

Avery Dennison Corp (AVY)

\$119.08 (As of 09/03/20)

Price Target (6-12 Months): **\$129.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/08/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: D

Summary

Avery Dennison expects sales and earnings to decline in 2020 on lower demand. In the third quarter, the company anticipates a decline in sales before the impact of currency translation in the range of 5-7%. The Retail Branding and Information Solutions segment will continue to be impacted, reflecting widespread retail store and apparel manufacturing closures amid the pandemic. However, demand surge in essential categories in the Label and Packaging Materials segment will aid growth. The company is targeting net temporary savings from cost control actions, of approximately \$150 million in 2020. Over half of this has been realized in the first half of the year. It is poised to gain from improvement in high-value product categories and productivity improvement. Moreover, its strong liquidity position will help it sail through these troubled times.

Price, Consensus & Surprise

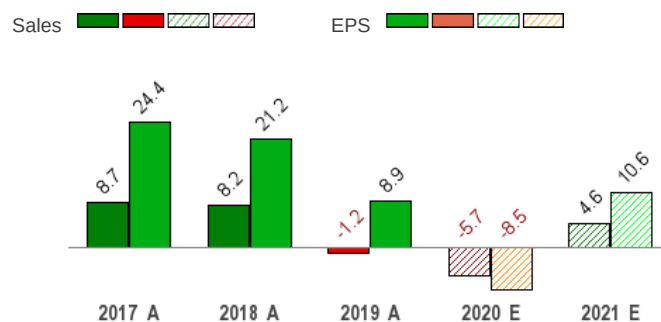


Source: Zacks Investment Research

Data Overview

52-Week High-Low	\$141.09 - \$76.96
20-Day Average Volume (Shares)	415,131
Market Cap	\$9.9 B
Year-To-Date Price Change	-9.0%
Beta	1.13
Dividend / Dividend Yield	\$2.32 / 1.9%
Industry	Office Supplies
Zacks Industry Rank	Bottom 6% (236 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	13.4%
Last Sales Surprise	1.1%
EPS F1 Estimate 4-Week Change	-1.1%
Expected Report Date	10/28/2020
Earnings ESP	0.0%
P/E TTM	18.8
P/E F1	19.7
PEG F1	2.4
P/S TTM	1.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					6,974 E
2020	1,723 A	1,529 A	1,653 E	1,774 E	6,665 E
2019	1,740 A	1,796 A	1,761 A	1,773 A	7,070 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$6.68 E
2020	\$1.66 A	\$1.27 A	\$1.46 E	\$1.70 E	\$6.04 E
2019	\$1.48 A	\$1.72 A	\$1.66 A	\$1.73 A	\$6.60 A

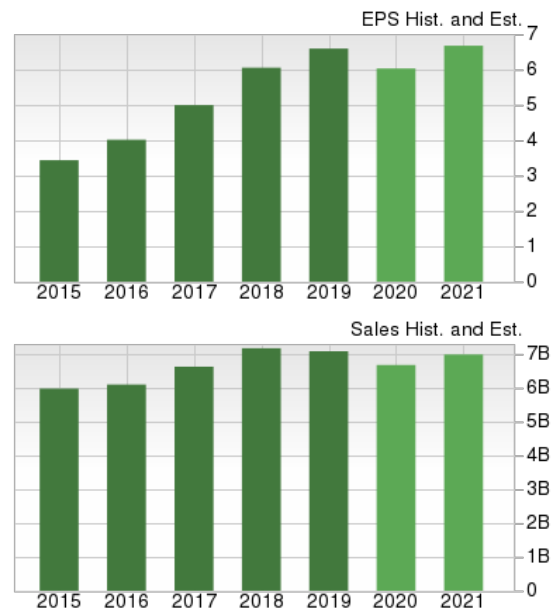
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 09/03/2020. The reports text is as of 09/04/2020.

Overview

Headquartered in Pasadena, CA, Avery Dennison Corporation produces pressure-sensitive materials, and a variety of tickets, tags, labels and other converted products. Its clientele is spread across the United States, Europe, Asia, Latin America and other regions. Avery Dennison reports under the following segments.

- The Label and Graphic Materials segment** (67% of 2019 revenues) includes Label and Packaging Materials, Graphics Solutions, and Reflective Solutions. Pressure-sensitive materials include papers, plastic films, metal foils and fabrics, which are coated with internally-developed and purchased adhesives, and then laminated with specially-coated backing papers and films. Label and packaging materials are sold to label converters for labeling, decorating, and specialty applications in the home and personal care, beer and beverage, durables, pharmaceutical, wine and spirits, and food market segments. The graphics and reflective products include a variety of films and products that are sold to the architectural, commercial sign, digital printing, and other related market segments. The segment also sells durable cast and reflective films to the construction, automotive and fleet transportation market segments and reflective films for traffic and safety applications.
- The Industrial and Healthcare Materials segment** (23%) includes Performance Tapes, Fasteners Solutions, and Vancive Medical Technologies. The tape products include coated tapes and adhesive transfer tapes that are sold for use in non-mechanical fastening, bonding and sealing systems. The segment also manufactures and sells Yongle brand tapes for wire harnessing and cable wrapping in automotive, electrical, and general industrial applications. The Vancive-brand products include an array of PSA materials and products to meet the needs of medical device manufacturers, converters, clinicians, and patients for surgical, wound and skin care, ostomy, diagnostic, electromedical and wearable device applications.
- Retail Branding and Information Solutions** (10%) includes tickets, tags, and labels for apparel and radio-frequency identification to retailers, brand owners, apparel manufacturers, distributors and industrial customers.



Source: Zacks Investment Research

Reasons To Buy:

- ▲ Avery Dennison continues to focus on four overarching priorities comprising driving outsized growth in high-value product categories, growing profitability in base businesses, relentlessly pursuing productivity improvement, and a disciplined capital-management approach. The company has strategically built inventory of some key products to enhance its ability to meet customer demand during the current supply chain uncertainty on coronavirus pandemic. Furthermore, the company is executing long-term strategic restructuring initiatives to enhance competitive position in base business, freeing up resources to invest in high value categories while supporting margins.
- ▲ In the wake of the weak demand in some of its business due to the COVID-19 pandemic, the company has undertaken temporary actions to reduce costs including reductions in travel and other discretionary spending, reduced usage of overtime and temporary employees, delays of merit increases, and furloughs. The company estimates incremental savings from restructuring actions, net of transition costs, of \$60 million to \$70 million during 2020. It anticipates carryover savings, net of transition costs, of approximately \$70 million in 2021. Additionally, Avery Dennison is targeting net temporary savings of approximately \$150 million in 2020, over half of which has been realized in the first half of the year.
- ▲ The company's Label and Packaging Materials segment serves essential categories that are experiencing higher demand during coronavirus pandemic. The segment is well poised for profitable growth in the current year, driven by solid top-line growth and continued margin expansion, volume improvement, focus on high-value categories led by specialty labels, as well as contributions from productivity initiatives. Further, Avery Dennison's completion of restructuring actions associated with the consolidation of the European footprint of its LGM segment will drive higher returns for the segment and improve its competitiveness.
- ▲ The company will benefit from its faster growing high-value product categories, such as specialty labels and Radio-frequency identification (RFID). Continued strength in RFID and external embellishments will drive Retail Branding and Information Solutions (RBIS) segment. The segment's global footprint is providing competitive advantage during the coronavirus pandemic. The company continues to increase investments to drive growth both organically and through acquisitions with higher spending for business development and R&D. In sync with this, Avery Dennison acquired Smartrac's Transponder (RFID Inlay) Division. The division is a leader in the development and manufacture of RFID products. Through the acquisition,

Avery Dennison will bolster its rapidly-growing Intelligent Labels platform across end markets and customers within the industrial and retail segments. The deal will generate greater revenues, with RFID business anticipated to grow 15-20% annually over the long term. Avery Dennison remains confident to see margin expansion for the current year at The Industrial and Healthcare Materials (IHM) segment. This segment will deliver significant value over the medium to longer term. Its medical division is benefiting from developing new products to meet urgent short-term need for personal protective equipment (PPE).

- ▲ Avery Dennison's balance sheet remains strong and has ample capacity to continue funding acquisitions, executing disciplined capital-allocation strategy, investing in organic growth as well as returning cash to shareholders. Its net debt to adjusted EBITDA ratio stood at 2.1 as of the end of the second quarter, below its long-term target of 2.3-2.6. The company currently has \$800 million available under its revolving credit facility, and approximately \$260 million in cash and cash equivalents on hand at quarter-end. The company renewed its revolving credit facility of \$800 million in February, extending the maturity date to 2025. In March, the company drew \$500 million under this revolving credit facility on uncertainty regarding availability of commercial paper.

The company's capital-allocation priorities support its primary objectives of delivering faster growth in high value categories with profitable growth of its base businesses. Although the company has curtailed its capital spending plans by approximately \$55 million for the current year, it will continue to invest in high value categories. The company has temporarily suspended its share-repurchase activity, while maintaining a quarterly dividend at the current rate.

Avery Dennison will gain from pricing actions, restructuring activities and execution of strategies. Focus on growing in high-value product categories and profitability in base business will aid growth

Reasons To Sell:

- ▼ Avery Dennison currently expects sales and earnings to decline in 2020 on lower demand. The company had earlier revoked its EPS guidance for the current year owing to the uncertainties related to the coronavirus pandemic and its impact on global demand for the company's products. In the third quarter, the company anticipates a decline in sales before the impact of currency translation in the range of 5% to 7%, or 7 to 9% on an organic basis.
- ▼ The company's RBIS business, which primarily serves apparel markets, is seeing a significant decline in demand, reflecting widespread retail store and apparel manufacturing closures. Consequently, it has started witnessing a significant decline in demand for RBIS tickets, tags, and labels for apparel as well as a decline in demand for graphics and products serving durable and industrial end markets. Strong volumes in essential label categories will be offset by decline demand in apparel and industrial end markets. These trends are expected to have a significant impact on the segment's performance. The graphic portion of the Label and Graphic Materials segment is also expected to bear the brunt of the pandemic this year.
- ▼ Avery Dennison's LGM segment has successfully navigated through a significant inflationary cycle and made subsequent transition to the modestly deflationary cycle. Given the sequential deflation in the third and fourth quarters, the company expects pricing to be headwind to LGM segment's organic growth in the current year.

Impact of the coronavirus outbreak on global demand for the company's products, weak apparel and industrial-end market as well as currency translation will hurt Avery Dennison.

Last Earnings Report

Avery Dennison Q2 Earnings & Revenues Beat Estimates

Avery Dennison reported second-quarter 2020 adjusted earnings of \$1.27 per share, surpassing the Zacks Consensus Estimate of \$1.12. However, the figure declined 26% year over year.

Including one-time items, the company reported net income of 95 cents per share compared with \$1.69 per share in the year-ago quarter.

Total revenues declined 15% year over year to \$1,529 million. Nevertheless, the top line beat the Zacks Consensus Estimate of \$1,512 million. Sales declined 13.7% on an organic basis.

Cost of sales in the quarter declined 13% year over year to \$1,146 million. Gross profit slumped 21% year over year to \$383 million. Gross margin contracted 180 basis points year over year to 25.1% in the second quarter.

Marketing, general and administrative expenses were \$219 million compared with the \$266 million incurred in the year-ago quarter. Adjusted operating profit amounted to \$164 million, down from the \$217 million in the prior-year quarter. Adjusted operating margin was 10.7% in the quarter, down from the prior-year quarter's 12.1%.

Segment Highlights

Revenues in the Label and Graphic Materials (LGM) segment declined 9% year over year to \$1,102 million. On an organic basis, sales were down 4.9%. Adjusted operating profit dipped 2% year on year to \$163 million.

Revenues in the Retail Branding and Information Solutions (RBIS) segment plunged 30% year over year to \$295 million. On an organic basis, sales were down 35.5% hurt by site closures and lower apparel demand. The segment's adjusted operating income tanked 96% year over year to \$2.2 million.

Net sales in the Industrial and Healthcare Materials (IHM) segment amounted to \$132 million, down 23% from \$171 million reported in the prior-year quarter. On an organic basis, sales were down 20.9% on decline in industrial categories driven by automotive. The segment reported adjusted operating income of \$9 million compared with the prior-year quarter's \$17.9 million.

Financial Updates

Free cash flow in the first half of 2020 for the company was \$109 million, down 34% from the prior year comparable period. Avery Dennison had cash and cash equivalents of around \$262.6 million as of Jun 27, 2020, up from \$247 million as of Jun 29, 2019. As of Jun 30, 2020, the net debt to adjusted EBITDA ratio was 2.1 as of the end of the second quarter, below the company's long-term target of 2.3-2.6. Avery Dennison currently has \$800 million available under its revolving credit facility, and approximately \$260 million in cash and cash equivalents on hand at quarter-end.

The company has initiated cost control and cash management actions to negate weak demand in few of its businesses, and is aiming to deliver free cash flow of approximately \$500 million in 2020.

Cost-Reduction Activities

Avery Dennison realized \$15 million in pre-tax savings from restructuring in the second quarter. The company anticipates incremental savings from restructuring actions of \$60-\$70 million during 2020. Carryover savings, net of transition costs, of approximately \$70 million is projected for 2021. On top of this, the company is targeting net temporary savings of approximately \$150 million in 2020, over half of which has been realized in the first half of the year.

Guidance

Avery Dennison expects sales and earnings to fall in 2020 on lower demand. In the third quarter, the company anticipates a decline in sales of 5-7%, before the impact of currency translation. Organic sales is expected to decline 7-9% in the quarter.

Quarter Ending	06/2020
Report Date	Jul 27, 2020
Sales Surprise	1.07%
EPS Surprise	13.39%
Quarterly EPS	1.27
Annual EPS (TTM)	6.32

Valuation

Avery Dennison's shares are down 9.0% in the year-to-date period and up 4.5% over the trailing 12-month period. Year to date, stocks in the Zacks Office Supplies industry and the Zacks Industrial Products sector are down 25.6% and 1.1%, respectively. Over the past year, the zacks sub-industry are down 12.5% while the sector are up 11.4%.

The S&P 500 index is up 3.0% in the year-to-date period and 11.8% in the past year.

The stock is currently trading at 18.40X forward 12-month earnings, which compares to 13.14X for the Zacks sub-industry, 21.74X for the Zacks sector and 23.08X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.65X and as low as 11.19X, with a 5-year median of 17.62X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$129 price target reflects 19.41X forward 12-month earnings per share.

The table below shows summary valuation data for AVY:

Valuation Multiples - AVY					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.4	13.14	21.74	23.08
	5-Year High	23.65	13.44	21.74	23.08
	5-Year Low	11.19	8.07	12.55	15.25
	5-Year Median	17.62	11.26	17.5	17.6
EV/EBITDA TTM	Current	12.98	7.73	2.95	4.24
	5-Year High	13.27	9.05	2.95	4.24
	5-Year Low	6.5	3.96	1.52	2.53
	5-Year Median	9.98	6.26	2.05	3.07
EV/Sales TTM	Current	1.72	1.01	19.78	12.49
	5-Year High	1.83	1.51	20.33	13.29
	5-Year Low	0.93	0.71	10.76	8.22
	5-Year Median	1.46	1.23	14.97	10.92

As of 09/03/2020

Industry Analysis Zacks Industry Rank: Bottom 6% (236 out of 251)



Source: Zacks Investment Research

Top Peers

Company (Ticker)	Rec	Rank
Berry Global Group, Inc. (BERY)	Outperform	2
Crown Holdings, Inc. (CCK)	Outperform	2
Graphic Packaging Holding Company (GPK)	Outperform	2
Silgan Holdings Inc. (SLGN)	Outperform	2
Ball Corporation (BLL)	Neutral	3
Greif, Inc. (GEF)	Neutral	4
3M Company (MMM)	Neutral	3
Sonoco Products Company (SON)	Neutral	3

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

Industry Comparison Industry: Office Supplies				Industry Peers		
	AVY	X Industry	S&P 500	BLL	SLGN	SON
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Outperform	Neutral
Zacks Rank (Short Term)	3	-	-	3	2	3
VGM Score	B	-	-	B	A	B
Market Cap	9.94 B	549.90 M	23.52 B	27.18 B	4.25 B	5.43 B
# of Analysts	6	5	14	8	5	5
Dividend Yield	1.95%	2.93%	1.62%	0.72%	1.25%	3.18%
Value Score	C	-	-	C	B	B
Cash/Price	0.03	0.20	0.07	0.02	0.05	0.16
EV/EBITDA	23.15	5.54	13.12	20.93	12.62	9.02
PEG F1	2.40	2.27	2.97	6.02	2.69	3.31
P/B	8.19	1.02	3.20	9.59	3.90	3.00
P/CF	13.44	8.29	12.72	17.69	9.42	9.08
P/E F1	19.80	13.46	21.67	30.09	13.47	16.55
P/S TTM	1.46	1.12	2.49	2.41	0.93	1.04
Earnings Yield	5.07%	7.46%	4.40%	3.33%	7.42%	6.04%
Debt/Equity	1.65	0.40	0.70	2.53	2.85	0.90
Cash Flow (\$/share)	8.86	2.17	6.93	4.70	4.07	5.96
Growth Score	B	-	-	B	B	B
Historical EPS Growth (3-5 Years)	17.06%	9.82%	10.41%	10.45%	13.28%	8.88%
Projected EPS Growth (F1/F0)	-8.53%	-38.06%	-4.75%	9.34%	31.67%	-7.42%
Current Cash Flow Growth	3.06%	3.06%	5.22%	4.20%	5.44%	3.38%
Historical Cash Flow Growth (3-5 Years)	8.17%	4.68%	8.49%	13.04%	4.92%	5.30%
Current Ratio	1.22	1.79	1.35	0.97	1.34	1.42
Debt/Capital	62.20%	27.73%	42.95%	71.67%	74.03%	47.24%
Net Margin	7.68%	7.83%	10.25%	3.28%	5.50%	5.23%
Return on Equity	45.88%	11.87%	14.59%	29.73%	27.83%	19.35%
Sales/Assets	1.19	0.66	0.50	0.67	0.84	1.00
Projected Sales Growth (F1/F0)	-5.73%	-5.73%	-1.42%	0.36%	7.08%	-4.41%
Momentum Score	D	-	-	C	B	D
Daily Price Change	-1.72%	-1.76%	-2.14%	-1.60%	-3.01%	-1.67%
1-Week Price Change	3.14%	0.00%	2.59%	4.76%	1.84%	1.09%
4-Week Price Change	4.05%	0.00%	2.25%	11.82%	0.63%	2.68%
12-Week Price Change	6.31%	1.21%	11.04%	23.94%	21.63%	10.73%
52-Week Price Change	4.52%	-19.33%	2.01%	5.76%	28.70%	-5.19%
20-Day Average Volume (Shares)	415,131	93,703	1,827,096	1,512,993	461,901	304,407
EPS F1 Estimate 1-Week Change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
EPS F1 Estimate 4-Week Change	-1.09%	0.00%	0.00%	4.04%	0.00%	0.00%
EPS F1 Estimate 12-Week Change	4.56%	4.56%	3.89%	3.88%	18.25%	0.49%
EPS Q1 Estimate Monthly Change	0.00%	0.00%	0.00%	2.74%	0.00%	0.00%

Source: Zacks Investment Research

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	B
Momentum Score	D
VGM Score	B

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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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.