THE EUROPEAN CONTRARIAN

The Contrarian Series

April 12, 2021

Ocean Yield ASA

(BUY)

Price: NOK29.30
52-Week Range: NOK20.50– NOK30.95
Shares Outstanding: 175.3 million
Market Capitalization: NOK5.1 billion ($608 million)
1

Ticker[2]: OCY NO
Dividend[3]: $0.212
Yield: 6.2%

Data as of April 8, 2021

[1]One Norwegian krone (NOK) is equivalent to $0.1183, as of April 8, 2021.
[2]The common shares of OCY NO trade on the Oslo Børse.
[3]Dividend reported and quoted in US dollars ($).

PCS RESEARCH GROUP

HORIZON KINETICS

Exclusive Marketers of
The European Contrarian Report

PCS Research Group LLC
100 Wall Street, 20th Floor
New York, NY 10005
research@pcsresearchservices.com
(212) 233-0100
www.pcsresearchservices.com

Research Team

Murray Stahl **Steven Bregman**

Rich Begun, Thérèse Byars, Ryan Casey, James Davolos, Peter Doyle

Matthew Houk, Utako Kojima, Eric Sites, Fredrik Tjernstrom, Steven Tuen

Investment Thesis

Ocean Yield ASA (OCY NO), based in Norway, owns a fleet of vessels that it leases out on long-term bareboat charters, which call for the counterparty to assume all operating expenses and liability related to the vessel. These charter agreements often include a purchase option at their conclusion. The shares were first recommended in *The European Contrarian* in July 2017 at a price of NOK64.50. The shares traded as high as NOK73.00 in 2018, but then traded gradually lower throughout 2019, falling to below NOK50 by the end of the year. The company then lost more than 50% of its market capitalization with the onset of the Covid-19 pandemic and has since rebounded only slightly to the current price of NOK30.

Although the coronavirus outbreak exacerbated some of the Ocean Yield's challenges, they had begun prior, starting with the failure to renew the charter for its FPSO (Floating Production Storage and Offloading) vessel, the *Dhirubhai-1*. The vessel has been laid up at an expense of just over $2 million per quarter while the company explores sale opportunities, implying that operating profit should increase by $8-$9 million per year once the vessel is divested or decommissioned. Earnings have also suffered from the operation of the company's construction and cable-lay vessel, the *Connector*. This ship was sold in the fourth quarter as part of a strategy to reduce exposure to the oil services industry, resulting in a loss on the sale of $70.7 million. This loss and the $94.8 million impairment on the FPSO vessel taken in the third quarter are responsible for negative earnings of $141.3 million on the year. It should be noted, however, that cash earnings were positive for 2020 and that profitability and free cash flow should improve going forward.

The *Connector* transaction and the eventual resolution of the FPSO vessel significantly reduce the risk in Ocean Yield's portfolio and should mark the end of the company's recent difficulties. Going forward, investors can anticipate a robust dividend yield, which currently stands at 6.2% and represents a historically low payout ratio on depressed earnings. There is a significant margin of safety for the company to gradually increase this distribution, which it has stated is its intention.

Another simplified valuation exercise highlights the investment thesis for Ocean Yield; assume the company is in run-off mode and will generate no earnings other than its EBITDA backlog of $2.9 billion over the average lease term of ten years. Cash taxes are insignificant and interest expense is an estimated $80 million per year, which leads to aggregate cash earnings of $2.1 billion. This is equal to the enterprise value of the company today, meaning investors are able to purchase the company at a price that assumes little more than simply holding its current charter agreements.

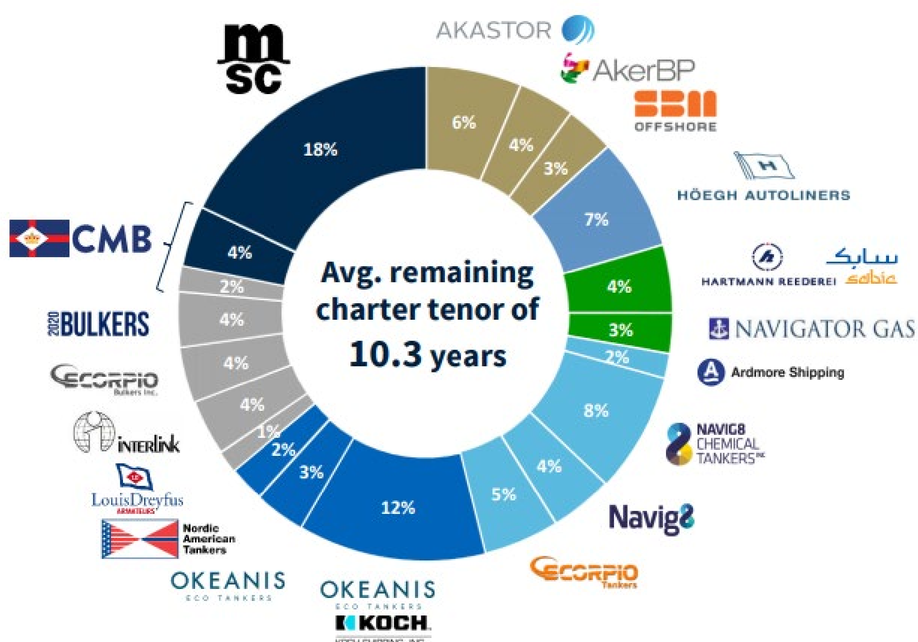
Although recent periods have demonstrated that the company is not immune to the risks of the shipping industry, the risk/reward of this yield-generating security is compelling for those seeking a meaningful income and modest growth potential. As such, shares of Ocean Yield are recommended for purchase.

Company Description

Ocean Yield ASA., based in Bærum, Norway, seeks to purchase ships with long-term charters, often acting as the acquirer in a sale-and-leaseback transaction. The transaction is often done at a price below market value for the vessel, and long-term charters are in place to cover nearly all of the payback period plus a modest return. The lease term typically ends with a purchase option to the counterparty. Many of these vessels are financed using asset-level debt with no recourse to Ocean Yield. The company is almost exclusively focused on bareboat charters, which means that the charterer provides the crew and assumes all operating expenses and liabilities related to the vessel. As such, Ocean Yield's operating expenses are negligible outside of the non-cash depreciation expenses related to its fleet, and its primary risk is the counterparty risk associated with its charterers, which is mitigated by choosing to work with highly credit-worthy operators. The company has historically paid out a large percentage of its earnings as dividends, thus creating an attractive income-generating investment.

Exhibit 1 shows EBITDA contribution by counterparty as of June 30, 2020, which is the most recent period for which this information was published. All are reported to be performing well in the current environment

Exhibit 1 Ocean Yield ASA: Composition of Fleet



Source: Company reports.

The company was formed as a wholly-owned subsidiary of Aker ASA (AKER NO) in March 2012, with a portfolio of oil-service assets with long-term charters that had been owned by Aker.

Ocean Yield went public at a price of NOK27 per share in July 2013, with Aker remaining the company's largest shareholder. It currently owns 61.65% of the shares.

The size of Ocean Yield's fleet has nearly doubled over the last four years, growing from 34 vessels at the end of 2016 to 65 vessels pro forma for the sale of three vessels that occurred in the first quarter of 2021. The fleet includes two newbuild Suezmax tankers scheduled for delivery in the second quarter of 2022. Its ship portfolio is relatively young, with an average age of 4.5 years, and it is chartered for an average duration of 9.8 years, representing a backlog of $2.9 billion in EBITDA. The company is also well diversified across shipping markets, as shown in Exhibit 2. The exhibit does not reflect two dry bulk ships and a chemical tanker sold since the end of last year.

Exhibit 2 Ocean Yield ASA: Composition of Fleet

Segment	Share of charter backlog[1]	# vessels[2]	Comments
Tankers	40%	29	Average lease outstanding of only 80% of market values
Dry bulk	14%	15	Average lease outstanding of only 90% of market values
Container	23%	10	Strong market improvement recently
Car carriers	7%	5	Recent improvement in utilization and earnings
Gas carriers	7%	3	All vessels with underlying charters to major chemical companies SABIC and Borealis
Oil-service	10%	6	2 vessels on charter to Aker BP 1 vessel chartered to Akastor/Akofs with Petrobras subcharter 2 vessels with variable charter 1 FPSO in lay-up

Source: Company reports.

The fleet includes seven tankers that are 50%-owned by Ocean Yield and six container vessels that are 49.9%-owned. The rest are wholly-owned and may have purchase options or obligations for the charterer at the end of the lease term.

FPSO

This segment, which is now included in the Oil-Services segment, consists of a single vessel, the *Dhirubhai-1*. It is a Suezmax tanker that was converted into a FPSO unit by Aker Floating Production for the production, processing and storage of hydrocarbons. Historically, it was the only vessel in Ocean Yield's fleet that is not contracted via a bareboat charter, instead being operated by a subsidiary of the company. Since its conversion, the vessel has been operating under a 10-year charter to the Indian company Reliance Industries Ltd. This charter expired in September 2018 and Reliance chose to not exercise the purchase option on the contract nor renew the charter, choosing instead to halt production on the field in which the FPSO was deployed. The vessel is currently in lay-up at a cost of approximately $2.5 million per quarter. Ocean Yield took an impairment charge of $94.8 million in the third quarter of 2020, which wrote the book value of the *Dhirubhai-1* down to $51.5 million. The company has stated that there are multiple parties interested in purchasing the asset, but the process to date has progressed slowly. Should the vessel be sold, it would not only unlock capital, but would lift future earnings by $9-$10 million per year by alleviating maintenance expenses while the vessel is in lay-up.

Other Oil Service
As of the end of 2020, the Other Oil Service segment includes two Anchor Handling Tug Supply vessels ("AHTS"), one construction vessel and two Platform Supply vessels. Ocean Yield has chosen to reduce its exposure to the oil service segment and, to that end, sold its construction and cable-lay vessel *Connector* during the fourth quarter. Ocean Yield stated that the vessel had contributed negatively to cash flow and earnings, implying that total profitability should improve going forward. A loss of $70.7 million was recognized on the sale. It also divested its 75% interest in the diving support & construction vessel *SBM Installer* during the third quarter for $33.7 million.

The two AHTS vessels had been on long-term bareboat charters to Solstad Offshore ASA (SOFF NO), but the lease was restructured during the fourth quarter of 2020 in exchange for 2.8 million shares in Solstad, which were then sold. The new lease agreement stipulates a duration of four years with variable charter rates, thus making the two AHTS vessels and the FPSO the only three ships in Ocean Yield's portfolio that are not on long-term fixed rate charters.

Car Carriers
This segment comprises five car carrier vessels, all of which have been chartered out to Höegh Autoliners AS on long-term contracts. A sixth vessel, also leased to Höegh, caught fire and was declared a total loss during 2020. Ocean Yield received an insurance payment of $26.3 million, which covered the debt remaining on the vessel and left $8 million in proceeds to the company. The remaining five ships account for 7% of the company's EBITDA backlog.

Container Vessels
Ocean Yield counts ten container vessels in its fleet, six of which are 49.9% owned via an indirect equity interest in BOX Holdings Inc. Quantum Pacific Shipping is the majority shareholder. The units have all been chartered to a major European container line for 15 years. Four of these vessels were delivered during the second half of 2016, while the final two were delivered during the first quarter of 2017. These assets are accounted for via the equity method as Income from Investments in Associates.

The remaining four container vessels in this segment are wholly-owned. The Container segment represents 23% of the EBITDA backlog.

Tankers
The Tanker segment consists of ten chemical tankers, four product tankers, two Suezmax tankers, two Suezmax newbuilds (being delivered in 2022) and four VLCCs ("Very Large Crude Carriers").

During 2020, the company sold to Aker Capital AS a 50% interest in its four product tankers and three of its Suezmax tankers. Ocean Yield's 50% interest is reported in this segment, which, in total, contributes 40% of the EBITDA backlog as of the end of 2020. One chemical tanker has since been sold, with the transaction expected to close in July 2021.

Other Shipping
This segment comprises three gas carriers and fifteen dry bulk vessels, which account for 7% and 14% of the EBITDA backlog, respectively. Two dry bulk vessels have since been sold, with delivery expected to take place in the first quarter of 2021. Ocean Yield will receive $38 million on the sale and record a small profit.

Dividends grew gradually from 2014 through 2018, but the disruptions to the oil service segment that began in late-2018/2019 caused the company to reduce its distribution in 2020. As one can see in Exhibit 3, the payout ratio has been reset to 68%, which is modest by the company's standards, and dividends are poised to increase over future quarters as the fleet continues to expand, the factors that contributed negatively to earnings are resolved, and the payout ratio is gradually increased. It is also worth noting that Ocean Yield's cash earnings are approximately 75%-80% higher than its adjusted earnings, given the large, non-cash depreciation and amortization expenses and the fact that IFRS accounting rules do not allow for the principal repayment of a finance lease to flow through the income statement. Ocean Yield received $97.1 million in finance lease receivable repayments during 2020, although this is only recorded on the cash flow statement (and in the company's self-reported Adjusted EBITDA figure). When one accounts for these factors, the current dividend is shown to be well covered with plenty of room to grow.

Exhibit 3 Ocean Yield ASA: Historical Dividend and Payout Ratio, 2014-Present
($, in millions)

	2014	2015	2016	2017	2018	2019	2020
Dividends Paid	69.1	80.7	94.0	110.2	119.1	121.6	60.0
Adjusted Net Profit[1]	100.7	108.1	130.9	137.7	121.6	46.0	88.2
Payout Ratio	**68.6%**	**74.7%**	**71.8%**	**80.0%**	**97.9%**	**264.3%**	**68.0%**

[1]Excludes one-time items and makes adjustements for cash taxes and the cash impact of derivatives and foreign exchange adjustments.

Source: Company reports.

Despite the disruptions experienced by Ocean Yield in recent years, it has been able to generate positive cash earnings since its inception, as seen in Exhibit 4. Revenues and EBITDA grew consistently until the loss of the FPSO charter, but profitability has since recovered. Other non-cash items reflected in adjusted net profit include impairment charges totaling $28.6 million in 2015 and $36.2 million in 2016. Net income reflects these charges, as well as a $24.6 million income tax benefit in 2015 versus a $16.5 million charge in 2016.

Exhibit 4 Ocean Yield ASA: Historical Financial Results, 2014-Present
($, in cents)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Revenue and Other Income	188.0	239.0	249.3	256.7	294.4	339.1	343.4	257.0	258.8
EBITDA	151.4	207.7	216.7	224.2	265.2	306.5	282.7	222.5	241.2
Adjusted EBITDA[1]	--	--	--	235.0	291.3	340.7	333.6	303.0	311.1
Operating Income	59.7	106.1	116.4	98.9	129.2	203.8	151.8	67.5	62.5
Net Profit Attributable to the Parent	27.7	82.7	100.7	104.0	76.1	128.2	57.0	(43.5)	(150.9)
Adjusted Net Profit[2]	--	--	--	108.1	130.9	137.7	121.6	46.0	88.2

[1]Includes repayment of finance lease receivables, as only the interest income of a finance lease is otherwise reported under IFRS.

[2]Excludes one-time items and makes adjustements for cash taxes and the cash impact of derivatives and foreign exchange adjustments.

Source: Company reports.

Balance Sheet

Ocean Yield utilizes a relatively high degree of leverage, with net debt of $1.5 billion representing approximately 75% of net debt plus equity attributable to shareholders as of December 31, 2020. These figures do not include any debt related to recent acquisitions, nor cash received from purchase options. It is worth noting, however, that the large majority of this debt is secured by specific vessels and that only $125 million in net debt is held by the parent company.

Valuation Analysis

Regular readers of our research will not be surprised to learn that Ocean Yield, a company with limited free float, has negligible ETF/index sponsorship. Although the company has experienced some uncertainty in recent periods, one could argue that this lack of passive ownership has had the impact on valuation that one has come to expect. As shown in Exhibit 5, the company currently trades at only 8.7x 2021 consensus earnings estimates, despite this forecast appearing conservative relative to 2020's earnings (adjusted for impairment charges of $88 million) and the fact that the company expects the new vessels it has acquired to offset the lost earnings from vessels that have been sold. Enterprise value to forecast EBITDA stands at 11.4x, although, again, it could be argued that the 2021 estimate does not properly reflect the company's EBITDA backlog and earnings potential.

Exhibit 5 Ocean Yield ASA: Current Valuation Metrics
(currency as stated, in millions)

Share Price (4/8/2021)	NOK 29.30
Shares Outstanding (millions)	175.3
Market Capitalization (NOK)	**NOK 5,135.9**
USD/NOK Exchange Rate	0.1183
Market Capitalization ($)	**$607.6**
Net Debt	**$1,498.1**
Enterprise Value	**$2,105.7**

2020 Earnings Attributable to Parent	($141.3)	2021E Earnings Attributable to Parent	$69.9
Price/2020 Earnings	**N/M**	**Price/2021E Earnings**	**8.69x**
2020 EBITDA	$241.2	2021E EBITDA	$184.6
EV/2020 EBITDA	**8.73x**	**EV/2021E EBITDA**	**11.41x**
2020 Equity Attributable to Parent	$512.7		
Price/2020 Book Value	**1.19x**		

Source: Company reports, *The European Contrarian* estimates.

Perhaps the primary valuation metric, however, is the current 6.2% dividend yield, which, as shown earlier in Exhibit 3, is well covered by cash earnings and represents a payout ratio that has been reset to historical lows. This positions the company to gradually increase the dividend going forward, as is its plan. Because of this, it is fair to categorize Ocean Yield as a yield-based investment, although one that is a vastly superior alternative to what is available in the fixed income market.

As one can see in Exhibit 6, dividend distributions represent nearly all of the value created for shareholders since 2012, as book value per share has declined meaningfully, largely due to recent impairments. The company may recoup some of these write-offs going forward as either the market for its impaired assets improves or it realizes a sales price for its vessels that is higher than the current carrying value. Although value created per share has been subpar during this period, it has remained modestly positive despite the challenges experienced over the last two years.

Exhibit 6 Ocean Yield ASA: Cumulative Value Created per Share; 2012-2020
($ in millions)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Equity Attributable to Shareholders of the Parent	533.0	703.7	708.1	697.2	804.2	821.1	845.7	738.4	512.7
Shares Outstanding (millions)	100.0	133.8	134.2	134.6	148.2	148.3	159.3	175.2	175.3
Book Value per Share	**$5.33**	**$5.26**	**$5.28**	**$5.18**	**$5.43**	**$5.54**	**$5.31**	**$4.21**	**$2.92**
Dividends		56.0	69.1	80.7	94.0	110.2	119.1	121.6	60.0
Cumulative Value Created per Share	**$5.33**	**$5.68**	**$6.21**	**$6.71**	**$7.45**	**$8.30**	**$8.63**	**$7.93**	**$6.98**
8-Year CAGR	**3.4%**								

Source: Company reports, *The European Contrarian* estimates.

Exhibit 7 shows that the company's cash from operations is significantly higher than its earnings, due to the large depreciation and amortization expenses. This exhibit also includes the repayment of finance lease receivables as operating cash flow. These are operating earnings in the sense that they are earnings related to the operations of a chartered vessel, the only qualifier being that this charter has been classified as a finance lease. As stated earlier, IFRS accounting rules do not include these as earnings, instead stipulating that they be included in investing activities on the company's cash flow statement.

In 2020, adjusted cash from operations amounted to $151.1 million relative to a dividend payment of $60 million (see Exhibit 3). Free cash flow has, in aggregate, been negative, but this is due to the acquisition of new vessels, which serves to both grow the company and offset the aging of the portfolio. It is important to remember that maintenance expenditures are effectively zero, as the bareboat charter*er* is responsible for all maintenance related to the vessel.

Exhibit 7 Ocean Yield ASA: Cash from Operations plus Finance Lease Receivables
($ in millions)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Net Cash From Operations	118.7	156.5	183.3	189.2	194.6	170.3	192.4	119.8	54.0
Repayment of Finance Lease Receivable	0.0	0.0	4.0	10.8	26.1	34.3	50.9	80.5	97.1
Adjusted Cash from Operations	**118.7**	**156.5**	**187.3**	**200.0**	**220.7**	**204.6**	**243.3**	**200.3**	**151.1**
Acquisition of Vessels and Other Fixed Assets	(327.3)	(255.5)	(367.8)	(52.2)	(139.3)	(163.5)	(2.6)	(0.5)	(4.2)
Proceed from Disposal of Vessels and Equipment	11.2	0.0	8.2	0.0	17.6	0.0	0.0	0.0	223.6
Acquisition of Vessels Accounted for as Finance	0.0	0.0	0.0	(130.5)	(248.6)	(47.0)	(411.0)	(568.4)	(91.1)
Free Cash Flow	**(197.4)**	**(99.0)**	**(172.3)**	**17.3**	**(149.6)**	**(5.9)**	**(170.3)**	**(368.6)**	**279.4**

Source: Company reports.

To simplify the ambiguity surrounding capital expenditures (i.e., what are growth expenditures versus what are investments to offset the depreciation of the fleet), one could assume no further investment in vessels, meaning the company would effectively be in run-off until its charters expire in approximately ten years. Ocean Yield would collect its EBITDA backlog of $2.9 billion during this period, with further optionality from cash payments received from purchase options at the end of the charters. Cash taxes are negligible, and the only other meaningful expense is the interest on the company's debt, which is approximately $80 million per year, based on 2020 figures. This simplified exercise estimates cumulative free cash flow in run-off to be EBITDA less interest expense, or $2.1 billion, which is equal to the enterprise value of the company today. In effect, shareholders are able to purchase the company at a price that assumes it will cease to exist in ten years.

The company's free cash flow is clearly compelling, and the fact that this cash is returned to shareholders in order to generate an attractive, absolute rate of return, makes Ocean Yield a superior income-generating security. Its risk is mitigated considerably by the fact that the vast majority of its debt is asset specific, while the client and end-market diversification also lends a degree of stability in an industry that has otherwise struggled in recent years. Given these characteristics, shares of Ocean Yield are recommended for purchase, especially to investors seeking to generate income.

Conclusion

Ocean Yield experienced some difficulties over the last few years, but it has now reset and is in a position to resume the growth of its dividend. The current yield of 6.2% arguably represents a distribution based on both trough earnings and a payout ratio that is as low as it has been since the company was founded. Counterparty risks have been resolved and the riskiest assets in its fleet are no longer a potential drag on earnings, as they have either been sold or laid up. In fact, the FPSO may prove to be a source of incremental upside should it be sold for a price above the heavily impaired valuation at which it is currently recorded on the company's balance sheet.

Recent events have shown that Ocean Yield is not immune to the inherent volatility of the shipping industry, buts its struggles have been modest relative to many traditional shipping companies, and its risks are significantly mitigated given its bareboat charter model, asset-level financing and diversified end-market exposure. These risks, when weighed against a robust current yield that is poised to grow going forward, appear reasonable, especially to investors that are seeking income. As such, shares of Ocean Yield are recommended for purchase.

Exhibit 8 Ocean Yield ASA: Consolidated Income Statement
($ in millions)

Amounts in USD million	Note	2020	2019 Restated*
Operating lease revenue	7	95.5	103.3
Finance lease revenue	8	112.4	114.1
Income from investments in associates	17	22.4	22.9
Other income	9	28.5	-
Total revenues and other income		**258.8**	**240.3**
Vessel operating expenses		-7.9	-9.3
Wages and other personnel expenses	10	-6.0	-6.8
Other operating expenses	10	-3.6	-5.9
Depreciation and amortization	16	-45.7	-49.7
Impairment charges	11	-62.2	0.0
Loss from sale of vessel	12	-70.7	-
Operating profit (loss)		**62.5**	**168.7**
Financial income	13	28.9	4.0
Financial expenses	13	-124.3	-107.8
Net financial items	13	**-95.4**	**-103.8**
Net profit (loss) before tax		**-32.9**	**64.9**
Income tax expense (-) / benefit (+)	14	-3.3	-3.4
Net profit (loss) from continuing operations		**-36.1**	**61.5**
Net profit (loss) from discontinued operation, net of tax	15	-105.1	-101.4
Net profit (loss) for the period		**-141.3**	**-39.9**
Attributable to:			
Equity holders of the parent		-150.9	-43.5
Non-controlling interests		0.4	0.9
Dividends on hybrid capital		9.3	2.7
Net profit (loss) for the period		**-141.3**	**-39.9**
Basic and diluted earnings per share (USD)	19	**-0.86**	-0.27
Basic and diluted earnings per share (USD), continuing operations	19	**-0.26**	0.36

Comparative information has been restated due to a discontinued operation, see note 15.

Source: Company reports.

Exhibit 9 Ocean Yield ASA: Consolidated Balance Sheet
($ in millions)

Amounts in USD million	Note	2020	2019
ASSETS			
Vessels and other fixed assets	16	550.4	1 053.7
Deferred tax assets	14	-	0.1
Investments in associates	17	178.0	178.2
Interest-bearing long-term receivables	18	1 221.6	1 506.6
Other shares and other non-current assets	18	1.3	2.3
Total non-current assets		**1 951.2**	**2 740.9**
Interest-bearing short-term receivables	18	164.2	219.8
Trade receivables and other interest-free receivables	5	4.2	7.1
Cash and cash equivalents	5	112.7	185.5
Current assets		**281.1**	**412.3**
Assets held for sale	15	54.0	-
Total current assets		**335.1**	**412.3**
Total assets		**2 286.3**	**3 153.2**
EQUITY AND LIABILITIES			
Share capital		271.0	271.0
Treasury shares		-0.0	-0.1
Other paid-in capital		237.3	366.1
Total paid-in capital	19	**508.3**	**637.0**
Retained earnings and other reserves		4.4	101.4
Total equity attributable to equity holders of the parent		**512.7**	**738.4**
Hybrid capital	19	125.0	125.0
Non-controlling interests		-	13.2
Total equity		**637.7**	**876.6**
Interest-bearing long-term debt	22	1 139.0	1 909.0
Deferred tax liabilities	14	5.2	2.6
Pension liabilities		0.0	0.0
Fair value of derivatives		13.7	23.7
Other interest-free long-term liabilities		1.2	8.3
Total non-current liabilities		**1 159.2**	**1 943.6**
Interest-bearing short-term debt	22	471.8	276.2
Current provisions	23	-	12.4
Trade and other payables		15.4	44.5
Current liabilities		**487.2**	**333.0**
Liabilities directly associated with the assets held for sale	15	2.2	-
Total current liabilities		**489.4**	**333.0**
Total liabilities		**1 648.6**	**2 276.6**
Total equity and liabilities		**2 286.3**	**3 153.2**

Source: Company reports.

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