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Corporate Governance Scorecard Volume III - H117

Shipping, Equipment Leasing, & Marine MLPs

- **H117 Scorecard – New Factors & Rankings, But Idea Remains The Same.** Before we delve into our updated rankings, framework, and company specific changes, we want to reiterate the idea that underpins this entire exercise, which is that **we believe there is no longer a place in the public Shipping markets for companies that do not prioritize strong corporate governance and capital stewardship**. We continue to believe that risk premiums associated with poor governance/capital discipline can (and should) continue to widen, eventually pricing-out conflicted players and antiquated structures from the public markets.
- **To Improve Is To Change, So To Be Perfect Is To Change Often – Winston Churchill.** In the past year we've seen some tangible, positive changes from a few companies – most notably STNG, SALT, CPLP, and SSW have all removed varies Related-Party fees from their structures, which we believe is a step in the right direction. While *perfect* may be a bit strong – they largely remain in the bottom half of our rankings – it *is* progress, and we hope to see more as the public space continues to mature and evolve.
- **We Shape Our Dwellings, And Afterwards Our Dwellings Shape Us – *Also* Winston Churchill.** Some of our most consistent feedback comes from owners with large, well-established platforms that argue in support of legacy, related-party relationships on the basis of superior operating metrics, profitability, or simply IPO vintage. While we're not entertaining relative cost arguments within the context of this scorecard, we can address the idea of *IPO vintage*. While we believe earlier entrants into the public space may have faced less skepticism for having an operational *foundation* built on related-party relationships, we think those structures will eventually need to change or evolve. *We believe structuring a public company like a private entity ultimately shapes behavior – at least to a degree,* and whether it's via proactive structural changes (SSW, CPLP, STNG, SALT), restructuring (EGLE, GNK, OSG), or simply pressure from repriced risk premiums and more expensive capital, we expect the market to continue gradually reshaping the public shipping landscape.
- **Adjusting Our Framework.** ***This year we've added two additional factors:*** (7) Board Composition and (8) Board Policy, while also expanding the scope of our Board Independence factor (5) – in collaboration with corporate governance consulting firm **Penmon**.

Superior Governance Translates To Outperformance:

- Companies with the ***strongest corporate governance*** scores (KEX, TRTN, MATX, GLOG, SBLK, EGLE, AVANCE, OSG, INSW, ASC, NVGS, EURN, and TGH) ***outperformed*** the group by 9% on a 3-year basis and 35% on a 5-year basis.
- Companies with the ***weakest corporate governance*** scores (STNG, NNA, DLNG, CPLP, CMRE, DSX, DCIX, SB, ESEA, TNP, GASS, DAC, and DRYS) ***underperformed*** the group by **(18%)** on a 3-year basis and **(25%)** on a 5-year basis.

Michael Webber, CFA, Senior Analyst
Senior Analyst|212-214-8019
michael.webber@wellsfargo.com

Donald D. McLee, Associate Analyst
Associate Analyst|212-214-8029
donald.mclee@wellsfargo.com

Hillary Cacanando, CFA, CPA, Associate
Associate Analyst|212-214-8040
hillary.cacanando@wellsfargo.com

Donald Bogden, Associate Analyst
Associate Analyst|212-214-8037
donald.bogden@wellsfargo.com

Please see page 19 for rating definitions, important disclosures and required analyst certifications. All estimates/forecasts are as of 05/15/17 unless otherwise stated. 05/14/17 23:55:41 ET

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- **What Is The Wells Fargo Shipping Scorecard?** Our scorecard ranks the shipping universe on a number of Corporate Governance metrics (Page 6), with the ultimate goal of identifying high quality names based on those underlying factors – crystallizing a framework that has been core to our investment strategy and coverage, while also keeping conflicted companies/interests from relying on anonymity or indifference to perpetuate what's become a consistent headwind for the entire group.
- **Adjusting Our Framework.** Our previous Scorecards focused on 6 factors to provide a baseline for Corporate Governance within the Shipping space – with a significant focus on potential conflicts of interest – including (1) Related Party Commercial Management, (2) Related Party Technical Management, (3) Sale and Purchase (S&P) Fees, (4) Related Party Transactions, (5) Board Independence, and (6) a Subjective factor that we use to capture scale, scope and context beyond the binary nature of the our data set. ***This year we've added two additional factors:*** (7) Board Composition and (8) Board Policy, while also expanding the scope of our Board Independence factor (5).
- Our new methodology has been developed in collaboration with Penmon (www.penmon.com), an independent consulting firm specializing in Corporate Governance analytics, with the goal of adding more depth to our analysis of Board Structure, Composition, and Independence. (Page 8).
- **Changes:** We've added two names to our scorecard (INSW and GNK), replacing GSL and RIGP (roll-up), maintaining our total universe at 52 companies. Within our evolving framework, a company's score and corresponding rank represents a ***rolling average*** *over the past 12 months* which we believe will allow us to reasonably account for any ongoing changes to corporate structures.

The H117 Scorecard Results

Figure 1. Shipping Corporate Governance Scorecard Rankings – H117

H117 Corporate Governance Rankings (12 Month Rolling Avg)

KEX	1		Quartile 1	CKH	27		Quartile 3
TRTN	2			FRO	28		
MATX	3			CAI	29		
GLOG	4	↑		GMLP	30	↓	
SBLK	5	↑		GNRT	31		
EGLE	6	↑		SDLP	32		
AVANCE	7			NAP	33		
OSG	8			NMM	34		
INSW	9	*New*		GOGL	35		
ASC	10	↓		SSW	36	↑	
NVGS	11	↓		KNOP	37		
EURN	12			NM	38		
TGH	13			SALT	39	↑	
DHT	14	↓	Quartile 2	STNG	40	↑	Quartile 4
GNK	15	*New*		NNA	41	↓	
LPG	16			DLNG	42		
BWLPG	17			CPLP	43	↑	
NAT	18	↓		CMRE	44		
TNK	19			DSX	45		
TK	20			DCIX	46		
GLOP	21			SB	47		
SFL	22	↑		ESEA	48		
HMLP	23			TNP	49		
TGP	24			GASS	50		
GLNG	25			DAC	51		
TOO	26			DRYS	52		

Source: Wells Fargo Securities, LLC estimates

Notes & Outliers

- The companies that had the **strongest** corporate governance scores within our framework were **KEX, TRTN, MATX, GLOG, SBLK, EGLE, AVANCE, OSG, INSW, ASC, NVGS, EURN,** and **TGH** as noted in Figure 1.
- The companies that had the **lowest** corporate governance scores within our model were **STNG, NNA, DLNG, CPLP, CMRE, DSX, DCIX, SB, ESEA, TNP, GASS, DAC,** and **DRYS** as noted in Figure 1.
- Our subjective input factor reflects history, frequency, and context that is inherently limited by the other data points. We note that excluding our subjective factor (which carries a 12.5% weighting), the results would have been largely the same. In fact:
    - *Excluding* our **subjective factor**, 12 out of the 13 top quartile (best ranked) names would have been the same.
    - *Excluding* our **subjective factor**, 12 out of the 13 bottom quartile (worst ranked) names would have been the same.
- **The Impact Of Revised Fee Structures: SSW, STNG, SALT, and CPLP.** All 4 names moved up in our rankings after removing various related-party fee structures from their platforms, with **SSW** and **SALT** moving into Quartile 3. Some of these were relatively minor fee removals that removed a binary headwind in our model (**CPLP**), others were partial (but significant) fee removals (**STNG, SALT**), and others were more sweeping, and included board changes as well (**SSW**). While we're well aware that a number of these fees (particularly the S&P fees) were *out of the money* or otherwise exhausted at these entities by the time of their removal, the fact that they were removed still alleviates that headwind in our model, with the full impact of the improved scores taking a full year to appear given our rolling-12 month rankings.
- **New Factor Impact: Top Of The List**. The additional/build-out of our Board Independence, Structure, and Policies factors had a noticeable impact on a few more prominent names. As was somewhat expected, the additional detail helped reshape the first quartile, with the additional factors *slightly* weighing on the scores of companies like **ASC** and **NVGS**, while supporting stronger scores for reemerging entities like **EGLE** and **SBLK**, and established entities like **GLOG**. While the new factors slightly rearranged our first quartile, the group's scores were still pretty tightly distributed, with a handful of names that skew towards the very top of our rankings, and 16-17 names (Quartile 1, top of quartile 2) that tend to comprise the top of our list, in some order.
- **New Factor Impact: Middle Of The List.** We think the impact on Quartile 2 and 3 companies was less noticeable. In general Marine GPs tended to fare better with the evaluation of the more nuanced best practices for Board Structure and Policies, and Marine MLPs (which tend to dominate the middle of our rankings) remain weighed down by the nature of their related party (parent) relationships, which are imbedded in their models.
- **New Factor Impact: Bottom Of The List.** The addition of more detail didn't particularly help names at the *very* bottom of our list (which was somewhat predictable), while the impact was mixed among some of the more solid operators that occupy Quartile 4. For instance, the scores for larger, more established names like **TNP** and **CMRE** are both significantly weighed down by their embedded related-party operating relationships, however the addition of more detail around board structure and policy actually helped **TNP's** scores, while they hurt **CMRE's.**
- Ultimately, we believe names like **SB, CMRE, TNP** are *stronger operators* than some of the companies above them in our rankings, however given the prominent weighting we give related party relationships within the model, from a numerical perspective, a move out of Quartile 4 is unlikely without evolving their board/operating structures.
- **Do We Look At Relative Costs Or Profitability? Sure, but not here.** We look at a mosaic of factors when determining our broader equity ratings, and governance is certainly one of those. For the purposes of this piece, **we've intentionally kept the scope relatively narrow (corporate governance)**, to focus on an idea/risk that's easily obfuscated or overrun by other dynamics like valuation and cyclicality. We know there's an argument that some conflicted or related-party structures may have competitive (or even superior) G&A, OPEX, or other efficiency gains. We hear it. A lot. And usually with a high degree of conviction from solid owners/operators. And while we don't dismiss those arguments, we come back to the broader point that it's simply a debate and an issue that public equity investors shouldn't have to entertain, and certainly not for free. Those legacy related-party relationships *may* save money in some cases, but we think there's a healthy (and growing) price-tag for the window they leave open for conflicts. **Ultimately, we believe the risk premiums associated with poor governance and capital stewardship can (and should) continue to widen, eventually pricing-out conflicted players or antiquated structures from the public markets.**

- Our scorecard doesn't measure intent, but rather whether certain avenues *exist* that could misalign with shareholder interests, hopefully providing a baseline from which investors can dig deeper. To that point, we think strong governance helps *minimize* the need for investors to delve into those kinds of vagaries, for which they're almost constantly at an informational disadvantage. In short, we won't be evaluating or adjusting our quantitative corporate governance factors for *intent* or *relative operating metrics*.
- **Changes To Our Rankings:**
  - **Quartile 1:** INSW is a new addition to our scorecard rankings and ranked in Quartile 1, while SBLK and EGLE moved into Quartile 1 from the top of Quartile 2 in our previous rankings.
  - **Quartile 2:** GNK is another addition to our scorecard rankings, with its initial score ranking towards the top end of Quartile 2, while the DHT, LPG and NAT all slid from Quartile 1 into Quartile 2. We also note that SFL has moved up from the top of Quartile 3 into Quartile 2. We note that scores for the top 15-16 companies are relatively tightly clustered, and we don't view those moves as particularly material.
  - **Quartile 3:** The updated scores for GMLP and FRO shifted them to the top of Quartile 3 from Quartile 2 in our H117 rankings, while SSW's improved score following the removal of its fee arrangements moved it from the top of Quartile 4 into Quartile 3, with SALT and STNG also moving up to the bottom of Quartile3/top of Quartile 4 following their fee removals.
  - **Quartile 4:** For Quartile 4, the inclusion of INSW and GNK helped shift NNA and CMRE to the top of Quartile 4. We note a ***material*** gap between the very bottom of our rankings (DRYS, GASS, etc.) and the majority of Quartile 4, whose scores are (on average) much closer to Quartile 3 than the bottom of the lower-end of Quartile 4.

Recent Developments

Figure 2. Recent (Select) Company Specific Changes - Summary

Ticker	Commentary
SSW	SSW eliminated its transaction fees and terminated its financial services agreement with Gerry Wang (CEO) and Graham Porter (former Board Member), while also appointing David Sokol to the Board as an independent Director. Graham Porter was replaced on SSW's Board by Larry Simkins (President & CEO of the Washington Group).
DHT	As part of its acquisition of BW Group's VLCCs, DHT has appointed Carsten Mortensen, CEO of BW Group, to its BoD with the right to appoint another director in H217. In response to FRO's merger attempts, DHT's Board has adopted a one-year shareholder rights plan (or poison pill) intended to prevent an outright hostile takeover of DHT (by FRO or anyone else) through the open market. While certainly a complex scenario, we view the poison pill as unfriendly to common shareholders.
TK/TGP/TOO	Peter Evensen resigned as President and CEO of the Teekay Group, replaced by Kenneth Hvid as CEO of TK, while Ingvild Saether was appointed President and CEO of Teekay Offshore Group (replacing Kenneth Hvid), and Mark Kremin was appointed President and CEO of Teekay Gas Group. Additionally Sean Day will be stepping down from his Chairman role at TK and TOO in June 2017, and will be replaced by current Director William Utt.
CPLP	In January, CPLP's sponsor waived 1) the Sale & Purchase fee (1%), and 2) the commercial services fee (1.25%) on CPLP's three legacy crude tanker vessels (MT Aias, MT Miltiadis, MT Amoureux) acquired from its merger with Crude Carriers in 9/2011. **We view the removal as a positive and proactive move on Capital's behalf.**
NMM	NMM agreed to purchase from Navios Holdings (NM) a 47.5% participation interest in certain loan facilities (12.7% interest, 12/2023 maturity) that NM previously made to Navios Europe. The $27MM purchase price was funded by $4.1MM cash payment to NM, with the remainder paid via ~13MM of NMM common units. While appearing somewhat benign, the related party (public) nature of the shift is worth noting.
NAT	In its most recent annual report, NAT disclosed a material weakness was discovered in its internal financial reporting, leading NAT's auditors to determine the company operated with ineffective controls/procedures during 2016. In light of that material weakness, NAT has completed substantive procedures, including a detailed review of accounting/budgeting controls. While the extent/nature of the material weakness were not fully disclosed, we view this development as an incremental negative for NAT's corporate governance track record.

Source: Company filings, Wells Fargo Securities, LLC

Containerships

- **SSW Board Changes.** SSW appointed Larry Simkins to its Board of Directors, to replace Graham Porter following his resignation. Mr. Porter is one of SSW's co-founders and its second largest shareholder (5% equity stake), and was a strong voice on SSW's board**,** while Larry Simkins is the current President, CEO and Director of the Washington Companies (WashCo), SSW's largest shareholder (~50% equity stake). Additionally SSW anticipates increasing its number of Board seats to 9 directors (up from 8), with WashCo nominating David Sokol to fill the additional seat pending the results of SSW's 2017 annual general meeting.

- **SSW Also Announced Revised/Eliminated Fee Agreements With Both Gerry Wang (CEO, Co-Chairman, And Co-Founder) And Graham Porter**. SSW eliminated Gerry Wang's 1.25% transaction fee on S&P activity and terminated its related party fee arrangement for newbuild financing and secondhand purchases (0.6% – 1.25% fee) with Seaspan Financial Services (controlled by Graham Porter). We view the board changes and revised fee structures as positive developments for shareholders that should improve the quality of SSW's corporate governance controls.

- **The removal of those fees was the single biggest contributor to SSW's move up from Quartile 4 to Quartile 3 in our most recent rankings.**

Tankers

- **DHT Adding Board Seats As Part Of BW Group Acquisition.** On 3/23 DHT announced an agreement with BW Group to acquire 11 Very Large Crude Carriers, with DHT financing the transaction via a combination of cash and equity - issuing 32MM common shares to BW Group along with 15,700 preferred shares that are carry mandatory conversion into 15.7MM shares of DHT common stock. On an adjusted basis, BW Group will own ~33.5% of DHT's outstanding shares, becoming DHT's largest shareholder. **BW Group has been granted customary rights, including the right to appoint two directors to DHT's Board of Directors** (with Carsten Mortensen, CEO of BW Group already appointed).

  - **DHT Adds Poison Pill.** In response to FRO's merger attempts, DHT's Board adopted a one-year shareholder rights plan, declaring a dividend of one preferred share purchase right for each share of DHT common stock. The plan (or poison pill) is intended to prevent an outright hostile takeover of DHT (by FRO or anyone else) through the open market. The rights will become exercisable if an entity acquires 10% ownership of DHT's common stock (15% or more in the case of passive institutional investors), **we generally view the defensive poison pill as unfriendly to shareholders.**

- **TNK** announced on 2/23/17 that Kenneth Hvid, President and CEO of Teekay Corporation (replacing Peter Evensen) was appointed to TNK's Board following Peter Evensen's retirement, inline with expectations around the timing of a transition (with TK announcing Peter Evensen's retirement in Oct-16). While worth noting, this has not positively or negatively impacted TNK's scoring.

- **Navios Group:** In Sept-16, NNA formalized a $70MM loan to its parent entity (after withdrawing a previous loan which had provisions/pricing more favorable to NM in reaction to a shareholder lawsuit and market feedback). The loan is secured by NM's holdings in NNA, as well as 78.5% of NM's interest in Navios South American Logistics. While we believe the loan has been a material headwind for the Navios group – and it's certainly reflected in our scorecard rankings; the Navios Group has previously enjoyed a better track record. We think repricing the loan was a step in the right direction; however there remains a (reasonable) argument to be made that no loan should have been made at all. Ultimately, we believe management has made messaging clear that it has a high degree of conviction in the necessity of the survival of each Navios entity and while we don't expect this debate to completely subside anytime soon, we note recent improvements in Dry Bulk fundamentals have lent a degree of credibility to that argument.

- **NAT**: In its most recent annual report, NAT disclosed a material weakness was discovered in its internal financial reporting, leading NAT's auditors to determine the company operated with ineffective controls/procedures during 2016. In light of that material weakness, NAT has completed substantive procedures, including a detailed review of accounting/budgeting controls. While the extent/nature of the material weakness were not fully disclosed, we view this development as an incremental negative for NAT's corporate governance track record.

- **STNG/SALT** began to actively and tangibly address corporate governance concerns last year; on 9/29/16, Scorpio announced it amended its Administrative Services Agreement with Scorpio Ship Management (SSM) and Scorpio Commercial Management (SCM) which **1) eliminated 1% sale and purchase fee, and 2) reduced the notice period to terminate the commercial/technical management agreements from 2 years to 3 months, with a fee equal to 3 months payable to SCM and SSM upon termination**. However, we note commercial/technical related third party agreements remain in place.

Marine GPs/MLPs

- **TK/TGP/TOO** announced the appointment of Kenneth Hvid as President and CEO of Teekay Corporation (replacing Peter Evensen), along with the appointments of Ingvild Sæther as President and CEO of Teekay Offshore Group (replacing Kenneth Hvid), and Mark Kremlin as President and CEO of the newly formed Teekay Gas Group during Q4. TK and TOO also underwent changes at the Board of Director level, with William Utt assuming the Chairman seat at both TK and TOO (replacing Sean Day), while George Watson retired from his TK board seat after an 11-year tenure.

- **NMM:** In Feb-17, NMM agreed to purchase NM's 47.5% participation interest in loan facilities previously funded by NM to Navios Europe Inc. for $27MM. The consideration paid by NMM to NM will be $4.0MM in cash and the issuance of 13.1MM common units of NMM to NM. NMM may require NM to repurchase the loans after the third anniversary of the data of the sale based on the then outstanding balance of the loans.

Updated Corporate Governance Methodology

- In our previous Corporate Governance rankings, we identified five factors to capture some of the basic elements of corporate governance and conflicts of interest, particularly as they pertain to shipping. Specifically we used **(1) Related Party Commercial Management, (2) Related Party Technical Management, (3) Sale and Purchase (S&P) Fees,** the history of **(4) Related Party Transactions,** as well as the **(5) Independence Level of Boards**.

- This year for the first time, we are expanding the scope of our analysis to include several additional measures to evaluate how a Board of Directors is composed/structured, as well as its functions and policies, **with the overarching goal of evaluating their alignment with shareholders.** Specifically, we've added two factors: **(1) Board Composition** and **(2) Board Policy** to our scorecard, while also adding additional criteria to another factor, **(3) Board Independence,** to help give the evaluation more depth and context. Several of the additions to our methodology have been developed using data from **Penmon (*www.penmon.com*)**, an independent firm specializing in Corporate Governance analytics. Penmon's analytics have been incredibly helpful in evaluating best practices, digging deeper into board composition, and developing a better perspective on the broader subject. Please see Page 9 for more details on Penmon, and their breakdown of the Shipping space and how it compares to other prominent companies and sectors.

Figure 3. Our Current And Previous Corporate Governance Scorecard Factors

	Previous Corporate Governance Factor	Weight
Factor #1	Related Party Commercial Management	17%
Factor #2	Related Party Technical Management	17%
Factor #3	Sale And Purchase Fees	17%
Factor #4	Related Party Transactions	17%
Factor #5	Independent Board Membership	17%
Factor #6	Subjective	17%

	Current Corporate Governance Factor	Weight
Factor #1	Related Party Commercial Management	12.5%
Factor #2	Related Party Technical Management	12.5%
Factor #3	Sale And Purchase Fees	12.5%
Factor #4	Related Party Transactions	12.5%
Factor #5	Board Independence	15.0%
Factor #6	Board Composition	10.0%
Factor #7	Board Policy	12.5%
Factor #8	Subjective	12.5%

Source: Wells Fargo Securities, LLC

- Under the new methodology, we continue to scrutinize related party relationships, while expanding our Board Independence measures to analyze Executive Chairman roles, Board Tenure and Executive Sessions in addition to the level of Independent Board Membership. For board composition we analyze the diversity of perspectives across gender and age, while also taking into account if directors hold multiple board seats at other companies and the board committee structure. Finally for corporate governance functions and policies we take into consideration if Board terms are staggered, if shareholders have limited voting rights and if there are any poison pills or blank check preferred stock in place. We have included our in-depth thoughts on each factor below:

Consistent Criteria

- **Factor #1: Related Party Commercial Managers (12.5%).** Commercial management covers the marketing, chartering, operations, and trading of vessels in the spot or time-charter market. While commercial management can be provided by wholly owned subsidiaries; it is common place in the industry for companies to outsource commercial management to third-party managers who charge a daily fee on a per vessel basis (with those fees ranging widely from $300 - $2,000/day across our Shipping universe). These management agreements can be with either public or private managers, which may be either related or unrelated parties, potentially creating conflicts of interest given the difficulty of comping the value of services within these arrangements. Commercial relationships with wholly owned subsidiaries or to unrelated third parties generally provide the least degree of potential conflicts of interest, while related party management presents higher potential risk for shareholders given those conflicts. Within related party commercial management structures, we believe the degree of the risks from conflicting interests are partially offset via public-to-public relationships given the greater degree of visibility on both ends of the agreement, while we view public-to-private related party arrangements as the least desirable. Additionally, given the presence of related party management relationships as an inherent aspect of the GP/MLP structure, our related party commercial management factor rankings are less punitive across the GP/MLP group so far as the arrangements are within the bounds of the typical GP/MLP relationship, and both entities are public.

- **Factor #2: Related Party Technical Managers (12.5%).** Technical management includes providing vessel maintenance, arranging and supervising newbuilding construction, dry-docking, repairs, capital improvements, and maintaining vessel safety management systems. While technical management can be provided internally by wholly owned subsidiaries; it is common place in the industry for companies to outsource technical management to either related or unrelated third-party managers who charge a daily fee on a per vessel basis (with those fees ranging widely from $250 - $1,000/day across our Shipping universe). Relationships with wholly owned subsidiaries or to unrelated third parties generally provide the least degree of potential conflicts of interest, while related party management presents a higher degree of potential risk for shareholders. We believe the degree of the risks from conflicting interests are partially offset via public-to-public relationships given the greater degree of visibility on both ends of the agreement, while we view public-to-private related party arrangements as the least desirable. As with commercial management, the presence of related party management relationships is an inherent aspect of the GP/MLP structure, our related party factor rankings are less punitive across the GP/MLP group, and both entities are public.

- **Factor #3: Sale And Purchase Fees (12.5%).** Shipping companies often have Sale & Purchase fee arrangements, whereby management directly (or indirectly via a related third-party) receives a fee for any newbuild orders, asset sales, or purchases at the company level, with these S&P fees typically ranging from 1-1.25% of the total transaction value. We view the presence of these S&P fee arrangements as a major red flag, and a reflection of lower quality corporate governance given weaker alignment of shareholder and management interests. We believe S&P arrangements between related parties often incentivize investment decisions based on deal size and frequency, rather than returns.

- **Factor #4: Related Party Transactions (12.5%).** We also scrutinize related party transactions, as we believe they create similar (very significant) conflicts of interest for management, with the potential for transaction values to deviate from market prices given the incentives for premium valuations charged between the two parties (and higher risk). This most readily presents itself via acquisitions from private fleets or related entities, with a number of Dry Bulk, Tanker, and Containership owners acquiring or selling assets to their personal fleets. DRYS comes to mind, with DSX, TNP, and others all recently transacting with a private arm. This also includes real estate and other assets.

PENMON
Corporate governance analytics

New Or Adjusted Criteria (Via Penmon)

- **Factor #5: Board Independence (15%).** We view board independence as a factor that is highly reflective of strong corporate governance controls. As such we believe it is important to differentiate between the varying levels of independent board membership across the shipping space. Additionally, within our recent scorecard rankings we have expanded our underlying variables from solely independent board membership to also reflect executive participation at the Board level and board member tenures.

- **Rationale:** We favor active, knowledgeable boards that are heavily weighted with independent directors. Boards run by insiders are more easily "captured" by management or otherwise promote interests that run counter to those of equity holders. Longer tenure of board members can improve the board's grasp of the company's business and strengthen their ability to challenge management. However, this rule of thumb is subject to diminishing returns: beyond a certain point, (10 years or longer in our model), high average tenure implies a lack of director turnover which may undermine the independence of the board.

- **Variables:**

(1) *Separated Chairman + CEO Roles:* We view separated Chairman and CEO roles as indicative of higher quality corporate governance, and penalize companies with an Executive Chairman role.

(2) *Executive Chairman And No Lead Director:* If there is an Executive Chairman role, we believe a Lead Independent Director in conjunction with the Executive Chairman role is indicative of higher quality corporate governance.

(3) *Degree of Board Independence:* We view a higher degree of Independent Directors as indicative of higher quality corporate governance, as it increases the likelihood of objectivity. We have compiled the independent board membership percentages across our universe into quartiles, with companies that have lower independent directorship percentages receiving more punitive scores in our model.

(4) *Length of Board Member tenure:* We tend to view shorter Board Member tenures as indicative of higher quality corporate governance as they help prevent stale and trenched directorships – many of which tend to be non-independent. That said, we note that there is also a trade-off between length of tenure and experience.

(5) *Existence of Executive Sessions:* We believe Board Members should participate in Executive Sessions that exclude management, and we penalize companies that lack Executive Sessions in our model.

- **Factor #6: Board Composition (10.0%).** We view the actual composition of a Board as a meaningful factor for perspectives and a diversity of skill sets that are generally a well-regarded best practice. While we believe Board Composition is very important (hence its inclusion), given how many basic and fundamental governance issues exist within the shipping space, we've modestly lowered this factors weighting relative to some others.

- **Variables:**

(1) *Utilization Of Specialized Committees:* Committees allocate specialized tasks such as the oversight of executive compensation to groups of directors. The committee structure will depend on the circumstances and priorities of a company.

(2) *Overboarding:* We believe Directors that hold multiple seats can impact the quality of corporate governance should it lead to insufficient time to fulfill their Board duties. To quantify this factor we have measured the average number of Board seats held by each company's Director, compiled the data into Quartiles and assigned the most punitive scores to companies with a higher number of "overboarded" Directors.

(3) *Age Diversity:* We view diversity across age ranges as another effective measure of adding perspective in support of higher quality corporate governance. As such, we have compiled the standard deviation of the age members across each company's Board of Directors into quartiles and we penalize companies with more concentrated age ranges.

(4) *Gender Diversity:* Diversity can enhance Board effectiveness by adding different perspectives and vantage points. As such we have a binary gender diversity variable within our model.

- **Factor #7: Board Policy (12.5%).** We view the limitation of shareholder rights as one of the more important topics within corporate governance as companies can limit shareholder rights by conferring disproportionate voting rights to certain classes of shareholders. While such policies may protect directors from short-term activist investors seeking changes, they also restrict the ability of ordinary shareholders to hold management accountable, while most research also suggests that provisions that limit shareholder power contribute to lower valuations.

- **Variables:**

(1) *Staggered Board:* We believe a staggered board limits the ability of shareholders to hold directors accountable by having directors serve multiple-year terms at a time. Annual reelection or something similar tends to be best-practice here.

(2) *Limited Shareholder Voting Rights:* We generally view limited shareholder voting rights arrangements as factors contributing to lower quality corporate governance, with those arrangements having a punitive impact on the Corporate Governance scores in our model.

(3) *Stockholder Rights Agreement/Poison Pill:* We generally view Poison Pills or other aggressively defensive mechanisms as unfriendly to common shareholders.

(4) *Blank Check Preferred Stock:* Similarly we generally view Blank Check Preferred Stock as an aggressively defensive mechanism that is unfriendly to common shareholders.

- **Factor #8: Subjective (12.5%).** For our final factor, we assess dynamics that may be difficult to quantify amid our primary inputs, including history, context, and scale, as we believe the binary nature of some of the data does not fully capture every dynamic.

- **About Penmon.** Penmon is a consulting firm that aims to transform how companies engage with corporate governance issues. Penmon is building a proprietary platform that uses data science to uncover insights into the corporate governance of companies. Penmon offers a range of related advisory services, from corporate governance audits to the development of shareholder engagement strategies. Penmon's offices are located in New York City. For more information, please visit www.penmon.com, call (646) 481-1244, or e-mail contact@penmon.com.

PENMON
Corporate governance analytics

Corporate Governance Quality & Returns

- **Better Corporate Governance Has Led To Better Performance.** As noted in Figure 4, companies in **Quartile 1 have significantly outperformed** Quartiles 2-4, **with an average total return of 15% over the past 5-years**, compared to an **average 5-year total return of -32% for Quartiles 2-4** (vs. the 5-year total return for the S&P 500 of 86%). While we believe cyclical pressure has impacted those 5-year return totals across the board, we believe the **35% relative outperformance** (on a 5-year basis) reflects the general idea that higher degrees of corporate governance tend to lead to (or at least be consistently associated with) better returns.

Figure 4. Price, Performance, And Rating By Quartile Rank

May 2017 Shipping Corporate Governance Rankings

Marine companies with top-tier corporate governance have Outperformed on a ytd and 5-year basis

			Price	% Total Return				
	Ticker	Rating	5/12/17	YTD	1 Year	3 Year	5 Year	Since Inception/10-Year[1]
Quartile 1	KEX	Market Perform	$67.45	1%	0%	-39%	32%	79%
	TRTN	Outperform	$30.51	97%	N/A	N/A	N/A	107%
	MATX	Market Perform	$30.54	-13%	1%	32%	N/A	23%
	GLOG	Outperform	$13.85	-12%	24%	-34%	73%	31%
	SBLK	Not Rated	$8.21	61%	N/A	N/A	N/A	87%
	EGLE	Not Rated	$4.88	-17%	-54%	N/A	N/A	-38%
	AVANCE	Market Perform	$2.73	-12%	-47%	-69%	N/A	-55%
	OSG	Not Rated	$3.34	-13%	-21%	N/A	N/A	-54%
	INSW	Not Rated	$20.43	46%	N/A	N/A	N/A	58%
	ASC	Outperform	$7.95	7%	-10%	-36%	N/A	-33%
	NVGS	Outperform	$8.90	-4%	-39%	-64%	-11%	-32%
	EURN	Outperform	$7.91	-4%	-13%	-8%	36%	-59%
	TGH	Market Perform	$11.40	53%	-6%	-66%	-57%	12%
	Average			***15%***	***-17%***	***-35%***	***15%***	***10%***
Quartile 2	DHT	Market Perform	$4.54	11%	-9%	-22%	-26%	-84%
	GNK	Not Rated	$10.38	41%	100%	N/A	N/A	-95%
	LPG	Market Perform	$8.75	7%	-1%	-57%	N/A	-53%
	BWLPG	Market Perform	$4.22	0%	-9%	-32%	N/A	18%
	NAT	Market Perform	$7.27	-11%	-42%	15%	-17%	-57%
	TNK	Market Perform	$1.98	-11%	-40%	-37%	-40%	-76%
	TK	Market Perform	$7.44	-6%	-15%	-86%	-68%	-82%
	GLOP	Outperform	$22.85	16%	35%	11%	N/A	13%
	SFL	Not Rated	$13.90	-3%	2%	4%	44%	19%
	HMLP	Not Rated	$19.25	6%	21%	N/A	N/A	8%
	TGP	Outperform	$16.85	19%	21%	-54%	-37%	-9%
	GLNG	Outperform	$27.27	19%	60%	-35%	-7%	159%
	TOO	Market Perform	$4.48	-8%	-19%	-84%	-76%	-70%
	Average			***6%***	***8%***	***-34%***	***-28%***	***-24%***
Quartile 3	CKH	Not Rated	$64.58	-9%	18%	-19%	3%	7%
	FRO	Market Perform	$6.33	-9%	-6%	0%	0%	0%
	CAI	Market Perform	$19.68	127%	179%	-11%	5%	31%
	GMLP	Market Perform	$21.11	-8%	37%	-12%	11%	40%
	GNRT	Not Rated	$5.32	19%	-25%	N/A	N/A	-61%
	SDLP	Underperform	$3.00	-27%	-33%	-86%	N/A	-80%
	NAP	Market Perform	$10.81	8%	8%	N/A	N/A	7%
	NMM	Market Perform	$1.70	21%	27%	-89%	-81%	-77%
	GOGL	Not Rated	$6.32	34%	86%	N/A	N/A	-70%
	SSW	Market Perform	$6.15	-29%	-59%	-65%	-45%	-57%
	KNOP	Market Perform	$22.55	0%	36%	11%	N/A	49%
	NM	Not Rated	$1.53	9%	104%	-82%	-44%	-75%
	SALT	Not Rated	$6.45	28%	79%	-94%	N/A	-94%
	Average			***12%***	***35%***	***-45%***	***-22%***	***-29%***
Quartile 4	STNG	Not Rated	$4.19	-7%	-18%	-45%	-7%	-59%
	NNA	Underperform	$1.65	0%	11%	-41%	-6%	-71%
	DLNG	Market Perform	$16.10	6%	31%	-8%	N/A	26%
	CPLP	Outperform	$3.41	12%	42%	-55%	-17%	-57%
	CMRE	Outperform	$7.49	38%	-11%	-56%	-18%	2%
	DSX	Market Perform	$3.80	26%	55%	-65%	-48%	-78%
	DCIX	Underperform	$0.45	-84%	-92%	-98%	-99%	-99%
	SB	Not Rated	$2.18	90%	130%	-72%	-62%	-81%
	ESEA	Market Perform	$1.14	-33%	-51%	-91%	-89%	-98%
	TNP	Outperform	$4.75	2%	-13%	-26%	15%	-73%
	GASS	Market Perform	$3.13	-7%	-35%	-70%	-44%	-77%
	DAC	Not Rated	$1.50	-43%	-52%	-75%	-63%	-94%
	DRYS	Not Rated	$5.07	-99%	-100%	-100%	-100%	-100%
	Average			***-8%***	***-8%***	***-62%***	***-45%***	***-66%***
	S&P 500		**$2,390.90**	**3%**	**17%**	**24%**	**80%**	**56%**

(1) 10-year performance used in lieu of since-inception data when applicable

Source: Capital IQ, Wells Fargo Securities, LLC

Figure 5. Shipping Corporate Governance Scorecard Rankings (H117)

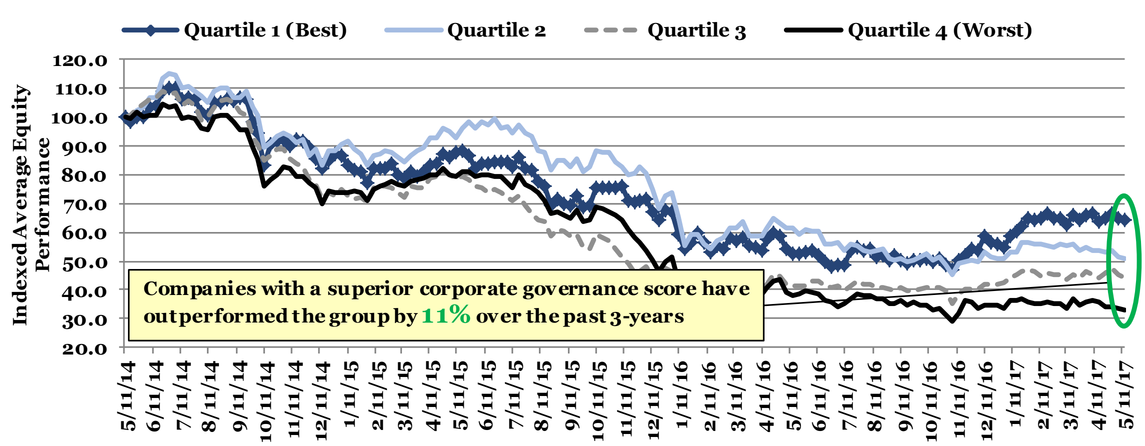
H117 Corporate Governance Rankings (12 Month Rolling Avg)

Ticker	Rank	Change	Quartile	Ticker	Rank	Change	Quartile
KEX	1		Quartile 1	CKH	27		Quartile 3
TRTN	2		Quartile 1	FRO	28		Quartile 3
MATX	3		Quartile 1	CAI	29		Quartile 3
GLOG	4	↑	Quartile 1	GMLP	30	↓	Quartile 3
SBLK	5	↑	Quartile 1	GNRT	31		Quartile 3
EGLE	6	↑	Quartile 1	SDLP	32		Quartile 3
AVANCE	7		Quartile 1	NAP	33		Quartile 3
OSG	8		Quartile 1	NMM	34		Quartile 3
INSW	9	*New*	Quartile 1	GOGL	35		Quartile 3
ASC	10	↓	Quartile 1	SSW	36	↑	Quartile 3
NVGS	11	↓	Quartile 1	KNOP	37		Quartile 3
EURN	12		Quartile 1	NM	38		Quartile 3
TGH	13		Quartile 1	SALT	39	↑	Quartile 3
DHT	14	↓	Quartile 2	STNG	40	↑	Quartile 4
GNK	15	*New*	Quartile 2	NNA	41	↓	Quartile 4
LPG	16		Quartile 2	DLNG	42		Quartile 4
BWLPG	17		Quartile 2	CPLP	43	↑	Quartile 4
NAT	18	↓	Quartile 2	CMRE	44		Quartile 4
TNK	19		Quartile 2	DSX	45		Quartile 4
TK	20		Quartile 2	DCIX	46		Quartile 4
GLOP	21		Quartile 2	SB	47		Quartile 4
SFL	22	↑	Quartile 2	ESEA	48		Quartile 4
HMLP	23		Quartile 2	TNP	49		Quartile 4
TGP	24		Quartile 2	GASS	50		Quartile 4
GLNG	25		Quartile 2	DAC	51		Quartile 4
TOO	26		Quartile 2	DRYS	52		Quartile 4

Source: Wells Fargo Securities, LLC estimates

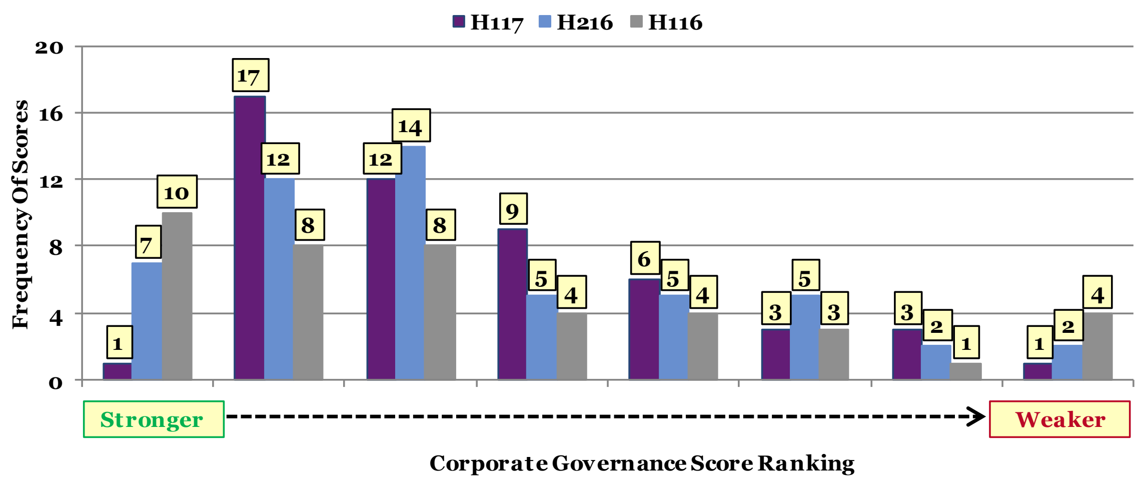
- **Stronger Corporate Governance Has Generally Been Associated With Stronger Returns.** As noted in Figure 6, our **Quartile 1 grouping** (KEX, TRTN, MATX, GLOG, SBLK, EGLE, AVANCE, OSG, INSW, ASC, NVGS, EURN, and TGH), **generally outperforming our other quartile groupings** (down 44% over the past three years), while our **Quartile 4 grouping** (STNG, NNA, DLNG, CPLP, CMRE, DSX, DCIX, SB, ESEA, TNP, GASS, DAC, and DRYS) which represents companies with the lowest degree of corporate governance amid our universe, **generally underperforming the other groups** (down 67% over the past three years).

Figure 6. Average Equity Performance By Corporate Governance Quartile Ranking



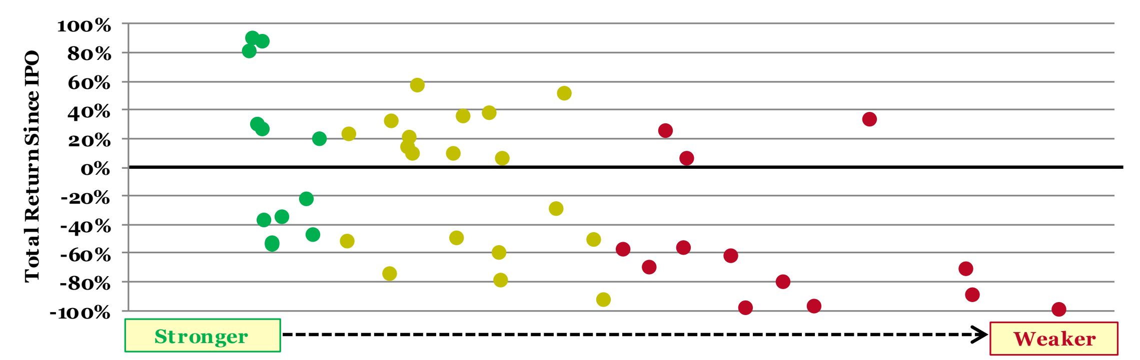
Source: Capital IQ, Wells Fargo Securities, LLC

Figure 7. Corporate Governance Score Distributions



Source: Company filings, Bloomberg, Wells Fargo Securities, LLC estimates

Figure 8. Total Return Since IPO Vs. Scorecard Ranking



Source: Company filings, Bloomberg, Wells Fargo Securities, LLC estimates

Scorecard Rationale

- The purpose of the scorecard is to provide a baseline, comparable quantitative and qualitative corporate governance ranking across the Marine universe. We use a proprietary factor model built on six quantitative and qualitative inputs that places Marine names into quartile rankings (Quartile 1 being our highest ranking in the model). Our model is centered on measuring corporate governance controls, with (1) related-party technical and (2) commercial management fees, (3) S&P fees, (4) related-party transactions, and (5) the level of independent board membership is evaluated. We also add a subjective factor (6) to capture dynamics, context, or risks that are missed by the inherently binary aspect of some of our metrics. Our model creates a cumulative value, or ranking for each company in each category, and, for example, if a Marine stock scores poorly (Quartile 4), we believe the corporate governance profile of that name should probably receive extra scrutiny. Thus, an investor would need to price this lower degree of corporate governance (and associated risk) appropriately (i.e., pay a lower price/valuation). In contrast, we believe Quartile 1 Marine names are more likely to fetch a relative valuation premium based on higher underlying quality indicated by our scorecard.

How Should The Scorecard Be Used?

- We believe our scorecard can be used as a tool to help evaluate degrees of corporate governance across shipping sectors and individual companies. While there are obviously dozens of risk factors and fundamentals on both a company and an industry basis that go into making an investment decision, we believe corporate governance is too often either overlooked or mispriced. All else equal, we believe companies in Quartile 1 generally screen more favorably than the lower quartiles, presenting stronger governance standards than many of their peers. Our primary goal for this scorecard is to help clients better understand the varying degrees of governance risk across the shipping space, enabling investors to differentiate among investment alternatives, and provide a relative baseline for further work.

What It Is Not?

- Our corporate governance scorecard **is not** an indication that an investor should only invest in Quartile 1 Shipping companies, as we believe governance is one factor among several risks or fundamentals to be considered, along with a specific investor's risk appetite and investment goals. We note that industry dynamics (be it Tankers, LNG, Containers, etc.) play a very large role in our formal, cumulative ratings and investment process, and are not necessarily captured within the narrower scope of this scorecard.

Ranking Methodology

Scorecard Step No.1: Evaluate Each Company Via Our Fundamental Scorecard Factors

- First, we calculate a fundamental score for each shipping company based on our eight-factor model, comparing relative degrees of corporate governance based on publicly available company data. The factors and weights are outlined in Figure 9 below.

Figure 9. Corporate Governance Scorecard Factors

	Current Corporate Governance Factor	Weight
Factor #1	Related Party Commercial Management	12.5%
Factor #2	Related Party Technical Management	12.5%
Factor #3	Sale And Purchase Fees	12.5%
Factor #4	Related Party Transactions	12.5%
Factor #5	Board Independence	15.0%
Factor #6	Board Composition	10.0%
Factor #7	Board Policy	12.5%
Factor #8	Subjective	12.5%

Source: Wells Fargo Securities, LLC

Scorecard Step No. 2: Compile the Factor Score and Ranking

- With each company scored or ranked according to the corporate governance factors mentioned in Step No. 1, we then proceed to compile an overall corporate governance score, based on the associated weights noted in Figure 9 above. First, we rank each shipping company based on the overall corporate governance score (compiled based on our 8 factors.). Second, we separate the group into quartiles based on the overall scorecard ranking utilizing each company's respective rolling average score.

Appendix

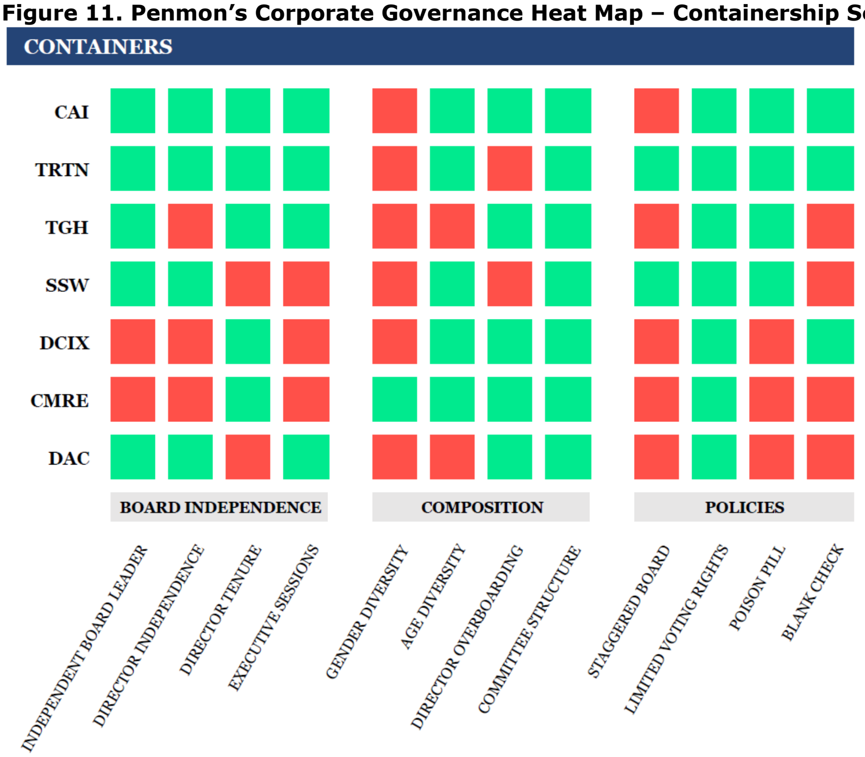
- To further supplement our Corporate Governance rankings, we have provided a detailed summary of our factor inputs (Commercial/Technical Management, S&P fees, Related Party Transactions, Independent Board Membership and our Subjective factor) to an individual company level.

Figure 10. Company Specific Corporate Governance Overview

			Related Party				
Ticker	Sector	Quartile	Commercial Management Fees	Technical Management Fees	S&P Fees / Commissions	Asset Transactions	% Indep. Board Membership
TGH	Container	1	No	No	No	No	29%
CAI	Container	3	No	No	No	Yes	43%
CMRE	Container	4	Yes	Yes	Yes	No	40%
SSW	Container	3	No	No	No	No	67%
DCIX	Container	4	Yes	No	Yes	No	57%
TRTN	Container	1	No	No	No	No	78%
DAC	Container	4	Yes	Yes	Yes	Yes	67%
SBLK	Dry Bulk	1	No	No	No	No	88%
DSX	Dry Bulk	4	No	No	Yes	Yes	67%
ESEA	Dry Bulk	4	Yes	Yes	Yes	No	63%
SB	Dry Bulk	4	Yes	Yes	Yes	Yes	43%
SALT	Dry Bulk	3	Yes	Yes	No	No	71%
DRYS	Dry Bulk	4	Yes	Yes	Yes	Yes	67%
EGLE	Dry Bulk	1	No	No	No	No	86%
GOGL	Dry Bulk	3	No	Yes	No	Yes	60%
GNK	Dry Bulk	2	No	No	No	No	78%
GLNG	Marine GP	2	No	No	No	Yes	86%
GLOG	Marine GP	1	No	No	No	No	50%
TK	Marine GP	2	No	No	No	No	78%
NM	Marine GP	3	No	No	No	Yes	57%
GLOP	Marine MLP	3	Yes	Yes	No	Yes	57%
GMLP	Marine MLP	3	Yes	Yes	No	Yes	86%
TGP	Marine MLP	2	Yes	Yes	No	Yes	80%
TOO	Marine MLP	2	Yes	Yes	No	Yes	80%
NAP	Marine MLP	3	Yes	Yes	No	Yes	57%
NMM	Marine MLP	3	Yes	Yes	No	Yes	57%
SDLP	Marine MLP	3	Yes	Yes	No	Yes	83%
KNOP	Marine MLP	3	Yes	Yes	No	Yes	86%
CPLP	Marine MLP	4	Yes	Yes	No	Yes	50%
HMLP	Marine MLP	2	Yes	Yes	No	Yes	71%
DLNG	Marine MLP	4	Yes	Yes	No	Yes	40%
AVANCE	LPG	1	No	No	No	No	100%
NVGS	LPG	1	No	No	No	No	86%
LPG	LPG	2	No	No	No	No	71%
BWLPG	LPG	2	Yes	Yes	No	Yes	100%
GASS	LPG	4	Yes	Yes	Yes	Yes	60%
INSW	Tankers	1	No	No	No	No	89%
EURN	Tankers	1	No	No	No	No	90%
ASC	Tankers	1	No	No	No	No	88%
DHT	Tankers	2	No	No	No	No	100%
OSG	Tankers	2	No	No	No	No	90%
NAT	Tankers	2	No	No	No	No	80%
TNK	Tankers	2	No	Yes	No	Yes	67%
FRO	Tankers	3	No	No	No	Yes	50%
GNRT	Tankers	3	Yes	No	No	No	71%
NNA	Tankers	4	Yes	Yes	No	Yes	57%
TNP	Tankers	4	Yes	Yes	Yes	Yes	80%
STNG	Tankers	4	Yes	Yes	No	No	63%
SFL	Tankers	2	Yes	Yes	No	Yes	100%
CKH	US Marine	3	No	No	No	Yes	57%
KEX	US Marine	1	No	No	No	No	78%
MATX	US Marine	1	No	No	No	No	88%

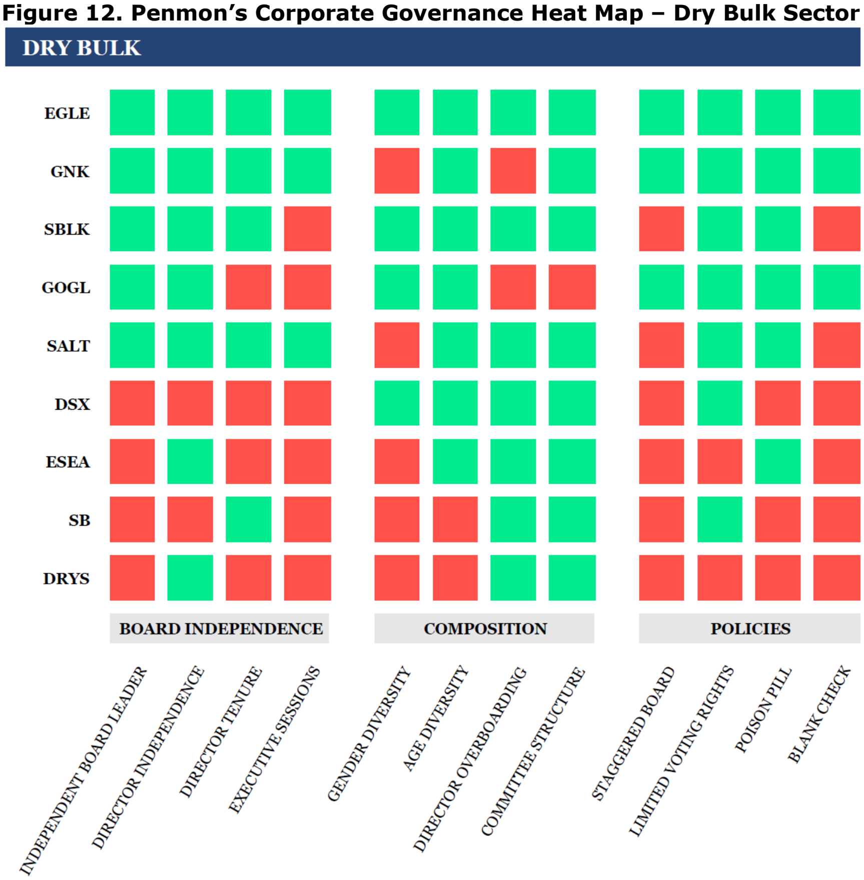
Source: company filings, Wells Fargo Securities, LLC estimates

Figure 11. Penmon's Corporate Governance Heat Map – Containership Sector



Source: Penmon

Figure 12. Penmon's Corporate Governance Heat Map – Dry Bulk Sector

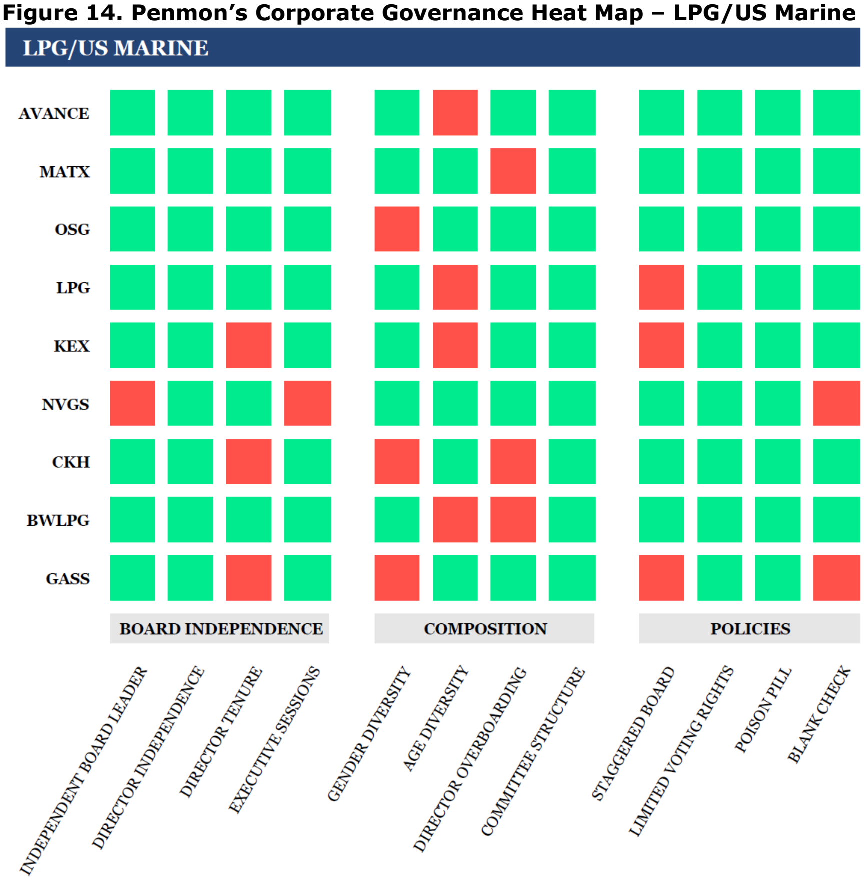


Source: Penmon

Figure 13. Penmon's Corporate Governance Heat Map – Marine MLPs/GPs

Source: Penmon

Figure 14. Penmon's Corporate Governance Heat Map – LPG/US Marine Sectors



Source: Penmon

Figure 15. Penmon's Corporate Governance Heat Map – Tanker Sector

Source: Penmon

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3=Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

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M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.
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As of: May 14, 2017

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