February 25, 2015

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Icad Inc (ICAD-NASDAQ)

ICAD: High-Margin Services Biz Driving Strong Top-Line Growth

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	04/29/2014
Current Price (02/22/15)	$9.90
Target Price	**$14.00**

OUTLOOK

We expect continued momentum in Therapy biz, particularly now with the addition of DermEbx. The Detection segment looks promising to return to long-term growth aided by iCAD's recent strategy shift towards a greater reliance on recurring revenue, services and a conventional software business model, new product launches, and a recently announced development agreement with Invivo (part of Philips Healthcare). New 3D breast tomo product could really accelerate Detection revenue beginning in late 2015/early 2016.

Mgmt has been very aggressive with driving awareness and at increasing clinical evidence which should help adoption in both the Detection and Therapy segments. We remain highly positive on ICAD and management's ability to continue to grow the top and bottom lines.

SUMMARY DATA

52-Week High	**$12.50**
52-Week Low	**$5.94**
One-Year Return (%)	**-7.84**
Beta	**1.08**
Average Daily Volume (sh)	**51,548**
Shares Outstanding (mil)	**16**
Market Capitalization ($mil)	**$164**
Short Interest Ratio (days)	**4.88**
Institutional Ownership (%)	**46**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**7.0**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2015 Estimate	**124**
P/E using 2016 Estimate	**30.0**
Zacks Rank	**N/A**

Risk Level	**Average,**
Type of Stock	**Small-Blend**
Industry	**Comp-Software**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	8,520 A	9,667 A	12,572 A	13,165 A	43,924 A
2015	13210 E	13891 E	14757 E	15380 E	57,243 E
2016					74,938 E
2017					91,936 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	-$0.02 A	-$0.07 A	$0.02 A	-$0.01 A	-$0.07 A
2015					$0.08 E
2016					$0.33 E
2017					$0.73 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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WHAT'S NEW…

Q4 / Full-Year 2014 Results: Revenue In-Line and Up Double-Digits in Both Detection and Therapy

iCAD (ICAD) announced financial results for the fourth quarter and full year ending December 31. Revenue was up 43% and 31% in Q4 and the full year, respectively and just about dead-on with our numbers in total revenue, Detection revenue and Therapy revenue. Q4 Detection, similar to the prior quarter was driven by strong PowerLook AMP sales and from continued flow of sales to MRI-license partner Invivo. Meanwhile, Therapy continues to ride the wave of new revenue coming from the DermEbx/Radion acquisition as well as the ongoing ramp in Xoft utilization – mainly from non-melanoma skin cancer but for breast cancer as well, the latter which saw a 36% yoy increase in balloon applicator sales.

The services segment has been the sole driving force behind the revenue growth for the last two quarters with product sales barely better then flat in both periods. This, however, was expected as iCAD focuses on driving utilization in the Therapy segment and is benefitting from the DermEbx leases. And with higher margin services now accounting for 58% of total revenue, up from 44% in 2014, gross margins are also benefitting with gross margin widening 130 basis points over the last 12 months. Management expects this trend towards more total revenue derived from services to continue throughout 2015.

The strong revenue growth is expected to persist in the current year. Management provided initial 2015 revenue guidance of between $55 million - $59 million, implying growth of 25% - 34% over 2014. While this is below our prior estimate of $59.4 million, management expects very little to no contribution from the 3D tomosynthesis product in the current year, which we had forecast to launch in Europe in 1H and provide meaningful revenue in 2015. iCAD now points to Q4 for launch in Europe, a slight delay from prior expectations, but the product should be a major revenue driver in the Detection segment during 2016.

And despite the launch delay, the revenue guidance remains impressive and is expected to be fueled by the continued rapid adoption and increased utilization of Xoft in non-melanoma skin cancer as well as contribution from DermEbx/Radion. In 2016, we expect to see a resurgence in revenue from the Detection business, catalyzed by the high profile 3D tomo product in Europe and, later in the year, in the U.S.

The 3D tomo products could have franchise-type opportunity for the long-term given the industry shift towards more effective screening methods. This is where we see the majority driver of the Detection segment for several years out so we would characterize the minor launch delay as a small speed bump. And Therapy looks to be a long-term growth driver of the top-line as well. With just barely over 1% of the non-melanoma skin cancer market penetrated and adoption increasing, we see this as holding major opportunity and one that we think will continue to ramp fairly rapidly. And breast IORT remains a growth area as well, although not likely to experience the acceleration overt the near-term as in skin but longer-term, with additional positive clinical data supporting its use, breast is a very attractive segment.

iCAD is not sitting idly by but instead continues to be very active in driving awareness of the benefits of electronic brachytherapy in both breast and skin cancer. This includes consistent participation and presentations at industry conferences and events as well as sponsoring clinical studies. The company is ramping up efforts on both fronts which includes the initiation of two new clinical studies in 2015.

iCAD already has one study ongoing, dubbed ExBRT (“A Safety and Efficacy Study of Intra-Operative Radiation Therapy Using the Xoft Axxent eBx System at the Time of Breast Conservation Surgery for Early-Stage Breast Cancer”), the study compares patient outcomes in those undergoing Xoft IORT to those undergoing external beam radiation. Patients will be followed for 10 years. ExBRT has enrolled 500 of an expected 1,000 total patients. Initial results are expected to be presented in poster sessions at the National Consortium of Breast Cancer meeting in March which could be another catalyst to driving awareness and adoption.

And on the Q4 call management first announced the planned initiation of two new studies. One will be in breast cancer where IORT is used as a boost treatment to patients undergoing external beam radiation. Enrollment is expected to be 500 patients, with the endpoint being cancer recurrence at five years. The second of the new studies is in skin cancer where Xoft will be compared to surgery with enrollment expected at 600 patients. Primary endpoint is local cancer recurrence at five years.

Studies such as these, which compare eBx to standard of care or eBx as a supplemental therapy, are what are critical to drive adoption of novel therapies. And iCAD is supplementing clinical data with awareness building at industry events. This has been an important piece of the company's marketing program and one that management has dedicated significant efforts towards. They recently attended the Radiological Society of North America meeting where they featured their high profile Detection products including PowerLook and VerLook. And they will be highlighting their Therapy products and services at the upcoming American Academy of Dermatology meeting as well as attending the Miami Breast Cancer conference this week.

Revenue
Q4 revenue of $13.2M was up 44% yoy and about 1% higher than our $13.0M estimate.

- **Cancer Detection(Q4):** $4.7M actual (+12% yoy) vs. $4.7M estimate
  - Total product revenue in cancer detection was about $2.5 million, up from about $1.9 million in Q4 2013 and in-line with our $2.4 million estimate. Similar to Q3, product Detection revenue was driven by sales of MRI licenses to their partner, Invivo, as well as strength in PowerLook sales. Detection has been fairly strong the last over the last nine months of 2014 despite slipping revenue from the services side. Detection may not fair quite as well in 2015, although we think PowerLook AMP and MRI licensing will continue to be significant contributors. However with the launch of the initial 3D breast tomosynthesis products, now expected in Q4 2014 in Europe, we think Detection will see a significant acceleration, particularly once the products are in both the U.S. and Europe (sometime in 2016). Meanwhile, as noted in prior updates, the historical issue of the erosion of Detection revenues from reduced conversion by imaging facilities from film-based to digital mammography has mostly run its course given that revenue related to this had already dropped to (almost) insignificant levels by early 2013.

    We continue to expect the Detection segment to remain on track for sustained growth over the long term. This being fueled by the recent and expected new product launches (PowerLook AMP, CAD for tomosynthesis, etc.), more annual licensing agreements, increased service contracts (to iCAD's 4k+ installed base as well as OEM partners'), partnership deals with OEM's with new products, development projects and service contracts, and the MRI software development deal with Invivo.

    And as we've noted in the past, while CT colon CAD revenue has yet to gain much traction in the U.S. as a result of a dearth of reimbursement, management recently indicated they are seeing some growth internationally and this remains a viable domestic growth opportunity with sufficient reimbursement. As improvement in the reimbursement picture could improve in the near-term, we see this as one area that could surprise on the upside over the near-term. The additional data from the ACRIN study that were recently published could be a catalyst to eventually gaining Medicare reimbursement for CT colon CAD. iCAD has been active in attending and presenting at industry conferences, which have included featuring their VeraLook CTC product.

    However, the Detection pipeline product that likely holds the most promise is the company's CAD platform for 3D breast tomosynthesis. ICAD continues to work to complete the initial product, which is expected to be rolled out in Q4 2015 (pushed back slightly from earlier expectations) in Europe on GE's SenoClair tomosynthesis instruments. SenoClaire received CE Mark in July 2013 and FDA clearance in August 2014. Shortly after the European launch, ICAD expects to introduce the product in the U.S. We think this could be a big winner for ICAD given the criticism and debate over the utility of stand-alone mammography and increased demand for more accurate detection of breast cancer. GE's instrument is billed as producing lower x-ray dose (i.e. - safer) than Hologic's Selenia Dimensions machine (FDA cleared in 2011), currently the only other 3D breast tomosynthesis instrument sold in the U.S., providing a real opportunity for GE's machine.

    Our modeled significant step-up in Detection revenue beginning in 2016 represents meaningful contribution from ICAD's 3D breast tomosynthesis platform.

- **Cancer Therapy (Q4):** $8.5M (+71% yoy) actual vs. $8.3M estimate
  - Cancer therapy revenue in Q4 grew 71% yoy and 11% sequentially. ICAD has not broken out legacy from acquired DermEbx revenue, although clearly the acquisition has provided the bulk of revenue growth in the Therapy segment in the last two quarters. Service and supplies revenue (i.e. - consumables and warranties) continues to be the driver of Therapy growth as system placements slow, as evidenced by the 19% yoy dip in Therapy product revenue from 2013 to 2014.

As we have noted in the past, expansion of the Therapy user base and increase in utilization appears to be coming from several fronts, including more favorable reimbursement, positive clinical outcomes data and greater awareness of the benefits the therapy. This is particularly benefitting the skin indication, which dually benefits revenue as skin cancer treatment typically requires more than one visit.

Relative to reimbursement, currently 21 states have a "positive policy" related to non-melanoma skin cancer whereas this stood at just 16 states in May 2014 and 10 states in mid-2013. Clearly the reimbursement picture is improving which has almost certainly aided uptake and utilization of Xoft for skin cancer. In addition, a CPT code for electronic brachytherapy specific to skin cancer was recently submitted for review. If established, we would expect this would further benefit uptake of Ebx for non-melanoma skin cancer. Nonetheless, we think it's reasonable to expect further improvement in the reimbursement picture going forward, from both public and private payers.

Much of the recent growth in Therapy is coming from skin which we think will continue given catalysts such as positive clinical trial data supporting the use of eBx in non-melanoma skin cancer, fairly rapid geographic growth in reimbursement and overall increased awareness (by both dermatologists as well as consumers) of its benefits over traditional surgical excision. ICAD remains very active in promoting at all these levels. And as noted, the DermEbx/Radion acquisitions will immediately contribute significant additional Therapy revenue.

We think it is reasonable to expect that an increase in reimbursement, from both an uptake on the payer side as well as level of reimbursement, will be facilitated with additional positive clinical data. This will be supported by published manuscripts and presentations such as the recent presentations at ASTRO detailing positive four-year follow up data (low toxicity, no recurrence and excellent cosmetic results) on non-melanoma skin cancer patients (n=187) treated with Xoft. Other data was presented in April 2014 of a study with 364 patients (561 lesions) which showed treatment with Xoft in non-melanoma skin cancer results in comparable cure rates compared with standard therapy (fractionation teletherapy, Mohs or excision) with Xoft treated patients having excellent cosmetic results. Strong efficacy and lack of scarring have been major selling points for Xoft in skin cancer.

And in order toad further to the clinical data supporting use of eBx in skin cancer, on the Q4 2014 earnings call iCAD noted that they will sponsor a skin cancer study. The study, expected to enroll 600 patients, will compare Xoft to surgery with the primary endpoint being local cancer recurrence at five years.

The company is also now tapping international markets with a handful of sites in Europe and one in Asia currently using Axxent. In April 2013 they announced distribution agreements for parts of China and Russia - launch in which is expected to happen following requisite regulatory approvals - potentially culminating in 2015. More recently they penned a distribution agreement in Canada.

We continue to see tremendous upside in the breast cancer indication. We think utilization remains relatively low and penetration of Axxent in the U.S. breast IORT market is likely only in the low single digits. Greater awareness and improved reimbursement could provide catalysts to ramp penetration, utilization and revenue. Support from a continued flow of positive clinical data, including recently published updated data from the landmark TARGIT-A trial which continued to show non-inferiority of IORT to whole breast radiotherapy at five years follow-up, should further facilitate uptake and support for greater reimbursement.

Despite the slow ramp in breast to-date, demand for Axxent in the breast cancer application is increasing. ICAD clearly remains highly committed to fully exploiting this opportunity and continues to dedicate time and resources towards building awareness and generating additional clinical data in support of the treatment. This includes ExBRT, a multi-center IORT early-stage breast cancer study comparing Xoft to external beam radiation which is expected to enroll ~1,000 patients at 50 sites. Initial data from the study, which just hit the 500-patient enrollment mark, is expected to be presented in poster sessions at the National Consortium of Breast Cancer meeting in March of this year. Positive outcomes from which should provide additional support for utilization and reimbursement of the treatment.

And iCAD is further ramping up their study efforts in breast cancer, just now announcing that they will initiate a new study in which IORT is used as a boost treatment to patients undergoing external beam radiation. Enrollment is expected to be 500 patients, with the endpoint being cancer recurrence at five years.

And in addition to skin and breast cancer, the Therapy business should further benefit as additional indications come online, including for cervical cancer which is now still in the early launch phase. This is an area in the Therapy business that could potentially surprise on the upside.

EPS
Q4 EPS of ($0.01) was below our $0.02 estimate. The entire difference came from higher than modeled depreciation/amortization (related to the DermEbx / Radion acquisition) as well as a one-time $200k litigation expense.

Cash
Excluding changes in working capital, cash from operations was an inflow of $4.2M through the 12 months ending 12/31/2014, including $1.9 million in Q4. iCAD exited Q4 with a very healthy $32.2 million on its balance sheet. While some of this will be used to retire debt (including $3.8 million due at end of 2015 and the remaining $7.5 million at end of 2016), their cash cushion provides significant flexibility, particularly as we think the company, despite an expected increase in operating expenses (some of which relates to the new clinical studies) will generate positive cash flow in 2016 (and beyond). Management has previously noted that they do not expect to be looking for additional acquisitions, at least in the near-term, and expect instead to reinvest some of the cash in growth of the existing businesses.

Guidance
Management's 2016 guidance is for revenue of $55 million - $59 million and adjusted EBITDA of 16% - 20% which compares to $44 million revenue and 14.5% adjusted EBITDA in 2014.

VALUATION / RECOMMENDATION

We have made some adjustments to our model following 2014 year-end results – which includes some trimming to the top-line as a result of the delay in the 3D tomo launch and additional OpEx related to the new clinical trials expenses. We now look for 2015 revenue of $57.2 million, roughly mid-range of management's guidance and down from $59.4 million prior to Q4 results. We look for 2015 EPS of $0.08, compared to a $0.07 loss in 2014.

We continue to value iCAD based on competitor price/sales (P/S) and enterprise value /sales (EV/S) multiples. Using analyst's revenue estimates for the years 2015 and 2016, we calculated P/S and EV/S ratios from imaging (HOLX, MRGE) as well as surgical (VAR, ARAY, ISR, EKTAF) companies. The six companies currently trade at an average P/S-2015 of 4.5x and P/S-2016 of 3.1x and average EV/S-2015 of 3.6x and EV/S-2016 of 2.5x.

Based on the average of the 2015 and 2016 EV/S multiples iCAD is valued at $13.1/share. Based on the average of the 2015 and 2016 P/S multiples iCAD is valued at $14.8/share. We use the average of the two which values iCAD at approximately $14/share. We are maintaining our Outperform recommendation.

FINANCIAL MODEL

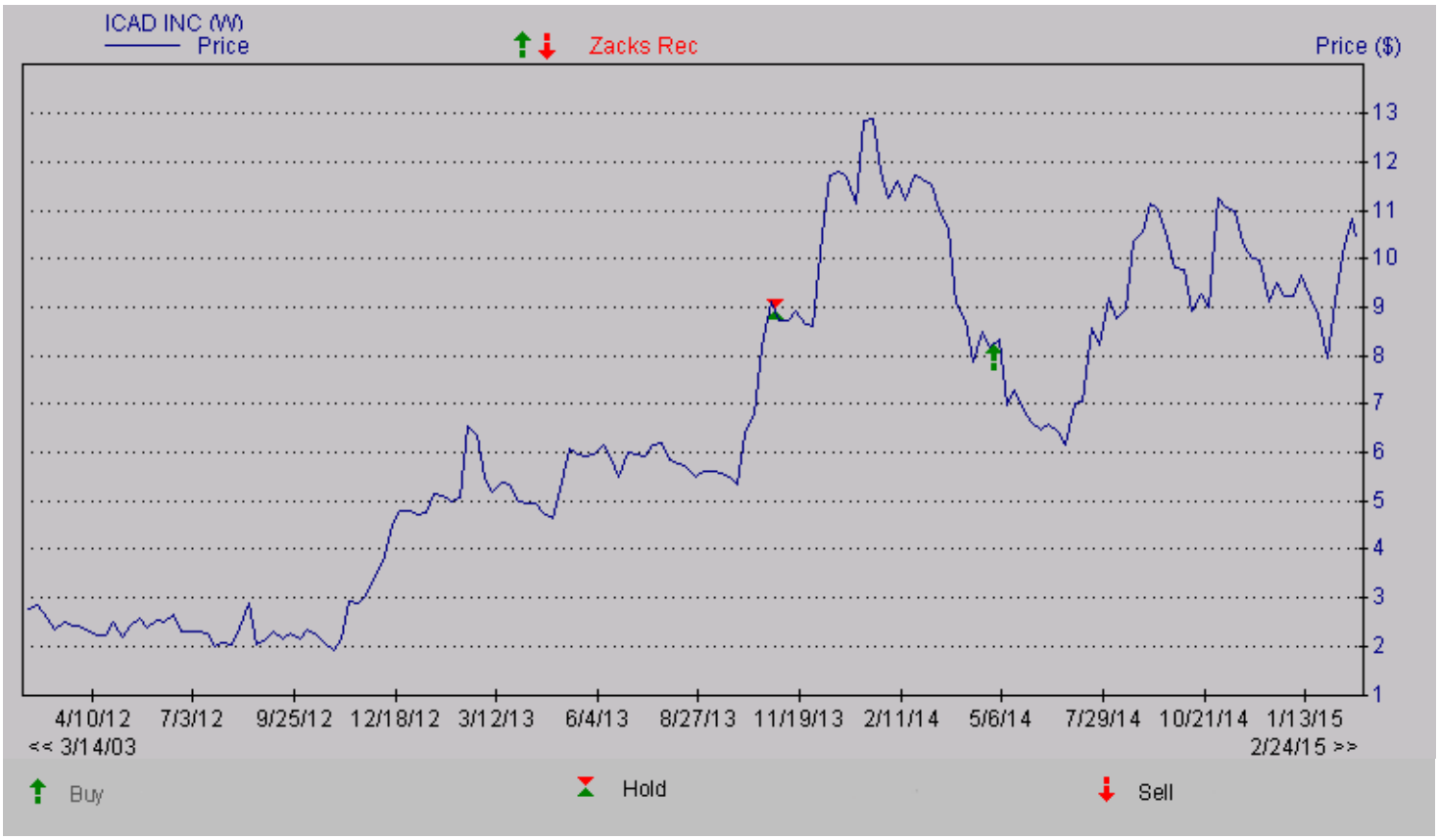
iCAD Inc.

	2014 A	Q1E	Q2E	Q3E	Q4E	2015 E	2016 E	2017 E	2018 E
Cancer Detection	$18,604.0	$4,554.5	$4,657.1	$4,970.2	$4,858.9	$19,040.6	$24,833.1	$30,960.6	$35,628.2
YOY Growth	*10.1%*	*9.1%*	*-3.6%*	*0.7%*	*4.2%*	*2.3%*	*30.4%*	*24.7%*	*15.1%*
% of total revenue	*42.4%*	*34.5%*	*33.5%*	*33.7%*	*31.6%*	*33.3%*	*33.1%*	*33.7%*	*34.3%*
Therapy	$25,320.0	$8,655.0	$9,240.0	$9,787.0	$10,521.0	$38,203.0	$50,105.0	$60,975.0	$68,133.0
YOY Growth	*56.7%*	*99.2%*	*91.1%*	*28.2%*	*23.7%*	*50.9%*	*31.2%*	*21.7%*	*11.7%*
% of total revenue	*57.6%*	*65.5%*	*66.5%*	*66.3%*	*68.4%*	*66.7%*	*66.9%*	*66.3%*	*65.7%*
Total Revenues	$43,924.0	$13,209.5	$13,897.1	$14,757.2	$15,379.9	$57,243.6	$74,938.1	$91,935.6	$103,761.2
YOY Growth	*31.0%*	*55.0%*	*43.8%*	*17.4%*	*16.8%*	*30.3%*	*30.9%*	*22.7%*	*12.9%*
Cost of Revenues	$12,697.0	$3,865.0	$3,989.8	$4,027.7	$4,388.9	$16,271.3	$20,415.5	$24,049.4	$24,521.2
Gross Income	$31,227.0	$9,344.5	$9,907.2	$10,729.5	$10,991.0	$40,972.3	$54,522.6	$67,886.2	$79,240.0
Gross Margin	*71.1%*	*70.7%*	*71.3%*	*72.7%*	*71.5%*	*71.6%*	*72.8%*	*73.8%*	*76.4%*
R&D	$8,490.0	$2,255.0	$2,458.0	$2,671.0	$2,777.0	$10,161.0	$11,966.0	$12,511.0	$12,898.0
% R&D	*19.3%*	*17.1%*	*17.7%*	*18.1%*	*18.1%*	*17.8%*	*16.0%*	*13.6%*	*12.4%*
Selling & Mktg	$12,526.0	$3,764.7	$3,835.6	$4,013.9	$4,152.6	$15,766.8	$20,982.7	$24,822.6	$27,496.7
% Sell&Mktg	*28.5%*	*28.5%*	*27.6%*	*27.2%*	*27.0%*	*28.5%*	*28.0%*	*27.0%*	*26.5%*
G&A	$9,396.0	$2,851.0	$2,920.0	$2,944.0	$2,951.0	$11,666.0	$12,780.0	$13,941.0	$15,044.0
% G&A	*21.4%*	*21.6%*	*21.0%*	*19.9%*	*19.2%*	*17.1%*	*16.1%*	*15.2%*	*15.2%*
Operating Income	$815.0	$473.8	$693.6	$1,100.5	$1,110.5	$3,378.5	$8,793.9	$16,611.6	$23,801.2
Operating Margin	*1.9%*	*3.6%*	*5.0%*	*7.5%*	*7.2%*	*5.9%*	*11.7%*	*18.1%*	*22.9%*
Other income	$969.0	$0.0	$0.0	$0.0	$0.0	$0.0	$150.0	$125.0	$0.0
Interest income, net	($2,640.0)	($455.0)	($455.0)	($455.0)	($455.0)	($1,820.0)	($1,220.0)	$45.0	$121.0
Pre-Tax Income	($856.0)	$18.8	$238.6	$645.5	$655.5	$1,558.5	$7,292.6	$16,781.6	$23,922.2
Taxes	$153.0	$2.6	$33.4	$90.4	$91.8	$218.2	$1,604.4	$4,363.2	$7,176.7
Tax Rate	*-17.9%*	*14.0%*	*14.0%*	*14.0%*	*14.0%*	*13.5%*	*22.0%*	*26.0%*	*30.0%*
Net Income	($1,009.0)	$16.2	$205.2	$555.2	$563.7	$1,340.3	$5,688.2	$12,418.4	$16,745.6
YOY Growth	*85.9%*	*108.5%*	*120.6%*	*-102.6%*	*687.2%*	*232.8%*	*-324.4%*	*-118.3%*	*-34.8%*
Net Margin	*-2.3%*	*0.1%*	*1.5%*	*3.8%*	*3.7%*	*2.3%*	*7.6%*	*13.5%*	*16.1%*
EPS	($0.07)	$0.00	$0.01	$0.03	$0.03	$0.08	$0.33	$0.73	$0.97
YOY Growth	*89.3%*	*105.9%*	*117.5%*	*-98.3%*	*643.2%*	*214.5%*	*-315.7%*	*-117.0%*	*-34.1%*
Pro-forma adjustments	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pro-forma EPS	($0.07)	$0.00	$0.01	$0.03	$0.03	$0.08	$0.33	$0.73	$0.97
Diluted Shares O/S	14,348	16,500	16,600	16,700	16,800	16,650	17,000	17,100	17,200

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HISTORICAL ZACKS RECOMMENDATIONS



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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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