

Hexcel Corporation (HXL)

\$56.00 (As of 12/03/20)

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

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 09/11/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:D

Value: C

Growth: C

Momentum: C

Summary

Rapid spread of coronavirus across the globe caused a notable decline in air travel, thereby hurting Hexcel. Lower deliveries for Boeing's 737 jets continue to impact its operational results. Hexcel's Engineered Product segment witnessed a 42.8% year over year plunge in its quarterly sales. Moreover, its commercial aerospace sales plunged 66.6% in the third quarter. Increased cost pressure in the wind industry is also hurting this stock. Deteriorating air traffic forecast for 2020 also poses threat to Hexcel's growth trajectory. Moreover, Hexcel Corp.'s shares have underperformed its industry in the past year. Although its long-term debt is much higher than its cash reserve, the current debt is much lower than the cash balance. This reflects the company's solid solvency level for the near term.

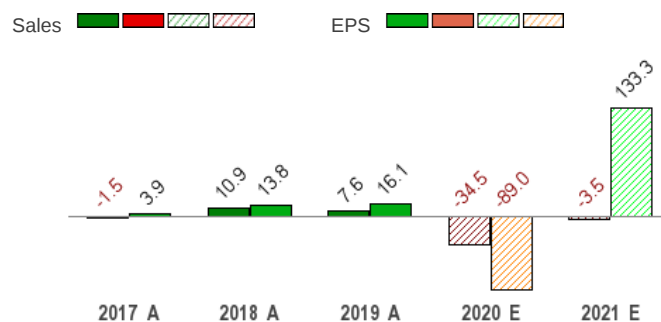
Price, Consensus & Surprise



Data Overview

52-Week High-Low	\$80.49 - \$24.54
20-Day Average Volume (Shares)	1,715,961
Market Cap	\$4.7 B
Year-To-Date Price Change	-23.6%
Beta	1.51
Dividend / Dividend Yield	\$0.00 / 0.0%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 22% (197 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-514.3%
Last Sales Surprise	-17.4%
EPS F1 Estimate 4-Week Change	0.0%
Expected Report Date	02/01/2021
Earnings ESP	0.0%
P/E TTM	43.4
P/E F1	143.6
PEG F1	14.4
P/S TTM	2.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	374 E	393 E	388 E	419 E	1,490 E
2020	541 A	379 A	287 A	324 E	1,544 E
2019	610 A	609 A	573 A	564 A	2,356 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.21 E	\$0.28 E	\$0.32 E	\$0.41 E	\$0.91 E
2020	\$0.64 A	\$0.08 A	-\$0.29 A	-\$0.10 E	\$0.39 E
2019	\$0.84 A	\$0.94 A	\$0.90 A	\$0.86 A	\$3.54 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, except sales and EPS estimates, is as of 12/03/2020. The reports text and the analyst-provided sales and EPS estimates are as of 12/04/2020.

Overview

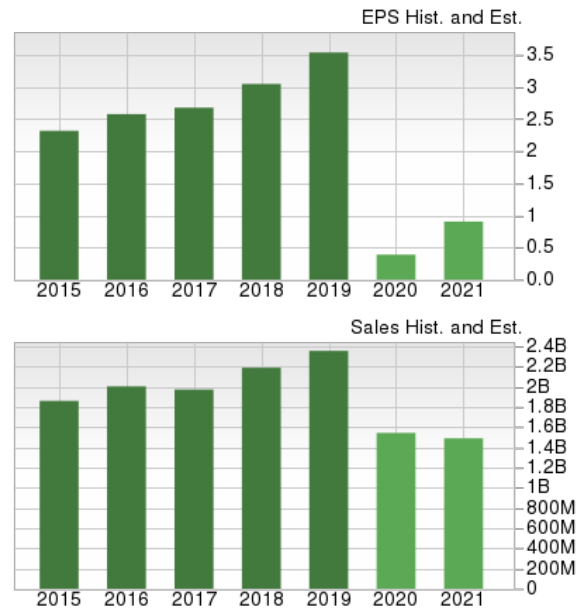
Delaware-based Hexcel Corporation develops, manufactures and distributes lightweight, high-performance structural materials for use in the Commercial Aerospace, Space & Defense and Industrial markets. Hexcel Corporation, founded in 1946, was incorporated in California in 1948, and reincorporated in Delaware in 1983. The company's products are used in a wide variety of end applications, such as commercial and military aircraft, space launch vehicles and satellites, wind turbine blades, automotive and other complex industrial applications. The company serves international markets through manufacturing facilities located in the United States, Asia Pacific, Europe, Russia and Africa.

Hexcel Corporation operates in two business segments namely the Composite Materials and Engineered Products.

The **Composite Materials** segment manufactures and markets carbon fibers, fabrics and specialty reinforcements, prepreps and other fiber-reinforced matrix materials, structural adhesives, honeycomb, molding compounds, tooling materials, polyurethane systems and laminates that are incorporated into military and commercial aircrafts, wind turbine blades, recreational products, automobiles and other industrial applications. Net sales for this segment were \$1,946.5 million in 2019, representing 82.6% of the company's total sales.

The **Engineered Products** segment manufactures and markets composite structures and precision machined honeycomb parts primarily for use in the aerospace industry. Composite structures are manufactured from a variety of composite and other materials, including prepreps, honeycomb, and structural adhesives, using manufacturing processes like autoclave processing, multi-axis numerically controlled machining, heat forming, and other composite manufacturing techniques. Net sales for this segment were \$493.4 million in 2019, representing 20.9% of the company's total sales.

However, total sales included corporate expenses of \$84.2 million.



Source: Zacks Investment Research

Reasons To Sell:

- ▼ Lower deliveries for Boeing's 737 jets continued to hurt Hexcel's operational results during the third quarter of 2020, ever since the grounding of these jets in March 2019. Notably, Boeing announced a temporary production rate decrease to 42 planes per month in April 2019 from 52 produced before. In December, Boeing announced its decision to temporarily suspend the production of its once fastest-selling jet. Such consecutive setbacks in the 737 Max program have been steadily affecting part suppliers like Hexcel.

737 Max issue and effects of the coronavirus pandemic poses concern for Hexcel Corp.'s growth

The company's Engineered Product segment, which comprises Hexcel's structures and engineered core businesses, witnessed a 42.8% year over year plunge in its quarterly sales, with the 737 Max crisis being one of the primary growth inhibitors. Moreover, the company's commercial aerospace sales suffered an annual revenue loss of 66.6% in the reported quarter, with lower sales from 737 Max being one of the major contributors.

- ▼ Owing to the rapid spread of coronavirus across the globe, dramatic decline in air travel along with stringent restrictions on businesses hassled to significant declines in demand both within the aerospace and industrial markets. Consequently, Hexcel has announced dismal quarterly figures so far in 2020, with the continued grounding of the Boeing 737 MAX and effects of the COVID-19 pandemic being the major growth inhibitors. Notably, during the third quarter of 2020, Hexcel's operational results were adversely impacted by lower demand for its products due to substantial reductions in original equipment manufacturer build rates combined with a move to reduce inventory throughout its supply chain, particularly carbon fiber. Considering the fact that the pandemic is still ongoing, it is expected to continue to negatively impact Hexcel's results of operations, cash flows and financial position, at least in the near term.
- ▼ Per International Air Transport Association's (IATA) latest report, in September, global revenue passenger kilometers (RPKs) were 72.8% lower than the prior-year quarter's figure. Following such dismal outcomes, IATA recently downgraded its 2020 global air traffic forecast to a year-over-year decline of 66% from its prior projection of 63% slump. This poses a serious threat to growth of aircraft manufacturing stocks along with those that supply parts like Hexcel. The fact that the company is already feeling the heat of the outbreak indicates the risk to the stock. This may have led the company's shares to slump 29.4% compared with the industry's decline of 28.2% in the past year.
- ▼ Meanwhile, the company's industrial sales continue to be challenged by the impact of the pandemic and changes in its wind energy business. In particular, Hexcel witnessed the sales decline in its wind energy segment, thanks to competitive pressure that has led to a shift in demand from Hexcel's advanced flask fiber prepreg to lower cost products. As a result of this demand change in November, the company must have closed its wind energy prepreg production facility in Windsor, CO, per its earlier expectation. Hexcel projects cost pressure for future wind turbine blades since greater outsourcing in manufacture of complete wind blades has been pushing up costs in this industry for quite some time.

Risks

- To compete in the diverse industries in which the company operates, Hexcel Corp. consistently brings in next-generation products to the market and also enters into collaborations to capture market share. In August 2020, the company launched a product in its additive manufacturing product line that integrates advanced electromagnetic performance from its ARC Technologies' acquisition into thermal plastic 3D printed parts for commercial aerospace and defense. Also, during the quarter, Hexcel unveiled its latest HexAM materials technology, HexPEKK EM – an electrically conductive, high-performance, PEKK-based thermoplastic carbon fiber composite additive manufacturing material offering industry-leading performance. HexPEKK EM integrates advanced electromagnetic (EM) performance within complex 3D-printed components for the Commercial Aerospace, Defense, and Military sectors. In April 2020, the company had launched a low temperature fast cure HexBond 679 adhesive film. Notably, HexBond 679 adhesive films allow boatbuilders to increase build rates with reduced heating and cooling times. Such innovations and collaborations should bolster this stock's growth over the long run.
- Hexcel ended the third quarter of 2020 with cash and cash equivalents of \$68 million. The company's long-term debt was \$999 million as of Sep 30, 2020, while its current debt was only \$1 million. Although the company's long-term debt is much higher than the cash reserve, its current debt is much lower than the cash balance. So, this is good news for the company's solvency level, at least in the near term. Moreover, the company's current ratio of 3.28 as of Sep 30, 2020 being more than 1 indicates the company's capability to pay off its short-term obligations. Also, its debt-to-capital ratio of 0.40 declined sequentially from 0.47. Such improving financial ratios further indicating the company's ability to duly pay off its short-term obligations.
- Further, to cope with the impact of the virus outbreak, Hexcel has started implementing significant reductions in its U.S. workforce, as well as short-term cost-saving actions, including temporary salary reductions, unpaid furloughs, and suspension of employee stock purchase plan. The company has also put in place actions to realize more than \$150 million of annualized overhead run rate savings including indirect labor, once its cost reduction initiatives start to take full effect. We expect such initiatives to shield the company to some extent from incurring huge losses.

Last Earnings Report

Hexcel Reports Loss in Q3, Misses Revenue Estimates

Hexcel Corporation reported third-quarter 2020 loss of 29 cents per share against the Zacks Consensus Estimate of earnings of 7 cents. The bottom line also declined from the prior-year quarter's earnings per share of 90 cents. The year-over-year downside can be attributed to poor sales figures.

The company reported GAAP earnings of 12 cents per share compared with the year-ago quarter's 93 cents.

Quarter Ending 09/2020

Report Date	Oct 19, 2020
Sales Surprise	-17.40%
EPS Surprise	-514.29%
Quarterly EPS	-0.29
Annual EPS (TTM)	1.29

Total Sales

Net sales totaled \$286.9 million, missing the Zacks Consensus Estimate of \$344 million by 17.4%. Moreover, the top line witnessed a decline of 49.9% from the year-ago quarter's \$572.5 million.

The year-over-year deterioration in sales can be primarily attributed to the impacts of the pandemic, leading to an unprecedented decline in demand, affecting the aerospace industry.

Operational Update

Hexcel's gross margin was 4.7% in the third quarter compared to the year-ago quarter's gross margin of 27.6%. The deterioration reflects the under absorption of fixed overhead from lower sales levels magnified by the temporary idling of select production assets and facilities during the period to align production with demand.

The company's operating expenses amounted to \$51.1 million in the third quarter compared with the year-ago quarter's \$48 million.

Quarterly Performance

Commercial Aerospace: Net sales were down 66.6% year over year to \$128.8 million. Lower sales across all major programs, with the Airbus A350 generating the largest quarterly revenue decline, resulted in this unit's poor top-line performance.

Space and Defense: Net sales edged down 0.9% year over year to \$108.8 million on account of lower demand from a number of European space & defense programs.

Industrial: Net sales declined 35.8% year over year to \$49.3 million, primarily due to lower wind energy sales on account of soft demand arising from the COVID-19 pandemic.

Financial Details

As of Sep 30, 2020, cash and cash equivalents were \$68 million compared with \$64.4 million as of Dec 31, 2019.

Long-term debt totaled \$998.7 million as of Sep 30, 2020, down from \$1,050.6 million as of Dec 31, 2019.

At the end of third-quarter 2020, cash generated from operating activities summed \$157 million compared with \$277.3 million generated at the end of third-quarter 2019.

2020 Guidance

Hexcel continues to withhold its financial guidance in the wake of the ongoing market uncertainties as a result of the pandemic.

Valuation

Hexcel Corp.'s shares are up 18.5% in the past six months period although down 29.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are up 6.4% and down 4.3% in the past six months period, respectively. Over the past year, the Zacks sub-industry is down 28.2% while the sector is down 27.5%.

The S&P 500 index is up 15.2% in the past six months period and 18% in the past year.

The stock is currently trading at 64.6X forward 12-month earnings, which compares to 27.6X for the Zacks sub-industry, 23.2X for the Zacks sector and 22.7X for the S&P 500 index.

Over the past five years, the stock has traded as high as 67X and as low as 8.1X, with a 5-year median of 19.4X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$48 price target reflects 55.4X forward 12-month earnings.

The table below shows summary valuation data for HXL

Valuation Multiples - HXL					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	64.6	27.62	23.18	22.7
	5-Year High	67	27.6	23.18	23.47
	5-Year Low	8.06	12.99	14.17	15.27
	5-Year Median	19.4	17.38	17.56	17.75
P/S F12M	Current	3.13	1.74	1.91	4.28
	5-Year High	3.13	1.74	1.91	4.3
	5-Year Low	1.01	0.79	0.93	3.17
	5-Year Median	1.31	1.07	1.25	3.67
EV/EBITDA TTM	Current	21.67	11.09	18.95	16.4
	5-Year High	21.67	12.01	18.95	16.4
	5-Year Low	6.12	5.85	7.61	9.55
	5-Year Median	12.89	9.14	10.85	13.15

As of 12/03/2020

Source: Zacks Investment Research

Industry Analysis Zacks Industry Rank: Bottom 22% (197 out of 254)



Source: Zacks Investment Research

Top Peers

Company (Ticker)	Rec	Rank
Ducommun Incorporated (DCO)	Outperform	2
AAR Corp. (AIR)	Neutral	3
Aerjet Rocketdyne Holdings, Inc. (AJRD)	Neutral	3
AeroVironment, Inc. (AVAV)	Neutral	3
CAE Inc (CAE)	Neutral	2
CurtissWright Corporation (CW)	Neutral	3
Heico Corporation (HEI)	Neutral	3
Moog Inc. (MOG.A)	Underperform	3

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

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	HXL	X Industry	S&P 500	AJRD	ATRO	TDY
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	3	3	3
VGM Score	D	-	-	C	C	D
Market Cap	4.68 B	2.36 B	26.33 B	2.96 B	390.86 M	14.15 B
# of Analysts	6	3	13	2	2	1
Dividend Yield	0.00%	0.00%	1.49%	0.00%	0.00%	0.00%
Value Score	C	-	-	B	C	D
Cash/Price	0.02	0.11	0.07	0.35	0.08	0.03
EV/EBITDA	9.88	10.47	14.58	7.31	4.92	23.83
PEG F1	14.39	11.21	2.76	NA	NA	NA
P/B	3.12	2.55	3.53	4.17	1.35	4.68
P/CF	10.59	10.59	13.76	14.08	6.28	27.65
P/E F1	143.59	37.62	21.83	22.39	NA	39.15
P/S TTM	2.64	1.45	2.81	1.45	0.67	4.55
Earnings Yield	0.70%	2.05%	4.41%	4.47%	-25.45%	2.55%
Debt/Equity	0.67	0.29	0.70	0.47	0.58	0.25
Cash Flow (\$/share)	5.29	2.26	6.94	2.72	2.02	13.88
Growth Score	C	-	-	C	C	C
Historical EPS Growth (3-5 Years)	2.38%	9.67%	9.72%	33.30%	-22.51%	19.36%
Projected EPS Growth (F1/F0)	-88.98%	-12.10%	0.83%	1.18%	-454.40%	-6.76%
Current Cash Flow Growth	12.73%	8.10%	5.23%	-8.04%	-23.43%	14.47%
Historical Cash Flow Growth (3-5 Years)	9.27%	5.99%	8.33%	70.16%	-8.28%	11.00%
Current Ratio	3.28	2.41	1.38	1.75	3.16	2.29
Debt/Capital	39.98%	32.22%	42.00%	31.86%	36.69%	20.10%
Net Margin	7.02%	4.02%	10.40%	6.26%	-22.15%	12.39%
Return on Equity	7.52%	8.15%	14.99%	19.05%	-2.68%	13.42%
Sales/Assets	0.56	0.66	0.50	0.74	0.80	0.66
Projected Sales Growth (F1/F0)	-34.48%	-3.19%	0.35%	4.46%	-35.85%	-3.19%
Momentum Score	C	-	-	D	D	C
Daily Price Change	5.18%	1.88%	0.20%	-0.55%	1.52%	-0.57%
1-Week Price Change	7.32%	4.84%	2.18%	1.41%	9.04%	1.10%
4-Week Price Change	57.44%	20.97%	6.65%	11.66%	86.34%	14.10%
12-Week Price Change	49.85%	22.72%	14.39%	-3.87%	60.23%	24.56%
52-Week Price Change	-29.44%	-5.33%	6.09%	-13.41%	-56.66%	11.13%
20-Day Average Volume (Shares)	1,715,961	140,795	2,053,456	530,743	587,121	161,820
EPS F1 Estimate 1-Week Change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
EPS F1 Estimate 4-Week Change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
EPS F1 Estimate 12-Week Change	-59.88%	0.00%	3.77%	-5.45%	4.84%	0.76%
EPS Q1 Estimate Monthly Change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

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	C
Momentum Score	C
VGM Score	D

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 a 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.