericksburg, eliminate a fee on alternative-fuel vehicles, and open the door to a regional approach to transportation needs under legislation proposed on behalf of the governor by House Speaker William J. Howell, R-Stafford. McDonnell's office said the governor prefers his original proposal, which would have replaced the gas tax with an increase in the state sales tax and vehicle fees. However, the governor's plan could run into a roadblock in the Senate, where Democratic leaders warn that the proposal won't get the 21 votes necessary for passage as long as it fails to raise a significant amount of money for Virginia transportation needs estimated at $1 billion a year. The proposal that advanced in the GOP-dominated House generally keeps with McDonnell's original proposal but eliminates a proposed fee on alternative fuel vehicle owners and blocks the state from spending money on any project involving tolls on Interstate 95 south of Fredericksburg. As approved by the House, the measure still would eliminate the state's 17.5-cents-per-gallon gas tax and raise the state and local sales tax to 5.8 percent from 5 percent. It would increase motor vehicle registration fees by $15 and capture more Internet sales taxes, pending congressional action. In addition, it still would increase the portion of the sales tax dedicated to roads to 0.75 percent from 0.5 percent over five years - over the objections of Democrats. The substitute also would remove the increased fees for vehicle registration and alternative fuel vehicles, and prohibit tolling on I-95. The new sales tax on gasoline initially would raise the same amount as the tax at the pump, but it would increase with inflation and generate $500 million to $650 million after five years to pay for road maintenance to stop the current drain on road construction money. It also would devote $50 million for intercity rail.
*Source: Richmond Times-Dispatch*

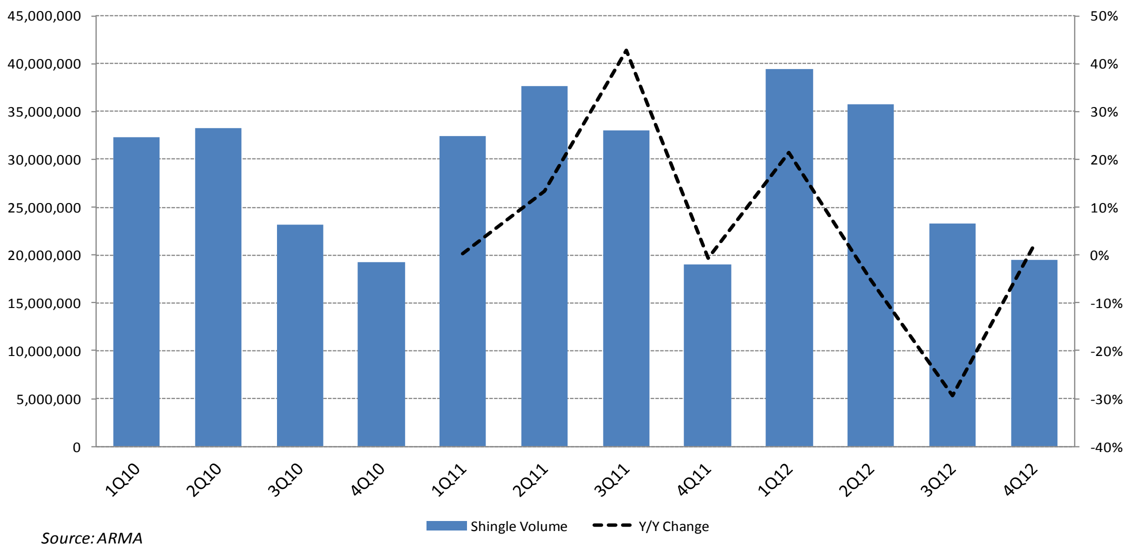
**Michigan Gov. Snyder Budget Calls for Higher Gas Tax, Vehicle Fee -** Gov. Rick Snyder on Thursday called for raising taxes on gasoline and diesel fuel to 33 cents per gallon as part of a plan to raise $1.2 billion more annually to fix the state's ailing roads. Snyder's plan would increase the 19-cents-per-gallon gas tax by nearly 74 percent and hike the 15-cent diesel tax by 120 percent. The Republican governor was to pitch the plan to lawmakers Thursday while presenting a $50.9 billion budget plan for the 2014 fiscal year that includes a 2 percent increase in funding for public schools, universities and community colleges in the next school year. On Wednesday, Snyder told The Detroit News he wants to make the diesel tax the same rate as the tax levied on unleaded gasoline. The gas tax is 19 cents a gallon and was last raised four cents per gallon in 1997. The 15-cent diesel tax hasn't been hiked since 1984. The plan would include mechanisms for increasing and lowering the rate based on fluctuations in price of oil. But the tax could not be lowered or increased more than 1 cent per gallon in any given year, according to Dick Posthumus, Snyder's legislative affairs director. The gas tax hike would raise $728 million. Snyder's budget also calls for increasing heavy truck and trailer registration taxes by 25 percent and increasing light vehicle registration fees by 60 percent to raise another $508 million annually for roads and infrastructure improvements. Snyder has said the average driver would pay $120 more annually for vehicle user fees.
*Source: Detroit News*

**NAHB: Metros Improving Across All 50 States** --Every state in the country has at least one metro area considered to be “improving,” according to the National Association of Home Builders/First American Improving Markets Index (IMI), which expanded to a total of 259 metro areas in February. The index—in which metros qualify as improving once they have shown gains in housing permits, employment, and house prices for six consecutive months after their respective troughs—tracks 361 metro areas, of which slightly more than 70% are considered to be improving.

*Source: Builderonline.com*

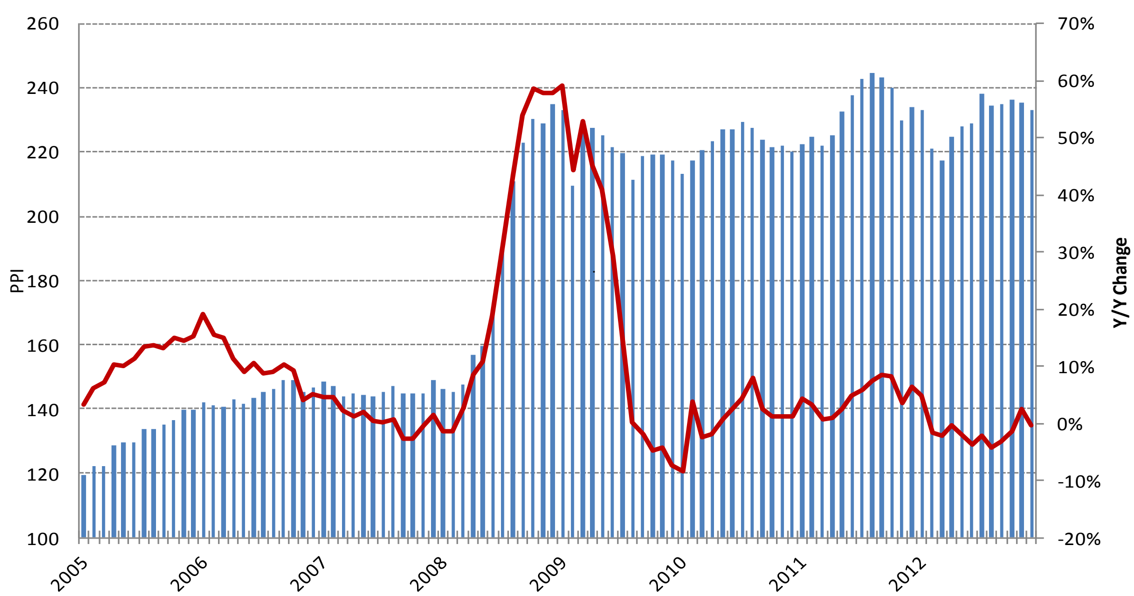
## DATA & GRAPHS

**Asphalt Shingle Demand**




*Source: ARMA*

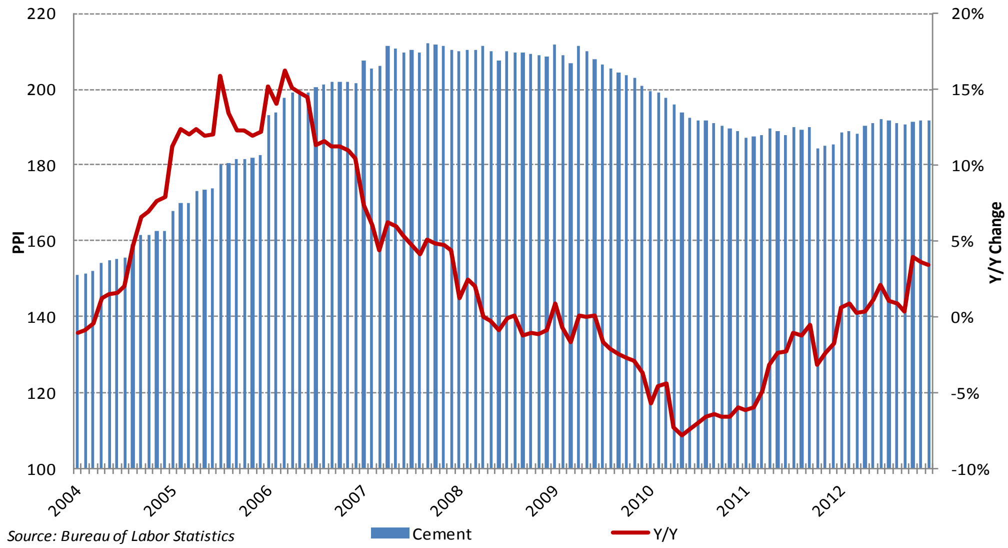
**PPI-Roofing**




*Source: Bureau of Labor Statistics*

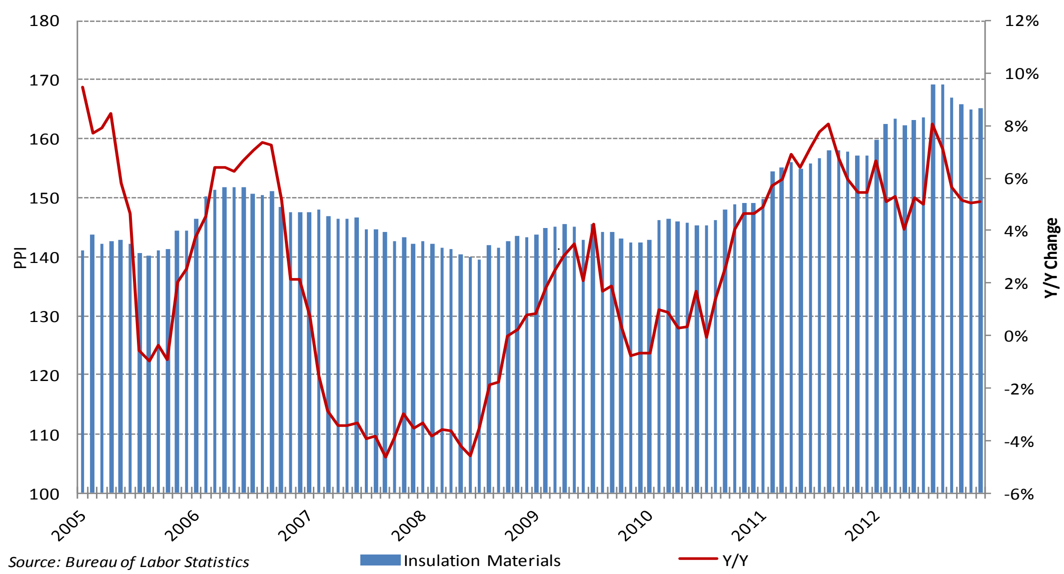
*Source: US Census Bureau*

**PPI-Cement**




*Source: US Census Bureau*

**PPI-Insulation**




*Source: US Census Bureau*

## CONSTRUCTION MATERIALS PEER VALUATION ANALYSIS

| Company Name | Ticker | Rating | Price 02/08/13 | 52-Week Low | 52-Week High | Share Count | Market Cap (mm) | Enterprise Value (mm) | Total Assets | Total Liabilities |
|---|---|---|---|---|---|---|---|---|---|---|
| Cemex | CX | NEUTRAL | $10.37 | $4.94 | $11.11 | 1,124 | 11,656 | 27,330 | 39,612 | 27,384 |
| CRH plc | CRH | NEUTRAL | $20.64 | $16.22 | $22.31 | 732 | 15,108 | 19,990 | 29,527 | 14,916 |
| Eagle Materials | EXP | NEUTRAL | $64.30 | $28.77 | $67.42 | 45 | 2,878 | 3,087 | 985 | 523 |
| Martin Marietta Materials | MLM | BUY | $97.37 | $63.64 | $101.57 | 46 | 4,450 | 5,513 | 702 | 1,784 |
| Owens Corning | OC | BUY | $42.23 | $25.70 | $42.80 | 121 | 5,114 | 7,280 | 7,833 | 4,152 |
| Pentair | PNR | BUY | $50.52 | $36.04 | $53.36 | 207 | 10,458 | 12,651 | 11,795 | 2,635 |
| Simpson Manufacturing | SSD | NEUTRAL | $31.79 | $23.22 | $35.06 | 48 | 1,533 | 1,345 | 867 | 96 |
| Texas Industries | TXI | NEUTRAL | $55.48 | $30.10 | $59.32 | 28 | 1,542 | 2,141 | 1,525 | 857 |
| USG Corp. | USG | NEUTRAL | $27.96 | $12.70 | $30.60 | 107 | 3,002 | 4,871 | 3,664 | 3,542 |
| Vulcan Materials | VMC | NEUTRAL | $55.41 | $32.31 | $59.48 | 130 | 7,181 | 9,750 | 8,216 | 4,470 |
| Watts Water | WTS | NEUTRAL | $45.27 | $30.88 | $45.57 | 37 | 1,666 | 2,051 | 1,712 | 893 |

***Earnings***

| Company Name | CY Earnings Per Share 2011A | 2012E | 2013E | Beta | CY EBITDA Per Share 2011A | 2012E | 2013E | CY 2012E Sales (mm) | Tangible Book Value/Share | Target Price |
|---|---|---|---|---|---|---|---|---|---|---|
| Cemex | (1.27) | (0.81) | (0.06) | 2.4 | $2.24 | $2.34 | $2.65 | 14,972 | $4 | - |
| CRH plc | 1.12 | 0.96 | 1.21 | 1.2 | $3.17 | $2.83 | $2.98 | 23,738 | $11 | - |
| Eagle Materials | 0.28 | 1.42 | 2.80 | 1.3 | $1.87 | $3.60 | $6.10 | 600 | $7 | - |
| Martin Marietta Materials | 2.05 | 2.37 | 3.42 | 1.0 | $7.70 | $8.14 | $9.67 | 1,999 | $16 | $113 |
| Owens Corning | 2.23 | 1.13 | 2.30 | 2.2 | $6.30 | $5.30 | $7.07 | 5,205 | $12 | $54 |
| Pentair | 2.41 | 2.39 | 3.23 | 1.1 | $4.79 | $5.08 | $5.66 | 7,272 | $8 | $56 |
| Simpson Manufacturing | 1.03 | 0.76 | 1.25 | 1.4 | $1.96 | $1.89 | $2.64 | 697 | $13 | - |
| Texas Industries | (2.22) | (1.41) | (0.35) | 2.0 | $0.98 | $2.03 | $4.36 | 639 | $25 | - |
| USG Corp. | (3.02) | (1.11) | 0.71 | 2.8 | $0.42 | $2.37 | $4.11 | 3,280 | $1 | - |
| Vulcan Materials | (0.82) | (0.48) | 0.28 | 1.3 | $2.67 | $3.22 | $4.30 | 2,561 | $5 | - |
| Watts Water | 2.18 | 2.16 | 2.68 | 1.6 | $5.13 | $5.49 | $6.11 | 1,455 | $3 | - |

***Valuations***

| Company Name | CY Price to Earnings 2011A | 2012E | 2013E | Price to Book Value | CY EV/EBITDA 2012E | 2013E | EV to Sales | Price to Sales | Dividend Yield | FCF Yield |
|---|---|---|---|---|---|---|---|---|---|---|
| Cemex | NM | NM | NM | 2.5x | 10.4x | 9.2x | 1.8x | 0.8x | NA | -0.1% |
| CRH plc | 18.4x | 21.6x | 17.1x | 1.9x | 9.6x | 9.2x | 0.8x | 0.6x | 4.3% | 13.0% |
| Eagle Materials | 230.5x | 45.1x | 22.9x | 9.2x | 19.1x | 11.3x | 5.1x | 4.8x | 1.1% | 0.7% |
| Martin Marietta Materials | 47.6x | 41.1x | 28.5x | 6.1x | 14.8x | 12.5x | 2.8x | 2.2x | 1.8% | -0.2% |
| Owens Corning | 18.9x | 37.5x | 18.3x | 3.5x | 11.3x | 8.5x | 1.4x | 1.0x | NA | 0.4% |
| Pentair | 21.0x | 21.1x | 15.6x | 6.6x | 12.0x | 10.8x | 1.7x | 1.4x | 2.2% | 5.6% |
| Simpson Manufacturing | 30.8x | 41.7x | 25.4x | 2.4x | 14.8x | 10.6x | 1.9x | 2.2x | 1.6% | -0.7% |
| Texas Industries | NM | NM | NM | 2.2x | 37.9x | 17.7x | 3.3x | 2.4x | 0.8% | -3.6% |
| USG Corp. | NM | NM | 39.2x | 24.6x | 19.1x | 11.0x | 1.5x | 0.9x | NA | -0.1% |
| Vulcan Materials | NM | NM | 195.7x | 10.9x | 23.4x | 17.5x | 3.8x | 2.8x | 0.1% | 2.4% |
| Watts Water | 20.8x | 21.0x | 16.9x | 15.2x | 10.2x | 9.1x | 1.4x | 1.1x | 1.1% | 2.9% |
| **Average** | **55.4x** | **32.7x** | **20.7x** | **7.8x** | **16.6x** | **11.6x** | **2.3x** | **1.8x** | **1.6%** | **1.8%** |

*Source: Baseline, Longbow Research*

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**APPENDIX**

**IMPORTANT DISCLOSURES**

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| Rating Category | Count | Percent |
|---|---|---|
| Buy | 69 | 31.4% |
| Neutral | 146 | 66.4% |
| Underperform | 5 | 2.3% |

**RATING SYSTEM:**

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"Buy" means that Longbow Securities expects total return to exceed 20% over a 12-month period.

"Neutral" means that Longbow Securities expects total return to be within a range of plus or minus 20% over a 12-month period.

"Underperform" means that Longbow Securities expects total return to be negative by greater than 20% over a 12-month period.

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