

ServiceNow Inc. (NOW)

\$431.40 (As of 07/30/20)

Price Target (6-12 Months): **\$453.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/28/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: F

Growth: A

Momentum: A

Summary

ServiceNow reported stellar second-quarter 2020 results. Both earnings and revenues increased on a year-over-year basis driven by solid growth in subscription revenues. Based on strong adoption of its solutions, ServiceNow raised its 2020 guidance for subscription revenues, billings and gross margin as well as operating margin. As businesses, government agencies and others continue to cloudify their infrastructure, ServiceNow's prospects are bright. Further, its expanding global presence, solid partner base and strategic buyouts are expected to aid growth. Notably, shares have outperformed the industry year to date. However, ServiceNow expects coronavirus-related headwinds to impact third-quarter 2020 results. Its exposure to coronavirus-hit industries like transportation, hospitality, retail and energy is a major concern.

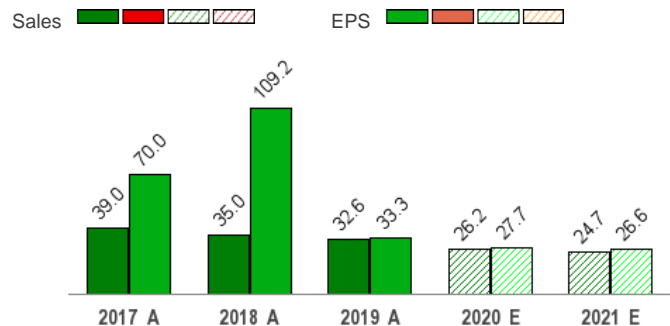
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$454.70 - \$213.99
20 Day Average Volume (sh)	1,545,994
Market Cap	\$82.3 B
YTD Price Change	52.8%
Beta	1.34
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computers - IT Services
Zacks Industry Rank	Bottom 28% (183 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	20.6%
Last Sales Surprise	2.3%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	10/28/2020
Earnings ESP	0.0%
P/E TTM	102.0
P/E F1	101.8
PEG F1	3.6
P/S TTM	20.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,271 E	1,315 E	1,377 E	1,468 E	5,442 E
2020	1,046 A	1,071 A	1,093 E	1,170 E	4,365 E
2019	789 A	834 A	886 A	952 A	3,460 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.23 E	\$1.23 E	\$1.44 E	\$1.43 E	\$5.37 E
2020	\$1.05 A	\$1.23 A	\$1.05 E	\$1.10 E	\$4.24 E
2019	\$0.67 A	\$0.71 A	\$0.99 A	\$0.96 A	\$3.32 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 07/30/2020. The reports text is as of 07/31/2020.

Overview

Santa Clara, CA-based ServiceNow Inc. provides cloud computing services that automate digital workflows to accelerate enterprise IT operations. The company's Now Platform enables enterprises to enhance productivity by streamlining system processes.

By utilizing ServiceNow's product portfolio, customers can design any workflow application to reduce the manual time taken by complex processes, and consequently optimize total cost of ownership or TCO.

The company's solutions address the needs of many departments within an enterprise, including IT, human resources (HR), facilities, field service, marketing, customer service, security, legal and finance.

Now platform is the foundation of the company's cloud-based services.

The company has three product suites for IT management and operations. These are IT Service Management (ITSM), IT Operations Management (ITOM) and IT Business Management (ITBM) solutions.

Non-IT products include Customer Service, HR and Security Operations.

ServiceNow's end-markets are quite varied, which includes financial services, consumer products, IT services, health care, government, education and technology.

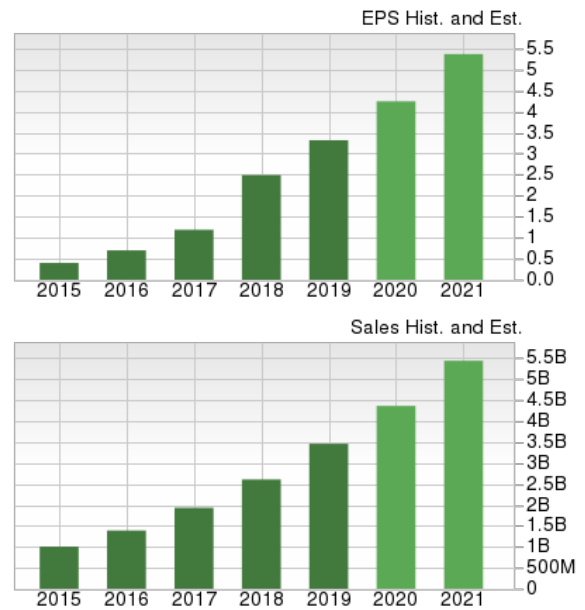
In 2019, total revenues came in at \$3.460 billion.

ServiceNow derives revenues from two sources – subscriptions (94% of 2019 revenues) and professional services and other (6% of 2019 revenues).

North America, Europe, the Middle East and Africa (EMEA), and Asia Pacific & Other contributed approximately 67%, 24% and 9% of revenues, respectively in first-quarter 2020.

The company operates data centers in Australia, Brazil, Canada, Hong Kong, Netherlands, Singapore, Switzerland, UK and the U.S.

ServiceNow has approximately 6,200 enterprise customers, including more than 44% of the world's 2,000 largest companies, as outlined by an annual ranking by the Forbes magazine. The figure also represents more than 80% of the Fortune 500 companies, as defined by an annual ranking by the Fortune magazine.



Reasons To Buy:

- ▲ ServiceNow is a dominant name in the IT service market (ITSM). The company continues to win market share by replacing legacy on-premise systems with cloud-based processes. G2K customers contribute approximately 50% of the top-line and the company expects the mix to remain steady in the long haul. The growing penetration at Fortune 500 clientele (80%) has been driving ServiceNow's top-line growth. Further, it is focusing primarily on public and big private entities, rapidly, which will further drive top-line growth in the long run.
- ▲ ServiceNow is rapidly expanding into non-ITSM markets like human resource and security solutions by launching new products and services. Shorter-sales cycle of these new products (particularly security solutions) as compared with the traditional ITSM business is driving top-line growth. The company is also focused on strengthening sales team across the different non-ITSM markets, which will expand customer base going ahead.
- ▲ ServiceNow has a diversified customer base, which is evident from the fact that none of the customers exceeded 10% of revenues in the last couple of years. Notably, the number of customers with annualized contract value (ACV) greater than \$1 million has also increased from 157 at the end of 2014 to 892 at the end of 2019. Given the company's expanding product portfolio (including emerging products), increasing multi-product customer base and strong renewal rate (almost 97%), we expect the company to achieve this target much earlier. ACV is also expected to improve from \$1 million in 2016 to \$2 million by 2020, which will help the company in achieving the top-line target of \$10 billion.
- ▲ Acquisitions have played an important part in ServiceNow's growth trajectory over the years. The acquisitions of Neebula Systems (2014), BrightPoint Security and ITapp (both in 2016) has aided the company to expand product portfolio, particularly security and ITOM solutions. Also in 2017, the company had acquired Qlue, a developer of virtual messaging agents. The buyout is expected to enhance its customer experience. The acquisitions of Telepathy and SkyGiraffe (both concluded in 2017) are expected to enhance the company's enterprise mobile experience. The acquisitions of DxContinuum (2017), Parlo (2018), FriendlyData (2018), Appsee (2019), Loom Systems (2020) and Passage AI (2020) are expected to boost its predictive modelling capabilities, consequently expanding ServiceNow's intelligent automation product portfolio going ahead.
- ▲ ServiceNow has a strong balance sheet with ample liquidity position. As of Jun 30, 2020, ServiceNow had cash and cash equivalents and short-term investments of \$2.34 billion compared with \$1.86 billion as of Mar 31, 2020. During the reported quarter, cash from operations came in at \$368.1 million, up 51% year over year. ServiceNow generated free cash flow of \$259.3 million, up 33.8% year over year. Further, free cash flow margin was 24.2%, up 100 bps on a year-over-year basis. The increasing liquidity and cash flow trend reflect that the company is making investments in the right direction. Moreover, the cash is available for pursuing strategic acquisitions, investment in growth initiatives and distribution to shareholders.

Dominant position in the ITSM, ITOM markets, growing fortune 500 customer base, rapid growth in non-ITSM markets like HR, Security and product enhancements via strategic acquisitions are key catalysts.

Reasons To Sell:

- ▼ ServiceNow faces stiff competition in the non-ITSM markets from the likes of Oracle and salesforce.com, which are well-established players. Although the company has an edge in the security response market, the customer service and HR solutions faces significant competition from these players. As non-ITSM markets become a larger contributor to the company's total revenue, increasing competition can weigh on growth. Moreover, cut-throat competition can hurt pricing power as well as lengthen the sales cycle, which will negatively impact top-line.
- ▼ ServiceNow has been incurring losses over the last five years and has an accumulated deficit of \$304 million as of Mar 31, 2020. The company anticipates reporting loss in the near term due to increased costs such as non-cash charges associated with equity awards, business combinations and other expenses. Despite the improving top line, mounting losses doesn't bode well for investor confidence.
- ▼ ServiceNow generates a significant portion of revenues from the International market. Adverse foreign currency exchange rates are likely to impede revenue growth in the near term owing to the strengthening of the U.S. dollar compared with the Euro and other foreign currencies, which is a significant concern.

Stiff competition in non-ITSM product segments, modest growth in professional business, continuing losses, muted free cash flow growth and stretched valuation are key negatives.

Last Earnings Report

ServiceNow Beats Q2 Earnings Estimates, Raises '20 View

ServiceNow reported second-quarter 2020 adjusted earnings of \$1.23 per share, which beat the Zacks Consensus Estimate by 20.6% and surged 73.2% year over year.

Revenues of \$1.07 billion beat the consensus mark by 2.3% and increased 28.4% year over year. After adjusting for forex, revenues of \$1.08 billion surged 30% year over year.

Subscription revenues soared 30% year over year to \$1.02 billion. After adjusting for forex, subscription revenues jumped 32% year over year.

Professional services and other revenues increased 4.5% year over year to \$55.3 million. After adjusting for forex, professional services and other revenues climbed 6%.

Following impressive second-quarter results and strengthening adoption of its solutions, ServiceNow raised its 2020 guidance for subscription revenues, billings and gross margin as well as operating margin.

Billing Details

Total billings on a non-GAAP basis rose 24% year over year to \$1.08 billion. After adjusting for forex, total billings increased 26% year over year to \$1.09 billion.

Subscription billings of \$1.02 billion increased 25% year over year. After adjusting for forex, subscription billings were \$1.03 billion, up 26%.

Professional services and other billings increased 13% to \$61 million. After adjusting for forex, professional services and other billings were \$61.7 million, up 14%.

Customer Base Details

Notably, in May, ServiceNow launched its safe-workplace application suite and dashboard that have been downloaded by more than 550 organizations worldwide including Uber, Coca-Cola European Partners and Bank United.

In the quarter under review, ServiceNow completed 40 transactions with more than \$1 million, including two transactions over \$10 million, in net new annual contract value (ACV).

Currently, the company has 964 total customers with more than \$1 million in ACV, up 26% year over year.

ServiceNow's consistent renewal rate of 97% reflects the resilience of the business as the Now platform remains a mission-critical part of its customer's operations.

Markedly, the company closed five deals worth more than \$1 million from verticals, including oil and gas, transportation and health care, which are most affected by the coronavirus. The company also won a large security deal with a U.S.-based multinational hotel chain. The hotel industry has been one of the most impacted sectors.

Notably, 18 of the company's top 20 deals included three or more products. ITSM Pro led eight of the 10 ITSM deals and was included in 17 of the top 20 deals. Further, 15 of the top 20 deals also included security.

ServiceNow completed its largest risk deal in its history with Providence Health & Services, which has 51 hospitals, 121,000 employees and 800 non-acute facilities.

Notable companies that selected the Now platform in the second quarter include JPMorgan, the U.S. State Department, Fiserv, State of Montana and Disney.

ServiceNow closed the largest IT business management and DevOps deal in its history with JPMorgan in the reported quarter.

The company's HR business now has more than 750 customers. In the reported quarter, ServiceNow had eight deals that were greater than \$1 million.

Markedly, Goldman Sachs, which has been an ITSM customer for a long-time, selected ServiceNow's HR solution in the reported quarter.

Additionally, the company has more than 50 customers with ACV of \$1 million that reflects growing momentum in its customer service management (CSM) business.

For instance, ServiceNow CSM solution is helping Zoom Video update its customer service operations. Zoom Video is also using ServiceNow's AIOps capabilities to enable its new hardware as a service business model.

Operating Details

In the second quarter, non-GAAP gross margin was 82.9%, up 240 basis points (bps) on a year-over-year basis. Subscription gross margin expanded 90 bps year over year to 86.7%.

Non-GAAP sales & marketing and general & administrative expenses as percentage of revenues declined 650 bps and 70 bps year over year to 32.4% and 6.6%, respectively.

Quarter Ending 06/2020

Report Date	Jul 29, 2020
Sales Surprise	2.26%
EPS Surprise	20.59%
Quarterly EPS	1.23
Annual EPS (TTM)	4.23

However, non-GAAP research & development expenses as a percentage of revenues grew 40 bps to 16.3%.

Total operating expenses on a non-GAAP basis came in at \$592.7 million in the reported quarter, up 14.3% year over year. As a percentage of revenues, operating expenses fell 680 bps year over year.

ServiceNow's non-GAAP operating margin was 27.5%, up 920 bps on a year-over-year basis. The solid expansion was driven by robust subscription revenues and lower expenses related to coronavirus.

Balance Sheet & Cash Flow

As of Jun 30, 2020, ServiceNow had cash and cash equivalents and short-term investments of \$2.34 billion compared with \$1.86 billion as of Mar 31, 2020.

During the reported quarter, cash from operations came in at \$368.1 million, up 51% year over year.

ServiceNow generated free cash flow of \$259.3 million, up 33.8% year over year. Further, free cash flow margin was 24.2%, up 100 bps on a year-over-year basis.

At the end of the second quarter, remaining performance obligations were roughly \$7 billion, up 31% year over year after adjusted for forex.

Management Changes

ServiceNow appointed Kevin Haverty as chief revenue officer and Lara Caimi as chief customer and partner officer, effective immediately.

Moreover, ServiceNow announced that David Schneider, president of Global Customer Operations, is retiring. Effective immediately, Schneider will step down from his role and serve as President Emeritus until his retirement at year end.

Third-Quarter Guidance

For third-quarter 2020, non-GAAP adjusted subscription revenues are anticipated between \$1.055 billion and \$1.060 billion, which indicates growth of 26-27% year over year.

Non-GAAP adjusted subscription billings are projected between \$995 million and \$1.015 billion, which suggests an increase of 15-17% year over year. After adjusting for forex and fluctuations in billings duration, subscription billings are expected in the range of \$1-\$1.02 billion, indicating 16-18% year-over-year growth.

Further, ServiceNow expects non-GAAP operating margin to be 22%.

Markedly, ServiceNow expects coronavirus-related headwinds to impact third-quarter 2020 results. The company assumes uncertainty around new business, renewal timing or billings terms, particularly with customers in industries like transportation, hospitality, retail and energy that are highly affected by coronavirus. These industries comprise 20% of the company's business.

Moreover, ServiceNow anticipates these economic conditions to persist throughout the remainder of the year.

2020 Guidance

For 2020, non-GAAP adjusted subscription revenues are anticipated between \$4.210 billion and \$4.225 billion, suggesting growth of 29-30% over 2019. Favorable forex is expected to add \$25 million in revenues.

Non-GAAP adjusted subscription billings are projected in the range of \$4.660-\$4.700 billion, which suggests a rise of 23-24% from the year-ago reported figure. After adjusting for forex and fluctuations in billings duration, subscription billings are expected in the range of \$4.70-\$4.74 billion, indicating 24-25% year-over-year growth.

Further, ServiceNow expects non-GAAP subscription margin to be 86% and non-GAAP operating margin to be 24% (up from previous guidance of 23%).

Moreover, non-GAAP free cash flow margin is expected to be 29.5%.

Recent News

On Jul 8, ServiceNow announced the expansion of its partnership with Deloitte to help customers boost their HR Service Delivery (HRSD) efforts and provide enhanced digital experiences to employees.

On Jul 7, ServiceNow announced that the Now platform has been adopted by Zoom ZM to support its new Hardware as a Service (HaaS) business model. Moreover, ServiceNow's customer service management (CSM) offering will be utilized by Zoom to deliver enhanced services to customers.

On Jun 25, ServiceNow announced that it is increasing investment to boost data center capacity and unveiled two new locations across Europe — Newport, the U.K. and Dublin, Ireland. The aim is to drive digital transformation for customers amid the post-Brexit landscape.

On Jun 22, ServiceNow announced that it has inked an agreement to acquire Belgium-based configuration data management startup — Sweagle. The deal will enable ServiceNow to help customers identify and avoid application and infrastructure misconfigurations, which will prevent halts in production and accelerate digital transformation process.

On Jun 10, ServiceNow announced that it had been named as a leader in the 2020 Gartner Magic Quadrant for the CRM Customer Engagement Center.

On Jun 3, ServiceNow unveiled new industry-specific products aimed at speeding up digital transformation in the telecommunications, financial services and healthcare & life science industries.

On May 18, ServiceNow announced the launch of ServiceNow Safe Workplace suite which contains four apps designed to help companies manage the essential steps for returning employees to the workplace and ensure employee health and safety.

On May 5, ServiceNow announced its partnership with software provider Expanse to enable joint customers to automatically view, prioritize, and more quickly remediate critical Internet Asset exposures as incidents.

On May 18, ServiceNow announced the launch of a four-app suite and dashboard designed to help companies manage the essential steps for returning employees to the workplace and ensuring employee health and safety.

Valuation

ServiceNow shares are up 53.5% in the year-to-date period and 58.1% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 18% and 16.5% in the year-to-date period, respectively. In the past year, the Zacks sub-industry and the sector are up 14% and 27.8%, respectively.

The S&P 500 index is up 1% in the year-to-date period and 10.4% in the past year.

The stock is currently trading at 16.52X forward 12-month sales compared with 5.76X for the Zacks sub-industry, 3.98X for the Zacks sector and 3.59X for the S&P 500 index

Over the past five years, the stock has traded as high as 17.31X and as low as 5.38X, with a five-year median of 9.9X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$453 price target reflects 17.35X forward 12-month sales.

The table below shows summary valuation data for NOW

Valuation Multiples - NOW					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	16.52	5.76	3.98	3.59
	5-Year High	17.31	10.11	3.98	3.59
	5-Year Low	5.38	3.91	2.32	2.53
	5-Year Median	9.9	7.03	3.14	3.04
P/B TTM	Current	36.30	18.64	6.05	4.46
	5-Year High	44.95	31.78	6.11	4.56
	5-Year Low	13.22	7.05	3.16	2.83
	5-Year Median	36.08	11.16	4.4	3.72
EV/Sales TTM	Current	20.32	5.78	4.63	3.18
	5-Year High	21.18	8.12	4.63	3.45
	5-Year Low	6.66	3.59	2.59	2.14
	5-Year Median	12.61	5.76	3.65	2.84

As of 07/30/2020

Industry Analysis Zacks Industry Rank: Bottom 28% (183 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
ASGN Incorporated (ASGN)	Neutral	2
Amdocs Limited (DOX)	Neutral	3
EPAM Systems, Inc. (EPAM)	Neutral	3
Fair Isaac Corporation (FICO)	Neutral	3
Infosys Limited (INFY)	Neutral	2
Inovalon Holdings, Inc. (INOV)	Neutral	3
CDW Corporation (CDW)	Underperform	3
DXC Technology Company. (DXC)	Underperform	5

Industry Comparison Industry: Computers - It Services				Industry Peers		
	NOW	X Industry	S&P 500	CDW	DOX	EPAM
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	A	A	B
Market Cap	82.27 B	3.12 B	22.57 B	16.46 B	8.20 B	15.97 B
# of Analysts	13	5	14	6	5	10
Dividend Yield	0.00%	0.00%	1.83%	1.31%	2.15%	0.00%
Value Score	F	-	-	B	A	D
Cash/Price	0.02	0.07	0.07	0.01	0.09	0.06
EV/EBITDA	147.22	9.50	12.96	14.40	9.88	44.28
PEG Ratio	3.67	2.42	3.04	1.62	1.65	3.33
Price/Book (P/B)	33.19	5.60	3.13	18.50	2.29	9.69
Price/Cash Flow (P/CF)	140.30	11.28	12.61	14.36	10.68	48.00
P/E (F1)	102.71	35.54	22.06	21.18	14.01	51.89
Price/Sales (P/S)	20.80	2.34	2.42	0.89	1.98	6.59
Earnings Yield	0.98%	2.33%	4.31%	4.72%	7.13%	1.93%
Debt/Equity	0.46	0.23	0.75	4.01	0.06	0.13
Cash Flow (\$/share)	3.07	1.07	6.94	8.05	5.70	5.98
Growth Score	A	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	NA%	18.58%	10.85%	22.51%	6.65%	28.92%
Proj. EPS Growth (F1/F0)	27.85%	-5.86%	-7.75%	-10.44%	0.79%	2.07%
Curr. Cash Flow Growth	49.82%	15.98%	5.39%	10.39%	2.45%	27.45%
Hist. Cash Flow Growth (3-5 yrs)	106.38%	16.03%	8.55%	13.51%	3.85%	26.53%
Current Ratio	1.17	1.44	1.31	1.28	1.25	3.87
Debt/Capital	31.36%	34.66%	44.32%	80.04%	5.75%	11.51%
Net Margin	18.42%	1.75%	10.44%	4.07%	11.98%	11.79%
Return on Equity	11.09%	9.17%	14.73%	97.93%	16.03%	18.45%
Sales/Assets	0.67	0.76	0.52	2.32	0.76	1.14
Proj. Sales Growth (F1/F0)	25.49%	0.42%	-1.95%	-2.76%	0.95%	12.10%
Momentum Score	A	-	-	B	D	C
Daily Price Chg	-3.21%	0.00%	-0.92%	0.04%	-0.62%	0.89%
1 Week Price Chg	0.80%	0.14%	0.37%	-3.33%	1.59%	3.56%
4 Week Price Chg	4.15%	4.29%	4.14%	-1.21%	1.42%	14.75%
12 Week Price Chg	12.98%	20.09%	12.21%	8.46%	-6.53%	26.45%
52 Week Price Chg	57.44%	1.32%	-1.73%	-2.39%	-3.87%	48.16%
20 Day Average Volume	1,545,994	386,140	1,887,986	631,099	787,669	275,904
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.68%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.38%	0.68%	0.00%	0.00%
(F1) EPS Est 12 week change	0.00%	-0.96%	-0.07%	-4.06%	-1.92%	-5.29%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.16%	-0.18%	0.00%	0.00%

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	A
Momentum Score	A
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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