

## Arthur J Gallagher(AJG)

**\$139.40** (As of 06/17/21)

Price Target (6-12 Months): **\$146.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 12/07/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

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

**3-Hold**

Zacks Style Scores:

VGM:D

Value: C

Growth: D

Momentum: D

## Summary

Shares of Arthur J. Gallagher have outperformed its industry in a year. The company is likely to continue benefiting from solid organic growth, which have been driving revenues. Sturdy performance across its Brokerage and Risk Management segments also bode well. The company expects organic revenues in Risk Management and Brokerage segment to be better than 2020 level. Its focus on tapping opportunities across the globe bodes well for growth. Its inorganic growth story seems impressive with strategic buyouts. Its solid performance is driving cash flow and helping it to deploy capital in shareholder-friendly moves. However, escalating expenses weigh on the company's margin expansion. Also, high debt level induces higher interest expenses and low times interest earned concerns. Lower return on equity poses financial risk for the company.

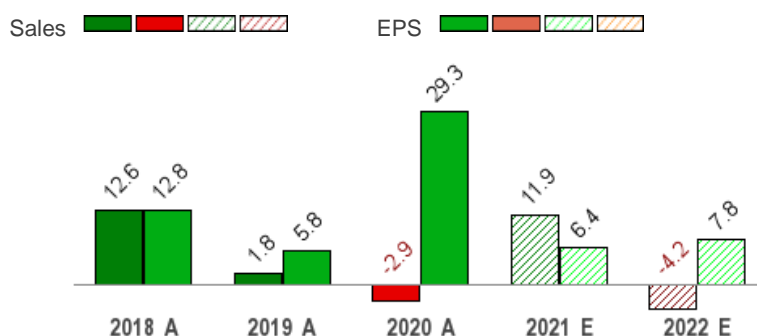
## Price, Consensus & Surprise



## Data Overview

52-Week High-Low	\$154.03 - \$93.87
20-Day Average Volume (Shares)	1,248,502
Market Cap	\$28.7 B
Year-To-Date Price Change	12.7%
Beta	0.70
Dividend / Dividend Yield	\$1.92 / 1.4%
Industry	Insurance - Brokerage
Zacks Industry Rank	Bottom 29% (178 out of 252)

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



## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	1,953 E	1,643 E	1,772 E	1,716 E	7,341 E
2021	2,133 A	1,686 E	1,959 E	1,812 E	7,665 E
2020	1,829 A	1,552 A	1,808 A	1,664 A	6,852 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$2.13 E	\$1.14 E	\$1.23 E	\$1.02 E	\$5.41 E
2021	\$2.02 A	\$1.04 E	\$1.09 E	\$0.91 E	\$5.02 E
2020	\$1.83 A	\$0.94 A	\$1.08 A	\$0.88 A	\$4.72 A

\*Quarterly figures may not add up to annual.

Last EPS Surprise	10.4%
Last Sales Surprise	10.9%
EPS F1 Estimate 4-Week Change	-0.3%
Expected Report Date	07/29/2021
Earnings ESP	-1.3%
P/E TTM	28.3
P/E F1	27.8
PEG F1	2.6
P/S TTM	3.9

The data in the charts and tables, including the Zacks Consensus EPS and sales estimates, is as of 06/17/2021. The report's text and the

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analyst-provided price target are as of 06/18/2021.

## Overview

Headquartered in Itasca, IL and founded in 1927, Arthur J. Gallagher & Co., together with its subsidiaries, provides insurance brokerage and consulting services and third-party claims settlement and administration services in the United States and internationally. While the company boasts world's largest property/casualty third-party claims administrator, it ranks world's fourth largest globally among insurance brokers based on revenues.

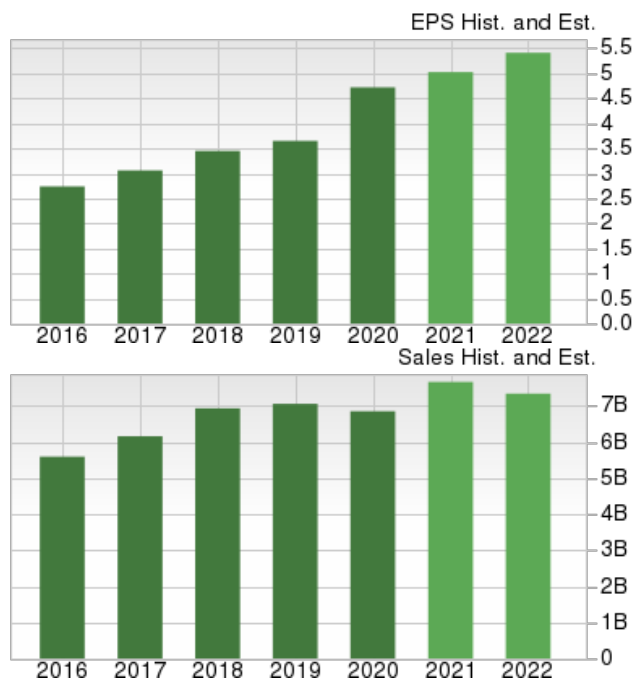
More than two-third of revenues comes from the combined brokerage and risk management segments domestically, with the remaining being generated internationally, primarily in Australia, Bermuda, Canada, the Caribbean, New Zealand and the United Kingdom. Substantially all the revenues of the corporate segment are generated in the United States.

Arthur J. Gallagher operates through three segments:

The Brokerage segment (61% of 2020 revenues) consists of retail and wholesale brokerage operations in a network of more than 550 sales and service offices located throughout the U.S. and in 29 other countries. The segment also offers client-service capabilities in approximately 140 countries. While retail brokerage operations negotiate and place property/casualty, employer-provided health and welfare insurance, and healthcare exchange retirement solutions for middle-market commercial, industrial, public entity, religious, and not-for-profit entities, the wholesale brokerage operations assist the company's brokers, and other unaffiliated brokers and agents in the placement of specialized and hard-to-place insurance programs.

The Risk Management segment (14%) provides contract claim settlement and administration services for enterprises that choose to self-insure some or all of their property/casualty coverage and for insurance companies that choose to outsource some or all of their property/casualty claims departments.

The Corporate segment (25%) reports the financial information related to our debt, clean energy investments, external acquisition-related expenses, other corporate costs and the impact of foreign currency translation. The revenues reported by this segment result almost solely from its consolidated clean energy investments.



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## Reasons To Buy:

- ▲ Shares of Arthur J. Gallagher have gained 47.1% compared with the industry's increase of 27.4% in the past year. Strong operational environment along with a favorable outlook for segment growth will further help the shares to trend higher.
- ▲ Arthur J. Gallagher boasts impressive growth, driven by organic sales, acquisitions and mergers. It completed and integrated 600 acquisitions from Jan 1, 2002 through Dec 31, 2020, most of which were within its brokerage segment. In first-quarter 2021, the company completed five mergers, representing about \$90 million of annualized revenues. The company's merger and acquisition pipeline is quite strong with about \$250 million of revenues, associated with about 40 term sheets either agreed upon or being prepared. The company expects a very active 2021, particularly in the United States due to concerns related to possible tax changes.
- ▲ The company's organic growth efforts have been driving revenues, on the back of growing contribution from its Brokerage and Risk Management segments. The momentum continued through the first quarter of 2021, with the company registering organic growth of 6%. Management estimates organic growth at Brokerage segment to be better than 2020 level. It further estimates 2021 organic growth in Risk Management to be closer to pre-COVID levels in the mid-single-digit range.
- ▲ Arthur J. Gallagher's revenues are geographically diversified with strong domestic and international operations with international operations contributing about one-third of revenues. The company expects international contribution to total revenue to increase, given the number and size of the non-U.S. acquisitions. Moreover, loss of clients or weakening of macro conditions in any particular country would not have any severe impact on the top line. Nonetheless, in 2021, the company estimates foreign exchange to favorably impact Brokerage revenues by \$100 million and \$14 million in Risk Management revenues.
- ▲ Strong operational performance has been driving Arthur J. Gallagher's cash flows. This, in turn, has helped cash and cash equivalents to grow over time. The company had more than \$1.6 billion of available liquidity at first-quarter 2021 end. The company targets about \$2.5 billion of mergers and acquisitions with free cash and debt in 2021. A sturdy liquidity position supports Arthur J. Gallagher to pursue strategic initiatives as required. It expects 2022 annual cash flows to increase by about \$125 million to \$150 million.
- ▲ A strong capital and liquidity position enable Arthur J. Gallagher to enhance its shareholder value. In the first quarter of 2021, the dividend was increased by 6.7%, reflecting a six-year CAGR (2016-2021) of 4.8%. Arthur J. Gallagher's dividend currently yields 1.3%, better than the industry average of 1.2%.

Arthur J. Gallagher remains focused on tapping opportunities in the U.K., Australia, New Zealand, Canada and the U.S.

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## Reasons To Sell:

- ▼ Arthur J. Gallagher has been experiencing an increase in expenses due to higher compensation, depreciation, amortization and operating expenses. Escalating expenses have been weighing on margins. Total expenses increased 16.3% in the first quarter of 2021 on higher compensation, depreciation, and cost of revenues from clean coal activities. Arthur J. Gallagher expects to lower expense by \$65 million to \$70 million per quarter.

In the Brokerage segment, foreign currency impact on earnings per share is estimated to be approximately 6 cents per share on a full-year basis.

In the Risk Management segment, the foreign currency is estimated to have little on full-year earnings.

Escalating expenses due to higher compensation and operating expenses that are hurting margins, debt level leading to unfavorable leverage ratio, and unfavorable interest coverage ratio are concerns.

- ▼ Debt level at Arthur J. Gallagher has been increasing over the years with deterioration in debt to capital ratio. High debt level has been inducing an increase in interest expenses. As of Mar 31, 2021, debt increased 2.3% to \$4.3 billion from the 2020-end level. The company has about \$2.3 billion of liquidity, with \$0.5 billion in cash on hand, which is not sufficient for the company to meet its debt obligations. Also, the company's times interest earned of 5.8 in the first quarter compares unfavorably with the industry average of 7.7, implying that its earnings are not sufficient to cover interest obligations. For the next two years, Arthur J. Gallagher has \$175 million of debt maturities due.
  - ▼ Further, Arthur J. Gallagher seems overvalued when compared with the broader industry. Its forward 12-month price-to-earnings ratio of 26.79 is higher than the industry average of 20.88.
  - ▼ Return on equity (ROE), a measure of how effectively the company is utilizing its shareholders' funds, underperformed the industry average. The company's ROE of 15.9% is lower than the industry average of 27.1%.
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## Last Earnings Report

### Arthur J. Gallagher Q1 Earnings & Revenues Top Estimates

Arthur J. Gallagher reported first-quarter 2021 adjusted net earnings of \$2.02 per share, which beat the Zacks Consensus Estimate by 10.4%. Moreover, the bottom line increased 10.4% on a year-over-year basis.

The company's performance was driven by higher revenues and strong margin expansion across Brokerage and Risk Management segments.

### Quarter Ending

03/2021

Report Date	Apr 29, 2021
Sales Surprise	10.92%
EPS Surprise	10.38%
Quarterly EPS	2.02
Annual EPS (TTM)	4.92

### Operational Update

Total revenues of \$2.1 billion outpaced the Zacks Consensus Estimate by 10.9%. Moreover, the top line improved 16.6% year over year.

Arthur J. Gallagher's total expenses increased 16.3% year over year to \$1.8 billion in the reported quarter due to higher compensation, and depreciation, cost of revenues from clean coal activities.

Adjusted earnings before interest, tax, depreciation and amortization and change (EBITDAC) in estimated acquisition earnout payables increased 25.5% from the prior-year quarter to \$614.8 million.

### Segmental Results

**Brokerage:** Revenues of \$1.6 billion increased 12.2% year over year on higher fees, and commission, supplemental and contingent revenues.

Expenses jumped 10.2% from the year-ago quarter to \$1.1 billion due to higher compensation and depreciation.

Adjusted EBITDAC climbed 24.1% from the year-ago level to \$629.7 million and margin expanded 480 basis points (bps) to 39.2%.

**Risk Management:** Revenues were up 4% year over year to \$220.3 million, mainly owing to higher fees.

Expenses rose 2.1% from the prior-year period to \$228.6 million on higher compensation.

Adjusted EBITDAC improved 11.9% year over year to \$40.5 million and margin expanded 180 bps.

**Corporate:** Total revenues of \$302.1 million were up 66.2% year over year due to higher revenues from consolidated clean coal facilities and higher royalty income from clean coal licenses.

EBITDAC was a negative \$43.4 million compared with a negative \$23 million in the year- ago quarter.

### Financial Update

As of Mar 31, 2021, total assets were \$24.4 billion, up 9.3% from the 2020-end level.

At the end of the quarter, cash and cash equivalents of \$526.3 million decreased 20.8% from the 2020-end level.

As of Mar 31, 2021, shareholders' equity increased 8.8% to \$6.8 billion from the level on Dec 31, 2020.

### Dividend Update

The board of directors approved a quarterly cash dividend of 48 cents per share. The dividend will be paid out on Jun 18, 2021 to shareholders of record on Jun 4.

### Acquisition Update

In the quarter, the company closed five acquisitions with estimated annualized revenues of about \$89.7 million.

## Recent News

### Arthur J. Gallagher Announces Excess Underwriting Buyout- Jun 16, 2021

Arthur J. Gallagher recently acquired Excess Underwriting Company. The terms of the transaction were not revealed. This recent deal with Excess Underwriting Company will provide the acquirer with an opportunity to present its new products and capacity to the Canadian marketplace along with its insurance carrier partners and thus reinforce its position.

### Arthur J. Gallagher Buys Remainder of Hesse & Partner- Jun 15, 2021

Arthur J. Gallagher recently acquired the remaining shares of Hesse & Partner AG and Hesse Consulting GmbH from founder, Guido Hesse. Terms of the transaction were kept under wraps. Arthur J. Gallagher had formed the partnership with Hesse and Partner three years ago when it acquired a majority interest in the business. This acquisition will fortify the acquirer's presence in Europe. Further, this transaction will boost the insurance services of Arthur J. Gallagher.

### Arthur J. Gallagher Buys AOBG, Expands in Affinity Market - May 28, 2021

Arthur J. Gallagher recently acquired LDJ American Online Benefits Group, LLC (AOBG). With this acquisition, Arthur J. Gallagher will leverage the expertise of AOBG in offering products that address the demands of self-employed and retired workers. This in turn will enhance and boost the acquirer's capabilities in the Affinity market.

## Valuation

Arthur J. Gallagher shares are up 12.7% in the year to date period and 47.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 11.3% and 17.3% in the year to date period, respectively. Over the past year, the Zacks sub-industry and sector are up 27.4% and 42.9%, respectively.

The S&P 500 index is up 13.2% in the year to date period and up 38.4% in the past year.

The stock is currently trading at 26.79x forward 12-month earnings, which compares to 20.88x for the Zacks sub-industry, 16.21x for the Zacks sector and 21.69x for the S&P 500 index.

Over the past five years, the stock has traded as high as 29.4x and as low as 15.11x, with a 5-year median of 19.72x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$146 price target reflects 28.07x forward 12-month earnings.

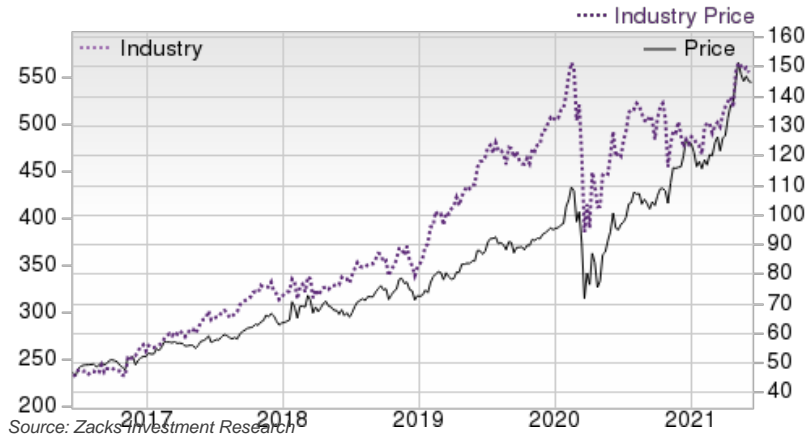
The table below shows summary valuation data for AJG

Valuation Multiples - AJG					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	26.79	20.88	16.21	21.69
	5-Year High	29.4	22.24	17.24	23.83
	5-Year Low	15.11	15.59	11.6	15.31
	5-Year Median	19.72	17.9	14.94	18.05
P/S F12M	Current	3.83	3.52	8.56	4.7
	5-Year High	4.02	3.72	8.56	4.74
	5-Year Low	1.33	2.15	5.08	3.21
	5-Year Median	1.91	2.64	6.21	3.72
P/B TTM	Current	4.03	6.08	3.31	7.03
	5-Year High	4.37	6.85	3.42	7.08
	5-Year Low	2.14	3.64	1.77	3.84
	5-Year Median	2.98	4.9	2.64	5.02

As of 06/17/2021

Source: Zacks Investment Research

## Industry Analysis Zacks Industry Rank: Bottom 29% (178 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
The Allstate Corporation (ALL)	Neutral	2
Aon plc (AON)	Neutral	3
Brown & Brown, Inc. (BRO)	Neutral	2
Erie Indemnity Company (ERIE)	Neutral	4
Hannover Ruck SE (HVRRY)	Neutral	3
Marsh & McLennan Companies, Inc. (MMC)	Neutral	2
Willis Towers Watson Public Limited Company (WLTW)	Neutral	3
eHealth, Inc. (EHTH)	Underperform	5

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

Industry Comparison Industry: Insurance - Brokerage				Industry Peers		
	AJG	X Industry	S&P 500	AON	ERIE	WLTW
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	4	3
VGM Score	D	-	-	C	B	C
Market Cap	28.75 B	1.22 B	29.66 B	52.54 B	8.74 B	29.95 B
# of Analysts	7	6	12	7	1	8
Dividend Yield	1.38%	0.79%	1.35%	0.88%	2.19%	1.22%
Value Score	C	-	-	C	C	C
Cash/Price	0.11	0.11	0.05	0.02	0.02	0.06
EV/EBITDA	18.26	18.31	16.95	18.31	21.57	13.87
PEG F1	2.61	3.13	2.09	NA	NA	NA
P/B	4.03	2.59	4.06	12.05	7.24	2.59
P/CF	18.06	20.44	17.27	19.72	26.69	13.05
P/E F1	27.54	21.46	20.99	20.99	32.53	18.36
P/S TTM	3.94	3.30	3.39	4.62	3.43	3.16
Earnings Yield	3.60%	4.66%	4.65%	4.76%	3.07%	5.44%
Debt/Equity	0.64	0.35	0.66	1.67	0.08	0.40
Cash Flow (\$/share)	7.72	2.15	6.83	11.81	7.09	17.79
Growth Score	D	-	-	D	B	D
Historical EPS Growth (3-5 Years)	12.56%	12.39%	9.44%	11.66%	12.27%	12.52%
Projected EPS Growth (F1/F0)	6.45%	14.82%	21.49%	13.08%	3.74%	8.07%
Current Cash Flow Growth	27.08%	-11.26%	0.99%	-2.60%	-5.75%	6.35%
Historical Cash Flow Growth (3-5 Years)	14.11%	10.99%	7.28%	5.24%	10.37%	30.24%
Current Ratio	1.10	2.13	1.39	2.78	1.41	2.27
Debt/Capital	39.17%	26.09%	41.51%	62.48%	7.17%	28.58%
Net Margin	11.70%	11.70%	11.95%	18.55%	12.06%	15.03%
Return on Equity	15.89%	14.34%	16.48%	62.86%	25.43%	14.34%
Sales/Assets	0.32	0.35	0.51	0.36	1.21	0.25
Projected Sales Growth (F1/F0)	11.87%	5.91%	9.41%	6.17%	2.93%	5.65%
Momentum Score	D	-	-	A	B	A
Daily Price Change	-1.69%	-0.15%	-0.04%	-4.61%	-0.62%	-2.09%
1-Week Price Change	-0.18%	-0.36%	-0.41%	-0.36%	-2.66%	-0.86%
4-Week Price Change	-4.94%	-3.78%	1.51%	-8.56%	-4.76%	-12.14%
12-Week Price Change	11.56%	3.47%	7.99%	3.47%	-15.65%	3.43%
52-Week Price Change	40.57%	21.91%	35.52%	21.91%	4.88%	18.39%
20-Day Average Volume (Shares)	1,248,502	158,594	1,771,802	1,840,500	80,151	1,191,409
EPS F1 Estimate 1-Week Change	0.00%	0.00%	0.00%	-0.26%	0.00%	0.00%
EPS F1 Estimate 4-Week Change	-0.31%	0.00%	0.03%	-0.26%	0.00%	0.42%

Past performance is no guarantee of future results. Please see important disclosures and definitions at the end of this report.



EPS F1 Estimate 12-Week Change	2.72%	:	1.83%	3.37%	:	1.07%	-0.85%	2.60%
EPS Q1 Estimate Monthly Change	0.00%	:	0.00%	0.00%	:	2.02%	0.00%	0.94%

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.

### 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	C
Growth Score	D
Momentum Score	D
VGM Score	D

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

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This material represents an assessment of the market and economic environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Forward-looking statements are subject to certain risks and uncertainties. Any statements that refer to expectations, projections or characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. Actual results, performance, or achievements may differ materially from those expressed or implied.

**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

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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-

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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 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

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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.