

Illinois Tool Works (ITW)

\$202.19 (As of 02/05/21)

Price Target (6-12 Months): **\$212.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/24/18)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: A

Summary

Illinois Tool's fourth-quarter earnings and revenues beat the Zacks Consensus Estimate by 19.2% and 5.1%, respectively. The company is poised to gain from a diversified business structure, enterprise initiatives and the policy of rewarding shareholders. The quarterly dividend rate was hiked 6.5% in August 2020. Moreover, the company is likely to benefit from strong recovery in majority of its end markets and all major geographies. For 2021, it expects organic revenues to grow 7-10% year over year. However, in the past six months, Illinois Tool's shares have underperformed the industry. The challenged demand environment across the food equipment end markets remains a concern. Foreign exchange headwinds might also adversely impact its performance. In addition, high debt levels are likely to weigh on the company in the quarters ahead.

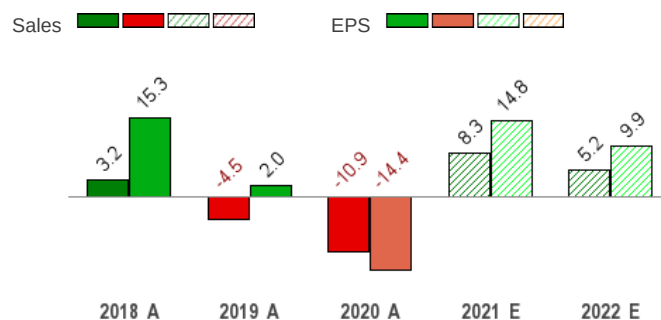
Price, Consensus & Surprise



Data Overview

52-Week High-Low	\$224.69 - \$115.94
20-Day Average Volume (Shares)	925,007
Market Cap	\$64.0 B
Year-To-Date Price Change	-0.8%
Beta	1.09
Dividend / Dividend Yield	\$4.56 / 2.3%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Top 32% (81 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	19.2%
Last Sales Surprise	5.1%
EPS F1 Estimate 4-Week Change	1.6%
Expected Report Date	NA
Earnings ESP	0.9%
P/E TTM	29.7
P/E F1	26.6
PEG F1	3.5
P/S TTM	5.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	3,577 E	3,376 E	3,680 E	3,666 E	14,329 E
2021	3,357 E	3,226 E	3,545 E	3,524 E	13,620 E
2020	3,228 A	2,564 A	3,307 A	3,475 A	12,574 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$2.05 E	\$1.95 E	\$2.21 E	\$2.16 E	\$8.36 E
2021	\$1.82 E	\$1.77 E	\$2.02 E	\$2.00 E	\$7.61 E
2020	\$1.77 A	\$1.09 A	\$1.83 A	\$2.11 A	\$6.63 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 02/05/2021. The report's text and the analyst-provided price target are as of 02/08/2021.

Overview

Headquartered in Glenview, IL, Illinois Tool Works Inc. is a worldwide manufacturer of highly engineered products and specialty systems. The company's diversified range of industrial products and equipment are sold in 53 countries (data as of October 2020-end). The company operates through seven operating business segments. A brief discussion is given below:

Test & Measurement and Electronics (15.6% of 2020 total segmental revenues): This segment deals with the production of equipment, consumables and related software for testing and measuring materials and structures, and equipment and consumables used in the production of electronic subassemblies and microelectronics. Products are mainly used in automotive original equipment manufacturers and tiers, general industrial, consumer durables and other markets.

Automotive OEM (20.4%): This segment produces fasteners and components for automotive-related applications. Products are mainly used by original equipment manufacturers in the automotive industry.

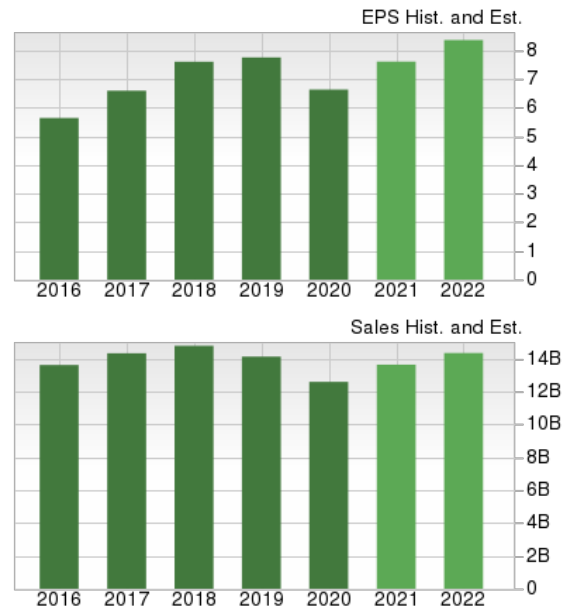
Polymers & Fluids (12.9%): This segment produces lubrication and cutting fluids, sealants, janitorial and hygiene products, adhesives, and fluids and polymers. It serves customers in general industrial, automotive aftermarket and other markets.

Food Equipment (13.8%): This segment is responsible for production and offering of commercial food equipment and related services. Customers mainly belong to restaurant, food retail and food service markets.

Welding (11%): This segment manufactures arc welding equipment, consumables and accessories. Products are mainly used in general industrial, fabrication, energy, construction, industrial capital goods, and other markets.

Construction Products (13.1%): This segment produces construction-fastening systems and truss products for commercial construction, residential construction and renovation markets.

Specialty Products (13.2%): This segment produces product coding and marking equipment and consumables, beverage packaging equipment and consumables, and appliance components and fasteners.



Source: Zacks Investment Research

Reasons To Buy:

▲ Illinois Tool is poised to benefit from its diversified businesses, solid product offerings and healthy liquidity position (including \$2,564 million of cash and cash equivalents at 2020-end, reflecting an increase of 18.2% sequentially) in the quarters ahead. Notably, the company generated a strong free cash flow of \$2,571 million in 2020. For 2021, it expects generating free cash flow in excess of net income as it focuses on cost-control actions and working capital management. Also, its enterprise strategy — including Business Structure Simplification, Portfolio Management and Strategic Sourcing — might be beneficial. The enterprise initiatives contributed 120 basis points (bps) and 130 bps to the operating margin in the third and fourth quarters of 2020, respectively. In the past 30 days, the company's earnings estimates increased 1.6% for 2021 and 2.5% for 2022.

Enterprise policies, rewards to shareholders and a diversified business portfolio are likely to work in Illinois Tool's favor. Strong recovery in demand levels in end markets is likely to be a tailwind.

▲ Illinois Tool's fourth-quarter revenues increased 5.1% on a sequential basis and 0.2% from the year-ago figure on the back of strong recovery in majority of the end markets it serves. In the fourth quarter, the company's majority of the operating segments witnessed continued solid recovery in demand levels sequentially, with Automotive OEM, Construction Products and Polymers & Fluids being the biggest gainers. Notably, it witnessed continued broad-based market recovery across all major geographies in the quarter. For 2021, it expects organic revenue to grow 7-10% year over year, with a 9-12% rise in total revenues. Also, Illinois Tool's focus on uninterrupted supply of products during the pandemic, innovation investments and initiatives by customers to build a localized supply chain are some important tailwinds for the near term. Also, the company is working diligently for the safety of its workers and management of its supply chain. In addition, its cost-reduction actions are likely to help it maintain a healthy margin performance in the quarters ahead. Notably, in the fourth quarter, its operating margin expanded 170 basis points year over year to 25.4%.

▲ Illinois Tool remains committed to rewarding its shareholders substantially through dividend payments and share buybacks. In the fourth quarter of 2020, the company paid out dividends of \$1.14 per share to its shareholders, while its diluted shares outstanding decreased 1.4% from the year-ago quarter. Notably, the quarterly dividend rate was hiked 6.5% in August 2020. The company noted that dividend payments remain a priority, while share buybacks have been halted temporarily due to the pandemic.

Reasons To Sell:

- ▼ In fourth-quarter 2020, Illinois Tool's organic sales declined in four of its segments — with a 19% decrease in Food Equipment. The challenged demand environment across the end markets caused by the pandemic is likely to affect the Food Equipment segment's top-line performance in the near term. In the past six months, the company's shares have gained 3.3% compared with the industry's growth of 12.8%.
- ▼ Illinois Tool generates a substantial portion of revenues from international operations. Although international businesses provide geographical diversity, these expose it to unfavorable movements in foreign currencies and geopolitical issues. Also, higher contribution from international operations is detrimental to operating margin expansion as foreign sales usually carry lower margins compared with domestic sales. A stronger U.S. dollar might further depress the company's overseas business results in the quarters ahead.
- ▼ A highly leveraged balance sheet can inflate Illinois Tool's financial obligations and subsequently hurt profitability. In the last five years (2016-2020), the company's long-term debt increased 1.6% (CAGR). Long-term debt balance at the end of the 2020 remained high at \$7,772 million, up 2.4% sequentially. Another concerning factor is the company's ability to repay its obligations, as evident from a fall in times interest earned from 14.2X in the third quarter to 14.1X in the fourth quarter.

The pandemic-led low demand remains a concern for Illinois Tool. Also, high debts weigh on the company.

Last Earnings Report

Illinois Tool Beats on Q4 Earnings, Gives Solid View

Illinois Tool has reported better-than-expected results for fourth-quarter 2020, with earnings surpassing the Zacks Consensus Estimate of \$1.77. This was the tenth consecutive quarter of impressive bottom-line results. Also, the quarter's sales surpassed estimates of \$3.3 billion.

The industrial tool maker's earnings in the reported quarter were \$2.02 per share. Also, the bottom line increased 1.5% from the year-ago reported number of \$1.99 on the back of sales generation and operating margin improvement. Adjusted earnings in the quarter were \$2.11 per share.

For 2020, the company's earnings were \$6.63, below the year-ago figure of \$7.74.

Revenue Details

Illinois Tool generated revenues of \$3,475 million in the reported quarter, reflecting growth of 0.2% from the year-ago figure. Top-line results were affected by a 0.7% decline from divestitures/acquisitions and a 0.9% drop in organic sales. However, movements in foreign currencies positively impacted results by 1.8%.

Illinois Tool reports revenues under the segments discussed below:

Test & Measurement and Electronics' revenues in the fourth quarter decreased 3.3% year over year to \$534 million. Revenues from **Automotive OEM** (Original Equipment Manufacturer) increased 10.4% to \$800 million. **Food Equipment** generated revenues of \$471 million, decreasing 17.3% year over year.

Welding revenues were \$368 million, declining 4.8% year over year. **Construction Products'** revenues were up 11.9% to \$430 million. Further, revenues of \$439 million from **Specialty Products** reflected a decline of 1.6%. Polymers & Fluids' revenues of \$437 million grew 7% year over year.

For 2020, the company's revenues were \$12.6 billion, down from the year-ago figure of \$14.1 billion.

Margin Profile

In the reported quarter, Illinois Tool's cost of sales declined 1.8% year over year to \$2,000 million. Selling, administrative, and research and development expenses declined 4.9% year over year to \$557 million. It represented 16% of fourth-quarter revenues.

Operating margin was 25.4% in the quarter, up from 23.8% reported in the year-ago quarter. Enterprise initiatives contributed 130 bps to operating margin.

Interest expenses in the quarter increased 2% year over year to \$52 million. Effective tax rate in the quarter was 22.1%.

Balance Sheet and Cash Flow

Exiting the fourth quarter, Illinois Tool had cash and cash equivalents of \$2,564 million, up 18.2% from \$2,169 million recorded at the end of the last reported quarter. Long-term debt increased 2.4% sequentially to \$7,772 million.

In the fourth quarter, the company generated net cash of \$773 million from operating activities, reflecting a decline of 0.1% from the year-ago quarter. Capital spending on the purchase of plant and equipment was \$68 million, down 17.1% year over year. Free cash flow was \$705 million, reflecting year-over-year growth of 1.9%.

Outlook

For 2021, Illinois Tool anticipates organic revenue growth of 7-10% year over year, with a 9-12% rise in total revenues. Foreign currency translation is expected to positively impact sales by 2%.

Earnings (GAAP) are expected to be \$7.60-\$8.00 per share, suggesting an increase of 15-21% from the previous year. Free cash is anticipated to be in excess of 100% of net income.

Quarter Ending 12/2020

Report Date	Feb 05, 2021
Sales Surprise	5.13%
EPS Surprise	19.21%
Quarterly EPS	2.11
Annual EPS (TTM)	6.80

Recent News

Dividend

On **Jan 14, 2021**, Illinois Tool paid out a quarterly dividend of \$1.14 per share to shareholders on record as of Dec 31.

Valuation

Illinois Tool's shares increased 3.3% in the past six months, while increased 10% in the trailing 12-month period. Stocks in the Zacks sub-industry are up 12.8%, while the Zacks Industrial Products sector increased 26% in the past six months. Over the past year, the Zacks sub-industry increased 5.4%, while the sector grew 24.6%.

The S&P 500 Index has increased 17.3% in the past six months and 18.2% in the past year.

The stock is currently trading at 26.31x forward 12-month earnings per share, which compares to 26.18x for the Zacks sub-industry, 23.26x for the Zacks sector and 22.82x for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.35x and as low as 14.73x, with a 5-year median of 20.12x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$212 price target reflects 27.59x forward 12-month earnings per share.

The table below shows summary valuation data for ITW.

Valuation Multiples - ITW					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	26.31	26.18	23.26	22.82
	5-Year High	31.35	28.11	23.26	23.8
	5-Year Low	14.73	15.83	12.64	15.3
	5-Year Median	20.12	20.45	17.89	17.83
P/Sales F12M	Current	4.67	3.72	3.52	4.54
	5-Year High	5.19	3.77	3.52	4.54
	5-Year Low	2.42	1.72	1.62	3.2
	5-Year Median	3.33	2.34	2.12	3.68
As of 02/05/2021		Source: Zacks Investment Research			

Industry Analysis Zacks Industry Rank: Top 32% (81 out of 253)



Source: Zacks Investment Research

Top Peers

Company (Ticker)	Rec	Rank
IHI CORP (IHICY)	Outperform	2
ParkerHannifin Corporation (PH)	Outperform	2
Atlas Copco AB (ATLKY)	Neutral	2
Dover Corporation (DOV)	Neutral	2
GEA GROUP AG SP (GEAGY)	Neutral	3
Roper Technologies, Inc. (ROP)	Neutral	3
SUMITOMO HEAVY (SOHVV)	Neutral	3
Tetra Tech, Inc. (TTEK)	Neutral	2

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

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	ITW	X Industry	S&P 500	IHICY	PH	ROP
Zacks Recommendation (Long Term)	Neutral	-	-	Outperform	Outperform	Neutral
Zacks Rank (Short Term)	3	-	-	2	2	3
VGM Score	B	-	-	C	B	D
Market Cap	64.00 B	2.02 B	27.69 B	2.91 B	36.00 B	42.47 B
# of Analysts	10	3	13	2	10	6
Dividend Yield	2.26%	0.00%	1.43%	0.72%	1.26%	0.56%
Value Score	C	-	-	A	C	D
Cash/Price	0.04	0.08	0.06	0.29	0.02	0.01
EV/EBITDA	17.64	15.19	14.96	4.74	17.73	18.05
PEG F1	3.54	2.22	2.44	NA	1.91	2.64
P/B	23.73	2.80	3.71	0.84	5.05	4.05
P/CF	22.03	14.17	15.54	4.43	18.48	23.47
P/E F1	26.84	24.48	20.33	94.40	22.47	27.74
P/S TTM	5.09	1.78	3.01	0.25	2.67	7.68
Earnings Yield	3.76%	3.78%	4.83%	1.06%	4.45%	3.61%
Debt/Equity	2.81	0.44	0.68	0.75	0.93	0.86
Cash Flow (\$/share)	9.18	2.74	6.78	1.06	15.12	17.25
Growth Score	B	-	-	F	B	F
Historical EPS Growth (3-5 Years)	8.61%	8.80%	9.46%	-43.06%	16.55%	19.05%
Projected EPS Growth (F1/F0)	14.71%	18.51%	13.31%	-44.44%	15.25%	14.60%
Current Cash Flow Growth	-2.44%	-2.44%	4.43%	-25.60%	-2.94%	11.79%
Historical Cash Flow Growth (3-5 Years)	4.24%	5.59%	8.19%	NA	7.19%	16.15%
Current Ratio	2.37	2.05	1.37	1.32	1.50	0.72
Debt/Capital	73.79%	31.96%	41.33%	42.76%	48.11%	46.38%
Net Margin	16.77%	3.82%	10.59%	0.62%	10.60%	17.18%
Return on Equity	80.95%	9.04%	14.84%	-0.03%	23.93%	13.41%
Sales/Assets	0.86	0.74	0.51	0.75	0.68	0.26
Projected Sales Growth (F1/F0)	9.78%	5.69%	6.14%	-12.53%	-1.68%	13.51%
Momentum Score	A	-	-	D	A	A
Daily Price Change	2.60%	0.57%	0.38%	0.00%	3.90%	0.30%
1-Week Price Change	-4.55%	-6.11%	-4.02%	-7.04%	-3.84%	-6.28%
4-Week Price Change	-3.38%	0.00%	0.24%	-3.87%	-0.67%	-5.95%
12-Week Price Change	-3.55%	16.14%	10.12%	40.48%	8.80%	3.66%
52-Week Price Change	8.66%	12.32%	7.73%	-25.08%	33.18%	5.17%
20-Day Average Volume (Shares)	925,007	76,417	2,075,178	2,055	960,177	577,011
EPS F1 Estimate 1-Week Change	0.20%	0.00%	0.00%	0.00%	11.78%	1.21%
EPS F1 Estimate 4-Week Change	1.56%	0.00%	0.46%	0.00%	13.50%	1.21%
EPS F1 Estimate 12-Week Change	1.89%	3.51%	1.32%	200.00%	14.42%	0.72%
EPS Q1 Estimate Monthly Change	0.00%	0.00%	0.08%	0.00%	2.33%	-4.27%

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	B
Momentum Score	A
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.