

IWT Tesoro Corporation (OTC.BB: IWTT.OB)

Rating: Buy rating maintained

Price target: maintained at \$3.6

Share Statistics

Symbol	IWTT
Current Price	\$2.65
High/Low 52 Weeks	\$3.15-2.60
Avg. daily vol. (3m)	449.231
Market Cap., \$ mn	31.0
Shares outstg., mn	11.7

Source: SEC Filings, Yahoo Finance!

Summary of Analyst Rating & Rationale

We reaffirm our Buy rating and price target on IWTT following Q2FY05 results. We consider that IWTT's financial performance was marked by favorable developments, among which are:

- ***ninth consecutive quarter of revenue growth above 20% yoy (for Q2FY05 FTG reported 25% yoy revenue growth);***
- ***improvement in the gross, operating and net profit margins by 2, 3 and respectively 2 percentage points over the similar period of FY04;***
- ***reporting of a net income above \$164 thousand compared to losses posted for Q2FY04;***
- ***further business expansion, including product portfolio augmentation, new regions served and new methods proposed to customers.***

The recent capital increase of about \$5 million should allow IWTT to follow its business growth strategy according to its plans, consequently expanding product offerings and geographic presence.

Recent Financial Performance

- **Double digit revenue growth track maintained during Q2FY05 in line with our estimates**

IWTT continued to report strong revenue during Q2FY05, increasing by 25% year-over-year versus similar quarter of 2004. IWTT's sales during this quarter were in line with our forecasts, released in our update at the end of May'05. The revenue increase is primarily attributable to the continued growth in sales distribution channels. We consider that IWTT will continue to exceed industry growth rates as a result of continued expansion into national markets and will record during the next quarter further solid revenue growth for the third consecutive year.

Income statement

US\$'000 Year end December 31	Actual			Our estimates		Actual		
	Q2FY05	Q2FY04 (Restated)	YoY%	Q2FY05	actual vs. our estimates	H1FY05	H1FY04 (Restated)	YoY%
Net sales	14,441.7	11,585.0	25%	14,597.0	-1%	28,134.7	21,119.6	33%
Gross profit	5,839.3	4,440.6	31%	5,547.0	5%	10,969.3	8,164.8	34%
Total operating expenses	5,381.5	4,392.1	23%	5,291.0	2%	10,297.4	8,641.0	19%
Income (loss) from operations	457.8	48.5	844%	255.0	80%	671.9	-476.2	n/m
Net income (loss)	164.3	-66.8	n/m	32.0	413%	215.8	-707.3	n/m
EPS, diluted	\$0.01	\$-0.01	n/m	\$0.00	n/m	\$0.02	\$-0.06	n/m

Source: SEC Filings, analyst's estimates

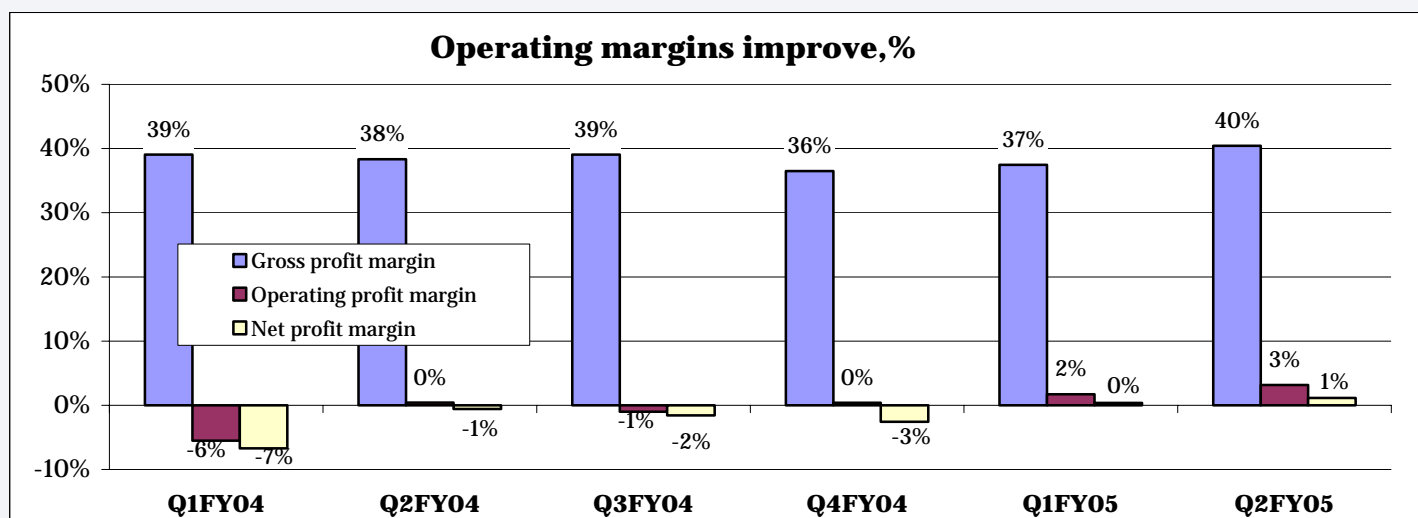
- Overall improvement of profit margins**

Following the positive revenue development accompanied by a decline in operating expenses as a percentage of revenue, IWTT registered an overall improvement of profit margins. The second quarter of 2005 was the best quarter in terms of profit margins since Q3FY03.

Gross profit margin improved by 2 percentage points during Q2FY05 versus Q2FY04. In addition to the impact of the revenue growth, the new pricing strategy implemented by the end of Q2FY05 also contributed to the increase in the gross profit margin.

Operating profit margin jumped to 3% during Q2FY05 versus 0% during the similar period of 2004 as a result of the economies of scale factor. Continued growth in the sales distribution channels and process efficiencies gained in delivering these services helped reduce the share of operating expenses in the revenue.

Net profit margin was slightly over 1%, as compared to a negative margin in Q2FY04. Increased revenue together with the decline in operating costs as percentage of revenue led to a net income of over \$164 thousand as compared to a loss of around \$67 thousand in Q2FY04.



Source: SEC Filings

- IWTT continues to finance its business mainly through long term debt and equity**

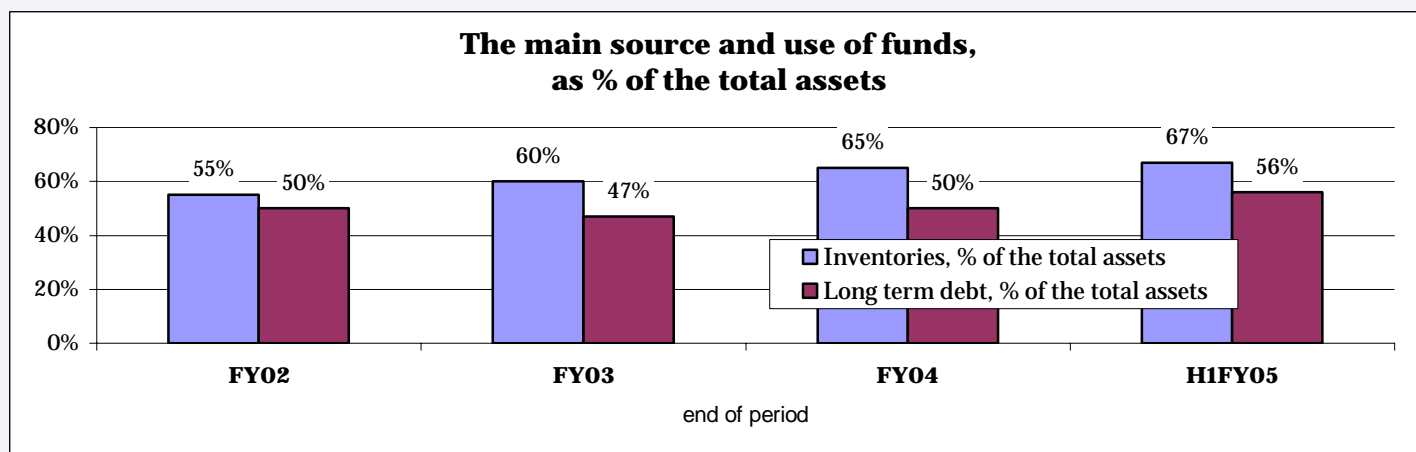
IWTT continued to finance the growth with new equity capital and new borrowings. The company's assets are primarily financed through long term debt, amounting to about \$22.3 million and covering 56% of total assets, compared to 50% as of December 31'04 and to 45% as of September 30'04. As of June 30'05, IWTT was not in compliance with the leverage and fixed charge coverage ratio requirements, which are stipulated by loan and security agreement.

Balance sheet

US\$'000	31-Dec-03	31-Dec-04	30-Jun-05
Cash	867.4	507.7	636.9
Net working capital	9,581.2	14,228.8	20,179.2
Long term debt	10,129.7	16,593.8	22,285.5
Equity	1,070.5	156.1	382.4

Source: SEC Filings

Management expects that the company will need to raise additional financing in the form of equity or loans. In August'05, IWTT, along with its wholly owned subsidiary International Wholesale Tile Inc., closed a \$5 million secured term note from Laurus Master Fund Ltd. The net proceeds are to be used to finance working capital, mainly the inventories. As of June 30'05, the inventories accounted for about 72% of current assets and 67% of total assets.



Source: SEC Filings

Recent events

On June 6'05, IWTT established a new subsidiary Import Flooring Group, Inc. The new entity will provide agency services by directly importing tile from foreign factories to wholesale tile distributors within the United States. Import Flooring was formed as part of Tesoro's growth strategy to support its agent-oriented business in the floor coverings market.

On June 20'05, The Tile Club, Inc., a wholly owned Tesoro subsidiary, and The Weir Farm Trust, a Connecticut based non-profit organization, entered into a Master License Agreement. Pursuant to the agreement, The Tile Club has the exclusive right to manufacture, market, sell and distribute licensed works of art in the form of high quality porcelain and ceramic tiles. It plans to produce a number of these tiles on a limited basis and sell as works of art to be incorporated into designs of residences and commercial sites.

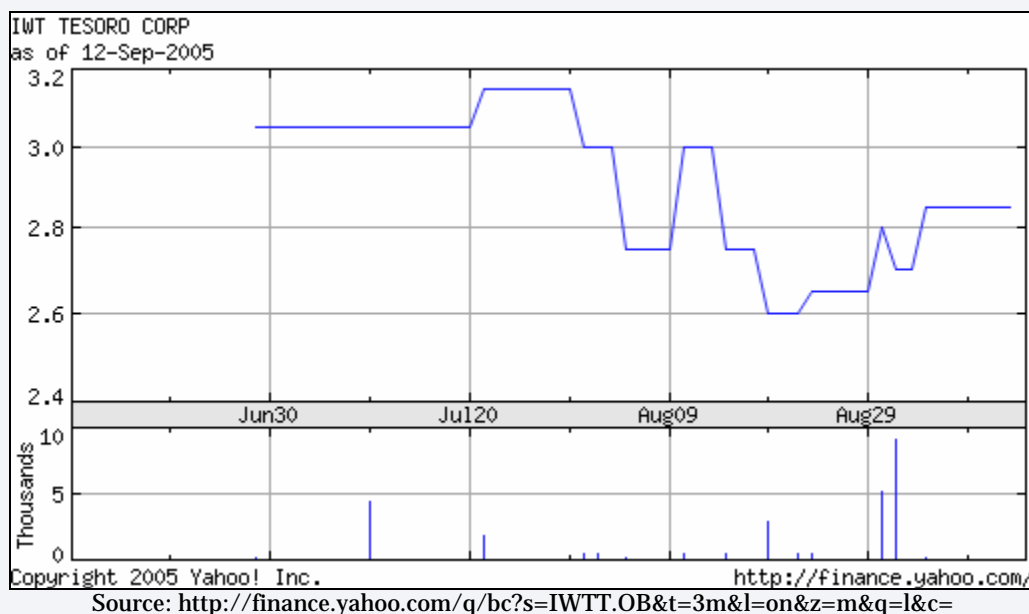
Risk

- **Constant restatements may lead to uncertainty among investors.**

In September'05, IWTT announced a new wave of restatements after two others had been carried out in the beginning of 2004 and in the beginning of 2005. In August'05 and September'05, IWTT carried out a new series of restatements for quarterly reports for year 2003.

Management affirms that IWTT incorrectly calculated in that period the accruals for sales commissions. In connection with the restatements corrections were made to financial statements, including in revenue and net income lines.

Stock performance: IWTT



Alexandru Voizian is a Senior Analyst with Spelman Research. He joined the company in 2003 and has been covering the Technology, Healthcare and Services sectors. Prior to joining the Company, Mr. Voizian held economist positions at two commercial banks. Mr. Voizian earned his bachelor's degree in finance from the Academy of Economic Studies of Moldova in 2000. Mr. Voizian passed Level 1 exam of the CFA program and is currently registered for the Level 2 (June 2006).

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