

## Capital One Financial (COF)

**\$104.13** (As of 01/17/20)

Price Target (6-12 Months): **\$111.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 04/02/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

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

**3-Hold**

Zacks Style Scores:

VGM:B

Value: A

Growth: C

Momentum: C

### Summary

Shares of Capital One have outperformed the industry over the past six months. Also, it has an impressive earnings surprise history, having outpaced the Zacks Consensus Estimate in three of the trailing four quarters. Earnings estimates have remained unchanged ahead of its fourth quarter 2019 results. Solid liquidity position, strength in credit card and online-banking businesses, efforts to diversify via acquisitions and continuous rise in loan demand are likely to support top-line growth, going forward. Moreover, strong balance sheet and business restructuring efforts will support its financials. However, rising operating expenses, mainly due to higher marketing costs, are likely to hurt bottom-line growth to some extent. Additionally, deteriorating credit quality is another major near-term concern and might hurt the company's financials.

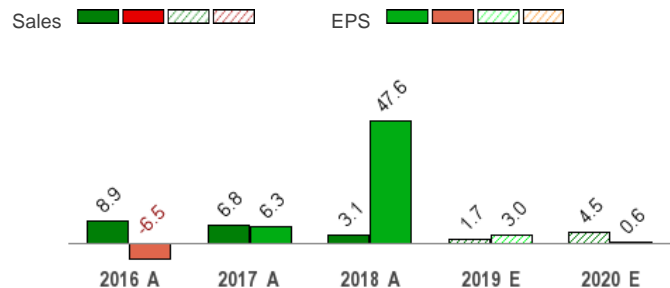
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$105.70 - \$76.82</b>
20 Day Average Volume (sh)	<b>1,507,952</b>
Market Cap	<b>\$48.5 B</b>
YTD Price Change	<b>1.2%</b>
Beta	<b>1.29</b>
Dividend / Div Yld	<b>\$1.60 / 1.5%</b>
Industry	<b>Financial - Consumer Loans</b>
Zacks Industry Rank	<b>Bottom 37% (159 out of 254)</b>

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



Last EPS Surprise	<b>15.7%</b>
Last Sales Surprise	<b>-3.1%</b>
EPS F1 Est- 4 week change	<b>-0.2%</b>
Expected Report Date	<b>01/21/2020</b>
Earnings ESP	<b>-3.8%</b>
P/E TTM	<b>9.1</b>
P/E F1	<b>9.2</b>
PEG F1	<b>1.3</b>
P/S TTM	<b>1.5</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	7,378 E	7,442 E	7,493 E	7,666 E	29,842 E
2019	7,083 A	7,124 A	6,959 A	7,365 E	28,564 E
2018	6,909 A	7,192 A	6,962 A	7,013 A	28,076 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$3.00 E	\$3.02 E	\$3.38 E	\$2.46 E	\$11.28 E
2019	\$2.90 A	\$3.37 A	\$3.32 A	\$2.38 E	\$11.21 E
2018	\$2.65 A	\$3.22 A	\$3.12 A	\$1.87 A	\$10.88 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 01/17/2020. The reports text is as of 01/20/2020.

## Overview

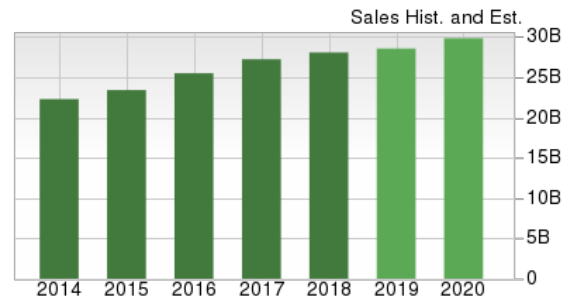
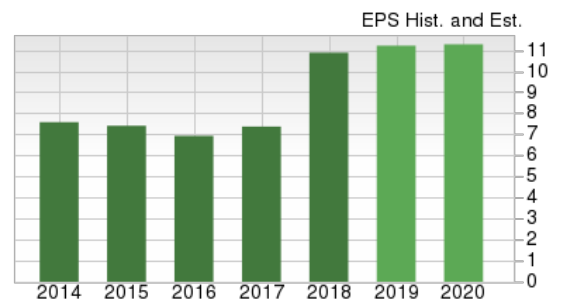
Headquartered in McLean, VA, Capital One Financial Corporation is primarily focused on consumer and commercial lending as well as deposit origination. Through its banking and non-banking subsidiaries, the company, founded in 1988, provides various financial products and services to consumers, small businesses and commercial clients in the U.S.

Capital One's principal subsidiaries include Capital One Bank (USA), National Association (COBNA) and Capital One, National Association (CONA). The company reports results of its business through the following operating segments:

- The **Credit Card** segment (contributed 63% of total net revenues in 2018) includes domestic consumer and small business card lending, domestic national small business lending, national closed end installment lending and the international card lending businesses in Canada and the U.K.
- The **Commercial Banking** segment (10.3%) includes lending, deposit gathering and treasury management services to commercial real estate and middle-market customers. The segment also includes the financial results of a national portfolio of small ticket commercial real estate loans that are in run-off mode. The commercial and industrial customers include companies with annual revenues between \$10 million–\$1.0 billion.
- The **Consumer Banking** segment (25.7%) comprises branch-based lending and deposit gathering activities for small businesses and retail customers, national deposit gathering, consumer mortgage lending and servicing activities as well as national automobile lending.

The **Other** category (1%) includes management of corporate investment portfolio and asset/liability management by centralized Corporate Treasury group.

As of Sep 30, 2019, Capital One had total assets of \$378.8 billion, loans held for investment of \$249.4 billion, total deposits of \$257.1 billion and shareholders' equity of \$58.2 billion.



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## Reasons To Buy:

- ▲ Revenue growth remains a major positive for Capital One. The company's top line depicts a five-year (2014-2018) CAGR of 5.9%. The same was relatively stable in the first nine months of 2019. Steady loan growth and opportunistic acquisitions over the past years continue to support revenues. In August 2019, the company agreed to acquire KippsDeSanto, through which it plans to foray into the M&A market. Moreover, acquisitions of Beech Street Capital and GE's healthcare unit reflect the company's revenue diversifying efforts. Revenue growth prospects look encouraging on the back of the company's solid credit card and online banking businesses.
- ▲ Capital One's Credit Card segment is likely to continue showing strength, given the domestic economic recovery and rise in consumer spending. In the first nine months of 2019, Domestic Card, which accounted for nearly 93% of the Credit Card net revenues, reflected strong loan growth and increasing purchase volume. Further, the acquisition of Cabela's Incorporated's credit card operations in 2017 continues to provide the company with a solid platform for growth. Management projects strong growth opportunities in card loans and purchase volumes despite an intense competitive environment.
- ▲ Capital One's strategic decisions have helped it counter economic challenges and continue to support profitability. As part of its initiative to focus on profitable ventures, the company has been undertaking restructuring efforts. Over the past year, the company sold its trust and asset management business, first and second lien mortgages as well as retail brokerage accounts. These initiatives are expected to help Capital One in strengthening its financials and focusing on core operations.
- ▲ Capital One's capital deployment activities remain decent. The company's 2019 capital plan, approved by the Federal Reserve in June, included maintaining the quarterly dividend at the current level and authorization to buy back \$2.2 billion worth shares. As of Sep 30, 2019, nearly \$1.7 billion worth of buyback authorization remained. Driven by a solid balance sheet position and continued earnings strength, the company will likely be able to sustain its capital deployment activities.
- ▲ Shares of Capital One have outperformed the industry over the past three months. The company's 2019 earnings estimates have remained unchanged over the past 30 days. Further, the stock seems undervalued when compared with the broader industry. Its current price-to-book (P/B) and price-to-cash flow (P/CF) ratios are lower than their respective industry averages. Also, Capital One has a Value Score of A. Therefore, given the strong fundamentals, the impressive price performance will likely continue.

Strength in credit card and online-banking operations, solid loan growth and business restructuring efforts will aid Capital One's profitability. Its capital deployment actions are commendable.

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## Reasons To Sell:

- ▼ Elevated non-interest expenses remain a major concern for Capital One. Expenses have been witnessing a CAGR of 5.2% for the last five years (2014-2018). The rise continued during the first nine months of 2019. The increase was mainly due to a rise in marketing costs, which are likely to remain elevated given the rising loan growth opportunities. Further, continued investments in technology and infrastructure will keep expenses on a higher side.
- ▼ Capital One's asset quality has been deteriorating. Provision for credit losses and net charge-off (NCO) rates has been steadily rising. Though provisions declined in 2018, it witnessed a CAGR of 13.4% over the last five years (ended 2018). Likewise, NCO rates have been rising over the past several years. Both witnessed an increase in the first three quarters of 2019. Hence, the company's overall credit quality is likely to remain under pressure.
- ▼ Capital One's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 10.40% compares unfavorably with ROE of 13.80% for the industry and 17.16% for the S&P 500, reflecting that it is less efficient in using shareholders' funds compared with its peers.

Continuously mounting operating expenses are expected to hamper Capital One's bottom-line growth. Further, deteriorating asset quality is a major near-term concern and might hurt its financials.

## Last Earnings Report

### Capital One Q3 Earnings Beat, Expenses Increase

Capital One's third-quarter adjusted earnings of \$3.32 per share easily surpassed the Zacks Consensus Estimate of \$2.87. Also, it improved 6% year over year.

Results benefited from rise in non-interest income, improving loan and deposit balances, and strength in card business. However, a rise in credit cost, lower net interest income (owing to decline in interest rates) and higher operating expenses were the undermining factors.

After taking into consideration non-recurring items, net income available to common shareholders was \$1.27 billion or \$2.69 per share, down from \$1.44 billion or \$2.99 per share in the prior-year quarter.

Quarter Ending **09/2019**

Report Date	Oct 24, 2019
Sales Surprise	-3.11%
EPS Surprise	15.68%
Quarterly EPS	3.32
Annual EPS (TTM)	11.46

### Revenues Stable, Expenses Rise

Net revenues were \$6.96 billion, almost on par with the prior-year quarter level. The figure lagged the Zacks Consensus Estimate of \$7.18 billion.

Net interest income declined 1% to \$5.74 billion. Also, net interest margin decreased 28 basis points (bps) to 6.73%.

Non-interest income of \$1.22 billion grew 4% from the prior-year quarter. Lower service charges and other customer-related fees was more than offset by rise in net interchange fees.

Non-interest expenses of \$3.87 billion were up 3%, mainly owing to 14% increase in professional services costs and 12% rise in salaries and associate benefits costs.

Efficiency ratio was 55.64% compared with 54.19% in the year-ago quarter. An increase in efficiency ratio indicates deterioration in profitability.

As of Sep 30, 2019, loans held for investment were \$249.4 billion, up 2% from the prior quarter. Total deposits, as of the same date, increased 4% sequentially to \$257.1 billion.

### Credit Quality: Mixed Bag

Net charge-off (NCO) rate decreased 3 bps year over year to 2.38%. The 30-plus day performing delinquency rate remained stable at 3.28%.

Also, allowance as a percentage of reported loans held for investment was 2.82%, down 20 bps. However, provision for credit losses rose 9% to \$1.38 billion.

### Profitability Ratios Decline, Capital Ratios Improve

Return on average assets was 1.42% at the end of the reported quarter, down from 1.66% in the year-ago quarter. Also, return on average common equity was 9.63%, down from 12.40% in the prior-year quarter.

As of Sep 30, 2019, Tier 1 risk-based capital ratio was 14.4%, up from 12.8% in the prior-year quarter end. Further, common equity Tier 1 capital (CET1) ratio under Basel III Standardized Approach was 12.5% as of Sep 30, 2019, up from 11.2% on Sep 30, 2018.

### Share Repurchase Update

During the third quarter, Capital One repurchased 5.3 million shares for \$466 million.

### Walmart Partnership Impact

In late September, Capital One launched the new Walmart co-brand and private label cards and on Oct 11, it closed the acquisition of the existing Walmart card portfolio, with on-boarding of \$8.1 billion in loans.

Management projects cumulative launch costs related to the partnership to be approximately \$225 million.

The company expects initial allowance build to be roughly \$85 million, which will be part of fourth-quarter 2019 allowance.

Driven by the revenue and loss sharing provisions, the acquired Walmart portfolio is expected to affect several Domestic Card metrics. The portfolio is projected to lower the Domestic Card charge-off rate by about 25 bps in the fourth quarter and in 2020 (with some quarterly variability).

Additionally, the acquired portfolio will reduce the Domestic Card revenue margin by nearly 35 bps in the fourth quarter 2019, about 50 bps in the first three quarters of 2020, and roughly 35 bps in the fourth quarter of 2020 as the revenue share on the acquired portfolio steps up in October 2020.

The charge-off rate and revenue margin impacts are expected to diminish over time as the acquired portfolio runs off.

Further, the existing Walmart portfolio is anticipated to increase Domestic Card delinquency rate by about 25 bps at the end of the fourth quarter and by about 15 bps at 2020-end.

### Outlook

Operating efficiency ratio (net of adjustments) is expected to improve modestly in 2019 and 2020, excluding the one-time Walmart launch and integration expenses. In 2021, the same is expected to improve to 42%, driven by the data center exit, continuing technology innovation and

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Walmart launch.

With the momentum in domestic cards and retail deposits, management expects marketing costs for 2019 to be modestly high year over year.

Management expects to incur certain incremental direct costs related to the cyber incident response at the lower end of \$100-\$150 million range. Additionally, some of these charges will be incurred in 2020. Though the significant part of these costs will be covered by insurance, the timing of insurance reimbursements may lag the occurrence of costs.

As the company will be redeeming outstanding preferred Series C and D stocks in December, it will result in a one-time charge that will lead to nearly \$30 million decline in net income available to common shareholders in the fourth quarter.

Annual auto NCOs are expected to increase gradually in the near-term.

The company anticipates the implementation of the CECL framework, to be adopted on Jan 1, 2020, to increase its corporate allowance in the range of 30-40%, which will be mainly driven by the consumer businesses. Therefore, the impact of adopting CECL, which will phase in over four years, is expected to lower the company's CET1 ratio by 13-18 bps in 2020.

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## Recent News

### Capital One to Acquire KippsDeSanto, Enter M&A Market - Aug 19, 2019

Capital One agreed to acquire Tysons Corner, VA-based investment banking firm, KippsDeSanto & Co. Terms of the deal were not disclosed.

KippsDeSanto focuses on serving growth-oriented aerospace/defense, government services and technology companies. The firm also specializes in merger and acquisition advisory services. Since its opening in 2007, it has advised on more than \$17 billion in deals.

By acquiring KippsDeSanto, Capital One is making its entry into the M&A market.

Once the transaction is complete, KippsDeSanto will become a wholly-owned subsidiary of Capital One but will continue to operate under its brand name.

Steve Tulip, the head of Capital Markets, Capital One Commercial Banking, stated, "Capital One and KippsDeSanto have a shared goal of providing clients with trusted advice and counsel enabled by deep industry expertise and a seamless client experience. By bringing our teams together, we'll be able to add scale and expertise to our growing M&A advisory group which will benefit clients in a wide variety of industries."

Bob Kipps, the managing director and co-founder of KippsDeSanto said, "All of KippsDeSanto's 30 professionals are excited to support Capital One's thrust into middle market M&A. With Capital One, a top 10 U.S. Commercial Bank, we found an innovative, technology savvy financial institution with a similar culture and business values."

He added, "Moreover, we see enormous synergy and growth potential with their capital markets products, expanded private equity and corporate relationships and industry knowledge in aerospace and defense and other key verticals."

### Capital One's Data Breach Incident to Raise Costs - Jul 29, 2019

Data breach at Capital One again brings forth the questions related to cyber security risks to everyone's mind. With major global banks increasing the use technology to store customer data and do banking transactions, the most important question is how safe is it.

Capital One, which championed the use of technology way ahead of other banks, revealed that there was an unauthorized access to personal information belonging to approximately 106 million people across the United States and Canada.

The stolen data included names, addresses and dates of birth, and some financial information (like self-reported income and credit scores) as well as 140,000 Social Security numbers and nearly 80,000 linked bank account numbers. Also, roughly 1 million Social Insurance Numbers of the company's Canadian credit card customers were compromised.

While the hacker has been arrested and charged with computer fraud and abuse, Capital One now faces a long battle to regain customer's confidence on its capability to keep the client data safe. The company is also facing litigations related to data breach incident. Even the New York attorney general stated that there will be probe in to this incident.

Management projects additional costs of about \$100-\$150 million related to "customer notifications, credit monitoring, technology costs, and legal support" this year.

### Dividend Update

On Oct 31, Capital One announced a quarterly cash dividend of 40 cents per share. The dividend was paid on Nov 22 to shareholders of record at the close of business on Nov 12.

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## Valuation

Capital One's shares are up 22.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 18.9% and 11.7% over the past year, respectively.

The S&P 500 index is up 23.8% in the past year.

The stock is currently trading at 9.17X forward 12 months earnings, which compares to 8.10X for the Zacks sub-industry, 14.73X for the Zacks sector and 19.20X for the S&P 500 index.

Over the past five years, the stock has traded as high as 12.72X and as low as 6.24X, with a 5-year median of 9.37X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$111 price target reflects 9.77X forward earnings.

The table below shows summary valuation data for COF

Valuation Multiples - COF				
	Stock	Sub-Industry	Sector	S&P 500
Current	9.17	8.1	14.73	19.2

P/E F12M	Current	9.17	8.1	14.73	19.2
	5-Year High	12.72	10.85	16.21	19.34
	5-Year Low	6.24	6.33	12.01	15.17
	5-Year Median	9.37	8.89	13.98	17.44
P/B TTM	Current	0.83	0.91	2.86	4.55
	5-Year High	1.07	1.22	2.89	4.55
	5-Year Low	0.63	0.75	1.83	2.85
	5-Year Median	0.83	0.96	2.51	3.61
P/S F12M	Current	1.62	1.42	6.53	3.57
	5-Year High	2.07	2.05	6.61	3.57
	5-Year Low	1.14	1.1	5.2	2.54
	5-Year Median	1.5	1.52	6.04	3

As of 01/17/2020



## Industry Analysis Zacks Industry Rank: Bottom 37% (159 out of 254)



## Top Peers

Ally Financial Inc. (ALLY)	Neutral
MR. COOPER GROUP INC (COOP)	Neutral
Discover Financial Services (DFS)	Neutral
First Cash, Inc. (FCFS)	Neutral
Navient Corporation (NAVI)	Neutral
SLM Corporation (SLM)	Neutral
Wells Fargo & Company (WFC)	Neutral
Santander Consumer USA Holdings Inc. (SC)	Underperform

Industry Comparison Industry: Financial - Consumer Loans				Industry Peers		
	COF Neutral	X Industry	S&P 500	ALLY Neutral	DFS Neutral	SC Underperform
<b>VGM Score</b>	<b>B</b>	-	-	<b>B</b>	<b>A</b>	<b>B</b>
Market Cap	48.50 B	1.04 B	24.65 B	11.57 B	26.47 B	7.86 B
# of Analysts	4	3	13	6	8	7
Dividend Yield	1.54%	0.00%	1.73%	2.23%	2.08%	3.81%
<b>Value Score</b>	<b>A</b>	-	-	<b>A</b>	<b>B</b>	<b>A</b>
Cash/Price	0.37	0.29	0.04	0.32	0.24	0.29
EV/EBITDA	7.06	8.45	14.11	8.45	10.02	1.46
PEG Ratio	1.32	0.65	2.08	0.58	1.20	1.63
Price/Book (P/B)	0.83	1.24	3.39	0.82	2.37	1.07
Price/Cash Flow (P/CF)	6.19	6.20	13.81	4.09	10.00	3.42
P/E (F1)	9.23	7.01	19.19	7.21	8.91	8.17
Price/Sales (P/S)	1.45	1.39	2.69	1.87	1.91	1.02
Earnings Yield	10.83%	14.07%	5.21%	13.86%	11.23%	12.25%
Debt/Equity	0.85	1.65	0.72	2.47	2.19	0.00
Cash Flow (\$/share)	16.81	2.89	6.94	7.45	8.45	6.75
<b>Growth Score</b>	<b>C</b>	-	-	<b>D</b>	<b>D</b>	<b>C</b>
Hist. EPS Growth (3-5 yrs)	10.75%	10.75%	10.56%	17.19%	12.36%	-0.53%
Proj. EPS Growth (F1/F0)	0.56%	8.71%	7.57%	12.77%	4.66%	-0.20%
Curr. Cash Flow Growth	22.03%	26.38%	14.73%	4.27%	20.79%	35.94%
Hist. Cash Flow Growth (3-5 yrs)	4.34%	5.02%	9.00%	5.70%	3.97%	36.75%
Current Ratio	1.02	2.25	1.24	1.05	1.28	0.79
Debt/Capital	46.04%	61.80%	42.99%	71.20%	67.61%	0.00%
Net Margin	16.84%	12.28%	11.14%	26.29%	20.97%	12.33%
Return on Equity	10.40%	13.80%	17.16%	10.69%	26.79%	13.20%
Sales/Assets	0.09	0.24	0.55	0.03	0.13	0.17
Proj. Sales Growth (F1/F0)	4.47%	6.16%	4.16%	6.16%	4.82%	6.86%
<b>Momentum Score</b>	<b>C</b>	-	-	<b>B</b>	<b>A</b>	<b>F</b>
Daily Price Chg	1.18%	0.00%	0.27%	-1.01%	0.96%	0.22%
1 Week Price Chg	-0.44%	-1.11%	0.39%	-1.45%	-1.43%	-1.47%
4 Week Price Chg	0.73%	-1.77%	2.95%	-2.90%	-2.18%	-2.98%
12 Week Price Chg	13.21%	2.45%	7.76%	-0.29%	5.89%	-8.66%
52 Week Price Chg	24.48%	6.89%	22.29%	17.39%	30.83%	21.95%
20 Day Average Volume	1,507,952	176,880	1,536,375	3,039,362	1,209,616	708,053
(F1) EPS Est 1 week change	0.02%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.19%	0.00%	0.00%	0.00%	-0.12%	-2.32%
(F1) EPS Est 12 week change	-3.48%	-0.71%	-0.40%	-0.71%	-0.99%	-6.18%
(Q1) EPS Est Mthly Chg	-0.13%	0.00%	0.00%	0.00%	-0.33%	-18.48%

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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 have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

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

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### Zacks Style Scores

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

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

Value Score	A
Growth Score	C
Momentum Score	C
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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### Disclosures

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