

AAR Corp. (AIR)

\$19.33 (As of 10/07/20)

Price Target (6-12 Months): **\$21.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 04/20/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: B

Growth: A

Momentum: A

Summary

AAR Corp. ended the first quarter of fiscal 2021 on an impressive note, with both revenues and earnings surpassing the respective Zacks Consensus Estimate. The company continues to witness strong performance in its parts supply and program activities. Strategic investments toward its parts supply activities have enabled the company to capitalize on steady parts demand. AAR Corp., being the largest aftermarket parts supplier in the world, will benefit from elevated demand for used serviceable materials. However, it has underperformed the industry in the past one year. AAR Corp. continues to witness labor shortages in its MRO business and the issue is expected to linger in the near term. Further, its unfavorable financial ratio indicates that AAR Corp. might face difficulties and struggle to meet debt obligations, at least in the near future.

Data Overview

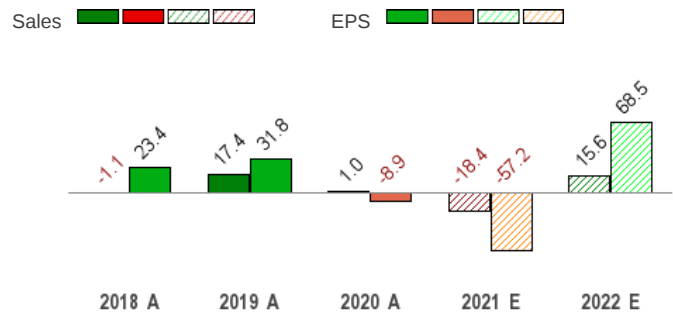
52-Week High-Low	\$52.78 - \$8.56
20-Day Average Volume (Shares)	387,936
Market Cap	\$682.4 M
Year-To-Date Price Change	-57.1%
Beta	1.59
Dividend / Dividend Yield	\$0.00 / 0.0%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 11% (224 out of 252)

Last EPS Surprise	206.3%
Last Sales Surprise	3.5%
EPS F1 Estimate 4-Week Change	187.5%
Expected Report Date	12/17/2020
Earnings ESP	0.0%
P/E TTM	11.1
P/E F1	21.0
PEG F1	NA
P/S TTM	0.4

Price, Consensus & Surprise



Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	460 E	455 E	515 E	533 E	1,955 E
2021	401 A	404 E	434 E	452 E	1,691 E
2020	542 A	561 A	553 A	417 A	2,072 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.29 E	\$0.33 E	\$0.44 E	\$0.49 E	\$1.55 E
2021	\$0.17 A	\$0.17 E	\$0.29 E	\$0.30 E	\$0.92 E
2020	\$0.57 A	\$0.64 A	\$0.67 A	\$0.26 A	\$2.15 A

*Quarterly figures may not add up to annual.

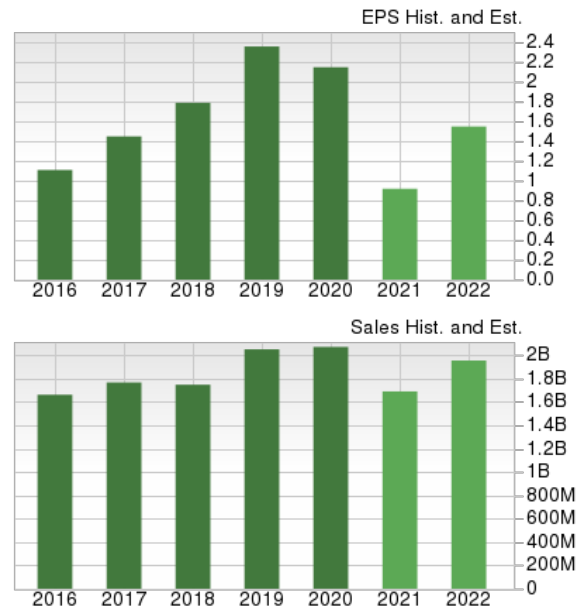
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 10/07/2020. The reports text is as of 10/08/2020.

Overview

Wood Dale, IL-based AAR Corp., incorporated in the year 1951, provides various products and services to the aviation and defense industries worldwide. Its principal customers include The Boeing Company and Airbus. The company now reports through two business segments – **Aviation Services** and **Expeditionary Services** – following the divestiture of Telair Cargo Group and the planned sale of Precision Systems Manufacturing.

The *Aviation Services* segment provides aftermarket support and services for the commercial aviation, and government and defense markets and accounted for approximately 95% of sales in fiscal 2020. It comprises supply chain maintenance, repair and overhaul (MRO) activities. The company sells and leases a wide variety of new, overhauled and repaired engine and airframe parts and components, and aircraft to its commercial aviation and government/defense customers. It provides inventory management and distribution services, overhaul, repair and engineering services. Segment sales in fiscal 2020 were \$1,964.2 million, representing 94.8% of the company's total sales.

The *Expeditionary Services* segment includes airlift and mobility activities. This division provides products and services for the movement of equipment and personnel by the U.S. Department of Defense (DoD), foreign governments and non-governmental organizations. This segment also designs manufactures and installs in-plane cargo loading and handling systems for commercial aircraft, military aircraft and helicopters. Business activities in this segment are primarily conducted through AAR Manufacturing, Inc. and Brown International Corporation. Sales during fiscal 2020 came in at \$107.8 million, contributing 5.2% to the company's total sales.



Source: Zacks Investment Research

Reasons To Buy:

- ▲ AAR Corp. continues to witness strong performance in its parts supply and program activities. In fact, within its parts business, both in trading and distribution, the company witnessed consistent performance in terms of order volume during the first quarter of fiscal 2021. Notably, the company's steady investments toward its parts supply activities have enabled it to capitalize on the continued robust demand for parts.
- ▲ Although the current COVID-19 pandemic has decreased the amount of commercial aircraft flying and flight hours and has created significant economic disruption, the company believes that its long-term commercial aftermarket growth trends are favorable. In particular, AAR Corp. expects elevated demand for used serviceable materials as airline companies look to save money using aftermarket parts. AAR Corp., being the largest aftermarket parts supplier in the world, will benefit from this trend. This along with maintenance deferrals occurring for both airframe and engine are expected to drive increased demand for services from the company's trading, distribution and MRO businesses as the commercial market recovers.
- ▲ Moreover, the company anticipates the competition in the aftermarket, which has intensified in recent years due to the length of the up cycle, to decrease as competitors struggle to survive or increasingly focus on core activities. Banking on such initiatives, management expects to witness continued growth in the company's parts supply business over the long term.
- ▲ Coming to its latest business developments, the company received a three-year contract from the Royal Netherlands Air Force to repair F-16 jet fuel starters, during the fiscal first quarter. Moreover, its Airinmar subsidiary, which provides component repair cycle management and aircraft warranty solutions, won two new contracts. Further, AAR Corp. was selected by both Frontier Airlines and Air Methods, the world's largest civilian helicopter operator to provide a full suite of warranty and value engineering services. Moreover, the company signed a new partnership deal with Corporation for Skilled Workforce (CSW) to grow and diversify the talent pool of aviation maintenance technicians and reduce future labor shortages. Such joint ventures and contract signing can be expected to enhance AAR Corp.'s footprint in the aerospace and defense space.

Solid performance from its parts supply program to boost AAR Corp's top line. Recent contract wins and partnership agreements should bode well for the stock.

Reasons To Sell:

▼ AAR Corp has been witnessing labor shortages in its MRO business for quite some time. Indeed, entire North America is facing labor shortage issues in its aviation industry, which has now been translated in to the aftermarket MRO industry. To this end, Oliver Wyman, a leading global management consulting firm, predicted in April 2018 that technician supply will be challenging over the next five years for the MRO aviation space, which could result in increased labor costs. Moreover, adverse impact of COVID-19 on commercial passenger air traffic has significantly reduced volumes in the company's MRO activities. Therefore, the growth prospects of AAR Corp's MRO business seem to be bleak, at least in the near future.

Labor shortage issues in MRO business and unfavorable financial ratio may limit the growth prospects of AAR Corp.

▼ In 2019, the U.S. Department of Justice (DoJ) conducted an investigation of AAR Corp.'s Airlift business segment, under the federal civil False Claims Act (FCA). The investigation was carried out, as Airlift's performance related to several contracts awarded by the U.S. Transportation Command, concerning the operations and maintenance of rotary-wing and fixed-wing aircraft in Afghanistan and Africa, was scrutinized. Considering these events, AAR Corp ultimately decided to divest its Airlift assets. This divestment might negatively impact the company's operating results, as it will lose the contracts it used to win for the Airlift business. This, in turn, will likely dampen investors' confidence in the stock. In the past year, shares of AAR Corp have plunged 52.9% compared with the industry's 37.6% decline.

▼ AAR Corp's cash equivalents as on Aug 31, 2020, remained considerably lower compared to its long-term debt levels. Evidently, at the end of the first-quarter fiscal 2021, its cash equivalents were \$114 million, while its long-term debt stood at \$255 million as of Aug 31, 2020. The quarterly cash reserve figure also deteriorated sequentially from \$425 million as of May 31, 2020. This along with the ongoing uncertainty related to the COVID-19 pandemic makes us skeptical about the company's ability to duly meet its obligations in the near future.

Moreover, the company's interest coverage came in at 0.1 as of Aug 31, 2020, significantly down sequentially from 4.3 and also lowest in the last four quarters. Its current ratio of 2.72 as of Aug 31, 2020 also came in lower sequentially from 3.76 as of May 31, 2020. Such unfavorable financial ratio indicates that AAR Corp. might face difficulties and struggle to meet debt obligations, at least in the near future.

Last Earnings Report

AAR Corp. Q1 Earnings Beat Estimates, Sales Fall Y/Y

AAR Corp. reported first-quarter fiscal 2021 adjusted earnings of 17 cents per share in contrast to the Zacks Consensus Estimate of a loss of 16 cents. The figure reflected a year-over-year decline of 70.2% from earnings of 57 cents registered in the year-ago quarter.

Excluding one-time items, the company reported a loss of 40 cents per share from continuing operations against earnings of 49 cents in first-quarter fiscal 2020.

Quarter Ending 08/2020

Report Date	Sep 24, 2020
Sales Surprise	3.49%
EPS Surprise	206.25%
Quarterly EPS	0.17
Annual EPS (TTM)	1.74

Total Sales

In the quarter under review, net sales totaled \$400.8 million. The reported figure outpaced the Zacks Consensus Estimate of \$382 million by 3.5% but plunged 26% from \$541.5 million recorded in the year-ago quarter.

The year-over-year decline in sales was due to the continued impact of COVID-19 outbreak.

Segment Details

In the fiscal first quarter, sales at the Aviation Services segment totaled \$363.6 million, down 29% year over year.

Expeditionary Services garnered sales of \$37.2 million, up 25.3% from \$29.7 million in the year-ago quarter.

Highlights of the Release

AAR Corp's cost of sales in the reported quarter fell 23.4% year over year to \$352.2 million.

Selling, general and administrative expenses declined 22% to \$45.3 million.

The company incurred interest expenses of \$1.6 million compared with \$2.1 million in first-quarter fiscal 2020.

During the quarter under review, the company paid out cash dividends of \$0.1 million.

Financial Condition

As of Aug 31, 2020, AAR Corp's cash and cash equivalents amounted to \$10.7 million compared with \$404.7 million as of May 31, 2020.

As of Aug 31, 2020, net property, plant and equipment expenses totaled \$127 million compared with \$135.7 million as of May 31, 2020.

As of Aug 31, 2020, total debt decreased to \$149.3 million from \$197.3 million as of May 31, 2020.

Recent News

On **Aug 3, 2020**, AAR Corp. announced that its subsidiary, Airinmar has signed a new services agreement with the world's largest civilian helicopter operator, Air Methods.

Airinmar's services will include the identification, claim, recovery and reporting of rotorcraft/aircraft component warranty. Airinmar will compliment Air Methods' existing processes and apply its proven procedures, support systems and skilled technical staff. With this partnership, Air Methods will also benefit from Airinmar's value engineering of costs associated with the repair process, including price quotes from suppliers and service vendors. Based on the data analyses and findings, Airinmar identifies cost reductions, as well as process improvements.

On **Jul 27, 2020**, AAR Corp. was awarded a three-year contract by the Royal Netherlands Air Force (RNLAf) to perform maintenance, repair and overhaul on F-16 jet fuel starters. AAR will service the jet fuel starters in its component repair facility in Amsterdam, where AAR has been supporting European Participating Air Forces (EPAf) for over 30 years as a prime provider or subcontractor for repair management, component maintenance, supply chain and depot services.

On **Jul 15, 2020**, AAR Corp. and Unison Industries jointly announced the expansion and extension of the longstanding partnership as the exclusive worldwide aftermarket distributor for Unison Industries' aviation, aerospace, military, civil and land vehicles products. The agreement, valued at more than \$1 billion over 11-year period, adds new material content to include new product introduction spanning multiple aircraft platforms.

Valuation

AAR Corp.'s shares are down 57.2% in the year-to-date period and 52.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 41.8% and 34.4% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 37.6% and the Zacks Aerospace sector witnessed a 37.7% decline.

The S&P 500 index is up 6.2% in the year to date period and 17.4% in the past year.

The stock is currently trading at 16.9X forward 12-month earnings, which compares to 21.9X for the Zacks sub-industry, 19.5X for the Zacks sector and 22.3X for the S&P 500 index.

Over the past five years, the stock has traded as high as 68.3X and as low as 3.2X, with a 5-year median of 16.5X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$21 price target reflects 18.4X forward 12-month earnings.

The table below shows summary valuation data for AIR

Valuation Multiples - AIR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	16.89	21.85	19.47	22.33
	5-Year High	68.34	23.54	20.96	23.47
	5-Year Low	3.22	12.99	14.17	15.27
	5-Year Median	16.5	17.38	17.54	17.7
P/S F12M	Current	0.38	1.4	1.63	4.1
	5-Year High	0.8	1.44	1.68	4.3
	5-Year Low	0.14	0.79	0.93	3.18
	5-Year Median	0.61	1.07	1.24	3.67
EV/EBITDA TTM	Current	6.29	9.39	15.95	14.91
	5-Year High	22	12.01	16.69	15.66
	5-Year Low	3.1	5.85	7.61	9.53
	5-Year Median	9.87	9.04	10.7	13.07

As of 10/07/2020

Source: Zacks Investment Research

Industry Analysis Zacks Industry Rank: Bottom 11% (224 out of 252)



Source: Zacks Investment Research

Top Peers

Company (Ticker)	Rec	Rank
Aerojet Rocketdyne Holdings, Inc. (AJRD)	Neutral	3
AeroVironment, Inc. (AVAV)	Neutral	3
CurtissWright Corporation (CW)	Neutral	3
Heico Corporation (HEI)	Neutral	3
Kratos DefenseSecurity Solutions, Inc. (KTOS)	Neutral	3
Triumph Group, Inc. (TGI)	Neutral	4
Astronics Corporation (ATRO)	Underperform	4
Hexcel Corporation (HXL)	Underperform	5

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

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	AIR	X Industry	S&P 500	AJRD	ATRO	HXL
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Underperform
Zacks Rank (Short Term)	2	-	-	3	4	5
VGM Score	A	-	-	A	A	C
Market Cap	682.36 M	1.57 B	23.47 B	3.18 B	248.20 M	3.14 B
# of Analysts	2	3.5	14	2	2	6
Dividend Yield	0.00%	0.00%	1.62%	0.00%	0.00%	0.00%
Value Score	B	-	-	B	B	B
Cash/Price	0.17	0.16	0.07	0.33	0.19	0.08
EV/EBITDA	9.87	8.42	13.46	7.99	3.48	7.31
PEG F1	NA	8.46	2.90	NA	NA	7.04
P/B	0.77	2.19	3.49	4.74	0.85	2.19
P/CF	5.71	8.32	13.28	14.88	3.99	7.12
P/E F1	21.01	27.57	21.75	22.54	NA	39.68
P/S TTM	0.35	1.25	2.62	1.60	0.38	1.53
Earnings Yield	4.76%	2.70%	4.41%	4.42%	-40.02%	2.52%
Debt/Equity	0.29	0.37	0.70	0.50	0.59	0.88
Cash Flow (\$/share)	3.39	2.26	6.92	2.72	2.02	5.29
Growth Score	A	-	-	A	B	C
Historical EPS Growth (3-5 Years)	27.26%	9.93%	10.45%	35.20%	-23.20%	8.21%
Projected EPS Growth (F1/F0)	-57.21%	-16.64%	-2.99%	6.21%	-454.40%	-73.21%
Current Cash Flow Growth	-5.56%	12.73%	5.47%	-8.04%	-23.43%	12.73%
Historical Cash Flow Growth (3-5 Years)	2.12%	5.99%	8.50%	70.16%	-8.28%	9.27%
Current Ratio	2.72	2.72	1.35	1.76	2.90	3.86
Debt/Capital	22.27%	32.58%	42.90%	33.51%	37.18%	46.81%
Net Margin	-0.75%	4.46%	10.28%	6.46%	-18.79%	9.48%
Return on Equity	6.72%	9.35%	14.79%	19.79%	-0.93%	14.73%
Sales/Assets	1.05	0.73	0.51	0.73	0.86	0.64
Projected Sales Growth (F1/F0)	-18.39%	-1.97%	-0.62%	4.26%	-36.85%	-30.44%
Momentum Score	A	-	-	B	C	F
Daily Price Change	1.58%	0.95%	1.74%	-0.54%	4.26%	1.95%
1-Week Price Change	-0.36%	0.00%	2.13%	-3.77%	2.29%	11.23%
4-Week Price Change	3.76%	-0.45%	1.57%	-0.61%	-2.30%	-0.45%
12-Week Price Change	-0.67%	-0.96%	5.89%	6.05%	-16.85%	-17.12%
52-Week Price Change	-52.92%	-15.52%	6.10%	-15.52%	-71.98%	-50.92%
20-Day Average Volume (Shares)	387,936	189,393	2,147,698	915,367	224,495	932,775
EPS F1 Estimate 1-Week Change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
EPS F1 Estimate 4-Week Change	187.50%	0.00%	0.00%	0.00%	0.00%	-2.43%
EPS F1 Estimate 12-Week Change	132.91%	2.02%	3.55%	5.77%	15.07%	-25.62%
EPS Q1 Estimate Monthly Change	650.00%	0.00%	0.00%	0.00%	0.00%	-13.07%

Source: Zacks Investment Research

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.

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	B
Growth Score	A
Momentum Score	A
VGM Score	A

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.

Disclosures

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Returns quoted represent past performance which is no guarantee of future results. Investment returns and principal value will fluctuate so that when shares are redeemed, they may be worth more or less than their original cost. Current performance may be higher or lower than the performance shown.

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.

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.

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.

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.