April 30, 2020

Zacks Small-Cap Research

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Mastech Digital (MHH-AMEX)

MHH: Mastech Digital Posts Stellar Q1 and Has Had Few Cancellations So Far

Based on a PE of 15xs, we believe MHH stock could be worth $18.45 per share by next year.

Current Price (04/29/20)	$14.93
Valuation	**$18.45**

OUTLOOK

Mastech Digital, based outside Pittsburgh, PA is an IT staffing business with a growing data and analytics consulting and project management service serving blue chip customers in the US. The data and analytics business, Mastech InfoTrellis, was 15% of sales this quarter and its run rate grew from $28.6 million to $29.4 million, up 28% year over year. While we expected accelerating earnings generated through internal growth and acquisitions, affording it a higher valuation based on an expanding multiple, it is uncertain as to the affect of the coronavirus shutdowns will be based on client plans and are being cautious.

SUMMARY DATA

52-Week High	**$17.84**
52-Week Low	**$4.71**
One-Year Return (%)	**180.4**
Beta	**0.7**
Average Daily Volume (sh)	**32,302**
Shares Outstanding (mil)	**11.1**
Market Capitalization ($mil)	**$167**
Short Interest Ratio (days)	**0.8**
Institutional Ownership (%)	**10**
Insider Ownership (%)	**64**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**12.5**
Earnings Per Share (%)	**18.6**
Dividend (%)	**N/A**
P/E using TTM EPS	**16.2**
P/E using 2020 Estimate	**18.2**
P/E using 2021 Estimate	**12.1**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**IT Services**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	43 A	45 A	44 A	45 A	177 A
2019	45 A	48 A	50 A	50 A	194 A
2020	50 A	47 E	49 E	52 E	198 E
2021					235 E

Non-GAAP Earnings Per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	$0.18 A	$0.21 A	$0.20 A	$0.16 A	$0.74 A
2019	$0.15 A	$0.20 A	$0.23 A	$0.26 A	$0.82 A
2020	$0.23 A	$0.18 E	$0.20 E	$0.24 E	$0.88 E
2021					$1.23 E

Zacks Projected EPS Growth Rate - Next 5 Years % **15**

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WHAT'S NEW

Mastech Digital Posts Stellar Q1 and Has Had Few Cancellations So Far

Mastech just reported a stellar Q1 growing revenues 12% year over year and up slightly sequentially. Any hit to business it has had from the coronavirus worldwide shut down certainly didn't show up in Q1 numbers. To date the company has experienced some customer cancellations and premature contract ends in IT staffing, but Mastech InfoTrellis (data and analytics) continues relatively unscathed except for the delay some potential customers have put on signing contracts. It is too early in the quarter to predict the total effect on revenues going forward but to date only about 50-60 billable employees in IT staffing have been sent home, which is about 5% of the total. Data and analytics continues strong, and signed yet another multi-million dollar long term contract with a financial services company. At this point we would be hard pressed to predict this business to decline in 2020.

The outbreak of coronavirus worldwide has effected Mastech's operations in both the US and India in Q1. Both employees of Mastech, and most employees in the staffing business working at client locations, have been ordered to work from home, but given the nature of the business this move has had little impact on operations or current revenues. IT staff had been in short supply anyway and the company has not reduced its staffing recruiting efforts. Most staffing projects are about nine months, but customers are allowed to cancel at any time. Recruiting continues from India, where employees have been working from home.

While business at Mastech InfoTrellis (aka D&A) continues on track with no cancellations so far, some potential customers that were expected to sign on this quarter have delayed going forward, particularly in Europe. The company has little exposure to the hardest hit industries such as travel and oil. It had only a handful of staffing employees working for an airline and a cruise line and none in oil. Much of what Mastech does for clients is mission critical. Certainly only those clients that are cash strapped or doing tangential projects would cancel current projects that relate to business improvements.

What mostly will be affected will be sales efforts, particularly in Europe, but certainly everywhere. In 2019, 99% of revenues came from the US and Canada. We are cutting estimates based on a reduction in the growth of new business, which we expect in Q2 through Q4, and a reduction in the need for IT staffing evidenced so far.

Total revenues increased 11.6% and total gross margin was 25.2% versus 24.0% a year ago and 24.5% in Q4 2019. Gross margin dollars increased 17.4%.

Looking at the two segments, IT staffing grew 9% to $43 million and was 85% of revenues. It had 1,100 billable consultants compared to 1,116 the year before and 1,167 in the fourth quarter of 2019. Gross margin for this segment improved to 21.5% from 20.8% last year and 21.4% in Q4 2019. New contracts are being signed at higher rates than last year.

Data and analytics grew 28% to $7.4 million or 15% of sales compared to 13% of sales last year. Gross margins also improved in this segment to 47.1% from 45.5% a year ago. As a result gross margin dollars increased 32.1%.

SG&A bumped up a million dollars from Q4 to $10.2 million versus only $9.0 million last year. The increased spending was due to $700,000 in increased spending on sales and marketing for the data and analytics business primarily in the rest of the world outside the US. Another $300,000 was from spending on IT staffing. Due to cost controls the company expects SG&A to decline in Q2.

Operating income increased 32% to $2.5 million and margin improved to 4.9% from 4.1% a year ago, though down from the 6.9% in Q4 2019.

Interest expense declined to $226,000 compared to $539,000 a year ago as the company pays off higher interest rate debt.

For the quarter the tax rate was lower than expected due to the exercise of stock, which results in a favorable tax treatment and reduced the tax rate to 17%. The company expects the year to still be in the 26% range.

GAAP net income was $1.9 million, up 94% from a year ago. On a non-GAAP basis it was $2.7 million up 66%.

GAAP EPS was $0.16 diluted compared to $0.09 a year ago and $0.20 in Q4 2019. On a non-GAAP basis it was $0.23 versus $0.15. The fully diluted share count was 11.7 million up 4.7%.

Balance Sheet

The company ended the quarter with $2.6 million in cash, a quick ratio of 1.6Xs, working capital of $13.6 million, and debt of $21.9 million. It reduced debt $3.4 million since last quarter and $16.3 million since last year at this time. Management feels it has enough liquidity to handle the effects of the pandemic.

2020 Estimates

For 2020 we are cutting revenues and earnings due to the pandemic primarily in staffing. Of course we are only guessing at this point, as there is no way to gage the affect coronavirus will have on Mastech's customers and their plans. All we can say is that to date, the company has not had many contracts end or not be renewed. Fortunately, this is one industry where employees can easily remain productive working from home as long as demand remains.

For Q2 we are assuming that data and analytics keeps growing sequentially based on the three large contracts signed in Q4 and the new one signed this quarter. This business seems on track. The IT staffing business has so far seen approximately 50, or 5% of its people sent home, so we are conservatively taking revenues down 8% sequentially today. This leaves us with a revenue estimate of $47 million for the June quarter versus $48 million last year. Management has said it expects expenses to be down in Q2 due to cost cutting measures and little to no travel. We estimated a non-GAAP EPS of $0.20 flat with last year.

For 2020 we are now looking for revenues of $198 million and non-GAAP EPS of $0.88 per share and admit this is a total guess. We would encourage investors to think long term and assume that business could return to normal next year or the year after and demand for Mastech's services could be even higher as companies reassess their businesses.

KEY POINTS

- Mastech Digital had historically been an IT staffing company, but it entered the data and analytics business in 2017 with its purchase of InfoTrellis. This business is higher margin and faster growing than IT staffing and is becoming an increasingly bigger part of total sales. This math should lead to accelerating earnings growth as well as a higher valuation for the stock.

- Mastech plans to augment its internal growth with acquisitions in the data and analytics space to expand its capabilities. It has been paying off debt through internally generated cash flow, which leaves it with increased debt capacity for asset purchases as well as cash to expand internationally.

- The economy continues robust and IT workers continue to be in short supply leading to continued demand from customers.

- On a PE multiple MHH is trading at 12.2 times 2021 earnings of $1.23 per share. We believe that given its non-pandemic growth, by next year that the stock price could move to 15 times or $18.45.

OVERVIEW

Mastech Digital is a minority-owned IT services company headquartered in Moon Township, PA with offices in the US, Canada and India. It has domestic sales offices in: Chicago; Boston; Orlando; Tampa; Dallas; Atlanta; Houston; Freemont, CA; and Toronto, in addition to its headquarters near Pittsburgh. Internationally, the company has a sales presence in Singapore; Ireland and in the UK; and it recruits and provides IT outsourcing through its locations in Noida and Chennai, India. The company currently has approximately 1,100 North American employees and 400 employees offshore, in addition to over 180 subcontracted professionals. Originally, it was the IT staffing business of iGATE Capital Corp., a public company that was sold to Capgemini in 2015 for $4+ billion in cash. Mastech Digital had been previously spun off as a separate public company from iGATE in 2008. Since then it has also become a consultant, project manager and VAR in the data analytics, data management and big data through its acquisition of InfoTrellis on July 13, 2017. It reports earnings of these two segments. IT staffing is still the largest part of the company but the smaller, faster growing, and higher margin, data and analytics business is an increasing percent of total revenues. This dynamic should result in continued accelerating earnings growth in 2021, and this growth could result in an expansion of the stock's PE ratio.

VALUATION

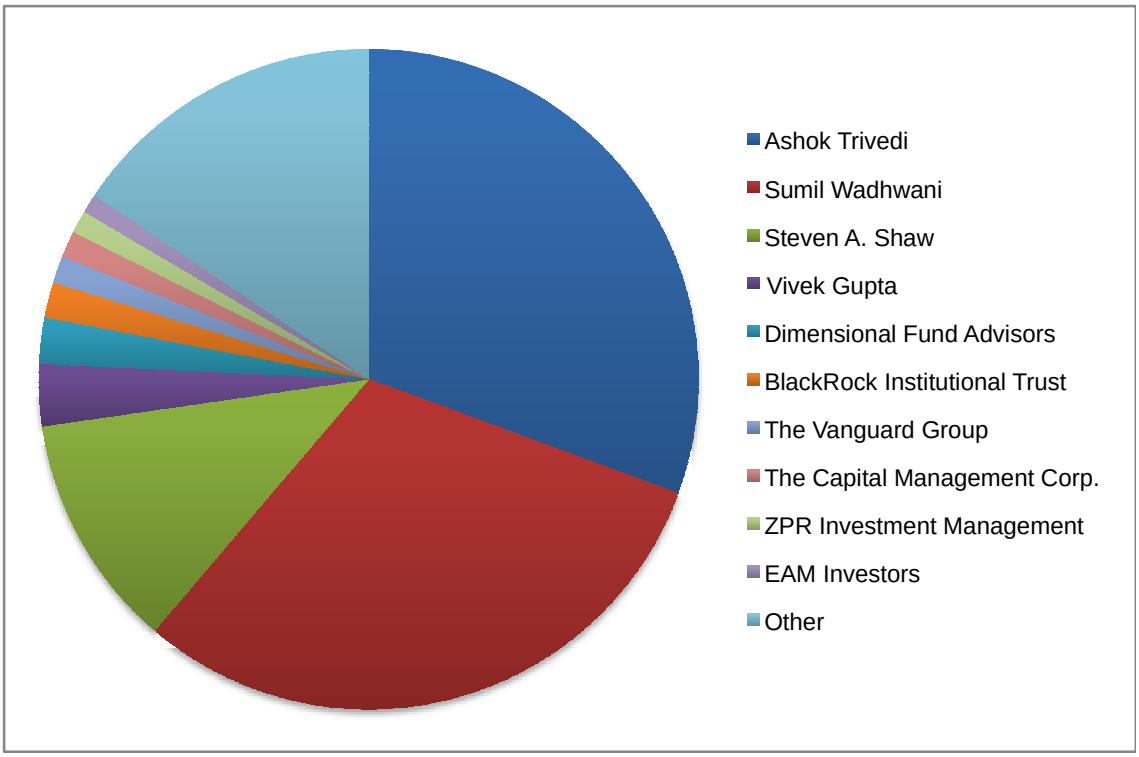
Since our initial report, valuations for staffing companies have come down, as have estimates. This is due to both an inability to predict numbers for 2020 as well as the cycle nature of staffing companies in a recession. Investors are being cautious, and the average company in this business is now trading at an average of 0.9 times EV to sales. As it evolves into a higher percentage of revenues from Mastech InfoTrellis we believe that multiple could expand in the future as that business enjoys higher multiples that basic staffing services as shown by the multiples below of companies such as Accenture, Cognizant, Infosys, and Wipro. On a PE multiple MHH is trading at 12.2 times 2021 earnings of $1.23 per share. We believe that given its non-pandemic growth, by next year that the stock price could move to 15 times or $18.45.

Company	Ticker	Calendar Revenue 2020E	LTM	EBIDTA Margin	Enterprise Value / Sales 2020E	Enterprise Value / Sales LTM	Included in Average?	Enterprise Value
Accenture	ACN	44,700	44,660	16%	2.6	2.6	y	116,000
Cross Country Healthcare, Inc.	CCRN	863	822	2%	0.4	0.4	y	340
Capgemini SE	CAP.PA	15,785	14,120	15%	1.0	1.1	y	15,800
Cognizant	CTSH	16,570	16,780	20%	1.8	1.8	y	29,480
Computer Task Group	CTG	365	384	3%	0.2	0.2	y	60
GEE Group, Inc.	JOB	135	151	6%	0.6	0.5	y	82
Infosys	INFY	12,300	12,780	24%	2.9	2.8	y	36,000
Kelly Services, Inc. Class A	KELYA	5,250	5,360	2%	0.1	0.1	y	637
Kforce Inc.	KFRC	1,240	1,350	6%	0.6	0.6	y	756
ManpowerGroup Inc.	MAN	16,900	20,440	4%	0.3	0.2	y	4,690
ASGN Inc.	ASGN	3,500	3,920	10%	1.0	0.9	y	3,480
Robert Half International Inc.	RHI	5,170	6,110	11%	1.0	0.8	y	5,130
Staffing 360 Solutions, Inc.	STAF	294	289	2%	0.2	0.2	y	46
TrueBlue, Inc.	TBI	2,060	2,370	4%	0.3	0.3	y	611
Wipro	WIT	7,900	8,123	23%	1.3	1.2	y	10,000
Average				9.9%	0.9	0.9		14,207

RISKS

- The company is subject to the business cycle and tends to do better when the economy is robust or at the end of a recession when companies are reluctant to bring on full time hires. The current pandemic, which has resulted in business interruptions, makes it difficult to gage the current business climate both short and long term.
- The company is almost entirely dependent on the US market in the IT Staffing segment.
- The top ten clients represent 45% of sales with CGI being over 11.3%.
- Any regulatory changes regarding H-1B visas could eventually trickle down to Mastech's pool of potential consultants; approximately 40% of its employee base is sourced from those currently holding these visas. Although there is talk about changes to visa grants for new entries into the US, Mastech sources its workforce base from those that already have the appropriate visas.

OWNERSHIP



Source: Zacks Investment Research

INCOME STATEMENT

	Q1 2019 31-Mar	Q2 2019 30-Jun	Q3 2019 30-Sep	Q4 2019 31-Dec	Q1 2020 31-Mar	Q2 2020E 30-Jun	Q3 2020E 30-Sep	Q4 2020E 31-Dec	2018	2019	2020E	2021E
Billable consultants	1,116	1,113	1,197	1,167	1,100	1,035	1,197	1,200	1,100	1,165	900	1,500
Average bill rate per hour	74.56	74.75	74.60	NA	NA				73.01	74.97	73.00	74.70
IT Staffing Services	39,431	41,818	42,463	43,199	43,065	39,620	41,000	44,000	153,361	166,911	167,685	198,000
Yr-to-yr Growth	7%	8%	10%	10%	9%	-5%	-3%	2%	11%	9%	0%	18%
IT Staffing Gross Margin	8,202	8,991	9,087	9,245	9,259	8,479	8,774	9,416	32,326	35,524	35,928	43,560
Gross Margin %	21%	22%	21%	21.4%	22%	21%	21%	21%	21.1%	21.3%	21.4%	22%
Data & Analytics Services	5,768	6,654	7,080	7,161	7,360	7,450	7,800	7,900	23,803	26,663	30,510	36,600
Yr-to-yr Growth	-12%	9%	22%	34%	28%	12%	10%	10%	159%	12%	14%	20%
Data & Analytics Gross Margin	2,624	3,067	3,236	3,516	3,467	3,427	3,588	3,713	10,477	12,444	14,195	17,202
Gross Margin %	46%	46%	46%	49%	47%	46%	46%	47%	44.0%	46.7%	46.5%	47%
Revenue	**$45,199**	**$48,472**	**$49,543**	**$50,360**	**$50,425**	**$47,070**	**$48,800**	**$51,900**	**$177,164**	**$193,574**	**$198,195**	**$234,600**
Yr-to-yr Growth	4%	8%	12%	13%	12%	-3%	-1%	3%	20%	9.3%	2.4%	18.4%
Cost of revenue	34,364	36,418	37,214	37,597	37,706	35,164	36,438	38,771	134,636	145,593	148,079	173,838
Gross profit	10,835	12,054	12,329	12,763	12,719	11,906	12,362	13,129	42,528	47,981	50,116	60,762
Gross Margin %	24.0%	24.9%	24.9%	24.5%	25.2%	25.3%	25.3%	25.3%	24.0%	24.8%	25.3%	25.9%
SG&A	8,965	9,544	9,259	9,295	10,243	9,700	9,800	10,000	32,221	37,063	39,743	45,000
Impairment of goodwill	0	0	0	0	0	0	0	0	9,738	0	0	0
Revaluation of contingent consideration liabilty	0	(6,069)	0	0	0	0	0	0	(11,056)	(6,069)	0	0
Total operating expenses	8,965	3,475	9,259	9,295	10,243	9,700	9,800	10,000	30,903	30,994	39,743	45,000
Operating income:	1,870	8,579	3,070	3,468	2,476	2,206	2,562	3,129	11,625	16,987	10,373	15,762
Operating margin	4.1%	17.7%	6.2%	6.9%	4.9%	4.7%	5.3%	6.0%	6.6%	8.8%	5.2%	6.7%
Other income:												
Interest income	(539)	(468)	(413)	NA	NA	(200)	(200)	(200)	(2,171)	NA	(826)	(900)
Other income	(15)	(39)	33	NA	NA	-	-	-	(40)	NA	-	-
Total other income	(554)	(507)	(380)	(327)	(226)	(200)	(200)	(200)	(2,211)	(1,768)	(826)	(900)
Income before income taxes	1,316	8,072	2,690	3,141	2,250	2,006	2,362	2,929	9,414	15,219	9,547	14,862
Pretax Margin	2.9%	16.7%	5.4%	6.2%	4.5%	4.3%	4.8%	5.6%	5.3%	7.9%	4.8%	6.3%
Income taxes	352	2,114	741	867	381	538	633	785	2,723	4,074	2,578	4,013
Tax rate	27%	26%	28%	28%	17%	27%	27%	27%	28.9%	26.8%	27%	27%
Net income	964	5,958	1,949	2,274	1,869	1,468	1,729	2,144	6,691	11,145	6,969	10,849
Yr-over-Yr	-30%	112%	20%	160%	94%	-75%	-11%	-6%	312%	67%	-37%	56%
Stk based compensation	236	267	263	170	456	215	215	215	470	936	1,100	1,100
One-time expenses	431	(4,046)	338	(224)	377	424	424	424	1,088	(5,518)	1,649	1,700
Non-GAAP Income	1,631	2,179	2,550	2,891	2,702	2,107	2,368	2,783	8,249	9,251	9,718	13,649
Yr-over-Yr	-17%	-5%	16%	63%	66%	-3%	-7%	-4%	79%	12.1%	5%	40%
Net income per share:												
Primary EPS	0.09	0.54	0.18	0.21	0.17	0.13	0.16	0.19	0.61	1.01	0.63	0.98
Diluted EPS	0.09	0.53	0.17	0.20	0.16	0.13	0.15	0.18	0.60	0.99	0.63	0.98
Diluted Non-GAAP EPS	0.15	0.20	0.23	0.26	0.23	0.18	0.20	0.24	0.74	0.82	0.88	1.23
	-18%	-6%	16%	61%	59%	-8%	-12%	-8%	60%	11%	7%	40%
Shares												
Basic	10,998	11,022	11,039	11,049	11,127	11,137	11,147	11,157	10,950	11,029	$11,049	$11,100
Yr-over-Yr	0.7%	0.9%	0.7%	0.5%	1.2%	1.0%	1.0%	1.0%	10.3%	1%	0%	0%
Diluted	11,218	11,164	11,205	11,314	11,675	11,725	11,775	11,825	11,161	11,232	11,050	11,101
Yr-over-Yr	1.4%	0.2%	-0.1%	1.1%	4.1%	5.0%	5.1%	4.5%	11.6%	1%	-2%	0%

BALANCE SHEET

	Mar. 31, 2020	Dec. 31, 2019	Qtr-Qtr % Growth	Mar. 31, 2019	Yr-Yr % Growth
Current assets:					
Cash and equivalents	**$ 2,575**	**$ 2,981**	-13.6%	**$ 1,548**	66.3%
Accounts receivable, net	33,596	32,352	3.8%	28,960	16.0%
Unbilled receivables	0	0	0.0%	10,171	-100.0%
Prepaid expenses & other curr assets	1,036	1,597	-35.1%	1,171	-11.5%
Total current assets	37,207	36,930	0.8%	41,850	-11.1%
Equipment, software and leasehold net	2,393	2,476	-3.4%	2,445	-2.1%
Deferred income taxes	0	0	0.0%	392	-100.0%
Right-of-use assets	4,348	4,617	-5.8%	5,328	-18.4%
Non-current deposits	388	405	-4.2%	531	-26.9%
Goodwill, net	26,106	26,106	0.0%	26,106	0.0%
Intangible assets, net	19,377	20,050	-3.4%	22,066	-12.2%
Total assets	89,819	90,584	-0.8%	98,718	-9.0%
Current liabilities:					
Current portion of long-term debt, net	**8,537**	**4,576**	86.6%	**4,575**	86.6%
Current portion of contingent consid. liab.	**0**	**0**	0.0%	**6,069**	-100.0%
Acconts payable	3,440	4,027	-14.6%	3,931	-12.5%
Accrued payroll and related costs	9,456	7,902	19.7%	7,616	24.2%
Current portion of operating lease liability	1,392	1,396	-0.3%	1,367	1.8%
Other accrued liabilities	764	1,191	-35.9%	1,545	-50.6%
Deferred revenue	0	0	0.0%	338	-100.0%
Total current liabilities	23,589	19,092	23.6%	25,441	-7.3%
Long-term debt, net	**13,358**	**20,682**	-35.4%	**33,667**	-60.3%
Lease liability	3,019	3,321	-9.1%	3,961	-23.8%
Long term accrued income taxes	185	185	0.0%	204	-9.3%
Long term deferred income taxes	843	1,025	-17.8%	0	NM
Total liabilities	40,994	44,305	-7.5%	63,273	-35.2%
Stockholders' equity					
Common stock	128	127	0.8%	126	1.6%
Additional paid-in capital	22,950	21,939	4.6%	21,065	8.9%
Retained earnings	30,628	28,759	6.5%	18,578	64.9%
Accumulated other comp loss	(694)	(358)	93.9%	(150)	362.7%
Treasury stock, at cost	(4,187)	(4,187)	0.0%	(4,174)	0.3%
Total stockholders' equity	48,825	46,280	5.5%	35,445	37.7%
Total liabilities and stockholders' equity	89,819	90,585	-0.8%	98,718	-9.0%
Current and quick ratio	1.6	1.9	-18.5%	1.6	-4.1%
Working Capital	13,618	17,838	-23.7%	16,409	-17.0%
Net cash	2,575	2,981	-13.6%	1,548	66.3%
Debt	21,895	25,258	-13.3%	38,242	-42.7%
Debt/TA	24%	28%	-12.6%	39%	-37.1%

CASH FLOWS

	Year 2018	3 Mo Ended Mar 31, 2019	3 Mo Ended Jun 30, 2019	3 Mo Ended Sep 30, 2019	3 Mo Ended Dec 31, 2019	Year 2019
Cash flows from operating activities:						
Net income	6,691	964	5,958	1,949	2,274	11,145
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	3,182	839	869	869	857	3,434
Bad debt expense	10	-	30	50	-	80
Interest amortization of deferred financing costs	100	26	26	26	26	104
Stock-based compensation	470	236	267	263	170	936
Deferred income taxes, net	171	(95)	1,549	(75)	(57)	1,322
Impairment of goodwill	9,738	-	-	-	-	-
Reevaluation of contingent consideration liability	(11,056)	-	(6,069)	-	-	(6,069)
Loss on disposition of fixed assets	7	-	-	-	-	-
Long term accrued income taxes	136	-	-	-	(19)	(19)
Operating lease assets and liabilities, net	-	-	95	5	-	100
Change in operating assets and liabilities:						
Accounts receivable & unbilled receivables	(7,428)	(1,051)	3,310	781	2,608	5,648
Prepaid expenses and other current assets	283	110	(248)	(52)	(196)	(386)
Accounts payable	(901)	(196)	(22)	450	(332)	(100)
Accrued payroll	(1,241)	(112)	2,472	(260)	(1,926)	174
Other accrued liabilities	(461)	327	(448)	232	(375)	(264)
Deferred revenues	(172)	80	(164)	72	(9)	(21)
Net cash used by operating activities	(471)	1,128	7,625	4,310	3,021	16,084
Cash flows from Investing activities:						
(Payment for) recovery of non-current deposits	(285)	9	84	37	5	135
Capital expenditures	(771)	(404)	(190)	(292)	(128)	(1,014)
Net cash used in investing activities	(1,056)	(395)	(106)	(255)	(123)	(879)
Cash flows from Financing activities:						
Borrowings on revolving credit facility, net	4,526	656	(4,183)	(4,701)	4,252	(3,976)
(Repayments) on term loan facility	(4,003)	(1,144)	(1,144)	(1,144)	(6,143)	(9,575)
Proceeds from the issuance of common shares	-		106	-	62	168
Payment of deferred financing costs	(71)	-	-	-	-	-
Purchase of treasury stock	(20)		(13)	-	-	(13)
Proceeds from the exericise of stock options	118	-	-	-	7	7
Net cash provided by financing activities	550	(488)	(5,234)	(5,845)	(1,822)	(13,389)
Effect of exchange rate changes of cash	(207)	9	36	(116)	(58)	(129)
Net change - cash	(1,184)	254	2,321	(1,906)	1,018	1,687
Cash, beginning of quarter	2,478	1,294	1,548	3,869	1,963	1,294
Cash, end of period	1,294	1,548	3,869	1,963	2,981	2,981
Supplemental information:						
Interest paid	2,060	-	-	-	-	1,780
Income taxes paid	2,031	-	-	-	-	2,634
Cash Flow	9,449	1,970	2,725	3,087	3,251	11,033
Free cash flow	8,678	1,566	2,535	2,795	3,123	10,019

HISTORICAL STOCK PRICE



Source: Zacks Investment Research

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