

A Schulman, Inc. SHLM (NAS)

Last Close	Industry	Sector
26.45 USD	Specialty Chemicals	Basic Materials

Profile

Pricing data through 10 Feb 2012

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A. Schulman, Inc. was organized as an Ohio corporation in 1928 and changed its state of incorporation to Delaware in 1969. It is an international supplier of high-performance plastic compounds and resins. A. Schulman is a global plastics compounder, specializing in multi-component blends that include polyolefins, nylons, elastomers, ionomers and ABS (acrylonitrile butadiene styrene). A. Schulman operates three lines of business: engineered plastics, masterbatch and distribution services. The Company's segments are Europe, North America Masterbatch ("NAMB") (previously, referred to as North America Polybatch or NAPB), North America Engineered Plastics ("NAEP"), North America Distribution Services ("NADS") (which includes rotomolding) and Asia. Its activities in each of its business segments could be classified into five main product families: color and additive concentrates; engineered compounds; polyolefins; PVC; and tolling. The Company's color and additive concentrates business consists of the compounding of resins that provide plastic with specific color and/or physical properties, such as conductivity, flexibility, viscosity and textures. Its engineered compounds are products designed to have and maintain characteristics such as chemical resistance, electrical conductivity, heat resistance and/or high strength-to-weight ratios. The Company's polyolefin business consists of numerous polypropylene and polyethylene resins and compounds. The Company's PVC business, under the name Polyvin (r), involves the formulation of compounds and elastomers to introduce product attributes, including weatherability, consistency, ease of processing, material flexibility, and high-gloss or low-gloss finish. The Company provides tolling services, mainly in Europe, as a fee for processing of material provided and owned by customers. The research and development centers are in Sindorf, Germany and Akron, Ohio. The Company competes with producers of basic plastic resins, many of which also operate compounding plants, as well as other independent plastic compounders. Its operations on and ownership of real property are subject to environmental, health and safety laws and regulations at the national, state and local governmental levels.

A Schulman, Inc. SHLM

Sales USD Mil 2,215 **Mkt Cap USD Mil** 778 **Industry** Specialty Chemicals **Sector** Basic Materials

A. Schulman engineers, manufactures, and distributes various plastic resins and compounds, which are used as raw materials for household goods, packaging, toys, sporting goods, and automotive parts, among other things. The company takes basic plastic compounds such as polyvinyl chloride (PVC) and polyethylene and engineers them to maintain certain properties desired by its clients, such as lasting color, flexibility, electrical conductivity, and heat resistance.

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Akron, OH 44333
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Website: <http://www.aschulman.com>

Employees: 3000

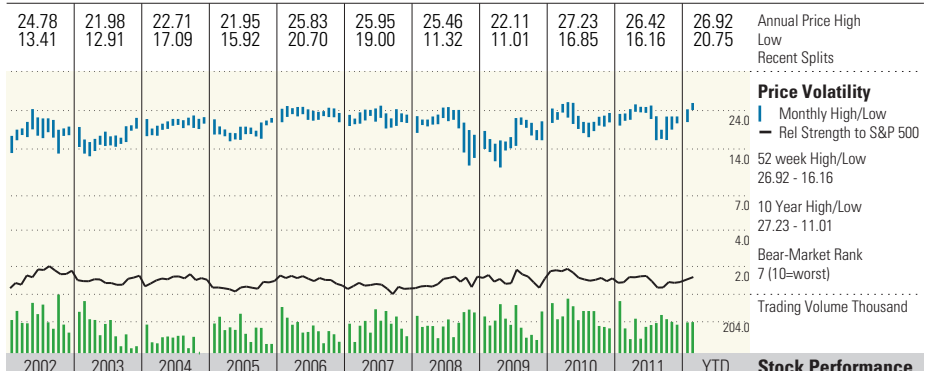
Growth Rates	Compound Annual			
	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	37.9	3.4	6.3	8.4
Operating Income %	43.9	3.4	-4.3	5.4
Earnings/Share %	-16.5	26.0	4.3	11.9
Dividends %	3.3	1.7	1.3	1.4
Book Value/Share %	15.6	3.6	5.1	5.0
Stock Total Return %	18.3	22.9	7.7	6.2
+/- Industry	16.9	-12.9	-6.1	-20.9
+/- Market	16.7	5.4	9.1	4.7

Profitability Analysis	Current	5 Yr Avg	Ind	Mkt
	Return on Equity %	9.0	5.4	19.8
Return on Assets %	4.0	2.5	8.1	9.5
Fixed Asset Turns	9.5	8.7	3.6	7.5
Inventory Turns	7.5	7.0	6.7	16.1
Revenue/Employee USD K	738.3	639.7*	—	1049.9
Gross Margin %	12.9	12.9	22.3	38.3
Operating Margin %	2.7	2.3	10.6	16.7
Net Margin %	2.0	1.3	7.0	11.2
Free Cash Flow/Rev %	1.9	—	4.1	0.1
R&D/Rev %	—	—	—	9.7

Financial Position	08-11 USD Mil	11-11 USD Mil
	Cash	156
Inventories	265	272
Receivables	347	309
Current Assets	802	720
Fixed Assets	234	225
Intangibles	168	161
Total Assets	1240	1141
Payables	265	215
Short-Term Debt	12	10
Current Liabilities	372	317
Long-Term Debt	185	192
Total Liabilities	691	635
Total Equity	549	507

Valuation Analysis	Current	5 Yr Avg	Ind	Mkt
	Price/Earnings	17.9	21.3	12.9
Forward P/E	10.9	—	—	13.5
Price/Cash Flow	11.1	—	10.5	7.4
Price/Free Cash Flow	19.2	—	21.2	16.9
Dividend Yield %	2.5	—	1.2	2.0
Price/Book	1.5	1.3	2.4	2.0
Price/Sales	0.4	0.3	0.9	1.2
PEG Ratio	0.9	—	—	1.4

Morningstar Rating **Last Price** 26.45 **Fair Value** **Uncertainty** **Economic Moat™** **Stewardship Grade**



2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	Stock Performance
40.3	17.5	3.0	3.2	6.1	-0.5	-18.4	22.2	16.4	-4.7	25.7	Total Return %
63.7	-8.9	-6.0	0.2	-7.5	-4.0	20.1	-1.2	3.6	-4.7	18.9	+/- Market
69.8	-224.9	-111.7	14.0	-22.7	-72.2	37.9	-48.5	-26.8	4.6	8.0	+/- Industry
2.9	2.5	2.5	2.7	2.6	2.7	3.5	3.0	2.6	3.0	2.5	Dividend Yield %
548	641	656	662	597	602	442	527	721	623	778	Market Cap USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Financials
967	1103	1241	1436	1616	1787	1984	1279	1590	2193	2215	Revenue USD Mil
16.6	14.7	15.0	13.6	13.6	11.9	11.9	13.3	14.6	13.0	12.9	Gross Margin %
63	43	63	57	71	53	52	8	40	57	61	Oper Income USD Mil
6.5	3.9	5.1	4.0	4.4	2.9	2.6	0.6	2.5	2.6	2.7	Operating Margin %
32	16	28	32	33	23	18	-3	44	41	45	Net Income USD Mil
1.08	0.53	0.91	1.03	1.07	0.82	0.66	-0.11	1.57	1.32	1.48	Earnings Per Share USD
0.54	0.54	0.54	0.57	0.58	0.58	0.59	0.60	0.60	0.62	0.64	Dividends USD
30	30	31	31	30	27	27	26	28	31	31	Shares Mil
12.29	13.91	15.37	14.96	14.74	16.30	14.28	15.04	15.92	17.23	17.23	Book Value Per Share USD
70	40	54	56	19	65	156	182	4	69	73	Oper Cash Flow USD Mil
-27	-20	-22	-27	-29	-29	-26	-25	-19	-26	-30	Cap Spending USD Mil
44	20	31	29	-10	35	130	157	-15	43	42	Free Cash Flow USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Profitability
5.4	2.5	4.1	4.3	4.0	2.6	2.0	-0.3	4.7	3.5	4.0	Return on Assets %
9.5	4.3	6.8	7.2	7.5	5.5	4.2	-0.7	10.3	7.9	9.0	Return on Equity %
3.3	1.4	2.2	2.2	2.0	1.3	0.9	-0.2	2.8	1.9	2.0	Net Margin %
1.62	1.76	1.81	1.90	1.99	2.08	2.25	1.52	1.70	1.90	1.95	Asset Turnover
1.7	1.7	1.7	1.7	2.1	2.0	2.1	2.2	2.2	2.3	2.3	Financial Leverage

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	11-11	Financial Health
301	319	358	406	404	419	403	362	292	430	403	Working Capital USD Mil
81	69	50	63	121	123	104	102	94	185	192	Long-Term Debt USD Mil
356	383	435	462	403	427	428	366	488	549	507	Total Equity USD Mil
0.23	0.18	0.11	0.14	0.30	0.29	0.24	0.28	0.19	0.34	0.38	Debt/Equity

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Valuation
15.8	37.2	26.0	17.9	28.8	19.6	28.0	26.3	18.5	14.3	17.9	Price/Earnings
0.6	0.6	0.5	0.5	0.4	0.3	0.2	0.4	0.4	0.3	0.4	P/E vs. Market
1.5	1.5	1.4	1.4	1.5	1.3	1.2	1.3	1.4	1.2	1.5	Price/Sales
11.3	11.9	29.8	8.6	25.4	11.0	2.4	3.6	—	8.9	11.1	Price/Cash Flow

Quarterly Results		Feb 11	May 11	Aug 11	Nov 11
Revenue	USD Mil	508.3	611.1	578.1	517.3
Most Recent Period		331.0	420.3	476.2	495.4
Prior Year Period					
Rev Growth %		53.6	45.4	21.4	4.4
Most Recent Period		21.4	41.2	48.6	36.5
Prior Year Period					
Earnings Per Share	USD	0.23	0.60	0.19	0.46
Most Recent Period		-0.26	0.91	0.22	0.29
Prior Year Period					

Industry Peers by Market Cap	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
	A Schulman, Inc.	778	2215	17.9
Asian Paints Ltd.	—	—	—	—
Asian Paints Ltd.	—	—	—	—

Major Fund Holders	% of shares
	—
	—
	—

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.



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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	Insider Activity
MR. JOSEPH M. GINGO	CEO/Chairman of the Board/ Director/President, Director	109,122	17 Jan 2012	-
MR. GREGORY T. BARMORE	Director	56,204	12 Jan 2012	-
MR. DAVID G. BIRNEY	Director	31,230	12 Jan 2012	-
MR. GARY A. MILLER		28,080	31 Jan 2012	-
MR. JOHN B. YASINSKY	Director	26,230	01 Feb 2012	2,000
ERNEST J. NOVAK, JR	Director	25,430	12 Jan 2012	-
MR. DAVID C. MINC	Other Executive Officer/Secretary/ Vice President	22,467	17 Jan 2012	-
MR. HOWARD R. CURD	Director	22,365	12 Jan 2012	-

*Report date represents the date on which the owner's common shares held was audited.

Fund Ownership

Top Owners	Morningstar Rating	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Royce Special Equity Invmt	QQQQ	4.84	1.24	69	31 Dec 2011
Allianz NFJ Small Cap Value Instl	QQQQQ	3.92	0.35	0	31 Dec 2011
DFA U.S. Small Cap Value II		2.06	0.19	0	30 Nov 2011
Franklin Small Cap Value A	QQQ	1.98	0.77	0	31 Dec 2011
iShares S&P SmallCap 600 (AU)		1.69	0.15	1	03 Feb 2012
Concentrated Holders					
PowerShares S&P SmallCap Materials		0.02	2.71	-1	31 Dec 2011
Auer Growth	Q	0.41	2.07	-30	31 Dec 2011
Altrius Small Cap Value I		0.04	2.00	12	30 Sep 2011
US Special Equity A	QQQQQ	0.14	1.62	-6	30 Sep 2011

Institutional Transactions

Top 5 Buyers	Morningstar Rating	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
SSgA Russell Small Cap Idx Fund Class A	QQQ	0.66	0.06	119	30 Jun 2011
Heartland Value	QQQ	1.63	0.81	100	30 Sep 2011
Northern Multi-Manager Mid Cap	QQQQ	0.28	0.17	82	31 Dec 2011
Royce Special Equity Invmt	QQQQ	4.84	1.24	69	31 Dec 2011
GuideStone Funds Small Cap Equity GS2	QQQ	0.18	0.29	53	31 Dec 2011
Top 5 Sellers					
Invesco Van Kampen SmallCapValue A	QQQQ	0.12	0.03	-431	30 Sep 2011
Delafield Fund	QQQQ	0.77	0.39	-365	31 Dec 2011
Russell US Small Cap Equity I	QQ	0.08	0.03	-69	30 Nov 2011
American Century Small Cap Value Inv	QQQQ	0.28	0.09	-55	30 Sep 2011

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Industry Focus: Chemicals

The Curious Chemistry of the Chemicals Business

08 August 2011

Min Tang-Varner, CFA
Securities Analyst

Economic moats
are tough to come
by in this capital-
intensive industry.

Executive Summary

In aggregate, the growth in the chemical industry is strongly correlated with macroeconomic growth, as chemical companies are the basic ingredient suppliers for almost all industrial aspects of a modern society. Most of their outputs feed into automotive, construction, industrial, and consumer product chains rather than being the end products themselves. The profitability of the industry is notoriously volatile, as capital-intensive chemical companies stand between hydrocarbon producers (crude oil and gas) and industrial and consumer product manufacturers, processing crude oil and natural gas into generic commodity chemicals (for example, ethylene, propylene, plastics, or glass) without much differentiation or specialty materials (for example, UV coating or super glues). We award economic moats to companies that have a clear advantage over their peers in terms of a unique asset base or high switching costs that give them pricing power over end customers. The moat rating has a material impact on how we value these companies since we are willing to pay more for a company with a long-term, sustainable competitive advantage than a cyclical company without one. **Key Takeaways**

Sticky client relationships (such as those forged as part of the design and application process), large global service footprints, and/or extensive sales networks help some chemical companies to sustain their pricing power by creating higher switching costs. Most specialty chemical companies provide some products in their portfolios that fit these attributes, which help those segments temper the industry cyclicality. However, we frequently find that small segments with moatworthy characteristics cannot shield the entire enterprise. Some companies do make the cut, though, and we highlight Ecolab ECL and Sigma-Aldrich SIAL as companies that have successfully dug themselves narrow economic moats, while BASF's BAS portfolio building is strengthening its competitive

advantages. Most chemical companies in our coverage area, including commodity chemical companies and paint and coating companies, do not possess economic moats. The lack of an economic moat does not mean these companies do not generate double-digit profits in an economic up-cycle. However, we think it translates into less certainty that these companies will continue to generate strong profitability over the long term. In this category, we highlight PPG Industries PPG, AkzoNobel AKZA, Solvay SOLB, and Royal DSM DSM. **Chemical Companies With High Switching Costs**

High switching costs is one of the most prominent features that grants a chemical company a moat. An illustrative example of high switching costs is Ecolab, which relies on its installed base and consumables model that drives high switching costs. Ecolab leases proprietary cleaning equipment and devices to its clients, and then supplies them with a steady stream of consumables (such as cleaners, solvents and detergents) that are required to keep the machines running. We favor this razor-razorblade business model that exchanges front-end capital investment with long-term stable streams of revenue and gives the company a higher return on invested capital. The same could be said about Ecolab's recent acquisition target-- Nalco NLC. Nalco's economic moat comes from its onsite engineers that service industrial and energy clients with customized design. In our coverage area, there are a few other companies that offer a small portion of services in this razor-razorblade model, including paint and coating companies that design and sell paint and coating application equipment, paper chemical companies that sell chemical delivery and monitoring systems outfitted with bleaching and coloring agents, and industrial gas companies that build onsite gas tanks and supply oxygen, hydrogen, and noble gases. An advantage of this model is that pricing power is strong once the client relationship is established, and contract duration is long due to the initial capital investment. However, the specialty chemical industry is very broad, catering to a variety of different clients at different entry points of production processes. For most companies, establishing an enterprisewide high switching cost model

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is quite difficult. **Chemicals Companies Operating Within Consolidated Industries**

Although sticky client relationships that create companywide high switching costs are rare in the chemical industry, a lack of substitution in the products, combined with a comparably consolidated supplier base can also create an economic moat. A consolidated industry usually fosters a rational competition environment, both in terms of pricing and capacity utilization during an extended economic cycle, which benefits most players in the field. Consolidated Industries: Seeds The same consolidated supplier pattern can be observed in the commercial seed sub-industry. This segment almost rivals a hi-tech industry with heavy annual RD investment. The turf is protected by multiple patents, which in turn creates a high barrier for new players. Coupled with the length of national government review processes, the environment is supportive for most existing players to establish moats. The two industry leaders-- Monsanto MON and DuPont DD (Pioneer is the seed operation's name)--dominate the North American corn and soybean markets. Syngenta, BASF, Dow (Dow AgroScience), and Bayer have some seed operations, but most have set up joint ventures in either development or marketing with these two leaders. The economic moat of the seed companies lies with the long-term research platforms and successful product pipelines. Secondly, any new seed traits can only be marketed after extensive governmental review, which involves lengthy and expensive testing and evaluation. In addition, the returns are protected by patents, which reward companies for successful discovery. Companies generate their high pricing power as long as they deliver yield improvements. However, these seed companies do not have the same advantage as Ecolab, which garners its moat from high switching costs. In fact, pricing power is not entirely one-sided because brand loyalty is low from this growing season to the next, as farmers switch choices based overwhelmingly on yield and cost-benefit concerns. Consolidated Industries: Selected Specialty Chemicals Titanium dioxide (TiO₂), a key chemical pigment for paint, coating, and construction materials, is another example of a consolidated industry that may create some extra value

for investors. Similar to potash and genetically modified seed producers, the global TiO₂ capacity is concentrated (five Western players occupy more than 65% of the global capacity, while the 27% capacity located in China are all small inefficient producers). Historically the industry has tended to increase capacity on a lump-sum basis and work down the overcapacity by undercutting pricing. However, as the global demand trend solidifies in an upward trajectory, producers have become more rational, which should boost the margins for everybody collectively. In our coverage area, we note that DuPont, Rockwood Industries ROC and Huntsman HUN may benefit from this long-term trend. The strength of the industry comes from heavy environmental regulations that protect existing suppliers while discouraging new entrants (except in China). In the mean time, years of poor financial performances have weeded out inefficient producers while empowering the survivors with rational capacity expansion plans and pricing competition, while mothballing inefficient capacities in Western Europe and the U.S. Similar to potash fertilizer, the pigment is not easily substitutable for paint and coating companies. Overall, we think these characteristics should provide producers with higher pricing power than they had previously enjoyed, unless we observe large capacity increases in the form of irrational behaviors from China (where AkzoNobel has tried to move its suppliers). However, TiO₂ operations occupy pretty small slices of DuPont's, Rockwood's, and Huntsman's operations, too small to grant the whole enterprises economic moats. **Chemicals Companies Producing Differentiated Products**

Chemical companies are always on the forefront in creating and innovating new products that give them a competitive edge over their peers and thus create sticky relationships with end customers. The more intertwined a chemical product becomes in its client's integrated design and manufacturing process, the more likely a chemical company can gain a competitive advantage (and pricing power). In addition, a chemical company's competitive advantage can also come from extensive government regulations (such as Royal DSM's feed premixes and pharmaceutical ingredients that require government approval for substituting suppliers)

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or providing any critical ingredients for end products (such as BASF's super absorbent pulp, coating for Pampers diapers by Johnson Johnson JNJ, or AkzoNobel's wetting technology for herbicide). Sigma-Aldrich is a company that successfully carves itself a narrow moat from the latter category. The company supplies chemical materials and equipment to labs that are willing to accept price increases consistently in return for crucial, stable, and quality ingredients. **Why Most Chemical Companies Do Not Have Economic Moats**

Despite all the strength we talk about, only a handful of the companies will actually dig enough of a moat around the business. It is difficult to sustain an economic moat in the chemical industry due to its nature of being a processor in the middle. Chemical companies that have a moat are more of an exception rather than the rule. We highlight two companies that have dug a moat and other companies that have a moaty portion of their business which may not be large enough to offer the whole company a moat. Lack of upstream pricing perennially causes margin squeeze. Upstream pricing power is low because crude oil and natural gas are traded in open markets around the world. Petrochemical companies that provide building blocks for specialty chemicals are operating in a similar fashion as refineries as they earn crack margins between hydrocarbon and commodity chemicals and their profitability demands heavily on capacity utilization. Specialty chemical companies, in turn, are not immune to the volatility in the upstream. This is one overarching reason for the lack of a moat for chemical companies. In fact, we think chemical companies will have to contend with a high energy cost environment going forward, which could reduce the earnings these companies enjoy. Average crude oil price range prior to 2007 was \$30-\$50 per barrel before it went haywire in 2008. The average crude oil price stood at around \$90-\$100 since 2011, opening up a trend of consolidating specialty chemical companies under petrochemical companies to avoid the long-term shock on their earnings capabilities. The petrochemical industry lacks pricing power, even for low-cost producers, due to its heavy up-front capital investment. Petrochemical companies are

larger in size due to capital intensity and scale requirements. Like a refinery, petrochemical companies have very heavy capital intensities and will only become profitable when capacity utilization is high and crack margin is healthy. Even on that count, they will incur heavy maintenance capital expenditures. Therefore, even if the company generates a reasonable EBITDA margin, its EBIT margin can still be quite low compared with specialty chemical companies. Because of its high capacity utilization requirements and lack of end-product differentiations, petrochemical companies are even more cyclical. The largest petrochemical companies are integrated with integrated oil companies or national oil companies such as ExxonMobil XOM, Chevron Phillips Chemical (the joint venture between Chevron and ConocoPhillips), Saudi Aramco, or Sinochem. A few large independent petrochemical companies have for years tried to diversify their end products from simple ethylene and propylene, to move upward in the value chain. Here we point out BASF, DuPont, and Dow Chemicals. The industry in general, however, does not have a real economic moat, even for low-cost producers. Low-cost producers are not guaranteed to have consistently high capacity utilizations, a condition critical for profitable performances. Size and scale do not translate into better margins, even in the specialty chemical industry. There are a lot of chemical companies that dominate the fields in which they operate, but most of them do not have an economic moat. Illustratively, we look at AkzoNobel's specialty coating business. AkzoNobel is the largest coatings company in the world, followed by PPG Industries, Sherwin-Williams SHW, DuPont, and BASF. However, the large scale does not translate into stable margins for the company. The reason for the lack of moat comes down to AkzoNobel's lack of upstream pricing power with its resin, polymer, additives, and pigment suppliers, and its lack of control over its end-product demand. AkzoNobel's performance coatings cater to marine, automotive, wood, and other industrial products, which are also highly correlated with economic growth. Passing on rapid cost increases is always a top concern of companies like that, and a high return on investment is difficult to sustain. Chemical companies usually have

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multiple product lines, with their moaty operations supporting the enterprise in a downturn, while commoditylike operations drive earnings growth in an upturn. This is one of the more pronounced trends we've witnessed in the past couple of years. Most of the chemical companies we cover have shown an upswing in earnings as they leverage the growth of the regional GDP, while their specialty chemical sides are contending with a more or less stable revenue stream. The opposite happens in an economic downturn. However, by diversifying businesses into multiple lines, chemical companies trade their potential moat with volatile earnings. **Conclusion**

As we are evaluating a company over the long term, we prefer moaty chemical companies over cyclical no-moat chemical companies. In our discounted cash flow model, companies that generate high returns on invested capital for longer periods of time naturally get higher valuations than companies whose high returns will be whittled away in relatively short order. It is fair to say that a moat rating does not determine how the company's stock performs in the near term, which, as we have noted before, is a function more correlated to economic growth rate than sustainable competitive advantages. We have noted that chemical companies without moats can perform very well during economic upswings, particularly if the company has large commodity chemical operations. Comparatively, moaty companies may lag the performance in the same period, but we do not think that changes our theory about their stable revenue streams and stable margins.