

Zacks Small-Cap Research

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O2Micro International Ltd (NASDAQ: OIIM)

O2Micro Reached Both Profitability and Positive EBITDA in Q2 After Rightsizing

Using an industry average value to trailing 12-month sales of 8.5 times and OIIM's \$66.8 m trailing 12-month revenue, we would calculate an enterprise value of \$566 million, a market cap of \$607 million and a price of **\$21.90 per share**, if the company could reach breakeven and stay there.

Current Price (07/30/20) \$2.25
Valuation **\$21.90**

OUTLOOK

O₂Micro International is a fabless semiconductor firm that designs, develops and markets high performance integrated circuits primarily for power management and battery management for TV backlighting, LED lighting, and portable tools and appliances. It has struggled to reach profitability and cash flow breakeven but this quarter achieved both. The company trades at an **enterprise value of \$21 million**. It is enjoying a surge in TV and battery operated tools sales due to shutdowns around the world. Its recent rightsizing actions have restructured it for profitability.

SUMMARY DATA

52-Week High \$2.41
52-Week Low \$1.00
One-Year Return (%) 63.5
Beta 0.8
Average Daily Volume (sh) 124,971

Shares Outstanding (mil) 27.0
Market Capitalization (\$mil) \$60.8
Short Interest Ratio (days) 1.0
Institutional Ownership (%) 37
Insider Ownership (%) 8

Annual Cash Dividend \$0.00
Dividend Yield (%) 0.00

5-Yr. Historical Growth Rates

Sales (%) 2.9
Earnings Per Share (%) N/A
Dividend (%) N/A

P/E using TTM EPS N/M

P/E using 2020 Estimate 28.1

P/E using 2021 Estimate 12.5

Risk Level

Type of Stock
Industry

Below Average
Small-Value
Elec Comp-Semis

ZACKS ESTIMATES

Revenue

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2018	14.1 A	15.2 A	16.8 A	16.6 A	63 A
2019	12.8 A	14.3 A	16.0 A	17.9 A	61 A
2021	15.6 A	17.3 A	18.3 E	18.0 E	69 E
2020					75 E

Earnings Per Share

(non-GAAP EPS before non-recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2018	-\$0.09 A	-\$0.05 A	-\$0.05 A	-\$0.05 A	-\$0.24 A
2019	-\$0.13 A	-\$0.08 A	-\$0.02 A	\$0.05 A	-\$0.18 A
2020	-\$0.00 A	\$0.03 A	\$0.05 E	\$0.04 E	\$0.08 E
2021					\$0.18 E

Zacks Projected EPS Growth Rate - Next 5 Years % 5

WHAT'S NEW

O2Micro Hits Profitability and Positive EBITDA in Q2

Sales continued strong in Q2 at O2Micro coming off a strong Q1 as it is benefitting greatly from global stay at home orders. Almost everything it sells product into is affected: TVs, laptops, monitors for gaming and medical devices, garden tools, power tools, and ebikes. Demand remains strong from customers. Fortunately the company also right sized the business to focus on higher margin products in Q2 and should emerge a consistently profitable company for the first time in years. By cutting staff sufficiently we expect the company to continue to show profits going forward. This cost cutting produced a surprise profit both on a GAAP and non-GAAP basis and as revenues rise, and expenses continue downward for two more quarters, the profit margin will widen. EBITDA was \$1.8 million this quarter and if it tracks with the average fabless semiconductor company that margin could double as a percent of sales.

Q2 Results

Revenues were \$17.3 million compared with \$14.3 million in Q2 a year ago, up 21%. Guidance for revenue for the third quarter of 2020 was for revenues between \$17.6 and \$19.0 million or a midpoint of \$18.3 million, which would be growth of 14% year over year.

For Q2 the gross margin was 51.2% compared to 50.1% a year ago and 51.9% in Q1 2020. The company said to expect Q3 2020 gross margin to be in the range of 50-52%.

Reported total operating expenses increased to \$9.5 million up from the \$8.7 million spent in Q1 2020, but down from the \$9.7 million in Q2 2019. Included in these expenses was a one-time charge of \$1.2 million for severance. The company went from 370 employees in Q1 to 289 in Q2. Without that charge operating expenses were only \$8.4 million

R&D increased in the quarter to \$5.0 million, but included in that number was \$957,000 in one time severance cost as the company streamlined operations to focus on higher margin products. Without that R&D would have been \$4.1 million, just like in Q1 2020.

Reported SG&A was \$4.5 million and included \$200,000 in severance. Without that, it would have been \$4.3 million sequentially down, as well as down from the \$4.9 million in Q2 2019.

Without the one-time charge, operating income in Q2 would have been \$482,000 versus a loss of \$2.6 million last year. Adding back depreciation and amortization (\$830,000) and stock-based compensation (\$327,000,) and adding the rental income, the adjusted EBITDA looks to be a positive \$1.8 million compared to \$445,000 in Q1 2020 and a negative \$2.8 million in Q2 2019.

Total other income was \$1.3 million versus a positive \$89,000 last year. This year included a \$1.1 million unrealized gain on the company holding in Excelliance MOS stock. In Q2 O2Micro sold 195,000 shares of Excelliance MOS stock for proceeds of \$724,000 at an average price of \$3.73. It had a cost basis of \$0.53. It still holds 589,000 shares, and expects to sell more in Q3 2020.

The company reported a GAAP net income of \$380,000 versus last year's loss of \$2.8 million last year. This yielded GAAP EPS of \$0.01 versus a loss per share of \$0.11 a year ago.

Non-GAAP income was \$805,000, versus a loss of \$2.2 million last year. This yielded a **non-GAAP EPS of \$0.03, versus a loss per share of \$0.08 last year.**

In Q2 2020, the company repurchased 1,900 ADS units at a cost of \$2,000.

On June 30, 2020, the company had \$41.4 million in cash and equivalents (or \$1.53 per ADS), down \$3.3 million sequentially. Net cash used by operating activities in the quarter was \$4 million. Capital expenditures were \$361,000 and depreciation and amortization was \$830,000.

In Q2 the company streamlined operations for profitability; the company's cash breakeven point is now between \$14-16 million and the profit breakeven to \$16-18 million. The full effect of these cost savings efforts will be felt in Q4 2020.

Revenue By Segment

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
Consumer	40-45%	42-44%	49-51%	43-45%	46-48%	43-45%	44-46%	43-45%	44-46	47-49
Computer	10-15	15-17	8-10	6-8	6-8	6-8	6-8	5-7	5-7	5-7
Industrial	40-45	40-42	40-42	47-49	45-47	47-49	47-49	48-50	48-50	45-47
Communications	<5	0	0	0	0	0	0	0	0	0

During the quarter strength in TVs, HDR monitors, garden and power tools, ebikes and even medical monitors continued. Both intelligent lighting (TVs and monitors) and battery management are exhibiting strong demand. Over 90% of the company's sales come from TVs and battery-powered devices.

Intelligent lighting again did very well in Q2 as TV viewing increased and consumers continued to upgrade to 4K and 8K TVs. The company is introducing improved technology that eliminates motion blur and halo effects by doing multi-scan refreshes. The technology is starting being used in HDR monitors (for gaming) and migrating to TVs where 2 scans are moving all the way up to 16 plus scans for high-end televisions. O2Micro has a patent application for this technology.

The battery business continues to have excellent growth. Battery prices have declined from \$1,100 per KWH to \$150 today and are projected to sink to \$100 per KWH by 2023. This opens up economics for formerly corded appliances and tools to become battery operated. One such appliance is Dyson's highly acclaimed new cordless *Corrale* hair straightener that does the job without damaging heat, and can get it done in five minutes versus 45 minutes according to some reviewers.

Figure 1. Dyson Cordless Vacuums



Source: Shutterstock

During Q2

On May 19, 2020 O2Micro was granted patent US10,660,176 B2 which patents a cost-effective and efficient power management solution for LED backlighting use, although it could be valid for any application using light.

System and method for driving light source comprising voltage feedback circuit and current feedback circuit

Abstract

A system for driving a light source includes a power converter and control circuitry coupled to the power converter. The power converter converts input power to an output voltage to power the light source. The control circuitry senses the output voltage and senses current of the light source. The control circuitry generates a control signal based on a voltage feedback signal indicative of a combination of said output voltage and said current of said light source, and controls the power converter by the control signal to adjust the output voltage.

VALUATION

Company Has Significant Upside If It Can End Cash Burn and Sustain a Profit

The company trades at an **enterprise value of \$21.0 million**. At the end of Q2 2020, the company had \$41.4 million (or \$1.53 per ADS) in cash and equivalents, no debt, and valuable real estate in China and California. In California it owns a 37,180 square foot building where it has its USA operations, which was bought for \$4.6 million in May 2004 and believe it is now easily worth more than \$7 million. Plus it also owns other real estate in China and Taiwan. Also on the balance sheet are long-term investments in other companies, including 589,000 shares of stock in Excelliance MOS (worth \$2.4 million.) The company has a high liquidation, as well as acquisition, value. Activists have tried to encourage a transaction with an acquirer, but the company has no interest in a sale and due to restrictions, it is difficult to force one.

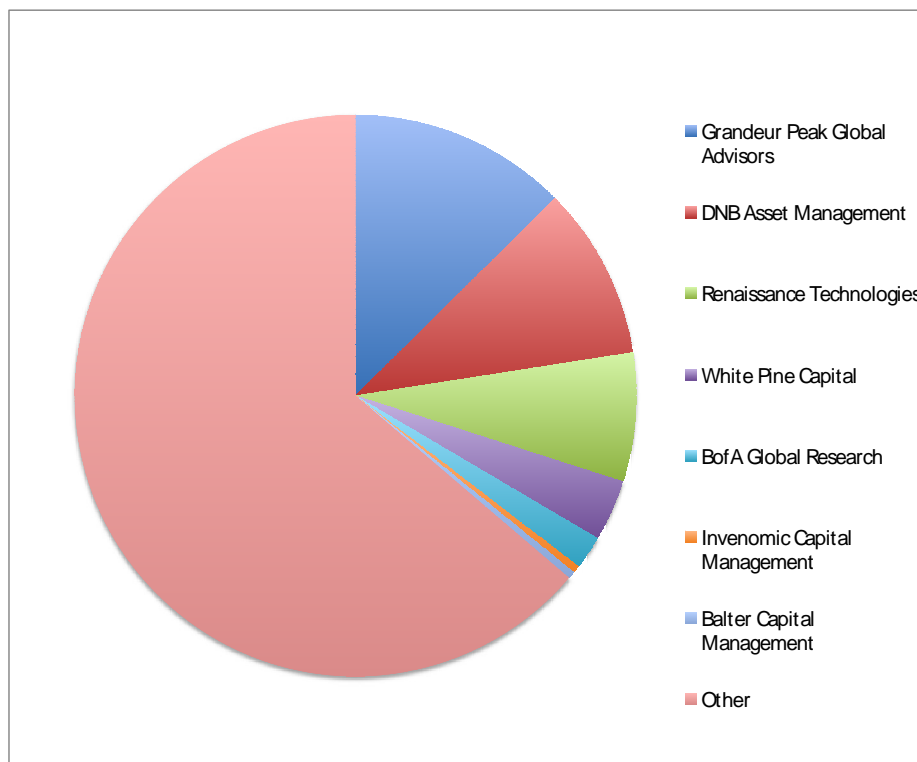
Looking at O2 Micro from an M&A prospective we can look at other fabless semiconductor transactions. In May 2018, Microchip Technology bought Microsemi for \$10.15 billion, which was a valuation of 5.5 times its trailing twelve-month revenues of \$1.845 billion. Two other comparable companies we had been using, Intersil and Linear Technology, were acquired at very high valuations. Intersil was acquired by Renesas for \$3.2 billion at a valuation of 5.9xs the company's trailing \$542.1 million in revenue. Analog Devices acquired linear Technology for \$14.8 billion. This was 9.9 times its trailing four quarters of revenue of \$1.5 billion.

Were we to use the current average enterprise value to trailing twelve-month sales of 8.5 times and apply it to OIIM's trailing 12-month \$66.8 million revenues, we would calculate an enterprise value of \$566 million. Adding to it \$41.4 million in cash and equivalents gives us a market cap of \$607 million or **\$21.90 per share**. We believe that once the company shows sustainable revenue growth and cash generation, the market should afford it a valuation closer to this price. It is certainly on the path to do this.

As it moves to profits, we can even look at the stock on a PE basis. Currently trades at only 12.5 times 2021 estimated EPS.

	Competitors	EV	TTM Sales	EV/Sales
Monolithic Power Systems	MPWR	11,600	688	16.9
Cree Inc.	CREE	7,110	950	7.5
Microchip Technology	MCHP	35,023	5,270	6.6
Maxim	MXIM	17,800	2,190	8.1
Texas Instruments	TXN	120,000	13,690	8.8
Cirrus Logic	CRUS	3,720	1,280	2.9
	Average			8.5

OWNERSHIP



Source: Zacks Investment Research

RISKS

- O₂Micro has high exposure to the global demand for TVs, particularly those sold in China. It is depending on free dimming and high power LED lighting, 4K and 8K and other high end TVs and monitors, lithium ion battery powered tools and appliances, and IoT to give it revenue and margin growth.

- In 2019, two customers accounted for 26% of revenues and their loss could cause a meaningful decline in revenues. 86% of revenues were from China. Without the FEIT license fee, we believe that number would be 89%.
- The company is currently being affected by the proliferation of the coronavirus in China as their production and most of their customers are located in China and sell to the Chinese market. Right now is unknown how restrictions and health concerns will affect commerce in both the short and long term.
- The firm has had only two profitable GAAP quarter since 2011, and although probable, it remains to be seen if positive results will be truly sustainable.
- Given its large number of patents, litigation risk is a possibility as the company enforces its patents.

INCOME STATEMENT

	March Q1 19	June Q2 19	Sept Q3 19	Dec Q4 19	March Q1 20	June Q2 20	Sept Q3 20E	Dec Q4 20E	2018	2019	2020E	2021E
REVENUE												
Net Revenue	12.8 [*]	14.3 [*]	16.0	17.9	15.6	17.3	18.3	18.0	62.7	60.9	69.2	74.7
Yr-to-yr Gr.	-10%	-6%	-5%	8%	22%	21%	14%	1%	4%	-3%	14%	8%
OPERATING EXPENSES												
Cost of goods sold	6.3	7.1	7.8	7.7	7.5	8.4	8.8	8.7	30.7	29.0	33.4	36.0
Gross Margin	6.4	7.1	8.2	10.1	8.1	8.9	9.5	9.3	32.0	32.0	35.7	38.7
% of Sales	50.5%	50.1%	51.4%	56.7%	51.9%	51.2%	51.9%	51.7%	51.0%	52.5%	51.7%	51.8%
R&D	5.1	4.8	4.7	4.4	4.1	4.1	4.1	4.0	19.8	19.1	16.3	17.0
SG&A	5.0	4.9	4.6	4.8	4.5	4.3	4.5	4.5	20.3	19.3	17.8	18.5
One-time expenses & Adj.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0
Tot Operating Exp.	10.0	9.7	9.4	9.2	8.7	8.4	8.6	8.5	40.1	38.4	34.2	35.5
Operating Income	(3.6)	(2.6)	(1.1)	0.9	(0.6)	0.5	0.9	0.8	(8.1)	(6.4)	1.6	3.2
Interest income	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.4	0.5	0.6	0.6
Unrealized fair value on LT Investment	0.0	(0.2)	0.7	0.2	(1.1)	1.1	0.0	0.0	9.8	0.8	(0.0)	0.0
Foreign exchange loss	(0.1)	0.1	0.0	(0.1)	0.0	(0.1)	0.0	0.0	0.1	(0.2)	(0.1)	0.0
Gain on sale of real estate	0.0	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.5	0.0	0.0
Other (rent) - net	0.1	0.1	0.4	0.2	0.1	0.2	0.2	0.2	1.0	0.8	0.7	0.8
One-time charge	0.0	0.0	0.0	0.0	0.0	(1.2)	0.0	0.0	0.0	0.0	(1.2)	0.0
Total other Income	0.1	0.1	1.2	1.1	(0.8)	0.2	0.3	0.3	11.4	2.5	0.1	1.4
Pretax Income	(3.5)	(2.5)	0.1	2.0	(1.3)	0.6	1.2	1.1	3.3	(3.9)	1.6	4.6
Pretax margin	-27.6%	-17.4%	0.8%	11.3%	-8.6%	3.7%	6.6%	6.2%	5.2%	-6.3%	2.4%	6.1%
Taxes	0.3	0.3	0.3	0.3	0.2	0.3	0.3	0.3	1.1	1.2	1.0	1.1
Tax Rate	-8.5%	-11.6%	251.5%	12.4%	-15.4%	40.8%	20.6%	25.1%	34.9%	-30.3%	60.8%	24.5%
GAAP Net Income	(3.8)	(2.8)	(0.2)	1.8	(1.5)	0.4	1.0	0.8	2.1	(5.0)	0.6	3.5
Non-GAAP Net Income	(3.5)	(2.2)	(0.5)	1.4	(0.0)	0.8	1.3	1.2	(6.3)	(4.8)	2.1	4.9
GAAP EPS-Basic	(\$0.15)	(\$0.11)	(\$0.01)	\$0.07	(\$0.06)	\$0.01	\$0.04	\$0.03	\$0.08	(\$0.19)	\$0.02	\$0.13
GAAP EPS-Fully dil.	(\$0.14)	(\$0.11)	(\$0.01)	\$0.07	(\$0.06)	\$0.01	\$0.03	\$0.03	\$0.08	(\$0.19)	\$0.02	\$0.13
Non-GAAP	(\$0.13)	(\$0.08)	(\$0.02)	\$0.05	(\$0.00)	\$0.03	\$0.05	\$0.04	(\$0.24)	(\$0.18)	\$0.08	\$0.18
Share Out	26.3	26.4	26.3	26.3	26.7	27.0	27.0	27.0	26.0	26.3	26.9	26.8
Fully diluted shares	26.9	26.4	26.3	27.1	26.7	27.7	27.7	27.7	26.6	26.3	27.5	27.3
Yr-to-yr Gr.	2%	0%	0%	2%	-1%	5%	5%	2%	3%	-1%	4%	-1%

BALANCE SHEET

	June 30, 2019	March 31, 2020	Qtr-to-Qtr % Change	June 30, 2019	Yr-to-Yr % Change
CURRENT ASSETS					
Cash and cash equivalents	\$12,676	\$16,108	-21.3%	\$12,955	-2.2%
Restricted cash	36	35	2.9%	34	5.9%
Short-term investments	28,684	28,595	0.3%	21,950	30.7%
Accounts receivable, net	11,730	11,016	6.5%	11,143	5.3%
Inventories	12,416	9,876	25.7%	9,910	25.3%
Prepaid expenses and other current assets	1,505	1,361	10.6%	2,360	-36.2%
Total current assets	67,047	66,991	0.1%	58,352	14.9%
LONG-TERM INVESTMENTS	3,327	3,020	10.2%	6,463	-48.5%
PROPERTY AND EQUIPMENT, NET	15,150	15,222	-0.5%	17,365	-12.8%
OTHER ASSETS	5,484	2,662	106.0%	2,321	136.3%
Total other assets	23,961	20,904	14.6%	26,149	-8.4%
TOTAL ASSETS	91,008	87,895	3.5%	84,501	7.7%
CURRENT LIABILITIES					
Notes and accounts payable	7,834	6,596	18.8%	2,839	175.9%
Income tax payable	318	702	-54.7%	384	-17.2%
Lease liabilities	644	714	-9.8%	975	-33.9%
Accrued expenses and other current liabilities	5,090	3,540	43.8%	4,420	15.2%
Total current liabilities	13,886	11,552	20.2%	8,618	61.1%
OTHER LONG-TERM LIABILITIES					
Accrued pension liabilities	193	207	-6.8%	295	-34.6%
Deferred tax liabilities	629	651	-3.4%	673	-6.5%
Lease liabilities	1,752	1,829	-4.2%	2,124	-17.5%
Other liabilities	66	65	1.5%	86	-23.3%
Total long-term liabilities	2,640	2,752	-4.1%	3,178	-16.9%
Total liabilities	16,526	14,304	15.5%	11,796	40.1%
SHAREHOLDERS EQUITY					
Ordinary shares	33	33	0.0%	33	0.0%
Additional paid-in capital	142,928	142,853	0.1%	142,775	0.1%
Accumulated deficits	(53,987)	(54,087)	-0.2%	(53,282)	1.3%
Accumulated other comprehensive income	4,573	4,408	3.7%	4,544	0.6%
Treasury stock	(19,063)	(19,616)	-2.8%	(21,365)	-10.8%
Total shareholders equity	74,484	73,591	1.2%	72,705	2.4%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	91,008	87,895	3.5%	84,501	7.7%
Cash and equivalents	\$41,360	\$44,703	-7.5%	\$34,905	18.5%
Change in cash and equivalents	(3,343)	(1,686)	98.3%	6,455	-151.8%
Market value	62,383,500	40,614,400	53.6%	37,161,960	67.9%
Enterprise value	20,987,500	(4,123,600)	-609.0%	2,222,960	844.1%
DSO	59	62	-4.8%	62	-4.8%
Inventory Days	119	112	6.3%	130	-8.5%

ANNUAL CASH FLOW

	2019	2018	2017	2016	2015
OPERATING ACTIVITIES					
Net loss	\$ (5,039)	\$ 2,088	\$ (6,145)	\$ (2,986)	\$ (21,095)
Adjustments to reconcile net loss to net cash used in operating activities:					
Depreciation and amortization	1,780	1,641	1,667	1,682	2,446
Stock-based compensation	1,462	1,421	1,589	1,606	1,912
Loss on asset write-off	0	0	0	0	0
Inventory write-downs	1,359	1,328	642	1,527	913
Net gain recognized on LT investments	(788)	(9,916)	0	0	0
Gain on sale of long-term investments	(500)	0	(20)	(948)	(8)
Impairment loss on long-term investments	0	0	0	0	4,953
Gain on disposal of property & eqt, net	2	(6)	(137)	(1,726)	(738)
Deferred income taxes	(133)	(155)	40	(1,231)	1,989
Other, net	0	0	0	0	0
Changes in operating assets and liabilities:					
Accounts receivable, net	1,053	(2,204)	(1,979)	(2,008)	1,592
Inventories	133	(2,286)	(697)	(1,140)	(1,933)
Prepaid expenses and other current assets	981	(1,031)	(139)	(6)	191
Deferred charges	(571)	(983)	(553)	(375)	(416)
Operating lease right of use assets	(1,477)	0	0	0	0
Notes and accounts payable	285	2,122	(1,869)	996	1,202
Income tax payable	198	72	161	(2,065)	1,595
Accrued expenses and other current liabilities	661	(105)	186	(1,064)	(1,039)
Operating lease liabilities	1,494	0	0	0	0
Accrued pension liabilities	(42)	(20)	13	(4)	(11)
Other liabilities	3	(1)	3	(56)	(168)
Net cash used in operating activities	861	(8,035)	(7,238)	(7,798)	(8,615)
Acquisition of:					
Short-term investments	(34,649)	(11,197)	(8,505)	(28,797)	(7,128)
Long-term investments	0	0	0	0	0
Property and equipment	(1,672)	(1,272)	(704)	(673)	(724)
Decrease (increase) in:					
Restricted assets	0	0	0	0	0
Restricted cash	0	0	0	0	132
Other assets	6	(12)	22	40	82
Proceeds from:					
Sale of short-term investments	4,953	22,540	12,635	18,331	16,755
Sale of long-term investments	7,061	2,582	0	5,982	167
Return of capital from LT investment	0	0	1,163	17	370
Sale of real estate	2,169				
Disposal of property and equipment	1	16	145	3,837	3,205
Net cash provided by investing activities	(22,131)	12,657	4,756	(1,263)	12,859
FINANCING ACTIVITIES					
Acquisition of treasury stock	(510)	(451)	(708)	(619)	(3,233)
Proceeds from:					
Exercise of stock options	7	10	29	2	31
Issuance of ordinary shares under the ESP Plan	109	86	84	73	180
Net cash used in financing activities	(394)	(355)	(595)	(544)	(3,022)
EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATE					
NET INCREASE (DECREASE) IN CASH AND CASH EQUIV.	(21,717)	3,893	(2,809)	(9,866)	130
CASH & CASH EQUIV. AT BEGINNING OF YR	32,448	28,555	31,364	41,230	41,069
CASH & CASH EQUIVALENTS AT END OF YR	10,731	32,448	28,555	31,364	41,199
Cash paid for tax	\$ 1,171	\$ 1,218	\$ 818	\$ 4,349	\$ 1,068
Cash Flow	(1,857)	(3,599)	(2,364)	(2,076)	(9,628)
Free cash flow	(3,529)	(4,871)	(3,068)	(2,749)	(10,352)

HISTORICAL STOCK PRICE



Source: Zacks Investment Research

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