

AUGUST 18, 2006



**BEACON
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RESEARCH**

Sonic Foundry, Inc.
NasdaqNM: SOFO

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5956 N.W. 213th Place, Portland, Oregon 97229

Price	\$2.17	Shares (mils)	32.0
P/E Ratio (ttm)	NA	Market Cap (mils)	\$69.6
P/S Ratio (ttm)	6.2 X	52 Week Range	\$2.50 - \$0.86
Sales/share (ttm)	\$0.35	Ave. Daily Vol.	111,158
Price/Book	5.9 X	Short Interest	436,470
Book Value	\$0.37	Gross Margin	77.7%
Cash/share	\$0.07	Oper. Margin	-16.5%
Quick Ratio	.65	Insider Ownership	14.3%
Debt to cap ratio	0.00 %	Inst'l Ownership	11.1%

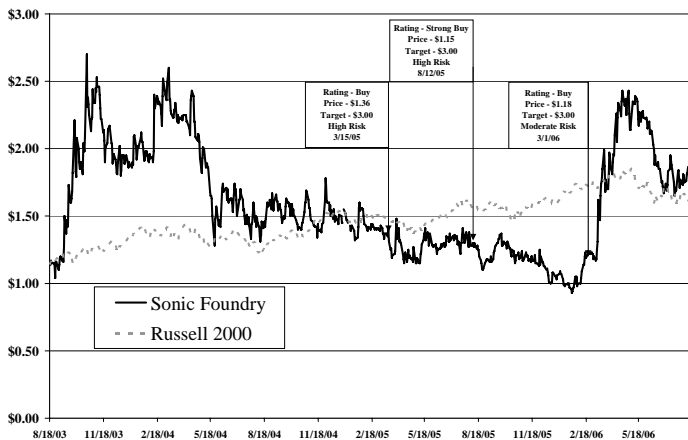
Disclosures 1,2,3,4

Price Target	\$3.00
Rating	Buy
Risk	Moderate

Sonic Foundry, Inc.'s (Nasdaq: SOFO) Mediasite presentation recorders provide an elegant solution for distributing "one-to-many" rich media content for educational institutions, corporations and government organizations. We see SOFO rapidly approaching profitability and increased investor awareness and market interest.

- Revenues of \$3.6 million in 3Q06, up 64% over 3Q05.
- Quarterly billings topped \$4.1 million, an 81% annual increase, 25% sequentially.
- Cash burn reduced to \$231,000, the lowest level since divesting assets in 2003.

We reiterate our Buy rating and price target is \$3 per share, or 4x our estimate of sale per share of \$0.77 per share for fiscal 2007.



Earnings Per Share					
	Q1: Dec	Q2: Mar	Q3: Jun	Q4: Sep	Annual*
2007E	\$ (0.00)	\$ 0.01	\$ 0.02	\$ 0.03	\$ 0.07
2006E	\$ (0.05)	\$ (0.03)	\$ (0.02)	\$ 0.00	\$ (0.10)
2005A	\$ (0.05)	\$ (0.03)	\$ (0.03)	\$ (0.02)	\$ (0.13)
2004A	\$ (0.04)	\$ (0.04)	\$ (0.05)	\$ (0.05)	\$ (0.18)

* numbers may not add up due to rounding

Corporate Officer
Contact Person
Corporate Address
Website

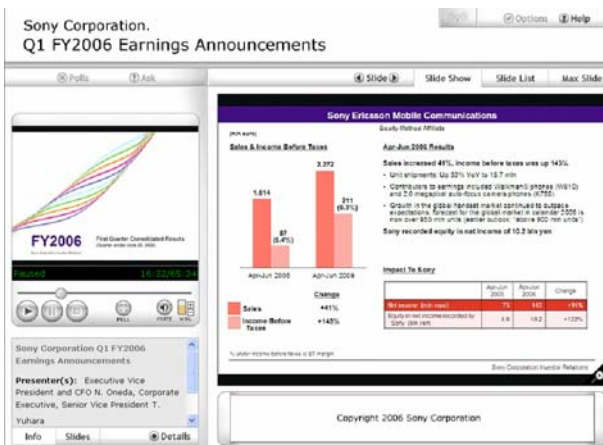
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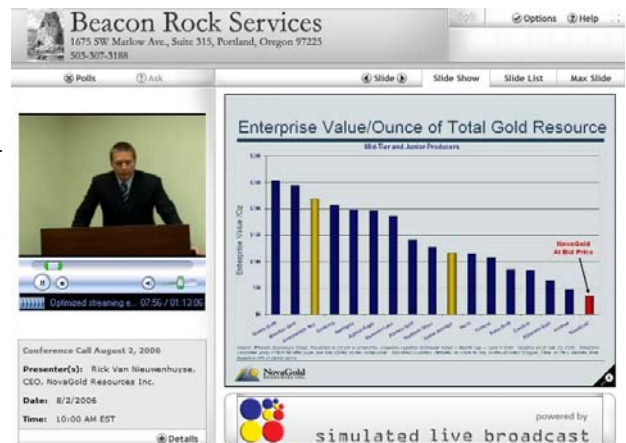
Sonic Foundry Earns the Pole Position in One-to-Many Internet Presentations:

It takes no fast talk to persuade doubters that Sonic Foundry, Inc. (Nasdaq: SOFO) is poised for break out performance as a company and as an investment. Evidenced by recent appreciation, investors are taking note of the company approaching breakeven and revaluation on an earnings basis. Management buying shares on the open market was a signal to long-time shareholders providing confidence in guidance offered for 2006. Management also stepped up communications with investors of all stripes. We recently noted SOFO CEO Rimas Buinevicius' interview on TheStreet.com on August 7, 2006. In addition, we see SOFO investing in wise name placement, in this case above the front bumper with Noble Financial Group.



We are now starting to get feed back from the academics themselves as they see introduction of SOFO's technology as a natural use of technology to leverage learning. Not only is it instructor friendly, but it accommodates a wide range of learning styles stimulating natural curiosity which we believe is the essence of student exploration and learning. The University of Texas-Austin has recently completed a study which should be due out soon. In addition, Villanova University College of Engineering just completed their 3rd year assessment. They found students enrolled on-line compared to the traditional in-class environment performed as well. In addition, by offering graduate courses on-line they completely eliminated their failure rate in the second year. We utilized the company's products to supplement the in-class lectures for professional development of executive bankers with overwhelming positive feedback. While not politically correct, Gregg Greenberg of TheStreet.com may have got it right, SOFO provides the long sought after elixir where "kids can be lazy and smart."

We have noticed with great interest and applause of the use of the company's products in the financial sector. While SOFO has been completing its quarterly earnings reports on line with its own products, we note that Sony Corporation did so as well (<http://www.sony.net/ne.jp/sonyir/SONY2006-1Q/E/Viewer.html>). This was also interesting considering it was produced in Japan, with great audio clarity and high resolution graphics. We were also invited by NovaGold Resources, Inc. (AMEX: NG) to capture their response following the announcement of the uninvited tender offer by Barrick Gold Corporation (NYSE: ABX) which may be found on the Beacon Rock Research website (<http://www.beaconrockresearch.com/node/63>). The only issues with the quality of presentations can be sourced to the quality of sound or video components, or with the presenters content itself. For this reason we see the company continuing to gain ground in both education, government, and corporate segments or for anyone with something important to say.



Investment Recommendation Update:

We reinitiated research coverage of SOFO on March 1, 2006, with a 12-month price target price of \$3.00 per share, when the stock was trading at about \$1.18 per share. On April 20, 2006, SOFO traded up to \$2.50 per share, a 112% increase in about three months. We were surprised by the rate of appreciation but not the direction. We believe the move was due to the introduction of new investors and insufficient supply of stock to keep up with demand. When the stock price consolidated, we were concerned that investors might be confused by the performance of the stock as an investment opposed to the performance of the company. We see the pull back from the year's high with the company continuing to execute to be an opportunity for investors to take another look at SOFO.

When we were initially introduced to SOFO over two years ago we perceived an emphasis on sales of units. We expected that numbers of units would be the key metric. In time we thought that by developing other products and services that they could sustain unit sales and create additional opportunities. We believed that the follow-on product would be the company's video search technology. During the interim we expected that with the advent of competing technology that average sales prices would moderate and margins would remain stable. With gradual realization of operating leverage we anticipated that they would gradually move to breakeven and profitability. We were half right. We now see that while the company gradually moves toward profitability, the income statement components seems to be telling a different story.

In retrospect we have been consistently high on our revenue estimates and the breakdown of revenues. We have also underestimated the increasing expansion of gross margin. As we expected, but for different reason, operating leverage continued to expand as management had good hand on administrative expenses and wisely continued to invest in development. We also have been a little light on marketing expenses, but in the mix we believe, we have been close in our forecasting, at least by the time these components worked their way to the bottom line.

Company Performance Beats Our Expectations:

In the last two quarters we began to see a change in the way we originally expected the company to develop. We know through our use of the company's products that for the producer and user of recorders there is both universal appeal and utility. We have been somewhat surprised that sales of units have been more linear rather than our inclination for realizing exponential growth. Interestingly we also anticipated a decline in average sales price but this has not occurred. To the contrary, rather than increasing unit sales by locating new customers, SOFO continues to experience significant repeat sales to existing customers which seems to fluctuate from 35% to 45%.

This leads us to conclude that sales of units incur long lead times due to customer reticence which is natural with most product introductions. This attitude seems to change fairly rapidly once units are acquired and put through their paces. SOFO reports 39% of its sales in 3Q06 were to repeat customers. They also note that the University of Southern California expanded the number of classroom recorders by 16 Mediasite units to a total of 24 units. This was similar to the company's experience with East Carolina (now utilizing 26 units) mentioned in our previous update. It is important to note that the sale to the University of Southern California included the EX Server Software suite. The company has mentioned that the sale of additional software, with longer lead times, actually makes possible larger sales. The sale of additional server, software, licensing, and service fees in addition to unit sales is a driver of increased deal size, margins, and operating leverage.

We have been impressed that with each quarter the company continues to introduce either new products, partnerships, demonstrations, or some initiative that proves their products are leaders in one-to-many presentations. We see the EX Server software as an important product that will come to dominate quarterly earnings releases. This is not only important to profitability but in providing leverage into the corporate enterprise segment. Over the past year, higher education customers increased 50% to 209, and corporate customers increased 67% to 149. While the introduction of the relationship with Dell should accelerate penetration of the education market, we see the enterprise market as very important to increasing revenues and smoothing out the seasonality resulting from a concentration on sales to the education market.

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The company is maturing ahead of our expectations. The increasing depth of its product offering maintains unit sales and average sales prices. Combined with a high level of repeat sales to existing customers, margins increase and the company accelerates toward profitability. Because of the high level of utility of the company's products, and high number of units sold to existing customers, we sense there is still a very large untapped market in the education, corporate, and government segments. If a third to a half of sales are to existing customers, the remaining education and corporate market, are all potential repeat buyers. So each new customer is a good candidate for additional sales. For these reasons, we see the SOFO story maturing on schedule and still approaching a tipping point where we begin to see a geometric progression in sales and earnings. Our thinking is that when the company breaks even on a GAAP basis in the next couple quarters, investors new or revisiting SOFO will find a well developed company and a compelling small cap investment.

Fiscal 3Q06 Financial Results:

Total revenues increased to \$3.6 million in 3Q06, up 64% over \$2.2 million in 3Q05, and just short of our forecast of \$4.0 million for the quarter. SOFO reported revenues from sales of Mediasite presentation recorders of \$3.0 million in 3Q06, up from \$1.9 million in 3Q05. Service revenue increased to \$663,000 in 3Q06, up from \$248,000 in 3Q05. The company noted an increase in the recurring source of income as total service billings increased to \$918,000 in the quarter, up from \$374,000 in 3Q05, and unearned revenue increased to \$1.6 million. Server revenues and customer support fees are becoming an important contributor to earnings. The company notes server software sales increased to \$719,000 in 3Q06 compared to \$124,000 in 3Q05. Other income was only \$17,000 for the quarter, down from \$72,000 in 3Q05, and is becoming a less meaningful addition to revenues.

Gross profit was \$2.8 million in 3Q06, up from \$1.4 million in 3Q05, and slightly below our forecast of \$2.9 million. As management anticipated, gross margin continued to expand to 78% in 3Q06, up from 64% in 3Q05, and ahead of our estimate of 72%. The year-over-year increase in gross margins is due to higher levels of server revenues and customer support fees. As mentioned above, we have underestimated the expanding gross margin due to higher levels of customer support fees.

Total operating expenses were \$3.4 million in 3Q06, compared to \$2.5 million in 3Q05, and slightly above our forecast of \$3.3 million. The company reported selling and marketing expense of \$2.1 million in 3Q06, up from \$1.4 million in 3Q05, only \$50,000 higher than our estimate. Other expenses for general and administrative as well as research and development met expectations. Management continues to maintain a solid grip on operating expenses, considering the company's rapid sales growth.

SOFO reported a net loss of \$583,000 in 3Q06, or a loss of \$0.02 per share, compared to a loss of \$0.03 per share in 3Q05. Excluding a non-cash charges of \$352,000 for stock compensation related to adoption of FAS No. 123 as well as depreciation and amortization charges, the resulting cash burn was \$231,000, the lowest level since the 2003 divestment of other business units.

SOFO's balance sheet remains strong despite the decline in cash to \$2.3 million at the end of 3Q06, compared to \$4.2 million at the end of fiscal 2005. The company remains debt free. Management reports that they have a net operating loss carry forward of approximately \$72 million, which could reduce future taxes of about \$27 million.

Management Guidance:

Management narrowed their guidance for total GAAP revenues to \$12.5 to \$13.5 million from \$12 to \$14 million for fiscal 2006. They further revised annual billings to \$14 to \$16 million from \$13 to \$16 million for fiscal 2006. They anticipate \$0.00 earnings per share on a GAAP basis in 4Q06, not including non-cash items, and a loss of \$0.10 for fiscal 2006. In addition, management forecasts generating positive cash flow in 4Q06 net of non-cash operating expenses.

Management reiterated its expectation of gross margins to expanding from the 70% level in 2006 to 80% in 2007, and to be profitable in 2007. While not offering guidance beyond 2007, management noted analysts are forecasting company revenues of \$60 to \$100 million in three years and earnings of \$5 to \$25 million. The source of these estimates was not disclosed and the intent of the information was only to suggest that upon reaching breakeven the company may be viewed on an earnings basis rather than as a multiple of sales. The information was also instructive to show the influence of increasing operating leverage that accompanies an exponential increase in revenues with good control of operating expenses.

Our Model:

We previously discussed our belief that the last two quarters of fiscal 2006 may be indicative of the probability of the company's future. While we previously fixed our gaze on the higher education segment, the advent of the Mediasite EX Server software, larger deals, we now believe a growing enterprise segment could lead to a positive revenue surprise in the final quarter of the year, on top of what are believed already to be seasonally strong quarters. Barring such optimistic results, we would anticipate that the increase in the enterprise segment may actually soften the impact of seasonality in the first half of fiscal 2007. In any event, regular increases in server revenues and support fees should also contribute to softening the effects of seasonality, and increasing the chances that the company may be profitable in 1Q07, its seasonally weakest quarter.

We estimate total revenues of about \$13 million for fiscal 2006 and increasing to over \$25 million in fiscal 2007. We forecast a loss of \$0.10 per share for fiscal 2006 and a net profit of \$0.07 per share for fiscal 2007. While we have not extended our model out further, if we apply a similar growth rate, we could see total revenues of around \$75 million by fiscal 2009, in line with management's view of analyst opinions. Applying the current level of shares outstanding this might suggest earnings of \$0.16 to \$0.80 per share for fiscal 2009. While this is a very wide range, we are still a very long way from fiscal 2009, but a trend in expanding margins and increasing operating leverage lead us to the upper end of the range.

Valuation and Conclusion:

We see the steady level of repeat buyers as an indicator of higher rates and levels of sales. All the components appear in place for increasing operating leverage and profitability in the next couple quarters. This should place the company in plain view for a new group of investors that look for the advent of profitability, increased market cap, and large market opportunity. Possibly not appreciated by those new to SOFO, we believe the company may be very close to exploiting the corporate market that may result in less seasonality and consistent financial performance. While we see a real opportunity for the stock to get ahead of itself, we maintain a **Moderate** risk assessment for the benefit of long-term investors. We maintain a price target of **\$3.00** per share, or 4x our forecast of \$0.77 sales per share for fiscal 2007, and retain our **Buy** recommendation.

Risks:

Though an unprofitable company in the early stages of development may merit a more cautious rating, the growing acceptance for the company's product, coupled with a reasonably strong balance sheet and cash position, with potential to breakeven on a cash flow basis warrants a measured risk assessment. We do anticipate increasing volatility in the quarter ahead, depending on investor perceptions of reasonable rates of appreciation and management's ability to meet or exceed guidance. With SOFO executing on its plan, we see the success attracting new investors that may upset the available balance of supply and demand leading to increased volatility.

Beacon Rock Research, LLC

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Sonic Foundry, Inc.
September FYE

	1Q05A	2Q05A	3Q05A	4Q05A	1Q06A	2Q06A	3Q06A	4Q06E	2004A	2005A	2006E	2007E
	Dec.-03	Mar.-04	Jun.-04	Sept.-04	Dec.-05	Mar.-05	Jun.-05	Sept.-05				
Income Statement												
Revenues												
Mediasite revenues	\$1,339	\$1,665	\$1,855	\$2,069	\$1,346	\$2,288	\$2,967	\$3,400	\$3,443	\$6,928	\$10,001	\$17,850
Customer support fees	189	177	248	361	415	652	663	1,000	425	975	2,730	7,205
Other	63	224	72	80	111	13	17	20	545	439	161	80
Total revenues	1,591	2,066	2,175	2,510	1,872	2,953	3,647	4,420	4,413	8,342	12,892	25,135
Cost of goods sold	536	669	776	773	560	861	812	961	1,759	2,754	3,194	5,172
Gross profit	1,055	1,397	1,399	1,737	1,312	2,092	2,835	3,459	2,654	5,588	9,698	19,963
Operating expenses												
Selling and marketing expenses	1,231	1,133	1,415	1,498	1,718	1,750	2,101	2,250	3,826	5,277	7,819	12,600
General and administrative expenses	815	771	650	628	696	766	744	725	2,826	2,864	2,931	2,980
Product development expenses	455	459	458	431	534	544	593	550	1,609	1,803	2,221	2,240
Total operating expense	2,501	2,363	2,523	2,557	2,948	3,060	3,438	3,525	8,261	9,944	12,971	17,820
Operating income	(1,446)	(966)	(1,124)	(820)	(1,636)	(968)	(603)	(66)	(5,607)	(4,356)	(3,273)	2,143
Other income (expense)	46	25	59	57	24	21	20	16	99	187	81	94
Interest expense	0	0	0	0	0	0	0	0	0	0	0	0
Income (loss) before income taxes	(1,400)	(941)	(1,065)	(763)	(1,612)	(947)	(583)	(50)	(5,508)	(4,169)	(3,192)	2,237
Provision for income taxes	0	0	0	0	0	0	0	0	0	0	0	0
Net income (continuing operations)	(1,400)	(941)	(1,065)	(763)	(1,612)	(947)	(583)	(50)	(5,508)	(4,169)	(3,192)	2,237
Earnings per share (continuing operations)	\$ (0.05)	\$ (0.03)	\$ (0.03)	\$ (0.02)	\$ (0.05)	\$ (0.03)	\$ (0.02)	\$ (0.00)	\$ (0.19)	\$ (0.14)	\$ (0.10)	\$ 0.07
Diluted shares	29,966	30,162	30,480	30,600	31,275	31,694	31,995	32,150	29,457	30,363	31,779	32,035
Revenue												
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	33.7%	32.4%	35.7%	30.8%	29.9%	29.2%	22.3%	21.8%	39.9%	33.0%	24.8%	20.6%
Gross profit	66.3%	67.6%	64.3%	69.2%	70.1%	70.8%	77.7%	78.3%	60.1%	67.0%	75.2%	79.4%
Selling and marketing expenses	77.4%	54.8%	65.1%	59.7%	91.8%	59.3%	57.6%	50.9%	86.7%	63.3%	60.7%	50.1%
General and administrative expenses	51.2%	37.3%	29.9%	25.0%	37.2%	25.9%	20.4%	16.4%	64.0%	34.3%	22.7%	11.9%
Product development expenses	28.6%	22.2%	21.1%	17.2%	28.5%	18.4%	16.3%	12.4%	36.5%	21.6%	17.2%	8.9%
Total operating expense	157.2%	114.4%	116.0%	101.9%	157.5%	103.6%	94.3%	79.8%	187.2%	119.2%	100.6%	70.9%
Operating income	-90.9%	-46.8%	-51.7%	-32.7%	-87.4%	-32.8%	-16.5%	-1.5%	-127.1%	-52.2%	-25.4%	8.5%
Other income (expense)	2.9%	1.2%	2.7%	2.3%	1.3%	0.7%	0.5%	0.4%	2.2%	2.2%	0.6%	0.4%
Net income (continuing operations)	-88.0%	-45.5%	-49.0%	-30.4%	-86.1%	-32.1%	-16.0%	-1.1%	-124.8%	-50.0%	-24.8%	8.9%
Sales/share (ttm)	\$ 0.17	\$ 0.21	\$ 0.24	\$ 0.27	\$ 0.28	\$ 0.31	\$ 0.35	\$ 0.48	\$ 0.04	\$ 0.15	\$ 0.40	\$ 0.77

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Sonic Foundry, Inc.
September FYE
BALANCE SHEET

ASSETS	2002	2003	2004	2005	4Q05	1Q06	2Q06	3Q06
Cash and equivalents - (000's)	\$3,704	\$12,623	\$7,583	\$4,271	\$4,271	\$3,417	\$2,727	\$2,315
Accounts receivable	484	508	1,345	2,232	2,232	1,656	2,505	3,338
Accounts receivable, other	43	139	18	0	0	0	0	0
Inventory	48	111	371	414	414	598	466	241
Other current assets	294	214	281	363	363	231	354	413
Assets of discontinued operations	4,087	0	0	0	0	0	0	0
Total current assets	8,660	13,595	9,598	7,280	7,280	5,902	6,052	6,307
Net property, plant, and equipment	574	588	745	1,007	1,007	1,087	1,292	1,372
Goodwill & intangibles	8,949	8,618	8,288	7,958	7,958	7,876	7,793	7,711
Deferred long-term asset charges	653	0	0	0	0	0	0	0
Other assets	0	0	0	0	0	0	0	0
Long-term assets of discontinued operations	0	0	0	0	0	0	0	0
Total assets	\$27,643	\$22,801	\$18,631	\$16,245	\$16,245	\$14,865	\$15,137	\$15,390
LIABILITIES AND SHAREHOLDERS' EQUITY								
Accounts payable	\$1,531	\$1,065	\$879	\$1,323	\$1,323	\$882	\$1,187	\$1,227
Accrued liabilities	950	1,263	686	780	780	441	673	753
Unearned revenues	0	194	473	957	957	1,100	1,421	1,569
Current portion of capital lease obligation	217	48	0	15	15	14	50	40
Convertible debt	3,482	0	0	0	0	0	0	0
Liabilities of discontinued operations	2,976	0	0	0	0	0	0	0
Current liabilities	2,481	2,570	2,038	3,075	3,075	2,437	3,331	3,589
Long-term debt	230	0	0	0	0	0	0	0
Deferred long-term liability charges	38	0	27	49	49	45	44	106
Other long term liabilities	235	0	0	0	0	0	0	0
Shareholders' equity	17,984	20,231	16,566	13,121	13,121	12,383	11,762	11,695
Total liabilities and shareholders' equity	\$27,643	\$22,801	\$18,631	\$16,245	\$16,245	\$14,865	\$15,137	\$15,390
Cash per share	\$0.14	\$0.44	\$0.26	\$0.14	\$0.14	\$0.11	\$0.09	\$0.07
Quick ratio	1.69	5.11	4.38	2.11	2.11	2.08	1.57	1.58
Current ratio	3.49	5.29	4.71	2.37	2.37	2.42	1.82	1.76
Debt to capitalization ratio	1.49%	0.00%	0.16%	0.37%	0.37%	0.36%	0.37%	0.91%
Book per share	\$0.67	\$0.70	\$0.56	\$0.43	\$0.43	\$0.40	\$0.37	\$0.37

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Beacon Rock Research, LLC provides information and analysis on selected companies, with a focus on small-cap and micro-cap companies.

This report has been written in accordance with current SEC regulations and the Standards of Practice developed by the Chartered Financial Analyst Institute (CFAI). Our research has been conducted by employing analytical practices generally accepted as standard within the analytical industry. In this instance, a comparison of financial strength, a bottom-up earnings projection based on a recovery in the U.S. economy, and relative multiples, were employed. The target price was calculated on comparative EPS, sales and book value multiples, and our knowledge of small-cap markets when enjoying both a sector and a cyclical rebound. Our conclusions are, by the very nature of forecasting, speculative, but are also reasonable, supportable and consistent.

Key to disclosures:

1. The research analyst has a long position in the securities of the Subject Company in .
2. The Subject Company has provided a Mediasite™ recording unit plus additional software and server availability valued at \$25,000 to SLB Equity Research, LLC., one of its affiliates, for securing research coverage and providing other awareness building services. SLB Equity Research, LLC may provide additional awareness building services on an ala carte basis.
3. The research analyst principally responsible for preparing this research report received compensation based upon various factors, including SLB Equity Research, LLC total revenue.
4. This report was prepared exclusively for the benefit of institutional investors and may or may not receive compensation directly or in soft dollar arrangements.

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EQUITY RECOMMENDATION SYSTEM:

- Buy** Immediate purchase is recommended. The security expected to outperform the market over the next 12 to 18 months.
- Hold** Holding the stock is recommended because the share price's appreciation potential is less than or equal to the market.
- Sell** The stock has reached the target price objective and/or conditions have changed sufficiently to alter the outlook for the stock.

EQUITY RISK SYSTEM:

- High** The security is more volatile than the market and/or the company is more leveraged than its peer group.
- Moderate** The security has about the same volatility as the market and/or the company carries a level of leverage in line with its peer group.
- Low** The security is less volatile than the market and/or the company is less leveraged than its peer group.

DISTRIBUTION OF RECOMMENDATIONS:

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