

## Lincoln Electric (LECO)

**\$114.03** (As of 11/23/20)

Price Target (6-12 Months): **\$120.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 05/31/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

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

**3-Hold**

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: B

### Summary

Lincoln Electric's third-quarter 2020 adjusted earnings per share improved on a year-over-year basis despite a decline in revenues. However, the company beat the Zacks Consensus Estimate on both counts. Lincoln Electric's end markets remain weak due to the impact of the COVID-19 pandemic. Automotive, transportation, energy, construction and heavy industries have been impacted. This will continue to dent the company's results until the situation stabilizes. Increase in customer facility closures are also anticipated to result in lower operating activity and higher inefficiencies in the business. Nevertheless, the company's cost cutting actions will sustain margins. Focus on new product development and utilization of digital platforms to engage customers will also drive growth. Acquisitions will contribute to growth.

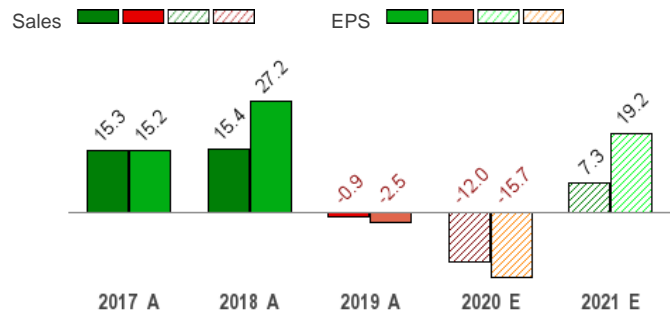
### Price, Consensus & Surprise



### Data Overview

52-Week High-Low	<b>\$118.44 - \$59.30</b>
20-Day Average Volume (Shares)	<b>308,761</b>
Market Cap	<b>\$6.8 B</b>
Year-To-Date Price Change	<b>17.9%</b>
Beta	<b>1.15</b>
Dividend / Dividend Yield	<b>\$2.04 / 1.7%</b>
Industry	<b>Manufacturing - Tools &amp; Related Products</b>
Zacks Industry Rank	<b>Bottom 3% (247 out of 254)</b>

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



Last EPS Surprise	<b>39.2%</b>
Last Sales Surprise	<b>9.5%</b>
EPS F1 Estimate 4-Week Change	<b>9.3%</b>
Expected Report Date	<b>02/11/2021</b>
Earnings ESP	<b>0.0%</b>
P/E TTM	<b>28.2</b>
P/E F1	<b>28.8</b>
PEG F1	<b>2.6</b>
P/S TTM	<b>2.5</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	701 E	700 E	715 E	715 E	2,834 E
2020	702 A	591 A	669 A	680 E	2,642 E
2019	759 A	777 A	731 A	736 A	3,003 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.13 E	\$1.19 E	\$1.24 E	\$1.18 E	\$4.72 E
2020	\$1.00 A	\$0.80 A	\$1.10 A	\$1.05 E	\$3.96 E
2019	\$1.17 A	\$1.28 A	\$1.09 A	\$1.15 A	\$4.70 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 11/23/2020. The reports text is as of 11/24/2020.

## Overview

Headquartered in Cleveland, OH, Lincoln Electric has more than 59 manufacturing locations, including operations and joint ventures in 18 countries, and a worldwide network of distributors and sales offices covering more than 160 countries.

Lincoln is a full-line manufacturer and reseller of welding and cutting products with products ranging from welding power sources, wire feeding systems, robotic welding packages, fume extraction equipment, consumables and fluxes to regulators and torches used in cutting.

Lincoln Electric produces three types of arc welding electrodes, including stick electrodes, solid electrodes used for continuous feeding in mechanized welding, and cored electrodes that are also used for mechanized welding. Arc welding is carried out in many industries. The metal working field involves production of arc welding in transportation, construction, fabrication, petrochemical and other industries.

The company's business units are aligned into three operating segments-

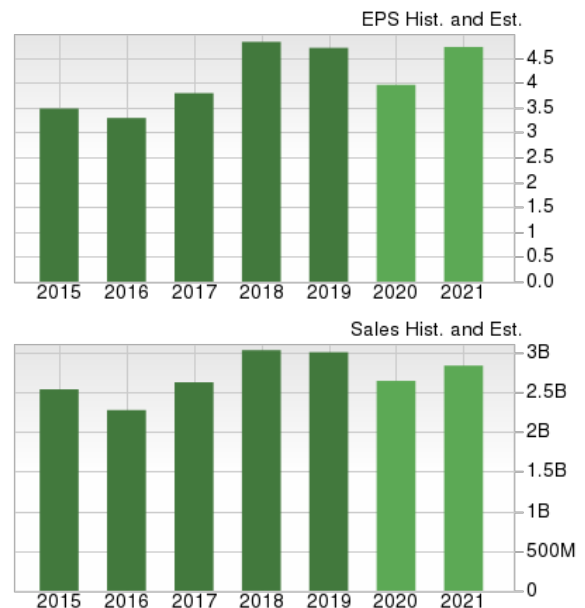
The **Americas Welding** segment (62% of fiscal 2019 revenues) includes welding operations in North and South America.

The **International Welding** (28% of fiscal 2019 revenues) segment includes welding operations in Europe, Africa, Asia and Australia.

The **Harris Products Group** (11% of fiscal 2019 revenues) includes the company's global cutting, soldering and brazing businesses, and retail business in the United States.

During July 2019, the company acquired the controlling stake of Turkey-based Askaynak, which is a supplier and manufacturer of welding consumables, arc welding equipment, including plasma and oxy-fuel cutting equipment and robotic welding systems. The buyout advances the company's regional growth strategy in Europe, the Middle East and Africa. During April 2019, the company acquired Detroit, MI-based Baker Industries, a provider of custom tooling, parts and fixtures primarily serving automotive and aerospace markets.

During December 2018, the company acquired the soldering business of Worthington Industries, which broadens Harris Products Group's portfolio of industry-leading consumables. Also during December 2018, the company acquired Coldwater Machine Company and Pro System.



Source: Zacks Investment Research

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## Reasons To Buy:

- ▲ As of Sep 30, 2020, Lincoln Electric had liquidity of \$602 million comprising \$152 million in cash and \$450 million in available credit under existing borrowing facilities. Total debt as of Sep 30, 2020 was \$717 million. The company has \$700 million in private notes with first maturity due in August 2025. Lincoln Electric's total debt to total capital ratio as of Sep 30, 2020 was at 0.50. The company's times interest earned ratio is 12.6, much higher than the industry's 4.9. This indicates that the company is poised well to navigate through this challenging period.
- ▲ Lincoln Electric has a balanced capital allocation strategy, prioritizing capital investment spending to cost reduction, new products, and growth initiatives. It has reduced its planned capital expenditure for 2020 to a range of \$50 million to \$60 million. The company will continue to evaluate M&A options focused primarily on tuck-in assets. The company's board of directors recently declared a 4.1% increase in the quarterly cash dividend — its 25th consecutive annual dividend increase and plans to resume share repurchases on an opportunistic basis.
- ▲ Lincoln Electric is focusing on cost management to sustain margins in the backdrop of weak demand. These measures include reducing work hours and overtime, lowering headcount, deferring annual wage increases, cutting down discretionary spending and eliminating travel. It has closed three facilities and initiated two facility rationalizations so far this year. The company has also offered a voluntary separation incentive program. It is evaluating additional contingency measures, which will be implemented if the situation demands. The company achieved \$27 million in cost savings in the third quarter, bringing the total to \$60 million in the first nine-month period of 2020. Cost reduction actions now anticipated to provide benefits of \$80 million to \$85 million in 2020. Exiting 2020, the company expects to realize \$10 to \$11 million in permanent costs savings per quarter.
- ▲ The company is focused on new product development and using digital platforms to engage customers. Lincoln Electric's product launches in the automation solutions market are likely to aid growth. The company is focused on its new additive services business, which will position Lincoln Electric as a manufacturer of large scale 3D-printed metal parts, prototypes and tooling for industrial customers. This is likely to be growth opportunity for Lincoln Electric.

It also continues to invest in long-term strategy for automation in support of its 2020 strategy initiatives. The company launched its new state-of-the-art advanced technology solution center in Germany, which gives it an unprecedented commercial presence in the European market. This tech center will enable the company to showcase its latest technologies and welding consumables, equipment and automation.

- ▲ Lincoln Electric is benefiting from several acquisitions. Lincoln Electric has acquired Inovatech Engineering Corporation and Coldwater Machine Company, Pro Systems LLC, boosting its automated cutting solutions and application expertise. In January 2019, Lincoln Electric acquired the soldering business of Worthington Industries. This broadened the Harris Products Group's portfolio of industry-leading consumables with the addition of premium solders and fluxes. In April 2019, Lincoln Electric acquired Baker Industries to expand automation and additive strategies. Recently, the company acquired a controlling interest in Askaynak, a leading Turkish producer of welding consumables and equipment. The buyout advances the company's regional growth strategy in Europe, the Middle East and Africa.

Focus on acquisitions, innovative product launches and execution of the 2020 vision and strategy will drive Lincoln Electric's growth. Its cost management actions will also aid margins.

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## Reasons To Sell:

▼ The COVID-19 pandemic has impacted Lincoln Electric's markets and operations, which include weakening demand, supply chain disruptions, and other logistics constraints. Automotive, transportation, energy, construction and heavy industries have all been impacted. This will continue to impact the company's results until the situation stabilizes. Even though many of the company's customers have begun to re-open or increase operating levels, such customers may be forced to close or limit operations due to resurgence of COVID-19 cases. In addition to weak demand, increase in customer facility closures and the continued risk of possible supply chain disruptions are expected to result in lower operating activity and higher inefficiencies in the business. The company expects organic sales in the fourth quarter 2020 to decline at a similar rate as the third quarter.

Lincoln Electric's performance in the near term will continue to bear the brunt of impact of the coronavirus pandemic on demand in its end markets as well as on its supply chain.

▼ Lincoln Electric's Americas Welding segment had been bearing the brunt of a weak manufacturing sector thanks to the U.S.-China trade tensions. The coronavirus pandemic has dealt a further blow to the sector. Per the Institute for Supply Management's report, the U.S. Purchasing Managers' Index (PMI) came in at 41.5% for April — the lowest since April 2009 when it registered 39.9%. In May, the PMI came in at 43.1%. A reading below 50 denotes contraction. The index climbed to 52.6% in June followed by 54.2% in July, 56% in August, 55% in September and 59.3% in October. It remains to be seen whether the recovery in the past five months will sustain considering the surge in coronavirus cases. Thus, uncertainty in the market and cautious customer spending are likely to persist this year aggravated by the coronavirus outbreak. This remains a concern for Lincoln Electric.

▼ Even though the company continues to announce new pricing actions, incremental margins could be impacted due to the timing of its response. Given its focus on innovation as a key value proposition, Lincoln Electric continued to increase investment in product development with higher year-over-year R&D spending. Though this has long-term benefits, it will impede margins in the near term. Also, a stronger U.S. dollar will affect the company's exports.

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## Last Earnings Report

### Lincoln Electric Q3 Earnings & Revenues Top Estimates

Lincoln Electric reported third-quarter 2020 adjusted earnings of \$1.10 per share, which beat the Zacks Consensus Estimate of 79 cents. The bottom line rose 1% year over year, reflecting the company's cost management efforts.

Including one-time items, the bottom line came in at 97 cents compared with \$1.17 in the prior-year quarter.

Total revenues declined 8.5% year over year to \$669 million. However, the top line surpassed the Zacks Consensus Estimate of \$611 million. The decline in revenues was due to a decrease of 8.3% in organic sales and an unfavorable impact of 0.2% from foreign exchange.

### Costs and Margins

Cost of goods sold went down 8% to \$454 million from the prior-year quarter. Gross profit declined 10% to \$215 million from the prior-year quarter. Gross margin came in at 32.2% compared with 32.6% in the year-ago quarter.

Selling, general and administrative expenses declined 11% year over year to \$131 million from the prior-year quarter. Adjusted operating profit was down 8% year over year to \$84 million in the quarter. Adjusted operating margin came in at 12.6% compared with 12.5% in the year-ago quarter.

### Financial Update

Lincoln Electric had cash and cash equivalents of around \$152 million at the end of third-quarter 2020 compared with \$200 million at the end of the 2019. The company reported cash flow from operations of \$89.5 million during the third quarter compared with \$129 million in the prior-year quarter. The company's board of directors declared a 4.1% increase in the quarterly cash dividend to 51 cents per share. The dividend will be dividend of \$0.51 per share is payable Jan 15, 2021 to shareholders of record as of Dec 31, 2020.

The company's debt to invested capital was at 50.2% as of Sep 30, 2020 compared with 47.7% as of Dec 31, 2019.

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Quarter Ending	09/2020
Report Date	Oct 27, 2020
Sales Surprise	9.50%
EPS Surprise	39.24%
Quarterly EPS	1.10
Annual EPS (TTM)	4.05

## Valuation

Lincoln Electric's shares are up 17.9% in the year-to-date period and up 22.3% over the trailing 12-month period. Stocks in the Zacks Manufacturing – Tool & Related Products industry are down 5.9% while the Zacks Industrial Products sector are up 15.0% in the year-to-date period. Over the past year, the Zacks sub-industry are down 1.5% while the sector are up 17.9%.

The S&P 500 index is up 11.3% in the year-to-date period and up 14.5% in the past year.

The stock is currently trading at 24.57X forward 12-month earnings, which compares with 17.48X for the Zacks sub-industry, 23.53X for the Zacks sector and 22.24X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.44X and as low as 12.33X, with a 5-year median of 18.26X.

Our Neutral recommendation indicates that the stock will perform better in-line with the market. Our \$120 price target reflects 26.02X forward 12-month earnings.

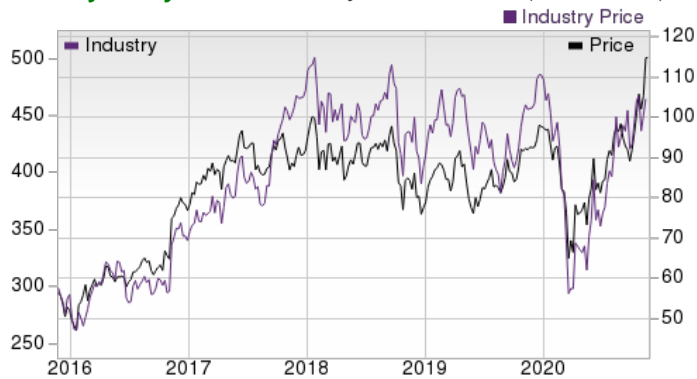
The table below shows summary valuation data for LECO:

Valuation Multiples - LECO					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	24.57	17.48	23.53	22.24
	5-Year High	26.44	21.45	23.53	23.47
	5-Year Low	12.33	12.49	12.59	15.27
	5-Year Median	18.26	16.91	17.72	17.72
P/S F12M	Current	2.41	1.1	3.31	4.16
	5-Year High	2.6	1.52	3.31	4.3
	5-Year Low	1.2	0.84	1.6	3.17
	5-Year Median	1.85	1.19	2.09	3.67
EV/EBITDA TTM	Current	18.18	12.18	22.08	15.83
	5-Year High	23.58	13	22.08	16.17
	5-Year Low	9.21	6.25	11.07	9.54
	5-Year Median	14.18	10.17	15.07	13.11

As of 11/23/2020

Source: Zacks Investment Research

## Industry Analysis Zacks Industry Rank: Bottom 3% (247 out of 254)



Source: Zacks Investment Research

## Top Peers

Company (Ticker)	Rec	Rank
Deere & Company (DE)	Outperform	1
Caterpillar Inc. (CAT)	Neutral	3
John Bean Technologies Corporation (JBT)	Neutral	3
Kennametal Inc. (KMT)	Neutral	4
The Manitowoc Company, Inc. (MTW)	Neutral	3
Stanley Black & Decker, Inc. (SWK)	Neutral	3
Enerpac Tool Group Corp. (EPAC)	Underperform	5
Sandvik AB (SDVKY)	Underperform	4

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

Industry Comparison Industry: Manufacturing - Tools & Related Products				Industry Peers		
	LECO	X Industry	S&P 500	CMI	CNHI	KMT
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	2	3	4
VGM Score	B	-	-	A	A	F
Market Cap	6.78 B	3.23 B	25.83 B	34.81 B	14.58 B	2.94 B
# of Analysts	8	6	14	9	6	6
Dividend Yield	1.72%	1.20%	1.49%	2.30%	0.00%	2.26%
Value Score	C	-	-	B	B	D
Cash/Price	0.02	0.08	0.07	0.10	0.50	0.04
EV/EBITDA	15.51	13.24	14.64	9.71	10.09	21.90
PEG F1	2.66	4.71	2.76	2.32	NA	8.97
P/B	9.54	3.50	3.55	4.03	3.04	2.32
P/CF	18.54	15.29	13.80	11.93	6.11	14.75
P/E F1	29.26	28.81	21.67	20.85	101.25	44.83
P/S TTM	2.51	2.36	2.79	1.78	0.58	1.67
Earnings Yield	3.47%	3.47%	4.40%	4.80%	1.02%	2.24%
Debt/Equity	1.01	0.50	0.70	0.42	5.14	0.47
Cash Flow (\$/share)	6.15	2.40	6.92	19.73	1.77	2.40
Growth Score	B	-	-	C	A	D
Historical EPS Growth (3-5 Years)	8.74%	6.36%	9.72%	13.77%	7.41%	8.51%
Projected EPS Growth (F1/F0)	-15.80%	-3.42%	0.42%	-25.03%	-87.30%	-16.14%
Current Cash Flow Growth	-3.32%	-7.68%	5.29%	9.29%	-1.24%	-45.40%
Historical Cash Flow Growth (3-5 Years)	0.03%	4.54%	8.33%	7.28%	2.82%	-7.39%
Current Ratio	1.92	2.35	1.38	1.94	6.14	2.25
Debt/Capital	50.17%	31.44%	41.99%	29.46%	83.74%	31.90%
Net Margin	7.59%	6.87%	10.40%	8.12%	-2.15%	-1.91%
Return on Equity	34.42%	5.59%	14.99%	20.30%	4.68%	5.19%
Sales/Assets	1.19	0.62	0.50	0.96	0.56	0.66
Projected Sales Growth (F1/F0)	-12.04%	0.00%	0.23%	-18.86%	-11.50%	-7.17%
Momentum Score	B	-	-	B	A	F
Daily Price Change	0.65%	1.35%	1.06%	1.98%	2.56%	5.30%
1-Week Price Change	-1.08%	2.12%	0.21%	-2.49%	4.36%	2.25%
4-Week Price Change	11.01%	9.01%	8.26%	6.59%	29.03%	7.61%
12-Week Price Change	17.91%	11.09%	9.20%	13.50%	36.71%	21.78%
52-Week Price Change	22.38%	19.87%	5.26%	27.82%	-2.17%	3.09%
20-Day Average Volume (Shares)	308,761	179,349	2,312,054	1,084,546	2,459,297	832,633
EPS F1 Estimate 1-Week Change	0.00%	0.00%	0.00%	0.00%	0.00%	-1.81%
EPS F1 Estimate 4-Week Change	9.29%	0.00%	0.96%	19.83%	1,014.29%	-18.25%
EPS F1 Estimate 12-Week Change	9.97%	-0.19%	3.72%	23.20%	436.84%	-11.99%
EPS Q1 Estimate Monthly Change	1.94%	0.00%	0.00%	34.97%	44.56%	-50.50%

Source: Zacks Investment Research

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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 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.

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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	C
Growth Score	B
Momentum Score	B
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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## Disclosures

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## 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.

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**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.

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**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.

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**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.