Zacks Small-Cap Research

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Lisa Thompson
312-265-9154
lthompson@zacks.com

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

Inuvo Inc. (INUV-NYSE)

INUV: Company Owned Web Sites Exceed Expectations: Raising Numbers

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	02/25/2015
Current Price (01/03/16)	$2.50
12-Month Target Price	**4.25**

OUTLOOK

Inuvo is digital publishing and advertising technology company that just reported Q4 revenues up 36% again beating estimates. The business is composed of a network of website and app partners and a network of owned and operated websites and apps. Revenue is earned from ads served by the company's proprietary technologies into those websites and apps. Its new native ad product "SearchLinks" could accelerate growth and increase valuation. Management's goal is to reach a revenue run rate of $100 million by the end of 2017 and it is on track to do so.

SUMMARY DATA

52-Week High	**$3.45**
52-Week Low	**$1.19**
One-Year Return (%)	**106.6**
Beta	**1.00**
Average Daily Volume (sh)	**48,436**
Shares Outstanding (mil)	**24**
Market Capitalization ($mil)	**$61**
Short Interest Ratio (days)	**4.9**
Institutional Ownership (%)	**31**
Insider Ownership (%)	**17**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**6.1**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**19.2**
P/E using 2015 Estimate	**17.9**
P/E using 2016 Estimate	
Zacks Rank	**N/A**

Risk Level	**Average**
Type of Stock	**Small-Growth**
Industry	**Internet-Services**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	10.1 A	10.9 A	13.0 A	15.5 A	49.6 A
2015	13.4 A	16.7 A	19.3 A	21.0 A	70.4 A
2016	19.6 E	21.6 E	24.4 E	24.6 E	90.1 E
2017					102.0 E

Earnings per Share
(Non-GAAP EPS from continuing operations)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	$0.03 A	$0.03 A	$0.03 A	$0.04 A	$0.13 A
2015	$0.03 A	$0.03 A	$0.03 A	$0.04 A	$0.13 A
2016	$0.02 E	$0.03 E	$0.04 E	$0.04 E	$0.12 E
2017					$0.14 E

Zacks Projected EPS Growth Rate - Next 5 Years **20%**

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KEY POINTS

- Inuvo is an emerging player in the digital advertising space a market that is growing over 16% per year and should benefit from this market growth.

- After transitioning out of a money-losing toolbar business, the company just reported its fifth quarter in a row of over 30% growth. It believes it is on track to deliver over 45% growth in Q1 2016.

- The company has stated its goal is to reach a $100 million in revenue run rate by the end of 2017. Given its trajectory this could happen as early as Q3 2016.

- The company's new advertising product, "SearchLinks", launched in July, generated $2.6 million in revenues in 2015. It should create a barrier to entry for its ad business, as it is complex and possibly unique in the industry. This native advertising product is in a very high growth space and companies in that space have higher valuations. We estimate private companies in this space are valued at 3Xs revenues.

- By being located almost exclusively in Arkansas, the company has an extremely low expense structure that is far superior to all the major companies in the web content and ad tech businesses. Almost all competitors are headquartered in expensive NYC or California locations that allows Inuvo to be price competitive while staying cash flow positive and avoiding shareholder dilution.

- Charles D. Morgan, Director and former founder and Chairman of Acxiom, has a 15% stake in the company (including Toqueville Asset Management.) We believe that this stake will help keep the company's objectives in line with that of shareholders. We believe that ultimately the company will be sold when it proves it has traction and reaches a size of interest to larger corporations.

- Since launching coverage of the company, the stock has moved up from $1.34 in February to its current price of $2.50. If the company is valued on enterprise value to sales (since many competitors operate at a loss), the stock is still priced below its peers who trade at an average of 1.0 times enterprise value to sales. With our increased revenues estimate from $80 million to $90 million. **If the company achieves $90 million in revenue in 2016, the price could move to $4.25 twelve months from now.** However, if SearchLinks gains meaningful traction, investors should look to others in the native advertising space that are currently valued at closer to 3x revenues which would reflect a valuation more than double that.

WHAT'S NEW

Q4 Revenues Beat Expectations as Owned and Operated Segment Soars

Once again INUV beat revenue expectations by reporting revenues of $21.0 million versus $15.5 million last year up 36%. Fully diluted EPS was on target with expectations at $0.02, and non-GAAP (ex-stock based compensation) fully diluted at $0.04, flat with a year ago. Owned and operated web site segment grew 93% year over year to $14.8 million, and up $2.8 million sequentially. Again, more than $1 million of this increase was due to the company buying two websites in March that were previously categorized under partner revenue, but the rest of the growth was organically driven.

Gross margin grew to 78% of sales versus 60% last year primarily due to product mix as owned and operated became 71% of sales versus 50% last year. We expect that margins will continue to move up in coming quarters due to that same dynamic.

Marketing costs for the quarter were in line at 14% of owned and operated revenues as they have been all year.

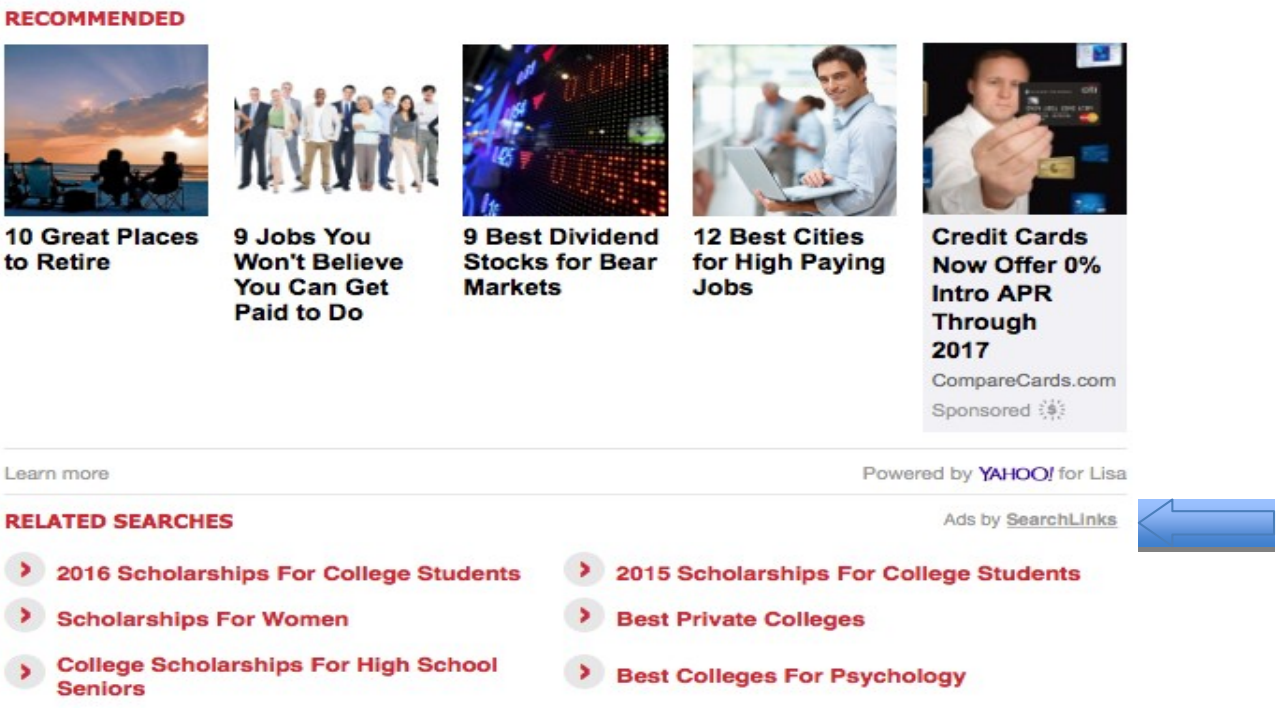
Compensation and SG&A were slightly higher as the company added employees and moved to a higher cost location in Little Rock, from Conway, Arkansas. In the quarter the company spent on furniture, fixtures, equipment and leasehold improvements for the space. The company now has an office twice the size of the former location in Conway, and the rent will only be slightly higher. In the quarter the company only added two employees to 63 people; this was up 10 employees since last year

Operating income was $700,000 versus $829,000. Interest expense was reduced to $30,000 from $65,000 last year as the company paid off $3.6 million in debt. Taxes were $79,000 versus a reversal of $72,000 last year.

Non-GAAP net income from continuing operations was $942,000 versus $1.2 million last year. EBITDA for the quarter was $1.55 million versus $1.78 last year. The company continues to invest as much as possible while still remaining cash flow positive as expected.

SearchLinks Shows Promise and is the Key to Improved Valuation

SearchLinks contributed $2.6 million to revenues in 2015 despite its slow rollout. Companies in the native advertising space are enjoying much higher valuations that basic digital advertising and we believe investors should focus on its progress. The company cited Kiplinger as a new SearchLinks customer. Below is an example of SearchLinks ads on the Kiplinger web site.



2016 Forecast

Given the strength of Q4 and management's guidance on Q1 revenues of $19.5 million being reasonable based on January sales, we are raising revenue estimates for 2016 to $90 million from $80 million. Since any excess profits are reinvested in marketing and content, any increase in profits flows through to the next quarter and increases that quarter's revenues. We are keeping EPS estimates the same, as we believe all profits will be plowed back into revenue growth.

VALUATION

Since we are increasing our revenue estimate, we are also increasing our price target. Inuvo is hybrid ad technology platform/ad network and website publisher. Since the company is almost spilt 50/50, we are using a combination of these types of pubic companies to create a blended valuation. Should SearchLinks, a native ad tech product be successful, we would look to higher revenue multiples as that business is much more attractive.

We applied average multiples to Inuvo's historical and projected revenues based on the comparable companies in the table below. Based purely on public company comps, the result is a market value of $93 million or $3.75 per share. Using this multiple and applying it to 2017 estimated revenues of $102 million, the stock is worth $4.11. However between now and then, we could see the IPOs of Outbrain, Taboola or Revcontent all of whom are much more highly valued and could increase the comparable multiples.

	Ticker	Revenue		TTM	Enterprise Value / Sales		EV/	Included	Enterprise
Company		2016E	LTM	EBITDA	2016E	LTM	EBITDA	Average?	Value
Autobytel	ABTL	$151	$123	$11	1.2x	1.5x	16.5x	y	179
Blucora	BCOR	$449	$487	$65	0.6x	0.6x	4.1x	y	269
Criteo	CRTO	$680	$474	$107	2.2x	3.2x	14.1x	y	1,510
Demand Media	DMD	$136	$135	-$18	0.4x	0.4x	-3.3x	y	58
Rocket Fuel	FUEL	$476	$476	-$54	0.3x	0.3x	-2.4x	y	129
Marchex	MCHX	$146	$148	$7	0.3x	0.3x	6.7x	y	44
The Rubicon Project	RUBI	$289	$196	-$7	1.8x	2.6x	-74.1x	y	519
MaxPoint Interactive	MXPT	$94	$138	-$13	0.2x	0.1x	-1.2x	y	16
SITO Mobile	SITO	$26	$16	-$1	1.9x	3.2x	-51.4x	y	50
Travelzoo	TZOO	$143	$133	$10	0.6x	0.6x	8.0x	y	82
IAC	IAC	$3,310	$3,210	$410	1.3x	1.4x	10.7x	y	4,400
Average				**47.0**	**1.0x**	**1.3x**	**-6.6x**		**$660**

	Revenue		TTM	Enterprise Value / Sales		Valuation Range	
	2016E	LTM	EBITDA	2016E	LTM	Low	High
Inuvo	**$90**	**$70**	**4.7**	**1.0x**	**1.3x**	**$88**	**$90**
YoY growth							
Conclusion of Enterprise Value			**$89,238,093**				
Market Value			**$92,609,345**				
Shares Outstanding			24,700,000				
Price per Share			**$3.75**				

	Revenue		2016E	Enterprise Value / Sales		Valuation Range	
	2017E	2016E	EBITDA	2017E	2016E	Low	High
Inuvo	**$102**	**$90**	**5.2**	**1.0x**	**1.3x**	**$100**	**$116**
YoY growth							
Conclusion of Enterprise Value			**$107,844,835**				
Market Value			**$111,216,087**				
Shares Outstanding			27,054,859				
Price per Share			**$4.11**				

Private Company Valuations

Inuvo two major competitors for SearchLinks are private companies so we need to take into account their valuation also. If the product is successful, it is possible that the company could achieve a valuation closer to its private competitors—however keep in mind there is often a disconnect between venture and public company valuations.

Outbrain, based in Netanya, Israel, is the older of the two and founded in 2006 and has $99 million in funding. It has approximately 540 employees of which about 180 are in New York City, 160 in Israel and 50 in the UK. In 2014, Outbrain did $260 million in revenues, and has an 80% CAGR. It has silently filed for an IPO and may be valued at $1 billion. If Outbrain grew 50% in 2014 to $195, that would be a trailing valuation of 3.8 times.

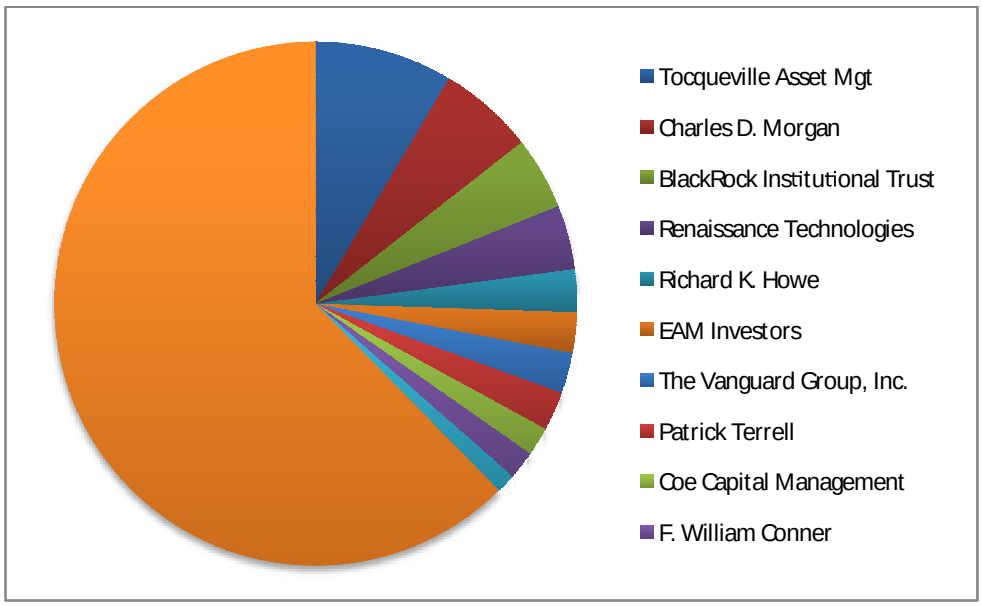
Taboola founded in 2007, has raised $160 million in venture funding. It says it is targeting $500 million in revenues in 2016. In January it struck as deal with AOL for advertising and it expects small equity investment from AOL. It has approximately 300 employees 120 of which are in its NYC headquarters and 100 are in the Israel where its R&D is based. The last round before AOL was in June of 2015 for $3 million and the strategic investor was the DailyMail.com. In February management said the company was at a $250 run rate and the last round was estimated to be $700 million by the Wall Street Journal. That would probably be three times the revenue run rate. At that valuation, it could now be worth near $1.5 billion.

RISKS

- There are few barriers to entry in the advertising network business and it typically operates with slim margins with competition mainly on price.
- The company is heavily dependent upon Yahoo! and Google for revenues.
- Some of the company's growth is dependent on the success of a new product that is virtually untested in the market and may not be adopted by new customers.
- The digital ad business is very competitive and there is far more inventory of ad space than is needed. There could be continued price pressure that would lower click rates going forward. Much of the ad inventory in the US goes unsold; more inventory could exacerbate this supply-demand imbalance. Thus, Inuvo may have to increase volume of ads sold just to maintain revenues.
- Inuvo has limited resources with which to compete against much larger companies and this could hinder its growth.
- SearchLinks, a new native advertising product, may not gain traction and its advertising results may not outperform competitors, which may decrease growth and certainly future valuation.

CURRENT OWNERSHIP

Charles D. Morgan owns Tocqueville Asset Management.



PROJECTED INCOME STATEMENT

Inuvo	Q4 2014 31-Dec	Q1 2015 31-Mar	Q2 2015 30-Jun	Q3 2015 30-Sep	Q4 2015 31-Dec	Q1 2016E 31-Mar	Q2 2016E 30-Jun	Q3 2016E 30-Sep	Q4 2016E 31-Dec	2014	2015	2016E	2017E
Partner Network Revenue	7.6	7.6	$9.3	$7.2	$6.2	5.3	$5.8	$6.7	$6.8	25.7	30.3	24.5	27.2
Yr-to-yr Growth	-1%	39%	67%	2%	-18%	-30%	-38%	-7%	10%	-29%	18%	-19%	11%
Owned and operated, excluding Appbar	7.7	5.8	7.3	12.0	14.8	14.2	$15.7	$17.7	$17.8	21.8	40.0	65.4	75.2
Yr-to-yr Growth	200%	59%	52%	114%	93%	144%	114%	48%	20%	157%	83%	64%	15%
Appbar	0.2	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.0	$0.0	2.1	0.4	0.2	0.0
Yr-to-yr Growth	-81%	-90%	-83%	-74%	-63%	-10%	0%	-100%	-100%	-80%	-82%	-51%	-100%
Total revenue	**15.5**	**13.4**	**16.7**	**19.3**	**21.0**	**19.6**	**21.6**	**24.4**	**24.6**	**49.6**	**70.4**	**90.1**	**102.4**
Yr-to-yr Growth	36%	32.6%	53%	48%	36%	46.1%	29%	27%	17%	-9.8%	42.0%	27.9%	13.6%
Cost of services	6.2	6.1	7.1	5.9	4.7	4.4	7.1	5.9	5.2	20.4	23.7	22.6	18.2
Partner network gross margin	1.4	1.5	2.2	1.4	1.5	1.0	1.2	1.5	1.6	5.5	6.6	5.2	5.4
% GM partner network	19%	20%	24%	19%	21%	19%	21%	22%	23%	21%	22%	19%	20%
Owned and Operated GM	7.9	5.8	7.4	12.0	14.8	14.2	15.7	17.7	17.8	23.7	40.1	65.4	75.2
% GM owned and operated	100%	100%	100%	100%	100%	100%	100%	100%	100%	99%	99%	100%	100%
Gross profit	9.3	7.4	9.6	13.4	16.4	15.2	16.9	19.2	19.3	29.2	46.7	70.6	80.6
Gross Margin	60.2%	54.8%	57.6%	69.5%	77.7%	77.8%	78.3%	78.7%	78.7%	58.8%	66.3%	78.4%	78.8%
Operating expenses:													
Marketing	5.9	4.9	6.6	10.2	12.7	12.1	13.3	15.0	15.1	17.5	34.3	55.6	63.9
Profit after marketing of owned and operated	2.0	0.9	0.8	1.8	2.2	2.1	2.3	2.7	2.7	6.3	5.7	9.8	11.3
Margin Percent	25%	15%	11%	15%	14%	15%	15%	15%	15%	26%	14%	15%	15%
Compensation	1.4	1.2	1.3	1.5	1.5	1.6	1.7	1.8	2.0	4.8	5.6	7.1	8.1
SG&A	1.2	1.0	1.2	1.0	1.4	1.4	1.4	1.5	1.5	4.4	4.6	5.8	6.0
Total operating expenses	8.4	7.1	9.1	12.7	15.6	15.1	16.4	18.3	18.6	26.7	44.6	68.4	78.0
Operating income:	0.9	0.3	0.5	0.6	0.7	0.2	0.5	0.8	0.8	2.5	2.1	2.3	2.6
Operating margin	5.8%	1.9%	3.2%	3.3%	3.5%	1.0%	2.2%	3.4%	3.2%	5.0%	3.0%	2.5%	2.6%
Other income:													
Interest expense, net	(0.065)	(0.1)	(0.0)	(0.0)	(0.030)	(0.0)	(0.0)	(0.0)	(0.0)	(0.4)	(0.1)	-	-
Total other income	(0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.4)	(0.3)	-0.1	0.0
Income before income taxes	0.829	0.2	0.5	0.6	0.7	0.2	0.4	0.8	0.7	2.1	1.9	2.1	2.6
Pretax Margin	5.3%	1.5%	3.0%	3.2%	3.3%	0.8%	2.0%	3.3%	3.0%	4.3%	2.7%	2.4%	2.6%
Income tax benefit	(0.1)	(0.4)	(0.0)	0.0	0.1	-	-	-	-	(0.2)	(0.4)	-	-
Tax rate	-9%	-204%	-7%	1%	11%	0%	0%	0%	0%	-7.1%	-18.7%	0.0%	0.0%
Net income from continuing operations	0.8	0.6	0.5	0.6	0.6	0.2	0.4	0.8	0.7	2.3	2.2	2.1	2.6
Net income from discontinued operations	(0.1)	0.0	(0.0)	0.0	-	-	-	-	-	(0.0)	0.0	-	-
Net income	0.6	0.6	0.5	0.6	0.6	0.2	0.4	0.8	0.7	2.3	2.3	2.1	2.6
Stk based compensation	0.3	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	1.0	0.8	1.0	1.3
One-time expenses	0.1	-	-	-	-	-	-	-	-	0.1	-	-	-
Non-GAAP Income from continuing	1.206	0.7	0.7	0.9	0.942	0.5	0.8	1.1	1.1	3.3	3.0	3.1	3.9
Yr-over-Yr										393.3%	-6.5%	3.2%	24.2%
Net income per share:													
Basic from continuing	0.03	0.03	0.02	0.02	0.03	0.01	0.02	0.03	0.03	0.10	0.09	0.08	0.10
Diluted from continuing	0.03	0.03	0.02	0.02	0.02	0.01	0.02	0.03	0.03	0.09	0.09	0.08	0.10
Non-GAAP Diluted from continuing	**0.04**	**0.03**	**0.03**	**0.03**	**0.04**	**0.02**	**0.03**	**0.04**	**0.04**	**0.13**	**0.13**	**0.12**	**0.14**
		-18.3%	5.5%	26.3%	-5.3%	-29.5%	14.1%	30.0%	13.3%	358%	-3%	-4%	18%
Shares													
Basic	23.6	24.1	24.3	24.3	24.4	24.5	24.3	24.3	24.4	23.5	24.2	25.5	26.7
Diluted	24.5	24.2	24.7	24.8	24.9	25.0	24.7	24.8	24.9	24.1	24.5	25.8	27.1
	5.0%	3.2%	2.7%	2.7%	1.7%	3.1%	0.0%	0.0%	0.1%	3.7%	1.6%	5.0%	5.0%
Adjusted EBITDA	1.78	0.67	1.09	1.35	1.55	1.01	1.29	1.64	1.60	5.48	4.66	5.12	5.76
	2138%	-50%	-9%	15%	-13%	49%	18%	22%	3%	46%	-15%	10%	13%

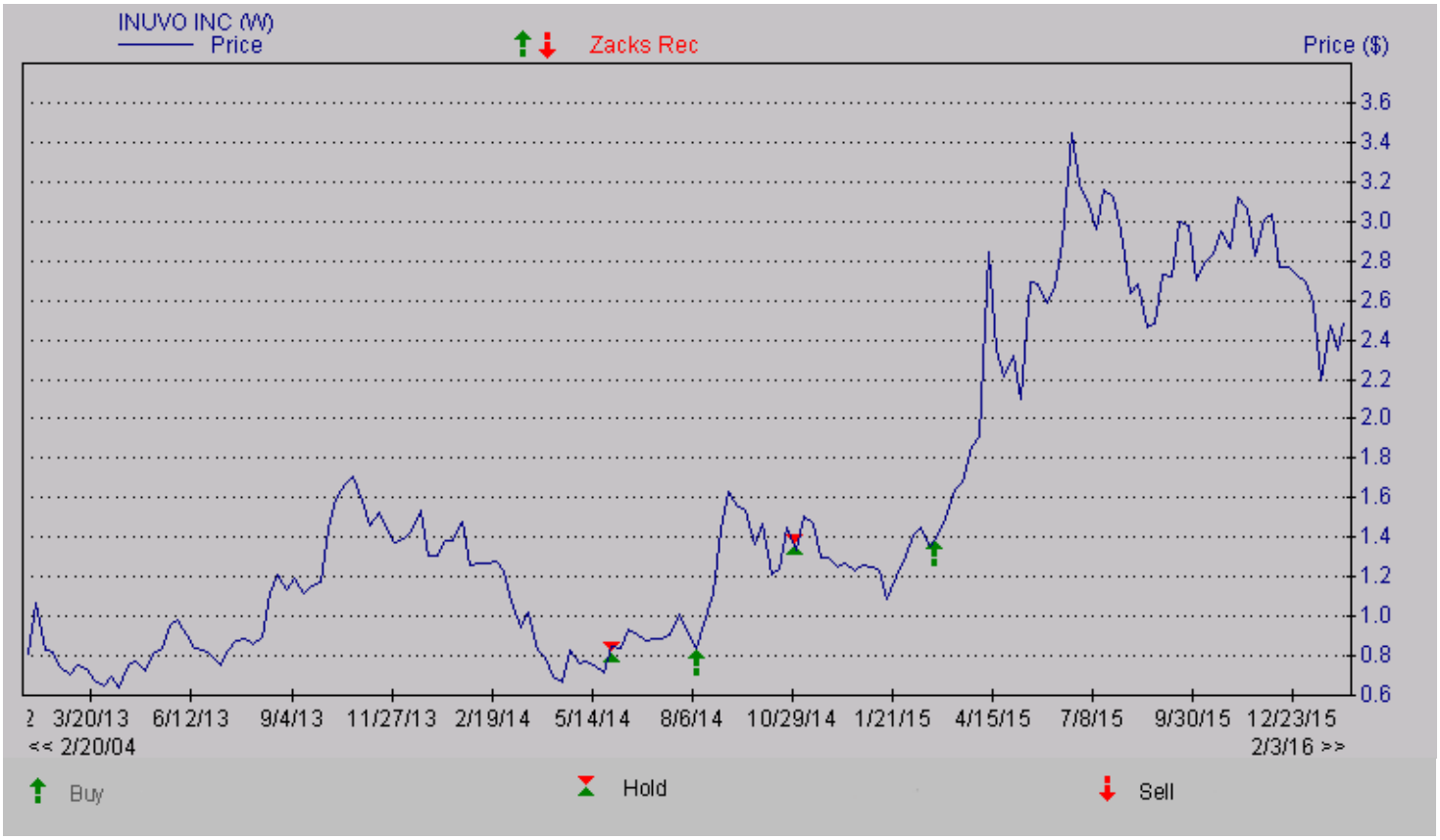
BALANCE SHEET

	Dec. 31, 2015	Sept. 30, 2015	% Change
Current assets			
Cash	$4,257,204	$3,921,938	9%
Accounts receivable, net	7,001,337	6,055,468	16%
Unbilled revenue	16,154	25,741	-37%
Prepaid expenses and other current assets	345,752	271,641	27%
Total current assets	11,620,447	10,274,788	13%
Property and equipment, net	1,805,561	1,421,362	27%
Other assets			
Goodwill	5,760,808	5,760,808	0%
Intangible assets, net of accumulated amortization	9,320,951	9,555,245	-2%
Other assets	224,759	225,382	0%
Total other assets	15,306,518	15,541,435	-2%
Total assets	28,732,526	27,237,585	5%
Current liabilities			
Accounts payable	10,080,315	8,776,552	15%
Accrued expenses and other current liabilities	3,169,445	4,226,665	-25%
Total current liabilities	13,249,760	13,003,217	2%
Long-term liabilities			
Deferred tax liability	3,799,600	3,552,500	7%
Other long-term liabilities	722,722	550,686	31%
Total long-term liabilities	4,522,322	4,103,186	10%
Total Liabilities	17,772,082	17,106,403	4%
Stockholder's equity			
Total stockholders' equity	10,960,444	10,131,182	8%
Total liabilities and stockholders' equity	$28,732,526	$27,237,585	5%
Quick Ratio	0.9	0.8	11%
Working Capital	(1,629,313)	(2,728,429)	-40%
Cash as % of assets	15%	14%	3%

CASH FLOWS

CONSOLIDATED STATEMENTS OF CASH FLOWS (USD $)	3 Months Ended March 31, 2015	3 Months Ended June 30, 2015	3 Months Ended Sept. 30, 2015	3 Months Ended Dec. 31, 2015	Year 2015
Operating activities:					
Net income	626,310	445,008	651,394	617,062	2,339,774
Adjustments to reconcile net income to net cash provided by operating activities:					
Settlement of tax liability	(406,453)	-	-	247,100	(159,353)
Depreciation and amortization	370,883	472,202	463,644	500,621	1,807,350
Deferred income taxes	-	-	-	-	-
Amortization of financing fees	9,533	645	3,226	6,400	19,804
Adjustment of European liabilities related to discontinued operations	(20,461)	9,056	(45,206)	(3,140)	(59,751)
Provision of doubtful accounts	(80)	(12,956)	-	7,000	(6,036)
Stock based compensation	51,924	82,750	251,144	321,726	707,544
Other, net	(251,084)	-	251,084	-	0
Cash Flow	**(987,184)**	**5,432,055**	**3,705,482**	**2,634,167**	**6,108,273**
Free cash flow	**(1,226,611)**	**5,094,342**	**3,231,944**	**2,530,565**	**4,582,385**

HISTORICAL ZACKS RECOMMENDATIONS



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