Zacks Small-Cap Research

October 26, 2015

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Inuvo Inc. (INUV-NYSE)

INUV: A Secret to Inuvo's Success—Is Arkansas

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	02/25/2015
Current Price (10/23/15)	$2.96
12-Month Target Price	**4.25**

OUTLOOK

Inuvo is digital publishing and advertising technology company that just reported Q3 revenues up 48% beating estimates. We are raising prices targets to reflect that beat. 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	**$1.09**
One-Year Return (%)	**104.14**
Beta	**1.00**
Average Daily Volume (sh)	**53,273**
Shares Outstanding (mil)	**24**
Market Capitalization ($mil)	**$72**
Short Interest Ratio (days)	**7.39**
Institutional Ownership (%)	**29**
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	**22.8**
P/E using 2015 Estimate	**26.9**
P/E using 2016 Estimate	**22.8**
Zacks Rank	**N/A**

Risk Level	**Above 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)
2013	16 A	13 A	15 A	11 A	55.0 A
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	19.5 E	68.5 E
2016	16.3 E	19.1 E	22.2 E	22.5 E	80.3 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.01 A	$0.01 A	$0.04 A	-$0.02 A	$0.03 A
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 E	$0.11 E
2016	$0.01 E	$0.03 E	$0.05 E	$0.04 E	$0.13 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 fourth quarter in a row of over 30% growth. It has just given conservative guidance for full year 2015 revenue growth of between 33-38%.

- The company has stated its goal is to reach a $100 million in revenue run rate by the end of 2017. This could happen even faster were the company to grow through acquisition as well as organically. It increased content on its company-owned sites 50% this quarter, internally as well as through the acquisition of content-based web sites.

- The company just introduced a new advertising product, "SearchLinks", that hopes to find success with its ad network partners and create more customer retention. 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.

- 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 $2.96. 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 1.3 times enterprise value to sales. With our increased revenues estimate, **we are raising our near-term target price to $3.95. If the company achieves $80 million in revenue in 2016, the price could move to $4.25 in twelve months.** However, if SearchLinks is successful, investors should look to others in the native advertising space that are currently valued at closer to 3.5x revenues which would reflect a valuation more than double that.

WHAT'S NEW

Q3 Revenues Beat Expectations as Owned and Operated Segment Soars

Once again INUV beat revenue expectations by reporting revenues of $19.3 million versus $13 million last year up 48%. Fully diluted EPS was on target with expectations at $0.03. It had an amazing showing in the owned and operated web site segment that grew 114% to $12 million (excluding Appbar revenues.) Granted, 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. Taking out $1.1 million in acquired revenues, internal growth was 94%. Even more amazing was

the company's ability to grow content 50% from Q2 to Q3 despite only a modest increase in employees and expenses. Since last quarter the company only added 11 employees to 61 people.

Due primarily to changes in technology, the company had a 30% increase in new users and a 25% increase in the average time spent on its site which resulted in advertising clicks being up 60% quarter-over-quarter.

The Cost Advantage is Arkansas

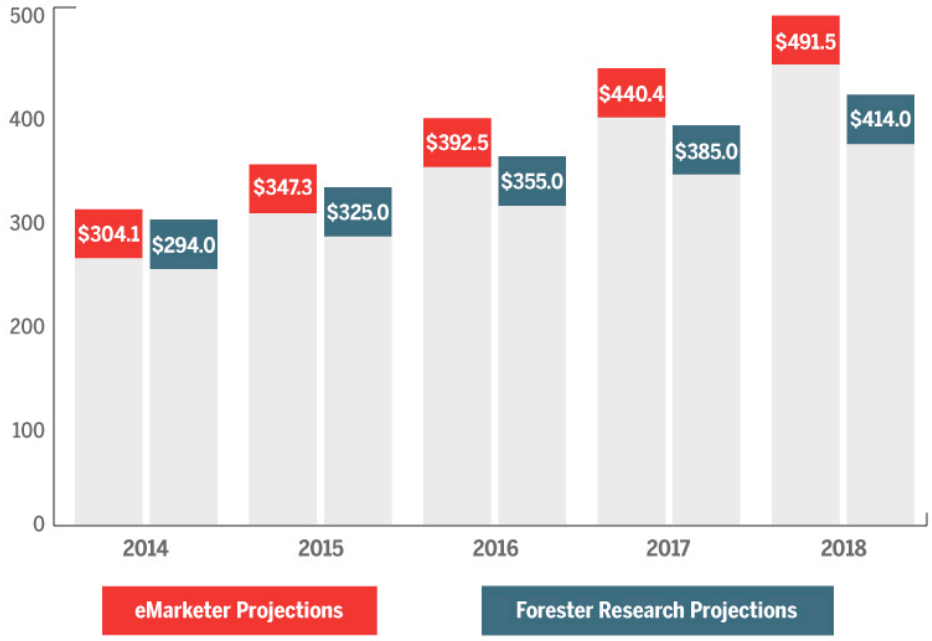
While investors may know that Inuvo almost uniquely operates in a low cost environment, it is now becoming evident in the company's financials. While competitors such as Taboola, Outbrain and Demand Media reside in, and pay staff, fancy New York City and LA salaries; Inuvo will always have a cost advantage due to its location in Arkansas and its judicious use of student talent. In fact, now all but five of Inuvo's employees are located in Arkansas, and its massive data center has been moved there as well. Just as impressively the moves were paid for by a generous grant from the state of Arkansas of $1.75 million. In mid-November the company will be moving to a Little Rock tech park at 500 President Clinton Avenue that also houses Acxiom, Hewlett Packard and a number of high tech startups. Despite being more than twice the size of the former location in Conway, the rent will only be slightly higher.

Growth Through New Products and Acquisition

SearchLinks revenues did not grow this quarter, as the company is still adding features to the product. We expect to see noticeable results from this SearchLinks in 2016. In the interim however, we believe the company may be opportunistically adding owned web sites where it can achieve the right ROI. The last two web sites were purchased because they were on topics where the company had a presence and there was no need to bring on any staff to support them resulting in a high ROI particularly if these sites meet their revenue targets as they have so far done. They were bought with stock and will can earn additional stock every year in March for the next three years should they reach certain targets.

2015 Revenues Should be at the High End of Guidance

Going forward we believe the company should be able to hit or exceed the high end of its guidance based on typical seasonality as well as high forecasts for online shopping this Christmas season. The fourth quarter typically equals revenues in the third quarter or is slightly better because although there are more ad dollars spent earlier in the quarter, but advertising typically ceases after Christmas. The National Retail Federation it expects sales in November and December to rise 3.7% to $630.7 billion versus growth of 4.1% last year. This weaker year could give an advantage to digital advertising, which can react more quickly than TV or print when more advertising is needed to spur sales in weak situations. Additionally online sales are expected to grow between 10.5% and 14.2% this year versus last as shown below.



As a result we are moving our Q4 revenues up to $19.5 million, and the year moves to $68.9 million. We believe the company will continue to reinvest in the business to grow revenues while maintaining cash flow positive. EPS estimates remain the same as we expect incremental profits will be plowed back into marketing spend for Owned and Operated sites.

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 $97 million or $3.95 per share. Using this multiple and applying it to 2016 estimated revenues of $80 million, we believe the stock price could move to $4.25, up 44%.

Company	Ticker	Revenue 2015E	Revenue LTM	TTM EBITDA	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	EV/ EBITDA	Included Average?	Enterprise Value	Location
Autobytel	ABTL	$132	$110	$9	1.9x	2.2x	26.8x	y	247	Irvine
Blucora	BCOR	$470	$517	$78	0.9x	0.8x	5.2x	y	404	Seattle
Criteo	CRTO	$526	$430	$87	3.9x	4.7x	23.3x	n	2,030	Paris/NYC
Demand Media	DMD	$131	$147	-$6	0.4x	0.4x	-8.4x	y	52	LA
Rocket Fuel	FUEL	$505	$466	-$53	0.4x	0.5x	-4.0x	y	213	Redwood City
Marchex	MCHX	$145	$159	$7	0.5x	0.4x	10.3x	y	69	Seattle
Millennial Media Inc.*	MM	$270	$285	-$41	0.9x	0.9x	-6.0x	y	250	Baltimore
The Rubicon Project	RUBI	$248	$164	-$10	2.4x	3.6x	-58.9x	y	583	LA/NYC
MaxPoint Interactive	MXPT	$90	$129	-$13	1.1x	0.8x	-7.7x	y	99	Morrisville, NC
SITO Mobile	SITO	$18	$14	-$1	3.6x	4.4x	-50.2x	y	63	Jersey City
Travelzoo	TZOO	$132	$136	$9	0.6x	0.6x	9.7x	y	84	NYC
IAC	IACI	$3,220	$3,160	$400	1.9x	1.9x	15.3x	y	6,110	NYC/Denver
Average				**34.4**	**1.3x**	**1.5x**	**-6.2x**		**$743**	

* Bought by AOL

	Revenue 2015E	Revenue LTM	TTM EBITDA	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM		Valuation Range Low	Valuation Range High
Inuvo	**$69**	**$65**	**4.9**	**1.3x**	**1.5x**	0.1x	**$91**	**$97**
YoY growth								
Conclusion of Enterprise Value			**$94,099,784**					
Market Value			**$97,471,036**					
Shares Outstanding			24,700,000					
Price per Share			**$3.95**					

	Revenue 2016E	Revenue 2015E	2015E EBITDA	Enterprise Value / Sales 2016E	Enterprise Value / Sales 2015E	Valuation Range Low	Valuation Range High
Inuvo	**$80**	**$69**	**4.9**	**1.3x**	**1.5x**	**$103**	**$106**
YoY growth							
Conclusion of Enterprise Value			**$104,651,438**				
Market Value			**$108,022,690**				
Shares Outstanding			25,428,412				
Price per Share			**$4.25**				

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.

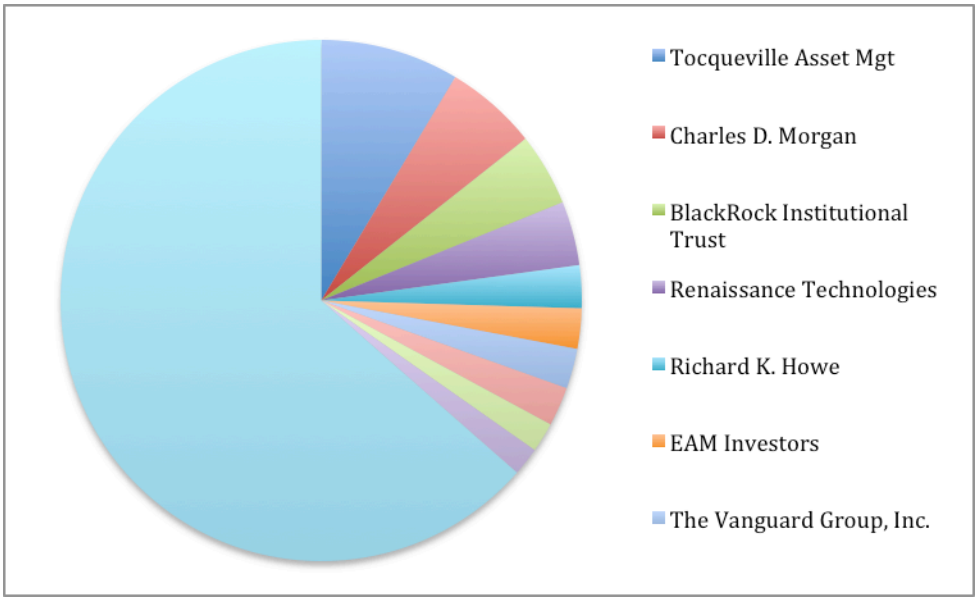
Taboola founded in 2007, has raised $160 million in venture funding. It has approximately 300 employees 120 of which are in its NYC headquarters and 100 are in the Israel where its R&D is based. Its latest round was in June of 2015 and the strategic investor was the DailyMail.com. In February management said the company was at a $250 run rate and the last round is rumored to be post money shy of $1 billion. That would probably be 3.5 times the run rate.

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 almost entirely 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



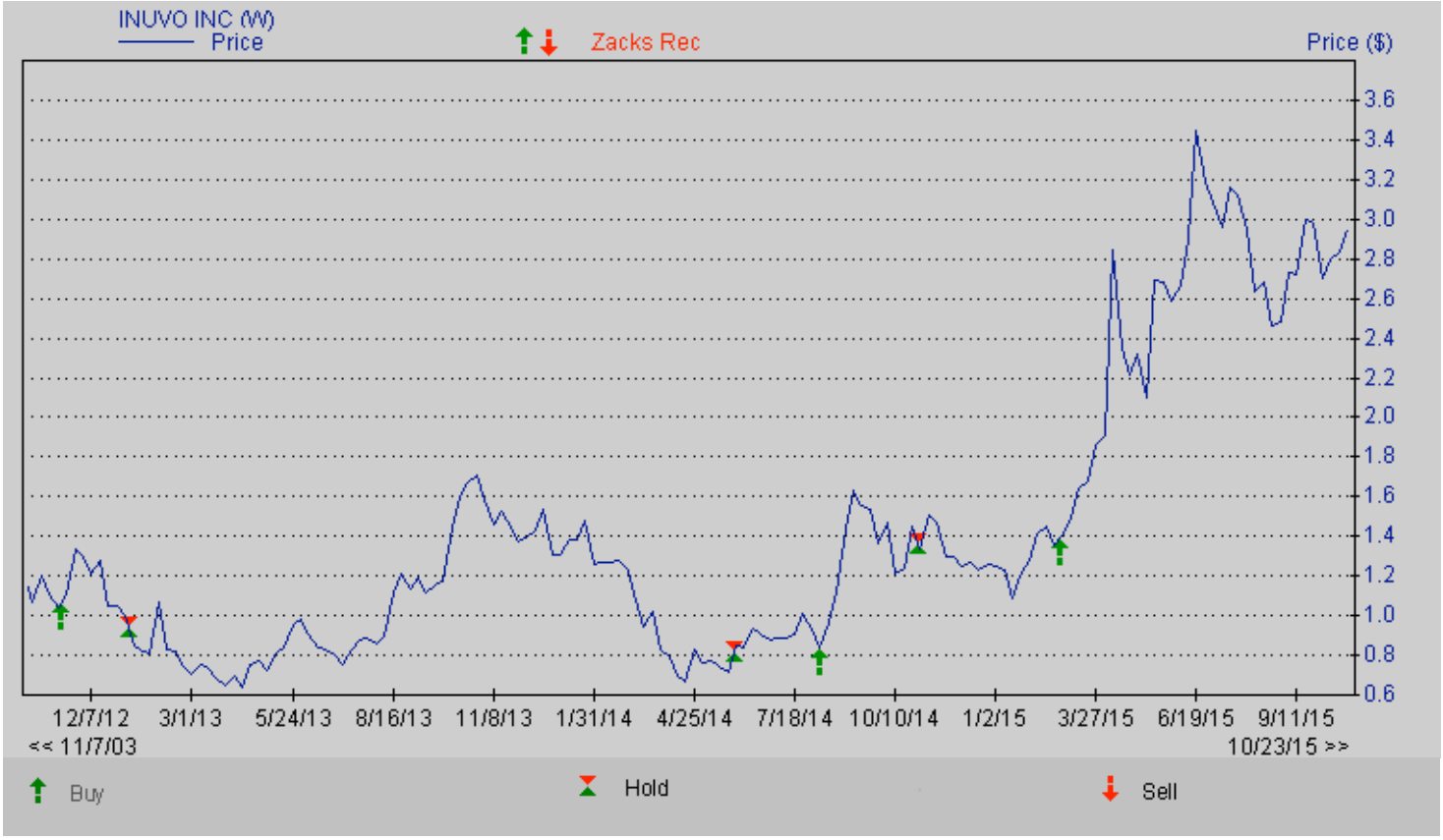
PROJECTED INCOME STATEMENT

Inuvo	Q4 2014 31-Dec	Q1 2015 31-Mar	Q2 2015 30-Jun	Q3 2015 30-Sep	Q4 2015E 31-Dec	Q1 2016E 31-Mar	Q2 2016E 30-Jun	Q3 2016E 30-Sep	Q4 2015E 31-Dec	2014	2015E	2016E
Partner Network Revenue	7.6	7.6	$9.3	$7.2	$7.4	6.3	$7.2	$8.3	$8.5	25.7	31.5	30.3
Yr-to-yr Growth	-1%	39%	67%	2%	-2%	-17%	-22%	16%	15%	-29%	23%	-4%
Owned and operated, excluding Appbar	7.7	5.8	7.3	12.0	12.0	10.2	$11.7	$13.8	$13.9	21.8	37.1	49.7
Yr-to-yr Growth	200%	59%	52%	114%	56%	74%	60%	16%	16%	157%	70%	34%
Appbar	0.2	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	2.1	0.4	0.4
Yr-to-yr Growth	-81%	-90%	-83%	-74%	-63%	-10%	0%	0%	0%	-80%	-82%	-3%
Total revenue	**15.5**	**13.4**	**16.7**	**19.3**	**19.5**	**16.6**	**19.1**	**22.2**	**22.5**	**49.6**	**68.9**	**80.3**
Yr-to-yr Growth	36%	32.6%	53%	48%	26%	23.5%	14%	16%	15%	-9.8%	38.9%	16.6%
Cost of services	6.2	6.1	7.1	5.9	5.9	5.2	7.1	5.9	6.6	20.4	25.0	24.8
Partner network gross margin	1.4	1.5	2.2	1.4	1.6	1.2	1.5	1.8	1.9	5.5	6.7	6.5
% GM partner network	19%	20%	24%	19%	21%	19%	21%	22%	23%	21%	21%	19%
Owned and Operated GM	7.9	5.8	7.4	12.0	12.0	10.2	11.7	13.8	13.9	23.7	37.3	49.7
% GM owned and operated	100%	100%	100%	100%	100%	100%	100%	100%	100%	99%	99%	100%
Gross profit	9.3	7.4	9.6	13.4	13.6	11.4	13.2	15.7	15.8	29.2	43.9	56.2
Gross Margin	60.2%	54.8%	57.6%	69.5%	69.5%	68.7%	69.5%	70.4%	70.5%	58.8%	63.7%	69.9%
Operating expenses:												
Marketing	5.9	4.9	6.6	10.2	10.2	8.7	10.0	11.8	11.8	17.5	31.9	42.2
Profit after marketing of owned and operated	2.0	0.9	0.8	1.8	1.8	1.5	1.8	2.1	2.1	6.3	5.4	7.5
Margin Percent	25%	15%	11%	15%	15%	15%	15%	15%	15%	26%	14%	15%
Compensation	1.4	1.2	1.3	1.5	1.6	1.6	1.7	1.8	2.0	4.8	5.7	7.1
SG&A	1.2	1.0	1.2	1.0	1.1	1.1	1.2	1.2	1.2	4.4	4.3	4.7
Total operating expenses	8.4	7.1	9.1	12.7	12.9	11.3	12.8	14.8	15.0	26.7	41.8	53.9
Operating income:	0.9	0.3	0.5	0.6	0.7	0.1	0.4	0.9	0.8	2.5	2.1	2.2
Operating margin	5.8%	1.9%	3.2%	3.3%	3.4%	0.4%	2.1%	4.1%	3.7%	5.0%	3.0%	2.8%
Other income:												
Interest expense, net	(0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(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)	0.0
Income before income taxes	0.8	0.2	0.5	0.6	0.6	0.1	0.4	0.9	0.8	2.1	1.8	2.2
Pretax Margin	5.3%	1.5%	3.0%	3.2%	3.3%	0.3%	2.1%	4.0%	3.7%	4.3%	2.6%	2.7%
Income tax benefit	(0.1)	(0.4)	(0.0)	0.0	-	-	-	-	-	(0.2)	-	-
Tax rate	-9%	-204%	-7%	1%	0%	0%	0%	0%	0%	-7.1%	0.0%	0.0%
Net income from continuing operations	0.8	0.6	0.5	0.6	0.6	0.1	0.4	0.9	0.8	2.3	1.8	2.2
Net income from discontinued operations	(0.1)	0.0	(0.0)	0.0	-	0.0	(0.0)	0.0	-	(0.0)	-	-
Net income	0.6	0.6	0.5	0.6	0.6	0.1	0.4	0.9	0.8	2.3	1.8	2.2
Foreign currency valuation	-	-	-	-	-	-	-	-	-	-	-	-
Comprehensive income	0.6	0.6	0.5	0.6	0.6	0.6	0.6	0.6	0.6	2.3	1.8	2.2
Stk based compensation	0.3	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	1.0	0.7	1.0
One-time expenses	0.1	-	-	-	-	-	-	-	-	0.1	-	-
Non-GAAP Income from continuing	1.2	0.7	0.7	0.9	0.9	0.3	0.6	1.1	1.1	3.3	2.5	3.2
Yr-over-Yr										393.3%	-23.1%	26.8%
Net income per share:												
Basic from continuing	0.03	0.03	0.02	0.02	0.03	0.00	0.02	0.04	0.03	0.10	0.08	0.09
Diluted from continuing	0.03	0.03	0.02	0.02	0.03	0.00	0.02	0.04	0.03	0.09	0.08	0.09
Non-GAAP Diluted from continuing	**0.04**	**0.03**	**0.03**	**0.03**	**0.04**	**0.01**	**0.03**	**0.05**	**0.04**	**0.13**	**0.10**	**0.13**
		-18.3%	5.5%	26.3%	-10.1%	-53.6%	-2.3%	33.9%	20.0%	358%	-20%	21%
Shares												
Basic	23.6	24.1	24.3	24.3	24.4	24.1	24.3	24.3	24.4	23.5	23.5	24.7
Diluted	24.5	24.2	24.7	24.8	24.9	24.2	24.7	24.8	24.9	24.0	24.2	25.4
	5.0%	3.2%	2.7%	2.7%	1.8%	0.0%	0.0%	0.0%	0.0%	3.2%	0.8%	5.0%
Adjusted EBITDA	1.78	0.67	1.09	1.35	1.37	0.78	1.12	1.62	1.55	5.48	4.48	5.07
	2138%	-50%	-9%	15%	-23%	16%	3%	20%	13%	46%	-18%	13%

BALANCE SHEET

	Sept. 30, 2015	June 30, 2015	
Current assets			
Cash	$3,921,938	$11,900	32857%
Accounts receivable, net	6,055,468	6,348,993	-5%
Unbilled revenue	25,741	29,038	-11%
Prepaid expenses and other current assets	271,641	286,577	-5%
Total current assets	10,274,788	6,676,508	54%
Property and equipment, net	1,421,362	1,201,858	18%
Other assets			
Goodwill	5,760,808	5,760,808	0%
Intangible assets, net of accumulated amortization	9,555,245	9,789,539	-2%
Other assets	225,382	210,050	7%
Total other assets	15,541,435	15,760,397	-1%
Total assets	27,237,585	23,638,763	15%
Current liabilities			
Accounts payable	8,776,552	8,368,632	5%
Accrued expenses and other current liabilities	4,226,665	4,175,373	1%
Term and credit notes payable - current portion	0	666,667	-100%
Total current liabilities	13,003,217	13,210,672	-2%
Long-term liabilities			
Deferred tax liability	3,552,500	3,552,500	0%
Term and credit notes payable - long term	0	833,334	-100%
Other long-term liabilities	550,686	581,052	-5%
Total long-term liabilities	4,103,186	4,966,886	-17%
Total Liabilities	17,106,403	18,177,558	-6%
Stockholder's equity			
Total stockholders' equity	10,131,182	9,228,644	10%
Total liabilities and stockholders' equity	$27,237,585	$27,406,202	-1%
Quick Ratio	0.8	0.5	56%
Working Capital	(2,728,429)	(6,534,164)	-58%
Cash as % of assets	14%	0%	28503%
Debt % of assets	2%	9%	-77%

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Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters.
Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution is as follows: Buy/Outperform- 26.0%, Hold/Neutral- 50.8%, and Sell/Underperform – 19.5%. Data is as of midnight on the business day immediately prior to this publication.