

Philip Morris(PM)

\$84.71 (As of 01/27/20)

Price Target (6-12 Months): **\$89.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 05/02/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: A

Summary

Philip Morris' shares have gained but lagged the industry in a year. Efficient pricing and gains from growth of IQOS in RRP's arena have remained as upsides for the company. These factors had a positive impact on third-quarter results, with earnings and revenues beating the Zacks Consensus Estimate. Also, earnings improved year on year. We note that the company is on track with investments to bolster presence in the RRP's space. However, the company has been facing persistent sluggishness in the cigarette category. During the third quarter, cigarette shipment volumes declined 5.9% while overall revenues from combustible products slipped 5.7%. We note that cigarette sales are being affected by stringent policies and fading consumer interests. Moreover, unfavorable currency movements are a threat.

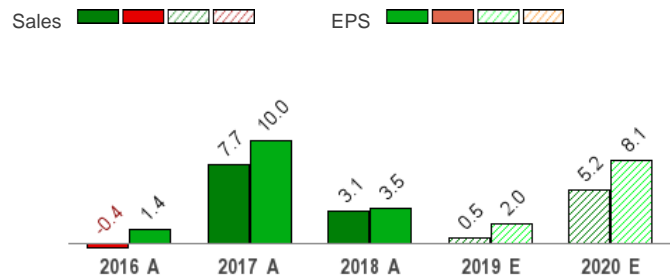
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$92.74 - \$69.27
20 Day Average Volume (sh)	4,308,973
Market Cap	\$131.8 B
YTD Price Change	-0.5%
Beta	1.00
Dividend / Div Yld	\$4.68 / 5.5%
Industry	Tobacco
Zacks Industry Rank	Bottom 31% (175 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.9%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	0.3%
Expected Report Date	02/06/2020
Earnings ESP	2.8%
P/E TTM	16.2
P/E F1	15.1
PEG F1	1.8
P/S TTM	1.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	6,785 E	8,143 E	8,174 E	8,122 E	31,312 E
2019	6,751 A	7,699 A	7,642 A	7,678 E	29,773 E
2018	6,896 A	7,726 A	7,504 A	7,499 A	29,625 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.13 E	\$1.56 E	\$1.58 E	\$1.37 E	\$5.62 E
2019	\$1.09 A	\$1.46 A	\$1.43 A	\$1.22 E	\$5.20 E
2018	\$1.00 A	\$1.41 A	\$1.44 A	\$1.25 A	\$5.10 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 01/27/2020. The reports text is as of 01/28/2020.

Overview

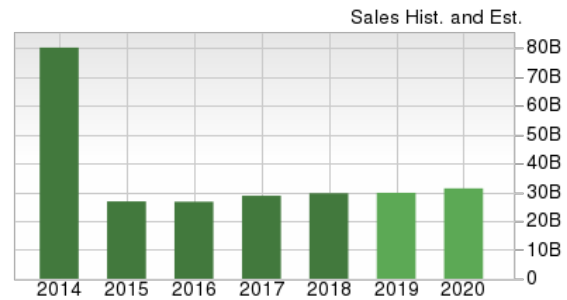
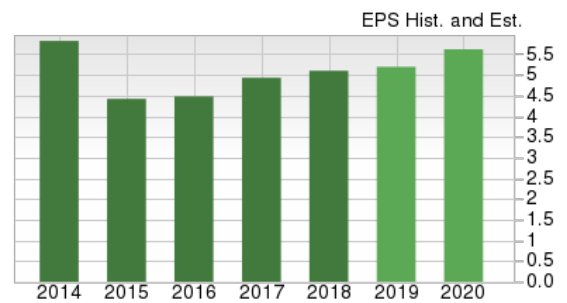
Incorporated in 1987 and headquartered in the New York, Philip Morris International manufactures and sells cigarettes, other tobacco products and other nicotine-containing products outside the U.S. in more than 180 countries. In Mar 2008, Philip Morris International was spun off from the Altria Group. However, Philip Morris USA, Inc. (PM USA) continues to be a subsidiary of the Altria Group.

Philip Morris participates in the profitable premium cigarette category with its Marlboro, Parliament and Virginia Slims brands; in the mid-price category with its L&M, Lark, Merit, Muratti and Philip Morris brands. Other leading international brands include Bond Street, Chesterfield, Next and Red & White.

The company is also engaged in the development and commercialization of Reduced-Risk Products ("RRPs"). RRP generally are less harmful than cigarette smoking. Philip Morris offers a wide range of RRP and many of them are being augmented to suit consumers as well as regulatory requirements. The company expects that RRP are likely to help smokers in quitting cigarette consumption.

On a product basis, Philip Morris reports results under the Combustible and the Reduced-risk products categories. Revenues from each of these categories include benefits from sales of the products including shipping and handling charges.

From Jan 1, 2018, Philip Morris started operating through the following six reporting segments: the European Union Region (EU); the Eastern Europe Region (EE); the Middle East & Africa Region (ME&A); the South & Southeast Asia Region (S&SA); the East Asia & Australia Region (EA&A); and the Latin America & Canada Region (LA&C). Notably, the ME&A region also include PMI Duty Free.



Reasons To Buy:

▲ **Strong Surprise History & Optimistic View:** Philip Morris' earnings in third-quarter 2019 surpassed the Zacks Consensus Estimate and improved year on year. In fact, this marks the company's seventh straight quarter of bottom-line surprise. On a like-for-like basis, after excluding currency, the bottom line improved 5.9%. The top line also surpassed estimates and improved year on year in the quarter. The quarterly results benefited from higher revenues and shipment volumes in the heated tobacco category. Also, favorable pricing was a key growth driver across most regions.

Philip Morris continues to benefit from efficient cigarette pricing and advancement in the RRP category.

Following encouraging result in the third quarter, management reiterated its view for 2019. Adjusted earnings are expected at \$5.14. The revised view indicates growth of almost 6% from the year-ago quarter's figure. Excluding currency impacts, earnings are projected to rise at least 9% to reach \$5.28. The forecast takes into consideration currency-neutral revenue growth, on a like-for-like basis, of approximately 6%. Shares of the company have gained 13.9% in a year, compared with the industry's growth of 18.4%.

▲ **Strong Pricing is a Growth Driver:** Philip Morris has always managed to remain afloat and generate revenues with higher cigarette pricing even in the face of unfavorable tax environment and declining cigarette volumes. Though higher pricing might lead to possible decline in cigarette consumption, it is seen that smokers tend to absorb price increases owing to the addictive quality of cigarettes. Evidently, higher pricing at the combustible tobacco portfolio has been aiding the company's performance for a while. In fact, higher pricing variance was an upside to the company's performance across several regions during the third quarter of 2019. Also, in the said quarter, favorable pricing in the combustible category boosted the top line that improved 7% on a like-for-like basis, after excluding currency. In fact, higher combustible tobacco pricing variance of approximately 6% is likely to drive the top line in 2019. The company continues to expect pricing as the key growth driver in the near term.

▲ **Moves to Strengthen RRP:** Serious health hazards due to cigarette smoking have pushed consumers toward low-risk, reduced risk products (RRP's). With radical investments for undertaking research and development in the RRP category, Philip Morris is pioneering the radical shift from harmful tobacco products to scientific and low-risk alternatives. In fact, the company's IQOS, a smokeless cigarette, counts amongst one of the leading RRP in the industry. Last year, the company launched additional versions of IQOS in Japan, which have been depicting encouraging results. These next generation devices, are backed by substantial scientific insights and research. The company expects such advanced and high-quality products to aid adult smokers to switch from traditional cigarettes to smoke-free options. IQOS users at the end of third-quarter 2019 totaled more than \$12.4 million.

In fact, strong growth in IQOS boosted revenues in the RRP unit, which increased almost 63.4% to \$1,344 million in the third quarter. Moreover, heated tobacco unit shipment volume of nearly 16 billion units surged 84.8% year over year. Management estimates that approximately 71% of IQOS users have quit smoking. Markedly, IQOS is now available in nearly 51 markets worldwide.

Going ahead, the company expects consistent growth in IQOS and Heated Tobacco category, and therefore remains committed toward expanding these products. In this context, the company recently launched the IQOS 3 DUO. The brand, which is currently available in Japan, will be rolled out to other markets by the end of 2019. Philip Morris has also been undertaking plant conversions, transforming them from cigarette to RRP manufacturing facilities. This was witnessed in the company's Papastratos factory in Greece, for the production of HEETS — a unit used with IQOS. Also, the marketing and technology sharing agreement between Philip Morris and Altria Group, pertaining to the sale of IQOS in the United States, has been approved by the FDA. Markedly, IQOS is presently the only heat-not-burn product in the U.S. market, which has been approved by the FDA. This is expected to radically boost the business of the companies. Philip Morris has opened its first IQOS store in the Georgia. Among other initiatives, Philip Morris inked a deal with Canada-based Parallax that provides low-risk tobacco alternatives. To further propel growth of this category, the company launched 'The Year of Unsmoke' in April, 2019. The action is aimed at creating a better future for smokers, by encouraging them to either quit smoking or shift to low-risk alternatives. For 2019, the company plans to invest nearly \$400 million for bolstering RRP portfolio.

▲ **Strong Brand Portfolio:** Philip Morris commands a leading market position in the tobacco industry supported by its strong brand portfolio. Its portfolio boasts popular names like Marlboro, L&M, Bond Street, Parliament, Philip Morris, Chesterfield, Sampoerna A, Virginia Slims, Champion and Benson & Hedges. Marlboro leads the brands and has the largest market share.

Reasons To Sell:

▼ **Cigarette Category to Remain Weak:** Receding cigarette sales volumes has been taking a toll on Philip Morris' performance. Cigarette shipment volumes declined 2.1% in 2018. Although the metric was flat year over year in first-quarter 2019, the same declined almost 3.6% and 5.9% in the second and the third quarter, respectively. Further, revenues from combustible products declined 5.7% during the third quarter. Going ahead, management anticipates total shipment volumes, including cigarettes and heated tobacco categories, to decline nearly 1-1.5% in 2019, on a like-for-like basis. Moreover, total tobacco industry volumes, excluding the U.S. and China, are expected to decline 2.5%.

Philip Morris struggles with soft cigarette volumes due to reduced demand, rising health concerns and anti-tobacco campaigns.

We note that cigarette shipment volumes are being adversely impacted by lower demand for cigarettes, stemming from anti-tobacco campaigns and consumers' rising health consciousness. Moreover, regulatory hurdles (discussed below) have created limitation for marketing cigarettes, further hindering its sales volumes.

▼ **Restrictions on Tobacco Consumption:** The tobacco industry faces many challenges as governments around the world are imposing restrictions on tobacco companies which, in turn, are lowering cigarette consumption. The U.S. Food and Drug Administration (FDA) has made it mandatory for tobacco companies to use precautionary labels on cigarette packets to dissuade customers from smoking. In fact, per court orders, Reynolds American along with Altria Group and other cigarette makers have been directed to put up self-critical advertisements on television and newspapers to dissuade customers from smoking. Apart from this, the court wants tobacco companies to admit that cigarettes have been made addictive, through the issuance of corrective ads. To add to the woes, the FDA is now bent on drastically reducing nicotine in cigarettes to minimally addictive levels. The initiative was proposed in 2017 but was delayed, due to ongoing research. If enacted, lowering of nicotine levels will undoubtedly prove disastrous for cigarette manufacturing companies. In more recent developments, the FDA has raised concerns surrounding the consumption of e-cigarettes amongst the youth. This has propelled the agency to issue warning letters and enforce fines upon several retailers who illegally sold e-cigarettes to minors.

Apart from these, FDA had earlier announced that tobacco makers must seek marketing authorization for any tobacco product introduced after Feb 15, 2007. The law was extended by the FDA to include e-cigarettes, pipe tobacco, cigars and hookah. Also, the European Union and the FDA have proposed a ban on menthol in accordance with the Tobacco Control Act which essentially states that menthol cigarettes have an adverse impact on public health and suggests the removal of menthol.

▼ **Currency Headwinds:** Philip Morris' significant international presence exposes it to the risk of adverse currency fluctuations. In fact, currency had an unfavorable impact on the company's performance in the third quarter of 2019. Going ahead, management expects currency to have adverse impacts of close to 14 cents upon earnings in 2019. That said, volatility in exchange rates always remains a concern.

Last Earnings Report

Philip Morris Q3 Earnings Top Estimates, Sales Improve Y/Y

Philip Morris delivered third-quarter 2019 results, with the top and the bottom line beating the Zacks Consensus Estimate. Also, the company's top line rose year on year.

The quarterly results benefited from higher revenues and shipment volumes in the heated tobacco category. Also, favorable pricing was a key growth driver across most regions. On the flip side, dismal performance in the combustible category was a drag.

Adjusted earnings per share of \$1.43 beat the Zacks Consensus Estimate of \$1.35. The bottom line inched down 0.7% year over year. On a like-for-like basis, after excluding currency, the bottom line rose 5.9%.

Net revenues of \$7,642 million beat the Zacks Consensus Estimate of \$7,610 million. The top line inched up 1.8% in the reported quarter. Excluding currency, the metric was up 3.4%, backed by favorable pricing variance and volume/mix.

During the quarter under review, revenues from combustible products declined 5.7% to \$6,298 million. Except South & Southeast Asia and Middle East & Africa, figures in the category declined across most regions. Further, revenues in the RRP's improved 63.4% to \$1,344 million. Growth in RRP's in most regions was partially offset by decline in Middle East & Africa.

Total cigarette and heated tobacco unit shipment volume inched down 2.1% to 199.5 billion units. Cigarette shipment volume fell 5.9% to 183.5 billion units in the third quarter, while heated tobacco unit shipment volume of nearly 16 billion units surged 84.8% year over year.

Adjusted operating income inched up 0.9% to reach \$3,184 million. On a like-for-like basis, after excluding currency, adjusted operating income went up 8% year over year. The metric rose 1.3% at constant currency (cc). However, adjusted operating margin contracted 40 basis points to 41.7%. Excluding currency, the metric declined 0.9 percentage points to 41.2%.

Region-Wise Performance

Net revenues in **European Union** increased 7.2% to \$2,645 million. Revenues increased 11.2% at cc, courtesy of favorable pricing and volume/mix. Total shipment volume in the region inched up 1.5% to 50,712 million units.

In **Eastern Europe**, net revenues grew 15.6% to \$899 million and rose 16.5% at cc. The upside can be attributed to favorable pricing. Total shipment volumes inched up 0.9% to 31,237 million units.

In **Middle East & Africa** region, net revenues declined 1.4% (flat at cc) to \$1,127 million. Further, total shipment volumes contracted 2.5% to 37,582 million units.

Revenues in **South & Southeast Asia** rose 4.1% (up 2.8% at cc) to \$1,246 million. The upside was driven by favorable pricing variance. Shipment volumes declined 7.6% to 42,362 million units.

Revenues from **East Asia & Australia** improved 7.4% (up 7.5% at cc) to \$1,252 million, primarily on favorable volume/mix. Total shipment volumes increased 10.2% to 20,668 million units.

Finally, revenues from **Latin America & Canada** fell 37.2% (down 36.1% at cc) to \$473 million. Moreover, total shipment volumes declined 13.8% to 16,943 million units.

Other Financials

The company ended the quarter with cash and cash equivalents of \$6,507 million. Also, the company had long-term debt of \$26,426 million and shareholders' deficit of \$9,155 million.

During the quarter under review, management raised the quarterly dividend from \$1.14 per share to \$1.17. This represents a hike of 2.6%. Accordingly, the company's annualized dividend rate is at \$4.68, up from the previous level of \$4.56.

Guidance

Philip Morris reiterated its outlook for 2019. Adjusted earnings are expected to be \$5.14. The view indicates growth of almost 6% from the year-ago quarter's figure. Excluding the impacts of unfavorable currency of approximately 14 cents, earnings are projected to rise at least 9% to \$5.28. Further, management expects effective tax rate for 2019 to be roughly 23%.

Quarter Ending **09/2019**

Report Date	Oct 17, 2019
Sales Surprise	0.42%
EPS Surprise	5.93%
Quarterly EPS	1.43
Annual EPS (TTM)	5.23

Recent News

Philip Morris and Altria End Merger Discussions – Sep 25, 2019

Philip Morris ended talks of a potential merger with Altria, as the companies were unable to come to terms. Nevertheless, both the companies will maintain their agreement pertaining to the commercialization of IQOS in the United States.

Philip Morris Hikes Dividend to Boost Shareholders Value - Sep 11, 2019

Philip Morris is committed to enhance shareholders' value, as evident from its recent move to raise dividend from \$1.14 per share to \$1.17. This represents a hike of 2.6%.

Accordingly, the company's annualized dividend rate is at \$4.68, up from the previous annualized rate of \$4.56. Notably, this marks the 12th straight year of dividend hike by Philip Morris since it officially became a public company in 2008. The hiked dividend will be paid out on Oct 11, 2019 to shareholders held in record at the close of business on Sep 25, 2019.

Valuation

Philip Morris shares are up 13.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are up 18.4% and 15.9%, respectively in the past year.

The S&P 500 index is up 24.1% in the past year.

The stock is currently trading at 14.98X forward 12-month earnings, which compares to 12.23X for the Zacks sub-industry, 19.68X for the Zacks sector and 18.93X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.71X and as low as 12.47X, with a 5-year median of 18.5X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$89 price target reflects 15.74X forward 12-month earnings.

The table below shows summary valuation data for PM

Valuation Multiples - PM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.98	12.23	19.68	18.93
	5-Year High	23.71	21.23	22.38	19.34
	5-Year Low	12.47	10.54	16.66	15.18
	5-Year Median	18.5	17.47	19.71	17.45
P/S F12M	Current	4.2	3.71	10.06	3.52
	5-Year High	6.47	6.8	11.13	3.52
	5-Year Low	3.41	3.13	8.09	2.54
	5-Year Median	4.8	4.9	9.88	3
EV/EBITDA F12M	Current	11.27	9.41	34.39	12.66
	5-Year High	16.08	17.13	37.23	12.66
	5-Year Low	9.75	8.03	29.38	9.08
	5-Year Median	12.9	12.91	33.54	10.78

As of 01/27/2020

Industry Analysis Zacks Industry Rank: Bottom 31% (175 out of 255)



Top Peers

Vector Group Ltd. (VGR)	Outperform
British American Tobacco p.l.c. (BTI)	Neutral
Imperial Tobacco Group PLC (IMBBY)	Neutral
JAPAN TOB INC (JAPAY)	Neutral
Altria Group, Inc. (MO)	Neutral
Constellation Brands Inc (STZ)	Neutral
Schweitzer-Mauduit International, Inc. (SWM)	Neutral
Turning Point Brands, Inc. (TPB)	Neutral

Industry Comparison Industry: Tobacco				Industry Peers		
	PM Neutral	X Industry	S&P 500	BTI Neutral	IMBBY Neutral	MO Neutral
VGM Score	B	-	-	D	A	B
Market Cap	131.80 B	1.62 B	23.86 B	93.25 B	24.15 B	92.98 B
# of Analysts	7	1	13	5	4	8
Dividend Yield	5.52%	5.10%	1.81%	6.12%	15.01%	6.75%
Value Score	C	-	-	B	A	C
Cash/Price	0.05	0.08	0.04	0.05	0.13	0.02
EV/EBITDA	12.31	8.65	13.94	NA	NA	11.56
PEG Ratio	1.84	1.76	2.00	1.29	1.03	1.76
Price/Book (P/B)	NA	2.17	3.25	1.11	3.39	8.74
Price/Cash Flow (P/CF)	14.74	8.91	13.46	8.91	4.94	12.04
P/E (F1)	15.09	11.55	18.67	10.12	7.10	11.29
Price/Sales (P/S)	1.69	1.69	2.62	NA	NA	3.69
Earnings Yield	6.63%	8.67%	5.35%	9.87%	14.06%	8.86%
Debt/Equity	-2.89	0.29	0.72	0.63	2.09	2.53
Cash Flow (\$/share)	5.75	3.04	6.92	4.91	5.11	4.13
Growth Score	B	-	-	D	A	B
Hist. EPS Growth (3-5 yrs)	1.54%	5.36%	10.68%	NA	NA	10.91%
Proj. EPS Growth (F1/F0)	8.17%	4.59%	7.51%	4.39%	5.73%	4.78%
Curr. Cash Flow Growth	4.57%	4.57%	13.40%	20.53%	-3.71%	15.41%
Hist. Cash Flow Growth (3-5 yrs)	-1.61%	1.95%	8.78%	8.12%	1.08%	9.32%
Current Ratio	1.08	1.20	1.22	0.73	0.90	0.56
Debt/Capital	NA%	38.82%	42.92%	38.82%	67.69%	71.69%
Net Margin	9.59%	7.00%	11.39%	NA	NA	7.00%
Return on Equity	-82.33%	10.83%	17.19%	NA	NA	56.17%
Sales/Assets	1.96	0.95	0.54	NA	NA	0.45
Proj. Sales Growth (F1/F0)	4.95%	1.63%	4.09%	1.42%	-69.80%	1.85%
Momentum Score	A	-	-	F	F	B
Daily Price Chg	-1.67%	-0.96%	-1.40%	-1.77%	-1.68%	-0.96%
1 Week Price Chg	-2.86%	-2.86%	-1.09%	-1.24%	-4.07%	-1.51%
4 Week Price Chg	-1.16%	-2.87%	-0.25%	3.06%	2.73%	-0.24%
12 Week Price Chg	1.52%	-2.72%	3.64%	22.06%	12.73%	9.14%
52 Week Price Chg	13.93%	-10.02%	18.08%	36.75%	-20.63%	9.87%
20 Day Average Volume	4,308,973	296,761	1,615,215	1,213,108	296,761	6,805,117
(F1) EPS Est 1 week change	0.14%	0.00%	0.00%	-1.00%	-0.35%	0.00%
(F1) EPS Est 4 week change	0.28%	0.00%	0.00%	-1.05%	-0.35%	-0.11%
(F1) EPS Est 12 week change	0.36%	0.39%	-0.17%	0.51%	-3.66%	-1.32%
(Q1) EPS Est Mthly Chg	0.89%	0.51%	0.00%	NA	NA	0.51%

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	C
Growth Score	B
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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