

16 October 2007

Active Voice: All Cap

Key Exhibits

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- Largest Industrials by Industry, pg 8
- Global Comps: Absolute and Relative Performance, pg 11
- Growth, Value and Quality Screens, pg 12-13
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Market Price Performance

As of 12 October	% Change Since	
	YTD	Jan '06
Cirrus MSX Industrials	36.2	62.3
Cirrus Mid Cap Industrials	43.2	69.7
Cirrus Small Cap Industrials	28.0	56.3
Cirrus Micro Cap Industrials	23.3	39.9
S&P 500 Industrials	14.4	29.2
S&P Mid Cap Industrials	26.6	41.4
S&P Small Cap Industrials	19.9	40.9
Ind. Select Sector SPDR Fund	18.0	31.5
iShares DJ US Ind. Sector Fund	18.2	32.3
Vanguard ETF Industrials	19.5	36.1
PowerShares Dyn. Ind. Port.	22.3	---
Rydex ETF S&P Eq. Wt. Ind.	18.7	---
iShares S&P Global Ind. Fund	22.1	---
Wisdom Tree Intl Ind. Fund	24.9	---

Sector dominance has caused Industrials valuation levels to reach structural highs. Spending in this sector, tied to rising energy costs, points to an ongoing buildout. Valuation levels coupled with heady growth expectations force selectivity.

Highlights

- Diverging business prospects have created valuation concerns for **Construction & Engineering** and **Construction Machinery** stocks. **Industrial Machinery, Electrical Equipment** and **Industrial Distribution** firms appear to be the most conservatively valued.
- **High energy costs point to sustained and potentially stronger industrial spending trends** (see Fig. 1). Investment Spending gap supports lengthier industrial spending cycle. Industrial outlays likely to siphon Tech spending.
- **Industrials – the linchpin behind the rotation into Growth.** Value managers risk selling too early but are forced to swallow structurally higher valuation levels. Conversely, how long can growth managers withstand the pain of not owning the sector because of its cyclical bent.
- **Penchant for Industrial stocks is clearly echoed in global markets.** Strongest performance seen in Asia (ex Japan) and Europe (ex UK).

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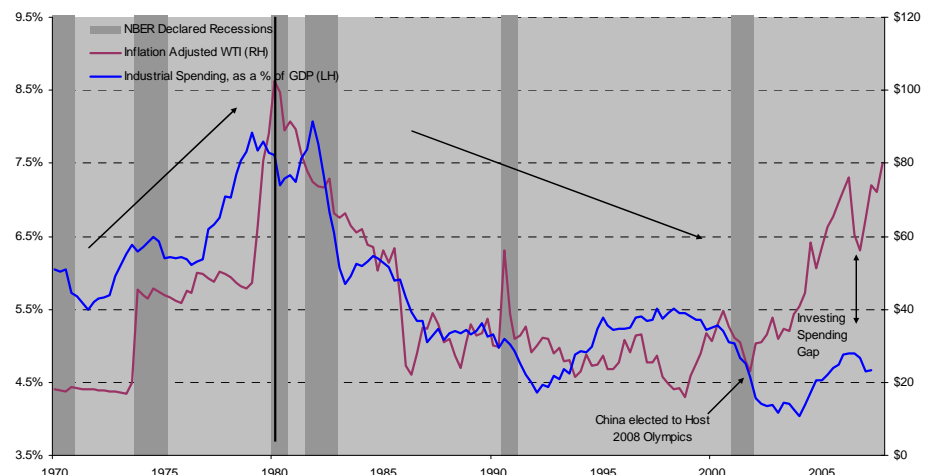
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Fig 1: Industrial spending can continue to play catch-up in a world of rising energy costs



Source: Cirrus Research

Industrials – the New High Beta

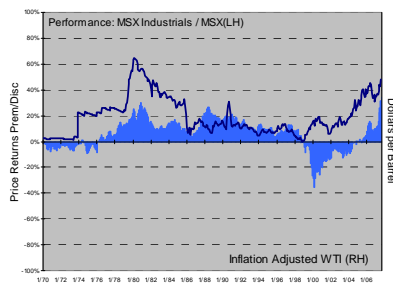
Cirrus Industrials Composite

- Aerospace & Defense
- Building Products
- Construction & Engineering
- Electrical Components & Equipment
- Multi-Industry
- Construction Machinery
- Farm Machinery
- Heavy Trucks
- Industrial Machinery
- Industrial Distribution

How ironic that a late-cycle, “old economy” group has rallied far past the peak growth of an economic cycle, outliving three years of Fed tightening and credit hiccups. Importantly, this run-up may be more long-standing than simply investors’ penchant for all things China. Stocks in the Industrials sector continue to dominate equity markets performance. The Cirrus MSX Industrial index is up 30% through September 2007 and a whopping 234% from the sector bottom in March 2003. The Russell 2000 has only gained 130% in the same period.

While we can reasonably assert that industrial spending will continue to support this sector, the run-up has caused valuation levels to reach historically high levels. Forecasts appear to imply robust earnings growth in the coming quarters. Selectivity and valuation sensitivity are imperative given these concerns. Construction & Engineering and Construction Machinery, to our eye, pose the most visible concerns. Industrial Machinery, Electrical Equipment and Industrial Distribution firms appear the most conservatively valued with reasonable expectations.

Industrial Sector Performance



Source: Cirrus Research

Fig 2: Summary of the MSX Industrial Sector: Valuations and Expectations

Testing for Value among the Industrials: Methodology

The table at right summarizes valuation and expectations data for the ten industries within the Cirrus Industrials sector. The vertical axis summarizes absolute and sector-relative valuations of the groups on price to book, price to sales, price to cash flow, price to forward earnings and, where appropriate, enterprise value (or Firm Value) to EBITDA or to cash flow ratios. The data is examined from 1985 to present.

The horizontal axis examines the current level of earnings expectations based on year-ahead analyst revisions (for short-term expectations) and consensus long-term growth rate forecasts (for longer term expectations).

		Expectations		
		Overly Pessimistic		Overly Optimistic
Valuations	Attractively Priced	Building Products Industrial Distribution Industrial Machinery		Elec. Components & Eq.
		Farm Machinery Heavy Trucks	Aerospace & Defense Multi-Industry	
	Expensive		Construction & Eng.	Construction Machinery

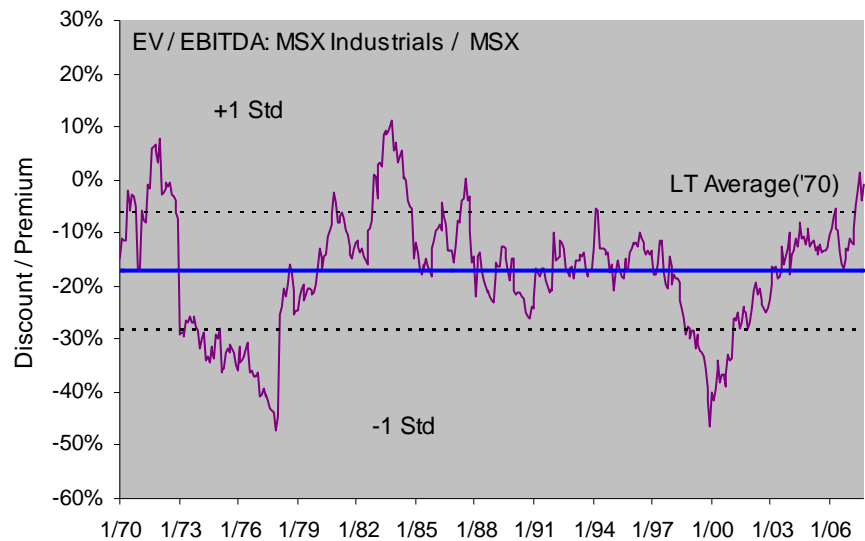
Source: Cirrus Research

Enterprise Value to EBITDA for Industrials, as a whole, are at historically high levels. However, there are pockets of value available in the sector.

Valuations appear rich

Long-term valuation comparisons for the Industrials sector appear to be secularly high. Current levels, as measured by firm value to cash flow, or enterprise value to EBITDA have reached 11.2x, a historical high and significantly above its ratio relative to the Cirrus Mid, Small and Micro Cap Index as a whole.

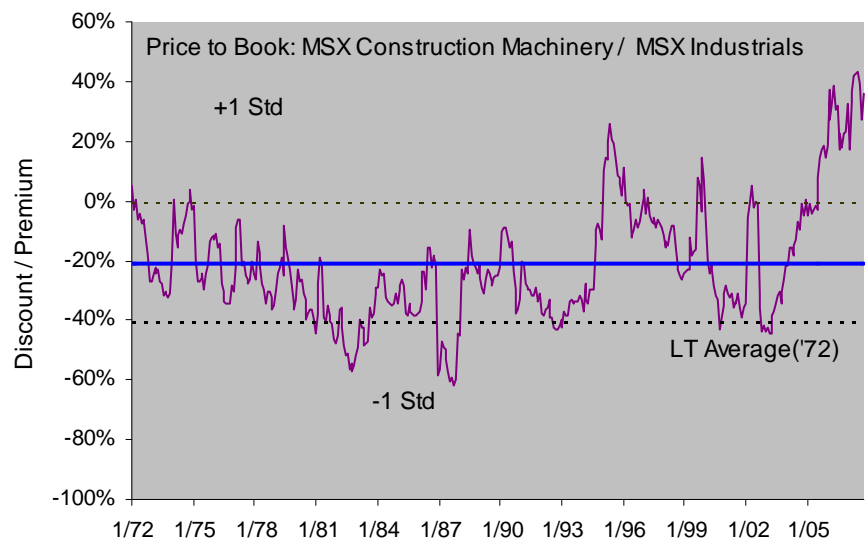
Fig 3: Relative Firm Value (Enterprise Value) to EBITDA for MSX Industrials



Source: Cirrus Research

Fig 4: Construction Machinery Relative Price to Book Value Ratio

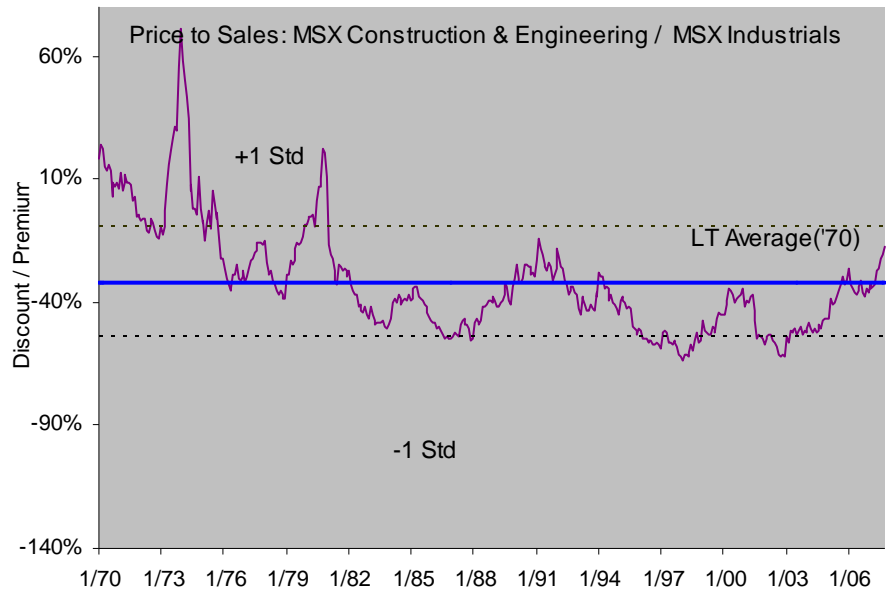
Construction Machinery appears richly priced given historical valuation ranges. Price to Book for Construction Machinery companies is at record high levels.



Source: Cirrus Research

Fig 5: Construction & Engineering Relative Price to Sales Ratio indicate a potentially expensive industry

While not quite as expensive as Construction Machinery, Construction & Engineering does not appear to be a bargain either.

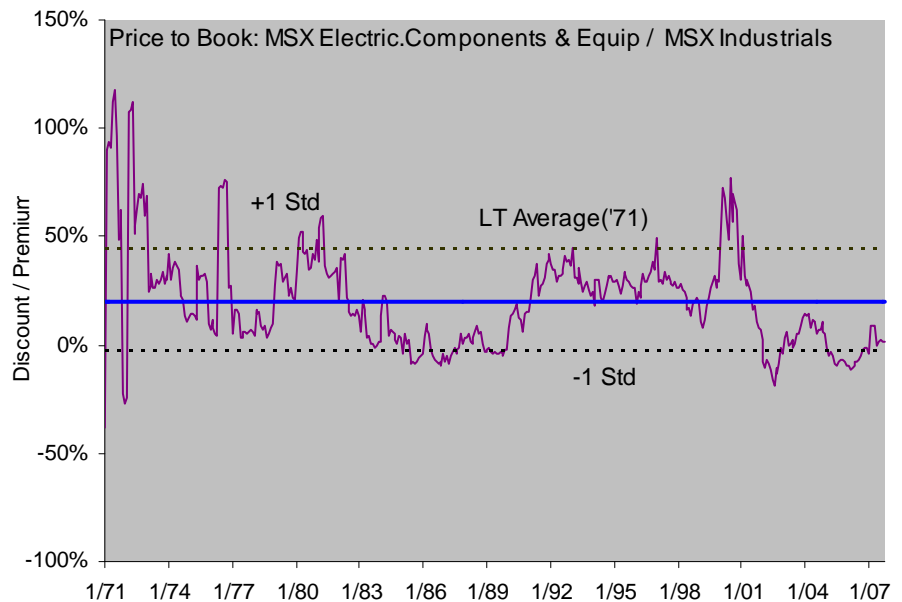


Source: Cirrus Research

Fig 6: Relative Price to Book Values are reasonable

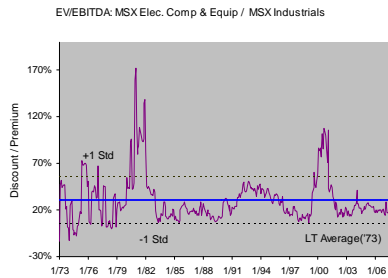
Conversely, Electrical Components & Equipment offer solid value.

The Industry is trading at historically low relative price to book value and at its long-term average relative price to sales and forward P/E ratios.



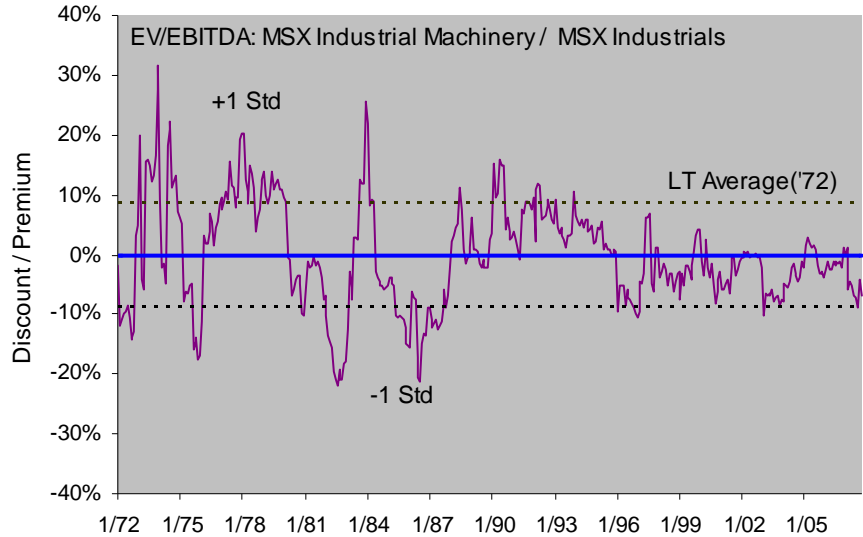
Source: Cirrus Research

Fig 8: Electric Components' Relative EV/EBITDA Ratios at fair value



Source: Cirrus Research

Fig 7: Industrial Machinery multiples are still below long-term averages

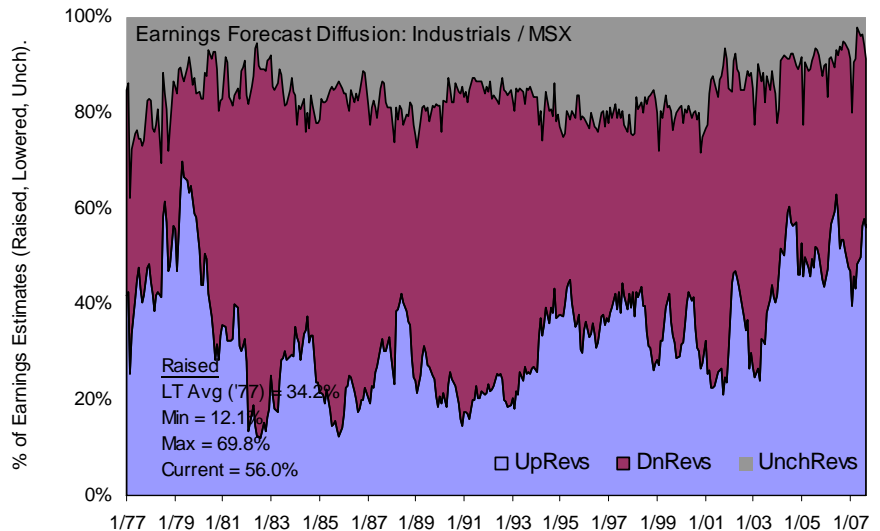


Source: Cirrus Research

Expectations are strong; no sign of a global slowdown here

In a world where economic growth expectations have come down, most notably in consumer finance and housing-related industries, the Industrials appear to be anything but soft. The nature of sharply rising growth forecasts is enough to scare away most value buyers. As industrial spending continues to rise, it is plausible that expectations simply trace future spending levels. In short, ongoing spending is likely to support this group, but higher hurdle rates from sell-side analysts imply that multiple expansion is a thing of the past and stock values will merely follow business performance.

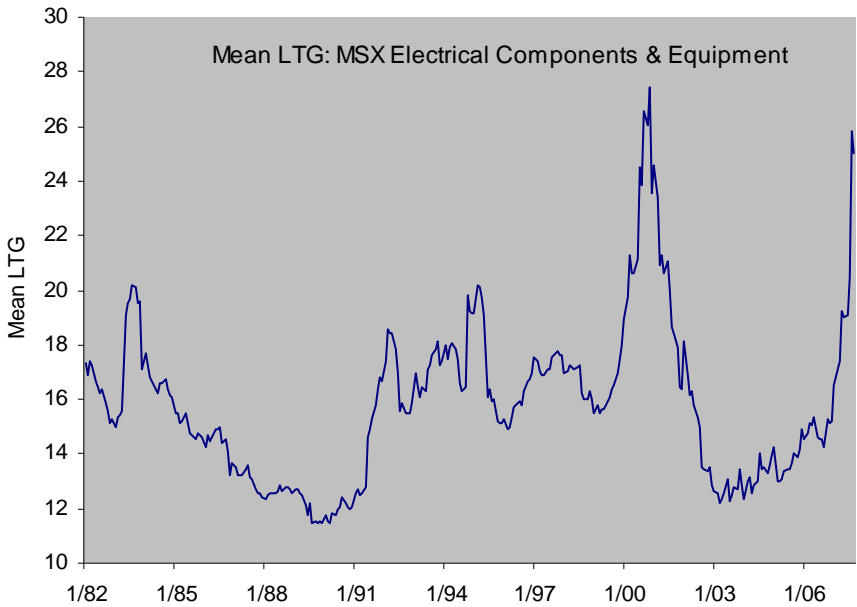
Fig 9: Robust forecasts means tougher hurdle rates



Source: Cirrus Research

Industries with the most buoyant forecasts are: Construction Machinery, Aerospace & Defense and Electrical Components & Equipment

Fig 10: Electrical Components' expectations have jumped sharply higher

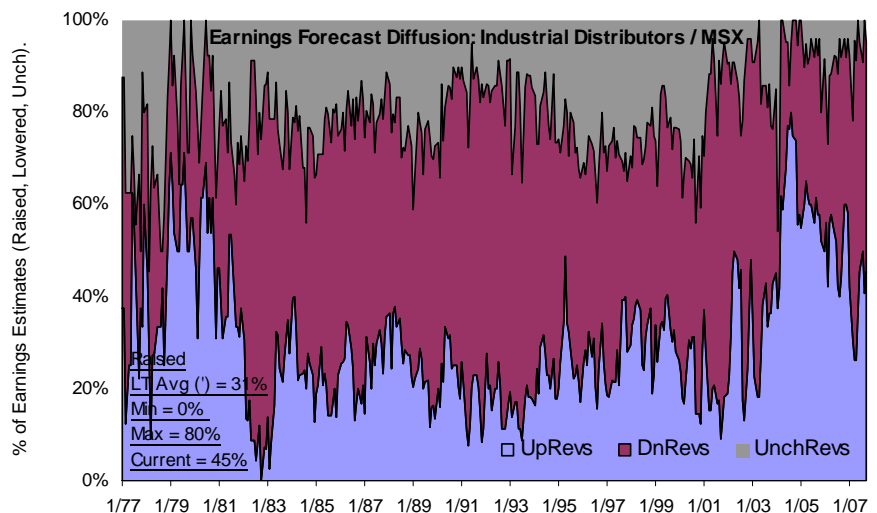


Source: Cirrus Research

The most conservative forecasts are found in: Industrial Machinery, Heavy Trucks, Industrial Distribution and Building Products.

Analysts have been lowering estimates for Industrial Distributors, making it easier for the industry to have positive earnings surprises.

Fig 11: Analysts' Earnings Revisions for Industrial Distributors



Source: Cirrus Research

Higher energy costs imply an industrial spending reinvestment cycle

There are two schools of thought. One posits that China and India are experiencing their own industrial revolutions and therefore real economy exposures matter. As a result, any firm exposed to industrial spending is likely to enjoy a supportive tailwind.

The pro-cyclical argument is that stronger demand and a buildup of plant and equipment may be driving energy costs. After all, so much of the rebuild requires greater energy and logistics needs (see Fig 13). Increasing industrial spending is pro-cyclical and therefore further points to needs for energy. A linkage between demand and oil suggests that unless a sharp reversal in the global buildout or a collapse in oil prices (south of \$30/bbl) occurs, the industrial spending pattern is likely to accelerate further.

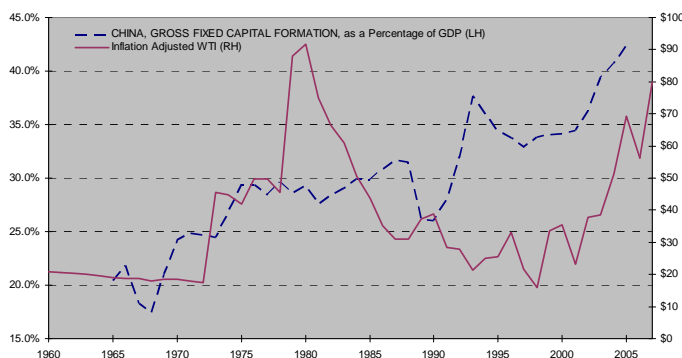
A second, more global underpinning, parallel to the China/India investment thesis, is that rising oil/energy costs also force most economies to adapt and as a result reinvest in plant and equipment. As energy costs increase, plant and equipment efficiencies come under greater scrutiny. Thus, cyclical demand may be less of a cause or determinant for an extended reinvestment cycle. The positive linkage between industrial spending and rising energy costs is compelling because it hints that the industrial buildout is far from over.

Figure 1 (cover chart) relates industrial spending in context of energy costs. This relationship over the past 30 years is far from tight, but nonetheless instructive. In a period such as the 1970s, the prior period in rising energy costs, the Industrial buildout was significant. Coincident to the waning in oil prices of the 1980s into the 1990s, a sharp slowdown in industrial spending ensued. Importantly, the industrial spending data since 2000 has quietly picked up coincident to the spike in oil prices. Figure 13 also relates the performance of the Industrial sector to the movement in oil prices.

The industrial build and oil price relationship, Figure 12, in China appears more related over the past few years. This is counter to trends seen in the US (Figure 1) and Europe. It is not surprising that the rising energy cost / industrial spending linkage is quite robust in China. One can only surmise that the India spending data corresponds to the China trend. This linkage appears to cross into the Industrial sector exposure among equities globally. (See the section starting on page 11.)

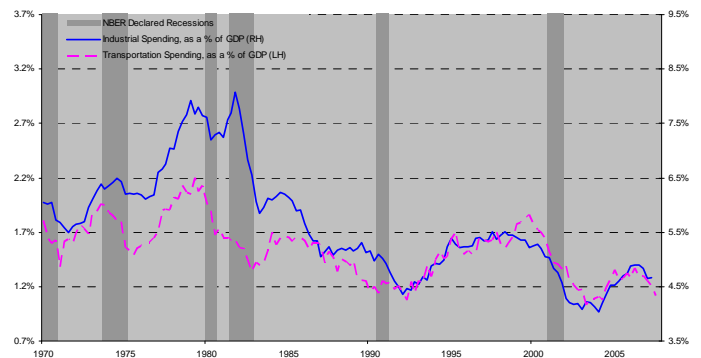
The positive linkage between industrial spending and rising energy costs is compelling because it hints that the industrial buildout is far from over.

Fig 12: Relationship between Chinese capital formation and the real price of oil



Source: Cirrus Research

Fig 13: The industrial and logistics spending trends are inter-related and correlated



Source: Cirrus Research

Largest Cirrus MSX Industrial Companies

As of 12 October			Market Value (\$MM)	YTD % Price Change
Aerospace & Defense	LLL	L-3 Communications Holdings	12,505	28.44
	GR	Goodrich Corp.	8,545	53.46
	SPR	Spirit AeroSystems Hldgs (CI A)	5,435	5.38
	ATK	Alliant Techsystems Inc.	3,671	42.38
Building Products	ASD	American Standard Cos. Inc.	7,263	8.56
	OC	Owens Corning Inc	3,277	-15.62
Construction & Engineering	FLR	Fluor Corp.	12,715	97.53
	FWLT	Foster Wheeler Ltd.	9,358	170.89
	JEC	Jacobs Engineering Group	9,063	109.00
	KBR	KBR Inc.	6,550	68.23
	SGR	Shaw Group Inc.	4,716	96.81
Electrical Components & Equip	CBE	Cooper Industries Inc.	9,385	24.41
	ROP	Roper Industries Inc.	5,802	33.12
	AME	Ametek Inc.	4,626	40.77
	HUB.B	Hubbell Inc. (CI B)	3,387	25.90
	TNB	Thomas & Betts Corp.	3,370	22.19
Multi-Industry	LUK	Leucadia National Corp.	10,445	82.94
	TFX	Teleflex Inc.	3,069	16.06
	CSL	Carlisle Cos.	3,021	18.14
Construction Machinery	TEX	Terex Corp.	9,071	36.53
	MTW	Manitowoc Co.	5,555	58.98
	JOYG	Joy Global Inc.	5,495	10.36
Farm Machinery	AG	AGCO Corp.	4,648	74.73
Heavy Trucks	CMI	Cummins Inc.	12,815	136.96
	OSK	Oshkosh Truck Corp.	4,596	28.05
	TRN	Trinity Industries Inc.	3,044	9.72
Industrial Machinery	ITT	ITT Corp.	12,301	19.82
	DOV	Dover Corp.	10,423	2.04
	SPW	SPX Corp.	5,042	54.77
	HSC	Harsco Corp.	4,989	59.45
	PLL	Pall Corp.	4,766	18.09
Industrial Distribution	GWW	W.W. Grainger Inc.	7,696	34.72
	FAST	Fastenal Co.	6,838	25.72
	MSM	MSC Industrial Direct (CI A)	3,336	27.89
	WCC	Wesco International Inc.	1,936	-22.68

Source: Cirrus Research

Industrials – the linchpin behind the rotation into Growth

The debate between growth and value leadership may be further clouded as growth investors reach to the Industrials sector, classically called the real economy cyclicals. As revenue growth continues to climb for the Industrials along with valuation levels, growth managers might look begrudgingly to this sector, while value managers exit wondering if they are about to miss the best part of the trade.

The run-up in share prices for the Industrials, the somewhat counter-cyclical behavior and the global growth theme may be enough to finally push this cyclical trade into a growth or at least “growth cyclical” category. In short, a debate is likely open in most investment houses as this report is being written as to whether the industrial spending buildout will continue.

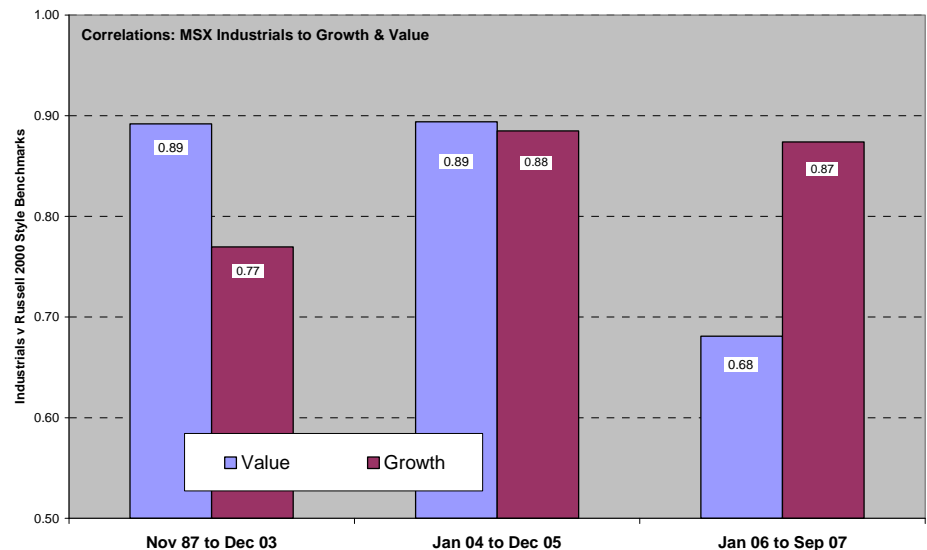
Case in point: the Technology sector in the early 1990s was seen as cyclical. By the end of that decade it became a dominant growth sector. This appears to be the transformation market participants are embracing as growth managers increase exposures to the Industrials sector.

That said, the equity market implication may be a bit more manageable. Valuation levels clearly dictate that the trade on the Industrial sector is in the latter stages. The “sector call” may be behind, and selectivity the new order of the day. It may be too late to attract the value or at least deep value buyer to increase their Industrial exposure.

Affirming the above, Figure 14 reveals that Industrials have become more closely correlated to the Russell Growth Index than the Russell Value Index since early 2004. This shift has become even more pronounced in the last 18-24 months.

Changing Face of Growth:
from Consumer (1980s)
to Technology (1990s)
to Industrials.

Fig 14: Industrials sector returns appear more correlated to growth benchmarks



Source: Cirrus Research

Technology shares may become more volatile if spending in the industrial segment for the economy remains robust.

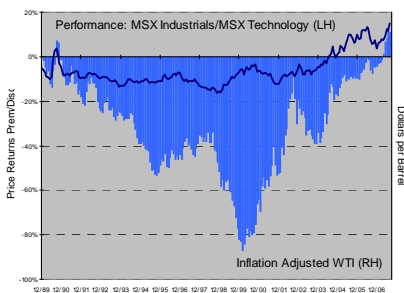
Corporate investments on Industrials siphons Tech spending

The performance of the Industrial sector may be the linchpin behind the rotation to growth from value investing. Ironically, the search for growth in a classic cyclical group limits the ability of the Technology sector to take on equity market leadership seen in past years.

The rotation to growth is fundamentally linked to the tradeoff in spending between the Industrial and Technology segments of the economy. While both camps of spending fall under the greater umbrella of capital expenditures, the rise in one segment can only limit the magnitude of the other. Ultimately, spending on industrials may temper investments into technology goods and therefore put pressure on shares in the Technology sector. Because corporate budgeting is a science of managing with limited resources, increased spending on industrial products can only limit technology consumption.

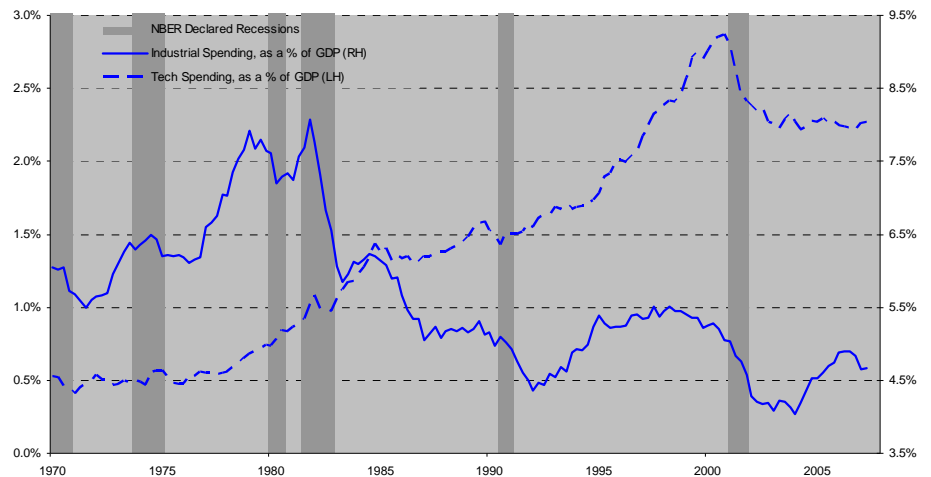
Spending on goods in the technology and industrials sectors is related, and yet, there are plenty of instances where they diverge. The late 1990s was perhaps the most dramatic example. The chart that follows reflects levels of spending in the technology and industrial segments. While they should both trend in a similar direction, the divergences are notable.

Fig 16: The tug-of-war between the real and virtual economy has played out between the performance of industrials to technology stocks



Source: Cirrus Research

Fig 15: Recessions, Industrial and Technology Spending



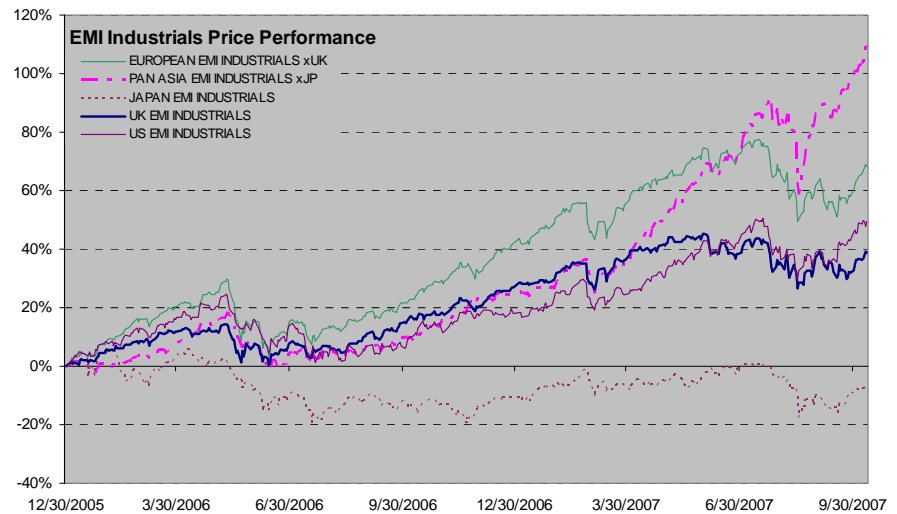
Source: Cirrus Research

Industrial penchant clearly echoed in markets globally

The global markets also appear to echo a strong industrial spending backdrop. The Industrial sector in Pan Asia (ex Japan) posts the most significant absolute returns since January 2006. This is followed by the Industrial sector results for the European (ex UK) markets. The Industrial sector in Japan seems to be a laggard. (See Figure 16.)

Fig 16: Pan Asia (ex Japan) Industrial performance appears to be the most robust among the global groups

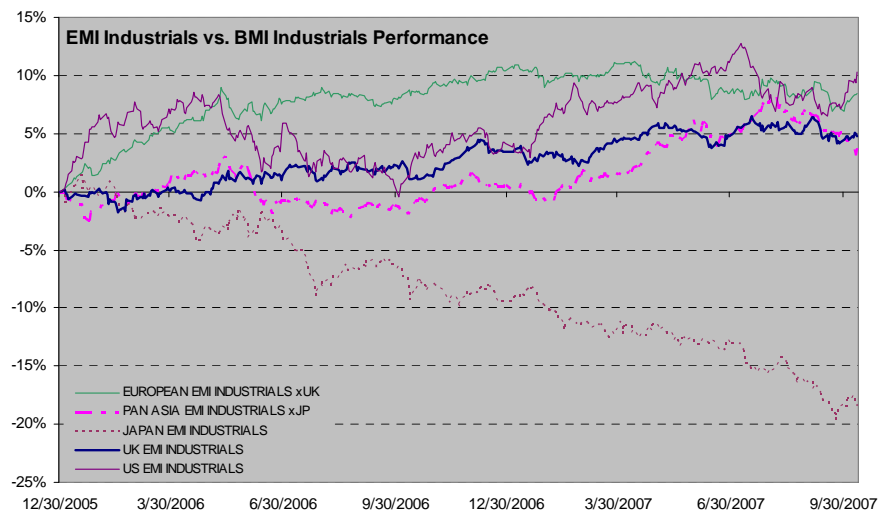
The Industrial sector implications appear least relevant to trends in the Japanese equity market.



Source: Cirrus Research

Fig 17: Small Cap Industrials severely underperformed in Japan

Figure 17 relates the relative performance of the Industrial sector adjusted by its large cap industrial sector counterpart. The US and European Industrial (ex UK) also appears to signify a more pronounced small cap effect. It is clear that the Industrial theme is not only a laggard in Japan, but, to the extent it is evident at all, is more of a large cap effect.



Source: Cirrus Research

Cirrus MSX Industrials Growth Screen

As of 12 October

			Market Value (\$MM)	YTD% Price Change	LTM Sales Growth	Mean F/C LTG
Construction & Engineering	ENG	ENGlobal Corp.	307	96.73	19.3	24.0
	SGR	Shaw Group Inc.	4,716	96.81	30.5	20.0
	PCR	Perini Corp.	1,505	103.93	61.6	12.5
	CBI	Chicago Bridge & Iron Co. N.V.	4,150	70.08	35.9	17.1
	FWLT	Foster Wheeler Ltd.	9,358	170.89	59.6	12.0
Electrical Components & Equip.	FSLR	First Solar Inc.	8,595	354.83	177.2	90.0
	BEZ	Baldor Electric Co.	1,832	30.49	139.1	16.5
	ACPW	Active Power Inc.	111	-33.21	68.0	N/A
	PWER	Power-One Inc.	445	-19.51	57.4	N/A
Construction Machinery	AMSC	American Superconductor Corp.	735	162.69	40.8	30.0
	BUCY	Bucyrus International Inc. (CI A)	2,727	50.02	106.2	30.0
	JOYG	Joy Global Inc.	5,495	10.36	3.9	32.5
	MTW	Manitowoc Co.	5,555	58.98	36.5	22.7
	ASTE	Astec Industries Inc.	1,271	69.69	18.4	27.3
Industrial Machinery	NC	NACCO Industries Inc. (CI A)	855	-22.14	4.3	N/A
	BWTR	Basin Water Inc.	236	74.89	29.2	60.0
	HURC	Hurco Cos.	345	89.21	32.7	28.0
	ASEI	American Science & Engineering	578	4.30	48.8	16.7
	TDSC	3D Systems Corp.	486	49.69	34.3	20.8
	HDNG	Hardinge Inc.	399	128.02	14.3	30.0

Source: Cirrus Research

Cirrus MSX Industrials Value Screen

As of 12 October

			Market Value (\$MM)	YTD% Price Change	Fwd PE	EV/EBITDA	Price/Book
Construction & Engineering	IESC	Integrated Electrical Services Inc.	393	58.46	N/A	16.6	2.8
	PCR	Perini Corp.	1,505	103.93	20.2	8.5	5.5
	EME	EMCOR Group Inc.	2,020	14.27	20.6	N/A	2.7
	URS	URS Corp.	2,995	43.76	24.3	11.2	2.0
	GVA	Granite Construction Inc.	2,224	13.43	17.9	9.4	3.3
Electrical Components & Equip.	AYI	Acuity Brands Inc.	2,202	-5.32	12.2	N/A	3.2
	LMS	Lamson & Sessions Co.	427	12.08	15.1	7.5	3.0
	AOS	A.O. Smith Corp.	1,350	25.43	15.7	8.4	2.0
	GLYT	Genlyte Group Inc.	1,839	-18.77	12.6	7.2	2.3
Construction Machinery	RBC	Regal-Beloit Corp.	1,500	1.12	15.0	7.3	2.0
	NC	NACCO Industries Inc. (CI A)	855	-22.14	N/A	5.0	1.1
	GEHL	Gehl Co.	273	-17.36	10.6	6.8	1.1
	CAE	Cascade Corp.	789	25.41	15.6	8.6	2.6
	TEX	Terex Corp.	9,071	36.53	15.4	N/A	4.3
Industrial Machinery	ASVI	A.S.V. Inc.	375	-22.93	21.6	14.5	1.9
	GNCI	Gencor Industries Inc.	95	-18.67	N/A	1.1	1.1
	THMD	Thermadyne Holdings Corp.	192	40.91	N/A	7.9	1.7
	LDL	Lydall Inc.	153	1.48	20.7	5.2	1.1
	NPO	EnPro Industries Inc.	865	26.62	11.1	N/A	2.0
	WTS	Watts Water Technologies Inc. (CI A)	1,188	-21.84	15.3	7.6	1.4

Source: Cirrus Research

Cirrus MSX Industrials Quality Screen

As of 12 October			Market Value (\$MM)	YTD% Price Change	LTM Oper. Margin	Leverage	Net Debt / Mkt Cap
Construction & Engineering	FWLT	Foster Wheeler Ltd.	9,358	170.89	9.9	0.02	-0.06
	PWR	Quanta Services Inc.	3,172	59.48	6.6	0.12	0.01
	URS	URS Corp.	2,995	43.76	5.2	0.04	0.02
	SGR	Shaw Group Inc.	4,716	96.81	2.0	0.18	0.15
	FRM	Furmanite Corp.	324	118.52	3.1	0.13	0.07
Electrical Components & Equip.	HRBN	Harbin Electric Inc.	270	135.48	36.1	0.10	-0.13
	PLPC	Preformed Line Products Co.	280	46.30	10.9	0.03	-0.06
	FSLR	First Solar Inc.	8,595	354.83	15.1	0.01	-0.02
	WGOV	Woodward Governor Co.	2,137	61.72	12.3	0.03	0.00
Construction Machinery	TNB	Thomas & Betts Corp.	3,370	22.19	13.5	0.10	0.01
	JOYG	Joy Global Inc.	5,495	10.36	18.0	0.08	0.06
	CAE	Cascade Corp.	789	25.41	14.8	0.06	0.04
	ASVI	A.S.V. Inc.	375	-22.93	9.2	0.00	-0.09
	ASTE	Astec Industries Inc.	1,271	69.69	9.7	0.00	-0.06
Industrial Machinery	MTW	Manitowoc Co.	5,555	58.98	11.8	0.05	0.02
	GNCI	Gencor Industries Inc.	95	-18.67	6.4	0.00	-1.76
	ASEI	American Science & Engineering	578	4.30	20.8	0.02	-0.25
	KDN	Kaydon Corp.	1,467	40.11	24.7	0.12	-0.13
	BOOM	Dynamic Materials Corp.	581	74.88	25.1	0.00	-0.02
GGG	Graco Inc.	2,567	0.40	27.2	0.02	0.02	

Source: Cirrus Research

Cirrus Research MSX Industrial Sector Industry Performance

As of 12 October	Valuation			Performance					Other	
	P/S	P/B	Fwd P/E	1 Mo	3 Mo	6 Mo	12 Mo	YTD	Count	Weight
Cirrus Industrial Industries										
Aerospace & Defense	1.18	3.23	21.40	2.3%	12.3%	22.6%	49.1%	38.2%	39	1.1%
Building Products	0.64	4.97	16.62	0.1%	-8.1%	-7.8%	5.6%	-0.2%	21	0.5%
Construction & Engineering	1.02	5.87	34.33	11.6%	25.1%	58.5%	95.7%	81.2%	22	1.2%
Electrical Components & Equip.	1.61	3.64	23.52	6.5%	6.7%	25.0%	43.7%	41.6%	37	1.2%
Multi-Industry	1.89	2.65	17.18	3.5%	18.4%	34.1%	50.2%	42.9%	8	0.4%
Construction Machinery	1.32	4.84	18.12	3.0%	8.1%	14.4%	52.5%	30.7%	9	0.5%
Farm Machinery	0.97	3.81	25.77	4.8%	22.5%	22.1%	64.9%	47.4%	6	0.2%
Heavy Trucks	0.96	3.66	17.47	5.7%	9.0%	16.8%	49.3%	48.5%	13	0.5%
Industrial Machinery	1.22	2.88	18.04	3.1%	6.5%	13.7%	27.1%	27.0%	62	2.0%
Industrial Distribution	0.90	3.21	17.56	2.5%	2.2%	4.9%	11.6%	15.6%	24	0.8%
Cirrus Research Benchmarks										
Industrial Sector: Large Cap	1.70	3.82	18.42	-0.1%	6.3%	12.0%	22.9%	17.9%	26	8.5%
Industrial Sector: Mid Cap	1.26	4.44	20.28	4.7%	11.6%	23.8%	47.1%	43.2%	48	8.1%
Industrial Sector: Small Cap	1.00	2.82	20.18	4.9%	6.2%	16.0%	34.6%	28.0%	90	9.3%
Industrial Sector: Micro Cap	0.87	2.69	30.90	4.6%	8.4%	17.4%	26.6%	23.3%	103	7.8%
Industrial Sector: MSX	1.12	3.59	20.82	4.8%	9.6%	20.7%	40.9%	36.2%	241	8.4%

Source: Cirrus Research

Analyst Certification

I, Satya D. Pradhuman, the Research Analyst who prepared this report, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject issuers and their respective securities. I also certify that no part of my respective compensation is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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Cirrus Benchmarks

Asset Class	Market Cap Range
Nano Cap	\$10 mn - \$100 mn
Micro Cap	\$100 mn - \$600 mn
Small Cap	\$600 mn - \$2.4 bn
Mid Cap	\$2.4 bn - \$10 bn
Large Cap	>\$10 bn