

Ironwood Pharma (IRWD)

\$9.87 (As of 09/02/20)

Price Target (6-12 Months): **\$11.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/05/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: C

Growth: D

Momentum: C

Summary

Ironwood reported encouraging second-quarter results wherein sales and earnings beat estimates. The company's Linzess has been performing encouragingly on the back of strong demand and expansion in new patient population and geographic regions. Ironwood is focused on further label expansions of the drug. Meanwhile, Ironwood's separation into two companies is increasing operational performance and strategic flexibility. The amendment of agreements related to Linzess rights in China and Japan with its partners is likely to boost margins. Shares have underperformed the industry so far this year. However, competition in Linzess' target markets is intensifying. Any Linzess-related pipeline/regulatory setbacks will weigh heavily on the stock as the rest of its pipeline is couple of year away from commercialization.

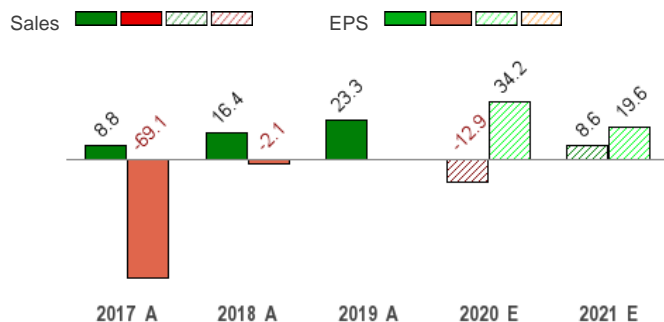
Price, Consensus & Surprise



Data Overview

52-Week High-Low	\$14.10 - \$7.91
20-Day Average Volume (Shares)	1,519,646
Market Cap	\$1.6 B
Year-To-Date Price Change	-25.9%
Beta	1.47
Dividend / Dividend Yield	\$0.00 / 0.0%
Industry	Medical - Drugs
Zacks Industry Rank	Bottom 27% (184 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	100.0%
Last Sales Surprise	6.9%
EPS F1 Estimate 4-Week Change	26.1%
Expected Report Date	10/29/2020
Earnings ESP	-5.7%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	83 E	93 E	108 E	124 E	405 E
2020	80 A	89 A	97 E	105 E	373 E
2019	69 A	102 A	131 A	126 A	428 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.06 E	\$0.13 E	\$0.21 E	\$0.30 E	\$0.61 E
2020	\$0.04 A	\$0.16 A	\$0.15 E	\$0.17 E	\$0.51 E
2019	-\$0.26 A	\$0.08 A	\$0.40 A	\$0.30 A	\$0.38 A

*Quarterly figures may not add up to annual.

P/E TTM	11.0
P/E F1	19.4
PEG F1	NA
P/S TTM	3.7

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 09/02/2020. The reports text is as of 09/03/2020.

Overview

Cambridge, MA-based Ironwood Pharmaceuticals, Inc. is focused on the development and commercialization of treatments primarily addressing gastrointestinal (GI) diseases. Linzess (linaclotide) was launched in December 2012 in collaboration with Allergan (now a subsidiary of AbbVie) for patients suffering from irritable bowel syndrome with constipation (IBS-C; 290 mcg) or chronic idiopathic constipation (CIC; 145 mcg & 72 mcg). Ironwood and AbbVie co-develop and co-commercialize Linzess and equally share Linzess' U.S. collaboration profits or losses as well as all development costs. Linzess is marketed by Allergan for IBS-C in Europe and Canada under the brand name Constella. Ironwood receives royalties on sales of Constella in Europe and Canada from AbbVie.

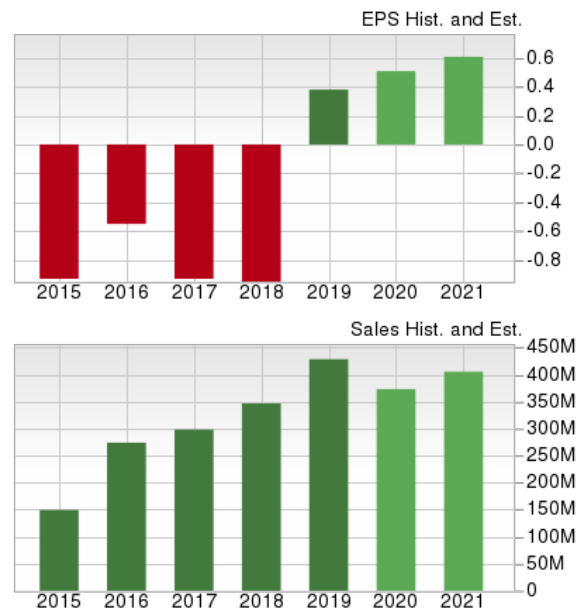
In Japan, Ironwood has partnered with Astellas Pharma for the development and commercialization of Linzess and with AstraZeneca in China, Hong Kong and Macau. Linzess received approval for IBS-C indication in Japan in December 2016 and for chronic constipation (CC) in August 2018. Meanwhile in January 2019, the drug was approved in China for IBS-C.

Ironwood has also partnered with AbbVie for the development and commercialization of Linzess in all other territories worldwide.

Meanwhile, in a bid to expand its reach among primary care physicians and gastroenterologists and earn additional funds, Ironwood has signed co-promotion deals with Alnylam for Givlaari [acute hepatic porphyria (AHP)] in the United States.

In April 2019, the company completed the spin-off of its soluble guanylate cyclase (sGC) segment into a separate, publicly traded company, Cyclacel Therapeutics.

Ironwood's revenues in 2019 were up 23.6% to \$428.4 million.



Source: Zacks Investment Research

Reasons To Buy:

- ▲ **Linness Performance Encouraging:** Following the approval of Linness in 2012, the sales of the drug has grown significantly on back of strong demand.

Ironwood is working on expanding managed care access to Linness and lowering out-of-pocket costs. Moreover, since 2016 CVS/Caremark has granted Linness an exclusive preferred position on its formulary. The company commenced a new direct-to-consumer (DTC) campaign in April 2020. Previous DTC campaigns have supported the drug's growth. Moreover, withdrawal of prescription MiraLAX is also favorably impacting sales.

Linness has the potential to be a blockbuster product. By the end of 2020, Ironwood expects annual sales of Linness to cross \$1 billion. The company is also progressing well with development of the drug in Japan and China. Per IQVIA data, Linness is the leading prescribed drug for adult patients in the United States with IBS-C or CIC. Ironwood estimates that its IBS-C/CIC franchise may represent a peak U.S. sales opportunity of over \$2 billion, with additional global potential. Moreover, Linness is well protected by patents and is unlikely to face generic competition before March 2029. Ironwood and Allergan are working to strengthen the patent further.

- ▲ **Pipeline Progress Encouraging:** Ironwood and Allergan are looking to broaden Linness' label to include new indications and patient populations.

In November 2019, the companies submitted a supplemental new drug application seeking label expansion of Linness in additional abdominal symptoms associated with IBS-C, including bloating and discomfort. Linness is also being evaluated as a potential treatment for pediatric patients with IBS-C and functional constipation. Efforts are on to expand in ex-U.S. territories as well.

Meanwhile, to capture the lucrative GI market, Ironwood is developing several candidates. Its most advanced pipeline candidate is IW-3718, which is being evaluated in two identical phase III studies for treating persistent refractory gastroesophageal reflux disease (GERD). Results from the studies are expected in the first half of 2021.

- ▲ **Strong Partnerships:** We are positive on Ironwood's agreement with AbbVie for the development and commercialization of Linness both in the United States and Europe. Given Allergan's expertise and strong presence both in the United States and EU markets, we believe it is a suitable partner for Ironwood. The company is co-promoting Givlaari as a treatment for AHP with Alnylam in the United States.

The company also has a deal with Astellas for the development of Linness in Japan. Ironwood has an agreement with AstraZeneca for Linness in China, Hong Kong and Macau. The collaborations have not only reduced the cost of developing the drug, these also act as a source of revenues for Ironwood. Additional partnerships in other territories will be a positive for the company.

- ▲ **Spin-off of Cyclorion Encouraging:** Separation of Ironwood's sGC pipeline into another entity, Cyclorion, is a positive. The transaction improved operating margin in the past couple of quarters, following the separation, by bringing down research and development costs. The company will also be able to put more efforts in building its GI products, especially Linness. Moreover, the spin-off along with some restructuring initiatives is also reducing the workforce, leading to further decrease in operating expenses. The company's operating cash flow turned positive in the third quarter of 2019.

- ▲ **Favorable Debt Profile:** Ironwood has a favorable debt profile. As of Jun 30, 2020, the company's debt to total capital ratio was 1.08, which compared favorably with the previous quarter's ratio of 1.19. The company's ratio has been declining over the past few quarters. The company had debt to total capital ratio of 1.28 at 2019-end. A lower ratio indicates lower financial risk. Moreover, the company's cash and equivalent of \$255 million is sufficient to pay its short-term debt of \$3 million in case of insolvency. The company's times interest earned improved to 4X in second-quarter 2020, compared with 3.5X in the previous quarter. This suggests that the company is capable of meeting its interest obligations from operating earnings.

Linness has blockbuster potential, if approved for additional indications. We are also encouraged by Ironwood's partnership deals with companies like Allergan.

Reasons To Sell:

- ▼ **Over-Dependence on Linzess:** While we are pleased with the performance of Linzess, we are concerned about the company's dependence on the product for growth. Any negative news related to Linzess would adversely impact the company and its growth prospects. Although the performance of Linzess improved in 2019, customer buying patterns can have unfavorable impact in future years as seen earlier.

Competition in CIC and IBS-C, Linzess' target markets, is intensifying.

Meanwhile in August 2018, Ironwood terminated its licensing agreement with AstraZeneca related to Zurampic and all products containing lesinurad, including Duzallo (fixed-dose combination of lesinurad and allopurinol). The termination was based on unfavorable data from a study exploring a path for value creation of lesinurad-based products. This has impacted the top line unfavorably as expected. Moreover, upon completion of the termination of lesinurad franchise, the company solely depends on Linzess for the majority of its revenues.

- ▼ **Pipeline Candidates Still a Few Years from Commercialization:** Ironwood's mid/late-stage nature of the pipeline runs its own risk. Although the company has a late-stage candidate in its pipeline, it will be a couple of years before the candidate is close to commercialization. Moreover, we note that clinical development involves a high degree of risk. Gaining approval for pipeline candidates has become more difficult given the tough regulatory environment. Meanwhile, the company discontinued development of a delayed-release formulation of Linzess, MD-7246, following failure in phase II study in May 2020. Any further development and any regulatory setbacks for pipeline candidates would be a major disappointment for the company and have an adverse impact on shares.
- ▼ **Competitive and Pricing Pressure:** Currently approved products for IBS-C and CIC include Takeda's Amitiza and Motegrity as well as laxatives and over-the-counter fiber supplements. Additional competition has entered the market in the form of Synergy's Trulance (plecanatide), which is marketed for treating CIC as well as IBS-C. In September 2019, Ardelyx received approval for Isbrela from the FDA for the treatment of IBS-C. Moreover, several other GI candidates are in late-stage development for Linzess' targeted indications. We are concerned about stiff competition limiting the sales potential of Linzess. Linzess is also facing pricing pressure in the United States, which is impacting sales.
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Last Earnings Report

Ironwood Q2 Earnings and Revenues Beat Estimates

Ironwood reported second-quarter 2020 adjusted earnings of 16 cents per share, which beat the Zacks Consensus Estimate of 8 cents. The company had reported adjusted earnings of 10 cents per share in the year-ago quarter.

Total revenues of \$89.4 million also beat the Zacks Consensus Estimate of \$83.7 million. However, revenues were down 12.5% year over year due to the absence of linaclotide API sales.

Quarter Ending 06/2020

Report Date	Aug 06, 2020
Sales Surprise	6.89%
EPS Surprise	100.00%
Quarterly EPS	0.16
Annual EPS (TTM)	0.90

Quarter in Detail

As reported by partner AbbVie, Linzess net sales totaled \$219 million in the United States, up 5.4% year over year.

Ironwood's share of net profits from the sales of Linzess in the United States (included in collaborative revenues) was \$86.5 million in the second quarter, up approximately 15.3% year over year.

Per data provided by IQVIA, volume of prescribed Linzess capsules in the second quarter increased about 9% year over year.

Revenues also include \$1.8 million in linaclotide royalties, \$0.9 million in co-promotion revenues, and \$0.2 million in other revenues.

On its second-quarter earnings call, Ironwood stated that the COVID-19 pandemic has not caused significant disruptions to manufacturing operations nor supply of Linzess in the United States. The company has enough supply of Linzess to meet U.S. demand in 2020.

2020 Guidance

Ironwood re-issued its outlook for 2020 after withdrawing the same on the first-quarter earnings call due to uncertainty related to COVID-19 pandemic.

The company expects net sales of Linzess to grow in mid-single percentage points in 2020. Total revenues are anticipated in the range of \$360 million-\$380 million. The company expects adjusted EBITDA to be more than \$105 million.

Recent News

Updates Design of Phase III Studies on IW-3718 – Jul 21

Ironwood announced that it has updated the design of the two identical phase III studies evaluating IW-3718 following discussion with the FDA. The company stated that primary endpoint has been changed from the previous responder endpoint to a continuous endpoint for both studies — IW-3718-301 and IW-3718-302.

Moreover, the company will conduct an early assessment of IW-3718-302 study and plans to stop enrollment in the study. It anticipates to report data from a blinded early assessment of efficacy in this study in the fourth quarter of 2020.

Discontinues MD-7246 Development – May 27

Ironwood announced that the delayed-release formulation of Linzess — MD-7246 — has failed to meet primary as well secondary endpoints in a phase II study. The study was evaluating MD-7246 in patients with abdominal pain associated with IBS-D. Data showed that MD-7246 failed to achieve statistically significant improvements in abdominal pain compared to placebo.

Based on the study data, Ironwood and its partner AbbVie are planning to discontinue the development of MD-7246.

Ironwood had previously reported data from another phase II study evaluating the candidate in patients with IBS-C in 2016. Data from the IBS-C study showed that MD-7246 numerically improved abdominal pain relative to placebo with no effect on bowel function.

Provides Update on Impact of COVID-19 – Mar 26

Ironwood announced that it is continuing development of its pipeline candidates amid the coronavirus pandemic. The company has completed enrolment in the phase II study evaluating MD-7246 for the treatment of abdominal pain associated with IBS with diarrhea and continues to expect to report top-line data in mid-2020.

However, the company stated that the pandemic is impacting enrolment in the phase III study evaluating Linzess for treating GERD. The study has reached 70% of its enrolment target but the company is currently assessing the situation and plans to provide an update on timing for top-line data after having some clarity. Top-line data was previously expected in the second half of 2020.

Valuation

Ironwood's shares are down 25.8% in the year-to-date period and up 5.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and sector are down 6% and up 0.2%, respectively, in the year-to-date period. Over the past year, stocks in the sub-industry are down 1.4% while stocks in the sector are up 8.8%.

The S&P 500 Index is up 3.7% in the year-to-date period and 14% in the past year.

The stock is currently trading at 3.7X trailing 12-month sales per share which compares to 2.23X for the Zacks sub-industry, 3.11X for the Zacks sector and 3.7X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 15.07X and as low as 2.97X, with a 5-year median of 8.11X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$11.00 price target reflects 4.12X trailing 12-month sales per share.

Industry Analysis Zacks Industry Rank: Bottom 27% (184 out of 251)



Source: Zacks Investment Research

Top Peers

Company (Ticker)	Rec	Rank
Horizon Therapeutics Public Limited Company (HZNP)	Outperform	1
AbbVie Inc. (ABBV)	Neutral	3
Alkermes plc (ALKS)	Neutral	3
Ardelyx, Inc. (ARDX)	Neutral	3
Bausch Health Cos Inc. (BHC)	Neutral	3
Mallinckrodt public limited company (MNK)	Neutral	3
Teva Pharmaceutical Industries Ltd. (TEVA)	Neutral	3
Evoke Pharma, Inc. (EVOK)	Underperform	5

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

Industry Comparison Industry: Medical - Drugs				Industry Peers		
	IRWD	X Industry	S&P 500	ABBV	HZNP	TEVA
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Outperform	Neutral
Zacks Rank (Short Term)	2	-	-	3	1	3
VGM Score	C	-	-	B	D	C
Market Cap	1.58 B	147.35 M	24.30 B	165.81 B	15.56 B	10.27 B
# of Analysts	4	3	14	6	6	10
Dividend Yield	0.00%	0.00%	1.6%	5.02%	0.00%	0.00%
Value Score	C	-	-	B	D	A
Cash/Price	0.16	0.27	0.07	0.04	0.05	0.23
EV/EBITDA	17.45	-2.33	13.46	20.23	48.51	71.07
PEG F1	NA	1.21	3.09	1.51	0.92	0.69
P/B	NA	3.12	3.25	11.26	6.09	0.69
P/CF	17.07	11.60	13.12	9.09	21.72	2.41
P/E F1	19.35	18.44	22.15	8.98	26.40	3.78
P/S TTM	3.70	6.30	2.57	4.58	10.25	0.61
Earnings Yield	5.17%	-16.35%	4.29%	11.13%	3.79%	26.49%
Debt/Equity	-11.94	0.02	0.70	5.57	0.42	1.66
Cash Flow (\$/share)	0.58	-0.53	6.93	10.33	3.47	3.89
Growth Score	D	-	-	C	D	F
Historical EPS Growth (3-5 Years)	NA%	6.78%	10.41%	21.34%	5.93%	-19.63%
Projected EPS Growth (F1/F0)	33.55%	19.03%	-4.75%	16.98%	47.16%	3.62%
Current Cash Flow Growth	-168.58%	2.60%	5.22%	8.78%	10.70%	-9.67%
Historical Cash Flow Growth (3-5 Years)	20.48%	5.94%	8.49%	19.92%	39.60%	-6.21%
Current Ratio	14.02	3.83	1.35	0.86	1.51	1.09
Debt/Capital	NA%	3.96%	42.92%	84.78%	29.79%	62.41%
Net Margin	22.74%	-115.25%	10.25%	19.20%	34.09%	0.03%
Return on Equity	-160.69%	-63.10%	14.66%	-628.57%	19.67%	17.88%
Sales/Assets	1.08	0.29	0.50	0.37	0.36	0.30
Projected Sales Growth (F1/F0)	-12.88%	0.00%	-1.42%	36.62%	48.02%	-3.73%
Momentum Score	C	-	-	C	C	C
Daily Price Change	0.92%	0.00%	1.82%	1.85%	-0.12%	-0.95%
1-Week Price Change	-2.69%	-1.82%	2.59%	-0.73%	-3.86%	-2.93%
4-Week Price Change	2.39%	-5.09%	4.80%	0.75%	-1.31%	-25.75%
12-Week Price Change	0.61%	-7.45%	6.31%	-3.04%	55.12%	-21.99%
52-Week Price Change	5.79%	-2.64%	5.43%	41.53%	181.58%	32.39%
20-Day Average Volume (Shares)	1,519,646	322,770	1,788,967	6,983,426	2,436,186	10,563,478
EPS F1 Estimate 1-Week Change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
EPS F1 Estimate 4-Week Change	26.09%	0.00%	0.00%	0.00%	47.32%	0.06%
EPS F1 Estimate 12-Week Change	26.88%	2.49%	3.89%	-0.96%	71.43%	0.40%
EPS Q1 Estimate Monthly Change	8.75%	0.00%	0.00%	-0.18%	62.74%	1.44%

Source: Zacks Investment Research

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	D
Momentum Score	C
VGM Score	C

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.