

## ON Semiconductor (ON)

**\$21.66** (As of 08/19/20)

Price Target (6-12 Months): **\$23.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 05/14/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

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

**3-Hold**

Zacks Style Scores:

VGM:B

Value: C

Growth: D

Momentum: A

### Summary

ON Semiconductor reported bleak second quarter results, wherein earnings and revenues declined year over year. Softness in demand from industrial, automotive and consumer end-markets due to the COVID-19 outbreak impacted the top line. Nonetheless, solid momentum in image sensors amid consistent growth in advanced driver-assistance systems (ADAS) and vehicle electrification domains holds promise. Moreover, strong traction for silicon carbide (SiC) and silicon power products driven by growth in electric vehicles (EVs) bodes well. Further, robust growth in the 5G infrastructure business favors growth prospects. However, sluggishness in the smartphone vertical is an overhang. Moreover, supply chain disruptions amid the coronavirus crisis remain a concern. Notably, shares of ON Semiconductor have underperformed the industry on a year-to-date basis.

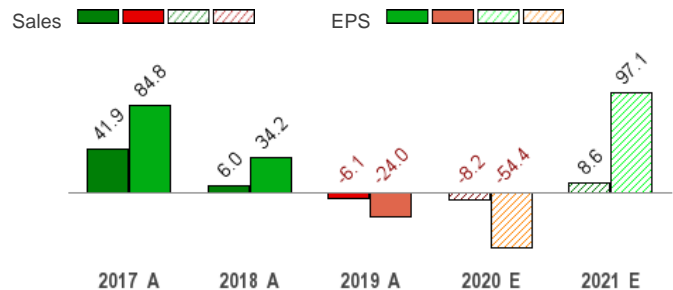
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$25.92 - \$8.17
20 Day Average Volume (sh)	6,051,974
Market Cap	\$8.9 B
YTD Price Change	-11.2%
Beta	2.21
Dividend / Div Yld	\$0.00 / 0.0%
Industry	<a href="#">Semiconductor - Analog and Mixed</a>
Zacks Industry Rank	Top 20% (50 out of 252)

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



Last EPS Surprise	500.0%
Last Sales Surprise	2.6%
EPS F1 Est- 4 week change	24.0%
Expected Report Date	10/26/2020
Earnings ESP	-0.4%
P/E TTM	25.5
P/E F1	31.9
PEG F1	4.5
P/S TTM	1.7

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,293 E	1,349 E	1,420 E	1,436 E	5,497 E
2020	1,278 A	1,214 A	1,267 E	1,308 E	5,064 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	\$0.23 E	\$0.30 E	\$0.37 E	\$0.39 E	\$1.34 E
2020	\$0.10 A	\$0.12 A	\$0.19 E	\$0.25 E	\$0.68 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 08/19/2020. The reports text is as of 08/20/2020.

## 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.

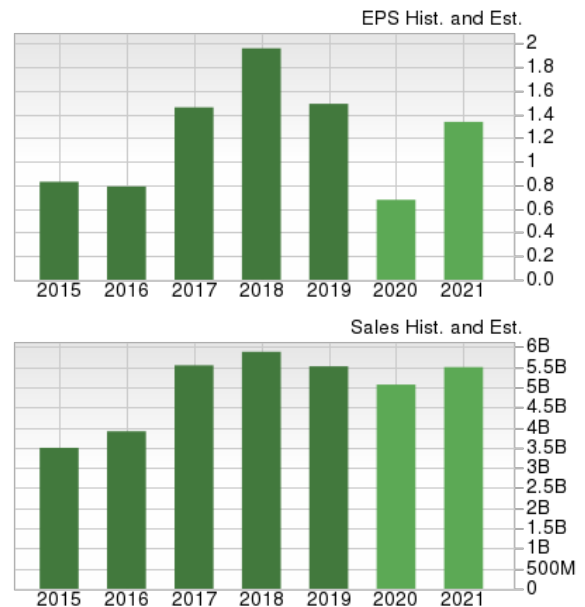
Signal processing products include amplifiers and comparators, analog switches, digital potentiometers, DSP systems and interfaces.

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.



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## Reasons To Buy:

- ▲ 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.

Improving end markets, acquisitions, product breadth, diversification across end markets and geographies, and the benefits of restructuring actions are positives.

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## 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 is expected to have added 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 Jul 3, 2020, the company's net debt was \$2.68 billion compared with \$2.751 billion as of Apr 3, 2020. Moreover, total debt to total capital of 59.3% is higher than the industry's figure of 48.5%. Further, times interest earned currently stands at 0.9X compared with the industry's figure of 3.4X. 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% of total assets as of Jul 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.

## Last Earnings Report

### ON Semiconductor Q2 Earnings Top Estimates

ON Semiconductor Corporation reported second-quarter 2020 non-GAAP earnings of 12 cents per share, which comfortably surpassed the Zacks Consensus Estimate of 2 cents. However, the figure declined 71% from the year-ago quarter's level.

Revenues of \$1.214 billion declined 10% on a year-over-year basis. The slowdown in macroeconomic activity across the world due to COVID-19 induced lockdowns caused the plunge.

ON Semiconductor intends to expand margins by streamlining its manufacturing footprint and accelerate the timeline for production with investments in the 300mm fab in east Fishkill. In the second quarter, the company initiated its first 300mm wafer production at East Fishkill lab. Moreover, it is considering potential sale of its six-inch fab located in Niigata, Japan.

Quarter Ending **06/2020**

Report Date	Aug 08, 2020
Sales Surprise	2.58%
EPS Surprise	500.00%
Quarterly EPS	0.12
Annual EPS (TTM)	0.85

### Top-Line Details

#### Business Units Metrics:

ON Semiconductor has three business units — Power Solutions Group (revenues of \$618 million), Analog Solutions Group (revenues of \$427 million) and Image Sensor Group (revenues of \$168 million).

#### End-Market Metrics:

Automotive (27% of revenues) end-market revenues were \$327 million, down 26% year over year. The decline was caused by closure of automotive factories globally due to COVID-19.

However, management noted that both U.S. and European markets have begun to recover slowly. The recovery is anticipated to continue throughout the year.

Markedly, 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. In the second quarter, the company bagged a major design win for its surround vision applications.

Moreover, the company continues to witness strong traction for its IGBT modules, silicon carbide (SiC) and silicon power products driven by growth in electric vehicles ("EVs"). Growing clout of the company's solutions are expected to instill investors' optimism regarding the stock in the upcoming days.

Industrial/Medical/Mil-Aero (29%) end-market revenues declined 3% year over year to \$348 million due to coronavirus crisis-induced sluggishness in industrial activity and supply chain disruptions.

Nevertheless, management noted strong traction for SiC products utilized in industrial power applications.

Moreover, the company is gearing up for its first industrial IoT connectivity product in a year's timeframe. Synergies from Quantenna acquisition are enabling the company to launch the product with robust Wi-Fi technology capabilities.

Communications (21%) end-market revenues increased 3% year over year to \$255 million owing to robust growth in the 5G infrastructure business.

Computing (13%) end-market revenues increased 14% year over year to \$158 million, courtesy of strong client and server business.

Consumer (10%) end-market revenues came in at \$126 million. The figure declined 22% 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 30.8% contracted 630 basis points (bps) on a year-over-year basis. Per management, the decline was caused by lower revenues and additional costs due to COVID-19.

Non-GAAP operating expenses dropped 1.2% from the year-ago quarter's figure to \$284.6 million, due to restructuring and cost containment measures.

Non-GAAP operating margin contracted 830 bps on a year-over-year basis to 7.4%, owing to lower gross margin.

### Balance Sheet & Cash Flow

As of July 3, 2020, ON Semiconductor had cash and cash equivalents of \$2.06 billion, compared with \$1.982 billion as of April 3, 2020.

In the second quarter, the company had total debt (including current portion) of \$4.74 billion, compared with \$4.733 billion in the last reported quarter.

During the reported quarter, cash from operations came in at \$154.5 million compared with the prior-quarter's figure of \$166 million.

Free cash flow came in at \$81.2 million compared with \$33.7 million in the previous quarter.

### Guidance

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For third-quarter 2020, ON Semiconductor projects revenues in the range of \$1.20-\$1.33 billion.

Management expects revenues from Automotive end-market to increase sequentially in the third quarter, driven by uptick in global automotive production.

Revenues from Industrial end-market are anticipated to decline on a quarter-over-quarter basis. Meanwhile, Communications end-market revenues are anticipated to decline sequentially in the third quarter. Revenues from Computing end-market is expected to increase on strength in client and server verticals. Consumer end-markets revenues is expected to increase in the third quarter due to seasonality.

For the third quarter, non-GAAP gross margin is projected in the range of 32-34%. Non-GAAP operating expenses are expected in the range of \$277-\$293 million.

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## Recent News

On Aug 19, ON Semiconductor announced the pricing of 3.875% Senior Notes slated to mature in 2028 worth \$700 million. The sale will close on Aug 21 subject to closing conditions.

On Aug 8, ON Semiconductor announced that it is considering to sell its manufacturing facility located in Niigata, Japan.

On Jul 20, ON Semiconductor unveiled a SiC module for solar inverter applications, which was chosen by Delta for its M70A three-phase PV string inverter portfolio.

On Jul 6, ON Semiconductor announced that its high-power insulated-gate bipolar transistors (IGBTs) and diodes have been selected by Danfoss to power inverter traction modules for the electric vehicles market.

On Jun 23, ON Semiconductor unveiled a Bluetooth Low Energy mesh networking solution based on its RSL10 System-in-Package (RSL10 SIP). The solution is optimized for building automation, smart home, industrial IoT, remote environment monitoring and asset tracking applications.

On Jun 8, ON Semiconductor announced that its board of directors has adopted a short-term stockholder rights plan designed to protect stockholder interests by ensuring that no person or group can gain control of the company through the open-market accumulation of shares.

On May 21, ON Semiconductor announced that Bernard R. Colpitts, Jr. has been appointed as the chief accounting officer of ON Semiconductor Corporation and its wholly-owned subsidiary, Semiconductor Components Industries, LLC.

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.

## Valuation

ON Semiconductor shares have declined 11.1% in the year-to-date period but are up 17.4% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 5.3% and 21.6% in the year-to-date period, respectively. In the past year, the Zacks sub-industry and sector are up 20.5% and 35.6%, respectively.

The S&P 500 index is up 4.8% in the year-to-date period, and 15.6% in the past year.

The stock is currently trading at 19.75X forward 12-month earnings compared with 25.53X for the Zacks sub-industry, 26.41X for the Zacks sector and 22.78X for the S&P 500 index.

In the past five years, the stock has traded as high as 24.28X and as low as 6.48X, with a five-year median of 11.32X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$23 price target reflects 20.97X 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	19.75	25.53	26.41	22.78
	5-Year High	24.28	27.04	26.41	22.78
	5-Year Low	6.48	13.42	16.72	15.25
	5-Year Median	11.32	18.16	19.61	17.58
P/S F12M	Current	1.67	5.01	4.1	3.7
	5-Year High	2	5.01	4.1	3.7
	5-Year Low	0.62	2.81	2.32	2.53
	5-Year Median	1.29	3.74	3.14	3.05
EV/Sales TTM	Current	2.06	5.82	4.78	3.29
	5-Year High	2.37	5.83	4.8	3.46
	5-Year Low	0.9	3.13	2.59	2.14
	5-Year Median	1.85	4.45	3.63	2.87

As of 08/19/2020

## Industry Analysis Zacks Industry Rank: Top 20% (50 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
Analog Devices, Inc. (ADI)	Outperform	2
Maxim Integrated Products, Inc. (MXIM)	Outperform	2
Silicon Laboratories, Inc. (SLAB)	Outperform	2
Microchip Technology Incorporated (MCHP)	Neutral	3
Monolithic Power Systems, Inc. (MPWR)	Neutral	3
MagnaChip Semiconductor Corporation (MX)	Neutral	2
NXP Semiconductors N.V. (NXPI)	Neutral	3
Semtech Corporation (SMTC)	Neutral	3

Industry Comparison Industry: Semiconductor - Analog And Mixed				Industry Peers		
	ON	X Industry	S&P 500	ADI	AVGO	DIOD
Zacks Recommendation (Long Term)	Neutral	-	-	Outperform	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	2	2	3
VGM Score	B	-	-	D	D	B
Market Cap	8.90 B	7.39 B	23.61 B	43.53 B	132.40 B	2.61 B
# of Analysts	11	9	14	12	13	2
Dividend Yield	0.00%	0.00%	1.65%	2.10%	3.95%	0.00%
Value Score	C	-	-	D	C	B
Cash/Price	0.23	0.08	0.07	0.02	0.07	0.19
EV/EBITDA	10.54	19.74	13.36	18.96	17.75	7.56
PEG Ratio	4.37	2.47	2.99	1.89	1.27	NA
Price/Book (P/B)	2.72	5.49	3.16	3.70	5.53	2.16
Price/Cash Flow (P/CF)	7.29	22.27	12.71	15.92	9.69	9.86
P/E (F1)	31.15	35.23	21.82	25.25	15.30	24.08
Price/Sales (P/S)	1.69	6.03	2.47	7.89	5.78	2.19
Earnings Yield	3.14%	2.84%	4.37%	3.96%	6.54%	4.16%
Debt/Equity	1.24	0.74	0.76	0.44	1.88	0.24
Cash Flow (\$/share)	2.97	2.82	6.94	7.42	33.97	5.12
Growth Score	D	-	-	D	C	C
Hist. EPS Growth (3-5 yrs)	16.44%	11.63%	10.44%	16.81%	22.21%	41.28%
Proj. EPS Growth (F1/F0)	-54.55%	9.34%	-5.97%	-9.13%	1.08%	-28.01%
Curr. Cash Flow Growth	-10.63%	-10.25%	5.22%	-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	2.35	2.54	1.33	1.47	2.15	3.46
Debt/Capital	55.38%	42.20%	44.50%	30.40%	65.31%	19.10%
Net Margin	-0.37%	3.58%	10.13%	20.14%	10.97%	10.59%
Return on Equity	10.85%	10.54%	14.67%	14.80%	32.00%	11.14%
Sales/Assets	0.59	0.50	0.51	0.26	0.31	0.70
Proj. Sales Growth (F1/F0)	-8.22%	1.94%	-1.54%	-7.99%	4.35%	-6.96%
Momentum Score	A	-	-	B	F	A
Daily Price Chg	-0.41%	-0.37%	-0.38%	0.23%	0.17%	-0.79%
1 Week Price Chg	5.76%	0.30%	1.09%	0.74%	0.58%	-0.12%
4 Week Price Chg	0.98%	1.53%	2.23%	3.75%	4.91%	-0.59%
12 Week Price Chg	24.23%	19.16%	6.91%	3.03%	14.47%	-1.04%
52 Week Price Chg	17.46%	23.24%	2.28%	8.80%	14.51%	27.47%
20 Day Average Volume	6,051,974	762,809	1,899,976	3,498,314	1,673,536	263,577
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.66%	0.00%	0.00%
(F1) EPS Est 4 week change	23.96%	5.82%	1.70%	0.66%	0.00%	-1.18%
(F1) EPS Est 12 week change	26.92%	21.30%	3.08%	9.62%	1.53%	2.20%
(Q1) EPS Est Mthly Chg	24.79%	9.42%	0.83%	2.06%	0.00%	6.48%



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## Zacks Stock Rating System

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

### Zacks Recommendation

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

### Zacks Rank

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

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	D
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.

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### Disclosures

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