

# EQUITY RESEARCH

**Monthly Stock Monitor**  
**November 1, 2007**



## HIGHLIGHTS

A.T. Cross Co.....Solid earnings  
CMS Energy.....Turnaround continues  
Dominion Resources.....Good earnings and affirms 2008 guidance  
First Capital Bancorp.....Lower earnings but higher income  
First Community Bancshares.....Improved profits  
Green Plains Renewable Energy.....Needs commodity pricing improvements  
Massey Energy.....Good earnings report, Expanding production  
Media General.....Attractive dividend yield & awaiting 2008  
Progress Energy.....Successor named to CEO and earnings growth  
Union Bankshares.....Lower earnings, attractive valuation  
Market Commentary.....“Trick or Treat”

## COMMENTS AND UPDATES

### A.T. Cross Co. (ATX--\$11.45)

A.T. Cross Co. (ATX--\$11.45) reported a solid 3Q07 with consolidated sales increasing 10.0% to \$35.1 million compared to \$31.9 million in the third quarter of 2006. The Cross Accessory Division, also referred to as the writing instruments and accessories segment, recorded revenue of \$26.3 million, up 3.9% compared to the same period last year. The Company's optical segment, comprised of Costa Del Mar, had a third quarter sales increase of 33.5% to \$8.8 million, compared to the same period last year as the company continues to expand gross margin. Gross margin in the third quarter increased 330 basis points to 56.7%, compared to 53.4% in last year's third quarter, as both segments reported continued improvements. Most importantly, the company raised its guidance above our estimate of \$0.40 per share. We introduced the stock when it was trading at \$9.62 and potentially see little downside given these results. ATX is rated OUTPERFORM with a target price of \$14.00. (STT)

### CMS Energy (CMS--\$16.71)

CMS Energy (CMS-\$16.71) reported earnings per share of \$0.34/share during 3Q07 compared to (\$0.47)/share during 3Q06. Results from 3Q07 include the recognition of a \$49 million insurance payment regarding a dispute in Argentina. Factoring out impairment charges and the Argentinean insurance payment CMS results on a quarter to quarter basis were \$0.13/share vs. \$0.13/share. Operating revenue was \$1.28 billion compared to \$1.28 billion while operating expenses declined to \$1.09 billion from \$1.33 billion due to lower electrical generation fuel costs, less market-to-market fuel cost for the MCV Partnership, lower operating/maintenance expenses, slight improvement of depreciation/depletion/amortization expenses. Electric utility revenues declined slightly to \$963 million from \$976 million, gas utility's increased to \$209 million from \$201 million, Enterprises fell to \$105 million from \$108 million, and Other grew to \$5 million from \$3 million. Earnings before interest, depreciation, and amortization improved to \$194 million from a negative \$27 million. While earnings were flat we were encouraged by improvement in CMS's

***For Important Disclosure information regarding the Firm's rating system, valuation methods and potential conflicts of interest, please refer page 7 of this report.***

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EBITDA and cash flow. CMS has worked hard to reduce expenses, lower debt levels, and exit non-regulated businesses during the past three years to improve its profitability. Evidence of success can be seen given the recent reintroduction of its common stock dividend. Going forward continued operating improvement could allow the company to increase the dividends with EBITDA and cash flow growth. The just completed quarter results showed CMS's EBITDA improving to \$194 million from (\$27 million) when compared to last year's quarter. Additionally, through the first nine months of the year cash flow increased to \$1.25 billion versus \$459 million during last year's nine month comparable period. Furthering the argument for a turnaround at CMS, management reaffirmed 2007 and 2008 earnings guidance of \$0.80/share and \$1.20/share, respectively. We believe a continuation of these positive trends at CMS may allow management to raise its dividend during the next 12 months and increase investor demand for its stock. We rate these shares OUTPERFORM and our price target is \$19/share. (SFM)

### **Dominion Resources (D--\$90.09)**

Dominion Resources (D-\$90.09) reported 3Q earnings, on a GAAP basis, of \$7.24/share versus \$1.85/share during 3Q06. Operating earnings were \$1.72/share compared to \$1.88/share. The decrease in operating earnings was due to lower natural gas/oil production because of the company's recent sale of its non-Appalachian exploration & production properties, the absence of an insurance benefit received from business interruption during 3Q06, lower production from producer services and the gas transmission businesses, and the absence of one-time gains for excess emission allowance sales. Partially offsetting these were lower Virginia fuel expenses resulting from the reapplication of deferred fuel accounting, improvement in the merchant generation business, lower interest expense, and fewer shares of outstanding common stock due to a recent share repurchase program. Operating revenue, on a quarter to quarter basis, was \$3.59 billion vs. \$3.97 billion. Dominion Generation produced profits of \$403 million versus \$253 million while corporate expenses declined to \$25 million from \$66 million. Earnings declines were seen at Dominion Delivery (\$74 million vs. \$78 million), Dominion Energy (\$61 million vs. \$102 million), and Dominion E&P (\$38 million vs. \$297 million). The Board of Directors recently an 11% increase in the common stock dividend and a 2-for-1 stock split. D is transitioning towards in reformulated business structure after selling off the majority of E&P business. The company's business units will now consist of Dominion Generation, Dominion Delivery, and Dominion Energy. The sale of its E&P business produced almost \$14 billion in proceeds which D used to repurchase approximately 16% of its outstanding common stock for \$5.3 billion, reduced its debt by \$3.3 billion, and increased its common stock dividend. Expect management to continue to fine tune its business structure by exiting ventures it feels are not geared towards earnings growth. For example, D announced it was terminating the State Line long-term power purchase sales agreement contract which management believes is more accretive to its earnings rather than buying back additional shares. The common stock dividend was increased 11%, to \$0.79/share vs. \$0.71/share on a pre-split basis, with plans to achieve a 55% payout ratio by 2010. Additionally, management gave 2008 earnings guidance of \$6.10-\$6.25/share followed by 6% annual earnings growth starting in 2009. Potentially, this translates into dividend increases in the future should the company attain 6% annual earnings growth. Given expected improvements in cash flow and proceeds from its recent E&P sales D may seek acquisitions during the next 12 months. Trading at 15x 2008 earnings guidance we maintain our NEUTRAL rating on D.

### **First Capital Bancorp (FCVA--\$13.50)**

First Capital Bancorp, Inc (FCVA--\$13.50) announced 3Q earnings of \$0.17/share versus \$0.21/share. Net income was higher on a quarter-to-quarter basis (\$501,000 vs. \$404,000) but per share results were lower due to an additional 1,172,900 common shares issued during the past year through a secondary offering. Interest income rose to \$5.28 million from \$4.04 million. Non-interest income increased to \$175,000 from \$118,000 benefiting from mortgage loan fees and 16.3% higher deposit fees generated by a growing deposit base. Interest expense was higher at \$2.63 million. Non-interest expense rose to \$1.87 million from \$1.39 million due primarily to costs associated with an expanded branch system. Total assets grew to \$311.06 million from \$257.24 million, representing an increase of 20.9%. Loans rose 26.1%, to \$251.86 million from \$199.75 million, while deposits increased 15.2%, to \$223.91 million from \$194.30 million. Return on assets (ROA) increased to 0.69% from 0.67% while return on equity (ROE) declined to 5.93% from 10.91%. Net interest margin increased to 3.73% from 3.32% as FCVA benefited from lower borrowing costs. Book value increased to \$11.51/share from \$8.71/share. FCVA continues to show good growth characteristics with increases in total assets, loans, and deposits. The recent secondary offering should provide ample

capital to grow during the next 12-24 months. Potentially, profitability and internal ratios, such as ROA/ROE, could improve with a successful execution of the bank's growth strategy, a friendly interest rate curve, and good credit quality of its loan portfolio. During the recent quarter, provisions for loan losses increased to \$186,000 from \$55,000 due primarily to growth of its loan portfolio, however FCVA does not appear to have taken a hit from the softening real estate markets. Improved profitability, asset growth, recent Fed Reserve rate cuts, and sound credit quality of the loan portfolio could lead to earnings growth in 2008. We currently rate FCVA shares NEUTRAL. (SFM)

### **First Community Bancshares (FCBC--\$30.08)**

First Community Bankshares (FCBC-\$30.08) reported 3Q07 earnings of \$0.65/share vs.\$0.64/share as profits rose 1.82% to \$7.32 million from \$7.19 million. Total interest income rose 8.24% to \$32.73 million from \$30.24 million due primarily to an increase in earning assets. Total non-interest income rose to \$6.02 million from \$5.1 million due to increases in fees from wealth management (\$908,000 vs. \$623,000), deposit accounts (\$3.01 million vs. \$2.61 million), and other charges/commissions (\$902,000 vs. \$750,000). Total non-interest expense increased to \$12.84 million from \$12.21 million as FCBC incurred higher salaries/benefits, FAS 91 salaries/benefits deferral differences, and other non-interest expenses. FCBC continues to build its footprint throughout the area for potential future growth. The bank completed the second phase of its efficiency program aimed at consolidation of branch operating systems, improved office staffing, and reviewing significant service contracts. A new branch was opened in Daniels WVA on 10/1 with plans to open an office in Richmond VA, Princeton WVA, and construction of branches in Mechanicsville VA and Summersville WVA. Over the next couple of years these new offices ability to attract new business, along with existing office growth, and a positive interest rate curve could increase FCBC's earnings. Gathering assets at these new offices & existing assets could lower the bank's efficiency ratio, adding to its bottom line while a positive spread to deposit costs/loan rates should add further to profitability. The credit quality of the loan portfolio looks sound as non-performing assets/percentage of loans held was 0.25% versus 0.34% and no provision for loan losses were made during the just-completed quarter compared to \$579,000 during 3Q06. Trading at 1.7x book these shares are rated OUTPERFORM with a \$40 target price. (SFM)

### **Green Plains Renewable Energy (GPRE--\$8.81)**

Green Plains Renewable Energy (GPRE-\$8.81) reported a 3Q07 operating loss of \$2.83 million compared to \$43,490 during 3Q06. The company had little revenue during the quarter since it recently completed the construction of its Shenandoah IA Plant and is still building the Superior IA plant. Both facilities are expected to annually generate 50 million gallons of ethanol. Revenues of \$9,303 were derived from sales of distillers dried grains with solubles (DDGS) produced from the initial start-up of the Shenandoah facility this past August. Operating expenses, on a quarter-to-quarter comparison, rose to \$1.75 million from \$598,622 and was attributable to an increase in employees, incentives/benefits needed for the staffing of the Shenandoah plant, in addition to higher stock-based compensation expenses. The one-two punch of higher corn prices and lower ethanol pricing has caused heavy selling of ethanol stocks during the past few months. Potentially, there may be light at the end of the tunnel for corn prices given the record amount of corn acreage currently being planted for next year's harvest. A bumper crop of corn in 2008 could push commodity pricing lower and potentially increase profit margins for ethanol producers. Under this scenario, combined with flat-to-higher ethanol pricing, this sector could rally, including GPRE. With the Shenandoah plant now in operation, and the Superior Plant scheduled to commence in 1Q08, GPRE now shifts from being a start-up company to an operating company. As an operating entity GPRE will now be judged on quarterly EPS and EBITDA numbers, especially after its 2nd plant (Superior) comes on line. The balance sheet should allow GPRE to fund the completion of its second plant and put it into commercial operation in 1Q08, thus giving total ethanol production capacity of 100 million gallons per year. Given the low prices of ethanol companies and an over abundance of production facilities the potential exists for mergers/consolidations in this group to 1) rationalize costs and 2) as buyers find it cheaper to buy other companies vs. constructing new plants. We speculate this merger/consolidation process could start within the 6-9 months anticipating Wall Street banking groups pushing the ethanol industry in this direction. We continue to rate these shares NEUTRAL until commodity pricing fundamentals move in favor of the ethanol industry. (SFM)

### **Massey Energy Company (MEE--\$30.57)**

Massey Energy (MEE--\$30.57) reported 3Q07 earnings of \$0.27/share vs. \$0.30/share during 3Q06, which included a \$0.24/share one-time gain on the sale of reserves. 3Q07's produced coal revenues were \$521.9 million, representing a 13% increase over last year's comparable quarter. Freight/handling revenues rose to \$38.4 million from \$36.1 million and purchased coal revenues increased to \$25.9 million from \$16.4 million. Produced coal revenues, on a per ton basis, were lower at \$50.75 versus \$51.40. MEE's operating cash margin improved to \$7.49/ton from \$6.79/ton due to improved product mix as metallurgical and industrial coal tonnage sales rose 23% and 20%, respectively. The company announced it was expanding Central Appalachian coal mining operations to take advantage of favorable market conditions and increase its annual production by 8 million tons by 2010. MEE's, and industry competitors, current earnings announcement, while not providing stellar earnings results, have forecasted potential profit improvement in the future and have begun to pull investors back into coal stocks. This is based on higher coal pricing down the road and the industry reducing operating costs. MEE's management anticipates rivals will lower coal production in the Appalachian area due to mine closures. These closures and continued world steel demand growth are bullish for coal prices, thus potentially growing MEE's revenue stream. The company's planned expansion in Central Appalachia metallurgical coal mining is being driven by a weak US dollar, economic growth in China, high vessel freight rates, and Australian infrastructure constraints on coal shipments which are allowing US coal companies to compete in Europe and South America. Potentially, this allows MEE to expand its low-cost production process and mine the large portfolio of idle reserves held by the company. Given management raising guidance of coal tons produced from anticipated 2007 levels of 40.0 million-40.5 million tons to 41.5 million-43.0 million tons in 2008 and pricing per ton increasing from \$51.25-\$51.50 to \$54, both EBITDA and earnings could see large increases during the next 2 years. This would be predicated on coal prices remaining stable, or rising, while MEE's cost per ton are level, or declining. We continue to rate MEE OUTPERFORM with a \$31 target price. (SFM)

### **Media General (MEG--\$27.09)**

Media General (MEG--\$27.09) reported 3Q07 earnings of \$0.11/share vs. \$0.87/share. Our estimate was for \$0.19/share. The current quarter's income took a hit from a \$4.5 million operating loss generated by the SPN Plant & a large decline in business coming from Florida. Revenues were \$230.4 million versus \$241 million while EBITDA was \$24.6 million compared to \$25.5 million. Total operating expenses declined to \$205.7 million from \$215.5 million due to lower production and selling, general, and administrative expenses. Interest expense declined to \$14.9 million from \$16.8 million resulting from lower debt levels. Classified advertising continued to suffer with a revenue decline of 16.1% suffering most from a 17% fall in income from its Tampa business. While MEG's Virginia advertising revenues were stable, Tampa Tribune's fell 33.7% generated by a slowing real estate market and economy in Florida. In aggregate the Community Newspaper group experienced a 6.2% decrease in classified advertising. While on the surface 3Q EPS numbers were weak, the EBITDA results showed signs of stabilization. EBITDA, on a quarter to quarter basis, was \$24.6 million vs. \$25.5 million. Results were not bad given the big drop in Florida business. A positive trigger for MEG could be its potential sale of the SPN Plant, thus eliminating a big drag on the company's earnings (\$4.5 million) this past quarter. While we don't expect much in earnings for 2007, 2008 could see a significant increase given a bottoming of the real estate markets, sale of the SPN facility, and ad revenue increases from next year's Presidential elections/Summer Olympics. This stock pays an attractive dividend yield of 3.3%, rewarding patient investors seeking an earnings turnaround at MEG, with current income. These shares are recommended for growth/income investors seeking above average appreciation potential. MEG is rated OUTPERFORM and our price target is \$38/share. (SFM)

### **Progress Energy (PGN--\$46.64)**

Progress Energy (PGN-\$46.64) lost its Chairman/CEO Robert McGehee, who passed away recently due to a heart attack. The Board of Directors named current President/Chief Financial Officer, William Johnson, as McGehee's replacement. William Johnson has been with PGN since 1992. No successor has been named to fill the CFO position. The company reported 3Q07 earnings of \$1.24/share vs. \$1.27/share during 3Q06. Ongoing earnings were

\$1.14/share versus \$1.09/share on a quarter to quarter comparison. Progress Energy Carolinas reported ongoing earnings of \$0.79/share vs. \$0.75/share. Progress Energy Florida had ongoing earnings of \$0.52/share vs. \$0.51/share. The improvement in ongoing earnings was due to favorable weather, lower income taxes at its core business, increased wholesale sales, and lower interest expense at the holding company. These were partially offset by higher operating/maintenance expenses and lower results from the synthetic fuel operations. Non-core operating produced losses of \$0.07/share compared to profits of \$0.03/share during last year's quarter caused by increased phase out reserve percentage partly offset by higher synthetic fuel sales and positive mark-to-market gains on derivative contracts. Operating revenues from the electric business increased to \$2.74 billion from \$2.60 billion and diversified business revenues rose to \$359 billion from \$177 billion. Total operating expenses rose to \$2.27 billion from \$2.22 billion. PGN continues to put distance between itself and the period a few years ago where negative results from its non-regulated business threatened its earnings and balance sheet. Since that period the company has jettisoned costly non-regulated businesses, reduced debt, and was still able to raise its common stock dividend. The just completed earnings release reinforces the positive trend at PGN as its core operating units continue to improve profitability. We believe this trend should continue going forward and were encouraged by management's guidance of 2007 core earnings of \$2.70/share - \$2.90/share. These shares are rated outperform and recommended for growth income investors given PGN's attractive 5.2% dividend yield and the potential of future dividend increases. Our price target is \$49/share. We continue to rate PGN OUTPERFORM with a \$49 target price. (SFM)

### **Union Bankshares (UBSH--\$18.87)**

Union Bankshares (UBSH--\$18.87) reported 3Q07 earnings of \$0.40/share compared to \$0.49/share during 3Q06. The decline in profits was due to the full quarter's worth of operating costs associated with the company's new operations center, expenses from buying and operating six new offices, and additional loan loss provisions. Net interest income declined to \$19.35 million from \$19.77 million as total interest expense rose to \$16.9 million from \$14.4 million. Higher costs generated by the new offices and the operations center caused UBSH's efficiency ratio to rise to 70.14% from 65.12%. UBSH's return on assets (ROA) and return on equity (ROE) declined to 0.97% from 1.26%, and to 10.32% from 13.54%, respectively. Total assets grew to \$2.22 billion from \$2.08 billion, as deposits rose to \$1.66 billion from \$1.63 billion and total net loans increased to \$1.69 billion from \$1.56 billion. On a quarter-to-quarter basis, provisions for loan losses declined to \$432,000 from \$485,000. Book value per share rose to \$15.59 from \$14.62. Recent cuts in interest rates by the Federal Reserve may produce a friendlier rate for UBSH and allow for a reduction in deposit costs during the next 12 months. A softening real estate market is a systemic problem for the banking industry and time will be needed for the stabilization in this area. With some industry experts predicting real estate may not bottom till 2008 or 2009, credit quality of bank loan portfolios will be scrutinized closely during the next few quarters. UBSH's credit quality looks sound as net-charge offs for 3Q07 were \$229,000 or 0.05% of average loans, and the loan-loss provision decreased to \$432,000 from \$485,000 during 3Q06. As of 9/30/07 UBSH, had \$8.5 million in non-performing assets which included a single credit of \$7.4 million. UBSH said although there has been declining real estate activity, the bank's market area has remained stable and has seen no significant deterioration in its loan portfolio's quality. While earnings are likely to be flat-to-down during the next few quarters, investors should look past this and focus on UBSH's 57 branch office network in Virginia as a currently undervalued asset. These shares look attractively valued paying an attractive dividend yield of 3.7% and trading at 1.3x book value. These shares are rated OUTPERFORM with a \$44 target price. (SFM)

## MARKET COMMENT – “Trick or Treat”

October gave the equity markets a both a "trick" and "treat" in the month possessing the ghostly day known as Halloween. The "trick" was mixed economic signals raising questions about the direction of the US economy and weak earnings from the financial sector. The "treat" was the continued bullishness exhibited by the major averages as demand for stocks pushed equities higher during the month assisted by a Halloween discount rate lowering by the Federal Reserve. The question now becomes will investors get "presents or coal" for their investment portfolios as we turn towards Christmas and 4th quarter earnings results.

The fallout from subprime market woes continue as various companies' 3Q earnings results were negatively impacted. Bank of America (BAC-\$45.71), Merrill Lynch (MER-\$62.19), UBS and other financials either took, or expect to take charges or reported lower profits due to losses incurred from investments related to the subprime area. BAC posted a 32% decline in earnings due to bad loan write-offs and poor performance at its investment banking unit. MER took a \$7.9 billion charge for its involvement in the sub-prime market. UBS recently warned its 4Q earnings could be negatively impacted from potential losses on investments in securities backed by US mortgage loans, in addition to an estimated 3Q loss of \$515 million -\$687 million due to earlier write-downs. This type of news is becoming more common amongst financial institutions involved in the subprime markets or derivative securities based on these known as SIVs (Securitized Investment Vehicles). Recently, a consortium of major financial institutions, Bank of America (BAC-\$45.71), Citigroup (C-\$38.51), JP Morgan (JPM-\$44.32), have proposed adding liquidity to the SIV market with an \$80 billion commitment. Apparently, with encouragement from the US Treasury Secretary Paulson, these companies are attempting to get other major US financial institutions to join the consortium to add strength to its rescue efforts of the SIV market.

Wall Street seems to have taken recent solace from the Federal Reserve appearing ready to keep financial markets from turmoil. To this end, the Fed gave the markets a "treat" when it lowered the Fed Funds rate by ¼ of a point to 4.5%. This marks the second reduction by the Federal Reserve during the past couple of months which has lowered the Fed Funds rate from 5.25% since mid-August when subprime contagion was spreading through the world markets. The Fed rate cuts appear to have stabilized the markets and will lead Wall Street to focus on earnings growth going forward into 2008. The month of October was positive for stocks with the Dow Jones Industrial Average rising 0.38%, the S&P 500 advancing 1.59%, and the NASDAQ 100 climbing 7.08%.

Expectations from market mavens expect the S&P 500 to show 11% earnings growth in the fourth quarter and accelerating in 2008. There could be several challenges to this expected growth rate as economic reports have suggested a potential slowing of the US economy. Recent reports have showed lower rail/truck freight amounts being shipped and some retail chain sales reports have shown decreased consumer spending. Additionally, the US consumer will need to deal with rising gasoline prices at the pump with oil prices moving above \$90 per barrel.

The US dollar has been falling against world currencies and current expectations anticipate this trend to continue going into 2008. While this creates higher prices for US imports, it makes US exports cheaper thereby helping the profitability of US companies selling items overseas such as technology, pharmaceuticals, food supplies, and manufactured items. Potentially, these types of companies could benefit during the next 4 quarters as additional orders from oversea purchasers may improve earnings and increase investor demand for their stocks. In other overseas matter, the Chinese economy appears to be morphing into the proverbial 800-pound economic gorilla. The country's growth has increased investor interest to the point where the Chinese stock market has seen incredible gains during the past 3 years. Since the beginning of this year the Chinese market has advanced over 100%. Given its rapid ascent, and the growing speculative fever exhibited by investors piling into the Chinese markets and high valuations, some noted investors, such as Warren Buffett, have begin to take profits in this area. Potentially, a bursting of the Chinese bubble could put downward selling pressure on other stock indexes. Individuals may want to consider if they want to follow Warren Buffett's lead. Given today's changing financial market place investors should contact Anderson & Strudwick representatives to discuss various investment ideas and strategies for their portfolio.

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Anderson & Strudwick makes a market in First Community Bancshares.

Anderson & Strudwick makes a market in Union Bankshares.

Anderson & Strudwick makes a market in First Capital Bancorp.

Steve Marascia owns shares of CMS Energy and Dominion Resources.

Anderson & Strudwick, or one of its employees may own shares in First Capital Bancorp and/or First Community Bancshares.

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For regulatory purposes, our ratings of Outperform, Neutral and Underperform most closely correspond to Buy, Hold and Sell, respectively.

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