

W.W. Grainger, Inc. (GWW)

\$403.39 (As of 11/11/20)

Price Target (6-12 Months): **\$411.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 04/24/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: A

Momentum: C

Summary

Grainger's third-quarter 2020 revenues and earnings were not only up year over year but also beat the respective Zacks Consensus Estimates. The company will gain from efforts to strengthen customer relationships in the United States, higher e-commerce sales and increased demand for certain products amid the COVID-19 pandemic. However, some of these products carry lower margins, which is a concern. This along with higher input and operating costs will hurt margins. Nevertheless, the company has undertaken several cost-control measures, which will help negate the impact. The Canada segment continues to face pandemic related softness. Weakness in heavy manufacturing also remains a woe. The Fabory divestiture and the sale of the distribution business in China will help simplify the company's footprint and focus on its core markets.

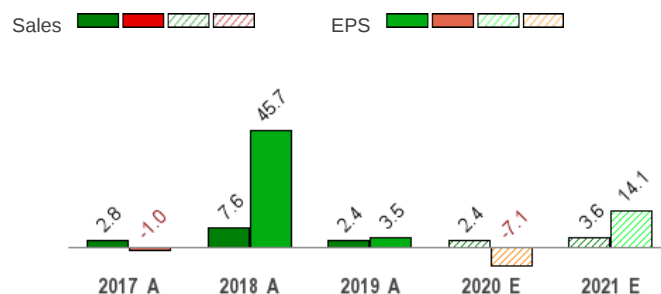
Price, Consensus & Surprise



Data Overview

52-Week High-Low	\$411.87 - \$200.61
20-Day Average Volume (Shares)	354,612
Market Cap	\$21.7 B
Year-To-Date Price Change	19.5%
Beta	1.10
Dividend / Dividend Yield	\$6.12 / 1.5%
Industry	Industrial Services
Zacks Industry Rank	Bottom 31% (173 out of 249)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.4%
Last Sales Surprise	1.6%
EPS F1 Estimate 4-Week Change	1.4%
Expected Report Date	02/04/2021
Earnings ESP	0.2%
P/E TTM	24.7
P/E F1	25.1
PEG F1	2.2
P/S TTM	1.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,986 E	3,026 E	3,109 E	3,016 E	12,182 E
2020	3,001 A	2,837 A	3,018 A	2,896 E	11,758 E
2019	2,799 A	2,893 A	2,947 A	2,847 A	11,486 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$4.46 E	\$4.61 E	\$4.88 E	\$4.25 E	\$18.33 E
2020	\$4.24 A	\$3.75 A	\$4.52 A	\$3.78 E	\$16.06 E
2019	\$4.51 A	\$4.64 A	\$4.26 A	\$3.88 A	\$17.29 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 11/11/2020. The reports text is as of 11/11/2020.

Overview

Incorporated in 1928, IL-based W.W. Grainger Inc. is a broad line, business-to-business distributor of maintenance, repair and operating (MRO) products and services. Its operations are primarily in North America, Europe and Japan.

The global MRO market is approximately \$608 billion, and the Grainger's estimated market size is \$284 billion. Its customers represent a wide array of industries including government, manufacturing, transportation, commercial and contractors.

Its products include material-handling equipment, safety and security supplies, lighting and electrical products, power and hand tools, pumps and plumbing supplies, cleaning and maintenance supplies, and metalworking tools.

The company reports revenues under two business segments — the **United States**, which contributes around 74% to revenues, and **Canada**, which generates around 5%. The Other Businesses accounts for nearly 21% of revenues.

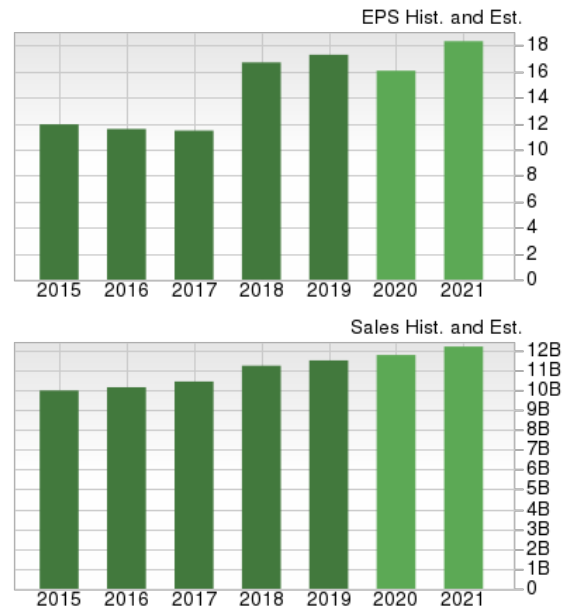
The U.S. business offers a broad selection of MRO products and services through its e-commerce platform, catalogs, branches and sales and service representatives. A combination of product breadth, local availability, speed of delivery, detailed product information and competitively priced products and services is provided by this business.

Customers range from small and mid-sized businesses to large corporations, government entities and other institutions within various industries.

Acklands – Grainger and its subsidiaries (the Canada business) provide a combination of product breadth, local availability, speed of delivery, detailed product information and competitively priced products and services. The Canada business serves customers through branches, distribution centers and sales and service representatives.

Other businesses include the endless assortment businesses, Zoro Tools, Inc. (Zoro) and MonotaRO Co., LTD (MonotaRO), and smaller high-touch businesses in the UK and Mexico.

On Jun 30, 2020, Grainger divested the Fabory business in Europe. Also, in August, Grainger completed the sale of its distribution business in China — Grainger China LLC.



Source: Zacks Investment Research

Reasons To Buy:

- ▲ The company accomplished the goal of remerchandising a record \$1.2 billion of products in the United States in 2019 and is on track to complete another \$1.6 billion in 2020. Grainger outgrew the U.S MRO market by 150-200 basis points in 2019. So far in 2020, the company has consistently outpaced the U.S MRO market. In first-quarter 2020, the U.S. MRO market declined between 1% and 1.5%. Grainger outgrew the U.S MRO market by around 700 basis points. In second-quarter 2020, the U.S. MRO market fared worse, declining between 14% and 15% while Grainger outgrew the U.S MRO market by around 100 basis points, highlighting consistent traction of its growth initiatives. In the third quarter, Grainger's U.S. Segment sales outgrew the U.S. MRO market by 850 basis points. The latter declined an estimated 5% to 6%. Grainger will continue its efforts to strengthen relationships with both large and mid-sized customers to improve sales force effectiveness. Grainger continues to re-engage lapsed customers and acquire new ones.
- ▲ During third-quarter 2020, Grainger returned \$82 million to shareholders through dividends. Despite the current unprecedented and challenging market conditions due to the COVID-19 pandemic, Grainger hiked quarterly dividend by 6% in July — marking its 49th year of consecutive dividend increase. The company repaid the revolving credit facility and plans to restart its share-repurchase program in fourth-quarter 2020. As of the end of the quarter, the company had \$2.1 billion of available liquidity. It had cash balance of \$859 million at the end of third-quarter 2020. Further, Grainger has no debt maturities or material financial obligations due within the next five years. As of Sep 30, 2020, the company's total debt to total capital ratio was at 0.50. Further, its times interest earned ratio is a healthy 10.4.
- ▲ Grainger experienced a surge of COVID-19 pandemic related product sales such as personal protective equipment (PPE) and safety products due to higher customer demand in response to the global outbreak. The incremental demand came primarily from customers in the front-lines of the pandemic, including hospitals, healthcare providers, governments, first responders and critical manufactures. The company expects increased levels of safety and cleaning product sales to large healthcare, government and critical manufacturing customers in the near term. Further, the pandemic has provided a boost to Grainger's e-commerce sales. The company is focused on improving the end-to-end customer experience by making investments in its e-commerce and digital capabilities, and executing improvement initiatives within its supply chain.
- ▲ Grainger's Canada business is an attractive market and is expected to deliver double-digit operating margin growth over the next five years. The company has been focused on reducing its cost structure in the Canada operations to drive profitable growth. Grainger has been managing inventory effectively to drive profitability, and is focused on making incremental investments in marketing and merchandising.
- ▲ In the wake of the ongoing uncertainty related to the COVID-19, the company has undertaken several cost control measures, which include limiting discretionary spending, temporarily furloughing employees or minimizing work hours, reducing short-term executive pay, delaying salary increases, scaling back advertising spend, eliminating non-essential travel, delaying or reducing hiring activities and deferring certain discretionary capital expenditures.
- ▲ Grainger remains focused on profitable growth in key geographies. In sync with this, in June, the company announced it has entered into a definitive agreement to sell its distribution business in China, Grainger China LLC (Grainger China). To support this portfolio, the company will maintain its Global Sourcing operations based in China. Grainger's Global Sourcing provides the company with private label products in categories that include safety, cleaning, electrical, motors and tools. Also, in sync with the company's strategic focus on broad-line MRO distribution in key markets, Grainger divested the Fabory business in Europe in June. These actions will help the company simplify its footprint and focus efforts on its core markets.

Grainger will continue to gain from the ongoing momentum in the United States, as well as strong demand for certain products and e-commerce sales mainly triggered by the coronavirus pandemic.

Reasons To Sell:

- ▼ The COVID-19 pandemic may cause disruption to Grainger's businesses and operations as well as the operations of its customers and suppliers going forward. Given the uncertainty related to the impact and duration of this pandemic, Grainger has suspended guidance for 2020. Weakness in heavy manufacturing will continue impact Grainger's sales as it contributes around 18% of the company's sales. Grainger's Canada business continues to be impacted by pandemic related weakness.
- ▼ The COVID-19 pandemic has led to a shift in demand toward lower-margin products. Further, higher operating costs in response to the COVID-19 pandemic and related activities are also likely to impact operating margins in the upcoming quarters. Further, the company anticipates SG&A expenses to come in sequentially higher in the fourth quarter thanks to incremental technology investments to support growth in the United States and at MonotaRO. All these factors are likely to weigh on the fourth-quarter results.
- ▼ Given the success of the Zoro business, the company has decided to invest in Zoro to accelerate its product expansion efforts. The company is also leveraging its knowledge of MonotaRO to improve marketing and analytics capability in the Zoro U.S. operation. These changes call for some incremental investment, which in turn will lower margins in the Zoro business in the near term. Grainger's operating expenses will be higher as the company invests in digital marketing capabilities. Its results will also bear the brunt of foreign exchange headwind.
- ▼ The implementation of tariffs has led to input cost inflation. This will put margins under pressure in the fourth quarter as well. The company is working with suppliers to minimize the cost impact, including identifying alternative supply and evaluating pricing actions. Moreover, the company is also facing higher freight costs.

Grainger's results will be impacted by shift in demand toward lower-margin products and higher operating costs due to the pandemic. Its Canada business will be hurt by pandemic related weakness.

Last Earnings Report

Grainger's Q3 Earnings & Sales Beat Estimates, Up Y/Y

Grainger reported third-quarter 2020 adjusted earnings per share of \$4.52, which beat the Zacks Consensus Estimate of \$4.13. The bottom line increased 6% year over year primarily on improved operating earnings and lower average shares outstanding in the current period, partly offset by a higher tax rate.

Including one-time items, earnings came in at \$4.41 in the reported quarter. The figure increased 4% from the year-ago quarter's \$4.25.

Grainger's revenues were up 2.4% year over year to \$3.02 billion. The top line also surpassed the Zacks Consensus Estimate of \$2.97 billion.

Daily sales for the quarter increased 2.4% compared with the prior-year quarter. This increase in sales primarily resulted from share gains in the U.S. segment and significant growth in the endless assortment businesses, offsetting declines in the Canada segment.

Operational Update

Adjusted cost of sales increased 5.2% year over year to \$1,944 million. Gross profit was down 2.3% year over year to \$1,074 million. Gross margin contracted to 35.6% in the quarter from 37.2% in the prior-year quarter due to pandemic-induced headwinds. The continued business unit mix impact from faster growth in the lower-margin endless assortment businesses also hurt gross margins.

Grainger's adjusted operating income in the third quarter climbed 10.3% year over year to \$374 million. Adjusted operating margin expanded to 12.4% compared with the prior-year quarter's 11.5%.

Financial Position

The company had cash and cash equivalents of \$859 million at the end of third-quarter 2020, substantially up from the \$360 million witnessed at the end of 2019. Cash provided by operating activities increased to \$787 million in the first nine-month period of 2020 from the year-ago comparable figure of \$770 million.

Long-term debt was \$2,388 million as of Sep 30, 2020, compared with \$1,914 million as of Dec 31, 2019. The company returned \$82 million to shareholders through dividends in the quarter.

The company repaid the revolving credit facility and increased the dividend in the September-end quarter. It also plans to restart its share-repurchase program in the fourth quarter of 2020.

Quarter Ending	09/2020
Report Date	Oct 22, 2020
Sales Surprise	1.62%
EPS Surprise	9.44%
Quarterly EPS	4.52
Annual EPS (TTM)	16.39

Valuation

Grainger's shares are up 19.5% in the year-to-date period and up 24.3% over the trailing 12-month period. Stocks in the Zacks Industrial Services industry and the Zacks Industrial Products sector are up 45.5% and 13.3% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 51.0% and 16.9%, respectively.

The S&P 500 index is up 10.4% in the year-to-date period and up 15.1% in the past year.

The stock is currently trading at 22.37X forward 12-month earnings, which compares with 63.06X for the Zacks sub-industry, 23.99X for the Zacks sector and 22.35X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.33X and as low as 11.27X, with a 5-year median of 17.97X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$411 price target reflects 23.68X forward 12-month earnings.

The table below shows summary valuation data for GWW:

Valuation Multiples - GWW					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	22.37	63.06	23.99	22.35
	5-Year High	25.33	63.06	23.99	23.47
	5-Year Low	11.27	13.91	12.59	15.27
	5-Year Median	17.97	16.23	17.72	17.72
P/S F12M	Current	1.79	3.76	3.3	4.15
	5-Year High	1.79	3.76	3.3	4.3
	5-Year Low	0.84	1.01	1.6	3.17
	5-Year Median	1.34	1.35	2.09	3.67
EV/EBITDA TTM	Current	17.57	27.66	21.72	15.67
	5-Year High	17.57	30.79	21.72	15.7
	5-Year Low	7.9	7.9	11.07	9.52
	5-Year Median	11.16	12.45	15.03	13.1

As of 11/10/2020

Source: Zacks Investment Research

Industry Analysis Zacks Industry Rank: Bottom 31% (173 out of 249)



Source: Zacks Investment Research

Top Peers

Company (Ticker)	Rec	Rank
ANDRITZ AG (ADRZY)	Neutral	3
Ardagh Group S.A. (ARD)	Neutral	3
Aggreko PLC (ARGKF)	Neutral	3
Ashtead Group PLC (ASHTY)	Neutral	3
HD Supply Holdings, Inc. (HDS)	Neutral	3
KION GROUP AG (KIGRY)	Neutral	3
MSC Industrial Direct Company, Inc. (MSM)	Neutral	3
ScanSource, Inc. (SCSC)	Neutral	4

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

Industry Comparison Industry: Industrial Services				Industry Peers		
	GWV	X Industry	S&P 500	ADRZY	ARD	KIGRY
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	A	B	A
Market Cap	21.71 B	4.29 B	24.97 B	4.06 B	322.82 M	9.15 B
# of Analysts	12	4	14	1	1	1
Dividend Yield	1.51%	0.00%	1.53%	0.93%	3.47%	0.03%
Value Score	C	-	-	A	A	A
Cash/Price	0.04	0.05	0.07	0.42	3.91	0.04
EV/EBITDA	15.32	11.68	14.44	6.54	5.35	5.42
PEG F1	2.20	3.96	2.72	NA	NA	NA
P/B	9.14	3.42	3.57	3.03	NA	2.37
P/CF	18.35	13.20	13.50	8.47	0.30	6.04
P/E F1	25.12	22.73	21.72	13.45	12.27	30.02
P/S TTM	1.85	1.41	2.81	0.54	0.05	0.93
Earnings Yield	3.97%	3.89%	4.45%	7.44%	8.15%	3.33%
Debt/Equity	1.01	0.46	0.70	1.17	-18.53	0.43
Cash Flow (\$/share)	22.04	3.36	6.92	0.92	58.12	3.48
Growth Score	A	-	-	A	C	B
Historical EPS Growth (3-5 Years)	11.62%	8.87%	9.77%	-20.69%	-2.69%	NA
Projected EPS Growth (F1/F0)	-7.11%	-17.54%	0.37%	107.14%	-22.53%	-35.19%
Current Cash Flow Growth	-1.82%	-2.21%	5.34%	1.75%	8.41%	-1.14%
Historical Cash Flow Growth (3-5 Years)	2.17%	1.85%	8.33%	NA	NA	NA
Current Ratio	2.97	1.63	1.38	1.24	1.73	0.76
Debt/Capital	50.14%	36.98%	42.01%	53.88%	NA	30.20%
Net Margin	5.37%	2.02%	10.44%	1.99%	22.20%	NA
Return on Equity	41.31%	7.18%	15.07%	11.29%	-132.97%	NA
Sales/Assets	1.74	0.96	0.50	0.95	0.72	NA
Projected Sales Growth (F1/F0)	2.37%	-2.05%	0.17%	3.89%	-21.10%	-2.05%
Momentum Score	C	-	-	A	D	C
Daily Price Change	4.19%	0.27%	1.02%	8.03%	-0.92%	0.27%
1-Week Price Change	11.60%	6.54%	5.72%	0.28%	3.40%	8.44%
4-Week Price Change	5.29%	5.35%	5.06%	11.43%	23.75%	-8.94%
12-Week Price Change	14.50%	10.75%	8.35%	15.90%	14.80%	0.95%
52-Week Price Change	24.29%	9.35%	6.36%	-5.68%	-9.19%	28.94%
20-Day Average Volume (Shares)	354,612	107,160	2,145,320	581	107,160	7,288
EPS F1 Estimate 1-Week Change	0.00%	0.00%	0.00%	9.43%	0.00%	0.00%
EPS F1 Estimate 4-Week Change	1.43%	1.22%	1.97%	9.43%	-1.40%	0.00%
EPS F1 Estimate 12-Week Change	0.96%	4.66%	4.17%	13.73%	-1.40%	20.69%
EPS Q1 Estimate Monthly Change	2.26%	-4.31%	0.81%	NA	-16.13%	NA

Source: Zacks Investment Research

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 maintain a 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	A
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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Returns quoted represent past performance which is no guarantee of future results. Investment returns and principal value will fluctuate so that when shares are redeemed, they may be worth more or less than their original cost. Current performance may be higher or lower than the performance shown.

Investing involves risk; principal loss is possible. There is no guarantee that companies that can issue dividends will declare, continue to pay or increase dividends.

Glossary of Terms and Definitions

52-Week High-Low: The range of the highest and lowest prices at which a stock has traded during the past year. This range is determined based on the stock's daily closing price which may differ from the intra-day high or low. Many investors use it as a technical indicator to determine a stock's current value and future price movement. The idea here is that if price breaks out from the 52-week range, in either direction, the momentum may continue in the same direction.

20-Day Average Volume (Shares): The average number of shares of a company traded in a day over the last 20 days. It is a direct indication of a security's overall liquidity. The higher the average daily trading volume, the easier it is to enter or exit the stock at a desired price with more buyers and sellers being available.

Daily Price Change: This is the percentage difference between a trading day's closing price and the prior trading day's closing price. This item is updated at 9 p.m. EST each day.

1-Week Price Change: This is the percentage change in a stock's closing price over the last 5 trading days. This change reflects the collective buying and selling sentiment over the 1-week period.

A strong weekly price increase for the stock, especially when accompanied by increased volume, is an indication of it gaining momentum.

4-Week Price Change: This is the percentage change in a stock's closing price over the last 20 trading days or past 4 weeks. This is a medium-term price change metric and an indication of the stock gaining momentum.

12-Week Price Change: This is the percentage change of a stock's closing price over the last 60 trading days or past 12 weeks. Similar to 4-week price change, this is a medium-term price change metric. It shows whether a stock has been enjoying strong investor demand, or if it has been in consolidation, or distress over this period.

52-Week Price Change: This is the percentage change in a stock's closing price over the last 260 trading days or past 52 weeks. This long-term price change metric is a good reference point for investors. Some investors seek stocks with the best percentage price change over the last 52 weeks, expecting the momentum to continue.

Market Cap: The number of outstanding common shares of a company times its latest price per share. This figure represents a company's size, which indicates various characteristics, including price stability and risk, in which investors could be interested.

Year-To-Date Price Change: Change in a stock's daily closing price in the period of time beginning the first day of the current calendar year through to the previous trading day.

of Analysts: Number of EPS estimates used in calculating the current-quarter consensus. These estimates come from the brokerage analysts tracking this stock. However, the number of such analysts tracking this stock may not match the number of estimates, as all brokerage analysts may not come up with an estimate or provide it to us.

Beta: A measure of risk commonly used to compare the volatility of a stock to the overall market. The S&P 500 Index is the base for calculating beta and carries a value of 1. A stock with beta below 1 is less risky than the market as a whole. And a stock with beta above 1 is riskier.

Dividend: The portion of earnings a company is expected to distribute to its common shareholders in the next 12 months for each share they own. Dividends are usually paid quarterly. Dividend payments reflect positively on a company and help maintain investors' trust. Investors typically find dividend-paying stocks appealing because the dividend adds to any market price appreciation to result in higher return on investment (ROI). Moreover, a steady or increasing dividend payment provides investors a cushion in a down market.

Dividend Yield: The ratio of a company's annual dividend to its share price. The annual dividend used in the ratio is calculated based on the most recent dividend paid by the company. Dividend yield is an estimate of the dividend-only return from a stock in the next 12 months. Since dividend itself doesn't change frequently, dividend yield usually changes with a stock's price movement. As a result, often an unusually high dividend yield is a result of weak stock price.

S&P 500 Index: The Standard & Poor's 500 (S&P 500) Index is an unmanaged group of securities considered to be representative of the stock market in general. It is a market-capitalization-weighted index of stocks of the 500 largest U.S. companies. Each stock's weight in the index is proportionate to its market value.

Industry: One of the 250+ groups that Zacks classifies all stocks into based on the nature of business. These groups are termed as expanded (aka "X") industries and map to their respective (economic) sectors; Zacks has 16 sectors.

Zacks Industry Rank: The Zacks Industry Rank is determined by calculating the average Zacks Rank for all stocks in the industry and then assigning an ordinal rank to it. For example, an industry with an average Zacks Rank of 1.6 is better than an industry with an average Zacks Rank of 2.3. So, the industry with the better average Zacks Rank would get a better Zacks Industry Rank. If an industry has the best average Zacks Rank, it would be considered the top industry (1 out of 250+), which would place it at the top 1% of Zacks-ranked industries. Studies have shown that roughly half of a stock's price movement can be attributed to the industry group it belongs to. In fact, the top 50% of Zacks-ranked industries outperforms the bottom 50% by a factor of more than 2 to 1.

Last EPS Surprise: The percentage deviation of a company's last reported earnings per share from the Zacks Consensus Estimate. Companies with a positive earnings surprise are more likely to surprise again in the future (or miss again if they recently missed).

Last Sales Surprise: The percentage deviation of a company's last reported sales from the Zacks Consensus Estimate.

Expected Report Date: This is an estimated date of a company's next earnings release. The information originated or gathered by Zacks Investment Research from its information providers or publicly available sources is the basis of this estimate.

Earnings ESP: The Zacks Earnings ESP compares the Most Accurate Estimate to the Zacks Consensus Estimate for the yet-to-be reported quarter. The Most Accurate Estimate is the most recent version of the Zacks Consensus EPS Estimate. The idea here is that analysts revising their estimates closer to an earnings release have the latest information, which could potentially be more accurate than what they and others contributing to the consensus had predicted earlier. Thus, a positive or negative Earnings ESP reading theoretically indicates the likely deviation of the actual earnings from the consensus estimate. However, the model's predictive power is significant for positive ESP readings only. A positive Earnings ESP is a strong predictor of an earnings beat, particularly when combined with a Zacks Rank #1 (Strong Buy), #2 (Buy) or #3 (Hold). Our research shows that stocks with this combination produce a positive surprise nearly 70% of the time.

Periods:

TTM: Trailing 12 months. Using TTM figures is an effective way of analyzing the most-recent financial data in an annualized format that helps neutralize the effects of seasonality and other quarter-to-quarter variation.

F1: Current fiscal year. This period is used to analyze the estimates for the ongoing full fiscal year.

F2: Next fiscal year. This period is used to analyze the estimates for the next full fiscal year.

F12M: Forward 12 months. Using F12M figures is an effective way of analyzing the near-term (the following four unreported quarters) estimates in an annualized manner. Instead of typically representing estimates for the full fiscal year, which may not represent the nitty-gritty of each quarter, F12M figures suggest an all-inclusive annualized estimate for the following four quarters. The annualization helps neutralize the potential effects of seasonality and other quarter-to-quarter variations.

P/E Ratio: The price-to-earnings ratio measures a company's current market price per share relative to its earnings per share (EPS). Usually, the trailing-12-month (TTM) EPS, current-fiscal-year (F1) EPS estimate, or forward-12-month (F12M) EPS estimate is used as the denominator. In essence, this ratio shows what the market is willing to pay today for each dollar of EPS. In other words, this ratio gives a sense of what the relative value of the company is at the already reported level of earnings or at a future level of earnings.

It is one of the most widely-used multiples for determining the value of a company and helps comparing its valuation with that of a competitor, the industry group or a benchmark.

PEG Ratio: The price/earnings to growth ratio is a stock's P/E ratio using current fiscal year (F1) EPS estimate divided by its expected EPS growth rate over the coming 3 to 5 years. This ratio essentially determines a stock's value by factoring in the company's expected earnings growth and is thus believed to provide a more complete picture than just the P/E ratio, particularly for faster-growing companies.

P/S Ratio: The price-to-sales ratio is calculated as a company's current price per share divided by trailing 12 months (TTM) sales or revenues per share. This ratio shows what the market is willing to pay today for each dollar of TTM sales per share. The P/S ratio is at times the only valuation metric when the company has yet to become profitable.

Cash/Price Ratio: The cash-to-price ratio or Cash Yield is calculated as cash and marketable securities per share divided by the company's current share price. Like the earnings yield, which shows the anticipated yield (or return) on a stock from earnings for each dollar invested, the cash yield does the same, with cash being the source of return instead of earnings. For example, a cash/price ratio of 0.08 suggests a return of 8% or 8 cents for every \$1 investment.

EV/EBITDA Ratio: The EV/EBITDA ratio, also known as Enterprise Multiple, is calculated as a company's enterprise value (market capitalization + value of total long-term debt + book value of preferred shares - cash and marketable securities) divided by EBITDA (earnings before interest, taxes, depreciation and amortization). Usually, trailing-12-month (TTM) or forward-12-month (F12M) EBITDA is used as the denominator.

EV/Sales Ratio: The enterprise value-to-sales ratio is calculated as a company's enterprise value (market capitalization + value of total long-term debt + book value of preferred shares - cash and marketable securities) divided by annual sales. It is an expansion of the P/S valuation, which uses market value instead of enterprise value. The EV/Sales ratio is perceived as more accurate than P/S, in part, because the market capitalization does not take a company's debt into account when valuing it.

EV/CF Ratio: The enterprise value-to-cash flow ratio is calculated as a company's enterprise value (market capitalization + value of total long-term debt + book value of preferred shares - cash and marketable securities) divided by the trailing-12-month (TTM) operating cash flow. It's a measure of how long it would take to buy the entire business if you were able to use all the company's operating cash flow.

The EV/CF ratio is perceived as more accurate than the P/CF ratio, in part, because the market price does not take a company's debt into account when valuing it.

EV/FCF Ratio: The enterprise value-to-free cash flow metric compares a company's enterprise value to its trailing-12-month (TTM) free cash flow (FCF). This metric is very similar to the EV/CF ratio, but is considered a more exact measure owing to the fact that it uses free cash flow, which subtracts capital expenditures (CAPEX) from a company's total operating cash flow, thereby reflecting the actual cash flow available for funding growth activities and payments to shareholders.

P/EBITDA Ratio: The P/EBITDA ratio is calculated as a company's per share market value divided by EBITDA (earnings before interest, taxes, depreciation, and amortization). This metric is very similar to the EV/EBITDA ratio, but is considered a little less exact measure as it uses market price, which does not take a company's debt into account. However, since EBITDA is often considered a proxy for cash income, the metric is used as a measure of what the market is willing to pay today for each dollar of the company's cash profitability in the trailing 12 months (TTM) or forward 12 months (F12M).

P/B Ratio: The price-to-book ratio is calculated as a company's current price per share divided by its book value (total assets – liabilities – preferred stocks) per share. In short, the book value is how much a company is worth. In other words, it reflects the total value of a company's assets that its common shareholders would receive if it were to be liquidated. So, the P/B ratio indicates whether you're paying higher or lower than what would remain if the company went bankrupt immediately. Investors typically use this metric to determine how a company's stock price stacks up to its intrinsic value.

P/TB Ratio: The price-to-tangible-book value ratio is calculated as the per share market value of a company divided by the value of its tangible assets (total assets – liabilities – preferred stocks – intangible assets) per share. Tangible book value is the same thing as book value except it excludes the value of intangible assets to get a step closer to the baseline value of the company.

P/CF Ratio: The price-to-cash flow ratio measures a company's per share market price relative to its trailing-12-month (TTM) operating cash flow per share. This metric is used to determine whether a company is undervalued or overvalued relative to another stock, industry or sector. And like the P/E ratio, a lower number is typically considered better from the value perspective.

One of the reasons why P/CF ratio is often preferred over P/E ratio is the fact that operating cash flow adds back non-cash expenses such as depreciation and amortization to net income. This feature helps valuing stocks that have positive cash flow but are not profitable because of large noncash charges.

P/FCF Ratio: The price-to-free cash flow ratio is an extension of P/CF ratio, which uses trailing-12-month (TTM) free cash flow per share instead of operating cash flow per share. This metric is considered a more exact measure than P/CF ratio, as free cash flow subtracts capital expenditures (CAPEX) from a company's total operating cash flow, thereby reflecting the actual cash flow available for funding activities that generate additional revenues.

Earnings Yield: The earnings yield is calculated as current fiscal year (F1) EPS estimate divided by the company's current share price. The ratio, which is the inverse of the P/E ratio, measures the anticipated yield (or return) from earnings for each dollar invested in a stock today.

For example, earnings yield for a stock, which is trading at \$35 and expected to earn \$3 per share in the current fiscal year (F1), would be 0.0857 ($3/35 = 0.0857$) or 8.57%. In other words, for \$1 invested in the stock today, the yield from earnings is anticipated to be 8.57 cents.

Investors most commonly compare the earnings yield of a stock to that of a broad market index (such as the S&P 500) and prevailing interest rates, such as the current 10-year Treasury yield. Since bonds and stocks compete for investors' dollars, stock investors typically demand a higher yield for the extra risk they assume compared to investors of U.S. Treasury-backed securities that offer virtually risk-free returns. This additional return is referred to as the risk premium.

Debt/Equity Ratio: The debt-to-equity ratio is calculated as a company's total liabilities divided by its shareholder equity. This metric is used to gauge a company's financial leverage. In other words, it is a measure of the degree to which a company is financing its operations through debt versus its own funds. The higher the ratio, the higher the risk for shareholders.

However, this ratio is difficult to compare across industry groups where ideal amounts of debt vary. Some businesses are more capital intensive than others and typically require higher debt to finance their operations. So, a company's debt-to-equity ratio should be compared with other companies in the same industry.

Cash Flow (\$/share): Cash flow per share is calculated as operating cash flow (after-tax earnings + depreciation + other non-cash charges) divided by common shares outstanding. It is used by many investors as a measure of a company's financial strength. Since cash flow per share takes into consideration a company's ability to generate cash by adding back non-cash expenses, it is regarded by some as a more accurate measure of a company's financial situation than earnings per share, which could be artificially deflated.

Current Ratio: The current ratio or liquidity ratio is a company's current assets divided by its current liabilities. It measures a company's ability to pay short-term obligations. A current ratio that is in line with the industry average or slightly higher is generally considered acceptable. A current ratio that is lower than the industry average would indicate a higher risk of distress or default. A higher number is usually better. However, a very high current ratio compared to the industry average could be an indication of inefficient use of assets by management.

Debt/Capital Ratio: Debt-to-capital ratio is a company's total debt (interest-bearing debt + both short- and long-term liabilities) divided its total capital (interest-bearing debt + shareholders' equity). It is a measure of a company's financial leverage. All else being equal, the higher the debt-to-capital ratio, the riskier the stock.

However, this ratio can vary widely from industry to industry, the ideal amount of required debt being different. Some businesses are more capital intensive than others and typically require higher debt to finance their operations. So, a company's debt-to-capital ratio should be compared with the same for its industry.

Net Margin: Net margin is calculated as net income divided by sales. It shows how much of each dollar in sales generated by a company translates into profit. For example, if a company's net margin is 15%, its net income is 15 cents for every \$1 of sales it makes.

A change in margin can reflect either a change in business conditions, or a company's cost controls, or both. If a company's expenses are growing faster than sales, its net margin will decline. However, different net margin rates are considered good for different industries, so it's better to compare net margin rates of companies in the same industry group.

Return on Equity: Return on equity (ROE) is calculated as trailing-12-month net income divided by trailing-12-month average shareholder equity (including reinvested earnings). This metric is considered a measure of how effectively management is using a company's assets to generate profits. For example, if a company's ROE is 10%, it creates 10 cents profits for every \$1 shareholder equity, which is basically the company's assets minus debt. A company's ROE deemed good or bad depends on what's normal for its peers or industry group.

Sales/Assets Ratio: The sales-to-assets ratio or asset utilization ratio or asset turnover ratio is calculated as a company's annual sales divided by average assets (average of assets at the beginning of the year and at the year's end). This metric helps investors understand how effectively a company is using its assets to generate sales. For example, a sales-to-assets ratio of 2.5 indicates that the company generated \$2.50 in sales for every \$1 of assets on its books.

The higher the sales-to-assets ratio, the better the company is performing. However, similar to many other ratios, the asset turnover ratio tends to be higher for companies in certain industries/sectors than in others. So, a company's sales-to-assets ratio should be compared with the same for its industry/sector.

Historical EPS Growth (3-5 Years): This is the average annual (trailing-12-month) EPS growth rate over the last 3-5 years. This metric helps investors see how a company's EPS has grown from a long-term perspective.

Note: There are many factors that can influence short-term numbers — a recession will reduce this number, while a recovery will inflate it. The longterm perspective helps smooth out short-term events.

Projected EPS Growth (F1/F0): This is the estimated EPS growth rate for the current financial year. It is calculated as the consensus estimate for the current fiscal year (F1) divided by the reported EPS for the last completed fiscal year (F0).

Current Cash Flow Growth: It measures the latest year-over-year change in operating cash flow. Cash flow growth tells an investor how quickly a company is generating inflows of cash from operations. A positive change in the cash flow is desired and shows that more 'cash' is coming in than going out.

Historical Cash Flow Growth (3-5 Years): This is the annualized change in cash flow over the last 3-5 years. The change in a longer period helps put the current reading into proper perspective. By looking at the rate, rather than the actual dollar value, the comparison across the industry and peers becomes easier.

Projected Sales Growth (F1/F0): This metric looks at the estimated sales growth for the current year. It is calculated as sales estimate for the current fiscal year (F1) divided by the reported sales for the last completed fiscal year (F0).

Like EPS growth, a higher rate is better for sales growth. A look at a company's projected sales growth instantly tells you what the outlook is for their products and services. However, different sales growth rates are considered good for different industries, so it's better to compare sales growth rates of companies in the same industry group.

EPS F1 Estimate 1-Week Change: The percentage change in the Zacks Consensus EPS estimate for the current fiscal year over the past week. The change in a company's consensus EPS estimate (or earnings estimate revision) has proven to be strongly correlated with the near-term price movement of its shares. It is an integral part of the Zacks Rank.

If a stock's consensus EPS estimate is \$1.10 now versus \$1.00 a week ago, that will be reflected as a 10% upward revision. If, on the other hand, it went from \$1.00 to 90 cents, that would be a 10% downward revision.

EPS F1 Estimate 4-Week Change: The percentage change in the Zacks Consensus EPS estimate for the current fiscal year over the past four weeks.

A stock's earnings estimate revision in a 1-week period is important. But it's more meaningful to look at the longer-term revision. And, of course, the 4-week change helps put the 1-week change into proper perspective.

EPS F1 Estimate 12-Week Change: The percentage change in the Zacks Consensus EPS estimate for the current fiscal year over the past 12 weeks.

This metric essentially shows how the consensus EPS estimate has changed over a period longer than 1 week or 4 weeks.

EPS Q1 Estimate Monthly Change: The percentage change in the Zacks Consensus EPS estimate for the current fiscal quarter over the past four weeks.

While the revision in consensus EPS estimate for the current fiscal year is strongly correlated with the near-term price movement of its shares, the estimate revision for the current fiscal quarter is an important metric as well, especially over the short term, and particularly as a stock approaches its earnings date. If a stock's Q1 EPS estimate decreases ahead of its earnings release, it's usually a negative sign, whereas an increase is a positive sign.