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Analyst's Notes

Analysis by Joseph Bonner, CFA, May 22, 2025

ARGUS RATING: **BUY**

- Platformization strategy gaining momentum
- Palo Alto reported non-GAAP EPS rose 21% on 15% revenue growth in fiscal 3Q25 as the company takes share as it scales next generation security solutions.
- Palo Alto continues to innovate, introducing new AI tools and expanding partnerships.
- We see Palo Alto as a strong competitor in the highly fragmented but rapidly growing enterprise cybersecurity space.
- We are raising our FY25 non-GAAP EPS estimate to \$3.28 from \$3.22 and our FY26 forecast to \$3.57 from \$3.51.

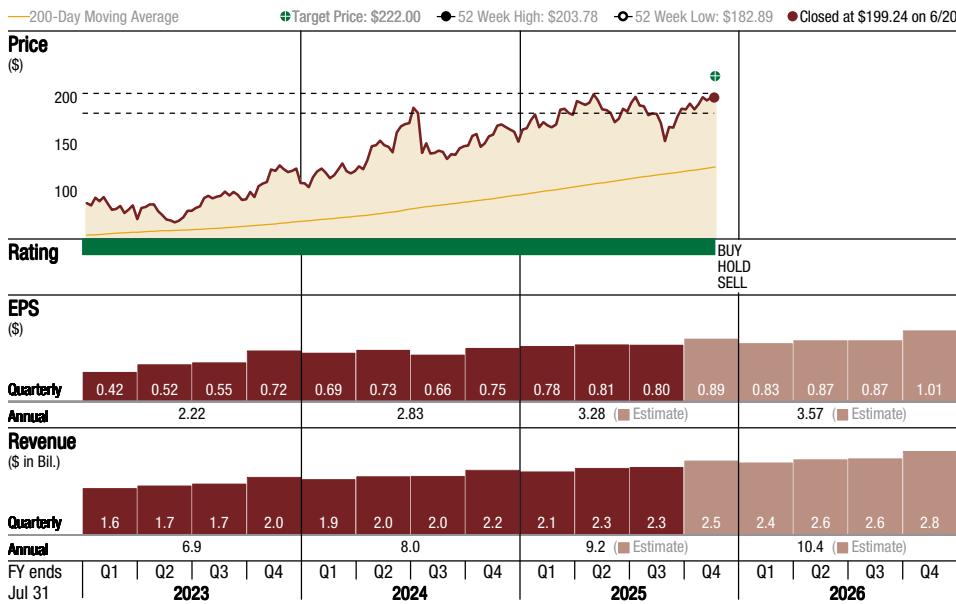
INVESTMENT THESIS

We are maintaining our BUY rating on Palo Alto Networks Inc. (NYSE: PANW) to a target price of \$222. Management is reporting traction with its new go-to-market strategy, which means slower near-term revenue growth with the promise of revenue acceleration over time as Palo Alto has removed some of the friction of onboarding new customers. The cybersecurity environment is, if anything, getting more toxic as generative AI may fuel even more sophisticated cyber-attacks as well as some defensive tools. GenAI and cloud expansion have made cybersecurity even more critical to enterprises. Palo Alto continues to stand out from its sector peers with not just best-in-class technology integrated into a comprehensive cybersecurity platform, but also its rapid product innovation cycle, focused on next-generation cloud security, secure access at the service edge, and automated security operations. We expect the company to continue to invest in its next-generation cybersecurity services.

While we expect revenue to decelerate in line with management's forecasts, Palo Alto will also maintain a consistent focus on margin improvement. We view this strong operating expense leverage as a hallmark of good management.

Market Data

Pricing reflects previous trading week's closing price.



Argus Recommendations

Twelve Month Rating	SELL	HOLD	BUY
Five Year Rating	SELL	HOLD	BUY
Sector Rating	Under Weight	Market Weight	Over Weight

Argus assigns a 12-month BUY, HOLD, or SELL rating to each stock under coverage.

- BUY-rated stocks are expected to outperform the market (the benchmark S&P 500 Index) on a risk-adjusted basis over the next year.
- HOLD-rated stocks are expected to perform in line with the market.
- SELL-rated stocks are expected to underperform the market on a risk-adjusted basis.

The distribution of ratings across Argus' entire company universe is: 72% Buy, 28% Hold, 0% Sell.

Key Statistics

Key Statistics pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified

Market Overview

Price	\$199.24
Target Price	\$222.00
52 Week Price Range	\$142.01 to \$208.39
Shares Outstanding	666.80 Million
Dividend	\$0.00

Sector Overview

Sector	Information Technology
Sector Rating	OVER WEIGHT
Total % of S&P 500 Market Cap.	31.60%

Financial Strength

Financial Strength Rating	MEDIUM-HIGH
Debt/Capital Ratio	21.4%
Return on Equity	30.2%
Net Margin	13.9%
Payout Ratio	—
Current Ratio	0.89
Revenue	\$8.87 Billion
After-Tax Income	\$1.24 Billion

Valuation

Current FY P/E	60.74
Prior FY P/E	70.40
Price/Sales	14.97
Price/Book	18.35
Book Value/Share	\$10.86
Market Capitalization	\$132.85 Billion

Forecasted Growth

1 Year EPS Growth Forecast	15.90%
5 Year EPS Growth Forecast	19.00%

1 Year Dividend Growth Forecast	N/A
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Risk

Beta	1.20
Institutional Ownership	0.77%

Analyst's Notes ...Continued**RECENT DEVELOPMENTS**

For fiscal 3Q25, the company beat the consensus revenue estimate by \$10 million and came in at the high end of its guidance range. It beat the consensus non-GAAP EPS forecast and the high end of its guidance range by \$0.03. With 3Q results, Palo Alto raised its FY25 guidance for the third time. Revenue guidance rose by a modest \$15 million at the midpoint to \$9.165 billion. However, non-GAAP EPS guidance rose by \$0.06 at the midpoint to \$3.27, implying 15% growth, up two percentage point from previous guidance and five points from its original guidance. PANW shares fell 6% intraday on May 21.

Fiscal 3Q revenue rose 15% from the prior year to \$2.3 billion. The company's primary revenue stream, Subscription and Support also rose 15%, slowing from 18% growth in 3Q24. The small Product segment saw revenue growth of 16%. The company's product line of security appliance hardware, which accounts for about 20% of revenue, has served mainly as a driver of higher-margin subscription services. The company is steadily shifting away from hardware toward a cloud-based software-as-a-service model. The fiscal 2Q non-GAAP gross margin narrowed by 160 basis points to 76% year over year as the company transitions to a new contract manufacturing facility.

Non-GAAP operating income rose 23% to \$627 million, as the non-GAAP operating margin expanded by 180 basis points from the prior year to 27.4%, as the company again demonstrated excellent operating cost leverage. Non-GAAP EPS rose 21% from

the prior year to \$0.80. GAAP EPS was \$0.37 in 3Q25, down from \$0.79 in 3Q24. Share-based compensation accounted for almost all of the difference between non-GAAP and GAAP results.

Management's favorite key performance indicators are remaining performance obligation (RPO), an indicator of the future revenue pipeline and next generation security annual recurring revenue (ARR). Current RPO, i.e. RPO to be recognized over the next year, rose 15% to \$6.2 billion, slowing from 20% in 3Q24. Next-gen security (NGS) ARR rose 34% to \$5.09 billion, slowing from 47% in 3Q24. However, the company is also landing many larger NGS deals with deals over \$5 million up 41% and deals over \$10 million up 63% in 3Q. Current RPO growth has been steady in the high teens over the last seven quarters while the growth of next-gen security ARR has consistently slowed from 53% growth in 1Q24.

While Palo Alto is constantly introducing new cybersecurity tools to protect against the rapidly evolving threat landscape, the company's launch of Prisma AIRS on April 28 is of particular note. Prisma AIRS is designed to be a comprehensive AI security platform that protects the entire enterprise AI ecosystem: AI applications, agents, models, and data.

On April 28, Palo Alto agreed to acquire Protect AI, a start-up focused on the security of AI models and applications for an undisclosed amount. We think Protect AI is another acquihire whereby Palo Alto is acquiring technology and talent in a deep focus investment area, i.e. generative AI cybersecurity.

Growth & Valuation Analysis**GROWTH ANALYSIS**

(\$ in Millions, except per share data)

	2020	2021	2022	2023	2024
Revenue	3,408	4,256	5,502	6,893	8,028
COGS	1,000	1,275	1,719	1,910	2,059
Gross Profit	2,409	2,981	3,783	4,983	5,968
SG&A	1,820	2,145	2,554	2,992	3,475
R&D	768	1,140	1,418	1,604	1,809
Operating Income	-179	-304	-189	387	684
Interest Expense	46	155	12	-197	-310
Pretax Income	-232	-465	-207	566	988
Income Taxes	35	34	60	127	-1,589
Tax Rate (%)	—	—	—	22	—
Net Income	-267	-499	-267	440	2,578
Diluted Shares Outstanding	581	578	591	685	708
EPS	-0.46	-0.86	-0.45	0.64	3.64
Dividend	—	—	—	—	—
GROWTH RATES (%)					
Revenue	17.5	24.9	29.3	25.3	16.5
Operating Income	—	—	—	—	76.6
Net Income	—	—	—	—	486.2
EPS	—	—	—	—	468.8
Dividend	—	—	—	—	—
Sustainable Growth Rate	-26.5	-80.6	-27.9	45.8	67.7
VALUATION ANALYSIS					
Price: High	\$62.50	\$95.44	\$106.82	\$159.00	\$207.24
Price: Low	\$20.91	\$51.93	\$68.37	\$66.11	\$130.04
Price/Sales: High-Low	10.7 - 3.6	13.0 - 7.1	11.5 - 7.3	15.8 - 6.6	18.3 - 11.5
P/E: High-Low	— —	— —	— —	248.4 - 103.3	56.9 - 35.7
Price/Cash Flow: High-Low	26.9 - 9.0	35.6 - 19.4	24.9 - 15.9	35.8 - 14.9	45.4 - 28.5

Financial & Risk Analysis**FINANCIAL STRENGTH**

	2022	2023	2024
Cash (\$ in Millions)	2,119	1,135	1,535
Working Capital (\$ in Millions)	-1,891	-1,689	-833
Current Ratio	0.77	0.78	0.89
LT Debt/Equity Ratio (%)	131.5	16.0	7.4
Total Debt/Equity Ratio (%)	1,882.3	129.9	26.0

RATIOS (%)

Gross Profit Margin	68.8	72.3	74.3
Operating Margin	-3.4	5.6	8.5
Net Margin	-4.9	6.4	32.1
Return On Assets	-2.4	3.3	14.9
Return On Equity	-54.8	44.9	74.5

RISK ANALYSIS

Cash Cycle (days)	—	—	—
Cash Flow/Cap Ex	10.3	19.0	20.8
Oper. Income/Int. Exp. (ratio)	-9.3	28.6	206.9
Payout Ratio	—	—	—

Analyst's Notes ...Continued

Management expects to integrate Protect AI into Prisma AIRS.

EARNINGS & GROWTH ANALYSIS

We are raising our FY25 non-GAAP EPS estimate to \$3.28 from \$3.22 and our FY26 forecast to \$3.57 from \$3.51. Our FY24 estimate is at the top of management's upwardly revised guidance range of \$3.26-\$3.28. Our estimates imply average EPS growth of 12% over the next two years. Our long-term earnings growth rate forecast is 19%.

In 2024, Palo Alto made a fundamental strategic pivot in its go-to-market strategy in order to make it easier for clients to transition from many legacy point security solutions to Palo Alto's platform, consolidating many security functions within its one platform thereby accelerating the customer transition. CEO Nikesh Arora calls this 'platformization.' However, to incentivize customers to make the transition from legacy vendor point cybersecurity tools to the Palo Alto platform, the company is offering extended free-trial periods, which have the effect of driving billings and revenue growth lower with the expected bottom in July 2025. As this program has matured, the company in partnership with its ecosystem of systems integrators signing larger platformization deals with expanded ARR. In 3Q25, Palo Alto reported a net 90 new platformizations, bringing the total to 1,250 of the company's top 5,000 customers, reflecting 29% growth year over year. Management's goal is to sign up 2,500-3,500 platformizations. Mr. Arora's long-term vision for Palo Alto is to

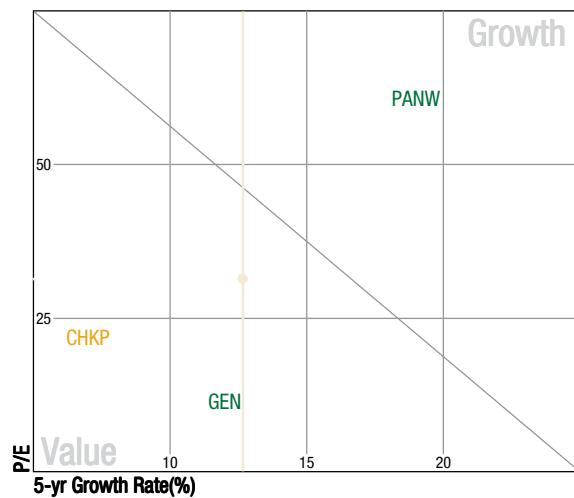
make enterprise network security simpler and more effective. We see the 'platformization' strategy as the current expression of this vision. Mr. Arora's aspiration is to drive \$15 billion in annual recurring revenue by 2030. Mr. Arora continues to reiterate that demand for cybersecurity remains robust in the current threat environment as the requirements of the new generative AI paradigm create greater urgency around the transformation of enterprise data architectures.

Mr. Arora has fleshed out many of the threats and opportunities for Palo Alto in the rapidly evolving generative AI landscape as GenAI-powered cyberattacks, often employing deepfakes, rapidly become both more difficult to detect and more powerful. The primary issue around generative AI or what we might call table stakes, is to protect against bad actors that penetrate the customers' IT systems and infect and/or hijack GenAI systems. The company's recently launched Prisma AIRS solution addresses customers' needs for a specific way to assess and protect GenAI applications, agents, models and data including runtime security, cloud posture management, AI agent security, AI red teaming, and model scanning. The second issue around generative AI is to provide customers with a way to use GenAI solutions to increase the ease of use, automation and efficiency of cyber security systems, thereby making customers' security operations centers both more effective at stopping cyberattacks and more cost effective to operate. The company's Cortex XSIAM, a next generation cybersecurity platform, addresses this customer need. Internally, Palo Alto is

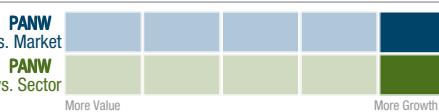
Peer & Industry Analysis

The graphics in this section are designed to allow investors to compare PANW versus its industry peers, the broader sector, and the market as a whole, as defined by the Argus Universe of Coverage.

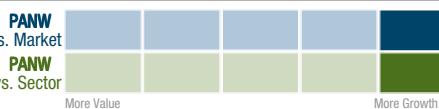
- The scatterplot shows how PANW stacks up versus its peers on two key characteristics: long-term growth and value. In general, companies in the lower left-hand corner are more value-oriented, while those in the upper right-hand corner are more growth-oriented.
- The table builds on the scatterplot by displaying more financial information.
- The bar charts on the right take the analysis two steps further, by broadening the comparison groups into the sector level and the market as a whole. This tool is designed to help investors understand how PANW might fit into or modify a diversified portfolio.



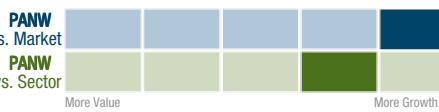
P/E



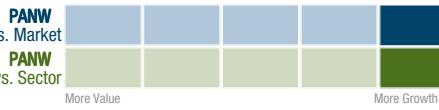
Price/Sales



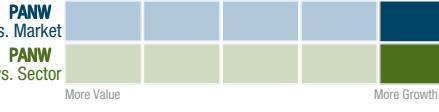
Price/Book



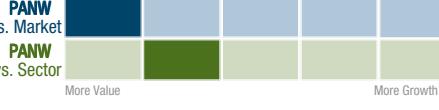
PEG



5 Year Growth



Debt/Capital



Analyst's Notes ...Continued

deploying generative AI as a cost saving measure, increasing automation and summarization. Mr. Arora has noted that the company expects to reduce contract labor by about 50% by the end of fiscal 2025 (July 2025).

Palo Alto's approach has been to integrate its security solutions into a platform that delivers consistent, highly automated solutions that protect the enterprise's IT core, as well as its endpoints (including mobile device endpoints and IoT) and cloud computing applications. Indeed, Palo Alto has partnered with all four of the largest enterprise cloud service providers, Amazon Web Services, Microsoft Azure, Alibaba Cloud, and Google Cloud Platform, to provide client-data security in a shared security model. As more IT workloads shift to the cloud over time, cloud security is likely to remain a critical growth vector. Palo Alto's multi-platform approach is intended to appeal to cloud customers who want to avoid being locked into a single vendor.

Palo Alto's go-to-market strategy uses its own field sales force as well as a range of global distributors and resellers, usually systems integrators. Almost all of the company's revenue flows through its partner sales channel, with about 40% of new business coming from that channel. While sales are made either by the in-house team or by partners, all fulfillment is carried out through the company's distribution channel. Customers typically make a smaller initial purchase, usually including the basic firewall, allowing the company to upsell additional services. Although customer net adds are important, we believe that the company's ability to increase its 'wallet share' at existing customers and international expansion in the EMEA and APJ regions are critical to future growth.

Palo Alto completed two smaller acquisitions, or so called 'acqui-hires' in fiscal 2Q24. The company completed the acquisition of Dig Security Solutions on December 5, 2023 for \$255.4 million in cash. The company expects the Dig acquisition to enhance Palo Alto's Prisma Cloud's ability to enable customers' visibility into their data in order to discover, classify, monitor and protect sensitive data stored across multi-cloud environments. Palo Alto completed the acquisition of Talon Cyber Security Ltd. on December 28, 2023 for \$459 million in cash. The company expects the Talon acquisition to support its Prisma secure access at the service edge (SASE) products for business applications for unmanaged and personal devices for access using an enterprise browser. Palo Alto expects to spend about \$1 billion per year on acquisitions.

Palo Alto's acquisition of Bridgecrew in early 2021 and of Cider Security in late 2022 highlight its recognition of the so-called 'shift to the left' in software development; security functionality is integrated into software code as it is written rather than applied to already completed software. This new development paradigm promises a higher level of cybersecurity integration, and has become even more critical with the advent of Gen AI systems.

On August 31, 2024, Palo Alto completed the acquisition of certain assets of IBM subsidiary QRadar including intellectual property, customer relationships and customer contracts for \$1.14 billion, including \$500 million in cash at closing and additional post-closing payments contingent upon QRadar customers migrating to the Palo Alto Cortex XSIAM security operations center cybersecurity platform through December 2027. Palo Alto is incorporating IBM's Gen AI WatsonX language models into the Cortex XSIAM platform. IBM has become a sales channel partner

for Palo Alto to jointly provide AI-powered security offerings. Following close of the transaction, Palo Alto added 550 QRadar customers to its Cortex customer base as QRadar added an incremental \$68 million to RPO.

At the Mobile World Congress event in February 2024, Palo Alto launched its Private 5G Security Solutions with Partner Ecosystem. This new feature integrates Palo Alto enterprise-grade 5G Security with its 5G partners to enable customers to easily, deploy, manage, and secure private networks over 5G, the latest mobile data and telephony standard. Palo Alto's partners include Celona, Druid, Ataya, NETSCOUT, NVIDIA, and NTT Data.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Palo Alto is Medium-High, the second-highest point on our five-point scale. Trailing 12-month free cash flow was \$3 billion in 3Q25, flat year over year.

Palo Alto has no plans to initiate a dividend, though it does make share repurchases opportunistically. The company did not repurchase shares in the first nine months of FY25. Share count rose by 2% year over year (10 million shares) in 3Q25. The company did buy back \$567 million of its stock in FY24, \$273 million in FY23, \$892 million in FY22, \$1.2 billion in FY21, and \$1.2 billion in FY20.

MANAGEMENT & RISKS

As an enterprise cybersecurity provider, Palo Alto may be more resilient than other enterprise software companies in a tech spending downturn as cybersecurity is often a high priority for customers; however, it is by no means immune to lengthening sales cycles, greater scrutiny of contracts by customers, or budget cutbacks.

Palo Alto depends heavily on 6,500 third-party distributor partners and resellers to sell and support its products. These partners also carry competing security solutions. If one or more of its partners fails or begins to focus on other products, Palo Alto's sales could be significantly impacted. Palo Alto also has significant client-concentration risk in that its top four channel distributors individually represented 10% or more of total revenue and together accounted for about 59% of sales in FY24. The company also relies on third-party contract manufacturers, principally Flex (previously called Flextronics), to produce its security appliances. Palo Alto has faced product supply-chain disruptions on its security hardware product lines, which have both limited production to meet customer demand and driven up the cost of components, compressing gross margin though these supply chain issues have abated. A higher-than-expected defect rate or other supply-chain or component-sourcing issues at Flex could also result in missed market opportunities for Palo Alto.

As an internet security company, Palo Alto would face high reputational risk in the event of a security breach at a customer, or within its own systems. The company produces highly complex security solutions that may have interoperability conflicts with client IT systems, or that may fail to provide the expected protection. The world witnessed just how significant of an impact an interoperability conflict could have when a software update in July, 2024, from Palo Alto enterprise cyber security competitor CrowdStrike caused massive global disruptions.

Palo Alto competes with both larger and smaller companies, some of which have significantly more resources; these include Cisco, Alphabet/Mandiant, Juniper, McAfee, Check Point, and

Analyst's Notes ...Continued

CrowdStrike. It also faces competition from startups like FireEye and Fortinet, some of which may focus on a specific security product. Further, hyperscale cloud providers like Amazon Web Services, Microsoft Azure, and Google Cloud Platform are providing cloud security service applications that could compete with Palo Alto.

Like many tech companies, Palo Alto faces patent challenges. Palo Alto lost a patent infringement case brought by Centripetal Networks, Inc. in January 2024 and has accrued \$142.8 million for the judgement and related interest as of the end of fiscal 2Q25. Palo Alto is appealing the judgement. A trial date of June 5, 2025 is set in another patent infringement case, brought by Finjan, Inc.

Palo Alto's sales cycle calls for seasonally strong second and fourth fiscal quarters and slower first and third fiscal quarters. Analysts may miss this seasonal variation and provide inaccurate sales forecasts.

Palo Alto's initial sale to a client is typically its next-generation firewall. The company will also need to upsell additional subscription services to its installed client base to expand revenue. An expanding client base is critical to Palo Alto's growth.

Security software requires a rapid product innovation cycle to keep pace with emerging threats and the swiftly changing enterprise computing environment. Palo Alto's security solutions are expected to address the fast-growing areas of mobility, virtualization, cloud computing, software-defined networks, generative AI, and the internet of things. R&D expense, which has been as high as 17% of revenue, has declined as management has refocused on profitability.

Management will need to successfully manage the company's explosive sales growth both in the U.S. and abroad. Growth will also inevitably slow as the company matures, which could disappoint some investors. As a high-growth tech company, Palo Alto trades at relatively high multiples; a guidance revision, or a sales or earnings miss could lead to a sudden and steep pullback in PANW shares.

Nikesh Arora has been the company's chairman and CEO since June 2018. Mr. Arora had previously been chief business officer at Google. Dipak Golechha became the company's CFO in March 2021. He previously served as a finance executive at Procter & Gamble as well as at a number of small tech-oriented companies.

COMPANY DESCRIPTION

Palo Alto provides integrated internet security solutions for enterprise customers. The company's solutions are based on its 'next-generation' firewall and security platform, and also include software applications for various enterprise security needs. The company's founders include current Chief Technology Officer Nir Zuk, formerly of Check Point Software. The company shipped its first products in 2009 and completed its IPO in July 2012 at an initial share price of \$42. Palo Alto executed a 3-for-1 stock split on September 13, 2022 through a two-share stock dividend and a 2-for-1 stock split on December 12, 2024. About 35% of the company's revenue is generated outside the U.S.

VALUATION

According to Bloomberg, Palo Alto shares have risen 17% in the last year, compared to a 10% increase for the S&P 500, an 11% gain for the S&P 500 Software & Services Industry Group GICS Level 2 Index, and a 27% gain for the Amplify Cybersecurity ETF (HACK). PANW shares have traded between \$142 and \$208

in the last year and are currently just above the midpoint of the range. The forward enterprise value/revenue multiple of 11 is 41% above the peer average, compared to an average premium of 42% over the past two years. Our target price on PANW is \$222.

On May 22 at midday, BUY-rated PANW traded at \$185.90, up \$4.65.

About Argus

Argus Research, founded by Economist Harold Dorsey in 1934, has built a top-down, fundamental system that is used by Argus analysts. This six-point system includes Industry Analysis, Growth Analysis, Financial Strength Analysis, Management Assessment, Risk Analysis and Valuation Analysis.

Utilizing forecasts from Argus' Economist, the Industry Analysis identifies industries expected to perform well over the next one-to-two years.

The Growth Analysis generates proprietary estimates for companies under coverage.

In the Financial Strength Analysis, analysts study ratios to understand profitability, liquidity and capital structure.

During the Management Assessment, analysts meet with and familiarize themselves with the processes of corporate management teams.

Quantitative trends and qualitative threats are assessed under the Risk Analysis.

And finally, Argus' Valuation Analysis model integrates a historical ratio matrix, discounted cash flow modeling, and peer comparison.

THE ARGUS RESEARCH RATING SYSTEM

Argus uses three ratings for stocks: BUY, HOLD, and SELL. Stocks are rated relative to a benchmark, the S&P 500.

- A BUY-rated stock is expected to outperform the S&P 500 on a risk-adjusted basis over a 12-month period. To make this determination, Argus Analysts set target prices, use beta as the measure of risk, and compare expected risk-adjusted stock returns to the S&P 500 forecasts set by the Argus Market Strategist.
- A HOLD-rated stock is expected to perform in line with the S&P 500.
- A SELL-rated stock is expected to underperform the S&P 500.

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