

Netflix Inc. (NFLX)

\$325.90 (As of 01/03/20)

Price Target (6-12 Months): **\$342.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/12/18)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: F

Growth: D

Momentum: F

Summary

Netflix is expected to benefit from a strong content portfolio and expanding bundle offerings through partnerships with Telefonica, KDDI, AT&T, Comcast, DISH, Verizon, Charter, Altice, T-Mobile and Sky. The company's solid international footprint, as indicated by the recently revealed numbers, is a key catalyst. However, streaming services from Disney, Apple, Comcast and AT&T pose a significant threat to Netflix's dominance in the space. Moreover, higher streaming content obligation and increased spending are expected to hurt cash flow generation. Meanwhile, estimates have been stable ahead of the company's fourth-quarter earnings release. The company has a positive record of earnings surprises in the recent quarters. Netflix's shares have underperformed the industry in the past year.

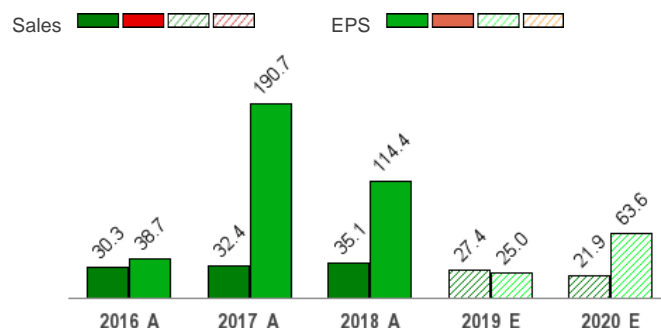
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$385.99 - \$252.28
20 Day Average Volume (sh)	5,491,207
Market Cap	\$142.7 B
YTD Price Change	0.7%
Beta	1.28
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Broadcast Radio and Television
Zacks Industry Rank	Top 28% (71 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	40.0%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-0.0%
Expected Report Date	01/21/2020
Earnings ESP	0.0%
P/E TTM	104.1
P/E F1	59.6
PEG F1	2.0
P/S TTM	7.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	5,744 E	6,003 E	6,254 E	6,498 E	24,532 E
2019	4,521 A	4,923 A	5,245 A	5,439 E	20,129 E
2018	3,701 A	3,907 A	3,999 A	4,187 A	15,794 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.14 E	\$1.39 E	\$1.72 E	\$1.17 E	\$5.48 E
2019	\$0.76 A	\$0.60 A	\$1.47 A	\$0.52 E	\$3.35 E
2018	\$0.64 A	\$0.85 A	\$0.89 A	\$0.30 A	\$2.68 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 01/03/2020. The reports text is as of 01/06/2020.

Overview

Founded in 1997 and headquartered in Los Gatos, CA, Netflix Inc. is a provider of Internet television (streaming services) and DVD-rental services. The company launched its streaming service in 2007.

Netflix streams movies, television shows and documentaries across a wide variety of genres and languages. Subscribers, both domestic and international, can watch them on a host of internet-connected devices, including television sets, computers and mobile devices.

Netflix reported revenues of \$15.79 billion in 2018. At the end of third-quarter 2019, the company had 165.93 million paid subscribers.

Netflix reports revenues under three separate segments — Domestic Streaming, International Streaming and Domestic DVD.

The Domestic and International Streaming segments generate revenues from monthly subscriptions on exclusive, non-exclusive and original content in the U.S. and international markets (present in more than 190 countries).

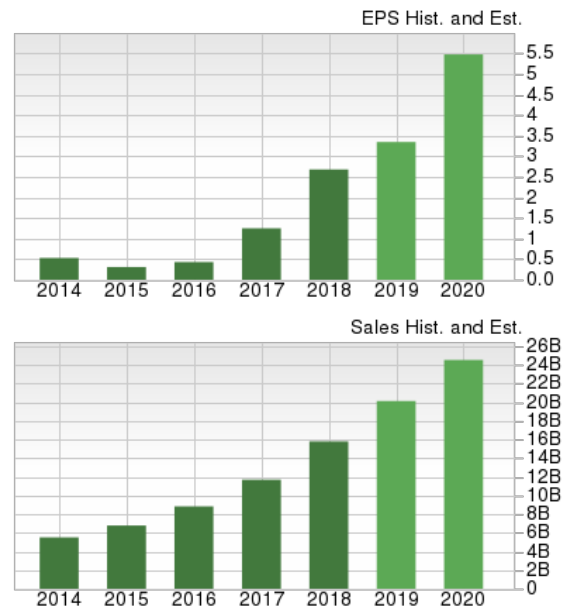
In 2018, the U.S. Streaming revenues came in at \$7.65 billion and accounted for 48.4% of total revenues. At the end of third-quarter 2019, the company had 61.22 million paid subscribers.

International Streaming revenues were \$7.78 billion and accounted for 49.3% of total revenues. At the end of third-quarter 2019, the company had 104.71 million paid subscribers.

Moreover, as of Dec 31, 2018, Netflix had approximately 7,100 full-time employees, of which nearly 6,900 supported its streaming business.

In the Domestic DVD segment, the company delivers DVDs through the U.S. postal service from distribution centers located in major U.S. cities. Revenues from DVD segment were \$365.6 million.

Netflix's competitors include MVPDs, internet-based movie and TV content providers, and DVD retailers. The company faces significant competition from YouTube, Amazon Prime Video and HBO in the streaming market. The upcoming services from Apple and Disney are likely to further intensify competition.



Reasons To Buy:

- ▲ Netflix's growing subscriber base is the primary factor that helps it to generate significant revenues. The company attributed this to strength of its content portfolio. It remains confident of adding more and more subscribers as the trend of Internet TV/binge viewing catches up fast. Moreover, the company's efforts to attract viewers through investing in more regional programming have added significantly to its user base. Moreover, partnerships with telcos like Telefonica in Spain, KDDI in Japan, AT&T, Comcast, DISH, Verizon, Charter, Altice and T-Mobile in the United States, Canal+ in France and Sky in the U.K., Germany and Italy are expected to enhance subscriber base in international markets.
- ▲ Netflix's focus on originals — both movies and TV shows — has been the major growth driver behind the company's surging subscriber base. Further, the company's endeavor to offer content catering to various genres has been a key catalyst in driving user engagement. The impressive content quality has helped the company win awards and accolades. Notably, in 2018, Netflix beat HBO in the number of Emmy nominations and tied for the most wins. This year, Netflix won 27 Emmy awards, trailing only HBO. The company's change in strategy to give its original movies more theatrical exposure is expected to boost its chances for winning the much-coveted Oscar. Notably, the company gave theatrical releases to some of its most popular hits including *Roma*, *Bird Box*, *The Ballad of Buster Scruggs* and *The Irishman*. It is set to offer limited theatrical release to two more movies — *Marriage Story* and *The Two Popes* — before bringing them to the platform.
- ▲ The success of *Roma*, *Bird Box*, *Triple Frontier*, *Murder Mystery* and *The Irishman* surely validates the company's evolution as a major movie studio. Moreover, the growing involvement of well-known Hollywood stars definitely makes the movies and shows more attractive. Netflix is currently working or set to work with a number of renowned Hollywood directors, including Martin Scorsese, Steven Soderbergh, Dee Rees, Guillermo del Toro, Noah Baumbach and Michael Bay. Actors involved with the streaming platform include Meryl Streep, Ben Affleck, Eddie Murphy, Sandra Bullock, Ryan Reynolds, Gal Gadot and Dwayne "Rock" Johnson, among others.
- ▲ Rapid international expansion has paid off for Netflix. The company is diversifying its content portfolio and also working on projects across India, Mexico, Spain, Italy, Germany, Brazil, France, Turkey and the entire Middle East. Notably, Netflix launched a low-priced mobile plan in India during the third-quarter. Moreover, the company has unveiled a number of new original series and films from Japan, Taiwan, Thailand and South Korea for 2019. The company now has 104.71 million subscribers internationally.

Netflix's growing subscriber base, driven by content strength, focus on originals across various genres and languages, rapid international expansion and partnerships with telcos are key drivers.

Reasons To Sell:

- ▼ Netflix faces stiff competition from Amazon Prime, Hulu, YouTube and HBO. Given the scope for growth in the market, all the players are ramping up their efforts to boost their subscriber base. Most of the players are investing heavily to develop original content that has become a differentiator for attracting new subscribers. Closing in on Netflix's success is Amazon's Prime, which offers a range of non-streaming benefits to its customers. Competition is heating up further with players like Facebook, Snapchat and Twitter also making efforts to improve video viewing on their platform. Moreover, entrance of Disney, Apple, WarnerMedia and NBCUniversal is expected to intensify competition.
- ▼ International expansion and content additions resulted in cost escalations in the form of technology investments and marketing expenses. The company is estimated to spend around \$15 billion on total content in 2019. In order to sustain market share amid intensifying competition, content strength is the primary focus, which requires significant investments in 2019 and beyond. We believe that Netflix's ability to effectively manage costs will dictate its future prospects.
- ▼ Cash flow burn is here to stay. Netflix reported free cash outflow of \$3 billion in 2018. The company now expects 2019 free cash outflow to be modestly higher at roughly \$3.5 billion due to higher cash taxes related to the company's change in corporate structure, and additional investments in real estate and other infrastructure. Although the fresh content will help in driving rapid subscriber growth, higher cash burn does not augur well for investors.

Intensifying competition from the likes of Amazon Prime, Hulu, YouTube and HBO, and entry of Apple and Disney into the streaming space along with continuing cash burn are major concerns.

Last Earnings Report

Netflix Q3 Earnings Beat, User Addition Target Missed

Netflix reported third-quarter 2019 earnings of \$1.47 per share that beat the Zacks Consensus Estimate by 42 cents and was better than management's guidance of \$1.04. Moreover, earnings jumped 65.2% year over year.

Revenues of \$5.245 billion increased 31.1% year over year but lagged the consensus mark. Excluding a negative impact of \$137 million related to unfavorable foreign exchange, consolidated revenues grew 35% year over year. Moreover, streaming ARPU grew 12%.

Netflix missed its subscriber addition target for the second consecutive quarter. Falling short of its target of 7 million paid subscribers, the streaming giant added 6.8 million, which, however, increased 15.3% year over year.

Moreover, the increase in the paid subscriber base in the reported quarter was much higher than 2.7 million Netflix added in the previous quarter.

At the end of the quarter, Netflix had 158.33 million paid subscribers globally, up 21.4% from the year-ago quarter. The company expected to have 158.56 million paid subscribers, globally.

Price Hike Hurts Retention Rate in US

In the International Streaming segment, Netflix recorded 97.71 million paid members that increased 33% from the year-ago quarter. The company added 6.26 million paid members, slightly better than management's expectation of 6.2 million, increasing 23.5% on a year-over-year basis.

In the U.S. Streaming segment, Netflix's paid subscriber base totaled 60.62 million, up 6.4% from the year-ago quarter. The company added 0.5 million paid subscribers compared with expectations of 0.8 million.

The subscriber addition target miss was primarily attributed to the price hike the company announced in January. Netflix stated that subscriber retention rate is yet to return to the "pre-price-change levels", which affected U.S. subscriber net addition.

However, the price hike has been beneficial for ARPU in the U.S. segment, which increased 16.5% year over year. Excluding unfavorable foreign exchange impact, International streaming ARPU improved 10% year over year.

Content & Viewership Details

Netflix's *Stranger Things 3*, *Unbelievable*, *La Casa De Papel*, *Sintonia*, *The Naked Director*, and *Sacred Games* were the most viewed shows in the reported quarter. Meanwhile, *Secret Obsession*, *Otherhood* and *Tall Girl* were the most viewed movies.

The third season of *Stranger Things* was watched by 64 million households in the first four weeks of release. The limited series drama *Unbelievable* was watched by 32 million households in the first 28 days of release.

Moreover, the third season of *La Casa De Papel* was watched by 44 million households in the first four weeks of release. This was the most-watched show on Netflix across its non-English language territories.

While *The Naked Director* was a hit in Japan, the second season of *Sacred Games* was the company's most-watched show in India.

The content slate for the fourth quarter includes shows and movies like *The Crown*, *The Witcher*, *The Irishman* from Martin Scorsese and action movie *6 Underground*, directed by Michael Bay and starring Ryan Reynolds.

Other notable releases include *Marriage Story* (starring Scarlett Johansson and Adam Driver), *The Two Popes* (featuring Anthony Hopkins and Jonathan Pryce), *Dolemite is My Name* (starring Eddie Murphy and Da'Vine Joy Randolph), Steven Soderbergh's *The Laundromat* (starring Meryl Streep and Gary Oldman) and *The King* (starring Timothee Chalamet, Lily-Rose Depp and Joel Edgerton). The slate also includes animated movies *Klaus* and *I Lost My Body*.

Other Details

During the quarter, Netflix launched a low-priced mobile plan in India.

Moreover, the company's partner-based bundle offerings expanded in the reported quarter. Netflix is now available on Sky Italia, Canal+ in France, KDDI in Japan and Izzi in Mexico.

In terms of languages, Netflix started offering its services in Vietnamese, Hungarian and Czech.

Quarter Details

International Streaming revenues (52.6% of revenues) jumped 39.9% year over year to \$2.76 billion. The figure missed management's guidance of \$2.78 billion.

U.S. Streaming revenues (46% of revenues) improved 24.6% from the year-ago quarter to \$2.41 billion. The figure was better than management's guidance of \$2.40 billion.

The DVD business revenues (1.4% of revenues) declined 19% year over year to \$71.9 million.

Quarter Ending 09/2019

Report Date	Oct 16, 2019
Sales Surprise	-0.07%
EPS Surprise	40.00%
Quarterly EPS	1.47
Annual EPS (TTM)	3.13

Notably, from fourth-quarter 2019, Netflix will start disclosing revenues and membership data by regions, namely Asia Pacific (APAC), Europe, Middle East & Africa (EMEA), Latin America (LATAM), and the United States and Canada (UCAN).

Marketing expenses increased 8.5% year over year to \$553.8 million. However, as a percentage of revenues, marketing expenses decreased 220 basis points (bps) to 10.6%.

Consolidated contribution margin (revenues minus the cost of revenues and marketing cost) expanded 640 bps on a year-over-year basis to 30.4%. International and the U.S. streaming segments' contribution margin expanded 560 bps and 920 bps, respectively.

Notably, from fourth-quarter 2019, Netflix will stop reporting the U.S. and the International segments' contribution margin.

Moreover, consolidated operating income soared 103.7% year over year to \$980 million. Consolidated operating margin expanded 670 bps on a year-over-year basis to 18.7%, better than management's guidance of 15.9%.

Balance Sheet & Free Cash Flow

Netflix had \$4.44 billion of cash and cash equivalents as of Sep 30 compared with \$5 billion as of Jun 30.

Long-term debt was \$12.43 billion, down from \$12.59 billion at the end of the previous quarter. Streaming content obligations were \$19.1 billion compared with \$18.5 billion at the end of the previous quarter.

Netflix reported free cash outflow of \$551 million compared with \$594 million in the previous quarter.

Guidance

For the fourth quarter of 2019, Netflix forecasts earnings of 51 cents per share, implying year-over-year growth of 70%.

Netflix expects to add 7.60 million paid subscribers, lower than 8.8 million added in the year-ago quarter. In the U.S. Streaming segment, the company anticipates adding 0.6 million subscribers. However, in the International Streaming segment, it expects paid subscriber addition of 7 million.

Netflix expects to have 165.93 million paid subscribers globally, up 19.2% from the year-ago quarter. Streaming ARPU is anticipated to grow 9%.

Total revenues, including the DVD business, are anticipated to be \$5.44 billion, up 30% year over year. The U.S. and International Streaming revenues are expected to be \$2.45 billion and \$2.92 billion, respectively.

Contribution profits for the U.S. and International Streaming segments are expected to be \$777 million and \$309 million, respectively. Moreover, contribution margin for the U.S. Streaming segment is expected to expand 200 bps year over year to 31.6%. The same for the International Streaming segment is projected to expand 670 bps to 10.6%.

Operating margin is projected at 8.7%, up from 5.2% in the year-ago quarter.

For 2019, Netflix now expects net additions in paid subscriber base to decline (26.7 million compared with 28.6 million in 2018) due to higher churn rate and increased competition.

Notably, upcoming streaming services from Disney (DIS - Research Report) , Apple (AAPL - Research Report) , Comcast (CMCSA - Research Report) and AT&T pose a significant threat to Netflix's streaming dominance.

However, the company reiterated operating margin guidance of 13% for 2019, up 300 bps on a year-over-year basis. Netflix targets another 300-bp improvement in operating margin for 2020.

Moreover, management still expects 2019 free cash outflow to be modestly higher at roughly \$3.5 billion. The company still expects free cash flow to improve in 2020 and beyond, driven by increasing member base, revenues and operating margins.

Recent News

On Dec 18, Netflix and Mattel Television announced that they are producing He-Man and the Masters of the Universe, an original animated adventure series.

Moreover, Netflix announced that it will team up with director Lee Eung-bok to produce a new original series Sweet Home, which will be available exclusively on the steaming service.

On Dec 16, Netflix released historical streaming revenues, membership and average revenue per paying streaming membership by region, in a regulatory filing.

On Nov 21, Netflix announced a strategic partnership with CJ ENM, Korea's No.1 media entertainment company, and its subsidiary Studio Dragon, Korea's leading production studio, highlighted by a multi-year content production and distribution agreement.

On Nov 13, Netflix announced a new, multi-year output deal with Nickelodeon to produce original animated feature films and television series based both on the Nickelodeon library of characters as well as all-new IP, for kids and families globally.

Per a MarketWatch report on Sep 16, Netflix acquired the streaming rights of Emmy-award winning comedy Seinfeld from its distributor Sony for five years beginning 2021.

Moreover, per a Reuters report, Canal+ will add Netflix to its bundle, which will cost €35 and be available in France from Oct 15.

Valuation

Netflix shares are down 13.3% in the six-months period but up 3.3% over the trailing 12-month period. While stocks in the Zacks sub-industry are down 5.4%, the Zacks Consumer Discretionary sector is up 5.3% in the six-months period. Over the past year, the Zacks sub-industry and the sector are up 10.2% and 22.6%, respectively.

The S&P 500 index is up 9.2% in the six-months period and 25.7% in the past year.

The stock is currently trading at 5.8X forward 12-month sales, which compares to 7.34X for the Zacks sub-industry, 2.37X for the Zacks sector and 3.47X for the S&P 500 index.

Over the past five years, the stock has traded as high as 10.05X and as low as 2.82X, with a 5-year median of 5.57X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$342 price target reflects 6.09X forward 12-month sales.

The table below shows summary valuation data for NFLX

Valuation Multiples - NFLX					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	5.8	7.34	2.37	3.47
	5-Year High	10.05	13.42	3.19	3.47
	5-Year Low	2.82	6.61	1.81	2.54
	5-Year Median	5.57	9.77	2.55	3
EV/Sales TTM	Current	7.98	9.15	3.32	3.23
	5-Year High	14.51	15.82	4.02	3.3
	5-Year Low	3.37	7.94	2.7	2.14
	5-Year Median	7.49	11.22	3.44	2.79
EV/EBITDA TTM	Current	13.48	23.26	12.77	12.01
	5-Year High	40.54	32.82	17.77	12.86
	5-Year Low	6.09	18.49	11.08	8.49
	5-Year Median	12.23	24.03	12.43	10.66

As of 01/03/2020

Industry Analysis Zacks Industry Rank: Top 28% (71 out of 252)



Top Peers

Apple Inc. (AAPL)	Neutral
Amazon.com, Inc. (AMZN)	Neutral
Comcast Corporation (CMCSA)	Neutral
The Walt Disney Company (DIS)	Neutral
Discovery, Inc. (DISCA)	Neutral
Alphabet Inc. (GOOGL)	Neutral
Sirius XM Holdings Inc. (SIRI)	Neutral
AT&T Inc. (T)	Neutral

Industry Comparison Industry: Broadcast Radio And Television				Industry Peers		
	NFLX Neutral	X Industry	S&P 500	AAPL Neutral	AMZN Neutral	GOOGL Neutral
VGM Score	F	-	-	C	D	C
Market Cap	142.69 B	755.00 M	23.66 B	1,321.56 B	929.60 B	939.02 B
# of Analysts	13	2	13	12	13	13
Dividend Yield	0.00%	0.00%	1.79%	1.04%	0.00%	0.00%
Value Score	F	-	-	C	D	C
Cash/Price	0.03	0.15	0.04	0.08	0.05	0.13
EV/EBITDA	16.27	5.69	13.88	16.77	32.43	18.92
PEG Ratio	1.99	0.77	1.99	2.16	2.60	1.49
Price/Book (P/B)	20.80	1.30	3.36	14.60	16.45	4.82
Price/Cash Flow (P/CF)	16.05	4.60	13.62	19.49	36.24	22.31
P/E (F1)	59.58	9.00	18.74	22.71	71.48	24.90
Price/Sales (P/S)	7.56	0.98	2.67	5.08	3.50	6.06
Earnings Yield	1.68%	9.83%	5.32%	4.40%	1.40%	4.02%
Debt/Equity	1.81	1.33	0.72	1.01	0.40	0.07
Cash Flow (\$/share)	20.31	2.14	6.94	15.26	51.74	61.03
Growth Score	D	-	-	C	A	B
Hist. EPS Growth (3-5 yrs)	72.13%	6.99%	10.56%	9.59%	116.18%	23.64%
Proj. EPS Growth (F1/F0)	63.58%	21.11%	7.41%	10.15%	27.90%	17.38%
Curr. Cash Flow Growth	28.72%	18.86%	14.83%	-3.74%	85.21%	44.22%
Hist. Cash Flow Growth (3-5 yrs)	30.20%	15.14%	9.00%	7.40%	48.43%	21.13%
Current Ratio	0.73	1.73	1.23	1.54	1.10	3.78
Debt/Capital	64.43%	57.73%	42.92%	50.36%	28.45%	6.59%
Net Margin	7.49%	8.56%	11.08%	21.24%	4.27%	21.04%
Return on Equity	23.65%	8.23%	17.10%	53.82%	22.52%	18.34%
Sales/Assets	0.66	0.38	0.55	0.76	1.45	0.62
Proj. Sales Growth (F1/F0)	21.88%	5.99%	4.20%	5.73%	18.48%	18.10%
Momentum Score	F	-	-	C	F	C
Daily Price Chg	-1.19%	-0.06%	-0.61%	-0.97%	-1.21%	-0.52%
1 Week Price Chg	-2.32%	-0.01%	0.13%	3.71%	4.66%	0.25%
4 Week Price Chg	7.61%	0.57%	2.60%	11.99%	7.73%	2.60%
12 Week Price Chg	16.19%	9.17%	8.87%	29.27%	8.99%	12.57%
52 Week Price Chg	20.17%	6.98%	29.34%	109.18%	24.97%	32.77%
20 Day Average Volume	5,491,207	120,077	1,603,615	27,210,122	2,979,273	1,191,893
(F1) EPS Est 1 week change	-0.03%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.03%	0.00%	0.00%	0.04%	-1.22%	0.05%
(F1) EPS Est 12 week change	-4.81%	-3.49%	-0.57%	0.58%	-18.91%	-2.18%
(Q1) EPS Est Mthly Chg	-0.11%	0.00%	0.00%	0.00%	-2.70%	0.07%

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.

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	F
Growth Score	D
Momentum Score	F
VGM Score	F

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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