

ON Semiconductor (ON)

\$14.72 (As of 05/14/20)

Price Target (6-12 Months): **\$13.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 02/04/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: B

Growth: D

Momentum: D

Summary

ON Semiconductor reported sluggish first-quarter results, with earnings and revenues declining year over year. Softness in demand from industrial, automotive and consumer end-markets due to the COVID-19 outbreak impacted the top-line. Weakness in smartphone and 5G infrastructure verticals also hurt growth. Moreover, significant exposure in China and supply chain disruptions amid the coronavirus crisis is a concern. Further, increasing investments on portfolio expansion and product enhancements is anticipated to put pressure on the bottom line at least in the near term. Notably, shares of ON Semiconductor have underperformed the industry in the past year. Nonetheless, continued growth in advanced driver-assistance systems (ADAS) and vehicle electrification design wins are likely to aid the top line in the days ahead.

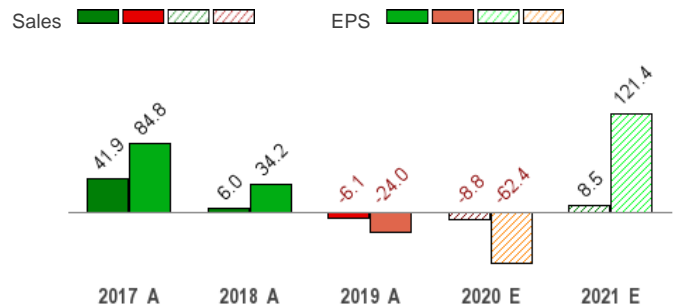
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$25.92 - \$8.17
20 Day Average Volume (sh)	8,102,888
Market Cap	\$6.0 B
YTD Price Change	-39.6%
Beta	2.27
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Semiconductor - Analog and Mixed
Zacks Industry Rank	Top 30% (75 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-33.3%
Last Sales Surprise	-1.6%
EPS F1 Est- 4 week change	-41.3%
Expected Report Date	08/03/2020
Earnings ESP	-66.7%
P/E TTM	12.8
P/E F1	26.3
PEG F1	3.7
P/S TTM	1.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,288 E	1,347 E	1,409 E	1,417 E	5,460 E
2020	1,278 A	1,180 E	1,264 E	1,302 E	5,033 E
2019	1,387 A	1,348 A	1,382 A	1,402 A	5,518 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.20 E	\$0.27 E	\$0.34 E	\$0.35 E	\$1.24 E
2020	\$0.10 A	\$0.04 E	\$0.15 E	\$0.22 E	\$0.56 E
2019	\$0.43 A	\$0.42 A	\$0.33 A	\$0.30 A	\$1.49 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 05/14/2020. The reports text is as of 05/15/2020.

Overview

Phoenix, AZ-based ON Semiconductor Corporation is an original equipment manufacturer (OEM) of a broad range of discrete and embedded semiconductor components. The company was spun off from Motorola in Aug 1999 and went public through an IPO in May 2000.

ON Semi's product lines include discretes, such as bipolar transistors, diodes, filters, FETs, rectifiers and thyristors.

ON Semi's acquisition of Fairchild Semiconductor International makes it a leader in the power semiconductor space. Moreover, the company's acquisitions of Cypress Semiconductor's CMOS Image Sensor Business Unit, SANYO Semiconductor, AMI Semiconductor, Analog Devices' power PC controller business, CMD, Catalyst, and SoundDesign gave it new technical capabilities, some custom ASIC products, higher-margin products, exposure to new end markets and greater product breadth.

The power management product line includes AC-DC controllers and regulators, DC-DC converters and regulators, drivers, thermal managers, and voltage controllers, references and supervisors.

The logic product line includes clocking, memory, differential logic and standard logic products.

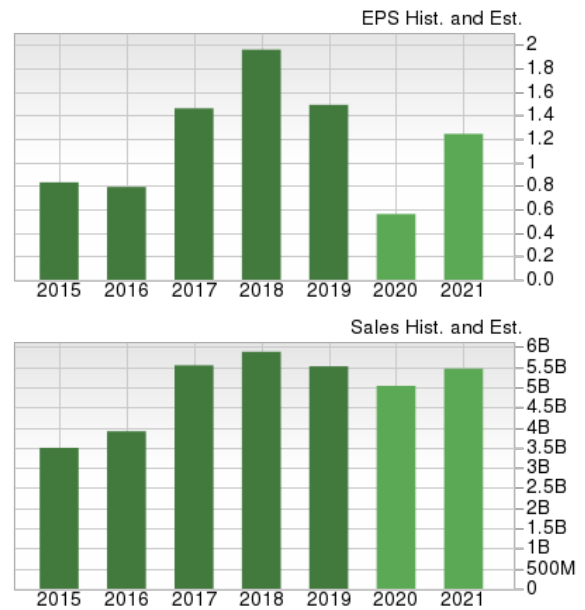
Signal processing products include amplifiers and comparators, analog switches, digital potentiometers, DSP systems and interfaces.

The company also offers custom application specific integrated circuits (ASICs), foundry services and memory products.

Customers include OEMs, electronic manufacturing service (EMS) providers and distributors. Top OEM customers include Motorola, Delta, Hewlett-Packard, Samsung, Siemens, Apple, Dell, Nokia, Intel, Sony, Continental Automotive Systems, DaimlerChrysler, Delphi, TRW and Visteon.

Top distributor customers include Arrow, Avnet, EBV Elektronik, Future, Solomon Enterprise and World Peace. Top EMS customers are Flextronics, Jabil and Celestica. In 2019, the company reported revenues of \$5.518 billion. ON Semi generated 14.7% of total revenues in 2019 from the United States.

The company's 10 largest customers contributed around 27% to total revenues in 2019.



Reasons To Sell:

- ▼ ON Semi has a significant debt burden, but management has been dealing with the difficult situation through consistent repayments and refinancing actions. The acquisition of Fairchild will add to the company's debt burden. Interest payments will continue to have a significant impact on net earnings. A high debt position increases the risk profile of the business. As of Apr 3, 2020, the company's net debt was \$2.751 billion compared with \$2.718 billion as of Dec 31, 2019. Moreover, total debt to total capital of 52.1% is higher than the industry's figure of 43.3%. Further, times interest earned currently stands at 2.9X compared with the industry's figure of 4.5X. Thus, the company is required to constantly generate adequate amount of cash flows to meet debt requirements.
- ▼ ON Semi has made several acquisitions in the past, but the two acquisitions that were completed in 2008 were perhaps the most significant. Integration of AMIS continued right up to 2010, even after years from the date the acquisition was completed. SANYO Semiconductor was another difficult acquisition and while it recently turned incremental to earnings, the margin impact may not be positive, given that it is a lagging edge facility. Consistent acquisition of companies is a distraction for management until the integration activities are completed. Moreover, we note that the buyouts negatively impacted the company's balance sheet in the form of high level of goodwill and net intangible assets, which comprised 23.6% of total assets as of Apr 3.
- ▼ ON Semi faces significant competition in all the served markets. Being a maker of building block components of a general-purpose nature, competition comes from every kind of integrated circuit manufacturer. The automotive market in Japan is particularly competitive, where the company must get designed in at an early stage. This is mainly because Japanese automotive customers prefer local makers that sometimes makes it difficult to operate.
- ▼ ON Semi's restructuring actions will likely have a positive impact on margins over the next year or so. Further, its recent acquisitions have increased its exposure to industrial, automotive and consumer markets that have helped it diversify away from a sluggish computing market. Some of these markets can generate higher margins than the traditional business, which is a positive. The company also stands to benefit from share gains within the computing business, considering the increasing dollar content at Intel's new process architecture. However, the company is considering cutting down utilization, as broader markets are witnessing weaker demand trends. This will invariably lead to poorer fixed cost absorption, thus eroding margins.
- ▼ ON Semi derives significant proportion of revenues from outside the United States (almost 85.3% of total revenues in 2019), subjecting the company to exchange rate volatility. Unfavorable movement in exchange rates of foreign currencies like Hong Kong dollar, euro, pound sterling, and Singapore Dollar, among others, related to the U.S. dollar can adversely impact results and undermine its growth potential to some extent. Further, imposition of tariffs owing to trade war between the United States and China amid coronavirus crisis is anticipated to negatively impact growth prospects. The macroeconomic uncertainty has impacted investors' confidence and is likely to weigh on the company's performance.

The significant debt position, integration risks from acquisitions, rising spend on restructuring initiatives and ever-increasing competition remain major headwinds.

Risks

- ON Semi is seeing strengthening demand across most end markets as evident from its bookings trends over the last few quarters. The company's backlog grew in each of the last four quarters and since it generates just a fifth of sales from turns, backlog growth is a good indicator of sustained demand. Also, increasing distributor inventories and strong resales is a positive. The design win momentum that the company is seeing also remained encouraging.
 - ON Semi's automotive segment is a strong growth driver for the company. Unit growth, share gains, attractive product offerings, rising content along with decreasing oil prices contribute to revenues. During the fourth quarter, the automotive segment registered a few impressive design wins for ADAS and rear-view cameras with leading OEMs in the Americas, Europe and South Korea. Also, the company is focused on investing in growth areas such as ADAS and wireless charging in the automotive business to broaden its exposure. This will further enhance its performance and help it deliver strong results. Given rising demand, ON Semi launched three new image sensors for ADAS and rear-view applications. Also demand for image sensors, MOSFET's, Smart FET's, led drivers, wireless battery free sensing solution, parking sensor interface and power supply products is strong. The product launches in the automotive end market for next generation automobile designs augur well for the top line.
 - ON Semi is active on the M&A front. The company's acquisitions of Cypress Semiconductor's CMOS Image Sensor Business Unit, SANYO Semiconductor, AMI Semiconductor, Analog Devices' power PC controller business, CMD, Catalyst, and SoundDesign gave it new technical capabilities, some custom ASIC products, higher-margin products, exposure to new end markets and greater product breadth. ON Semi's acquisition of Fairchild Semiconductor International makes it a leader in the power semiconductor space. The deal will help the company diversify across many markets with a planned focus on smartphone, automotive and industrial end markets. ON Semi has also acquired Quantenna Communications (June 2019), which is engaged in providing high performance Wi-Fi solutions. The transaction is anticipated to strengthen the company's connectivity portfolio and enable it to better address Industrial and Automotive end markets.
 - ON Semi has successfully integrated big acquisitions like AMIS in the past, so it shouldn't have trouble with the integration. Management expects Fairchild acquisition to be immediately accretive to non-GAAP earnings and free cash flow. Further gains are expected within a few quarters of close. Annual cost savings of at least \$150 million are expected within 18 months of closing. We believe that ON Semi can drive new socket opportunities by leveraging these acquisitions, thus generating top-line growth.
 - ON Semi has a very well diversified business. The company generates a significant percentage of revenues from each of the computing, consumer, industrial, communications and automotive markets. This mitigates the impact of seasonality typical of any of the markets, resulting in balanced growth through the year. Moreover, this diversity also helps the company to offset any weakness in a market by growth in others.
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Last Earnings Report

ON Semiconductor Q1 Earnings Miss Estimates, Down Y/Y

ON Semiconductor Corporation reported first-quarter 2020 non-GAAP earnings of 10 cents per share, which lagged the Zacks Consensus Estimate by 33.3%. Notably, the figure declined 76.7% from the year-ago quarter's level.

Revenues of \$1.278 billion declined 7.8% on a year-over-year basis. Supply chain disruptions and fall in demand due to COVID-19 induced lockdowns caused the downturn.

The company intends to expand margins by enhancing manufacturing footprint and accelerate the timeline for production with investments in the 300mm fab in east Fishkill. Moreover, it is undertaking measures like reduction in executive salaries and board member compensation to maintain liquidity in this time of crisis.

Top-Line Details

Business Units Metrics:

ON Semiconductor has three business units — Power Solutions Group (revenues of \$624 million), Analog Solutions Group (revenues of \$467 million) and Image Sensor Group (revenues of \$187 million).

End-Market Metrics:

Automotive (34% of revenues) end-market revenues were approximately \$439 million, down 6% year over year. The decline was caused by closure of automotive factories globally and disruption in supply chain due to COVID-19.

Notably, management noted weakness in China earlier in the quarter but there has been a slight recovery as factories started to reopen. Moreover, there is significant weakness in U.S. and European markets.

However, the company holds a competitive edge over its peers when it comes to delivering a comprehensive image sensor solution for autonomous driving applications and ADAS. ON secured a design win for ADAS image sensors with a major Japanese OEM during the first quarter.

Moreover, the company witnessed strong traction for its silicon carbide (SiC) and silicon power products driven by growth in electric vehicles (EVs). Extension of subsidies for electric vehicles in China till 2022 also bodes well for its silicon carbide and IGBT business.

Industrial/Medical/Mil-Aero (25%) end-market revenues declined 12% year over year to \$315 million, thanks to fall in global industrial activity and supply chain disruptions due to COVID-19.

Nevertheless, the company is witnessing strong demand for SiC modules, which holds promise. During the first quarter, the company witnessed a design win for its high-voltage super-junction MOSFETs for EV charging stations.

In the medical end-market, the company is taking measures to support higher COVID-19 induced demand for components of medical equipment like ventilators, infusion pumps, patient monitoring systems and cardiac assist systems.

Moreover, robust pipeline for the company's CMOS image sensors across e-commerce vertical for warehouse automation systems and delivery robots is expected to be a key catalyst in the days ahead.

Communications (20%) end-market revenues declined 1% year over year to \$254 million due to sluggishness in the smartphone business. However, the company witnessed robust growth in the 5G infrastructure business.

Computing (11%) declined 7% year over year to \$136 million due to the company's selective participation in the client-related business. ON Semiconductor witnessed robust momentum in the server business as companies are enhancing their IT infrastructure to support the growing work-from-home trend.

Consumer (10%) end-market revenues came in at \$134 million. The figure declined 17% from the year-ago quarter's level, primarily due to softness in consumer electronics stemming from COVID-19.

Margins in Detail

Non-GAAP gross margin of 31.5% contracted 550 basis points (bps) on a year-over-year basis. Management attributes the decline to lower revenues and lower level of factory utilization.

Non-GAAP operating expenses increased 6.7% from the year-ago quarter's figure to \$318.7 million, driven by costs pertaining to the acquisition of Quantenna. As a percentage of revenues, the figure expanded 250 bps on a year-over-year basis to 24.9%.

Non-GAAP operating margin contracted 890 bps on a year-over-year basis to 6.6%, owing to lower gross margin.

Balance Sheet & Cash Flow

As of Apr 3, 2020, ON Semiconductor had cash and cash equivalents of \$1.982 billion, compared with \$894.2 million as of Dec 31, 2019.

In the first quarter, the company had total debt (including current portion) of \$4.733 billion, up from \$3.613 billion in the last reported quarter.

Quarter Ending **03/2020**

Report Date	May 09, 2020
Sales Surprise	-1.56%
EPS Surprise	-33.33%
Quarterly EPS	0.10
Annual EPS (TTM)	1.15

During the reported quarter, cash from operations came in at \$166 million compared with the prior-quarter's figure of \$91.7 million.

Free cash flow came in at \$33.7 million compared with \$20.7 million free cash outflow in the previous quarter.

Guidance

For second-quarter 2020, ON Semiconductor projects revenues in the range of \$1.10-\$1.26 billion.

Management expects revenues from Automotive end-market to decline sequentially in the second quarter. Revenues from Industrial end-market are anticipated to improve on a quarter-over-quarter basis. Meanwhile, Communications and Consumer end-markets are anticipated to decline sequentially in the first quarter, while Computing is expected to increase.

For the second quarter, non-GAAP gross margin is projected in the range of 29-31%. Non-GAAP operating expenses are expected in the range of \$297-\$313 million.

Recent News

On May 6, ON Semiconductor announced its collaboration with Airspan Networks to develop Wi-Fi 6 performance solutions, utilizing the QCS-AX chipset for Fixed Wireless Access (FWA) applications.

On Apr 27, ON Semiconductor expanded its NXH family of transfer-molded power integrated modules (TM-PIM) to strengthen its portfolio of Industrial Motor Drive Applications.

On Apr 21, ON Semiconductor unveiled its new QCS-AX2 chipset family that supports the 6GHz spectrum band to support Wi-Fi 6E Applications.

On Mar 24, ON Semiconductor announced withdrawal of \$1.17 billion from its revolving credit facility, to maintain sufficient liquidity in coronavirus-hit uncertain macroeconomic environment.

On Mar 10, ON Semiconductor launched the 900 V and 1200 V SiC MOSFETs, which offer significantly better performance than Si MOSFETs.

On Mar 9, ON Semiconductor introduced the Connected Lighting Platform to drive innovation of Smart LED lighting solutions.

On Mar 6, ON Semiconductor updated first-quarter 2020 guidance on COVID-19 impact. The company forecasts first-quarter 2020 revenues in the range of \$1.275-\$1.325 billion, compared with earlier guided range of \$1.355-\$1.405 billion.

On Feb 26, ON Semiconductor unveiled the FAN6390 and NCP12601 USB-C PD 3.0 Controllers which have advanced feature sets and enhanced efficiency.

On Feb 4, ON Semiconductor introduced two LED drivers and two current controllers to power advanced vehicle lighting applications and improve road safety.

On Feb 3, ON Semiconductor announced intention to expand margins by enhancing manufacturing footprint and accelerate the timeline for production with the acquisition of 300mm East Fishkill fab. Moreover, the company also announced plans of selling its six-inch manufacturing facility in Oudenaarde, Belgium.

Valuation

ON Semiconductor shares are down 39.6% in the year-to-date period and 25.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are down 15.6% and 1.3%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and sector are up 1.3% and 10.5%, respectively.

The S&P 500 index is down 11.5% in the year-to-date period and 1.2% in the past year.

The stock is currently trading at 14.07X forward 12-month earnings, which compares to 23.94X for the Zacks sub-industry, 23.23X for the Zacks sector and 20.67X for the S&P 500 index.

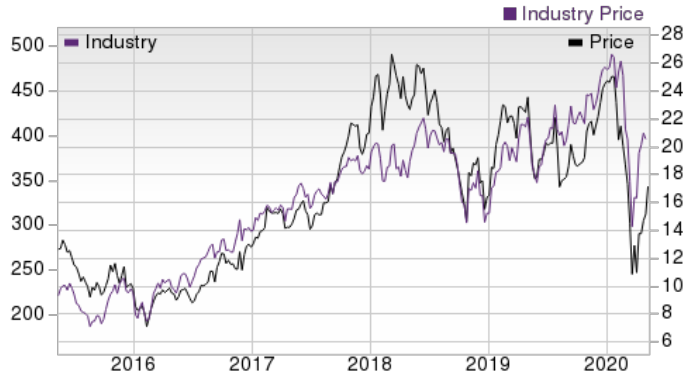
Over the past five years, the stock has traded as high as 16.62X and as low as 6.48X, with a 5-year median of 11.2X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$13 price target reflects 12.5X forward 12-month earnings.

The table below shows summary valuation data for ON

Valuation Multiples -ON					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.07	23.94	23.23	20.67
	5-Year High	16.62	23.94	23.23	20.79
	5-Year Low	6.48	13.42	16.71	15.19
	5-Year Median	11.2	18.12	19.26	17.45
P/S F12M	Current	1.13	4.23	3.53	3.22
	5-Year High	2	4.52	3.59	3.44
	5-Year Low	0.62	2.81	2.32	2.54
	5-Year Median	1.28	3.7	3.10	3.02
EV/Sales TTM	Current	1.5	4.86	3.84	2.72
	5-Year High	2.37	5.52	4.43	3.45
	5-Year Low	0.9	3.13	2.58	2.15
	5-Year Median	1.83	4.38	3.57	2.8

As of 05/14/2020

Industry Analysis Zacks Industry Rank: Top 30% (75 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Analog Devices, Inc. (ADI)	Neutral	3
Microchip Technology Incorporated (MCHP)	Neutral	3
Monolithic Power Systems, Inc. (MPWR)	Neutral	3
MagnaChip Semiconductor Corporation (MX)	Neutral	3
Maxim Integrated Products, Inc. (MXIM)	Neutral	3
Semtech Corporation (SMTC)	Neutral	3
NXP Semiconductors N.V. (NXPI)	Underperform	5
Silicon Laboratories, Inc. (SLAB)	Underperform	4

Industry Comparison Industry: Semiconductor - Analog And Mixed				Industry Peers		
	ON	X Industry	S&P 500	ADI	AVGO	DIOD
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	D	-	-	D	B	B
Market Cap	6.03 B	5.66 B	18.95 B	38.84 B	106.58 B	2.23 B
# of Analysts	11	9	14	12	12	1
Dividend Yield	0.00%	0.00%	2.2%	2.35%	4.88%	0.00%
Value Score	B	-	-	D	C	C
Cash/Price	0.13	0.09	0.06	0.02	0.06	0.10
EV/EBITDA	8.89	16.96	11.58	17.00	15.04	6.36
PEG Ratio	3.56	1.97	2.60	1.95	1.09	NA
Price/Book (P/B)	1.86	3.69	2.59	3.32	4.37	1.88
Price/Cash Flow (P/CF)	4.95	16.37	10.20	14.21	7.85	8.50
P/E (F1)	25.38	33.59	19.00	24.40	12.60	21.23
Price/Sales (P/S)	1.12	4.44	1.93	6.75	4.70	1.82
Earnings Yield	3.80%	3.01%	5.05%	4.10%	7.94%	4.71%
Debt/Equity	1.25	0.57	0.75	0.41	1.74	0.04
Cash Flow (\$/share)	2.97	2.91	7.01	7.42	33.97	5.12
Growth Score	D	-	-	D	C	B
Hist. EPS Growth (3-5 yrs)	24.74%	14.19%	10.82%	19.53%	25.01%	31.39%
Proj. EPS Growth (F1/F0)	-62.42%	-13.50%	-10.48%	-16.03%	-0.58%	-29.55%
Curr. Cash Flow Growth	-10.63%	-12.47%	5.68%	-9.88%	8.07%	15.35%
Hist. Cash Flow Growth (3-5 yrs)	14.73%	22.53%	8.52%	24.75%	48.32%	12.13%
Current Ratio	2.32	2.56	1.27	1.08	1.56	3.02
Debt/Capital	55.53%	38.02%	44.25%	28.87%	63.52%	3.75%
Net Margin	1.55%	2.31%	10.54%	21.06%	11.64%	11.54%
Return on Equity	14.62%	11.96%	16.29%	15.38%	32.46%	12.52%
Sales/Assets	0.62	0.47	0.54	0.27	0.31	0.76
Proj. Sales Growth (F1/F0)	-8.78%	-6.28%	-2.55%	-10.58%	3.90%	-8.65%
Momentum Score	D	-	-	A	B	C
Daily Price Chg	4.73%	0.98%	1.17%	1.63%	1.31%	2.47%
1 Week Price Chg	13.23%	8.85%	3.23%	5.97%	5.90%	6.66%
4 Week Price Chg	10.35%	7.24%	1.06%	3.59%	3.22%	-2.97%
12 Week Price Chg	-28.57%	-13.58%	-22.80%	-15.30%	-13.79%	-9.99%
52 Week Price Chg	-25.49%	-0.57%	-12.40%	0.75%	-10.32%	18.33%
20 Day Average Volume	8,102,888	1,102,334	2,553,422	2,175,221	2,324,675	304,605
(F1) EPS Est 1 week change	-35.23%	0.00%	0.00%	0.12%	0.00%	-21.15%
(F1) EPS Est 4 week change	-41.33%	-2.30%	-5.57%	0.12%	0.00%	-21.15%
(F1) EPS Est 12 week change	-59.69%	-31.66%	-16.22%	-9.46%	-9.71%	-21.15%
(Q1) EPS Est Mthly Chg	-79.31%	0.00%	-11.63%	0.00%	0.00%	-26.47%

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	B
Growth Score	D
Momentum Score	D
VGM Score	D

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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