

John Tumazos Very Independent Research, LLC

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### ***Registration Effective August 27<sup>th</sup> and Now Operational***

Plum Creek (PCL \$44.95, Overweight) GLOBAL LIQUIDITY, RATE CUT, NEW HOUSING PERMITS, AND HIGH ENERGY PRICE LEAD TO INCREASED PRICE TARGET OF \$80 DESPITE ESTIMATE CUTS

	2007E	2008E	2009E	2010E
Earnings per share revised 9-21	\$1.55	\$2.05	\$2.45	\$2.57
Prior at Prudential Equities Group 4-23	\$1.60	\$2.30	\$2.45	\$2.57

We are raising our price target from \$47, with the stock having recently nearly met our target, to \$80 based on an expected further gradual appreciation to \$2,000 from the recent near \$1,250 per acre enterprise value. We attribute the expected appreciation to four factors.

- First, housing permits have risen 10%-31% this year in eight largely rural states, and not declined much in 17 states suggesting that "rural" activity in "nonspeculative" places has been firm even as FL, AZ, NV or CA melt down (please see our Sept. 18<sup>th</sup> research report on building permit trends).
- Second, the massive \$1 trillion global liquidity stimulus, rate cut, weak dollar and evolving trends benefit land prices.
- Third, investors appear gradually to appreciate the inherent conservatism of PCL's financial practices and pay a premium for it. We compare it to Newmont Mining, AngloGold or Barrick Gold and marvel at how PCL just has to "let the trees grow" and "watch the land appreciate" although management indeed adds value in development, silvaculture, share repurchases and finance.
- Fourth, higher energy prices increase the likelihood that pulp logs grow lucrative for their inherent BTU values, whether expressed as fireplace cord wood, chips blended with coal or gas in conventional power plants, wood ethanol, biodiesel or some other emerging method.

We cut our 2007 and 2008 earnings estimate to reflect higher fuel and delivery costs, higher "unallocated expense," the lesser log volume or prices and possible decelerating land sale activity in 2007. PCL can "sit tight" and "let the trees grow" or land appreciate if markets are sloppy.

## OUTLOOK -- REPORTED EARNINGS REVISION NOT KEY DYNAMIC TO CHANGE IN PRICE TARGET

We cut our 2007 earnings estimate to \$1.55 from \$1.64 and 2008 to \$2.05 from \$2.30 per share while staying at \$2.45 for 2009 and \$2.57 per share for 2010 to reflect higher fuel and delivery expenses, higher “unallocated expense,” the lesser log volume or prices and decelerating land sale activity in 2007. PCL can “sit tight” and “let the trees grow” or land appreciate if markets are sloppy. So far this year PCL’s eps per quarter has come in just under our estimates. They continued to pay a \$.42 dividend quarterly this year and continue to perform slightly better than they guide. Due to these factors we lowered our eps estimates to \$.46 from \$.48 and to \$.50 from \$.54 for the third and fourth quarters respectively. This results in an estimate of \$1.55 per share for yearend 2007 down from \$1.64 previously.

The “basis” of the lands PCL actually sells has a large impact on reported earnings. In the 2007 first half the basis was \$23 mm and the revenues \$110 mm. We have estimated the full year 2007 total basis at \$115 mm and the revenues at \$350 mm. Any achievement of an 80% rather than 65% operating profit margin due to low basis provides earnings upsides, and vice versa.

Pulp wood prices have risen slightly this year, and the price and volume declines in the northern, southern and manufacturing segments have proven much less than we feared. Fuel and delivery cost escalations have offset these good surprises.

Our earnings estimate revision could prove conservative. For example, we have not factored any new tranches of share repurchases once the current authorization expires, which is possible but we do not “count the winnings” until won. Further, we have not factored in any possible good opportunities to buy land, which might occur. Please do not take literally our projection in our earnings model that acreage falls slightly every year as we tabulate intended sales but harshly do not factor in the “replacement” land purchases fully until management finds the deal.

## PRICE OBJECTIVE AND INVESTMENT OVERVIEW

We rate Plum Creek Overweight as we expect its increased concentration on land sales will allow the company to grow its earnings per share, cash flow, and dividends. Plum Creek’s potential to maintain or modestly increase its 8.16-million-acre land base as it “sells retail” and “buys wholesale” appears attractive financially. We expect Plum Creek’s image as a mature logging company will improve as investors see property resale returns materialize from innovative development concepts.

The valuation methodology behind our price target of \$80 per share is based on an enterprise value of \$2,000 per acre. The current stock price represents a valuation of about \$1,250 per acre.

Table 1 Enterprise value estimate

	2Q07	Estimate
Shares outstanding	174200000	174200000
Stock Price	45.39	80.88
debt and debt like liabilities	2417000000	2.417E+09
Cash	1070000000	1070000000
Acres	8200000	8200000
Enterprise value	1245.96805	2000

Source: John Tumazos Very Independent Research, LLC

## HOUSING PERMITS

It is our belief that current data shows that housing permits are beginning to increase in rural non speculative markets and this will avoid any decline in rural timberland values key to PCL's asset value, permit values to continue to rise and lead to an increase in demand for logs regionally. Currently there are 8 states which have shown increases of between 10 and 31% in new housing permits in the second quarter of 2007 compared to the same quarter in 2006. We feel this number will increase over the coming months. We also believe the number of states where permits are down slightly will begin to decrease as the market stabilizes. A safe estimate would be for 1 to 2 states to move from the decreasing side to the increasing side every month or two for the remainder of the year as the excess inventory of standing homes nationally becomes "absorbed."

**Table 2**

**Plum Creek Earnings Model**

(\$ millions)

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Northern resources	413	351	385	394	392	390	392	390
Southern resources	479	444	478	489	494	504	514	523
Manufacturing (pre-2001 Lumber)	493	454	463	463	463	463	463	463
Land Sales	308	350	350	325	325	325	325	325
Other/Natural Resources	19	21	23	25	27	29	31	33
Inter-segment elimination	(85)	(88)	(88)	(88)	(88)	(87)	(86)	(85)
Total Third-party Revenues	1,627	1,532	1,610	1,609	1,614	1,625	1,640	1,650
Northern resources	105	60	85	118	118	117	118	117
Southern resources	178	169	191	245	242	252	257	262
Manufacturing (pre-2001 Lumber)	22	0	10	13	16	16	16	16
Land Sales	178	235	235	211	211	211	211	211
Other/Natural Resources	16	20	23	25	27	29	31	33
Unallocated expense	(38)	(62)	(50)	(60)	(60)	(60)	(60)	(60)
Total Operating Income	461	421	493	552	554	565	572	578
Cost of goods sold	925	867	872	810	811	809	814	816
Depreciation, depletion, amortization	128	130	132	134	136	138	140	142
SG&A	113	113	113	113	113	113	113	113
Interest expense	(133)	(143)	(134)	(118)	(101)	(83)	(64)	(45)
Interest income								
Gain (loss) on asset sales								
Reorganization costs								
Other (expense) income, net								
Pretax income	328	278	359	433	453	482	509	534
Income taxes	(13)	(7)	(7)	(13)	(13)	(13)	(14)	(15)
Equity income								
Change in accounting	2							
Net income	317	271	352	420	440	469	495	519
General partner interest								
Net income to unitholders	317	271	352	420	440	469	495	519
Units/shares out	180.5	174.2	171.1	171.1	171.1	171.1	171.1	171.1
FD units/shares out	180.9	174.6	171.5	171.5	171.5	171.5	171.5	171.5
Net income per share	\$1.75	\$1.55	\$2.05	\$2.45	\$2.57	\$2.73	\$2.89	\$3.03
Dividends per share	\$1.60	\$1.68	\$1.68	\$1.68	\$1.68	\$1.78	\$1.88	\$1.97
Cash flow per share	\$2.47	\$2.32	\$2.84	\$3.27	\$3.40	\$3.58	\$3.74	\$3.90
Book value per share	\$11.55	\$10.69	\$11.27	\$12.04	\$12.93	\$13.89	\$14.91	\$15.97
FFO per share (PCL)	\$2.94	\$2.96	\$3.50	\$3.90	\$4.02	\$4.20	\$4.37	\$4.52
FFO per share (conservative)	\$1.37	\$0.84	\$1.34	\$1.88	\$2.01	\$2.19	\$2.35	\$2.51
Dividend as % PCL FFO	54.5%	56.9%	48.0%	43.1%	41.8%	42.3%	43.0%	43.6%
Dividend as % NAREIT FFO	117.2%	200.9%	125.4%	89.2%	83.6%	81.1%	79.7%	78.5%
Dividend as % of EBITDA	49.0%	53.1%	46.0%	41.9%	41.7%	43.2%	45.0%	46.7%
	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Change in Northern pulpwood prices	-2.6%	2.0%	4.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Change in Northern sawwood prices	0.0%	-8.0%	4.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Change in Northern harvest volume	26.2%	-10.0%	6.0%	3.0%	0.0%	0.0%	1.0%	0.0%
Change in Southern pulpwood prices	0.0%	2.0%	4.0%	2.0%	0.0%	0.0%	0.0%	0.0%
Change in Southern sawwood prices	-8.1%	-12.0%	4.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Change in Southern harvest volume	26.2%	-2.0%	4.0%	2.0%	1.5%	2.5%	2.5%	2.3%
Change in manufacturing prices	-2.0%	-5.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Change in manufacturing volumes	-2.0%	-3.0%	2.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Timberland Area (000 acres)	8,204	8,163	8,122	8,081	8,041	8,001	7,961	7,921

Source: Company Reports, John Tumazos Very Independent Research, LLC estimates

Table 3

**Plum Creek Sources and Uses of Cash**  
(\$ millions)

Sources	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Net Income (Loss)	317	271	352	420	440	469	495	519
Depreciation	128	130	132	134	136	138	140	142
Deferred income taxes	1	4	3	7	6	7	7	7
Equity earnings								
Dividends received								
Accounting change								
Asset sales	86	115	116	114	114	114	114	114
Issuance of common stock	(256)	(200)	0	0	0	0	0	0
Issuance of debt	3,699	10	0	0	0	0	0	0
Other	(7)							
<b>Total Sources</b>	<b>3,968</b>	<b>330</b>	<b>603</b>	<b>674</b>	<b>696</b>	<b>727</b>	<b>755</b>	<b>782</b>
<b>Uses</b>								
Capital Expenditures	86	100	75	75	75	75	75	75
Acquisitions, net cash	111	21	20	20	20	20	20	20
Debt repayment	3,606	30	100	250	250	250	250	250
Cash distributions	290	293	287	287	287	304	321	337
Payments/advances non-cons. Subs.								
Changes in non-cash w/c	(29)							
Changes in cash	(96)	(114)	120	42	63	78	90	101
<b>Total Uses</b>	<b>3,968</b>	<b>330</b>	<b>603</b>	<b>674</b>	<b>696</b>	<b>727</b>	<b>755</b>	<b>782</b>

Table 4

**Plum Creek Balance Sheet**  
(\$ millions)

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E
<b>Assets</b>								
Cash and equivalents	273	159	280	321	385	463	552	653
Restricted cash	4	4	4	4	4	4	4	4
Accounts receivable	40	77	81	80	81	81	82	82
Inventories	83	107	113	113	113	114	115	115
Assets held for sale	82	82	82	82	82	82	82	82
Other current assets	31	31	31	31	31	31	31	31
<b>Total current assets</b>	<b>513</b>	<b>460</b>	<b>590</b>	<b>631</b>	<b>695</b>	<b>775</b>	<b>866</b>	<b>968</b>
Timberlands, net	3,876	3,752	3,599	3,447	3,292	3,136	2,977	2,816
Property, plant, equipment, net	216	216	216	216	216	216	216	216
Equity investments	28	28	28	28	28	28	28	28
Other assets	28	28	28	28	28	28	28	28
<b>Total assets</b>	<b>4,661</b>	<b>4,484</b>	<b>4,461</b>	<b>4,350</b>	<b>4,260</b>	<b>4,183</b>	<b>4,115</b>	<b>4,056</b>
<b>Liabilities</b>								
Short-term debt	125	50	50	50	50	51	52	53
Accounts payable and other current	156	217	226	226	227	228	230	231
<b>Total current liabilities</b>	<b>281</b>	<b>267</b>	<b>276</b>	<b>276</b>	<b>277</b>	<b>279</b>	<b>282</b>	<b>284</b>
Long-term debt	1,617	1,803	1,703	1,903	1,653	1,402	1,151	900
Line of credit	581	450	450	0	0	0	0	0
Deferred income	0	0	0	0	0	0	0	0
Deferred taxes	25	29	32	38	45	51	58	66
Other liabilities	68	68	68	68	68	68	68	68
Shareholders' equity	2,089	1,867	1,932	2,065	2,217	2,382	2,556	2,739
<b>Total Liabilities and shareholders'</b>	<b>4,661</b>	<b>4,484</b>	<b>4,461</b>	<b>4,350</b>	<b>4,260</b>	<b>4,183</b>	<b>4,115</b>	<b>4,056</b>
Accounts receivable/sales	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Inventories/sales	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
AP and current liabilities/sales	9.6%	14.2%	14.0%	14.1%	14.0%	14.0%	14.0%	14.0%

Source: Company reports, John Tumazos Very Independent Research, LLC estimates.

## BUSINESS MIX OF SECOND-QUARTER EARNINGS

Revenues rose \$15 mm or 4% to \$395 from \$380 mm. Revenues from logs fell just \$4 mm surprisingly, land sales rose \$19 mm, lumber or plywood manufacturing fell \$1 mm and “other” was unchanged. Northern log revenues fell \$8 mm while Southern log revenues rose \$4 mm. Southern sawlog prices fell 13% and Northern sawlog prices fell 10% from last year, while pulp log prices increased. The total log harvest rose 4% to 4.9 from 4.7 million tons as very low priced Southern pulp log volumes rose by 250,000 tons to 1.901 from 1.651 million tons last year.

Gross margin fell \$1 mm as costs of sales rose \$16 mm as revenues rose \$15 mm. Costs rose \$11 mm for timber log harvests, fell \$2 mm for land sales and rose \$6 mm for manufacturing.

Thus, the gross profit was \$66 mm for logs, \$48 mm for land sales, \$6 mm for manufacturing and \$5 mm for “other” such as hunting or mineral lease revenues. We were ecstatic that PCL avoided a loss from its lumber, plywood and related manufacturing. Net of SG&A and other, the EBIT operating profit was \$14 mm for Northern logs, \$41 mm for Southern logs, \$47 mm for Real Estate, \$2 mm for Manufacturing, \$5 mm for hunting or mineral lease and other and a \$13 mm intercompany elimination.

Northern logs, southern logs and manufacturing had bigger declines as EBIT fell to \$94 from \$99 mm last year, while land rose and Other was constant.

Plum Creek sold just 31,025 acres in the June 2007 quarter, which was up slightly from the second quarter of 2006.

## CASH ISSUES IN JUNE QUARTER

Cash balances fell \$103 mm in the March quarter owing to \$20 mm net reduction in debt-like liabilities, \$48 mm put in “like-kind exchange funds escrow,” and paydowns of \$30 mm in payables while noncash current assets rose \$57 mm.

Capital spending and real estate development outlays were just \$13 mm, which permitted PCL to spend \$89 mm to buy back stock. Thus, average shares outstanding fell almost 2.2 mm shares while cash flows were meager at \$73 mm when working capital consumed \$72 mm.

Plum Creek has \$111 million remaining on the new repurchase authorization, and referred to its \$22 million in repurchases at \$37.85 in the first quarter as “embarrassingly cheap.”

## RISKS

Risks to the stock include weak paper and wood product markets, which could hurt its log harvesting business. Further risks include high interest rates, which could reduce land values as it could cool the real estate market, or increased competition for timberlands from institutional investors, which could drive up prices.

We worry about “reserve replacement,” or Plum Creek’s ability to find new land to replace the parcels it sells. Otherwise its earnings and dividends are “returns of capital” not “returns on capital.”

## CHANGE IN THIS RESEARCH OPERATION

This report reflects research coverage by JTVIR, LLC. In no way shape or form should it be misconstrued as involving Prudential Equities Group (PEG), which shut down on June 6, 2007 as noted. The continuation of that same quarterly or full year earnings estimate for 2007 as JTVIR, LLC should not be construed or mistaken to involve PEG, which shut down on June 6, 2007. Certain data, such as the logic of the earnings model, are similar owing to the same primary author, but this coverage initiation herein involves a different entity and no employment or affiliation with the former Prudential Equity Group, LLC.

## DISCLOSURES

"John Tumazos Very Independent Research, LLC" (JTVIR) is a Delaware Corporation with registration effective on August 27, 2007 as an investment advisor in the state of New Jersey owing to our place of business in New Jersey.

JTVIR is not a broker-dealer, and conducts no trades. Its primary business is to provide "unbundled" metals and paper industry securities and market research to institutions or corporations in a zero commission, electronic execution, electronic dissemination, unbundled format for a specified annual fee structure.

Our investment rating system for securities recommendations is Overweight, Neutral Weight or Underweight. Overweight or Underweight recommendations are estimated to vary from the relative performance of the S&P 500 by more than 10% annually, and the intended time horizon is up to 24 months. Our securities research is intended for institutional investors that might buy up to 10% of a given company, and as such focuses more towards longer-term dynamics impacting the net present value of future cash flows rather than "day trading" sorts of near-term issues.

Neither JTVIR, its members or its employees own or have a financial interest in any securities discussed in this report. Our policy is full disclosure.

Our policy permits personal trading in the metals or paper industries, though no positions were taken in companies within regular research coverage after July 2001 after joining Prudential Financial and until after one month of completed New Jersey registration of JTVIR. Our policy is that any personal trading must be consistent with our recommendation, made two business days or more AFTER a recommendation or change in recommendation and held for a minimum of 30 days or one month. We believe it is virtuous for a securities analyst to "put his or her money where his mouth is" to invest consistent with the recommendation to clients after such recommendation has been made, and we disagree with some restrictions made upon broker-dealer employees after 2000 era scandals.

Our policy permits up to three directorships and up to five consulting projects, advisory assignments or financial advice to corporations that might supplement, backcheck or

substitute for certain services of a large investment banking firm. For example, we would accept an engagement to evaluate investment banking advice on behalf of a manufacturing company concerned whether advice is sincere or intended to maximize fees. Currently no such relationships exist.

Our policy is full disclosure of any advisory relationship or conflict going back three years. None currently exist.

Numerous prior investment banking relationships existed prior to three years history to the pre-1997 time frame under the employment of Donaldson, Lufkin and Jenrette or Oppenheimer & Co., Inc. Some of these we can recollect included 14 different gold mine valuations or sales for Barrick Gold, LAC Minerals (later acquired by Barrick), Addington Resources (gold assets in Montana acquired by Canyon Resources), Westworld Industries (Bolivian assets acquired by Battle Mountain Gold later acquired by Newmont Mining), Coeur d'Alene Mines, Crown Resources (acquired by Kinross Gold), Freeport-McMoRan Gold (acquired by Minorco later AngloGold later Queenstake Resources), FMC Gold (later renamed Meridian Gold) and others. Sole managed initial public offerings included Reliance Steel & Aluminum and Huntco. Lead-managed initial public offerings included American Steel & Wire (later acquired by Birmingham Steel) and lead-managed underwritings included Quanex. Co-managed underwritings included the IPO of Century Aluminum and offerings for AK Steel, Kaiser Aluminum, Agnico-Eagle Mines, Cameco and others. Asset sales or purchase advisories, fairness opinion or trusteeships were done for Thyphin Steel (sold to Ryerson Tull), Cyclops Corp. (sold to Armco later sold to AK Steel), Allegheny Corp., Bethlehem Steel, the U.S. Dept. of Justice pursuant to the June 1984 merger of LTV and Republic Steel to sell the Gadsden, AL integrated flat-rolled mill, Cobre Copper, and others. Typically more than five investment banking assignments were evaluated, partly executed or "due diligenced" for any completed transaction. Some examples we can recall for which a prospectus was either drafted or partly drafted indicating much work included stock underwritings not completed for Wheeling-Pittsburgh Steel, Steel Dynamics, Atlas Corp., Webco, Sharon Steel, IPSCO, Co-Steel Inc., and others.

#### **ANALYST UNIVERSE COVERAGE:**

John C. Tumazos, CFA: Rio Tinto, Louisiana-Pacific, Nucor Corp., Newmont Mining, U.S. Steel, International Paper, BHP Billiton, MeadWestvaco Corp., Antofagasta PLC, Allegheny Technologies, Alcoa Inc., Inco Limited, Bowater, Inc., Temple-Inland, Barrick Gold, Abitibi-Consolidated, Weyerhaeuser Co., Alcan Inc., Smurfit-Stone Container, Plum Creek Timber, Worthington Industries, Goldcorp Inc., AngloGold Ashanti, Freeport McMoRan Copper & Gold, Novelis Inc., FNX Mining.

Dynatec is a company not continued in the research coverage of JTVIR, LLC that was previously included in the prior June 6, 2007 Prudential Equities Group universe owing to a pending takeover by Sherritt International.

In accordance with applicable rules and regulations, we note above parenthetically that our stock ratings of “Overweight,” “Neutral Weight,” and “Underweight” most closely correspond with the more traditional ratings of “Buy,” “Hold,” and “Sell,” respectively; however, please note that their meanings are not the same. (See the definitions above.) We believe that an investor’s decision to buy or sell a security should always take into account, among other things, that the investor’s particular investment objectives and experience, risk tolerance, and financial circumstances. Rather than being based on an expected deviation from a given benchmark (as buy, hold and sell recommendations often are), our stock ratings are determined on a relative basis (see the foregoing definitions).

There is no intention to “balance” the number of Overweight or Underweight ratings, as instances of broad over- or under-performance among basic industrials may occur. JTVIR makes each investment judgment in a “bottoms up” manner based on the assets of each individual company.

### **Price Target – Methods/Risks**

The methods used to determine the price target generally are based on future earning estimates, product performance expectations, cash flow methodology, historical and/or relative valuation multiples. The risks associated with achieving the price target generally include customer spending, industry competition and overall market conditions.

Additional risk factors as they pertain to the analyst's specific investment thesis can be found within the report.

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