

Montrose Environmental Group, Inc.

Strong '24 guide with benefits from secular trends; tuck-in M&A continues

Reiterate Rating: BUY | PO: 48.00 USD | Price: 41.38 USD

4Q23 adj. EBITDA beats Street; 2024 guidance strong

MEG's 4Q23 results came in above consensus but below our estimates, partially due to margin headwinds from the Matrix acquisition and the planned transition of the biogas business. The '24 guide came in above our estimates and consensus. The '24 guide shows the company's focus on EBITDA and revenue expansion (both guided for double-digit growth), and it appears the message is well received by shareholders with MEG up 25% today vs the S&P 500 index up 0.5%. Crisis response (i.e., CTEH) revenue is guided to be down y/y in '24 after revenue in '23 was higher than expected due to carryover from the two large projects that were booked in 2Q23. We reiterate our Buy rating and raise our price objective by \$8 to \$48 based on 28x (from 24x) 2025 EV/EBITDA reflecting peer rerating and raised estimates.

Regulatory potentially a benefit in '24; M&A continues

MEG expects to benefit in '24 from regulatory changes related to PFAS and methane. Projects related to PFAS (Per- and polyfluoroalkyl substances) were delayed in 2023 as clients awaited clarity on PFAS regulations. The delay in projects is expected to mitigate throughout the year as MEG expects clarity on PFAS regulations. The company noted the funnel for PFAS-related projects has expanded materially. The EPA's new methane rule was finalized in December 2023, supporting incremental demand for MEG's emission measurement and monitoring solutions in '24. In Jan. the company bought Epic Environmental and in February bought Two Dot Environmental, continuing the company's tuck-in M&A strategy.

Adj. EBITDA of \$17.5mn beat consensus of \$17.1mn

Revenue of \$166mn came below BofA's \$169mn estimate but was slightly above \$161mn consensus. Adj. EBITDA of \$17.5mn came in below BofA \$19.9mn and slightly above consensus of \$17.1mn. Assessment, Permitting & Response was a \$(0.04)/sh miss vs our model driven by 350bp lower margin. Measurement & Analysis was a \$(0.02)/sh miss driven by 220bp lower margin. Remediation & Reuse was a \$0.01/sh miss driven by 150bp higher margin. The net impact of adj. EBITDA was a \$(0.05)/sh miss vs our model.

Maintaining our 2024 adj. EBITDA at \$91mn, +16% y/y

We maintain our adj. EBITDA at \$91mn (versus \$90-95mn guidance). We forecast 11% y/y revenue growth and 50bp of y/y margin expansion.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	(1.62)	(1.57)	(0.62)	0.14	0.80
EPS Change (YoY)	-3.8%	3.1%	60.5%	NM	471.4%
Consensus EPS (Bloomberg)			0.17	0.43	1.35
DPS	0.55	0.55	0.35	0.16	0
Valuation (Dec)					
P/E	NM	NM	NM	295.6x	51.7x
Dividend Yield	1.3%	1.3%	0.9%	0.4%	0%
EV / EBITDA*	109.6x	79.8x	35.9x	26.0x	20.3x
Free Cash Flow Yield*	0.8%	2.1%	3.3%	4.9%	5.7%

* For full definitions of *IQmethod*SM measures, see page 6.

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Refer to important disclosures on page 7 to 9. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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Timestamp: 01 March 2024 05:00AM EST

01 March 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	40.00	48.00
2024E Rev (m)	694.9	695.4
2025E Rev (m)	766.1	765.5
2026E Rev (m)	839.6	836.6
2024E EPS	-0.44	-0.62
2025E EPS	0.33	0.14
2026E EPS	0.82	0.80

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Stock Data

Price	41.38 USD
Price Objective	48.00 USD
Date Established	1-Mar-2024
Investment Opinion	C-1-9
52-Week Range	21.96 USD - 51.58 USD
Mkt Val (mn) / Shares Out (mn)	1,257 USD / 30.4
Free Float	91.6%
Average Daily Value (mn)	6.60 USD
BofA Ticker / Exchange	MEG / NYS
Bloomberg / Reuters	MEG US / MEG.N
ROE (2024E)	-5.7%
Net Dbt to Eqty (Dec-2023A)	33.2%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

iQprofileSM Montrose Environmental Group, Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	-3.5%	-3.6%	-0.2%	2.4%	4.6%
Return on Equity	-15.3%	-14.9%	-5.7%	1.2%	6.0%
Operating Margin	-5.1%	-4.6%	-0.2%	3.1%	5.8%
Free Cash Flow	11	26	41	62	72

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	NM	NM	NM	17.7x	3.4x
Asset Replacement Ratio	0.2x	0.6x	0.4x	0.5x	0.6x
Tax Rate	NM	3.1%	28.0%	28.0%	28.0%
Net Debt-to-Equity Ratio	19.3%	33.2%	44.8%	46.3%	33.5%
Interest Cover	-5.3x	-4.2x	-0.2x	2.3x	4.2x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	544	624	695	766	837
% Change	-0.4%	14.7%	11.4%	10.1%	9.3%
Gross Profit	193	240	270	302	334
% Change	8.5%	24.8%	12.3%	11.8%	10.7%
EBITDA	15	20	45	62	80
% Change	-77.0%	37.4%	122.1%	38.2%	28.4%
Net Interest & Other Income	(2)	(2)	(10)	(10)	(12)
Net Income (Adjusted)	(48)	(47)	(19)	5	27
% Change	-15.6%	2.0%	59.9%	NM	486.9%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(32)	(31)	(8)	10	27
Depreciation & Amortization	47	46	47	38	31
Change in Working Capital	(42)	(14)	(27)	(15)	(15)
Deferred Taxation Charge	2	(1)	0	0	0
Other Adjustments, Net	45	56	47	48	48
Capital Expenditure	(10)	(30)	(17)	(18)	(18)
Free Cash Flow	11	26	41	62	72
% Change	-65.3%	148.4%	55.4%	51.3%	15.9%
Share / Issue Repurchase	2	5	(60)	(60)	(33)
Cost of Dividends Paid	(16)	(16)	(11)	(5)	0
Change in Debt	(13)	(17)	34	14	15

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	90	23	16	27	83
Trade Receivables	95	112	131	144	157
Other Current Assets	63	65	72	78	84
Property, Plant & Equipment	36	57	58	59	61
Other Non-Current Assets	508	559	545	528	518
Total Assets	792	817	822	836	904
Short-Term Debt	28	32	32	32	32
Other Current Liabilities	84	95	98	107	116
Long-Term Debt	152	149	183	196	211
Other Non-Current Liabilities	62	67	67	67	67
Total Liabilities	326	343	379	402	425
Total Equity	466	474	442	435	478
Total Equity & Liabilities	792	817	822	836	904

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Industrials/Multi-Industry

Company Description

Montrose is an environmental services company founded in 2012. The company is headquartered in California with 1,400 employees across 70+ offices in the US, Canada, and Australia. Montrose offers a wide range of services to public and private sector clients including: regulatory consulting, emergency response, testing, lab services, water treatment, and soil remediation.

Investment Rationale

Montrose is a beneficiary of remediation work on per- and polyfluoroalkyl (PFAS) compounds, environmental regulations, growing private corporate focus on ESG, and US infrastructure stimulus. We see accelerating revenue and earnings growth from these factors in 2024.

Stock Data

Average Daily Volume 159,555

Quarterly Earnings Estimates

	2023	2024
Q1	-0.49A	-0.22E
Q2	-0.24A	-0.12E
Q3	-0.25A	0.02E
Q4	-0.05A	0.05E

Exhibit 1: 4Q23 earnings variance analysis

Adj. EBITDA of \$17.5 was above Street's estimate of \$17.1mn

	Actual	Reported		BofA Estimate		Variation Versus BofA Est.		
(in US\$ mn, except per share data)	4Q:22A	4Q:23A	y/y% chg.	4Q:23E	y/y% chg.	Dollar	Percentage	EPS
Segment Sales								
Assessment, Permitting and Response	45	50	11%	50	11%	(0)	0%	
Measurement and Analysis	47	54	16%	53	14%	1	1%	
Remediation and Reuse	48	62	29%	65	37%	(4)	-5%	
Total	140	166	19%	169	21%	(3)	-2%	
Segment EBITDA								
Assessment, Permitting and Response	7	9	27%	11	52%	(2)	-16%	\$ (0.04)
Measurement and Analysis	10	10	-7%	11	3%	(1)	-10%	\$ (0.02)
Remediation and Reuse	9	8	-3%	8	-9%	1	6%	\$ 0.01
Segment Total	26	27	4%	29	13%	(2)	-8%	\$ (0.05)
Corporate and other	(8)	(10)	NM	(10)	NM	(0)	1%	\$ (0.00)
Total	18	17.5	-2%	19.9	12%	(2)	-12%	\$ (0.06)
Segment EBITDA Margin								
Assessment, Permitting and Response	15.9%	18.3%	240 bp	21.8%	590 bp		(350 bp)	
Measurement and Analysis	22.3%	17.9%	(440 bp)	20.1%	(220 bp)		(220 bp)	
Remediation and Reuse	18.0%	13.5%	(450 bp)	12.0%	(600 bp)		150 bp	
Segment Total	12.7%	10.5%	(220 bp)	11.8%	(100 bp)		(120 bp)	
Net Sales	140	166	19%	169	21%	(3)	-2%	
COGS	91	102	12%	106	17%	(4)	-4%	
Gross Profit	49	64	31%	62	28%	2	3%	\$ 0.04
Selling, General & Administrative	45	61	35%	52	15%	9	17%	\$ (0.21)
Related-party expense	0	(0)	NM	-	NM	(0)	NM	\$ 0.01
Depreciation and amortization	12	12	4%	11	-2%	1	6%	\$ (0.02)
Operating Income	(8)	(9)	NM	(1)	NM	(8)	600%	\$ (0.18)
Other expense (income)	1	(6)	NM	0	-79%	(6)	-3067%	\$ 0.15
Interest expense, net	1	2	86%	1	4%	1	79%	\$ (0.02)
EBT	(10)	(5)	NM	(3)	NM	(3)	92%	\$ (0.06)
Taxes	0	(4)	NM	(1)	NM	(3)	397%	
Tax Rate	-3.4%	72.6%	7600 bp	28.0%	3140 bp	4460 bp	159%	\$ 0.08
Net Income (Continuing Operations)	(11)	(1)	NM	(2)	NM	1	-27%	\$ 0.02
Noncontrolling Interest	-	-	NM	-	NM	-	NM	\$ -
Equity adjustment from foreign currency translation	-	-	NM	-	NM	-	NM	\$ -
Net Income to firm	(11)	(1)	NM	(2)	NM	1	-27%	\$ 0.02
Accretion of redeemable preferred stock	-	-	NM	-	NM	-	NM	\$ -
Convertible preferred stock dividend	4	4	0%	4	0%	(0)	0%	\$ 0.00
Net Income attributable to common stock holders	(15)	(6)	NM	(6)	NM	1	-9%	\$ 0.02
GAAP EPS	(\$0.50)	(\$0.18)	NM	(\$0.20)	NM	\$0.02	-9%	\$ -
Diluted Shares Outstanding	30	30	2%	30	2%	(0)	0%	\$ (0.00)

	Actual	Reported	BofA Estimate	Variation (b.p.)
Margin Analysis	4Q:22A	4Q:23A	4Q:23E	BofA Est. 4Q:22A
COGS	65.1%	61.5%	63.1%	(160 bp) (360 bp)
Gross Margin	34.9%	38.5%	36.9%	160 bp 360 bp
SG&A	32.4%	36.9%	31.0%	590 bp 450 bp
Operating Margin	-5.9%	-5.4%	-0.8%	(460 bp) 60 bp
EBT Margin	-7.5%	-3.2%	-1.6%	(150 bp) 430 bp
Net Margin	-10.7%	-3.3%	-3.6%	30 bp 730 bp
Segment Incremental Margin	14.2%	-1.2%	7.2%	(840 bp) (1530 bp)

Source: Company reports, BofA Global Research estimates

BofA GLOBAL RESEARCH



Maintain our 2024 adj. EBITDA at \$91mn, +16% y/y

We maintain our adj. EBITDA at \$91mn (versus \$90-95mn guidance). We forecast 11% y/y revenue growth and 50bp of y/y margin expansion.

Exhibit 2: BofA 2024/2025 estimates versus guidance

Maintain 2024 adj. EBITDA at \$91mn

	2024 Guidance	BofA 2024 estimates		BofA 2025 estimates	
(\$mn, except per share amounts)	As of 4Q23	Old	New	Old	New
Revenue	\$675-725mn	695	695	766	766
Revenue growth %y/y	8-12%	10.8%	11.4%	10.3%	10.1%
Adjusted EBITDA	\$90-95mn	91	91	110	110
Adjusted EBITDA % (midpoints)	13.2%	13.1%	13.1%	14.4%	14.3%

Source: BofA Global Research estimates, company reports

BofA GLOBAL RESEARCH

Valuation

We base our \$48 price objective on 28x EV/EBITDA of our 2025 estimates. This is at a premium to the peer group average trading at 11x on 2024E. We believe the premium is warranted given capital allocation and secular growth trends from US environmental regulations.

Exhibit 3: Montrose comparable valuation analysis

We base our \$48 PO on 28x EV/EBITDA of 2025E

Company	Ticker	Stock Price 2/29/2024	P/E		EV/EBITDA		P/FCF		EBITDA Margin		Revenue Growth	
			2024E	2025E	2024E	2025E	2024E	2025E	2024E	2025E	2024E	2025E
Eurofins*	ERF FP	\$55.24	18.3 x	15.7 x	10.0 x	9.1 x	22.0 x	18.4 x	21.0%	21.4%	6.8%	7.7%
ALS*	ALQ AU	\$11.93	17.3 x	16.2 x	10.1 x	9.6 x	17.9 x	16.8 x	26.0%	26.0%	5.1%	5.5%
Intertek*	ITRK LN	\$46.22	19.8 x	18.2 x	10.6 x	9.6 x	18.5 x	17.2 x	22.2%	22.7%	3.9%	5.2%
SGS*	SGSN SW	\$84.80	23.4 x	21.1 x	12.0 x	11.0 x	19.9 x	18.1 x	22.2%	22.8%	2.0%	5.5%
Bureau Veritas*	BVRDF	\$26.87	20.2 x	18.9 x	10.7 x	10.0 x	16.9 x	16.0 x	20.2%	20.3%	4.8%	5.0%
Jacobs	J	\$146.55	17.3 x	15.6 x	12.3 x	11.0 x	16.7 x	15.6 x	10.9%	10.1%	10.4%	16.3%
AECOM	ACM	\$89.04	20.5 x	N/A	11.3 x	N/A	18.9 x	N/A	7.4%	N/A	6.9%	N/A
AVERAGE			19.5 x	17.6 x	11.0 x	10.0 x	18.7 x	17.0 x	18.6%	20.5%	5.7%	7.5%
Montrose	MEG	\$40.19	NM	NM	34.0 x	24.0 x	29.0 x	19.4 x	6.6%	8.4%	12.1%	11.3%
Montrose at PO	MEG	\$48.00	NM	NM	39.2 x	27.6 x	34.6 x	23.2 x	-	-	-	-

Source: BofA Global Research estimates, Bloomberg

*Bloomberg consensus estimates used. All others represent BofA Global Research estimates

Note: For comparability, we include stock-based compensation in adjusted EBITDA for Eurofins

BofA GLOBAL RESEARCH



Price objective basis & risk

Montrose Environmental Group, Inc. (MEG)

We base our \$48 price objective on 28x EV/EBITDA of our 2025 estimates. This is at a premium to the peer group average trading at 11x on 2024E. We believe the premium is warranted capital allocation and secular growth trends from US environmental regulations/infrastructure stimulus.

Downside risks to our PO are 1) greater-than-expected y/y declines in the CTEH business, 2) inability to source or integrate deals, and 3) poor execution tied to ERP rollout and initiation of European operations.

Analyst Certification

I, Andrew Obin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Multi-Industrials/Engineering and Construction Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AspenTech	AZPN	AZPN US	Andrew Obin
	Atmus Filtration	ATMU	ATMU US	Andrew Obin
	Dover Corp	DOV	DOV US	Andrew Obin
	Eaton Corp PLC	ETN	ETN US	Andrew Obin
	Emerson Electric Co	EMR	EMR US	Andrew Obin
	Flowserve	FLS	FLS US	Andrew Obin
	General Electric Company	GE	GE US	Andrew Obin
	Honeywell International Inc.	HON	HON US	Andrew Obin
	ITT Inc.	ITT	ITT US	Andrew Obin
	Montrose Environmental Group, Inc.	MEG	MEG US	Andrew Obin
	Parker Hannifin Corporation	PH	PH US	Andrew Obin
	PTC Inc.	PTC	PTC US	Andrew Obin
	Rush	RUSHA	RUSHA US	Andrew Obin
	Vertiv	VRT	VRT US	Andrew Obin
	Vontier	VNT	VNT US	Andrew Obin
NEUTRAL				
	3M Company	MMM	MMM US	Andrew Obin
	AMETEK Inc	AME	AME US	Andrew Obin
	Fortive Corporation	FTV	FTV US	Andrew Obin
	Johnson Controls International PLC	JCI	JCI US	Andrew Obin
	Pentair plc	PNR	PNR US	Andrew Obin
	Rockwell	ROK	ROK US	Andrew Obin
	Trane Technologies PLC	TT	TT US	Andrew Obin
UNDERPERFORM				
	Allegion	ALLE	ALLE US	Andrew Obin
	Carrier Global Corp.	CARR	CARR US	Andrew Obin
	Core & Main	CNM	CNM US	Andrew Obin
	Illinois Tool Works	ITW	ITW US	Andrew Obin
	John Bean Technologies	JBT	JBT US	Andrew Obin
	Keysight	KEYS	KEYS US	David Ridley-Lane, CFA



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

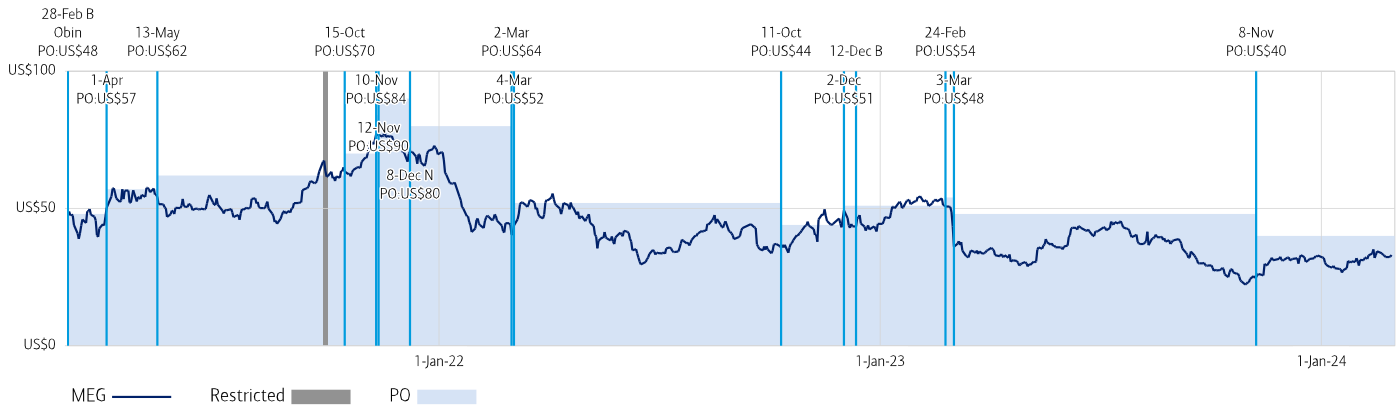
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Disclosures

Important Disclosures

Montrose (MEG) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Industrials/Multi-Industry Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	45	50.56%	Buy	25	55.56%
Hold	26	29.21%	Hold	13	50.00%
Sell	18	20.22%	Sell	7	38.89%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

Price Charts for the securities referenced in this research report are available on the [Price Charts website](#), or call 1-800-MERRILL to have them mailed.

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