

August 15, 2003

# Huffy Corporation

NYSE: HUF - \$7.40

[www.huffy.com](http://www.huffy.com)

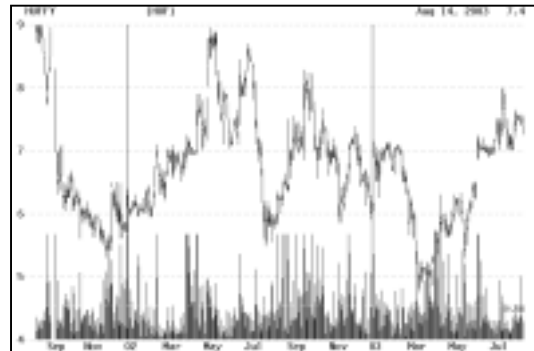
Richard J. Wayman, CFA

rwayman@researchstock.com

## 2Q03 Results

### HUF On Track to Post Solid EPS Growth, Target Price Raised

Current Data		EPS		P/E
Fiscal Year End	Dec	2002	\$ (0.12)	-64.3
Current Price	\$ 7.40	2003E	\$ 0.55	13.6
52-Week Range	8.95-5.48	2004E	\$ 0.68	10.9
Shares Out (Mill)	14.7	Valuation		Current
Ave Volume LTM	30,891	P/E (Next FY)	13.56	34-12
Market Cap. (Mill)	\$ 108.63	P/B	1.54	1.7-0.9
LTD/Total Capital	18.0%	Price/Sales	0.23	0.27-0.16
Institutional Hldngs	35.0%	Operating Data		Current
Insider Holdings	9.3%	Sales Growth	34.4%	46.0%
Book Value	\$ 4.81	Operating Margin	-0.4%	1.7%
10Yr Bond	4.57%	Net Inc. Growth	-316.7%	136.9%
Source: Baseline except for EPS estimates, researchstock.com				



Source: Baseline

#### Key Investment Points

- EPS from continuing operations on track to hit \$0.55 in 2003 versus (\$0.12) in '02.
- Sales increased 26% due to Gen-X sales and new Huffy Service First ("HSF") customers, offset by some weakness in Bikes and Sporting Goods.
- The gross margin improved to 21.6% from 18.2% due to Gen-X products in the mix.
- Financial Condition weaker due to impact of GenX seasonality and debt from that acquisition, but cash flows expected to improve as we move into seasonal highpoint.
- 12-18 month target increased to \$8.90 from \$8.00.

#### Company Description

Huffy Corporation ("HUF") designs and manufactures sport products and provides services for retailers. The Company's Consumer Products segment sells bicycles, basketball backboards, backboard support systems, goals and related products through its operating divisions Huffy Bicycle Company and Huffy Sports Company. Gen-X, the company's wholly owned subsidiary, sells golf, hockey, skis, snowboards, and in-line skates and other action sports equipment. The Company's Huffy Service First unit provides retailers with in-store and in-home assembly and repair and in-store display services for a variety of products as well as other in-store display and merchandising services. HUF acquired McCalla on 3/27/02 and Gen-X on 9/19/02. The addition of McCalla added about \$15-\$20 million in sales in 2002 while the acquisition of Gen-X could add sales of \$150 million in 2003.

Note: Please read the important disclosures at the end of this report.

## The Bottom Line

HUF appears on track to hit our EPS forecast of \$0.55 from continuing operations in 2003, a 42% improvement from the \$0.38 from continuing ops posted in 2002. GAAP EPS is expected to be \$0.61 in 2003 versus a net loss per share of \$0.12 in 2002. The main growth drivers remain the benefit of the Gen-X and McCalla acquisitions (both occurred in 2002) as well as the rebound in the sporting goods sector. Our 2004 EPS forecast remains at \$0.68 but reflects changes in outstanding shares (higher) and interest expense (lower rates).

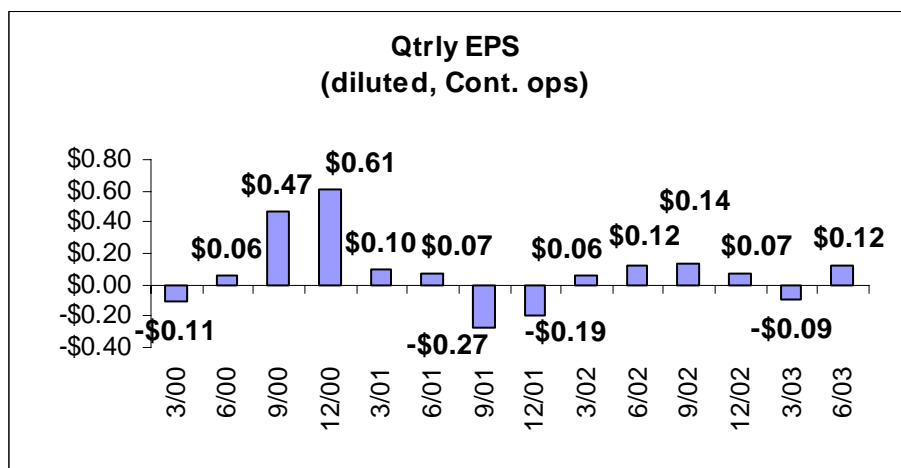
The Gen-X acquisition also materially changed HUF's cash flow and leverage. At this point of the sales cycle, operating cash flows are low and more debt is needed to fund working capital than in the past. However, it does appear that the trends are improving (as expected) as we approach the Company's seasonal high point.

We raised our 12-18 month target price to \$8.90 from \$8.00 based upon our EPS forecasts and assumed valuation multiples (as discussed below). Most of the increase is due to the expectation of higher multiples as the group benefits from a strengthening economy.

## 2Q03 Results

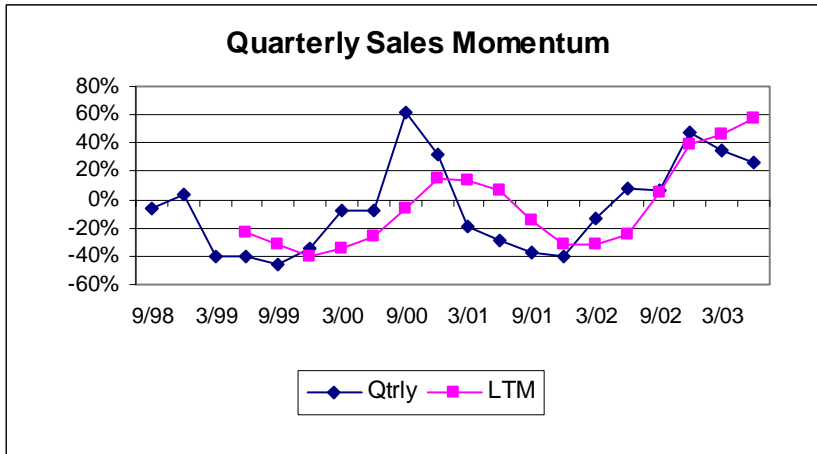
Results from continuing operations were as expected and HUF remains on track to post EPS of \$0.55 this year, up from a net loss per share of \$0.12 in 2002. In 2Q03, HUF posted GAAP EPS of \$0.18 versus \$0.12 in 1Q02, with the additional \$0.06 coming from a reversal of a litigation charge related to a divested operation (for more information on the Washington Inventory Service charge, see our report dated January 14, 2003). The quarterly EPS trend is shown in Figure 1.

Fig 1



2Q03 sales increased 25.8% (compared to 34% in 1Q03) due to the contributions of the McCalla and GenX acquisitions (acquired in late 3/02 and 9/02, respectively). Product sales increased 36.3% as Gen-X sales offset weakness in the "core" business caused by the decline in K-Mart business and the weak economy. Sales momentum is illustrated in Figure 2.

Figure 2



The gross margin improved to 21.6% from 18.2%. (During 1Q03 the gross margin improved to 21.0% from 17.1%.) This growth is largely due to the addition of the higher-margin sales from Gen-X and a 4% improvement in Service gross margin (see Fig 3).

Operating margins improved as the growth in sales and the gross margin offset higher SG&A expenses. SG&A expenses increased as HUF continued to invest in branding and new product introduction. The trend in operating margins is shown in Fig 4.

Figure 3

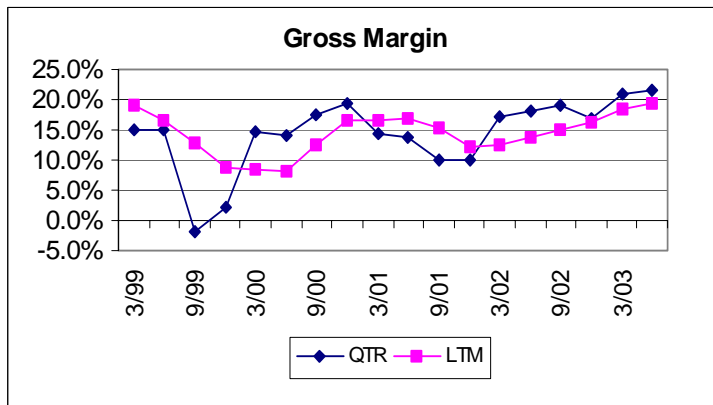
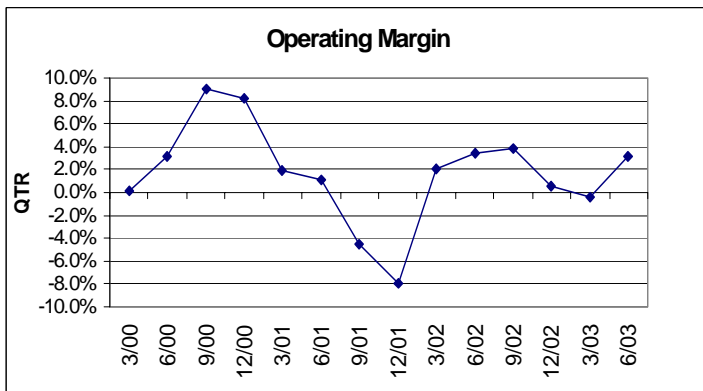


Figure 4



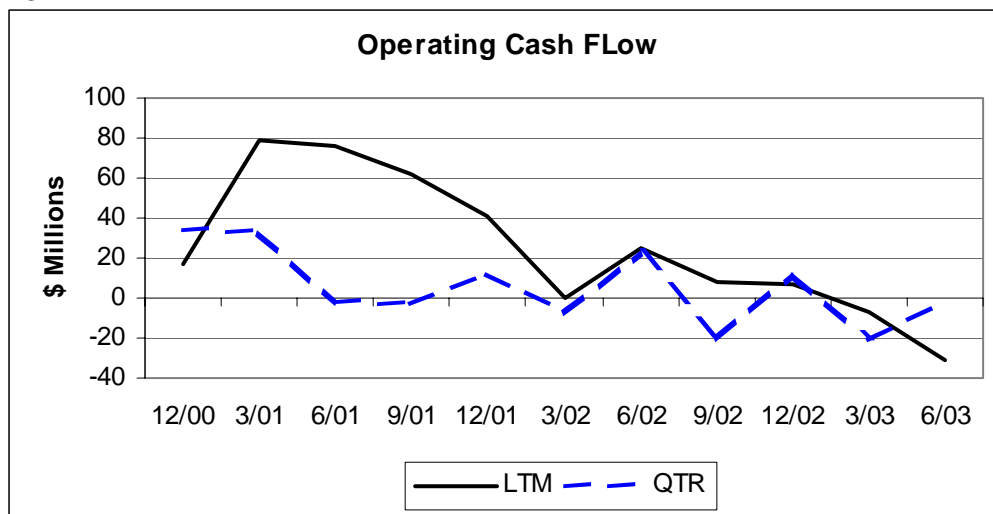
The net operating results for 2Q03 are compared to the year ago period in Table 1.

<b>Table 1: Quarter Comparison</b>			
(\$ Million, except per share)	<b>6/02</b>	<b>6/03</b>	<b>Change</b>
Revenues	93.41	117.48	26%
Cost of Goods Sold	76.38	92.13	21%
Gross Profit	17.03	25.35	49%
SG&A	13.85	21.63	56%
Operating Income	3.18	3.72	17%
Interest Expense/ (Inc.)	0.32	1.28	302%
Other Expenses/ (Inc.)	0.76	0.17	-77%
PreTax Income	2.10	2.27	8%
Income Taxes (benefit)	0.83	0.45	-45%
Net Income-Cont. Ops	1.28	1.81	42%
Discont. Ops.	0.00	0.96	na
Net Income	1.28	2.77	117%
EPS-Diluted	\$ 0.12	\$ 0.18	54%
FAS 142 equivalent	\$ 0.12	\$ 0.18	54%
Diluted Shares	10.736	15.112	41%
Effective Tax Rate	39%	20%	
<b>Margin Analysis</b>			
Gross	18.2%	21.6%	18%
EBITDA	4.4%	4.3%	-100%
Operating	3.4%	3.2%	-100%
Net-Continuing operations	1.4%	1.5%	-100%
<b>Other Data</b>			
Cash per share	\$ 3.38	\$ 0.04	-99%
Days Sales Outstanding	55	54	-2%
Inventory Turnover	13	10	-22%

## Financial Condition

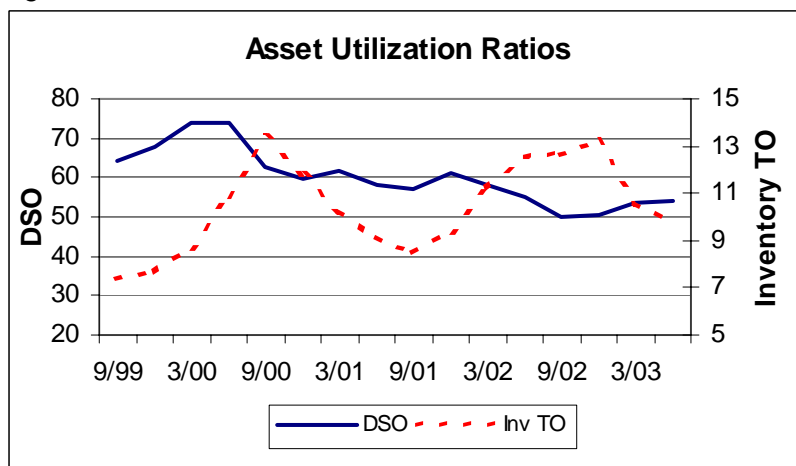
Operating cash flow for 2Q03 improved but remained negative, the result of the seasonality of the GenX business and some weakness in consumer demand (see Figure 5).

Figure 5



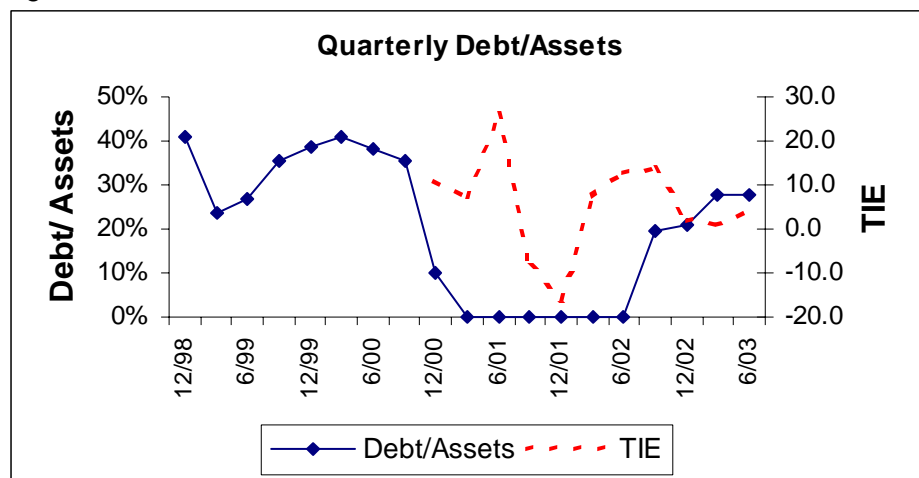
The impact of the GenX acquisition (which occurred late in 4Q02) caused inventory turns to fall and day sales outstanding to increase slightly (see Figure 6).

Figure 6



The combination of the added debt and changed seasonality caused both leverage and times interest earned ("TIE") to deteriorate (as shown in Figure 7). While the trend in operating cash flow and leverage is a concern, we think it is a temporary condition and it appears to have started to improve as we expected (see our report on 1Q03). However, if consumer spending slides and operating results fall below expectations, this will become more of a concern. (See Risk Considerations, below.)

Figure 7



### Peer Group Comparison

HUF's trailing 12-month comparative performance reflects the impact of the Gen-X acquisition, which, while boosting sales and gross margin, negatively impacted net income and leverage. We expect to see some improvement in cash flow and leverage as we enter the second half, which is the seasonal high point for both HUF's core business and Gen-X.

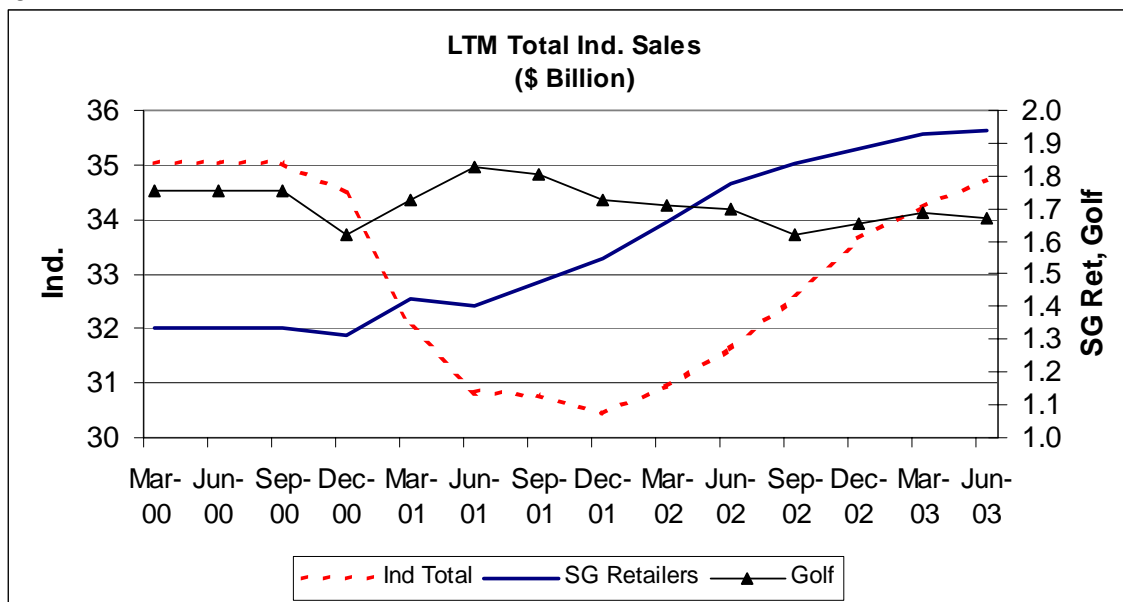
(\$Million)	Sales		Margins			EPS	% Change	Assets/ Equity	TIE	Operat. cashflow	% Change
	\$	Growth	Gross	EBIDTA	Net						
<b>HUF</b>	\$ 421.2	29%	20%	2.4%	0.7%	\$0.24	192%	313%	1.9	-17.8	-119.0%
Leisure Industry	\$ 677.8	8%	37%	2.4%	0.7%	\$0.76	41%	314%	14.7	0.0	0.0%
Golf	\$ 416.0	-3%	37%	24%	1%	\$ 0.41	21%	23%	74.7	0.0	0.0%
Peer group	\$ 350.6	11%	34%	11%	2%	\$ 0.56	70%	424%	29.2	155.8	-1.1%
<b>Peer Group</b>											
ALDA	\$ 35.6	-4.1%	19%	na	-7.8%	(\$0.45)	21%	-	-	6.8	171.9%
ELY	\$ 796.3	-1.7%	55%	23.8%	9.8%	\$1.27	20%	23%	74.7	283.5	29.2%
VFLX	\$ 60.0	39.3%	18%	5.0%	3.1%	\$0.39	203%	38%	57.5	-0.8	-142.7%
ESCA	\$ 184.7	21.3%	34%	11.8%	5.9%	\$1.65	-6%	373%	10.9	-8.3	-149.7%
HED	\$ 392.6	1.5%	44%	5.3%	-2.3%	(\$0.25)	na	882%	0.4	58.1	-36.9%
KTO	\$ 634.5	8.8%	33%	8.3%	1.4%	\$0.72	112%	805%	2.6	35.9	-23.2%

Source: Baseline

## Industry Overview

The sporting goods manufacturing industry appears to be rebounding after bottoming at December 2001 (see Figure 8). The strong sales trends of the major sporting goods retailers indicate good sell-through, which bodes well for the upcoming season. The golf sector, while still below par of the booming 2001 season, appears to be stabilizing.

Fig 8.



## Outlook

We reiterate our EPS forecast of \$0.54 to \$0.56 in 2003 and \$0.68 for 2004. Our 2004 model changed to reflect our revised assumptions of an increase in diluted shares outstanding and a decline in interest rates. Our key assumptions are as follows:

- 2003 revenues are expected to grow 28% due to the timing of the GenX acquisition (acquired late in 2001). Our pro-forma assumption is that core growth rate of the combined entities will be 2.9% in 2003 and 2.5% in 2004 due to continued economic weakness and low consumer confidence assumptions.
- 2004 Sales are currently assumed to grow 3.2%. The growth rate slows as the anniversary of the Gen-X acquisition occurs and comparisons are more difficult. In addition, HUF indicated in its 2Q03 SEC filing that its bid to retain one of its major service clients was not accepted. While this is not expected to impact 2003 results, it could adversely impact our 2004 forecast if the business volume is not replaced. (See Risk Considerations for more details.)
- The gross margin will range between 21.0% and 22.0%, higher than HUF's historical range because of the higher margins on GenX products.
- SG&A expenses increase due to higher pension and health care costs and as HUF increases marketing efforts (17.0-17.7% versus a historic range of 11.0%-15.5%).
- Interest expense increased due to the addition of GenX-related debt. We assumed a 7% interest rate (versus a range of 7% to 8%).

Our annual forecast is outlined in Table 3 and our quarterly expectations for 2003 are shown in Table 4.

<b>Table 3: Operating Forecast</b>								
(\$ Million, except per share)	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003e</b>	<b>2004e</b>
Revenues	481.5	584.2	422.9	488.2	331.1	372.9	<b>476.1</b>	<b>491.3</b>
Cost of Goods Sold	407.5	392.2	386.1	406.8	291.2	306.5	<b>374.1</b>	<b>385.7</b>
Gross Profit	74.0	76.2	36.7	81.3	40.0	66.3	<b>102.0</b>	<b>105.6</b>
SG&A	61.8	59.7	56.2	53.8	47.6	57.9	<b>84.2</b>	<b>86.4</b>
Plant Reconfig	0.0	21.3	38.6	0.7	3.7	0.0	<b>0.0</b>	<b>0.0</b>
Operating Income	12.2	-4.9	-58.0	26.9	-11.4	8.5	<b>17.8</b>	<b>19.2</b>
Int Expense-Net (Inc)	0.5	2.5	1.8	8.6	1.8	2.0	<b>4.7</b>	<b>3.3</b>
Non-recurring						0		
Other Expenses/(inc.)	1.4	0.0	0.3	1.3	0.3	1.6	<b>0.8</b>	<b>0.4</b>
PreTax Income	10.3	-7.4	-60.1	17.1	-12.8	5.2	<b>12.3</b>	<b>15.6</b>
Income Taxes	2.7	-2.9	-20.8	6.4	-4.4	0.6	<b>4.1</b>	<b>5.3</b>
Discont. Ops	1.4	2.3	6.1	24.3	0.0	-6.0	<b>1.0</b>	<b>0.0</b>
Net Income	9.0	-2.2	-33.3	35.0	-8.4	-1.4	<b>9.1</b>	<b>10.3</b>
<b>EPS-Diluted (as reported)</b>	\$ 0.69	\$ (0.18)	\$ (3.13)	\$ 3.39	\$ (0.82)	\$ (0.03)	<b>\$ 0.61</b>	<b>\$ 0.68</b>
- FAS 142 equivalent				\$ 3.46	\$ (0.75)	\$ (0.03)	<b>\$ 0.61</b>	<b>\$ 0.68</b>
Diluted Shares	13.1	12.3	10.6	10.3	10.3	12.0	<b>15.0</b>	<b>15.2</b>
Effective Tax Rate	26%	39%	35%	38%	34%	11%	<b>33%</b>	<b>34%</b>
<b>Boldface data are forecasts.</b>								
<b>Growth Rates</b>								
Sales	-16.9%	21.3%	-27.6%	15.4%	-32.2%	12.6%	<b>27.7%</b>	<b>3.2%</b>
Net Income	9.6%	-124.2%	-1438%	205.1%	-124.0%	83.6%	<b>763.8%</b>	<b>12.6%</b>
EPS- FAS 142 equivalent					-121.7%	96.0%		
<b>Margin Analysis</b>								
Gross	15.4%	13.0%	8.7%	16.7%	12.1%	17.8%	<b>21.4%</b>	<b>21.5%</b>
SGA/Sales	12.8%	10.2%	13.3%	11.0%	14.4%	15.5%	<b>17.7%</b>	<b>17.6%</b>
Operating	2.5%	-0.8%	-13.7%	5.5%	-3.4%	2.3%	<b>3.7%</b>	<b>3.9%</b>
Net	1.9%	-0.4%	-7.9%	7.2%	-2.5%	-0.4%	<b>1.9%</b>	<b>2.1%</b>

<b>Table 4: Quarterly Operating Forecast</b>								
(\$ Million, except per share)	<b>Mar-02</b>	<b>Jun-02</b>	<b>9/02</b>	<b>12/02</b>	<b>Mar-03</b>	<b>Jun-03</b>	<b>9/03</b>	<b>12/03</b>
Revenues	70.39	93.41	83.03	126.07	94.63	117.48	<b>131.00</b>	<b>133.00</b>
Cost of Goods Sold	58.38	76.38	67.07	104.71	74.74	92.13	<b>102.84</b>	<b>104.41</b>
Gross Profit	12.00	17.03	15.96	21.36	19.89	25.35	<b>28.17</b>	<b>28.60</b>
SG&A	10.53	13.85	12.83	20.66	20.30	21.63	<b>21.30</b>	<b>21.00</b>
Plant Reconfig	0.00	0.00	0.00	0.00	0.00	0.00	<b>0.00</b>	<b>0.00</b>
Operating Income	1.47	3.18	3.13	0.70	-0.41	3.72	<b>6.86</b>	<b>7.60</b>
Interest Expense/ (Inc.)	0.30	0.32	0.29	0.78	1.11	1.28	<b>1.20</b>	<b>1.10</b>
Other Expenses/ (Inc.)	0.20	0.76	0.42	0.25	0.17	0.17	<b>0.20</b>	<b>0.25</b>
PreTax Income	0.97	2.10	2.42	-0.33	-1.69	2.27	<b>5.46</b>	<b>6.25</b>
Income Taxes	0.34	0.83	0.75	-1.35	-0.34	0.45	<b>1.86</b>	<b>2.12</b>
Net Income-Cont. Ops	0.62	1.28	1.67	1.02	-1.35	1.81	<b>3.61</b>	<b>4.12</b>
Discont. Ops.	0.00	0.00	-0.72	-5.25	0.00	0.96	<b>0.00</b>	<b>0.00</b>
Net Income	0.62	1.28	0.95	-4.22	-1.35	2.77	<b>3.61</b>	<b>4.12</b>
EPS-Diluted	\$ 0.06	\$ 0.12	\$ 0.08	\$ (0.29)	\$ (0.09)	\$ 0.18	<b>\$ 0.24</b>	<b>\$ 0.27</b>
FAS 142 equivalent	\$ 0.06	\$ 0.12	\$ 0.08	\$ (0.29)	\$ (0.09)	\$ 0.18	<b>\$ 0.24</b>	<b>\$ 0.27</b>
Diluted Shares	10.618	10.736	12.128	14.788	14.68	15.112	<b>15.112</b>	<b>15.112</b>
Effective Tax Rate	35%	39%	31%	412%	20%	20%	<b>34%</b>	<b>34%</b>
Boldfaced data are estimates.								
<b>Growth Rates</b>								
Sales	-13.4%	7.5%	6.5%	48.2%	34.4%	25.8%	<b>57.8%</b>	<b>5.5%</b>
Operating Income	-7.5%	222.3%	-190.1%	110.4%	128.0%	-16.8%	<b>-119.4%</b>	<b>-980.4%</b>
Net Income	62.8%	166.0%	-33.8%	42.7%	316.7%	-117.3%	<b>-281.3%</b>	<b>197.6%</b>
EPS (FAS 142)	-46.6%	48.4%	-130.7%	58.8%	256.7%	-54.4%	<b>-206.0%</b>	<b>195.5%</b>
<b>Margin Analysis</b>								
Gross	17.1%	18.2%	19.2%	16.9%	21.0%	21.6%	<b>21.5%</b>	<b>21.5%</b>
EBITDAR	2.1%	3.4%	3.8%	0.6%	-0.4%	3.2%	<b>5.2%</b>	<b>5.7%</b>
Operating	2.1%	3.4%	3.8%	0.6%	-0.4%	3.2%	<b>5.2%</b>	<b>5.7%</b>
Net	0.9%	1.4%	1.1%	-3.3%	-1.4%	2.4%	<b>2.8%</b>	<b>3.1%</b>

## Valuation

We raised our 12-18 month target valuation to \$8.90 from \$8.00 based upon our earnings forecast and the methodology shown in Table 5. We revised some of the assumed multiples to factor in current valuations, which we feel should expand for the group as the economy strengthens.

<b>Table 5: Target Price Calculations</b>									
		<b>Multiples</b>							
		<b>LTM</b>			<b>2003</b>	<b>Target</b>	<b>Mult.</b>	<b>2004</b>	<b>Target</b>
		<b>Range</b>	<b>Current*</b>	<b>Forecast</b>	<b>Est.**</b>	<b>Range</b>	<b>F'cast</b>	<b>Est.**</b>	<b>Range</b>
<b>Price/Book</b>	High	1.4	1.5	1.6	\$ 7.30	\$ 11.68	1.6	\$ 7.98	\$ 12.76
	Low	0.9		1.0		\$ 7.30	1.0		\$ 7.98
<b>Price/Sales</b>	High	0.29	0.26	0.40	\$ 31.73	\$ 12.69	0.30	\$ 32.32	\$ 9.70
	Low	0.17		0.17		\$ 5.39	0.17		\$ 5.49
<b>P/E*</b>	High	-10.5	10.9	19.0	\$ 0.55	\$ 10.45	18.0	\$ 0.68	\$ 12.19
	Low	-191.7		8.0		\$ 4.40	8.0		\$ 5.42
* Current P/E is based on 2003 EPS forecast									
** Continuing operations				Average	High	\$ 11.61	Average	High	\$ 11.55
					Low	\$ 5.70		Low	\$ 6.30
				Average		\$ 8.65	Average		\$ 8.92

Our assumed valuation multiples are also in line with the peer group. A summary of peer group valuation metrics are shown in Table 6.

		P/E		Price to			Sales/ Share	Ent Val/ EBITDA
		2002	2003	Book	CF	Sales		
<b>HUF</b>	\$7.40	<b>19.0</b>	<b>13.5</b>	<b>1.5</b>	<b>14.8</b>	<b>0.26</b>	<b>\$28.63</b>	<b>18.7</b>
Leisure Industry	\$16.43	7.5	1.0	2.9	11.3	0.95	\$32.63	9.0
Peer group	\$15.23	1.1	15.1	1.5	10.7	0.7	\$ 21.15	8.0
Golf	\$8.66	1.0	14.5	1.2	8.6	0.9	\$8.87	5.4
Sport. Goods Retail	\$26.16	1.5	14.5	2.8	11.9	0.7	\$39.08	8.7
<b>Peer Group</b>								
ALDA	\$2.11	-	-	0.4	-	0.3	\$ 7.19	-
ELY	\$15.21	1.0	14.5	2.0	8.6	1.4	\$ 10.54	5.4
VFLX	\$5.96	-	-	0.9	11.5	0.5	\$ 13.03	6.3
ESCA	\$16.25	-	-	2.3	7.3	0.6	\$ 28.70	7.3
HED	\$2.10	-	-	0.3	11.8	0.2	\$ 9.86	9
KTO	\$17.90	0.5	19.2	1.6	14.2	0.8	\$ 23.66	12
<b>Sporting Goods Retailers</b>								
TSA	\$28.70	2.0	12.7	1.7	10.3	0.7	\$ 42.84	8.6
GLYN	\$12.50	0.8	11.9	1.0	6.2	0.4	\$ 35.71	5.3
GRTS	\$28.98	-	-	-	-	-	-	-
HIBB	\$22.62	1.1	17.4	3.3	15.5	1.2	\$ 18.81	10.4
DKS	\$38.00	2.0	16.1	5.3	15.4	0.6	\$ 58.96	10.3

### Risk Considerations

In addition to normal investment risk, investors need to consider the following when evaluating an investment in the shares of this stock:

Loss of a Service customer could have an adverse impact on 2004 sales if volume is not replaced. In the 2Q03 10-Q HUF disclosed that its "bid to retain a portion of its current business with a retailer in the home improvement segment was not accepted." While we do not expect this to impact 2003 sales, it could impact 2004 sales if the business is not replaced. The extent of a worst case (no replacement is found) scenario is difficult to quantify because no additional data was provided. It appears that the potential loss is material enough that Management felt it should be disclosed, but not material (or not yet quantifiable) enough to be more specific. With the pressure on retailers to cut costs, it is possible that HUF could replace the lost business.

The acquisition of GenX, combined with a slow economy, resulted in negative operating cash flow and increased leverage during 1Q03. (One of HUF's fundamental strengths has been its ability to generate positive cash flows.) While we think the GenX acquisition will be good for the long term, it could cause some near-term concern as investors get accustomed to the new seasonal working capital flows of the combined company. However, if consumer spending falls, it could have an adverse impact on demand for HUF's products and cause HUF's operating

results to fall below our forecast. This could result in continued negative operating cash flows which would adversely impact leverage and solvency ratios.

The shares are thinly traded and could experience significant volatility.

The Company is not widely followed by Wall Street analysts. As a consequence, any improvement in operations may not be reflected in the share price as quickly as it might if the Company was widely followed.

The EPA issue regarding groundwater contamination at a former HUF site appears to have been resolved, with the superfund settlement which was announced on May 10, 2002. The Company has reserved the estimated amount needed (\$6.93 million), and the costs will have no impact on earnings. The Company continues to seek contribution from other non-signatory potentially responsible parties, although no payback of funds is included in any of our estimates.

The introduction of Schwinn bicycles into the mass marketing retail segment is expected to create strong competition with HUF not only for sales but also for floor space at various retailers. 2002 floor space allocations have already been decided, but there is risk in this area in 2003.

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**FULL FRONTAL DISCLOSURE** (In plain English)

- We are paid a fixed annual cash-only fee by the subject company to provide research, much as a corporation pays a fee to a bond-rating agency for bond research and ratings. We do not accept any form of equity as payment nor a "performance bonus."
- The opinions expressed in this report represent the true opinions of the analyst.
- Any "forward looking statements" are our estimates and are based upon information that is publicly available and that we believe to be correct, but we have not independently verified its truthfulness.
- Our forecasts may turn out to be wrong.
- The analyst does not own any shares of the subject company in any form.
- We do not make a market in the shares of the subject company.
- We have not done any investment banking business with the subject company.

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(Legalese)

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