

## American Financial(AFG)

**\$66.76** (As of 09/28/20)

Price Target (6-12 Months): **\$70.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 09/08/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank: (1-5)**

**3-Hold**

Zacks Style Scores:

VGM:C

Value: A

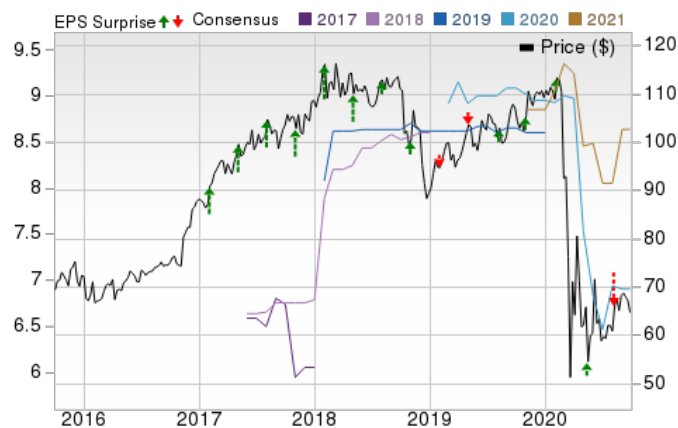
Growth: D

Momentum: D

## Summary

American Financial's consistent price increase in property and casualty business should favor results. P&C renewal pricing in 2020 is expected to be up 7% to 10%. It boasts impressive inorganic growth and is prudently investing in businesses. American Financial is actively involved in startups, small-to-medium sized acquisitions, and product launches. Better industry fundamentals, a high renewal ratio, and favorable combined ratio should drive growth. Solid capital position enables it to deploy capital effectively. It expects earnings per share in the range of \$6.60-\$7.40 in 2020. Shares of American Financial have underperformed its industry in the past year. However, soft performance of Annuity business continues to weigh on earnings. Also, exposure to weather-related calamities induces earnings volatility and high cost weighs on margin.

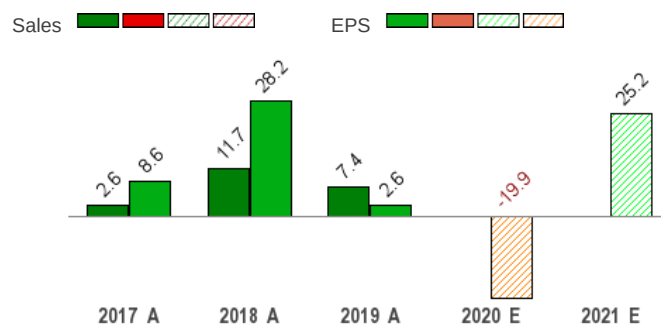
## Price, Consensus & Surprise



## Data Overview

|                                |                                          |
|--------------------------------|------------------------------------------|
| 52-Week High-Low               | <b>\$115.03 - \$44.01</b>                |
| 20-Day Average Volume (Shares) | <b>585,348</b>                           |
| Market Cap                     | <b>\$5.9 B</b>                           |
| Year-To-Date Price Change      | <b>-39.1%</b>                            |
| Beta                           | <b>0.89</b>                              |
| Dividend / Dividend Yield      | <b>\$1.80 / 2.7%</b>                     |
| Industry                       | <b>Insurance - Property and Casualty</b> |
| Zacks Industry Rank            | <b>Top 48% (119 out of 250)</b>          |

## Sales and EPS Growth Rates (Y/Y %)



|                               |                   |
|-------------------------------|-------------------|
| Last EPS Surprise             | <b>-36.8%</b>     |
| Last Sales Surprise           | <b>26.0%</b>      |
| EPS F1 Estimate 4-Week Change | <b>0.0%</b>       |
| Expected Report Date          | <b>11/03/2020</b> |
| Earnings ESP                  | <b>0.0%</b>       |

## Sales Estimates (millions of \$)

|      | Q1      | Q2      | Q3      | Q4      | Annual* |
|------|---------|---------|---------|---------|---------|
| 2021 | 1,324 E | 1,349 E | 1,372 E | 1,385 E | 5,429 E |
| 2020 | 1,810 A | 1,703 A | 1,391 E | 1,337 E | -       |
| 2019 | 1,771 A | 1,836 A | 2,088 A | 2,016 A | 7,711 A |

## EPS Estimates

|      | Q1       | Q2       | Q3       | Q4       | Annual*  |
|------|----------|----------|----------|----------|----------|
| 2021 | \$2.23 E | \$2.03 E | \$1.94 E | \$2.45 E | \$8.64 E |
| 2020 | \$1.88 A | \$1.05 A | \$1.55 E | \$2.14 E | \$6.90 E |
| 2019 | \$2.02 A | \$2.12 A | \$2.25 A | \$2.22 A | \$8.62 A |

\*Quarterly figures may not add up to annual.

|         |            |
|---------|------------|
| P/E TTM | <b>9.0</b> |
| P/E F1  | <b>9.7</b> |
| PEG F1  | <b>1.6</b> |
| P/S TTM | <b>0.8</b> |

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 09/28/2020. The reports text is as of 09/29/2020.

## Overview

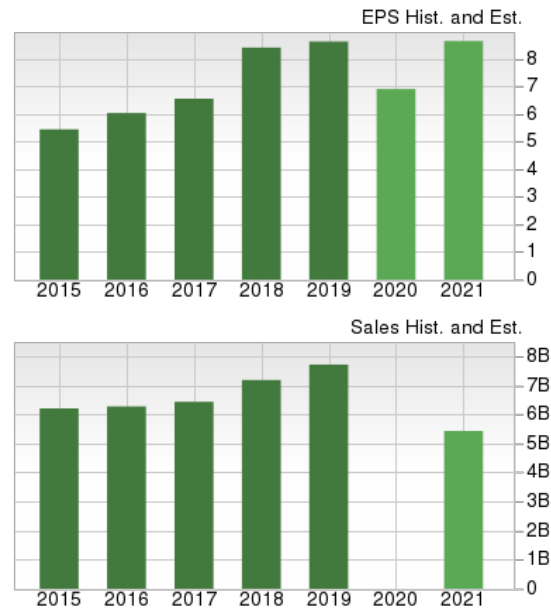
Founded in 1872 and headquartered in Cincinnati, OH, American Financial Group, Inc. is a holding company which, through its subsidiaries, engages primarily in property and casualty insurance, with focus on specialized commercial products for businesses. The company also engages in the sale of traditional fixed, fixed-indexed and variable-indexed annuities in the retail, financial institutions, registered investment advisor and education markets.

American Financial Group reports its earnings in three segments:

**Property and Casualty Insurance Operations** – These operations consist of approximately 30 niche insurance businesses offering a wide range of commercial coverage. The business is conducted through Property and Transportation (consisting Inland and Ocean Marine, Agricultural-related and Commercial Automobile), Specialty Casualty (consisting Executive and Professional Liability, Umbrella and Excess Liability, Excess and Surplus, General Liability, Targeted Programs and Workers' Compensation) and Specialty Financial (consisting Fidelity and Surety and Lease and Loan Services). These operations are conducted through subsidiaries namely Great American Insurance, National Interstate, Summit (Bridgefield Casualty and Bridgefield Employers), Republic Indemnity, Neon Lloyd's Syndicate and Mid-Continent Casualty. These subsidiaries carry strong ratings from AM Best and S&P.

**Annuity Operations** – Annuity operations primarily involve the sale of traditional fixed, fixed-indexed and variable-indexed annuities in the retail, financial institutions, broker-dealer and registered investment advisor markets through independent producers and through direct relationships with certain financial institutions. These operations are conducted primarily through the subsidiaries, Great American Life Insurance Company and Annuity Investors Life Insurance Company.

**Other Operations** – Through subsidiaries, it is engaged in a variety of other operations, including commercial real estate operations in Cincinnati (office buildings), Whitefield, New Hampshire (Mountain View Grand Resort), Chesapeake Bay (Skipjack Cove Yachting Resort and Bay Bridge Marina), Charleston (Charleston Harbor Resort and Marina) and Palm Beach (Sailfish Marina and Resort).



Source: Zacks Investment Research

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## Reasons To Buy:

- ▲ **Share Price Movement:** Shares of American Financial have lost 38.1% in a year, compared with the industry's decline of 4.4%. We believe that acquisitions, better pricing and improving industry fundamentals will help the shares bounce back.
- ▲ **Sturdy Growth Profile:** American Financial is actively involved in startups, small-to-medium sized acquisitions, and product launches. It is prudently investing in businesses. Though net premiums written declined 5.1% year over year in the first half of 2020 in the Specialty Property and Casualty Insurance segment, the company expects decline in 2020 net premiums written to improve. It now estimates Specialty Property and Casualty Insurance net premiums written to decline in the range of 5-11%, an improvement from 8-14% decline estimated earlier.

American Financial, a niche player in the P&C and annuity markets, will benefit from the strategic acquisitions and improved pricing. Improving industry fundamentals will drive overall growth.

American Financial estimates property and casualty pretax core operating earnings, excluding the impact of alternative investments, between \$615 million and \$675 million. The company expects 2020 core net operating earnings per share excluding marked to market (MTM) investments to be in the range of \$6.60-\$7.40 per share, up from the earlier expectation of \$6.45-\$7.25 per share.

- ▲ **Consistent Price Increase in Property and Casualty (P&C) Business:** American Financial witnessed renewal pricing increase of around 9% in the second quarter of 2020 in the Property and Casualty group. The company noted that average renewal rate increases in the first half of 2020 have been the highest that it achieved in over 15 years. It intends to maintain satisfactory rates in P&C renewal pricing going forward. Management estimates property and casualty renewal pricing in 2020 to be up 7% to 10%, an increase from the range of 5% to 8% expected earlier. Excluding workers' compensation, the company estimates renewal rate increase of 10-13%, an increase from the range of 8% to 11% estimated previously. Along with price increase, projects loss cost trends are expected to remain stable and appear relatively benign across all the P&C lines. These trends should favor the company in the long run.
- ▲ **Favorable Combined Ratio:** American Financial's combined ratio has been better than the industry average for more than two decades. For 2020, the company expects combined ratio for the Specialty Property & Casualty Group in the range of 92% to 94%. Combined ratio is projected in the range of 90% to 94% (an improvement from 92% to 96% guided earlier) for Property and Transportation Group and between 91% and 95% (deterioration from 90% to 94% guided earlier) for Specialty Casualty Group in 2020. For Specialty Financial Group, combined ratio is expected to be in the range of 91% to 95% (a deterioration from 97% to 91% guided earlier).
- ▲ **Strong Capital Management:** American Financial has traditionally maintained moderate adjusted financial leverage around 20%, with good cash flow and interest coverage ratio. On Jun 30, 2020, excess capital was approximately \$850 million which will enable the company to meet the debt obligations. The company expects to have significant excess capital and liquidity throughout 2020 and beyond. It scores strongly with credit rating agencies.

Also, in each of the last 14 years, the company has successfully increased its dividends and paid out special dividend. The robust operating profitability at the P&C segment, a stellar investment performance and an effective capital management look. Its dividend strategy reflects its solid financial position. The company intends to hold back about \$200-\$300 million of the excess capital to maintain flexibility for any opportunity that may arise in the future.

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## Reasons To Sell:

▼ **Annuity Business:** The company has been witnessing weak performance at this segment over the past quarters. Gross statutory premiums declined 31% in the first half of 2020. The company implemented several rate decreases to maintain proper returns on annuity sales that have started to affect new sales. In fact annuity sales were lower in all channels during the second quarter of 2020 due to stay-at-home orders and other factors related to the COVID-19 pandemic. The company estimates the softness to continue through the third quarter. Operating earnings too dropped 44% in the first half of 2020.

Nonetheless, American Financial expects an attractive return on its alternative investments over the long term. It estimates pretax core operating earnings, excluding earnings from alternative investments, between \$300 million and \$320 million, an increase from \$280 million and \$310 million guided earlier. The company also anticipates 2020 gross annuity sales in the range of \$3.4 billion to \$3.9 billion and result in growth in average investments and reserves of 5% to 7% in 2020.

▼ **Exposure to Catastrophes:** The company's earnings have traditionally been affected by catastrophes. Even drought, which does not otherwise qualify as a catastrophe, had impacted its earnings, given its exposure to the crop business. Irrespective of catastrophe mitigation techniques deployed by it, exposure to weather-related calamities makes its earnings volatile.

▼ **Rising Expenses:** The company has been experiencing an increase in expenses due to higher P&C insurance losses & expenses, annuity, life, accident & health benefits & expenses, interest charges on borrowed money, expenses of managed investment entities and other expenses. In the first half of 2020, total costs and expenses increased 2.6% year over year. The expenses are likely to weigh on operating margin expansion. Net margin contracted 620 bps in the second quarter of 2020.

▼ **Increasing Debt with lower Times Earned Interest:** American Financial's debt level has been increasing over the last several years. As of Jun 30, 2020, the company's long-term debt was \$1.9 billion, up 30% from 2019-end level. Debt to total adjusted capital was 27.8% at June end, down 610 basis points from 2019 end level and compared unfavorable with the industry average of 21.8%. Also, times interest earned, which indicates how efficiently a company can service debt, has been declining. It was 4.5x in the second quarter of 2020, down 1020 year over year. The company must service debt uninterruptedly else creditworthiness could be dented.

Underperforming Annuity business weighing on earnings and exposure to cat losses (specifically its exposure to the crop business) inducing volatility to underwriting results pose near-term headwinds.

## Last Earnings Report

### American Financial Misses on Q2 Earnings, Ups View

American Financial reported second-quarter 2020 core net operating earnings per share of \$1.05, which missed the Zacks Consensus Estimate by 36.8%. Also, the bottom line decreased 50.5% year over year.

Core net operating earnings take into account 48 cents per share loss from alternative investments and 75 cents per share of COVID-19 related losses.

Quarter Ending 06/2020

| Report Date      | Aug 04, 2020 |
|------------------|--------------|
| Sales Surprise   | 25.96%       |
| EPS Surprise     | -36.75%      |
| Quarterly EPS    | 1.05         |
| Annual EPS (TTM) | 7.40         |

### Behind the Headlines

Total operating revenues of \$1.7 billion decreased 7.2% year over year. This top-line decline can be attributed to lower net investment income and decrease in net earned premiums at its P&C insurance as well as lower other revenues. The top line however beat the Zacks Consensus Estimate of \$1.4 billion.

Net earned premiums at its P&C insurance declined 1.3% to \$1.2 billion. Net investment income of \$468 million decreased 0.2% year over year.

American Financial's total cost and expenses were \$1.7 billion, up 1.9% year over year due to higher P&C insurance loss and expenses, annuity and supplemental insurance benefits & expenses and interest charges on borrowed money.

### Segment Results

**Specialty Property and Casualty Insurance** generated \$1.1 billion in net premiums written, down 11% year over year, primarily as a result of the run-off of Neon.

Core operating earnings were \$116 million in the second quarter, down 34% year over year. Lower P&C net investment income was responsible for the decline.

Underwriting profit of \$54 million declined 10%, attributable to lower profits at Specialty Casualty and Specialty Financial Groups, partly offset by higher profits at Property and Transportation Group.

The segment's combined ratio deteriorated 20 basis points (bps) year over year to 95.2%.

**Annuity** segment's gross statutory premiums of \$687 million declined 49% year over year. Annuity sales were lower in all channels as a result of stay-at-home orders and other factors related to the COVID-19 pandemic

Operating earnings totaled \$42 million, down nearly 60% year over year.

### Financial Update

As of Jun 30, 2020, American Financial had cash and investments of \$56.7 billion, which grew 2.7% from the level at 2019 end.

As of Jun 30, 2020, long-term debt of \$1.9 billion was up 29.8% from 2019-end level.

As of Jun 30, 2020, the company's book value per share (excluding unrealized gains/losses on fixed maturities) was \$56.95, down 4.6% from the figure at 2019 end.

Annualized return on equity was 7.5%, down 720 bps year over year. The company had about \$850 million of excess capital at Jun 30, 2020.

The company bought back \$76 million worth shares in the reported quarter.

### 2020 Guidance Upped

American Financial estimates net operating earnings in the bracket of \$6.60-\$7.40 per share, compared with the earlier expectation of \$6.45-\$7.25 per share.

Pretax annuity core operating earnings are expected to increase in the range of \$300 million to \$320 million, up from \$280 million to \$310 million guided earlier.

Gross annuity premiums are expected to be between \$3.4 billion and \$3.9 billion, and result in growth in average investments and reserves of 5% to 7% in 2020. This reflects higher persistency so far in 2020.

## Recent News

### American Financial to Offload Neon, Exit Lloyd's - Sep 28, 2020

American Financial Group has agreed to divest Lloyd's-based insurer Neon. The insurer inked a definitive agreement with RiverStone Holdings Limited to divest GAI Holding Bermuda and its subsidiaries, comprising the legal entities that own Neon. This marks American Financial's move to exit from the Lloyd's of London insurance market.

The company decided to exit the Lloyd's platform to intensify focus on other Specialty property and casualty (P&C) businesses, redeploy capital in business and growth opportunities that have potential to earn targeted returns on investment, improve earnings, and enhance long-term value for shareholders. Neon has not been able to achieve American Financial's profitability target.

Once the divestiture closes, this Zacks Rank #3 (Hold) niche player in the P&C and annuity markets expects release of all its funds at Lloyd's. This also includes release of the letters of credit and collateral pledge facility that the company guarantees in support of Neon's funds at Lloyd's.

American Financial expects to record the sale in the third quarter. However, the transaction is not estimated to have material impact on the results.

### American Financial Offers 4.50% \$200M Senior Unsecured Notes - Aug 8, 2020

American Financial announced the pricing of \$200 million aggregate principal amount of senior unsecured notes. The notes carry an interest rate of 4.50% and are scheduled to mature on Sep 16, 2060.

The company plans to deploy the net proceeds for general corporate purposes that may include redemption of its \$150 million aggregate principal amount of 6% subordinated debentures due 2055.

### American Financial Rewards Shareholders With Dividend Hike - Aug 18, 2020

In concerted efforts to enhance shareholder value, the board of directors of American Financial Group approved an 11.1% hike in its annual dividend. With this, the payout now stands at \$2.00 per share compared with the earlier payout of \$1.80 per share.

## Valuation

American Financial's shares are down 39.2% and 38.1% in the year-to-date period and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 9.3% and 18.3% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 4.4% and 12.5%, respectively.

The S&P 500 index is up 4.1% in the year-to-date period and 12.9% in the past year.

The stock is currently trading at 1.88x trailing 12-month book value, which compares to 1.28x for the Zacks sub-industry, 2.47x for the Zacks sector and 5.77x for the S&P 500 index.

Over the past five years, the stock has traded as high as 2x and as low as 0.68x, with a 5-year median of 1.57x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$70 price target reflects 1.04x trailing 12-month book value.

The table below shows summary valuation data for AFG

| Valuation Multiples - AFG |               |       |              |        |         |
|---------------------------|---------------|-------|--------------|--------|---------|
|                           |               | Stock | Sub-Industry | Sector | S&P 500 |
| P/B TTM                   | Current       | 0.98  | 1.28         | 2.47   | 5.77    |
|                           | 5-Year High   | 2     | 1.67         | 2.91   | 6.19    |
|                           | 5-Year Low    | 0.68  | 0.93         | 1.72   | 3.75    |
|                           | 5-Year Median | 1.57  | 1.46         | 2.54   | 4.87    |
| P/S F12M                  | Current       | 1.11  | 1.70         | 6.44   | 4.09    |
|                           | 5-Year High   | 2.05  | 11.3         | 6.67   | 4.3     |
|                           | 5-Year Low    | 1.01  | 1.4          | 4.97   | 3.11    |
|                           | 5-Year Median | 1.64  | 1.84         | 6.07   | 3.66    |
| P/E F12M                  | Current       | 8.15  | 25.01        | 15.78  | 21.94   |
|                           | 5-Year High   | 17.94 | 31.56        | 16.72  | 23.44   |
|                           | 5-Year Low    | 5.2   | 21.02        | 11.6   | 15.26   |
|                           | 5-Year Median | 12.58 | 25.72        | 14.27  | 17.63   |

As of 09/28/2020

Source: Zacks Investment Research

## Industry Analysis Zacks Industry Rank: Top 48% (119 out of 250)



## Top Peers

| Company (Ticker)                                  | Rec        | Rank |
|---------------------------------------------------|------------|------|
| Markel Corporation (MKL)                          | Outperform | 1    |
| Arch Capital Group Ltd. (ACGL)                    | Neutral    | 3    |
| American International Group, Inc. (AIG)          | Neutral    | 3    |
| Cincinnati Financial Corporation (CINF)           | Neutral    | 4    |
| CNA Financial Corporation (CNA)                   | Neutral    | 3    |
| The Hartford Financial Services Group, Inc. (HIG) | Neutral    | 3    |
| Everest Re Group, Ltd. (RE)                       | Neutral    | 3    |
| Alleghany Corporation (Y)                         | Neutral    | 2    |

The positions listed should not be deemed a recommendation to buy, hold or sell.

| Industry Comparison Industry: Insurance - Property And Casualty |         |            |           | Industry Peers |         |         |
|-----------------------------------------------------------------|---------|------------|-----------|----------------|---------|---------|
|                                                                 | AFG     | X Industry | S&P 500   | MKL            | RE      | Y       |
| Zacks Recommendation (Long Term)                                | Neutral | -          | -         | Outperform     | Neutral | Neutral |
| Zacks Rank (Short Term)                                         | 3       | -          | -         | 1              | 3       | 2       |
| VGM Score                                                       | C       | -          | -         | D              | B       | D       |
| Market Cap                                                      | 5.91 B  | 1.27 B     | 23.11 B   | 13.48 B        | 8.06 B  | 7.41 B  |
| # of Analysts                                                   | 2       | 2          | 14        | 2              | 3       | 1       |
| Dividend Yield                                                  | 2.70%   | 1.29%      | 1.66%     | 0.00%          | 3.08%   | 0.00%   |
| Value Score                                                     | A       | -          | -         | C              | A       | B       |
| Cash/Price                                                      | 0.49    | 0.30       | 0.08      | 0.50           | 0.22    | 0.38    |
| EV/EBITDA                                                       | 3.50    | 5.09       | 13.15     | 4.08           | 5.94    | 4.96    |
| PEG F1                                                          | 1.56    | 2.11       | 2.88      | NA             | 1.55    | NA      |
| P/B                                                             | 0.98    | 0.96       | 3.29      | 1.25           | 1.09    | 0.88    |
| P/CF                                                            | 5.77    | 9.90       | 12.83     | 16.70          | 9.10    | 16.06   |
| P/E F1                                                          | 9.56    | 13.57      | 21.32     | 55.35          | 16.15   | 67.69   |
| P/S TTM                                                         | 0.79    | 0.79       | 2.49      | 1.67           | 0.95    | 0.91    |
| Earnings Yield                                                  | 10.34%  | 6.07%      | 4.44%     | 1.81%          | 6.19%   | 1.48%   |
| Debt/Equity                                                     | 0.31    | 0.23       | 0.70      | 0.33           | 0.07    | 0.24    |
| Cash Flow (\$/share)                                            | 11.57   | 3.12       | 6.92      | 58.60          | 22.15   | 32.24   |
| Growth Score                                                    | D       | -          | -         | D              | C       | D       |
| Historical EPS Growth (3-5 Years)                               | 11.69%  | 4.32%      | 10.43%    | 4.32%          | -15.88% | -17.29% |
| Projected EPS Growth (F1/F0)                                    | -19.95% | -7.68%     | -4.22%    | -54.57%        | -41.52% | -67.82% |
| Current Cash Flow Growth                                        | 7.42%   | 3.77%      | 5.47%     | 13.53%         | 310.65% | 25.33%  |
| Historical Cash Flow Growth (3-5 Years)                         | 12.34%  | 4.81%      | 8.52%     | 9.05%          | -5.41%  | -8.44%  |
| Current Ratio                                                   | 0.15    | 0.43       | 1.35      | 0.68           | 0.36    | 0.37    |
| Debt/Capital                                                    | 23.79%  | 19.02%     | 42.91%    | 25.08%         | 6.27%   | 20.99%  |
| Net Margin                                                      | 3.13%   | 5.15%      | 10.28%    | 2.66%          | 6.24%   | -0.76%  |
| Return on Equity                                                | 11.34%  | 6.89%      | 14.73%    | 3.31%          | 5.74%   | 1.32%   |
| Sales/Assets                                                    | 0.11    | 0.31       | 0.50      | 0.22           | 0.31    | 0.31    |
| Projected Sales Growth (F1/F0)                                  | 0.00%   | 0.00%      | -1.38%    | 9.67%          | 11.21%  | 0.00%   |
| Momentum Score                                                  | D       | -          | -         | F              | F       | F       |
| Daily Price Change                                              | 3.33%   | 2.14%      | 1.85%     | 3.08%          | 1.49%   | 2.45%   |
| 1-Week Price Change                                             | -3.73%  | -3.55%     | -2.32%    | -3.11%         | -1.35%  | 0.93%   |
| 4-Week Price Change                                             | -0.13%  | -3.48%     | -2.53%    | -9.98%         | -8.40%  | -6.62%  |
| 12-Week Price Change                                            | 9.34%   | 3.38%      | 4.17%     | 7.00%          | -2.13%  | 5.94%   |
| 52-Week Price Change                                            | -38.10% | -17.29%    | 0.12%     | -17.22%        | -24.24% | -35.09% |
| 20-Day Average Volume (Shares)                                  | 585,348 | 110,068    | 2,098,704 | 42,280         | 238,815 | 74,749  |
| EPS F1 Estimate 1-Week Change                                   | 0.00%   | 0.00%      | 0.00%     | 0.00%          | 0.00%   | 0.00%   |
| EPS F1 Estimate 4-Week Change                                   | 0.00%   | 0.00%      | 0.00%     | 0.00%          | 0.00%   | 0.00%   |
| EPS F1 Estimate 12-Week Change                                  | 5.26%   | -2.04%     | 4.22%     | 0.00%          | -20.13% | NA      |
| EPS Q1 Estimate Monthly Change                                  | 0.00%   | 0.00%      | 0.00%     | 0.00%          | 0.00%   | 0.00%   |

Source: Zacks Investment Research



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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we maintain a balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

|                |   |
|----------------|---|
| Value Score    | A |
| Growth Score   | D |
| Momentum Score | D |
| VGM Score      | C |

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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## Disclosures

**This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page.** Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

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Investing involves risk; principal loss is possible. There is no guarantee that companies that can issue dividends will declare, continue to pay or increase dividends.

## Glossary of Terms and Definitions

**52-Week High-Low:** The range of the highest and lowest prices at which a stock has traded during the past year. This range is determined based on the stock's daily closing price which may differ from the intra-day high or low. Many investors use it as a technical indicator to determine a stock's current value and future price movement. The idea here is that if price breaks out from the 52-week range, in either direction, the momentum may continue in the same direction.

**20-Day Average Volume (Shares):** The average number of shares of a company traded in a day over the last 20 days. It is a direct indication of a security's overall liquidity. The higher the average daily trading volume, the easier it is to enter or exit the stock at a desired price with more buyers and sellers being available.

**Daily Price Change:** This is the percentage difference between a trading day's closing price and the prior trading day's closing price. This item is updated at 9 p.m. EST each day.

**1-Week Price Change:** This is the percentage change in a stock's closing price over the last 5 trading days. This change reflects the collective buying and selling sentiment over the 1-week period.

A strong weekly price increase for the stock, especially when accompanied by increased volume, is an indication of it gaining momentum.

**4-Week Price Change:** This is the percentage change in a stock's closing price over the last 20 trading days or past 4 weeks. This is a medium-term price change metric and an indication of the stock gaining momentum.

**12-Week Price Change:** This is the percentage change of a stock's closing price over the last 60 trading days or past 12 weeks. Similar to 4-week price change, this is a medium-term price change metric. It shows whether a stock has been enjoying strong investor demand, or if it has been in consolidation, or distress over this period.

**52-Week Price Change:** This is the percentage change in a stock's closing price over the last 260 trading days or past 52 weeks. This long-term price change metric is a good reference point for investors. Some investors seek stocks with the best percentage price change over the last 52 weeks, expecting the momentum to continue.

**Market Cap:** The number of outstanding common shares of a company times its latest price per share. This figure represents a company's size, which indicates various characteristics, including price stability and risk, in which investors could be interested.

**Year-To-Date Price Change:** Change in a stock's daily closing price in the period of time beginning the first day of the current calendar year through to the previous trading day.

**# of Analysts:** Number of EPS estimates used in calculating the current-quarter consensus. These estimates come from the brokerage analysts tracking this stock. However, the number of such analysts tracking this stock may not match the number of estimates, as all brokerage analysts may not come up with an estimate or provide it to us.

**Beta:** A measure of risk commonly used to compare the volatility of a stock to the overall market. The S&P 500 Index is the base for calculating beta and carries a value of 1. A stock with beta below 1 is less risky than the market as a whole. And a stock with beta above 1 is riskier.

**Dividend:** The portion of earnings a company is expected to distribute to its common shareholders in the next 12 months for each share they own. Dividends are usually paid quarterly. Dividend payments reflect positively on a company and help maintain investors' trust. Investors typically find dividend-paying stocks appealing because the dividend adds to any market price appreciation to result in higher return on investment (ROI). Moreover, a steady or increasing dividend payment provides investors a cushion in a down market.

**Dividend Yield:** The ratio of a company's annual dividend to its share price. The annual dividend used in the ratio is calculated based on the most recent dividend paid by the company. Dividend yield is an estimate of the dividend-only return from a stock in the next 12 months. Since dividend itself doesn't change frequently, dividend yield usually changes with a stock's price movement. As a result, often an unusually high dividend yield is a result of weak stock price.

**S&P 500 Index:** The Standard & Poor's 500 (S&P 500) Index is an unmanaged group of securities considered to be representative of the stock market in general. It is a market-capitalization-weighted index of stocks of the 500 largest U.S. companies. Each stock's weight in the index is proportionate to its market value.

**Industry:** One of the 250+ groups that Zacks classifies all stocks into based on the nature of business. These groups are termed as expanded (aka "X") industries and map to their respective (economic) sectors; Zacks has 16 sectors.

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**Zacks Industry Rank:** The Zacks Industry Rank is determined by calculating the average Zacks Rank for all stocks in the industry and then assigning an ordinal rank to it. For example, an industry with an average Zacks Rank of 1.6 is better than an industry with an average Zacks Rank of 2.3. So, the industry with the better average Zacks Rank would get a better Zacks Industry Rank. If an industry has the best average Zacks Rank, it would be considered the top industry (1 out of 250+), which would place it at the top 1% of Zacks-ranked industries. Studies have shown that roughly half of a stock's price movement can be attributed to the industry group it belongs to. In fact, the top 50% of Zacks-ranked industries outperforms the bottom 50% by a factor of more than 2 to 1.

**Last EPS Surprise:** The percentage deviation of a company's last reported earnings per share from the Zacks Consensus Estimate. Companies with a positive earnings surprise are more likely to surprise again in the future (or miss again if they recently missed).

**Last Sales Surprise:** The percentage deviation of a company's last reported sales from the Zacks Consensus Estimate.

**Expected Report Date:** This is an estimated date of a company's next earnings release. The information originated or gathered by Zacks Investment Research from its information providers or publicly available sources is the basis of this estimate.

**Earnings ESP:** The Zacks Earnings ESP compares the Most Accurate Estimate to the Zacks Consensus Estimate for the yet-to-be reported quarter. The Most Accurate Estimate is the most recent version of the Zacks Consensus EPS Estimate. The idea here is that analysts revising their estimates closer to an earnings release have the latest information, which could potentially be more accurate than what they and others contributing to the consensus had predicted earlier. Thus, a positive or negative Earnings ESP reading theoretically indicates the likely deviation of the actual earnings from the consensus estimate. However, the model's predictive power is significant for positive ESP readings only. A positive Earnings ESP is a strong predictor of an earnings beat, particularly when combined with a Zacks Rank #1 (Strong Buy), #2 (Buy) or #3 (Hold). Our research shows that stocks with this combination produce a positive surprise nearly 70% of the time.

**Periods:**

**TTM:** Trailing 12 months. Using TTM figures is an effective way of analyzing the most-recent financial data in an annualized format that helps neutralize the effects of seasonality and other quarter-to-quarter variation.

**F1:** Current fiscal year. This period is used to analyze the estimates for the ongoing full fiscal year.

**F2:** Next fiscal year. This period is used to analyze the estimates for the next full fiscal year.

**F12M:** Forward 12 months. Using F12M figures is an effective way of analyzing the near-term (the following four unreported quarters) estimates in an annualized manner. Instead of typically representing estimates for the full fiscal year, which may not represent the nitty-gritty of each quarter, F12M figures suggest an all-inclusive annualized estimate for the following four quarters. The annualization helps neutralize the potential effects of seasonality and other quarter-to-quarter variations.

**P/E Ratio:** The price-to-earnings ratio measures a company's current market price per share relative to its earnings per share (EPS). Usually, the trailing-12-month (TTM) EPS, current-fiscal-year (F1) EPS estimate, or forward-12-month (F12M) EPS estimate is used as the denominator. In essence, this ratio shows what the market is willing to pay today for each dollar of EPS. In other words, this ratio gives a sense of what the relative value of the company is at the already reported level of earnings or at a future level of earnings.

It is one of the most widely-used multiples for determining the value of a company and helps comparing its valuation with that of a competitor, the industry group or a benchmark.

**PEG Ratio:** The price/earnings to growth ratio is a stock's P/E ratio using current fiscal year (F1) EPS estimate divided by its expected EPS growth rate over the coming 3 to 5 years. This ratio essentially determines a stock's value by factoring in the company's expected earnings growth and is thus believed to provide a more complete picture than just the P/E ratio, particularly for faster-growing companies.

**P/S Ratio:** The price-to-sales ratio is calculated as a company's current price per share divided by trailing 12 months (TTM) sales or revenues per share. This ratio shows what the market is willing to pay today for each dollar of TTM sales per share. The P/S ratio is at times the only valuation metric when the company has yet to become profitable.

**Cash/Price Ratio:** The cash-to-price ratio or Cash Yield is calculated as cash and marketable securities per share divided by the company's current share price. Like the earnings yield, which shows the anticipated yield (or return) on a stock from earnings for each dollar invested, the cash yield does the same, with cash being the source of return instead of earnings. For example, a cash/price ratio of 0.08 suggests a return of 8% or 8 cents for every \$1 investment.

**EV/EBITDA Ratio:** The EV/EBITDA ratio, also known as Enterprise Multiple, is calculated as a company's enterprise value (market capitalization + value of total long-term debt + book value of preferred shares - cash and marketable securities) divided by EBITDA (earnings before interest, taxes, depreciation and amortization). Usually, trailing-12-month (TTM) or forward-12-month (F12M) EBITDA is used as the denominator.

**EV/Sales Ratio:** The enterprise value-to-sales ratio is calculated as a company's enterprise value (market capitalization + value of total long-term debt + book value of preferred shares - cash and marketable securities) divided by annual sales. It is an expansion of the P/S valuation, which uses market value instead of enterprise value. The EV/Sales ratio is perceived as more accurate than P/S, in part, because the market capitalization does not take a company's debt into account when valuing it.

**EV/CF Ratio:** The enterprise value-to-cash flow ratio is calculated as a company's enterprise value (market capitalization + value of total long-term debt + book value of preferred shares - cash and marketable securities) divided by the trailing-12-month (TTM) operating cash flow. It's a measure of how long it would take to buy the entire business if you were able to use all the company's operating cash flow.

The EV/CF ratio is perceived as more accurate than the P/CF ratio, in part, because the market price does not take a company's debt into account when valuing it.

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**EV/FCF Ratio:** The enterprise value-to-free cash flow metric compares a company's enterprise value to its trailing-12-month (TTM) free cash flow (FCF). This metric is very similar to the EV/CF ratio, but is considered a more exact measure owing to the fact that it uses free cash flow, which subtracts capital expenditures (CAPEX) from a company's total operating cash flow, thereby reflecting the actual cash flow available for funding growth activities and payments to shareholders.

**P/EBITDA Ratio:** The P/EBITDA ratio is calculated as a company's per share market value divided by EBITDA (earnings before interest, taxes, depreciation, and amortization). This metric is very similar to the EV/EBITDA ratio, but is considered a little less exact measure as it uses market price, which does not take a company's debt into account. However, since EBITDA is often considered a proxy for cash income, the metric is used as a measure of what the market is willing to pay today for each dollar of the company's cash profitability in the trailing 12 months (TTM) or forward 12 months (F12M).

**P/B Ratio:** The price-to-book ratio is calculated as a company's current price per share divided by its book value (total assets – liabilities – preferred stocks) per share. In short, the book value is how much a company is worth. In other words, it reflects the total value of a company's assets that its common shareholders would receive if it were to be liquidated. So, the P/B ratio indicates whether you're paying higher or lower than what would remain if the company went bankrupt immediately. Investors typically use this metric to determine how a company's stock price stacks up to its intrinsic value.

**P/TB Ratio:** The price-to-tangible-book value ratio is calculated as a the per share market value of a company divided by the value of its tangible assets (total assets – liabilities – preferred stocks – intangible assets) per share. Tangible book value is the same thing as book value except it excludes the value of intangible assets to get a step closer to the baseline value of the company.

**P/CF Ratio:** The price-to-cash flow ratio measures a company's per share market price relative to its trailing-12-month (TTM) operating cash flow per share. This metric is used to determine whether a company is undervalued or overvalued relative to another stock, industry or sector. And like the P/E ratio, a lower number is typically considered better from the value perspective.

One of the reasons why P/CF ratio is often preferred over P/E ratio is the fact that operating cash flow adds back non-cash expenses such as depreciation and amortization to net income. This feature helps valuing stocks that have positive cash flow but are not profitable because of large noncash charges.

**P/FCF Ratio:** The price-to-free cash flow ratio is an extension of P/CF ratio, which uses trailing-12-month (TTM) free cash flow per share instead of operating cash flow per share. This metric is considered a more exact measure than P/CF ratio, as free cash flow subtracts capital expenditures (CAPEX) from a company's total operating cash flow, thereby reflecting the actual cash flow available for funding activities that generate additional revenues.

**Earnings Yield:** The earnings yield is calculated as current fiscal year (F1) EPS estimate divided by the company's current share price. The ratio, which is the inverse of the P/E ratio, measures the anticipated yield (or return) from earnings for each dollar invested in a stock today.

For example, earnings yield for a stock, which is trading at \$35 and expected to earn \$3 per share in the current fiscal year (F1), would be 0.0857 ( $3/35 = 0.0857$ ) or 8.57%. In other words, for \$1 invested in the stock today, the yield from earnings is anticipated to be 8.57 cents.

Investors most commonly compare the earnings yield of a stock to that of a broad market index (such as the S&P 500) and prevailing interest rates, such as the current 10-year Treasury yield. Since bonds and stocks compete for investors' dollars, stock investors typically demand a higher yield for the extra risk they assume compared to investors of U.S. Treasury-backed securities that offer virtually risk-free returns. This additional return is referred to as the risk premium.

**Debt/Equity Ratio:** The debt-to-equity ratio is calculated as a company's total liabilities divided by its shareholder equity. This metric is used to gauge a company's financial leverage. In other words, it is a measure of the degree to which a company is financing its operations through debt versus its own funds. The higher the ratio, the higher the risk for shareholders.

However, this ratio is difficult to compare across industry groups where ideal amounts of debt vary. Some businesses are more capital intensive than others and typically require higher debt to finance their operations. So, a company's debt-to-equity ratio should be compared with other companies in the same industry.

**Cash Flow (\$/share):** Cash flow per share is calculated as operating cash flow (after-tax earnings + depreciation + other non-cash charges) divided by common shares outstanding. It is used by many investors as a measure of a company's financial strength. Since cash flow per share takes into consideration a company's ability to generate cash by adding back non-cash expenses, it is regarded by some as a more accurate measure of a company's financial situation than earnings per share, which could be artificially deflated.

**Current Ratio:** The current ratio or liquidity ratio is a company's current assets divided by its current liabilities. It measures a company's ability to pay short-term obligations. A current ratio that is in line with the industry average or slightly higher is generally considered acceptable. A current ratio that is lower than the industry average would indicate a higher risk of distress or default. A higher number is usually better. However, a very high current ratio compared to the industry average could be an indication of inefficient use of assets by management.

**Debt/Capital Ratio:** Debt-to-capital ratio is a company's total debt (interest-bearing debt + both short- and long-term liabilities) divided its total capital (interest-bearing debt + shareholders' equity). It is a measure of a company's financial leverage. All else being equal, the higher the debt-to-capital ratio, the riskier the stock.

However, this ratio can vary widely from industry to industry, the ideal amount of required debt being different. Some businesses are more capital intensive than others and typically require higher debt to finance their operations. So, a company's debt-to-capital ratio should be compared with the same for its industry.

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**Net Margin:** Net margin is calculated as net income divided by sales. It shows how much of each dollar in sales generated by a company translates into profit. For example, if a company's net margin is 15%, its net income is 15 cents for every \$1 of sales it makes.

A change in margin can reflect either a change in business conditions, or a company's cost controls, or both. If a company's expenses are growing faster than sales, its net margin will decline. However, different net margin rates are considered good for different industries, so it's better to compare net margin rates of companies in the same industry group.

**Return on Equity:** Return on equity (ROE) is calculated as trailing-12-month net income divided by trailing-12-month average shareholder equity (including reinvested earnings). This metric is considered a measure of how effectively management is using a company's assets to generate profits. For example, if a company's ROE is 10%, it creates 10 cents profits for every \$1 shareholder equity, which is basically the company's assets minus debt. A company's ROE deemed good or bad depends on what's normal for its peers or industry group.

**Sales/Assets Ratio:** The sales-to-assets ratio or asset utilization ratio or asset turnover ratio is calculated as a company's annual sales divided by average assets (average of assets at the beginning of the year and at the year's end). This metric helps investors understand how effectively a company is using its assets to generate sales. For example, a sales-to-assets ratio of 2.5 indicates that the company generated \$2.50 in sales for every \$1 of assets on its books.

The higher the sales-to-assets ratio, the better the company is performing. However, similar to many other ratios, the asset turnover ratio tends to be higher for companies in certain industries/sectors than in others. So, a company's sales-to-assets ratio should be compared with the same for its industry/sector.

**Historical EPS Growth (3-5 Years):** This is the average annual (trailing-12-month) EPS growth rate over the last 3-5 years. This metric helps investors see how a company's EPS has grown from a long-term perspective.

Note: There are many factors that can influence short-term numbers — a recession will reduce this number, while a recovery will inflate it. The longterm perspective helps smooth out short-term events.

**Projected EPS Growth (F1/F0):** This is the estimated EPS growth rate for the current financial year. It is calculated as the consensus estimate for the current fiscal year (F1) divided by the reported EPS for the last completed fiscal year (F0).

**Current Cash Flow Growth:** It measures the latest year-over-year change in operating cash flow. Cash flow growth tells an investor how quickly a company is generating inflows of cash from operations. A positive change in the cash flow is desired and shows that more 'cash' is coming in than going out.

**Historical Cash Flow Growth (3-5 Years):** This is the annualized change in cash flow over the last 3-5 years. The change in a longer period helps put the current reading into proper perspective. By looking at the rate, rather than the actual dollar value, the comparison across the industry and peers becomes easier.

**Projected Sales Growth (F1/F0):** This metric looks at the estimated sales growth for the current year. It is calculated as sales estimate for the current fiscal year (F1) divided by the reported sales for the last completed fiscal year (F0).

Like EPS growth, a higher rate is better for sales growth. A look at a company's projected sales growth instantly tells you what the outlook is for their products and services. However, different sales growth rates are considered good for different industries, so it's better to compare sales growth rates of companies in the same industry group.

**EPS F1 Estimate 1-Week Change:** The percentage change in the Zacks Consensus EPS estimate for the current fiscal year over the past week. The change in a company's consensus EPS estimate (or earnings estimate revision) has proven to be strongly correlated with the near-term price movement of its shares. It is an integral part of the Zacks Rank.

If a stock's consensus EPS estimate is \$1.10 now versus \$1.00 a week ago, that will be reflected as a 10% upward revision. If, on the other hand, it went from \$1.00 to 90 cents, that would be a 10% downward revision.

**EPS F1 Estimate 4-Week Change:** The percentage change in the Zacks Consensus EPS estimate for the current fiscal year over the past four weeks.

A stock's earnings estimate revision in a 1-week period is important. But it's more meaningful to look at the longer-term revision. And, of course, the 4-week change helps put the 1-week change into proper perspective.

**EPS F1 Estimate 12-Week Change:** The percentage change in the Zacks Consensus EPS estimate for the current fiscal year over the past 12 weeks.

This metric essentially shows how the consensus EPS estimate has changed over a period longer than 1 week or 4 weeks.

**EPS Q1 Estimate Monthly Change:** The percentage change in the Zacks Consensus EPS estimate for the current fiscal quarter over the past four weeks.

While the revision in consensus EPS estimate for the current fiscal year is strongly correlated with the near-term price movement of its shares, the estimate revision for the current fiscal quarter is an important metric as well, especially over the short term, and particularly as a stock approaches its earnings date. If a stock's Q1 EPS estimate decreases ahead of its earnings release, it's usually a negative sign, whereas an increase is a positive sign.