

MARCH 21, 2010



**BEACON
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RESEARCH**

Sonic Foundry, Inc.
NasdaqCM: SOFO

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Price	\$7.95	Shares (mils)	3.6
P/E Ratio (ttm)	NA	Market Cap (mils)	\$28.6
P/S Ratio (ttm)	1.38 X	52 Week Range	\$4.30 - \$7.30
Sales/share (ttm)	\$5.31	Ave. Daily Vol.	7,389
Price/Book	4.25 X	Short Interest	30,599
Book Value	\$1.72	Gross Margin	77.3%
Cash/share	\$0.66	Oper. Margin	-5.5%
Quick Ratio	0.33	Insider Ownership	13.8%
Debt to cap ratio	0.00 %	Inst'l Ownership	5.1%

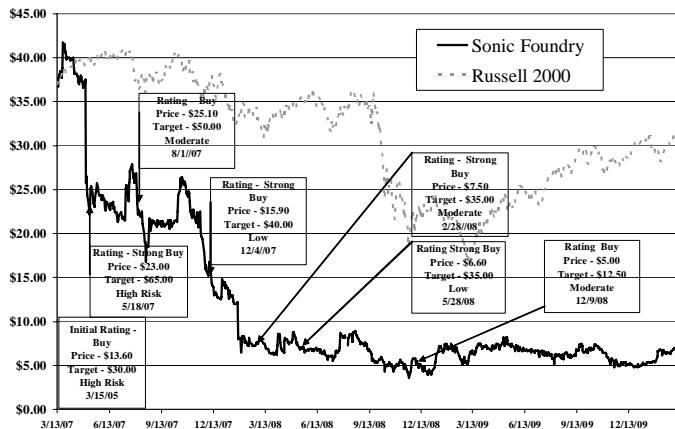
Disclosures 1,2,3,4

Price Target	\$12.50
Rating	Buy
Risk	Low

Sonic Foundry, Inc.'s (NasdaqCM: SOFO) reported one of its best starts for the first quarter of its fiscal year, typically one of its two weakest quarters. This was due to the culmination of years of focus, squeezing operating expenses, and developing a product with the customer and end user in mind. The company continues to maintain good cash balances and is negotiating an additional credit facility in anticipation of increasing working capital demands. Financial highlights are as follows:

- Revenues of \$4.5M in 1Q10
- Gross margin of 77.3% in 1Q10
- Deferred revenue of \$5.0M at the end of 1Q10

Sonic Foundry announced a large sale subsequent to the end of its first fiscal quarter and management believes it has several deals in its pipeline. Considering current economic conditions, the company is now better positioned to exceed prior operating results and expectations. We believe that Sonic Foundry has good potential in the near term to realize significant positive operating leverage. We reiterate our **Buy** rating and our 12-month price target to **\$12.50** per share.



Earnings Per Share					
	Q1: Dec	Q2: Mar	Q3: Jun	Q4: Sep	Annual*
2011E	\$ (0.03)	\$ 0.04	\$ 0.08	\$ 0.07	\$ 0.17
2010E	\$ (0.09)	\$ 0.03	\$ 0.06	\$ 0.04	\$ 0.04
2009A	\$ (0.35)	\$ (0.04)	\$ (0.05)	\$ (0.26)	\$ (0.70)
2008A	\$ (1.00)	\$ (0.64)	\$ (0.23)	\$ (0.34)	\$ (2.21)

* numbers may not add up due to rounding

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Investment Thesis

It is becoming increasingly clear that Sonic Foundry, Inc. (NasdaqCM: SOFO) may soon experience a significant increase in financial results due to established operating leverage in fiscal 2010 and early fiscal 2011. We have maintained a very strong opinion of Sonic Foundry's products being well positioned, making the most of education (and a wide range of corporate and government communication) over the Internet for several years. We have been impressed with management's ability to keep their product aligned with rapidly changing viewing devices. Management was also keen to maintain that alignment during the economic downturn by increasing focus on key market segments while developing a lean and flexible organization. Should the economy be slow in its recovery, it would appear that Sonic Foundry is well positioned to experience significant growth in revenues and operating leverage important for sustained profitability.

Sonic Foundry noted a rebound in its corporate segment that has given it a strong start in its first fiscal quarter, usually considered one of its softer quarters. We find it interesting that while the visibility for profitability is improving in the next twelve months, Sonic Foundry's risk profile may be improving relative to the current national economic uncertainty and anxiety. This is due to management advancing the company into a balanced and durable position.

The increase in corporate activity has balanced the revenue stream with other education segments. Corporate rebounded from a year ago and Sonic Foundry is enjoying penetration into community colleges, providing an offset to private for-profit and non-profit institutions. In addition, they continue to enjoy increasing revenues from higher margin services and maintain a healthy balance of new and existing customers. Also, increasing international sales provide an interesting forward balance with sustained economic development in Asia and the Middle East relative to North America.

If there was a potential surprise imbalance in the next twelve months, it would be management's increasing visibility for big deals in its sales pipeline which could bring in up to a half dozen deals ranging from one half to two million dollars. Sonic Foundry was an early adapter to the economic downturn and took advantage of the downturn by refocusing on the education segment, larger deals, cutting expenses, and listening to customers. The pipeline is full, the products are becoming the standard for on-line distance education, and the company is organized to ramp up production. Considering the actual market size for Sonic Foundry's products, should Sonic Foundry close on any number of these "larger deals", the future beyond fiscal 2010 could be even more interesting.

Our Experience Observing Mediasite Products and Services

We have observed the use of Sonic Foundry's Mediasite presentation recorders for several years at the Pacific Coast Banking School (PCBS) at the University of Washington. Each year several hundred bankers, midway in their careers, take two weeks to complete a three-year program that is highly regarded in the banking industry. The PCBS student body is diverse, with bankers from community banks to major financial institutions and varying expertise ranging from generalist to highly specialized backgrounds. While this diversity is important for enriching the learning experience for students, a cornerstone of the school's mission, it also injects anxiety, as students come from different backgrounds and are competing for honors and recognition. Having the opportunity to review presentations, it is not unusual for students to make statements that the presentations have been "life saving." A sample of student feedback from the 2009 session, illustrating Mediasite's unique value proposition to individual students, is as follows:

"I used the video recordings for each paper. It was very valuable to me so that I could go back and listen to certain points that were unclear in my notes. I thought it was a very beneficial resource to refresh the memory of what was discussed in class."

Laura Christensen

Wells Fargo Business Banking Support Group



Figure 1 - Mobile Mediasite Recorder
Source: Sonic Foundry

“The recorded presentations were critical for me in the completion of my extension papers. I received excellent grades on my extension papers on the three classes where the recorded presentations were available. I think it was an excellent learning tool and was a great refresher given some of these papers were done months after we got out (of) our first year.”

Greg Oakes

Columbia Community Bank

“...the recorded presentations for the 2008 residence sessions were extremely helpful for completing post session extension assignments. All of us come from different backgrounds and learn differently; the recorded lectures allow us to listen and review the lectures as many times (in our comfortable environment) as we could to complete the assignments. I wouldn't be able to obtain excellent grades without the help of the recorded presentations!”

Monica M. Ng

Senior Vice President

Union Bank



Figure 2 - Capturing PCBS Lecture
Source: Analystry

“The presentations were an integral part of my first year PCBS experience. The presentations provided a learning experience beyond the two week class session and the four post session extension assignments completed later in the year. During the class sessions, I found that it was a challenge to listen, process the information and take notes at the same time. I have found that the best way to maximize on the in-class lectures was to listen rather than take extensive notes and then review the presentations at a later time. Additionally, the presentations offered an extra option outside of study groups as my schedule did not always allow time to work with a group of people.”

Carrie Lee

Vice President

Union Bank

“Without the recorded presentations to refer to, it would have been extremely difficult for me to complete my four term papers and to have received the grades that I did. It was so nice to be able to review the presentations and pick up key points the instructors wanted.”

Sachiko Yenokida

Vice President and Manager

Union Bank

We have found that PCBS management has found Sonic Foundry's Mediasite products to be one of the few innovative additions it has been able to incorporate in many years. National post-graduate banking schools (which may be expected of other education institutions) have become increasingly competitive for students and are attentive to their value proposition.

“Our students and instructors have benefited greatly over the last five years by utilizing Sonic Foundry's Mediasite presentation recorders. The technology is transparent to instructors allowing them to focus on instruction while benefiting from enhanced comprehension of material by their students. Our students are relieved to have access to the lectures for self directed review after a rigorous class schedule when post session extension assignments compete with demands of their careers and families. We believe the Mediasite presentation recorders have allowed us to innovate and improve our product offering, allowing us to remain the nation's premier post graduate banking school.”

Dave Enger

CEO

Pacific Coast Banking School

Fiscal 2010 First Quarter Financial Discussion:

Sonic Foundry reported financial results for the first quarter of its 2010 fiscal year ending December 31, 2009. Sonic Foundry reported revenues of \$4.5 million in 1Q10, exceeding our estimate of \$4.2 million, and revenues of \$4.0 million in 1Q09. Total billings were \$4.3 million in 1Q10, up from \$4.0 million in 1Q09. Product billings were \$1.9 million in 1Q10, up 11% from \$1.7 million in 1Q09, service billings (for support, hosting, training, and events) were \$2.3 million, up 6% from \$2.2 million in 1Q09.

Gross margin was about 77.3% in 1Q10, unchanged from 77.8% in 1Q10. Average sale price of units increased to about \$10,800 per unit, up from \$10,000. Sonic Foundry shipped 195 units in 1Q10, up from 183 units in 2Q08. Sonic Foundry reported gross income of \$3.5 million in 1Q10, up slightly from \$3.1 million in 1Q09.

Sonic Foundry continues to benefit from its cost reduction program it commenced over a year ago and has now enjoyed seven consecutive quarters of lower operating expenses. Operating expenses declined to \$3.7 million in 1Q10, down 14% from \$4.3 million in 1Q09. Reductions in operating expenses appear to be primarily from reduction in headcount and incentive compensation. Marketing expense was \$2.2 million in 1Q10, or 49.3% of sales, compared to \$2.7 million in 1Q09, or 66.4% of sales, and below our estimate of \$2.6 million. In addition, general and administrative expenses increased slightly to \$803,000 in 1Q10 compared to \$783,000 in 1Q09, while product development was \$711,000 in 1Q10, down from \$903,000 in 1Q09. Consequently, an overall reduction in operating expenses reduced the operating loss to \$250,000 in 1Q10, from \$1.2 million in 1Q09. Sonic Foundry reported a loss of \$320,000 in 1Q10, or \$0.09 per share, ahead of our earnings forecast, and an improvement from a loss of \$1.3 million or \$0.36 per share in 1Q09.

Unearned income was \$5.0 million at the end of 1Q10, down from \$5.3 million in 1Q09. Management believes this was due to a couple large events and timing recognition of revenues. Sonic Foundry reported cash balances of \$2.4 million at the end of 1Q10, down slightly from \$2.6 million in the previous quarter. Management believes it has adequate capacity under credit arrangements and does not expect to rely on its shelf registration for potential working capital needs. They are in negotiation to secure additional short term financing in anticipation of closing several larger deals. Management appears pleased with financial performance in the quarter relative to exceptional financial challenges faced by its customers and the wider economy.

Management Reiterates Guidance for Balance of Fiscal 2010

Sonic Foundry management reiterated guidance from its previous conference call, anticipating larger deals materializing in fiscal 2010. They anticipate the rebound in their corporate segment and international sales to continue. The return of the corporate segment is most likely to be expressed through their high margin services with hosting events. Also, having noted a large transaction with a community college subsequent to the end of the first fiscal quarter, they anticipate closing several larger deals in the next twelve months. We have seen the community college market as one of the more attractive markets for Sonic Foundry's products. While community colleges may lack the patina of marquee higher education establishments, their need (and that of their students) is nevertheless as real and imperative. Also, community colleges are more likely to quickly recognize the ease of adoption of Mediasite products. It would appear that community colleges may be higher on the list of priorities for stimulus monies for job training. Management also anticipates that it is well prepared to meet demand and to enjoy operating leverage and profitability in fiscal 2010.

Our Model to Include Pro Forma Earnings Performance and Forecast

Our model reflects earlier consistent growth of gradually increasing revenues and high-margin service income. It also reflects some increased sales, common with the last two quarters of the fiscal year typical of the education segment. We also anticipate relatively constant gross margins and operating expenses. This would suggest a steady improvement of operating results, which is a very solid best case for Sonic Foundry.

Reality for the balance of fiscal 2010, or for the next twelve months, may be quite different. If the closing of the half million dollar community college deal is any indication, Sonic Foundry is in good position to significantly increase profitability in fiscal 2010. As these larger deals may have a long life, future transactions with existing customers are likely to be high margin and long lasting. As we see an adoption of a half dozen large deals to be significant on a historic basis, this remains an exceptionally small percentage of a large and rapidly growing market.

Conclusion and Valuation: The Time Has Come to Realize Leverage

In our years of providing research coverage of Sonic Foundry, it would appear that the company is in position to experience another significant appreciation in the price of its shares. The company earlier enjoyed a run-up in the stock price, and was noted as one of the highest performing stocks on the Nasdaq about the time that Google acquired YouTube. Subsequent weaker performance and the economic downturn took the stock to its current level. Despite continuing anxiety in the markets that drains optimism or momentum, Sonic Foundry is poised to experience fundamental progress in its operation, which if not resulting in higher valuations, may be exhibited through a lower risk profile.

We see no deterioration in acceleration of trends toward online learning. We continue to see Sonic Foundry's products as agents of creative destruction on good times, and a source of relief to both students and learning institutions of all types in the current economic environment. We are reiterating our 12-month target price of **\$12.50** per share, or about 2.0X our sales per share estimate, and a **Buy** rating. As Sonic Foundry continues to execute on its marketing and operational focus, and enters historically stronger quarters as well, we maintain a **Low** risk assessment.

Beacon Rock Research, LLC

March 21, 2010

Sonic Foundry, Inc.

September FYE

(#'s in 000's)

Income Statement	1Q09A		2Q09A		3Q09A		4Q09A		1Q10A		2Q10E		3Q10E		4Q10E		2008A		2009A		2010E		2011E		
	Dec.-08	Mar.-09	Jun.-09	Sept.-09	Dec.-10	Mar.-10	Jun.-10	Sept.-10	Dec.-10	Mar.-10	Jun.-10	Sept.-10	Dec.-10	Mar.-10	Jun.-10	Sept.-10	Dec.-10	Mar.-10	Jun.-10	Sept.-10	Dec.-10	Mar.-10	Jun.-10	Sept.-10	
Revenues																									
Mediasite revenues	\$1,744	\$3,249	\$2,637	\$2,014	\$1,928	\$2,600	\$2,900	\$2,600	\$1,928	\$2,600	\$2,900	\$2,600	\$8,439	\$9,644	\$10,028	\$10,700									
Customer support fees	2,236	2,129	2,367	2,081	2,548	2,500	2,550	2,400	2,548	2,500	2,550	2,400	7,037	8,813	9,998	10,350									
Other	29	35	23	33	26	35	35	33	26	35	35	35	125	120	131	135									
Total revenues	4,009	5,413	5,027	4,128	4,502	5,135	5,485	5,035	4,502	5,135	5,485	5,035	15,601	18,577	20,157	20,385									
Cost of goods sold	891	1,330	1,095	1,015	1,020	1,100	1,175	1,075	1,020	1,100	1,175	1,075	4,205	4,331	4,370	4,575									
Gross profit	3,118	4,083	3,932	3,113	3,482	4,035	4,310	3,960	3,482	4,035	4,310	3,960	11,396	14,246	15,787	15,810									
Operating expenses																									
Selling and marketing expenses	2,663	2,607	2,586	2,494	2,218	2,450	2,600	2,300	2,218	2,450	2,600	2,300	12,905	10,350	9,568	9,850									
General and administrative expenses	783	733	652	742	803	750	750	775	803	750	750	775	2,843	2,910	3,078	3,125									
Product development expenses	903	887	845	829	711	725	730	735	711	725	730	735	3,531	3,464	2,901	2,990									
Total operating expense	4,349	4,227	4,083	4,065	3,732	3,925	4,080	3,810	3,732	3,925	4,080	3,810	19,279	16,724	15,547	15,965									
Operating income	(1,231)	(144)	(151)	(952)	(250)	110	230	150	(250)	110	230	150	(7,883)	(2,478)	240	645									
Other income (expense)	(9)	(8)	(11)	3	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	27	(25)	(40)	0									
Income (loss) before income taxes	(1,240)	(152)	(162)	(949)	(260)	100	220	140	(260)	100	220	140	(7,873)	(2,503)	200	605									
Net income	(1,240)	(152)	(162)	(949)	(320)	100	220	140	(320)	100	220	140	(7,873)	(2,503)	140	605									
Earnings per share	\$ (0.35)	\$ (0.04)	\$ (0.05)	\$ (0.26)	\$ (0.09)	\$ 0.03	\$ 0.06	\$ 0.04	\$ (0.09)	\$ 0.03	\$ 0.06	\$ 0.04	\$ (2.21)	\$ (0.70)	\$ 0.04	\$ 0.17									
Diluted shares	3,561	3,581	3,591	3,603	3,606	3,610	3,615	3,620	3,606	3,610	3,615	3,620	3,557	3,559	3,613	3,633									
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%	100.0%	100.0%	100.0%	100.0%									
Cost of goods sold	22.2%	24.6%	21.8%	24.6%	22.7%	21.4%	21.4%	21.4%	22.7%	21.4%	21.4%	21.4%	27.0%	23.3%	21.7%	22.4%									
Gross profit	77.8%	75.4%	78.2%	75.4%	77.3%	78.6%	78.6%	78.6%	77.3%	78.6%	78.6%	78.6%	73.0%	76.7%	78.3%	77.6%									
Selling and marketing expenses	66.4%	48.2%	51.4%	60.4%	49.3%	47.7%	47.4%	45.7%	49.3%	47.7%	47.4%	45.7%	82.7%	55.7%	47.5%	48.3%									
General and administrative expenses	19.5%	13.5%	13.0%	18.0%	17.8%	14.6%	13.7%	15.4%	17.8%	14.6%	13.3%	15.4%	18.2%	15.7%	15.3%	15.3%									
Product development expenses	22.5%	16.4%	16.8%	20.1%	15.8%	14.1%	13.3%	14.6%	15.8%	14.1%	13.3%	14.6%	22.6%	18.6%	14.4%	14.7%									
Total operating expense	108.5%	78.1%	81.2%	98.5%	82.9%	76.4%	74.4%	75.7%	82.9%	76.4%	74.4%	75.7%	123.6%	90.0%	77.1%	78.3%									
Operating income	-30.7%	-2.7%	-3.0%	-23.1%	-5.6%	2.1%	4.2%	3.0%	-5.6%	2.1%	4.2%	3.0%	-50.5%	-13.3%	1.2%	3.2%									
Other income (expense)	-0.2%	-0.1%	-0.2%	0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	0.2%	-0.1%	-0.2%	0.0%									
Net income (continuing operations)	-30.9%	-2.8%	-3.2%	-23.0%	-7.1%	1.9%	4.0%	2.8%	-7.1%	1.9%	4.0%	2.8%	-50.5%	-13.5%	0.7%	3.0%									
Sales/share (ttm)	\$ 4.80	\$ 5.21	\$ 5.18	\$ 5.18	\$ 5.31	\$ 5.22	\$ 5.33	\$ 5.58	\$ 5.31	\$ 5.22	\$ 5.33	\$ 5.58	\$ 4.39	\$ 5.18	\$ 5.58	\$ 5.83									

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Sonic Foundry, Inc.

September FYE

(#'s in 000's)

BALANCE SHEET

ASSETS	2006	2007	2008	2009	2Q09	3Q09	4Q09	1Q10
Cash and equivalents - (000's)	\$2,751	\$8,008	\$3,560	\$2,598	\$2,497	\$2,371	\$2,598	\$2,366
Accounts receivable	3,442	5,001	3,864	3,741	4,012	4,007	3,741	3,516
Inventory	398	204	330	440	128	335	440	307
Other current assets	399	975	429	472	738	570	472	278
Total current assets	6,990	14,188	8,183	7,251	7,375	7,283	7,251	6,467
Net property, plant, and equipment	2,294	2,183	1,694	1,316	1,545	1,423	1,316	1,203
Goodwill & intangibles	7,628	7,610	7,597	7,576	7,590	7,611	7,576	7,576
Other assets	0	0	0	30	0	0	30	24
Total assets	\$16,912	\$23,981	\$17,474	\$16,173	\$16,510	\$16,317	\$16,173	\$15,270
LIABILITIES AND SHAREHOLDERS' EQUITY								
Line of credit	\$0	\$0	\$0	\$0	\$0	\$0	\$300	\$300
Accounts payable	1,521	1,512	1,256	636	704	722	636	739
Accrued liabilities	1,225	1,023	1,113	1,047	1,158	775	1,047	716
Unearned revenues	2,005	3,314	4,661	5,272	4,722	4,697	5,272	5,041
Current portion of capital lease obligation	41	399	379	340	373	364	340	337
Current liabilities	4,792	6,248	7,409	7,595	7,557	6,858	7,595	7,133
Long-term debt	0	0	0	0	0	0	0	0
Deferred long-term liability charges	519	973	502	727	274	808	727	623
Other long term liabilities	0	0	0	1,250	0	0	1,250	1,310
Shareholders' equity	11,601	16,760	9,563	6,601	8,679	8,651	6,601	6,204
Total liabilities and shareholders' equity	\$16,912	\$23,981	\$17,474	\$16,173	\$16,510	\$16,317	\$16,173	\$15,270
Cash per share	\$0.09	\$0.23	\$1.00	\$0.73	\$0.70	\$0.66	\$0.72	\$0.66
Quick ratio	1.29	2.08	1.00	0.83	0.86	0.93	0.83	0.82
Current ratio	1.46	2.27	1.10	0.95	0.98	1.06	0.95	0.91
Debt to capitalization ratio	4.47%	5.81%	5.25%	11.01%	3.16%	9.34%	11.01%	10.04%
Book per share	\$3.59	\$6.43	\$2.69	\$1.83	\$2.42	\$2.41	\$1.83	\$1.72

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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.

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