

E*TRADE Financial (ETFC)

\$45.37 (As of 12/31/19)

Price Target (6-12 Months): **\$48.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/02/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: A

Growth: D

Momentum: C

Summary

Shares of E*TRADE have underperformed the industry over the past three months. Yet, the company has an impressive earnings surprise history, surpassing the Zacks Consensus Estimate in each of the trailing four quarters. Continuous improvement in daily average revenue trades (DARTs) acts as a tailwind for the company. Further, several restructuring measures and balance-sheet growth plans keep us encouraged. Focus on core operations and strategic initiatives are likely to boost top line. The company's online innovations and steady capital deployment activities are commendable. However, rising costs due to growing franchise remain a major concern. Also, significant dependence on interest-based revenue streams and intense competition are headwinds. Further, introduction of zero trading commission plan is likely to adversely impact revenue growth.

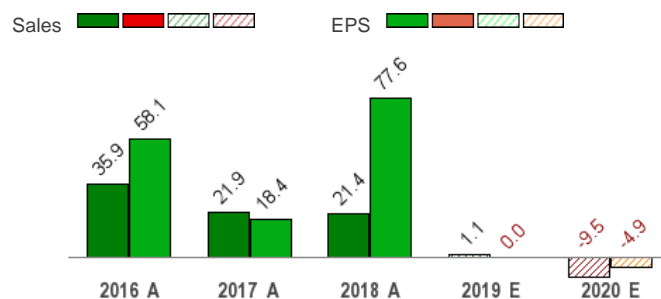
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$52.35 - \$34.68
20 Day Average Volume (sh)	2,385,079
Market Cap	\$11.1 B
YTD Price Change	3.4%
Beta	1.22
Dividend / Div Yld	\$0.56 / 1.2%
Industry	Financial - Investment Bank
Zacks Industry Rank	Top 26% (67 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	8.0%
Last Sales Surprise	4.1%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	01/23/2020
Earnings ESP	0.9%
P/E TTM	10.4
P/E F1	11.7
PEG F1	1.1
P/S TTM	3.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	669 E	659 E	656 E	654 E	2,630 E
2019	755 A	685 A	767 A	672 E	2,905 E
2018	708 A	710 A	720 A	735 A	2,873 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.83 E	\$0.96 E	\$0.91 E	\$1.01 E	\$3.70 E
2019	\$1.09 A	\$1.12 A	\$1.08 A	\$0.82 E	\$3.89 E
2018	\$0.88 A	\$0.95 A	\$1.00 A	\$1.06 A	\$3.89 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 12/31/2019. The reports text is as of 01/02/2020.

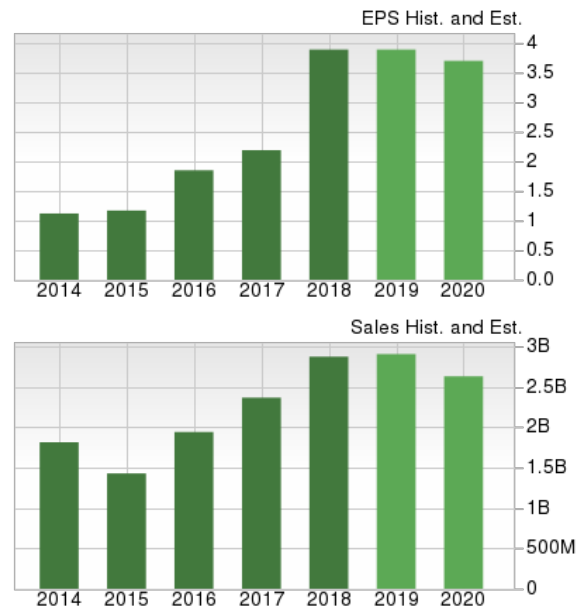
Overview

Founded in 1982 in California and headquartered in New York, E*TRADE Financial Corporation provides online brokerage and related products and services primarily to individual retail investors, under the brand name of “E*TRADE Financial” worldwide. The company was reincorporated in Delaware in July 1996. Along with its subsidiaries, E*TRADE offers various brokerage products and services including automated order placement and execution of the U.S., as well as international equities, currencies, futures, options, exchange-traded funds, mutual funds, and bonds. The banking products and services include checking, savings and clearing facilities, along with money market and certificates of deposit products. E*TRADE operates worldwide, primarily in the U.S., Europe and Asia. The company provides these services to customers online through its network of customer service representatives, investment professionals, and investment advisors – over the phone and in person in all of its 30 E*TRADE branches.

Previously, the company operated through two reporting segments – *Trading and Investing* and *Balance Sheet Management*. However, the company made several reporting changes in the first quarter of 2016 including consolidation of its reporting segments. Given that most of the company’s legacy costs are behind it and balance sheet strength now depends on maximizing the value of customer deposits, management viewed that it was the right time to terminate the balance sheet management segment as well as the corporate category.

In January 2015, the company obtained regulatory approval for moving its two U.S. broker-dealers – E*TRADE Clearing LLC and E*TRADE Securities LLC – from under E*TRADE Bank. E*TRADE Securities and E*TRADE Clearing were moved from under E*TRADE Bank in February 2015 and July 2015, respectively. The reorganized structure will aid in simplification of distribution of capital generated by those entities to the parent.

In April 2018, E*TRADE completed the Trust Company of America (TCA) acquisition deal, diversifying business and securing access to high growth Advisor service delivery model. Previously, in an effort to fortify its derivatives platform, the company completed the acquisition of online options broker — OptionsHouse — in September 2016.



Reasons To Buy:

- ▲ E*TRADE, with the introduction of brokerage products and services and enhancement of capabilities on professional trading and mobile platforms, remains focused on improving its technology space to offer a better digital experience to customers. The company's DARTs recorded a three-year compound annual growth rate (CAGR) of 31.1% in 2018, with the increasing trend continuing in the first nine months of 2019. Notably, second-quarter 2018 marked the second best quarter in the company's history in terms of recording DARTs.
- ▲ In an effort to boost its derivatives platform and diversifying business, E*TRADE completed a number of acquisitions since 2016. The company is focused on derivatives mix and crossed the target of increasing it to 35% of DARTs in third-quarter 2019 and also set managed account AUM target of \$6 billion within the next two years. The company aims to achieve 2-3% improvement in its rate of annual organic growth, across accounts, assets and trades. We expect several of its ongoing initiatives and customer services to further lower the attrition rate of the annual brokerage accounts and support its overall growth strategy.
- ▲ E*TRADE continues to streamline its balance sheet risk by reducing credit risk in its legacy loan portfolios. Notably, the company's loan portfolio recorded a negative CAGR of 23%, over the last five years (2014-2018), with the trend continuing in the first nine months of 2019. We believe successful completion of the balance sheet restructuring will significantly strengthen the company's financials in the mid to long term.
- ▲ Driven by a solid capital position, E*TRADE is now focused on returning capital to shareholders. This July, it announced a new share-repurchase plan worth \$1.5 billion and initiated common stock dividend in October 2018. Notably, the company completed its previous \$1-billion authorization in third-quarter 2019 and made progress toward the current \$1.5-billion program. We believe, with strengthening of its overall performance, the company enhances shareholders' value with the commitment to return excess capital to them.
- ▲ E*TRADE has seen improvement in its net interest margin (NIM) after years of facing declining trend. It recorded NIM of 3.08%, 2.79%, 2.65%, 2.50% and 2.30% in 2018, 2017, 2016, 2015 and 2014, respectively. Margin continued to expand in the first nine months of 2019 with slight contraction in the first quarter. Amid Fed's accommodative monetary policy stance, improvement in economy and decent loan growth might support margin further.
- ▲ Shares of E*TRADE have underperformed the industry over the past six months. Despite this unfavorable trend, the company's current-year earnings estimates have been revised slightly upward over the past 30 days. Also, the stock seems undervalued when compared with the broader industry. Its current PEG ratio is below the industry average. Also, it has a Value Score of A. Therefore, given the progress on fundamentals and positive estimates revision, the stock has upside potential.

E*TRADE remains well positioned for growth due to its online innovations and renewed focus on trading business. Further, strategic moves and steady capital-deployment activities are commendable.

Reasons To Sell:

- ▼ E*TRADE's expanding cost base exposes the company to operational risks. Notably, non-interest expenses recorded a CAGR of 6.1% over the last five years (2014-2018), with some annual volatility, primarily due to increase in almost all the cost components. The increasing trend continued in the first nine months of 2019. Therefore, mounting expenses will likely remain a near-term headwind as the company focuses on growing its franchise.
- ▼ E*TRADE has to compete with many established and renowned players with greater financial, marketing and technical capabilities. Some of these competitors are in position to withstand the changing market conditions in a better way and can mould to take advantages of the opportunities. Also, these big peers can easily come out with better terms, conduct promotional activities and can offer better terms to entice customers. This intense competition can have adverse impact on the company's revenues and customer base.
- ▼ We remain apprehensive about E*TRADE's significant dependence on interest-based revenue streams (net interest income constituted 65% of net revenues in the first nine months of 2019). Therefore, following the recent Fed rate cuts, reversal in interest-rate environment can affect its top line.

Escalating expenses and significant dependence on interest-based revenue streams remain key concerns for E*TRADE. Further, intense competition with other established companies keeps us apprehensive.

Last Earnings Report

E*TRADE Q3 Earnings & Revenues Beat on Rise in DARTs

Riding on top-line strength, E*TRADE delivered a positive earnings surprise of 8% in third-quarter 2019. Earnings of \$1.08 per share comfortably surpassed the Zacks Consensus Estimate of \$1.00. Moreover, the results compare favorably with the prior-year quarter's \$1.00.

Results include net benefit of \$9 million or 4 cents per share, associated with the benefit to provision for loan losses.

The company's results reflect improved DARTs. Further, rise in non-interest income and a benefit to provision for loan losses were tailwinds. Additionally, the company registered a rise in customer accounts in the quarter. However, decreased net interest income and escalating expenses were major drags.

E*TRADE's net income available to common shareholders for the reported quarter came in at \$254 million compared with the \$261 million recorded in the year-ago quarter.

Revenues Up, Expenses Escalate

Net revenues in the third quarter came in at \$767 million, outpacing the Zacks Consensus Estimate of \$736.5 million. Furthermore, revenues were up 6.5% from the year-ago quarter.

Net interest income declined 2.4% year over year to \$455 million, primarily due to elevated interest expenses, partially offset by higher interest income. Net interest margin was 3.28%, up 18 basis points from the 3.10% reported in the prior-year quarter.

Non-interest income was \$312 million, up 22.8% year over year. Higher commissions, along with elevated fees and service charges, partly offset by lower gains on securities and other revenues, primarily led to this upside.

Total non-interest expenses escalated 5% year over year to \$399 million. This upside mainly resulted primarily from rise in almost all components of expenses.

Steady Trading Performance

Total DARTs increased 5% year over year to 266,935 during the September-end period, including 36% in derivatives. At the end of the quarter, E*TRADE had 7.2 million customer accounts (including 5.1 million retail accounts), up 21% from the year-ago quarter.

Also, the company's total customer assets were \$604 billion, up 2% year over year. Brokerage-related cash increased 11% year over year to \$65 billion.

Notably, customers were net sellers of about \$0.2 billion of securities compared with net buyers of \$2.2 billion recorded in the prior-year quarter. Net new retail assets totaled \$2.8 billion, down 10% from the comparable period last year.

Credit Quality

E*TRADE's overall credit quality displayed a decent performance. Net recoveries were \$9 million during the July-September quarter compared with \$8 million recorded as of Dec 31, 2018. Also, the company recorded a provision benefit of \$12 million, in line with the comparable period last year.

Balance Sheet and Capital Ratios

E*TRADE's loan portfolio totaled \$1.7 billion at the end of the reported quarter, down from \$2.1 billion as of Dec 31, 2018.

As of Sep 30, 2019, E*TRADE had total assets of \$61.7 billion compared with \$65 billion as of Dec 31, 2018.

The company's capital ratios remained strong. As of Sep 30, 2019, E*TRADE reported Tier 1 risk-based capital ratio of 37.8% compared with the 40.5% witnessed in the year-ago quarter. Total risk-based capital ratio was 38.2%, down from the prior-year quarter's 40.9%. Tier 1 leverage ratio was 7.4% compared with the year-earlier quarter's 7.1%.

During the third quarter, the company returned \$600 million to shareholders, including dividends worth \$34 million and share repurchases worth \$566 million.

Outlook

Management plans to complete the review of the new accounting standard for current expected credit losses, also known as CECL, in the fourth quarter. It currently anticipates this to result in a net benefit to equity of around \$75 million to \$100 million, which will be reflected in the first quarter of 2020. This benefit primarily relates to the write-up of the collateral backing the company's legacy loan portfolio.

Management targets adjusted operating margin of 44% for 2019, including potential discrete charges associated with restructuring or exit costs from cost containment initiatives in the fourth quarter.

The full-year tax rate is expected to be around 27%.

NIM is anticipated to be in the range of 315-320 basis points for 2019, assuming customer margin balances at their current levels, deposit grow

Quarter Ending **09/2019**

Report Date	Oct 17, 2019
Sales Surprise	4.14%
EPS Surprise	8.00%
Quarterly EPS	1.08
Annual EPS (TTM)	4.35

off-balance sheet and one Fed funds rate cut in October.

For fourth-quarter 2019, management anticipates gross fees from off-balance sheet sweep deposits will be around 195 basis points and expects net fees to be around 180 basis points, which assumes an expected 25-basis-point cut in Fed funds in October. Further, net money market fees are expected to remain flat at Q3 levels. Also, among the remaining components of fees and service charges, gains are expected to realize around \$10 million to \$15 million per quarter.

For 2019, management anticipates marketing spend to come in above \$190 million.

Long-term Targets

E*TRADE targets sustainable double-digit EPS growth and to grow the top line by mid to high-single digits over the next five years. Given the reduction in commission revenues of around \$300 million annually, the expected-rate environment and the resulting impact on capital generation and capital return, management estimates around \$6 in 2023 EPS and \$7 in 2024.

For 2019, management targets a reduction to non-interest expense in 2020, even after excluding any one-time costs in 2019. Therefore, non-interest expenses will likely be around \$1.5 billion in 2020.

Recent News

E*TRADE Up 2.5% as November DARTs, New Accounts Rise - Dec 11, 2019

E*TRADE reported a sequential and year-over-year rise in DARTs for November. The DARTs came in at 354,434, up 22% from the previous month and 32% year over year. Notably, derivatives comprised 33% of DARTs.

At the end of November, E*TRADE's total number of accounts were approximately 7.2 million, comprising about 5.1 million retail accounts, 1.9 million corporate services accounts, and 0.1 million advisor services accounts.

Also, E*TRADE reported net new accounts of 35,373 for November. Total brokerage accounts highlight the company's ability to gain and retain customers who trade and invest.

Further, E*TRADE's net new retail assets came in at \$2.4 billion compared with \$0.7 billion in the previous month and \$16.4 billion in November 2018.

At the end of November, E*TRADE's customer security holdings were \$301 billion, up 3% from October 2019 and 13% year over year. The company's brokerage-related cash and deposits came in at \$68.7 billion, increasing 4% from the prior month and 17% from the prior-year month.

However, bank-related cash and deposits of \$4.2 billion declined 58% sequentially and 26% year over year.

E*TRADE Reports 9% Sequential Growth in October DARTs - Nov 12, 2019

E*TRADE has reported a sequential rise in DARTs for October. According to its monthly market activity, the company's DARTs came in at 290,578, up 9% from the previous month, but down 1% year over year. Notably, derivatives comprised 36% of DARTs.

Broker performance is generally measured through DARTs that represent the number of trades from which brokers can expect commission or fees. The rise in DARTs largely reflects investors' willingness to invest in equity markets.

At the end of October 2019, E*TRADE's total number of accounts were approximately 7.2 million, comprising about 5.1 million retail accounts, 1.9 million corporate services accounts, and 0.2 million advisor services accounts.

E*TRADE's total accounts included 13,535 net reductions for October. Total brokerage accounts highlight the company's ability to gain and retain customers who trade and invest.

Moreover, E*TRADE's net new retail assets came in at \$0.7 billion compared with \$1.4 billion reported in the previous month.

At the end of October, E*TRADE's customer security holdings were \$291.6 billion, up from the \$284.7 billion in September. The company's brokerage-related cash came in at \$66.1 billion compared with the previous month's \$65 billion. In addition, bank-related cash and deposits for the company totaled \$10 billion, up from the \$9.6 billion recorded in September.

E*TRADE Announces Commission Free Trading, Revenues to Take a Hit - Oct 2, 2019

E*TRADE has eliminated retail commissions for online U.S. listed stock, ETF and options trades. Also, it reduced the options contract charge to 65 cents per contract for all traders while maintaining its active trader pricing at 50 cents per contract. These changes took effect on Oct 7, 2019.

The company estimates that this move will have a 10% adverse impact on its net revenues.

Post this news, Moody's Investors Service downgraded the outlook for E*TRADE to negative from stable. However, the ratings of the three firms were not changed. Moody's affirmed their ratings.

Per Moody's, relatively lower interest rates and flattening of the yield curve are already adversely impacting financials of the brokerage firm. With this fee cut, profitability is likely to be hurt even more. This is the main reason why Moody's downgraded the outlook.

Dividend Update

On Oct 17, E*TRADE's board of directors announced a quarterly common stock cash dividend of 14 cents per share. The dividend was paid on Nov 15 to shareholders on record as of Nov 8.

Valuation

E*TRADE's shares are up 2.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 16.9% and 20.3% over the past year, respectively.

The S&P 500 index is up 30.7% in the past year.

The stock is currently trading at 11.07X forward 12 months earnings, which compares to 12.3X for the Zacks sub-industry, 15.56X for the Zacks sector and 20.29X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 24.13X and as low as 8.09X, with a 5-year median of 16.53X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$48 price target reflects 11.62X forward earnings.

The table below shows summary valuation data for ETFC

Valuation Multiples - ETFC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.07	12.3	15.56	20.29
	5-Year High	24.13	15.3	16.21	20.29
	5-Year Low	8.09	6.05	12.01	15.17
	5-Year Median	16.53	11.39	13.98	17.44
P/TB TTM	Current	3.64	2.38	3.28	12.32
	5-Year High	5.03	3.33	3.98	12.36
	5-Year Low	1.56	1.6	2.44	6.03
	5-Year Median	3.09	2.39	3.46	9.06
P/S F12M	Current	3.82	3.26	6.56	3.51
	5-Year High	5.85	4.53	6.61	3.51
	5-Year Low	2.97	2.8	5.2	2.54
	5-Year Median	4.23	3.62	6.04	3

As of 12/31/2019

Industry Analysis Zacks Industry Rank: Top 26% (67 out of 253)



Top Peers

TD Ameritrade Holding Corporation (AMTD)	Outperform
The Charles Schwab Corporation (SCHW)	Outperform
Evercore Inc (EVR)	Neutral
GAIN Capital Holdings, Inc. (GCAP)	Neutral
LPL Financial Holdings Inc. (LPLA)	Neutral
Raymond James Financial, Inc. (RJF)	Neutral
WisdomTree Investments, Inc. (WETF)	Neutral
Virtu Financial, Inc. (VIRT)	Underperform

Industry Comparison Industry: Financial - Investment Bank				Industry Peers		
	ETFC Neutral	X Industry	S&P 500	AMTD Outperform	RJF Neutral	SCHW Outperform
VGM Score	B	-	-	F	B	B
Market Cap	11.10 B	519.11 M	23.93 B	26.92 B	12.41 B	60.99 B
# of Analysts	3	3	13	6	1	5
Dividend Yield	1.23%	0.69%	1.78%	2.49%	1.65%	1.43%
Value Score	A	-	-	D	A	B
Cash/Price	0.17	0.37	0.04	0.48	0.52	0.59
EV/EBITDA	6.39	4.89	13.95	5.17	4.89	6.67
PEG Ratio	1.07	1.52	2.12	1.48	NA	3.05
Price/Book (P/B)	1.89	1.87	3.33	3.13	1.87	3.35
Price/Cash Flow (P/CF)	8.88	8.65	13.67	10.59	10.62	15.43
P/E (F1)	11.66	11.35	19.66	16.58	11.04	17.73
Price/Sales (P/S)	3.77	1.52	2.69	4.47	1.55	5.66
Earnings Yield	8.57%	8.21%	5.08%	6.04%	9.05%	5.63%
Debt/Equity	0.24	0.41	0.72	0.41	0.42	0.40
Cash Flow (\$/share)	5.11	2.72	6.94	4.69	8.43	3.08
Growth Score	D	-	-	D	D	B
Hist. EPS Growth (3-5 yrs)	39.06%	12.15%	10.56%	28.24%	21.66%	28.77%
Proj. EPS Growth (F1/F0)	0.41%	0.00%	0.00%	-27.44%	9.46%	10.26%
Curr. Cash Flow Growth	46.38%	31.63%	14.83%	17.86%	13.40%	38.26%
Hist. Cash Flow Growth (3-5 yrs)	11.88%	15.78%	9.00%	21.50%	17.54%	23.74%
Current Ratio	0.28	1.31	1.23	1.17	1.11	0.30
Debt/Capital	17.67%	27.30%	42.92%	29.23%	29.33%	25.81%
Net Margin	35.79%	5.73%	11.08%	36.72%	12.89%	35.12%
Return on Equity	18.41%	12.26%	17.10%	27.18%	16.51%	20.81%
Sales/Assets	0.05	0.23	0.55	0.15	0.21	0.04
Proj. Sales Growth (F1/F0)	0.00%	0.00%	0.00%	-12.48%	5.30%	0.00%
Momentum Score	C	-	-	F	C	D
Daily Price Chg	-0.02%	0.00%	0.33%	-0.54%	-0.68%	-0.54%
1 Week Price Chg	-0.26%	0.00%	0.13%	0.42%	-0.32%	0.46%
4 Week Price Chg	2.25%	0.11%	3.67%	-2.34%	1.66%	-2.26%
12 Week Price Chg	23.69%	5.59%	10.64%	48.71%	17.03%	35.00%
52 Week Price Chg	3.40%	3.93%	27.46%	1.51%	20.23%	14.52%
20 Day Average Volume	2,385,079	95,375	1,693,267	4,281,654	518,648	9,238,084
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.10%	0.00%	0.00%	-0.11%	0.00%	-0.26%
(F1) EPS Est 12 week change	-3.35%	-3.26%	0.14%	-16.44%	-0.92%	2.80%
(Q1) EPS Est Mthly Chg	0.61%	0.00%	0.00%	0.26%	NA	-0.26%

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	A
Growth Score	D
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.

Disclosures

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