

Cisco Systems(CSCO)

\$47.79 (As of 01/14/20)

Price Target (6-12 Months): **\$50.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/14/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: B

Summary

Cisco is benefiting from solid security business. Strong contribution from Infrastructure Platforms and applications is a positive. Moreover, order strength and improving traction of the subscription-based business model are tailwinds. Further, strengthening collaboration portfolio, which includes Webex Teams, bodes well. Additionally, acquisitions of Voicea and CloudCherry hold promise. Cisco's latest Silicon One strategy to enhance its network hardware business is expected to boost revenue base. However, weakness in service provider business in China remains a concern. Further, stiff competition from Arista and Juniper in switching and routing verticals is likely to create pricing pressure and impact profitability. Also, increasing investments on product enhancements are likely to limit margin expansion at least in the near-term.

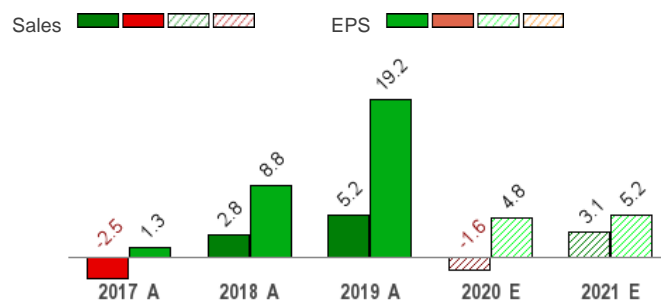
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$58.26 - \$43.40
20 Day Average Volume (sh)	17,295,774
Market Cap	\$202.7 B
YTD Price Change	-0.4%
Beta	1.23
Dividend / Div Yld	\$1.40 / 2.9%
Industry	Computer - Networking
Zacks Industry Rank	Top 15% (39 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.7%
Last Sales Surprise	0.6%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/12/2020
Earnings ESP	0.0%
P/E TTM	15.0
P/E F1	14.7
PEG F1	2.1
P/S TTM	3.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	13,362 E	12,573 E	13,235 E	13,730 E	52,640 E
2020	13,159 A	11,980 E	12,692 E	13,228 E	51,056 E
2019	13,072 A	12,446 A	12,958 A	13,428 A	51,904 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.87 E	\$0.80 E	\$0.85 E	\$0.89 E	\$3.42 E
2020	\$0.84 A	\$0.76 E	\$0.81 E	\$0.84 E	\$3.25 E
2019	\$0.75 A	\$0.73 A	\$0.78 A	\$0.83 A	\$3.10 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 01/14/2020. The reports text is as of 01/15/2020.

Overview

Headquartered in San Jose, CA and founded in December 1984, Cisco Systems Inc. is an IP-based networking company, which offers other products and services to service providers, companies, commercial users and individuals.

Cisco has seven product categories: Switches aggregate and distribute information, collecting LANs, MANs and WANs filtering, processing and distributing it in the required volume and to the designated locations. They provide connectivity to end users, workstations, IP phones, access points and servers.

Next-Generation Network (NGN) Routers transport data, voice and video information from one IP network to another. Collaboration products integrate voice, video, data and mobile applications on fixed and mobile networks. Key products are Unified Communications and Cisco TelePresence Systems products.

Wireless technology includes networking products: wireless LAN controllers, wireless integrated switches and routers, wireless management software, wireless LAN clients and client software, bridges, antennas and accessories.

Security includes products and services preventing unauthorized access to system resources and protecting from worms, spam, viruses and other malware. The Data Center product category includes Cisco Unified Computing System (UCS) and Server Access Virtualization. It also comprises of The Other products segment and Related Services.

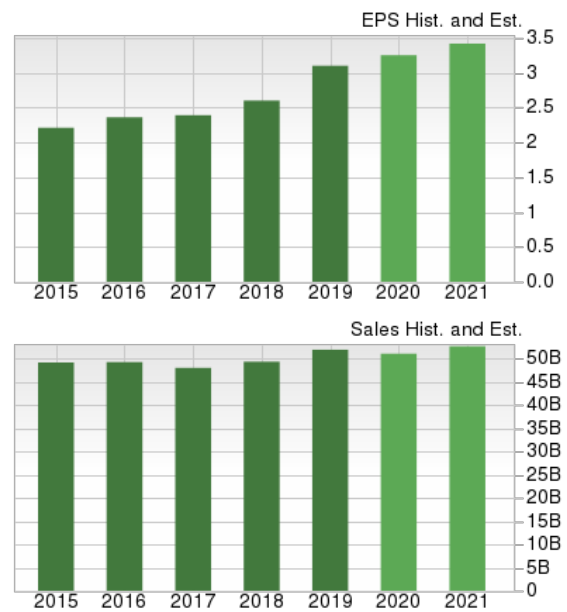
Cisco realigns its reporting segments into four distinct categories – infrastructure platform, applications, security, and other products.

On Oct 28, 2018, Cisco concluded the divestiture of its Service Provider Video Software Solutions (SPVSS) business. SPVSS included digital STBs and media technology products for reception, encoding, transcoding, translating, multiplexing, switching and modulation.

Total revenue was \$51.74 billion in fiscal 2019, up 7% over fiscal 2018 tally, excluding SPVSS business.

In fiscal 2019, the Americas, EMEA and APJC generated 59.6%, 25.2% and 15.2% of total revenue, respectively.

The company competes in the networking and communications equipment markets with companies like Amazon Web Services, Check Point Software Technologies, Dell, F5 Networks, FireEye, Fortinet, Hewlett-Packard Enterprise Company, Juniper Networks and Microsoft Corporation, to name few.



Reasons To Buy:

- ▲ Cisco is the largest player in the networking space. The company has a strong presence in the router and switch market. It also retained a leadership position in WLAN and Ethernet switching. Moreover, expansion into relatively under-penetrated markets is expected to drive growth.
- ▲ Cisco's focus on wireless carriers has increased of late, as evidenced by acquisitions such as Intucell, BroadHop, Cognitive Security, Cariden, ClearAccess and Ubiquisis. With data demand exploding, the wireless carrier segment has grown in importance. Mobile carriers in the U.S. are increasingly looking to make their networks more spectrum-efficient and put their network resources to use without having to materially increase capex expenditure. Also, the proliferation of smartphones has caused mobile data traffic to grow exponentially and the advent of high-speed LTE networks is likely to accelerate that growth. Therefore, networking solutions that allow carriers to manage traffic efficiently are to become increasingly important in the coming years. Cisco intends to tap this market by adding network management solutions to its product portfolio and broadening its relationship with carriers. The increased carrier focus might help Cisco to gain share in the edge routing segment, where its competitors, Juniper and Alcatel Lucent, have substantial market share. Moreover, these acquisitions have diversified Cisco's revenue source. Increasing recurring nature of the top line is a major growth factor.
- ▲ In order to counter the threat of SDN, Cisco has devised a strategy of its own, which it is referring to as Application Centric Infrastructure (ACI). ACI is a comprehensive approach that ties together physical and virtual compute, network and storage by leveraging centralized policies and orchestration. ACI is made up of new hardware in the Nexus 9000 portfolio and software in the shape of an updated NX-OS operating system along with the Application Policy Infrastructure Controller (APIC). The solution streamlines operational processes and reduces operating expenses for power, cooling and cabling. This reduces the total cost of ownership by 75% when compared with software-only network virtualization. The technology ensures the infrastructure is focused on the application. Nexus 9000 Series switches deliver high scalability, performance and energy in a compact form factor and are ideal for data center aggregation- and access-layer deployments in enterprise, service provider, and cloud networks. It is quite encouraging to see that Cisco's ACI technology is gaining significant traction with customers.
- ▲ The company has pioneered a network system, which has been referred to as the Unified Computing System (UCS). This blade server system based on x86 architecture is transforming data centers. The system lowers the cost of ownership by making the entire data center more network-centric, significantly reducing the number of computers/servers required. The UCS is intended to simplify the operation of the data center, improving its flexibility and scalability. For this purpose, the company has tied up with Accenture, BMC, EMC, Intel, Microsoft, NetApp, Novell, Oracle, Red Hat and VMWare. Notably, UCS adoption is increasing owing to the inherent cost advantage and the growing number of data centers across the world. This is working in Cisco's favor. UCS remains a major factor to Cisco's future success as the company builds its Next Generation Data Center stack.
- ▲ Cisco has inked strategic alliances with most of major technology companies globally. These partnerships have increased access to new technology, helped in developing innovative products, facilitated joint sales & marketing programs, and expanded total addressable market (TAM). The company has strategic partnerships with Apple, IBM, Microsoft, Viacom, Telenor, Google and Alibaba, which are expected to aid the company in enhancing business opportunities. We believe partnerships will help Cisco in winning new customers in the long haul.
- ▲ Management execution has been good in recent times. The solid net-cash balance of \$9.54 billion as of Oct 26, 2019, provides the flexibility required to pursue any growth strategy, whether by way of acquisitions or otherwise. Moreover, the strong balance sheet helps Cisco to continue shareholder friendly initiatives of share repurchase and dividend hike. Notably, lower number of outstanding shares helps bottom-line. In the fiscal first quarter, Cisco returned \$2.3 billion to shareholders through share buybacks and dividends. The company has \$12.7 billion remaining under its current share buyback program.

Order growth in new markets of the company remain encouraging and we are positive about the company's market position, innovative prowess, product range, growth initiatives and dividend payouts.

Reasons To Sell:

- ▼ Cisco continues to acquire a large number of companies. While this improves revenue opportunities, it increases integration risks. Moreover, we also note that the large acquisitions negatively impact the balance sheet in the form of high level of goodwill, which totaled \$35.69 billion or 38.6% of total assets as of Oct 26, 2019.
 - ▼ Cisco has been forced to offer discounts and deals in response to actions by peers due to stiff competition from Arista Networks, Juniper, HPE and Huawei, in Ethernet switch and router market. Cisco's competitors are revamping their product lines with faster and power-efficient products. Although the edge business remains strong, the competitive pressure at the core remains intense and is likely to hurt profitability.
 - ▼ One of the primary markets that Cisco serves is federal, state and local governments. Therefore, the company is widely exposed to the stringent budget activities of the U.S. government, which remains a major concern.
 - ▼ Moreover, Cisco generates significant portion of revenues from outside the United States (40.4% of total revenues in fiscal 2019), subjecting the company to exchange rate volatility. Unfavorable movement in exchange rates of foreign currencies like renminbi, euro, pound sterling, Costa Rican colon, and yen related to the U.S. dollar can adversely impact results and undermine its growth potential to some extent. Weakness in service provider business in China, is a headwind. Moreover, imposition of tariffs owing to trade war between the United States and China is anticipated to affect growth prospects. The uncertainty over the recent trade war truce has impacted investors' confidence and is likely to remain an overhang on the company's performance.
 - ▼ We note that the stock currently has a trailing 12 month P/B ratio of 5.67, which compares unfavorably to some extent with what the industry saw over the last year. Hence, valuation looks slightly stretched from P/B perspective.
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Cisco is facing integration risks as well as stiff competition from smaller players.

Last Earnings Report

Cisco Beat Q1 Earnings Estimates, Near Term Outlook Grim

Cisco Systems reported first-quarter fiscal 2020 non-GAAP earnings of 84 cents per share that beat the Zacks Consensus Estimate by 3.7% and grew 12% year over year.

Revenues climbed 0.7% year over year to \$13.16 billion and surpassed the consensus estimate by 0.6%. Excluding the Service Provider Video Software Solutions (SPVSS) business that was divested in second-quarter fiscal 2019, revenues increased 2% year over year.

Acquisitions contributed 50 basis points (bps) to the top line. Notably, Cisco completed four acquisitions, all in the applications space, in the reported quarter.

Notably, the company blamed sluggish macro-economic conditions (due to the U.S.-China trade, Brexit and others) and a slowing China economy for the weakness in the service provider, enterprise and commercial end markets. Management expects growth in these markets to be muted in the near term.

Top-Line Details

Product revenues (75.1% of total revenues) were flat on a year-over-year basis at \$9.88 billion.

Service revenues (25% of total revenues) increased 3.1% to \$3.28 billion, driven by growth in software and solutions services. Software subscriptions represent 71% of Cisco's software revenues.

Region-wise, Americas and EMEA revenues decreased 3% and 2% year over year, respectively. Moreover, revenues from APJC decreased 9%. Total emerging markets declined 13% and the BRICs plus Mexico fell 26%.

In terms of customer segments, both enterprise and commercial revenues declined 5% each. Moreover, service provider revenues were down 13%. However, public sector revenues rose 6%.

Remaining performance obligations (RPO) at the end of the reported quarter were \$24.9 billion, up 11%. The metric represents total committed non-cancelable future revenues.

Total product orders were down 4% on a year-over-year basis.

Segment Details

Infrastructure Platforms (57.3% of total revenues) comprise Switching, NGN routing, Wireless and Data Center solutions. Revenues fell 1% year over year to \$7.54 billion.

While routing declined due to weakness in service provider, Switching grew in both campus and data center end markets, driven by strong demand for Catalyst 9000 family of switches and Nexus 9K solutions.

Additionally, Wireless solution grew owing to Meraki. Data Center witnessed solid growth, led by HyperFlex.

Applications (11.4% of total revenues) consist of the Collaboration portfolio of Unified Communications (UC), Conferencing and TelePresence, IoT and application software businesses such as AppDynamics and Jasper.

Revenues increased 6% year over year to almost \$1.50 billion, driven by double-digit growth at AppDynamics.

Security revenues (6.2% of revenues) improved 22% to \$815 million. The growth can be attributed to solid demand witnessed by web security, unified threat, network security and advanced threat solutions.

Other Products segment contains service provider video, cloud and system management, and various emerging technology offerings. Revenues plunged 85% to \$26 million.

Operating Details

Non-GAAP gross margin expanded 210 bps from the year-ago quarter to 65.9%. On a non-GAAP basis, product gross margin expanded 290 bps but service gross margin contracted 30 bps.

Management stated that the gross margin benefited from increasing software content in the revenue mix.

Non-GAAP operating expenses were \$4.26 billion, up 2.1% year over year. As a percentage of revenues, operating expenses increased 40 bps to 32.4%.

Non-GAAP operating margin expanded 170 bps year over year to 33.6%.

Balance Sheet and Cash Flow

As of Oct 26, 2019, Cisco's cash & cash equivalents and investments balance were \$28 billion, down from \$33.41 billion as of Jul 27, 2019.

Total debt, as of Oct 26, was \$18.50 billion compared with \$24.67 billion as of Jul 27.

Quarter Ending 10/2019

Report Date	Nov 13, 2019
Sales Surprise	0.64%
EPS Surprise	3.70%
Quarterly EPS	0.84
Annual EPS (TTM)	3.18

The company generated \$3.6 billion in cash flow from operations during the quarter under review.

In the fiscal first quarter, Cisco returned \$2.3 billion to shareholders through share buybacks and dividends. The company has \$12.7 billion remaining under its current share buyback program.

Guidance

For second-quarter fiscal 2020, revenues are expected to decline 3-5% on a year-over-year basis.

Non-GAAP gross margin is expected in the range of 64.5-65.5%, while operating margin is anticipated between 32.5% and 33.5% for the quarter.

Cisco expects pricing pressure in the server market to accelerate in the fiscal second quarter. Moreover, the company expects the gross margin to continue benefiting from lower DRAM prices (in the server market). Further, lower operating expenses are expected to boost operating margin.

Non-GAAP earnings are anticipated between 75 cents and 77 cents per share.

Recent News

On **Dec 16, 2019**, Cisco announced plans to acquire Exablaze to enhance Nexus switching portfolio with advanced FPGA capabilities.

On **Dec 11, 2019**, Cisco rolled out Silicon One Q100 networking chip with an aim to enhance its network hardware business. The new Silicon One Q100 networking processor functions as both switch and routing chip. It is enabled to transfer data at a faster rate and can be programmed as required.

On **Dec 9, 2019**, Cisco announced quarterly cash dividend of 35 cents per share to be paid on Jan 22, 2020 to shareholders as on Jan 3, 2020.

On **Nov 11, 2019**, Cisco secured regulatory approval from the German Federal Cartel Office regarding the acquisition of Acacia Communications. Notably, regulatory clearance has been obtained from the United States and Austria. The buyout is expected to conclude in the second half of Cisco's fiscal 2020.

On **Oct 11, 2019**, Cisco announced that it has successfully closed the acquisition of privately-held CloudCherry, a Customer Experience Management (CEM) company.

On **Sep 26, 2019**, Cisco rolled out Webex Control Hub Extended Security Pack with an aim to empower Webex customers with robust data security enhancements.

On **Sep 11, 2019**, Cisco and Zenoss, provider of intelligent application and service monitoring services, announced Unlock & Extend Program. Cisco announced its UCS customers can avail Zenoss Cloud upgrade.

On **Sep 6, 2019**, Cisco announced closure of Voicea acquisition. Cisco plans to enrich Webex portfolio with Voicea's AI-based voice-recognition and transcription capabilities.

Valuation

Cisco shares are down 15.8% in the past six-month period, while it is up 11.7% over the trailing 12-month period. Stocks in the Zacks sub-industry is down 15.2% while the Zacks Computer & Technology sector is up 15.3% in the past six-month period. Over the past year, the Zacks sub-industry and the sector are up 11% and 34.9%, respectively.

The S&P 500 index is up 10.9% in the past six-month period and 27.3% in the past year.

The stock is currently trading at 14.36X forward 12-month earnings, which compares to 16.13X for the Zacks sub-industry, 22.84X for the Zacks sector and 18.96X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.8X and as low as 10.48X, with a 5-year median of 14.75X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$50 price target reflects 15.02X forward 12-month earnings.

The table below shows summary valuation data for CSCO

Valuation Multiples - CSCO					
		Current	Stock	Sub-Industry	Sector S&P 500
P/E F12M	Current	14.36	16.13	22.84	18.96
	5-Year High	19.8	19.21	22.84	19.34
	5-Year Low	10.48	11.26	16.87	15.17
	5-Year Median	14.75	15.17	19.24	17.44
P/S F12M	Current	3.92	3.26	3.68	3.68
	5-Year High	5.19	4.3	3.68	3.68
	5-Year Low	2.28	2.36	2.30	2.30
	5-Year Median	3.41	3.25	3.01	3.01
EV/Sales TTM	Current	3.64	3.22	4.33	3.29
	5-Year High	4.48	4.03	4.33	3.3
	5-Year Low	1.5	1.46	2.56	2.16
	5-Year Median	2.55	2.41	3.45	2.80

As of 01/14/2020

Industry Analysis Zacks Industry Rank: Top 15% (39 out of 254)



Top Peers

Amazon.com, Inc. (AMZN)	Neutral
Check Point Software Technologies Ltd. (CHKP)	Neutral
F5 Networks, Inc. (FFIV)	Neutral
Juniper Networks, Inc. (JNPR)	Neutral
Microsoft Corporation (MSFT)	Neutral
NVIDIA Corporation (NVDA)	Neutral
Palo Alto Networks, Inc. (PANW)	Neutral
VMware, Inc. (VMW)	Neutral

Industry Comparison Industry: Computer - Networking				Industry Peers		
	CSCO Neutral	X Industry	S&P 500	AMZN Neutral	JNPR Neutral	VMW Neutral
VGM Score	B	-	-	C	C	D
Market Cap	202.74 B	115.40 M	24.31 B	926.86 B	8.19 B	62.34 B
# of Analysts	12	2	13	13	9	11
Dividend Yield	2.93%	0.00%	1.76%	0.00%	3.11%	0.00%
Value Score	C	-	-	D	B	C
Cash/Price	0.14	0.16	0.04	0.05	0.28	0.03
EV/EBITDA	10.92	9.47	14.08	32.33	10.48	17.54
PEG Ratio	2.12	2.51	2.06	2.60	2.59	1.76
Price/Book (P/B)	5.89	1.67	3.33	16.40	1.82	10.72
Price/Cash Flow (P/CF)	13.89	15.21	13.62	36.13	12.18	23.40
P/E (F1)	14.83	15.74	18.86	71.27	13.30	23.13
Price/Sales (P/S)	3.90	1.63	2.65	3.49	1.85	6.39
Earnings Yield	6.80%	5.90%	5.27%	1.40%	7.52%	4.33%
Debt/Equity	0.42	0.07	0.72	0.40	0.40	0.63
Cash Flow (\$/share)	3.44	0.18	6.94	51.74	2.01	6.50
Growth Score	B	-	-	A	D	F
Hist. EPS Growth (3-5 yrs)	8.00%	2.63%	10.56%	116.18%	2.86%	15.51%
Proj. EPS Growth (F1/F0)	4.86%	46.61%	7.52%	27.90%	7.19%	3.88%
Curr. Cash Flow Growth	6.95%	-33.65%	14.88%	85.21%	-22.13%	23.44%
Hist. Cash Flow Growth (3-5 yrs)	3.53%	16.42%	9.00%	48.43%	1.14%	12.60%
Current Ratio	1.70	2.33	1.23	1.10	2.24	0.58
Debt/Capital	29.63%	6.53%	42.99%	28.45%	28.51%	38.53%
Net Margin	21.15%	-3.65%	11.14%	4.27%	8.35%	67.21%
Return on Equity	35.01%	2.58%	17.16%	22.52%	9.54%	61.67%
Sales/Assets	0.53	0.88	0.55	1.45	0.49	0.54
Proj. Sales Growth (F1/F0)	-1.63%	0.00%	4.18%	18.55%	1.11%	12.87%
Momentum Score	B	-	-	F	B	C
Daily Price Chg	-0.38%	0.00%	0.08%	-1.16%	-0.33%	0.06%
1 Week Price Chg	-1.05%	0.44%	0.39%	0.44%	-0.74%	-2.69%
4 Week Price Chg	2.91%	7.22%	1.93%	4.40%	1.03%	2.11%
12 Week Price Chg	0.50%	4.66%	6.50%	5.87%	-1.21%	-0.61%
52 Week Price Chg	8.56%	4.53%	22.56%	11.64%	-13.05%	3.38%
20 Day Average Volume	17,295,774	14,804	1,571,506	3,221,894	2,551,361	920,347
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-1.03%	0.00%	0.00%
(F1) EPS Est 12 week change	-3.29%	2.38%	-0.52%	-18.79%	-7.90%	-0.87%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-2.70%	0.00%	0.00%

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.

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	B
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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