

Cal-Maine Foods, Inc (CALM)

The most heavily shorted stock in America?

June 30, 2008

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Investment Highlights

- *Cal-Maine is very attractively priced, trading at 4.24X forward earnings*
- *125% of free float is sold short*
- *Industry egg supply will be constrained due to new cage requirements*
- *Cal-Main will earn \$7.74 per share in FY 2009 at \$7.75 full-year corn prices*

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Executive Summary

Cal-Maine Foods, which is buy-rated with a \$46.00 price target, is on track to earn \$6.41 per share in fiscal 2008, just as food cost inflation becomes front page news and short interest has reached record levels. Cal-Maine is officially the most heavily shorted stock in the U.S., according to the NASDAQ, AMEX and NYSE exchanges, with 125.64% of the free float sold short as-of June 24.

June has been a very exciting month for the Ag sector, and Cal-Maine foods was no exception. Many areas of the Midwest are experiencing record flooding as heavy winter snow gave way to spring storms and record rainfall. This is significant because Iowa, Illinois, Nebraska and Minnesota account for over 50% of the corn grown in the U.S. and 15% of the corn grown globally.

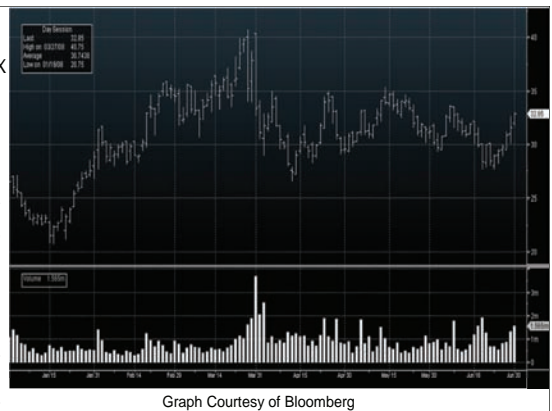
We have increased our egg price estimates for Cal-Maine in Calendar year 2008 from \$1.24 to \$1.31. These increases are partially offset by increasing our corn price assumptions from a \$6.00-\$6.50 range to \$8.00 through March of 2009 before falling to \$7.00 for the remainder of 2009 (we believe corn acres will be at record levels in 2009). We have also increased our soy meal price estimates from \$350 to \$375 in FY 2009 Q1, \$400 in FY 2009 Q2 and Q3 and \$425 in FY2009 Q4.

For more details, or to receive a copy of our March 24 initiation report, contact Nathan Weiss at 857-233-4902 or nweiss@uniteconomics.com.

Financial Summary and Statistics

Current Price: \$32.83	Book Value/Share:	\$10.52
Price Target: \$46.00	Sales/Share (ttm):	\$25.42
Market Cap: \$778mln	Forward PE (e):	4.24X

	FY 2007	F2008e	F2009e
Revenues	\$ 598,128	\$ 915,815	\$ 1,098,512
Cost of Sales	\$ 479,504	\$ 617,080	\$ 755,222
Gross Profit	\$ 118,624	\$ 298,735	\$ 343,291
SG&A	\$ 60,394	\$ 72,395	\$ 70,317
Operating Income	\$ 58,230	\$ 226,340	\$ 272,973
Other	\$ (1,969)	\$ 6,711	\$ 9,348
Taxes	\$ 19,605	\$ 80,977	\$ 98,812
Net Income	\$ 36,656	\$ 152,074	\$ 183,509
EPS (Diluted)	\$ 1.56	\$ 6.41	\$ 7.74
Shares out	23,569	23,724	23,714



Unit Economics LLC

Overview

June has been a very exciting month for the Ag sector, and Cal-Maine foods was no exception. Many areas of the Midwest are experiencing record flooding as heavy winter snow gave way to spring storms and record rainfall. This is significant because Iowa, Illinois, Nebraska and Minnesota account for over 50% of the corn grown in the U.S. and 15% of the corn grown globally. The Iowa river, which runs through my hometown of Marshalltown, Iowa, was 30.5 feet above flood levels on June 11th, according to the [Globe Gazette](#). These levels smashed the past record of 18.74 feet above flood levels. Estimates range from 10% to 20% of Iowa crops have been destroyed and will need to be replanted. The yield loss from planting in mid-June is around 40% in northern and central Iowa and around 20% in southern Iowa based on research conducted in the mid 1990's at Iowa State University. Yields in fields that did survive will be compromised as well. In the 1993 floods, corn yields in Iowa fell by 23%. The corn price situation is potentially explosive as the estimated U.S. corn inventories of 673 mln bu before the 2009 harvest, down 53% from the prior year, would represent just 20 days of use. Futures markets predict that corn prices will remain around \$7.50 per bushel through much 2009 and there is risk that a spike could temporarily take corn prices above \$10.00. Today's USDA acreage report seems to have calmed the market somewhat, but keep in mind that the survey took place in the first two weeks of June, before much of the major flood damage took place. The next acreage update from the USDA will not occur until August 12th.

The USDA provides daily and weekly updates on the shell egg markets and the number of layers. In our April 30 note we introduced our full calendar-year shell egg price target for Cal-Maine of \$1.24. Since then, we have final wholesale pricing data for April and May, with April coming in \$.06 above our previous expectations (at \$1.25 per dozen for wholesale eggs) and \$.10 above our expectations for May (\$1.14 per dozen). As corn prices climbed from \$6.27 per bu to the current \$7.59 per bu during June (+21.05%), the USDA reports that South Central Regional egg prices (the USDA region most closely correlated with Cal-Maine price realizations) increased by 28.71% to \$1.30, well ahead of the typical June seasonal increase of 7.14%. We have increased our egg price estimates for Cal-Maine in Calendar year 2008 from \$1.24 to \$1.31, as the following table displays:

2008 Shell Egg Price Predictions

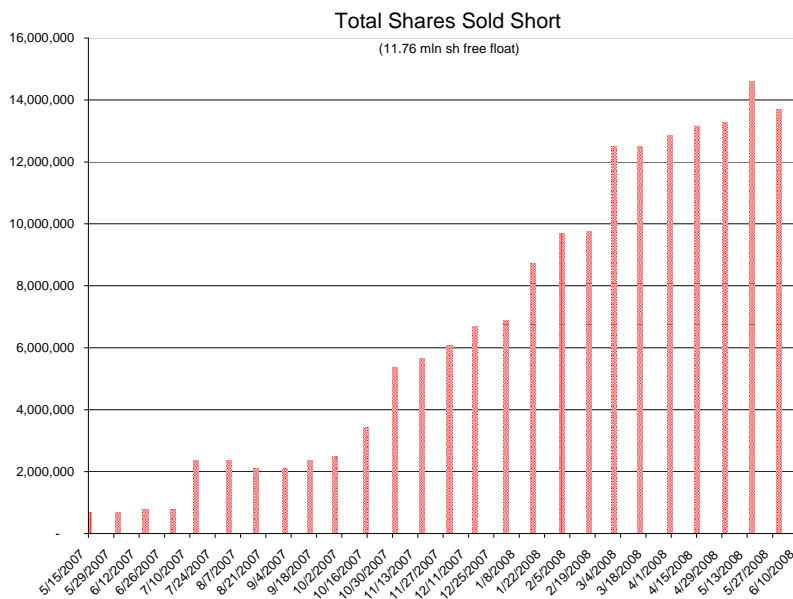
Full Year Avg: \$ 1.31

Month	Seasonality Factor	Predicted Price	Actual
Jan	1.07	\$ 1.40	\$ 1.36
Feb	1.00	\$ 1.31	\$ 1.31
Mar	1.09	\$ 1.43	\$ 1.34
Apr	0.96	\$ 1.26	\$ 1.25
May	0.84	\$ 1.10	\$ 1.14
Jun	0.90	\$ 1.18	
Jul	0.96	\$ 1.26	
Aug	1.00	\$ 1.31	
Sep	0.96	\$ 1.26	
Oct	1.02	\$ 1.34	
Nov	1.12	\$ 1.47	
Dec	1.11	\$ 1.45	



In addition, the number of table egg layers is down 2.51% to 278,517 from the December USDA report. As you know, our bullish thesis on Cal-Maine is that ‘this time it is different’ - high profitability for egg producers will not lead to a supply response due largely to new requirements from the United Egg Producers. The UEP's revisions dictate that average cage space per layer be expanded to 67 square inches, for all 196 mln cage spaces in its program, by 2010. This represents a 33% increase from 2002 levels. To date, compliance is estimated to have cost the industry 37 mln cage spaces. By April 2010, when full-compliance is required, an additional 19.5 mln cage spaces will be lost. As we have previously highlighted, there have been 3 years since 1988 when the avg number of layers actually fell - 1989 (-2.93%), 2003 (-.19%) and 2007 (-1.57%) with the price per dozen increasing by 40.37%, 39.81% and 55.17% respectively. With our revised egg price forecast, we are now expecting a 35.5% increase in the egg price realizations for Cal-Maine in CY 2008.

The short sellers of Cal-Maine apparently do not yet believe our thesis. Cal-Maine is officially the most heavily shorted stock in the U.S., according to the NASDAQ, AMEX and NYSE exchanges, with 125.64% of the free float sold short as-of June 24. Cal-Maine does not simply edge out the second-place company, Usana Health Sciences (USNA), it is the ONLY security we could find in the recent exchange filings with more than 100% of the free float sold short. In fact, Cal-Maine CEO Fred Adams Jr. recently wrote a letter to the SEC stating that the short interest indicates SEC rules are being violated, as the company maintains that the shares held by management and the ESOP program are not in the stock lending pool, leaving a theoretical maximum of 12.372 mln of the 21.312 mln total shares available to borrow. Cal-Maine has been a threshold security for some time and our most recent check of the stock loan rebate rate showed the cost to borrow the shares is now over 20%. The following table shows the recent development of the short interest for Cal-Maine:



Earnings Model Updates

We have increased our egg price estimates for Cal-Maine in calendar year 2008 from \$1.24 to \$1.31. The wholesale table egg price estimate for the coming fourth quarter was increased from \$1.184 to \$1.23. The following quarter, Q1 of FY 2009, saw increased wholesale egg price estimates from \$1.232 to \$1.36. These increases are partially offset by increasing our corn price assumptions from a \$6.00-\$6.50 range to \$8.00 through March of 2009 before falling to \$7.00 for the remainder of 2009 (we believe corn acres will be at record levels in 2009). We have also increased our soy meal price estimates from \$350 going forward to \$375 in FY 2009 Q1, \$400 in FY 2009 Q2 and Q3 and \$425 in FY2009 Q4. The net result of the egg price increases and grain price increases are that our earnings estimates for the coming two quarters (FY2008 Q4 and FY2009 Q1) have been increased from \$1.38 and \$1.65 to \$1.55 and \$1.75 respectively. Our overall earnings estimate for FY2009 decreases slightly from \$8.04 to \$7.74. With the current dividend payout policy of 1/3 of net income, Cal-Maine should pay out \$2.58 in dividends in FY2009, providing a 7.85% dividend yield at the current \$32.86 a share.

On June 25 Cal-Maine announced that they were acquiring the majority of the assets of the Zephyr Egg Company, located in Zephyrhills, Florida. Zephyr eggs has a 40 year operating history and the acquisition will include some 2 mln laying hens in in-line facilities, pullet growing facilities, two egg processing plants, a feed mill and a fleet of delivery trucks. This should provide an 8.7% increase in total egg capacity for Cal-Maine. We do not have financial details of the transaction yet, and thus the transaction is not incorporated into our earnings model going forward, but will include the details when they become available.

Financials

Model Inputs

	175.2	174.1	173.2	174.2	172.0	174.1
Dozens of eggs sold (in millions)	\$ 1,348	\$ 1,500	\$ 1,460	\$ 1,360	\$ 1,230	\$ 1,377
Adj Market Egg Price	\$ 0.631	\$ 0.700	\$ 0.700	\$ 0.650	\$ 0.531	\$ 0.499

Change these variable to calculate earnings

Income Statement

	FY08 End				FY07 End							
	Q4 (Jun 09) (e)	Q3 (Mar 09) (e)	Q2 (Dec 08) (e)	Q1 (Sep 08) (e)	Q4 (Jun 08) (e)	Q3 (Mar 08)	Q2 (Dec 07)	Q1 (Sep 07)	Q4 (Jun 07)	Q3 (Mar 07)	Q2 (Dec 06)	Q1 (Sep 06)
Net Sales	262,712	290,608	281,476	263,716	235,504	278,017	223,696	178,598	169,872	175,211	137,737	115,308
Cost of Sales	182,569	195,601	192,876	184,175	163,283	173,115	147,664	133,018	128,792	131,029	112,782	106,901
Gross Profit	80,143	95,006	88,600	79,541	72,221	104,902	76,032	45,580	41,080	44,182	24,955	8,407
Selling, General and Administrative Expense	17,625	17,598	17,567	17,527	17,474	19,244	17,029	18,648	14,564	16,902	14,458	14,470
Operating Income	62,518	77,408	71,033	62,015	54,747	85,658	59,003	26,932	26,516	27,280	10,497	(6,063)
Other Income (expense)												
Interest Expense, net	1,522	932	342	(248)	(376)	(676)	(1,377)	(1,647)	(677)	(1,639)	(1,764)	(1,795)
Other	200	2,200	2,200	2,200	2,200	2,905	3,744	1,936	1,269	1,956	824	(143)
INCOME (LOSS) BEFORE TAXES	64,240	80,540	73,575	63,967	56,571	87,887	61,370	27,223	27,108	27,597	9,557	(8,001)
Income tax Expense (benefit)	22,484	28,189	25,751	22,388	19,800	30,704	21,216	9,257	8,825	10,194	3,156	(2,570)
Net Income (loss)	41,756	52,351	47,824	41,578	36,771	57,183	40,154	17,966	18,283	17,403	6,401	(5,431)
Net income (loss) per share												
Basic	1.763	2.211	2.019	1.756	1.553	2.412	1.696	0.761	0.777	0.740	0.272	(0.231)
Diluted	1.761	2.208	2.017	1.753	1.551	2.408	1.693	0.757	0.775	0.738	0.271	(0.231)
Weighted avg Shares Outstanding												
Basic	23,681	23,681	23,681	23,681	23,681	23,712	23,681	23,599	23,526	23,519	23,503	23,503
Diluted	23,714	23,714	23,714	23,714	23,714	23,744	23,714	23,724	23,599	23,578	23,597	23,503
Dividend Per Share	0.581	0.729	0.666	0.579	0.512	0.604	0.013	0.013	0.013	0.013	0.013	0.013

Balance Sheet

	Q4 (Jun 09) (e)	Q3 (Mar 09) (e)	Q2 (Dec 08) (e)	Q1 (Sep 08) (e)	Q4 (Jun 08) (e)	Q3 (Mar 08)	Q2 (Dec 07)	Q1 (Sep 07)	Q4 (Jun 07)	Q3 (Mar 07)	Q2 (Dec 06)	Q1 (Sep 06)
Assets												
Current Assets:												
Cash and Equivalents	141,517	120,214	103,582	95,012	90,828	85,798	28,535	23,117	15,032	15,134	11,364	16,717
Investments	-	-	-	-	-	-	59,250	46,951	39,500	28,600	10,000	10,000
Trade and Receivables	68,305	75,558	73,184	68,566	61,231	63,977	68,888	45,051	37,096	40,525	43,745	30,753
Recoverable Income Taxes	-	-	-	-	-	-	-	-	-	836	1,086	3,596
Inventories	97,272	104,488	102,871	95,985	81,462	74,703	69,403	66,310	62,208	62,855	60,369	57,310
Other	-	-	-	-	-	-	-	-	1,084	-	-	-
Prepaid Expenses and Other	1,500	1,500	1,500	1,500	1,500	1,068	881	1,596	1,390	1,266	1,544	2,403
Total Current Assets	308,593	301,760	281,137	261,064	235,020	225,546	226,957	183,025	156,310	149,216	128,108	120,779
Notes Receivable and Investments	59,142	59,142	59,142	59,142	59,142	59,142	9,893	8,373	7,913	8,241	8,496	9,775
Goodwill	4,195	4,195	4,195	4,195	4,195	4,195	4,195	4,195	4,195	4,195	4,016	4,016
Other Assets	7,476	7,476	7,476	7,476	7,476	7,476	2,944	2,560	2,560	2,560	2,652	2,700
Property, Plant and Equipment	435,390	429,271	423,067	416,777	410,399	403,933	393,155	383,788	377,875	363,209	346,805	340,870
Less Accumulated Depreciation	227,872	221,991	216,195	210,485	204,863	199,329	192,656	187,627	184,285	178,278	172,271	167,887
TOTAL ASSETS	586,924	579,852	558,821	538,168	511,369	500,948	449,020	394,698	364,568	349,133	317,806	308,453
							1.31%	0.88%	1.65%	1.73%	1.29%	
Liabilities and Stockholder's Equity												
Current Liabilities												
Accounts payable and Accrued Expenses	78,505	84,109	82,937	79,195	70,212	74,488	75,581	62,127	45,051	53,482	44,325	42,539
Dividends Payable	13,779	17,276	15,782	13,721	12,134	19,059	-	-	-	-	-	-
Current Maturities of Purchase Obligation	10,756	10,757	10,758	10,758	10,758	10,758	6,769	5,435	5,435	5,435	5,435	5,435
Current Maturities of Long-Term Debt	6,780	8,130	9,480	10,830	11,505	11,717	11,661	13,126	13,442	13,610	12,930	12,248
Deferred Income Taxes	12,136	12,136	12,136	12,136	12,136	11,745	12,136	12,633	11,830	11,610	11,690	11,895
Total Current Liabilities	121,956	132,407	131,092	126,640	116,745	127,762	110,136	94,655	75,758	84,137	74,380	72,117
Long-Term debt, Less current maturities	50,220	60,220	70,220	80,220	85,220	90,220	92,572	97,437	99,410	94,383	90,650	90,004
Minority Interest	888	888	888	888	888	1,707	898	1,194	1,894	923	752	782
Purchase obligation, less current maturities	9,600	9,600	9,600	9,600	9,600	9,600	9,437	5,848	9,867	9,673	9,479	9,284
Other non-current liabilities	2,200	2,200	2,200	2,200	2,200	2,240	2,210	2,190	2,150	3,701	3,920	3,890
Deferred Income Taxes	19,867	19,867	19,867	19,867	19,867	19,855	19,867	19,879	19,750	18,705	18,355	18,280
TOTAL LIABILITIES	204,731	225,182	233,867	239,415	234,520	251,389	235,110	221,193	208,829	211,522	197,536	194,357
Stockholders Equity												
Common Stock at \$.01 Par	351	351	351	351	351	351	351	351	351	351	351	351
Class A Common Stock \$.01 Par	24	24	24	24	24	24	24	24	24	24	24	24
Paid-in Capital	30,039	29,959	29,879	29,799	29,719	28,639	28,427	29,179	29,043	28,955	28,809	28,755
Retained Earnings	371,828	343,763	314,348	290,280	269,077	240,708	205,121	165,262	147,667	129,679	112,569	106,449
Common Stock in Treasury	(20,763)	(20,843)	(20,923)	(21,003)	(21,083)	(21,163)	(21,013)	(21,311)	(21,346)	(21,398)	(21,483)	(21,483)
Total Shareholders Equity	381,479	353,254	323,679	299,451	278,088	249,559	213,910	173,505	155,739	137,611	120,270	114,096
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	586,290	578,516	557,626	538,946	512,687	500,948	449,020	394,698	364,568	349,133	317,806	308,453

Statement of Cash Flows

	Q4 (Jun 09) (e)	Q3 (Mar 09) (e)	Q2 (Dec 08) (e)	Q1 (Sep 08) (e)	Q4 (Jun 08) (e)	Q3 (Mar 08)	Q2 (Dec 07)	Q1 (Sep 07)	Q4 (Jun 07)	Q3 (Mar 07)	Q2 (Dec 06)	Q1 (Sep 06)
Cash Provided by Operations	56,502	55,328	45,772	34,326	33,584	60,968	29,114	29,687	22,765	34,614	207	2,138
Cash Provided by (used in) Investing Activities												
Net Decrease in Investments	-	-	-	-	-	12,100	(12,300)	(7,450)	(10,900)	(18,600)	-	15,000
Acquisitions of Businesses net of cash	-	-	-	-	-	-	-	-	(10,901)	(1,152)	-	-
Purchases of Property, Plant and Equip.	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(11,410)	(7,641)	(4,530)	(6,401)	(5,006)	(6,827)	(5,238)
Payments Received on Notes and Investments	300	300	300	300	300	313	481	91	607	286	232	328
Increase in Notes Receivable and Investments	-	-	-	-	-	(76)	(17)	(651)	(22)	(150)	-	(1,030)
Net Proceeds from Disposal of PP&E	200	200	200	200	200	195	1,914	173	101	125	-	277
Net Cash Provided by (used in) Investing Activities	(11,500)	(11,500)	(11,500)	(11,500)	(11,500)	1,120	(17,563)	(12,367)	(27,516)	(24,497)	(6,595)	9,337
Cash Provided by (used in) Financing Activities												
Purchases of common stock for Treasury	-	-	-	-	-	-	-	-	-	-	-	-
Payment of purchase obligations	-	-	-	-	-	-	-	(6,769)	-	-	(1)	(6,101)
Proceeds from issuance of Treasury Stock	80	80	80	80	80	9	491	117	85	177	-	-
Long-Term Borrowings	-	-	-	-	-	-	-	-	26,500	-	3,000	-
Principle Payments on Long-Term Debt	(10,000)	(10,000)	(10,000)	(5,000)	(5,000)	(2,297)	(6,330)	(2,289)	(21,641)	(6,232)	(1,671)	(1,660)
Capital Distributions	-	-	-	-	-	(2,537)	-	-	-	-	-	-
Payment of Dividends	(13,779)	(17,276)	(15,782)	(13,721)	(12,134)	-	(294)	(294)	(295)	(292)	(293)	(292)
Net Cash Provided by (used in) Finance Activities	(23,699)	(27,196)	(25,702)	(18,641)	(17,054)	(4,825)	(6,133)	(9,235)	4,649	(6,347)	1,035	(8,053)
Net Change in Cash and Equivalents	21,303	16,632	8,570	4,185	5,030	57,263	5,418	8,085	(102)	3,770	(5,353)	3,422



Critical Accounting Policies

From FY2007 10K:

Critical Accounting Policies. The preparation of financial statements in accordance with U.S. generally accepted accounting standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Management suggests that our Summary of Significant Accounting Policies, as described in Note 1 of the Notes to Consolidated Financial Statements, be read in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations. We believe the critical accounting policies that most impact our consolidated financial statements are described below.

Allowance for Doubtful Accounts. In the normal course of business, we extend credit to our customers on a short-term basis. Although credit risks associated with our customers are considered minimal, we routinely review our accounts receivable balances and make provisions for probable doubtful accounts. In circumstances where management is aware of a specific customer's inability to meet its financial obligations to us (e.g. bankruptcy filings), a specific reserve is recorded to reduce the receivable to the amount expected to be collected. For all other customers, we recognize reserves for bad debts based on the length of time the receivables are past due, generally 100% for amounts more than 60 days past due.

Inventories. Inventories of eggs, feed, supplies and livestock are valued principally at the lower of cost (first-in, first-out method) or market. If market prices for eggs and feed grains move substantially lower, we would record adjustments to write-down the carrying values of eggs and feed inventories to fair market value. The cost associated with flock inventories, consisting principally of chick purchases, feed, labor, contractor payments and overhead costs, are accumulated during the growing period of approximately 22 weeks. Capitalized flock costs are then amortized over the productive lives of the flocks, generally one to two years. Flock mortality is charged to cost of sales as incurred. High mortality from disease or extreme temperatures would result in abnormal adjustments to write-down flock inventories. Management continually monitors each flock and attempts to take appropriate actions to minimize the risk of mortality loss.

Long-Lived Assets. Depreciable long-lived assets are primarily comprised of buildings and improvements and machinery and equipment. Depreciation is provided by the straight-line method over the estimated useful lives, which are 15 to 25 years for buildings and improvements and 3 to 12 years for machinery and equipment. An increase or decrease in the estimated useful lives would result in changes to depreciation expense. When property and equipment are retired, sold, or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations. We continually reevaluate the carrying value of our long-lived assets, for events or changes in circumstances, which indicate that the carrying value may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) are less than the carrying amount of the asset, an impairment loss is recognized to reduce the carrying value of the long-lived asset to the estimated fair value of the asset.

Investment in Affiliates. We have invested in other companies engaged in the production, processing and distribution of shell eggs and egg products. Our ownership percentages in these companies range from less than 20% to 50%. Therefore, these investments are recorded using the cost or the equity method, and accordingly, not consolidated in our financial statements. Changes in the ownership percentages of these investments might alter the accounting methods currently used. Our investment in these companies amounted to \$6.4 million at June 2, 2007. The combined total assets and total liabilities of these companies were approximately \$24 million and \$11 million, respectively, at June 2, 2007. We are a guarantor of approximately \$4.8 million of long-term debt of one of the affiliates.

Goodwill. At June 2, 2007, our goodwill balance represented 1.2% of total assets and 2.7% of stockholders' equity. Goodwill relates to the fiscal 1999 acquisition of Hudson Brothers, Inc., the fiscal 2006 acquisition of Hillandale Farms, LLC, and the fiscal 2007 acquisition of Green Forest Foods, LLC. We adopted, as of June 3, 2001, Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). Under SFAS 142, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually or more frequently if impairment indicators arise, for impairment. An impairment loss would be recorded if the recorded goodwill exceeds its implied fair value. We have only one operating segment, which is our sole reporting unit. Accordingly, goodwill is tested for impairment at the entity level. Significant adverse industry or economic changes, or other factors not anticipated could result in an impairment charge to reduce recorded goodwill.



Disclaimers

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