

## Kennametal Inc. (KMT)

**\$28.53** (As of 06/02/20)

Price Target (6-12 Months): **\$30.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 05/26/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: B

### Summary

Kennametal is poised to benefit from its diversified business structure, simplification/modernization activities, solid liquidity position and innovation capabilities. Also, its policy of rewarding shareholders with dividends bodes well. However, the company is wary of the adverse impacts of the pandemic and it, therefore, suspended its financial projections for fiscal 2020. Notably, its cost-saving measures might be of help in the quarters ahead, while raw material prices are likely to aid fourth-quarter fiscal 2020 results. In addition, weakness in gross and operating margins as well as unfavorable movements in foreign currencies might prove challenging. In the past six months, the company's shares have underperformed the industry. Also, its earnings estimates have declined for fiscal 2020 and fiscal 2021 in the past 60 days.

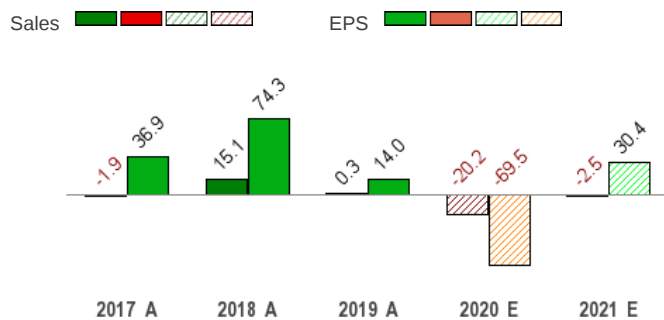
### Price, Consensus & Surprise



### Data Overview

|                            |                                                              |
|----------------------------|--------------------------------------------------------------|
| 52 Week High-Low           | \$38.73 - \$14.45                                            |
| 20 Day Average Volume (sh) | 743,136                                                      |
| Market Cap                 | \$2.4 B                                                      |
| YTD Price Change           | -22.7%                                                       |
| Beta                       | 2.37                                                         |
| Dividend / Div Yld         | \$0.80 / 2.8%                                                |
| Industry                   | <a href="#">Manufacturing - Tools &amp; Related Products</a> |
| Zacks Industry Rank        | Top 34% (87 out of 253)                                      |

### Sales and EPS Growth Rates (Y/Y %)



|                           |            |
|---------------------------|------------|
| Last EPS Surprise         | 43.8%      |
| Last Sales Surprise       | -5.7%      |
| EPS F1 Est- 4 week change | 15.0%      |
| Expected Report Date      | 08/03/2020 |
| Earnings ESP              | 0.0%       |
| P/E TTM                   | 17.4       |
| P/E F1                    | 31.0       |
| PEG F1                    | 3.7        |
| P/S TTM                   | 1.1        |

### Sales Estimates (millions of \$)

|      | Q1    | Q2    | Q3    | Q4    | Annual* |
|------|-------|-------|-------|-------|---------|
| 2021 | 423 E | 471 E | 513 E | 446 E | 1,848 E |
| 2020 | 518 A | 505 A | 483 A | 390 E | 1,896 E |
| 2019 | 587 A | 587 A | 597 A | 604 A | 2,375 A |

### EPS Estimates

|      | Q1       | Q2       | Q3       | Q4       | Annual*  |
|------|----------|----------|----------|----------|----------|
| 2021 | \$0.07 E | \$0.26 E | \$0.56 E | \$0.50 E | \$1.20 E |
| 2020 | \$0.17 A | \$0.17 A | \$0.46 A | \$0.13 E | \$0.92 E |
| 2019 | \$0.70 A | \$0.71 A | \$0.77 A | \$0.84 A | \$3.02 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 06/02/2020. The reports text is as of 06/03/2020.

## Overview

Based in Latrobe, PA, Kennametal Inc. is a manufacturer, marketer and distributor of high-speed metal cutting tools, tooling systems and wear-resistant parts. It has operations in various countries, including the Americas, the Asia Pacific, and Europe, Middle East and Africa. Exiting fiscal 2019 (ended June 2019), it had approximately 10,400 employees.

Its products are marketed through a number of channels to the end users, comprising manufacturers of machine tools, transportation vehicles and various components, airframe, aerospace components, machinery (light and heavy), components (energy-related), and others. Also, the company's products are used by manufacturers and suppliers in the oil and gas exploration, road construction, and other industries.

Kennametal reports results under three segments — including Industrial, WIDIA and Infrastructure. A brief discussion of the segments is provided below.

- **Industrial** (54% of revenues generated in third-quarter fiscal 2020): The segment provides products and services in the industrial end markets such as general engineering, aerospace & defense, transportation, and energy.

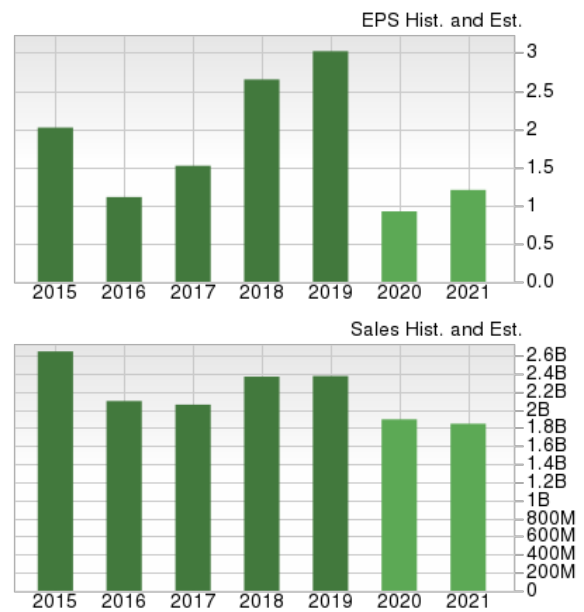
The segment offerings — sold under Kennametal Brand — are, in turn, used for the production of automobiles, ships, aero engines, trucks, airframe and other equipment.

- **WIDIA** (8.8%): The segment provides metal cutting solutions (both customized and standard) in the energy, general engineering, aerospace and transportation end markets.

The main product brands under the segment are WIDIA Hanita, WIDIA and WIDIA GTD.

- **Infrastructure** (37.2%): The segment serves end users in the energy, general engineering and earthworks markets. These players, in turn, support mining, oil and gas, petrochemical, process, aerospace, packaging, and other industries.

The main product brand offered under the segment is Kennametal.



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## Reasons To Buy:

- ▲ In the quarters ahead, Kennametal anticipates gaining from simplification/modernization activities (discussed below), innovation capabilities and solid liquidity position. Also, its cost-reduction actions — including furloughs, lowering of discretionary spending, production-reduction at manufacturing facilities globally and travel restrictions — will likely help in effectively deal with the difficult environment. Further, it anticipates benefiting from raw material prices in the fourth quarter compared with the year-ago quarter.
- ▲ Kennametal's three initiatives — including growth, modernization and simplification — have been proving advantageous. The growth initiative is helping boost the company's sales through improvement in commercial execution. The simplification initiative is improving operational efficiency and reducing costs. The modernization initiative is in progress now and is contributing to strong operating leverage. Compared with the year-ago quarter, the initiatives boosted the company's bottom line by 15 cents per share in the third quarter. Also, it anticipates the second phase of simplification/modernization to yield annualized savings of \$30-\$35 million (down from \$35-\$40 million mentioned earlier) by the end of fiscal 2020 and \$25-\$30 million by fiscal 2021.
- ▲ Kennametal remains committed to rewarding its shareholders through dividend payments. In the first nine months of fiscal 2020, it distributed dividends totaling \$49.7 million to its shareholders. Also, the company's diversified customer base in various end markets enables it to avoid customer concentration risks. Prime end-markets served include aerospace, automotive, and machine tool and farm machinery industries as well as manufacturers and suppliers in the highway construction, coal mining, quarrying, and oil and gas exploration industries.

Kennametal is well-positioned to gain from simplification/modernization activities, diversified business structure, cost-saving measures and innovations capabilities. Its shareholder-friendly policies might also aid.

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## Reasons To Sell:

- ▼ In the past six months, Kennametal's shares have moved down 18.2% compared with the industry's decline of 16.9%. In first-quarter 2020, the company's earnings decreased 40.3% from the year-ago quarter on weak sales and margin results. It is wary about the impacts of end-market challenges due to the coronavirus outbreak. It suspended financial projections for fiscal 2020. In the past 60 days, its earnings estimates have declined 8% for fiscal 2020 and 22.6% for fiscal 2021. This makes us cautious about the stock.
- ▼ Weakness in gross and operating profits can be dragging for Kennametal. In third-quarter fiscal 2020, the company recorded a 24.5% year-over-year decline in gross profit, while gross margin was down 230 basis points (bps). Also, adjusted operating income dipped 30.8% year over year on a decline in organic sales, negative impacts of simplification/modernization actions, restructuring changes and lower absorption of costs (including fixed and volume-related labor costs). Notably, charges related to simplification/modernization initiatives (pre-tax) were \$6 million or 6 cents per share in the fiscal third quarter. For fiscal 2020, the company predicts incurring pre-tax restructuring charges of \$55-\$60 million, while that for fiscal 2021 to amount to \$55-\$65 million.
- ▼ Kennametal's business is exposed to risks related to foreign currency translation, given its strong presence in international markets. Though international diversity increases business scope, it also exposed the company to risks arising from unfavorable movements in foreign currencies and geopolitical issues. In this regard, foreign currency translation had an adverse impact of 1% on revenues and 3 cents per share on earnings in third-quarter fiscal 2020. Fluctuations in foreign exchange rates may continue to affect the company's top and bottom lines in the quarters ahead. At the end of third-quarter fiscal 2020, Kennametal's long-term debt stood at \$593.6 million, reflecting growth of 0.1% from the previous quarter. It is the company's ability to repay its financial obligations (not its debts) that are more concerning presently. Its times interest earned was 3.2x at the end of the third quarter, lower than 4.6x in the previous quarter. We believe that further rise in debts as well as worsening ability to repay debts might be dragging in the quarters ahead.

Challenging end-market conditions caused by the pandemic remain concerning for Kennametal. Also, restructuring charges and forex woes might be dragging in the quarters ahead.

## Last Earnings Report

### Kennametal Beats Q3 Earnings Estimates, Withdraws View

Kennametal reported better-than-expected results for third-quarter fiscal 2020 (ended Mar 31, 2020), with earnings surpassing estimates by 43.75%. However, the quarterly sales lagged the consensus mark by 5.74%.

This machinery company's adjusted earnings in the reported quarter were 46 cents, surpassing the Zacks Consensus Estimate of 32 cents. However, the bottom line decreased 40.3% from the year-ago figure of 77 cents on weak sales and margin results.

Quarter Ending **03/2020**

| Report Date      | May 04, 2020 |
|------------------|--------------|
| Sales Surprise   | -5.74%       |
| EPS Surprise     | 43.75%       |
| Quarterly EPS    | 0.46         |
| Annual EPS (TTM) | 1.64         |

### Revenue Details

Kennametal generated revenues of \$483.1 million, declining 19% year over year. While organic sales fell 17% in the quarter, forex woes had an impact of 1% and divestitures hurt results by 1%. The quarterly results suffered from the slowdown in global manufacturing activities due to the pandemic.

Kennametal's top line lagged the Zacks Consensus Estimate of \$512.5 million.

On a geographical basis, the company generated revenues of \$242.4 million from America operations, decreasing 20% year over year. Sales in Europe, the Middle East and Africa (EMEA) were down 19% to \$146.8 million, while the same from the Asia Pacific dropped 166.9% to \$93.8 million.

The company reports revenue results under three segments, including Industrial, WIDIA and Infrastructure. Its segmental performance for the fiscal third quarter is briefly discussed below:

**Industrial** revenues of \$260.7 million were down 18% year over year. The results were adversely impacted by a 17% decline in organic revenues and a 2% impact from forex woes, partially offset by a 1% positive impact from business days.

**WIDIA** revenues were \$42.7 million, reflecting a decline of 16% year over year. The results were negatively impacted by an organic sales decline of 16% and forex woes of 1%, partially offset by a positive impact of 1% from business days.

**Infrastructure** revenues totaled \$179.6 million, declining 21% year over year. The results were affected by 1% from forex woes, a 17% decline in organic sales and a 3% adverse impact of divestitures.

### Margin Profile

Kennametal's cost of goods sold in the reported quarter dipped 16.2% year over year to \$326.1 million. It represented 67.5% of revenues compared with 65.2% in the year-ago quarter. Gross profit deteriorated 24.5% year over year to \$157 million, wherein margin contracted 230 basis points (bps) to 32.5%. Operating expenses summed \$98.5 million in the quarter under review, decreasing 18% year over year. As a percentage of revenues, operating expenses were 20.4% compared with 20.1% a year ago.

Adjusted operating income in the reported quarter slumped 30.8% year over year to \$59.1 million. Notably, the downside is caused by a decline in organic sales, the negative impacts of simplification/modernization actions, lower absorption of costs (including fixed and volume-related labor costs) and restructuring charges. However, the adverse impacts were to partly offset by the benefits of simplification/modernization actions, and a fall in variable compensation and raw material costs. Adjusted operating margin slipped 210 bps to 12.2%.

Adjusted effective tax rate was 28.5% in the quarter, up from 19.8% in the prior year.

### Balance Sheet and Cash Flow

Exiting the fiscal third quarter, Kennametal had cash and cash equivalents of \$85.2 million, decreasing 19% from \$105.2 million at the end of the last reported quarter. Long-term debt and capital leases inched up 0.1% sequentially to \$593.6 million.

In the first nine months of fiscal 2020, the company generated net cash of \$146.1 million from operating activities, declining 7.2% from the year-ago period. Capital invested in purchasing property, plant and equipment came in at \$206.1 million, above \$145.9 million in the year-earlier period. Free cash outflow was \$57.2 million compared with an inflow of \$15.1 million in the first nine months of fiscal 2019.

During the first nine months of fiscal 2020, the company distributed dividends of \$49.7 million.

### Restructuring Actions

In July 2019, the company announced that it is undertaking certain measures as part of its simplification/modernization initiatives, which are likely to help it streamline the business structure, improve efficiency and boost shareholder value. The restructuring moves are likely to be completed within the next two years.

The suggested restructuring actions will likely yield annualized savings of \$30-\$35 million (down from \$35-\$40 million mentioned earlier) in fiscal 2020 (ending June 2020). Pre-tax charges associated with the efforts will be \$55-\$60 million (versus the previously stated \$55-\$65 million).

The company predicts that facility closures scheduled for fiscal 2021 will lead to annualized savings worth \$25-\$30 million. Pre-tax charges in the year will be \$55-\$65 million.

### Outlook

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In the quarters ahead, Kennametal anticipates gaining from simplification/modernization activities, solid liquidity position and cost-reduction actions. However, end-market challenges will likely persist due to the coronavirus outbreak.

The company withdrew its financial projections for fiscal 2020.

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## Recent News

### Dividend

On **May 27, 2020**, Kennametal paid a quarterly cash dividend of 20 cents per share to its shareholders of record as of May 12, 2020.

### Valuation

Kennametal shares are down 22.7% and 13.9% year to date and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are down 22.9% and 14.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 5.4% and 6.1%, respectively.

The S&P 500 Index has moved down 5.2% in the year-to-date period and increased 9% in the past year.

The stock is currently trading at 24.13x forward 12-month earnings per share, which compares to 21.29x for the Zacks sub-industry, 21.51x for the Zacks sector and 22.13x for the S&P 500 index.

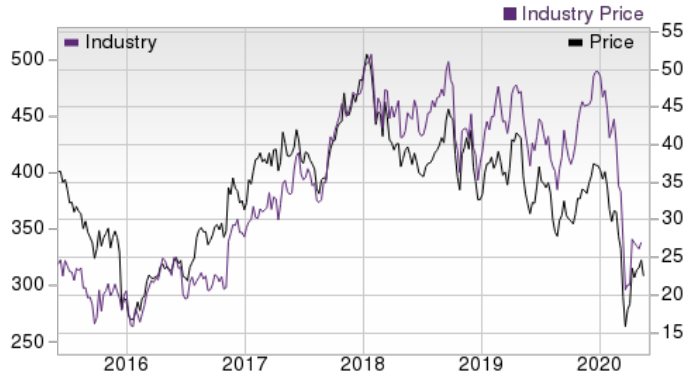
Over the past five years, the stock has traded as high as 25x and as low as 8.68x, with a 5-year median of 16.32x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$30 price target reflects 25.37x forward 12-month earnings per share.

The table below shows summary valuation data for KMT.

| Valuation Multiples - KMT |               |       |              |        |         |
|---------------------------|---------------|-------|--------------|--------|---------|
|                           |               | Stock | Sub-Industry | Sector | S&P 500 |
| P/E F12M                  | Current       | 24.13 | 21.29        | 21.51  | 22.13   |
|                           | 5-Year High   | 25    | 21.29        | 21.51  | 22.13   |
|                           | 5-Year Low    | 8.68  | 12.49        | 12.55  | 15.23   |
|                           | 5-Year Median | 16.32 | 16.42        | 16.58  | 17.49   |
| EV/EBITDA F12M            | Current       | 5.76  | 9.18         | 16.44  | 12.31   |
|                           | 5-Year High   | 11.62 | 11.02        | 18.09  | 12.65   |
|                           | 5-Year Low    | 4.96  | 7.15         | 10.59  | 9.05    |
|                           | 5-Year Median | 8.56  | 8.87         | 14.13  | 10.81   |
| EV/Sales F12M             | Current       | 1.55  | 1.43         | 3.1    | 3.21    |
|                           | 5-Year High   | 2.06  | 1.96         | 3.13   | 3.52    |
|                           | 5-Year Low    | 0.86  | 0.95         | 1.76   | 2.28    |
|                           | 5-Year Median | 1.41  | 1.45         | 2.31   | 2.82    |

As of 06/02/2020

## Industry Analysis Zacks Industry Rank: Top 34% (87 out of 253)



## Top Peers

| Company (Ticker)                          | Rec          | Rank |
|-------------------------------------------|--------------|------|
| Allegheny Technologies Incorporated (ATI) | Neutral      | 3    |
| Colfax Corporation (CFX)                  | Neutral      | 3    |
| SPX FLOW, Inc. (FLOW)                     | Neutral      | 3    |
| IDEX Corporation (IEX)                    | Neutral      | 3    |
| Ingersoll Rand Inc. (IR)                  | Neutral      | 3    |
| MSC Industrial Direct Company, Inc. (MSM) | Neutral      | 2    |
| Sandvik AB (SDVKY)                        | Neutral      | 3    |
| Stanley BlackDecker, Inc. (SWK)           | Underperform | 3    |

| Industry Comparison Industry: Manufacturing - Tools & Related Products |         |            |           | Industry Peers |         |              |
|------------------------------------------------------------------------|---------|------------|-----------|----------------|---------|--------------|
|                                                                        | KMT     | X Industry | S&P 500   | CFX            | IEX     | SWK          |
| Zacks Recommendation (Long Term)                                       | Neutral | -          | -         | Neutral        | Neutral | Underperform |
| Zacks Rank (Short Term)                                                | 3       | -          | -         | 3              | 3       | 3            |
| VGM Score                                                              | B       | -          | -         | B              | B       | D            |
| Market Cap                                                             | 2.37 B  | 3.37 B     | 22.11 B   | 3.35 B         | 12.06 B | 20.21 B      |
| # of Analysts                                                          | 5       | 6.5        | 14        | 10             | 7       | 10           |
| Dividend Yield                                                         | 2.80%   | 1.67%      | 1.93%     | 0.00%          | 1.25%   | 2.10%        |
| Value Score                                                            | B       | -          | -         | C              | D       | D            |
| Cash/Price                                                             | 0.04    | 0.09       | 0.06      | 0.11           | 0.05    | 0.05         |
| EV/EBITDA                                                              | 6.37    | 10.25      | 12.69     | 13.88          | 19.05   | 12.81        |
| PEG Ratio                                                              | 3.91    | 3.63       | 2.98      | 4.53           | 3.43    | 4.60         |
| Price/Book (P/B)                                                       | 1.82    | 2.71       | 3.07      | 1.00           | 5.41    | 2.71         |
| Price/Cash Flow (P/CF)                                                 | 6.46    | 10.88      | 11.86     | 6.11           | 23.28   | 10.88        |
| P/E (F1)                                                               | 32.57   | 28.33      | 21.79     | 23.43          | 34.30   | 24.62        |
| Price/Sales (P/S)                                                      | 1.12    | 1.29       | 2.29      | 0.97           | 4.89    | 1.42         |
| Earnings Yield                                                         | 3.22%   | 3.54%      | 4.39%     | 4.27%          | 2.91%   | 4.06%        |
| Debt/Equity                                                            | 0.48    | 0.41       | 0.76      | 0.79           | 0.45    | 0.63         |
| Cash Flow (\$/share)                                                   | 4.42    | 3.14       | 7.01      | 4.64           | 6.87    | 12.06        |
| Growth Score                                                           | C       | -          | -         | B              | B       | F            |
| Hist. EPS Growth (3-5 yrs)                                             | 18.05%  | 9.32%      | 10.87%    | 8.44%          | 13.62%  | 8.77%        |
| Proj. EPS Growth (F1/F0)                                               | -69.47% | -36.54%    | -10.74%   | -48.07%        | -19.63% | -36.61%      |
| Curr. Cash Flow Growth                                                 | 10.92%  | 4.61%      | 5.48%     | 27.59%         | 4.80%   | 4.61%        |
| Hist. Cash Flow Growth (3-5 yrs)                                       | 2.02%   | 6.22%      | 8.55%     | 3.20%          | 7.29%   | 6.22%        |
| Current Ratio                                                          | 2.52    | 2.52       | 1.29      | 1.93           | 3.51    | 1.06         |
| Debt/Capital                                                           | 32.59%  | 29.09%     | 44.75%    | 44.24%         | 30.94%  | 34.23%       |
| Net Margin                                                             | 3.10%   | 6.81%      | 10.59%    | -13.62%        | 16.92%  | 6.46%        |
| Return on Equity                                                       | 10.16%  | 11.65%     | 16.29%    | 8.89%          | 19.89%  | 16.40%       |
| Sales/Assets                                                           | 0.81    | 0.76       | 0.55      | 0.40           | 0.65    | 0.66         |
| Proj. Sales Growth (F1/F0)                                             | -20.18% | -15.58%    | -2.67%    | -20.67%        | -10.97% | -15.58%      |
| Momentum Score                                                         | B       | -          | -         | D              | B       | B            |
| Daily Price Chg                                                        | 1.86%   | 1.11%      | 0.99%     | 0.93%          | 1.13%   | 4.82%        |
| 1 Week Price Chg                                                       | 7.44%   | 3.26%      | 4.60%     | 6.98%          | 5.93%   | 3.26%        |
| 4 Week Price Chg                                                       | 17.80%  | 14.53%     | 9.15%     | 17.59%         | 5.35%   | 22.41%       |
| 12 Week Price Chg                                                      | 26.52%  | 8.63%      | 4.65%     | -0.32%         | 10.70%  | 0.41%        |
| 52 Week Price Chg                                                      | -13.94% | -1.04%     | -0.30%    | 5.27%          | 1.51%   | -1.04%       |
| 20 Day Average Volume                                                  | 743,136 | 49,484     | 2,486,038 | 1,387,235      | 542,080 | 1,828,919    |
| (F1) EPS Est 1 week change                                             | 0.00%   | 0.00%      | 0.00%     | -0.09%         | 0.00%   | 1.62%        |
| (F1) EPS Est 4 week change                                             | 15.01%  | 0.00%      | -0.33%    | -15.91%        | 0.00%   | -10.22%      |
| (F1) EPS Est 12 week change                                            | -29.80% | -37.46%    | -16.13%   | -44.41%        | -18.77% | -40.37%      |
| (Q1) EPS Est Mthly Chg                                                 | 4.84%   | -4.46%     | -0.55%    | -71.02%        | 0.00%   | -41.21%      |

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### 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    | <b>B</b> |
| Growth Score   | <b>C</b> |
| Momentum Score | <b>B</b> |
| VGM Score      | <b>B</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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### Disclosures

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