Aug 07, 2020

Diageo plc (DEO)

$135.87 (As of 08/06/20)

Price Target (6-12 Months): **$115.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 08/06/20) Prior Recommendation: Neutral	**Underperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**5-Strong Sell**
	Zacks Style Scores:	VGM:B
	Value: D | Growth: A | Momentum: B	

Summary

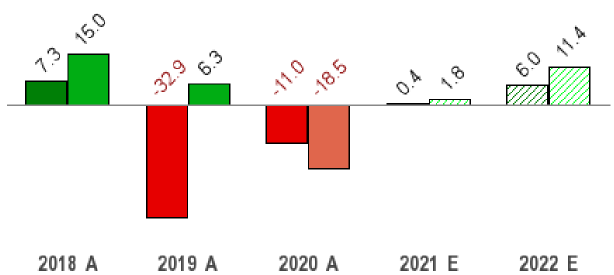
Diageo has lagged the industry in the past three months, thanks to the pandemic-related headwinds in the second half of fiscal 2020, which more than offset its consistently strong results in the first half. This led to top and bottom line declines in fiscal 2020. Top line was hurt by decline in organic volumes in the second half on the widespread closure of bars and restaurants around the world and the disruption to global travel. Moreover, soft organic operating margin due to soft gross margin and elevated costs hurt earnings. Driven by the uncertainty over the pace and the shape of the recovery from the pandemic, the company did not provide specific guidance for fiscal 2021. However, it predicts sequential improvements in net sales, volume and operating profit in the first half of fiscal 2021 owing to the gradual reopening of on-trade channels.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$176.22 - $100.52**
20 Day Average Volume (sh)	**403,148**
Market Cap	**$79.4 B**
YTD Price Change	**-19.3%**
Beta	**0.63**
Dividend / Div Yld	**$4.40 / 2.0%**
Industry	**Beverages - Alcohol**
Zacks Industry Rank	**Top 42% (106 out of 252)**
Last EPS Surprise	**NA**
Last Sales Surprise	**NA**
EPS F1 Est- 4 week change	**-4.1%**
Expected Report Date	**08/06/2020**
Earnings ESP	**0.0%**
P/E TTM	**NA**
P/E F1	**24.3**
PEG F1	**2.9**
P/S TTM	**NA**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2022					15,769 E
2021					14,880 E
2020					14,817 A

EPS Estimates

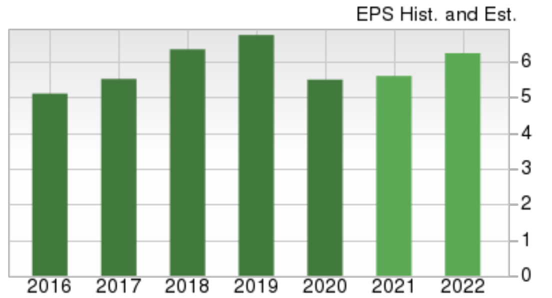
	Q1	Q2	Q3	Q4	Annual*
2022					$6.24 E
2021					$5.60 E
2020					$5.50 A

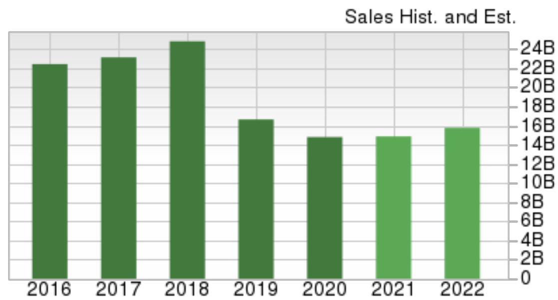
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/06/2020. The reports text is as of 08/07/2020.

Overview

London-based Diageo plc operates in approximately 180 countries and is involved in producing, distilling, brewing, bottling, packaging as well as distributing spirits, wine and beer. The company offers its products under globally recognized flagship brands, such as Smirnoff, Johnnie Walker, Captain Morgan, Baileys, Buchanan's, J&B, Tanqueray and Guinness. Among these, 14 brands – Johnnie Walker, Smirnoff, Baileys, Crown Royal, Captain Morgan, Jose Cuervo, JeB, Buchanan's, Windsor, Ketel One vodka, Cîroc, Tanqueray, Bushmills and Guinness – are classified as global strategic brands.





The company operates through five regions:—

- **North America** includes four operating units — U.S. Spirits, Diageo-Guinness USA, Diageo Chateau & Estate Wines Co. and Diageo Canada.

- **Europe** comprises Great Britain, Ireland, Iberia, France, Germany, Benelux, Italy, Nordics, Greece, Switzerland, Austria, the Western European reserve brands, Diageo Guinness Continental Europe, European wines and the Western European operations of Global Travel. Western Europe.

- **Africa** is one of the oldest and largest markets for the Guinness brand. The company operates either through subsidiaries or under license.

- **Latin America and the Caribbean** region, which includes Mexico, Diageo distributes mainly through a mixture of Diageo companies and third-party distributors. In addition, Diageo owns a controlling interest in Desnoes & Geddes Limited, the Jamaican brewer of Red Stripe lager.

- **Asia Pacific** includes operations in India, China, Australia, New Zealand, South Korea, Japan, Thailand, Vietnam, Singapore, Malaysia and other Asian markets.

Reasons To Sell:

- **Soft Second Half Performance FY20 Results:** Shares of Diageo fell 2.4% in the past three months, against the industry's 10.8% growth. The dismal stock performance primarily reflects disruptions in the past few months due to the coronavirus pandemic, which also marred the company's results. Diageo reported dismal fiscal 2020 results with 16% year over year decline in earnings per share (in local currency) and 8.7% fall in net sales. Additionally, operating profit fell 47.1% in the fiscal owing to organic declines. The company's performance in fiscal 2020 was hurt by the significant challenges related to the coronavirus outbreak in the second half, which more than offset the consistently strong results in the first half. Notably, the coronavirus related impacts led organic net revenues and operating profit to register declines of 8.4% and 14.4%, respectively, which affected the bottom line. Although organic sales benefited from top-line gains in North America, this was more than offset by declines across all other regions. Driven by the significant uncertainty over the pace and the shape of the recovery owing to the pandemic, the company did not provide specific guidance for fiscal 2021.

Diageo's performance in fiscal 2020 was hurt by the significant challenges related to the coronavirus outbreak in the second half, which more than offset the consistently strong first half results.

- **On-Trade and Global Travel Disruptions Hurt Volume:** Diageo's organic volumes dipped 11.2% in fiscal 2020. While the company delivered strong volume growth across all regions in the first half, volume in the second half of fiscal 2020 was largely impacted by the coronavirus outbreak. The volume declines in the second half were primarily due to the widespread closure of bars and restaurants around the world (on-trade channel) and the disruption to global travel. Notably, the on-trade segment, which is the sale of alcoholic beverages in licensed premises, accounts for nearly 40-50% of Diageo's revenues. Though trends in the on-trade channel are picking up due to re-opening of restaurants and bars, it expects restrictions on travel retail continue hurting volume in the near term.

- **Dismal Margins:** Diageo's margin performance was significantly hurt by continued pressures from cost inflation as well as lower volume, thanks to the pandemic. Notably, the company's gross margin contracted 174 basis points (bps) in fiscal 2020, hurt by inflation in cost of goods sold (COGS), slightly negative product mix and lower volume with reduced fixed cost absorption. This was only slightly negated by productivity-led gross margin gains. During fiscal 2020, the company witnessed inflationary pressures from commodity costs, including base neutral spirits in India and agave as well as glass globally. Further, Organic operating margin contracted 212 basis points (bps) in fiscal 2020, owing to soft gross margin and costs arising from the disruptions in the operating environment, partially negated by overhead efficiencies and lower marketing spend in the fiscal fourth quarter. Notably, the company witnessed the peak of pandemic-related impacts on organic operating margin in the fourth quarter of fiscal 2020 owing to significant volume declines. Operating margin in included more than 10 percentage points of the aforesaid impacts, witnessed in the fourth quarter.

- **Higher Taxes May Hurt Performance:** The beer and beverage industry remains susceptible to unfavorable changes in taxes. In many regions, these taxes constitute a major chunk of the cost of beer that is charged to customers. Thus, any rise in excise taxes or indirect taxes on Diageo's products is likely to shift consumers' preferences to other beverages and weigh upon the overall consumption of the company's products, thus hurting its revenues and margins. Consequently, adverse taxation amendments remain a hurdle for the company's profitability.

- **Macroeconomic Concerns:** Diageo's customers remain sensitive to macroeconomic factors including interest rate hikes, increase in fuel and energy costs, credit availability, unemployment levels, and high household debt levels, which may negatively impact their discretionary spending, and in turn the company's growth and profitability.

Risks

- **Outlook Suggests Sequential Growth:** Diageo notes that the lockdowns across the globe have started easing, leading to a return of growth in the on-trade channel, which includes bars and restaurants, in some regions. This has led to a gradual recovery in on-trade volumes. Though the company expects the results for the first half of 2021 to reflect significant impacts of the pandemic, it predicts organic net revenues to witness sequential gains in the first and second quarters of fiscal 2021 as the on-trade channel further reopens and consumer demand begins to recover. Further, it anticipates sequential volume growth in the first half, even though its performance versus the first half of fiscal 2020 will reflect significant COVID-related impacts and margin dilution.

  Additionally, the company expects operating margin to improve sequentially in the first half of fiscal 2021 compared with the peak effects of the pandemic impact experienced in the fourth quarter. It also plans to increase marketing investment as demand recovers. Overall, it anticipates sequential improvement in operating margin in the first half of fiscal 2021 as compared with the second half of fiscal 2020.

- **North America Performance Aid Price/mix in FY20:** Diageo delivered a positive price mix of 2.8% in fiscal 2020, which partly offset the decline in organic volume. Price/mix benefited from a strong market mix, with resilience in North America, which is its most profitable segment. Notably, net sales for the company's U.S. Spirits business improved 2.2% in fiscal 2020. Strong growth of 6.1% in the first half of fiscal 2020 was only partially offset by lower on-trade sales in the second half. This was attributed to the strong demand in the off-trade channel during the COVID-19 lockdown in the United States. Consequently, U.S. Spirits volumes were down 0.7% in fiscal 2020, while price/mix rose 2.9% primarily driven by strong growth in tequila and Canadian whisky brands.

- **Digital Investments Aid Amid COVID-19:** Diageo is relentlessly working to leverage its existing e-commerce capabilities and accelerate investments in the online platform to cater to the lockdowns-driven shift in consumer shopping behavior. The online platforms have become more relevant amid the coronavirus pandemic as consumers were confined to their homes. The company has diverted its efforts to connect with consumers and maintain brand relevance, by responding to increased opportunities of at-home consumption occasions. This included new occasion like wanting to enjoy bar-quality drinks at home. Further, the company has inspired consumers with cocktail recipes, new serves and ways to enjoy its brands with food. It also rapidly responded to increased demand for home delivery. In the United States and Latin America, it reached customers with new "cocktail to go' programs. In East Africa, the company explored new ways to get products delivered at consumers' homes, through partnerships with motorbike delivery companies, known as boda-bodas.

- **Financial Status:** Despite the impacts of the pandemic on its operating profit, Diageo managed to deliver strong operating cash flow and free cash flow in fiscal 2020. It generated net cash from operating activities of £2.3 billion, which reflected a decline of £0.9 billion from last year. Furthermore, the company reported free cash flow of about £1.6 billion in fiscal 2020, down £1 billion from the last year. To stay afloat amid the pandemic and manage finances, the company earlier halted its ongoing three-year return of capital program as well as shareholder returns. In the first seven months of fiscal 2020, through January, it returned £1.25 billion to shareholders through its return of capital program. Moreover, the company announced a recommended final dividend for fiscal 2020, which brings the full year dividend growth to 2%. Further, to reinforce its already solid liquidity, it issued a £2.0-billion bond in April 2020 and put in place an additional credit facility of £2.5 billion.

Last Earnings Report

Diageo FY20 Earnings & Revenues Reflect Coronavirus Woes

Quarter Ending	06/2020
Report Date	**Aug 04, 2020**
Sales Surprise	**NA**
EPS Surprise	**NA**
Quarterly EPS	**NA**
Annual EPS (TTM)	**NA**

Diageo reported preliminary fiscal 2020 results, ending Jun 30, 2020, wherein pre-exceptional earnings per share fell 16% year over year (in local currency). This was mainly driven by a decline in organic operating profit due to the impacts of the coronavirus outbreak. The company's performance in fiscal 2020 was hurt by the significant challenges related to the coronavirus outbreak in the second half, which more than offset the consistently strong results in the first half.

Moreover, it notes that the lockdowns across the globe have eased, with the return of the on-trade channel, which includes bars and restaurants, in some regions. This has led to a gradual recovery in on-trade volumes. However, restrictions on travel retail continue, which is likely to mar results in the near term. Driven by the significant uncertainty over the pace and the shape of the recovery owing to the pandemic, the company did not provide specific guidance for fiscal 2021.

Nonetheless, it expects organic net revenues to witness sequential gains in the first and second quarters of fiscal 2021 as the on-trade channel further reopens and consumer demand begins to recover. Despite these gains, it expects the results for the first half of 2021 to reflect significant impacts of the pandemic. Although the company predicts sequential volume growth in the first half, it continues to anticipate significant COVID-related impacts and margin dilution compared with the robust performance in the first half of fiscal 2020.

Additionally, the company expects operating margin to improve sequentially in the first half of fiscal 2021 compared with the peak of the pandemic impact experienced in the fourth quarter due to significant volume declines. Notably, operating margin in the fourth quarter of fiscal 2020 was impacted by more than 10 percentage points. Additionally, the company plans to increase marketing investment as demand recovers. Overall, it anticipates sequential improvement in operating margin in the first half of fiscal 2021 as compared with the second half of fiscal 2020.

Fiscal 2020 Highlights

On a reported basis, net sales and operating profit declined 8.7% and 47.1%, respectively, owing to organic declines. During fiscal 2020, organic sales declined 8.4% as top-line gains in North America were more than offset by declines across all regions.

Notably, organic volumes dipped 11.2%. While the company delivered strong volume growth across all regions in the first half, volume in the second half of fiscal 2020 was largely impacted by the coronavirus outbreak. The volume declines in the second half were primarily due to the widespread closure of bars and restaurants around the world (on-trade channel) and the disruption to global travel.

However, the company delivered a positive price mix of 2.8% in fiscal 2020, which partly offset the decline in organic volume. Price/mix benefited from a strong market mix, with resilience in North America, which is its most profitable segment. However, volume declines across all other regions partly offset growth in the price/mix.

Gross margin contracted 174 basis points (bps) in fiscal 2020, hurt by inflation in cost of goods sold (COGS), slightly negative product mix and lower volume with reduced fixed cost absorption. This was only slightly negated by productivity-led gross margin gains. During fiscal 2020, the company witnessed inflationary pressures from commodity costs, including base neutral spirits in India and agave as well as glass globally.

Moreover, organic operating profit was down 14.4% on soft volumes, cost inflation and unabsorbed fixed costs, partly negated by short-term cost reductions and ongoing productivity benefits. Organic operating margin contracted 212 basis points (bps) in fiscal 2020, owing to soft gross margin and costs arising from the disruptions in the operating environment, partially negated by overhead efficiencies and lower marketing spend in the fiscal fourth quarter.

Financials

Diageo generated net cash from operating activities of £2.3 billion in fiscal 2020, which reflected a decline from the last year due to lower organic operating profit, lower dividends from associates, one-off tax impacts and increased working capital use. Furthermore, the company reported free cash flow of about £1.6 billion in fiscal 2020, down £1 billion from the last year.

Notably, the company delivered solid free cash flow of about £1 billion in the first half of fiscal 2020, which was only slightly enhanced by its second-half performance due to operating profit declines related to the Covid-19 pandemic.

Driven by the impacts of the pandemic, the company halted the current three-year return of capital program. In the first seven months of fiscal 2020, through January, it returned £1.25 billion to shareholders through its return of capital program. Further, to reinforce its already solid liquidity, it issued a £2.0-billion bond in April 2020 and put in place an additional credit facility of £2.5 billion.

Recent News

Diageo Plans to Launch Paper Packaging for Spirits – Jul 13, 2020

In a first-of-its-kind sustainability initiative, Diageo is ready to serve its leading Scotch Whisky brand — Johnnie Walker — in a plastic-free 100% paper bottle, starting 2021. The paper-only bottle will be made from sustainably sourced wood. The company's new venture is part of its partnership with Pilot Lite to launch a sustainable packaging company — Pulpex Limited.

Currently, most of Diageo's spirits are packaged in glass bottles, the making of which also consume energy and emit carbon. The company plans to run trails of the new packaging in different markets from the next year. It said that the new environment-friendly bottles will find space in store shelves of supermarkets and other retail outlets, leaving out the bars and restaurants.

Pulpex is the first to develop a paper-only bottle for the packaging of FMCG goods, which is also recyclable. It is also in talks with leading companies in the field like PepsiCo and Unilever to launch their branded paper bottle by 2021. Additionally, it is enthusiastic about the participation of other leading companies in the consortium. Pulpex's paper bottle complies with the food safety standards and allows brands to move their packaging design to paper, while not compromising the product quality.

Consumer product companies have lately been under the radar for excessive plastic waste generated through the packaging of food and other household items. The move of shifting packaging of drinks to paper bottle may go a long way in contributing to their commitment to reduce plastic and produce recyclable packaging.

Diageo Plans Sustainability, Strengthens E-commerce Channel – Jun 28, 2020

Diageo is one of the companies that have witnessed hardships in its on-premise channel amid the coronavirus crisis. The Beverages – Alcohol industry has been significantly impacted by the coronavirus outbreak across the globe, which dealt a huge blow to the on-premise sales channels as bars, restaurants and pubs remain closed due to lockdowns in most countries.

Consequently, alcohol makers have been looking to shift resources to the off-premise channels like supermarkets and retail stores as well as enhance e-commerce presence as the coronavirus outbreak has given rise to growing at-home consumption trends.

Per media reports, Diageo is looking to strengthen its e-commerce portals in Brazil, citing the coronavirus-induced lockdowns. Reports indicate that the company has witnessed strong growth in at-home consumption in the past three months. However, revenues earned do not completely make for the sales lost through the closures of bars, restaurants and pubs. Analysts note that the "on-trade segment", which is the sale of alcoholic beverages in licensed premises, accounts for nearly 40-50% of Diageo's revenues.

The company has been leaving no stone unturned to adapt to this shift in sales trends by reallocating resources to online channels to compensate for the closure of the on-trade channels. Eventually, it entered partnerships with major retailers in Brazil, including local chains like French supermarkets groups Casino Guichard Perrachon SA and Carrefour SA. It also made pacts with international online companies like Amazon and MercadoLibre.

While these efforts standout, Brazil's alcoholic beverages association Abrabe predicts total alcohol sales to be down nearly 50%, on average, due to the coronavirus crisis.

With restrictions starting to ease out in Brazil, Sao Paulo is expected to be allowed to reopen bars and restaurants from Jul 6.

Additionally, on Jun 24, Diageo announced a $100-million recovery fund to help bars, pubs and restaurants around the world welcome customers after the lockdowns are lifted. The two-year program will be available from July 2020 and is called "Raising the Bar".

The program will provide support for the recovery of major hospitality centers in New York, London, Edinburgh, Dublin, Belfast, Mexico City, Sao Paulo, Shanghai, Delhi, Mumbai, Bangalore, Nairobi, Dar es Salaam, Kampala, Sydney and more. The program was designed after a global survey of bar owners to identify their requirements in the post-lockdown situation. These include hygiene initiatives, digital backup and practical equipment to transform the functioning of their outlets.

Valuation

Diageo shares are down 19.3% in the year-to-date period and nearly 16.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are down 24.5% and 8.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 28.6% and 6.4%, respectively.

The S&P 500 index is up 3.3% in the year-to-date period and 13.6% in the past year.

The stock is currently trading at 23.51X forward 12-month earnings, which compares to 24.98X for the Zacks sub-industry, 19.9X for the Zacks sector and 22.69X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.02X and as low as 14.61X, with a 5-year median of 20.86X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our $115.00 price target reflects 19.9X forward 12-month earnings.

The table below shows summary valuation data for DEO

Valuation Multiples - DEO					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	23.51	24.98	19.9	22.69
	5-Year High	26.02	27.52	22.37	22.69
	5-Year Low	14.61	18.8	16.63	15.25

	5-Year Median	20.86	23.3	19.57	17.55
P/S F12M	Current	5.34	16.02	9.41	3.63
	5-Year High	6.95	20.67	11.15	3.63
	5-Year Low	3.51	13.04	8.1	2.53
	5-Year Median	5.09	17.28	9.89	3.04
EV/EBITDA TTM	Current	12.96	37.29	35.83	12.89
	5-Year High	23.12	55.56	45.91	12.89
	5-Year Low	12.96	29.05	28	8.24
	5-Year Median	18.99	44.61	39.09	10.89

As of 08/06/2020

Industry Analysis **Zacks Industry Rank:** Top 42% (106 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
AnheuserBusch InBev SANV **(BUD)**	Outperform	2
Pernod Ricard SA **(PDRDY)**	Outperform	2
BrownForman Corporation **(BF.B)**	Neutral	3
Craft Brew Alliance, Inc. **(BREW)**	Neutral	3
Heineken NV **(HEINY)**	Neutral	3
Constellation Brands Inc **(STZ)**	Neutral	3
Molson Coors Beverage Company **(TAP)**	Neutral	3
Ambev S.A. **(ABEV)**	Underperform	5

Industry Comparison Industry: Beverages - Alcohol

	DEO	X Industry	S&P 500	BUD	HEINY	TAP
				Industry Peers		
Zacks Recommendation (Long Term)	Underperform	-	-	Outperform	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	2	3	3
VGM Score	B	-	-	F	B	A
Market Cap	79.39 B	10.83 B	23.20 B	110.66 B	52.49 B	7.92 B
# of Analysts	4	2	14	2	2	6
Dividend Yield	1.99%	0.00%	1.78%	1.52%	2.01%	0.00%
Value Score	D	-	-	D	B	A
Cash/Price	0.01	0.04	0.07	0.00	0.04	0.10
EV/EBITDA	NA	9.71	13.21	9.62	10.11	9.31
PEG Ratio	2.93	3.56	2.94	NA	NA	1.66
Price/Book (P/B)	7.46	2.67	3.12	1.62	2.71	0.60
Price/Cash Flow (P/CF)	14.39	15.42	12.27	8.68	10.54	4.26
P/E (F1)	24.26	27.50	21.69	25.29	36.30	9.96
Price/Sales (P/S)	NA	1.94	2.48	2.31	NA	0.65
Earnings Yield	4.12%	3.14%	4.39%	3.95%	2.74%	10.04%
Debt/Equity	1.80	0.45	0.77	1.55	0.77	0.61
Cash Flow ($/share)	9.44	1.53	6.94	6.32	4.32	8.59
Growth Score	A	-	-	F	B	B
Hist. EPS Growth (3-5 yrs)	NA%	7.36%	10.46%	-7.49%	NA	7.18%
Proj. EPS Growth (F1/F0)	1.86%	-5.79%	-6.80%	-46.81%	-48.35%	-19.09%
Curr. Cash Flow Growth	20.52%	-2.83%	5.39%	11.61%	2.45%	-5.29%
Hist. Cash Flow Growth (3-5 yrs)	-0.55%	3.18%	8.55%	0.84%	5.02%	11.28%
Current Ratio	1.77	1.49	1.33	1.17	0.68	0.67
Debt/Capital	64.27%	31.20%	44.50%	60.81%	43.57%	37.83%
Net Margin	NA%	2.55%	10.13%	2.55%	NA	-1.33%
Return on Equity	NA%	9.22%	14.39%	9.03%	NA	7.18%
Sales/Assets	NA	0.51	0.51	0.41	NA	0.42
Proj. Sales Growth (F1/F0)	0.43%	0.00%	-1.51%	-15.47%	-11.94%	-8.03%
Momentum Score	B	-	-	A	F	C
Daily Price Chg	-0.72%	0.00%	-0.04%	-1.63%	-1.81%	0.11%
1 Week Price Chg	2.57%	0.12%	0.14%	-0.18%	0.75%	2.82%
4 Week Price Chg	-1.06%	0.00%	7.78%	7.59%	-3.13%	9.98%
12 Week Price Chg	0.94%	8.92%	17.48%	38.87%	16.40%	0.77%
52 Week Price Chg	-16.94%	-5.34%	0.68%	-44.29%	-14.98%	-30.63%
20 Day Average Volume	403,148	26,984	2,057,775	1,948,254	43,779	2,019,248
(F1) EPS Est 1 week change	-1.67%	0.00%	0.00%	6.63%	-17.71%	20.49%
(F1) EPS Est 4 week change	-4.07%	0.00%	1.36%	22.95%	-17.71%	26.54%
(F1) EPS Est 12 week change	-5.56%	4.22%	1.57%	26.53%	-24.85%	22.33%
(Q1) EPS Est Mthly Chg	NA%	0.00%	0.54%	41.51%	NA	-16.13%

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	D
Growth Score	A
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.

Disclosures

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