Zacks Small-Cap Research

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May 15, 2023
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Tower Semiconductor (NASDAQ: TSEM)

TSEM: This Could Be the Last Reported Quarter for Tower; Despite Revenue Declines, it Still is Outperforming the Market

We believe that the stock will appreciate to the acquisition price as the risk discount and time value of money versus the acquisition price dissipates. The deal is expected to close as soon as it gets regulatory approval.

Current Price (5/12/2023)	$40.41
Valuation	**$53.00**

OUTLOOK

Tower Semiconductor has accepted an offer to be acquired by Intel in an all-cash deal at $53 per share. We believe the deal is still awaiting permission from China. Tower is a pure-play analog semiconductor wafer foundry that manufactures SiGe, MEMS, RF, embedded flash-based memory, analog/mixed-signal, and CMOS image-sensor devices in the US, Israel, and Japan. It is serving markets in mobile such as RF High Position analog, as well as in CMOS image sensors, and power management. It also added a new fab in Italy in partnership with STMicro.

SUMMARY DATA

52-Week High	**48.43**
52-Week Low	**39.86**
One-Year Return (%)	**-14.3**
Beta	**0.9**
Average Daily Volume (sh)	**721,880**
Shares Outstanding (mil)	**110.0**
Market Capitalization ($mil)	**$4,445**
Short Interest Ratio (days)	**1.2**
Institutional Ownership (%)	**54**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**5.2**
Earnings Per Share (%)	**0.9**
Dividend (%)	**N/A**
P/E using TTM EPS	**15.8**
P/E using 2023 Estimate	**22.1**
P/E using 2024 Estimate	**N/A**

Risk Level	**Low**
Type of Stock	**Large Blend**
Industry	**Elec Comp-Semis**

ZACKS ESTIMATES

Revenue
(In millions of US$)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2021	$347 A	$362 A	$387 A	$393 A	$1,508 A
2022	$421 A	$426 A	$427 A	$403 A	$1,668 A
2023	$356 A	$356 E	$359 E	$377 E	$1,448 E
2024					

Earnings per Share
(non-GAAP)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2021	$0.31 A	$0.34 A	$0.41 A	$0.55 A	$1.61 A
2022	$0.55 A	$0.58 A	$0.72 A	$0.69 A	$2.52 A
2023	$0.56 A	$0.47 E	$0.48 E	$0.52 E	$1.83 E
2024					

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WHAT'S NEW

Q1 2023 Revenue Slightly Better Than Expected While Earnings Benefit from a One-Time Gain

This quarter, which could be its last reported quarter, Tower Semiconductor reported less information than usual. While total revenues in Q1 2023 were $356 million versus $421 million in Q1 2022, down 16%, it did not indicate the organic revenue component. We estimate that this quarter had $20 million less from the Japanese fab than in last year's quarter. The company is no longer providing guidance or hosting earnings calls. Revenues declined sequentially as expected due to the softness in demand from customers across the board. Tower saw a build-up in inventory and we expect that revenues will continue weaker than expected for the rest of the year.

Revenues were impacted by the shutdown of the Aral manufacturing factory in Japan as of July 1. That fab serviced Nuvoton exclusively and were low-margin revenues. The fab will not be reopened and most of the one-time $4 million restructuring charges in Q3 were due to a write-down of that fab and its equipment and assets. In Q4 there was a one-time gain mostly from the sale of equipment and machinery from Aral. This quarter there was an even larger one-time gain. Although there could be some small one-time gain in Q2 it should not be material.

Q1 2023 gross margin increased to 26.9% from 24.8% a year ago but down from 30.9% in higher revenue Q4 2022. The increase was primarily from the elimination of approximately $20 million of low-margin revenues from the closure of the Japanese fab. Gross margin dollars decreased by $9 million, or 9%. Not including one-time charges, operating expenses decreased to $3.6 million. This year there was also a one-time restructuring gain of $31.7 million from the sale of unneeded tools and equipment. Without the gain, the operating margin improved to 16.2% from 15.0% last year. Other income was $7 million compared to an expense of $2.1 million a year ago. No doubt higher interest rates and lower debt is helping Tower with its large cash balance.

With the one-time gain, pretax profit was $96.4 million versus $60.9 million a year ago. Taxes were $15.0 million in the quarter compared to $5.2 million last year.

GAAP net income was $71.4 million versus $54.0 million last year, while non-GAAP net income was an estimated $62 million versus $60.3 million a year ago.

Diluted GAAP EPS was $0.64 per share versus $0.49 last year. Adjusted non-GAAP diluted EPS increased to an estimated $0.56 versus $0.55 a year ago. Average diluted shares for the quarter were 111.1 million, up from 110.5 million last year. EBITDA for the fourth quarter of 2022 was $120.7 million compared to $133.6 million a year ago and down sequentially from $161.5 million in Q4 2022.

Q2 revenues could be flat given current demand and the industry woes. Tower is still outperforming the overall market. We are reducing our 2023 non-GAAP EPS estimate to $1.83 from $2.14 due to weaker demand offset somewhat by higher sequential gross margins. We still are waiting for the deal to close and believe the final step is regulatory approval from China. If the deal does not close by August it could be extended, renegotiated, or even terminated adding risk to what should have been a speedier transaction. If the deal does close by August this should be the last quarter Tower reports.

Balance Sheet

On March 31st the company had cash, short-term deposits, and marketable securities of $946 million compared to $1.0 billion last quarter. Debt decreased by $29 million to $244 million. Its quick ratio is high at 3.2xs and it has $1.1 billion in working capital. Operating cash flow declined sequentially to $144 million but was

still up year over year. Free cash flow was $38 million after spending $105 million on cap ex in the quarter net of sales of machinery and equipment from the Arai fab.

Recap of Tower Acquisition by Intel

On February 15, 2022, Intel announced it plans to buy Tower Semiconductor for $53 per share in cash. The deal is proceeding and we believe it is only awaiting regulatory approval from China. The original agreement is **still in place through August** (the outside date). We have copied part of the conditions for termination below:

Section 8.1 Termination. This Agreement may be terminated and the Merger and the other Transactions may be abandoned (except as otherwise provided below, whether before or after receipt of the Company Shareholder Approval) as follows:

(a) by mutual written consent of Parent and the Company;

(b) by either the Company or Parent, at any time prior to the Effective Time, **if a Governmental Authority of competent jurisdiction shall have issued a final and non-appealable Adverse Law or Order that remains in effect and that permanently restrains, permanently enjoins or otherwise permanently prohibits the consummation of the Merger**; provided, however, that the right to terminate this Agreement under this Section 8.1(b) will not be available to any Party where material failure to fulfill any obligation under this Agreement has been the principal cause of or resulted in, such Adverse Law or Order;

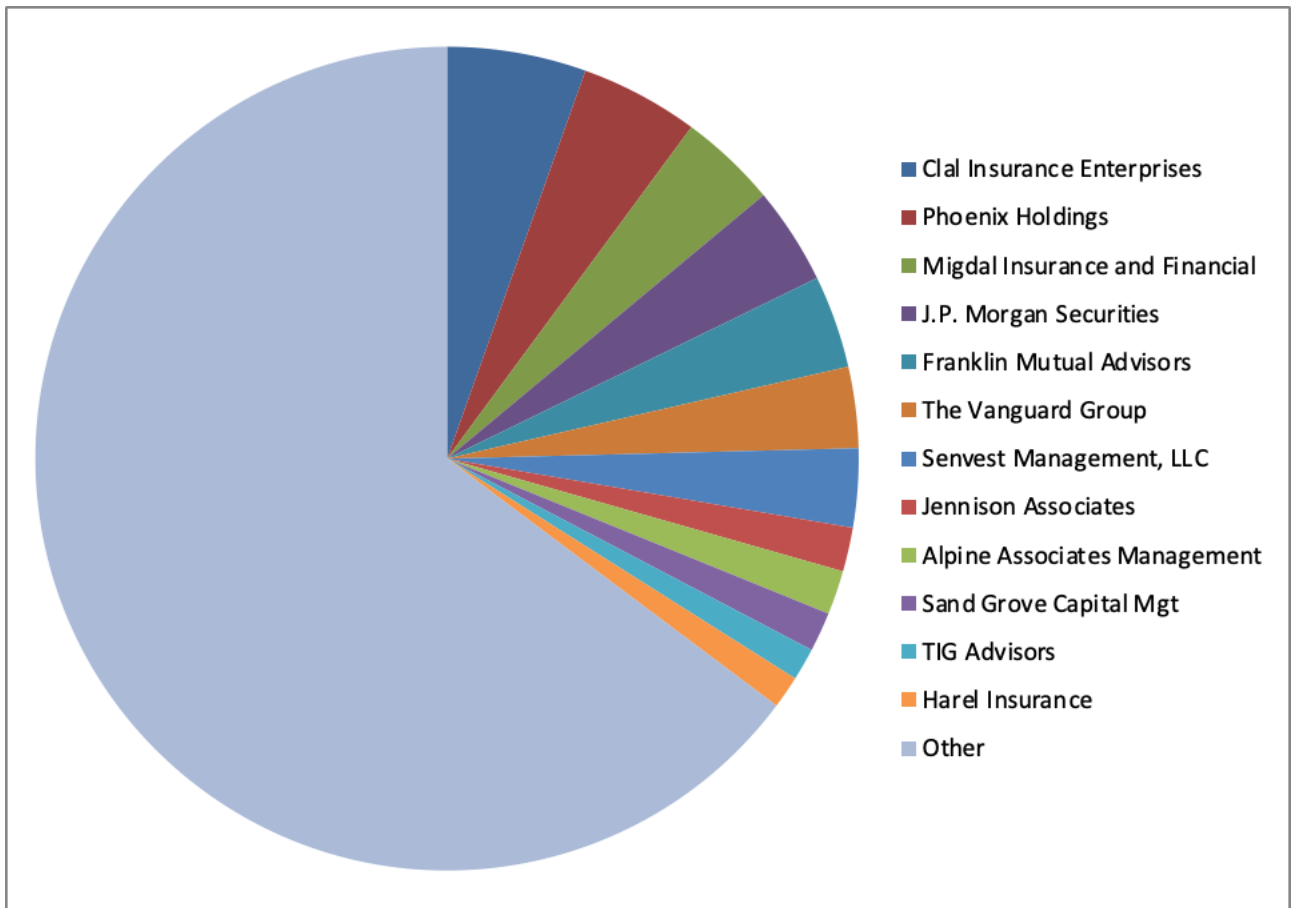
According to the merger document, Tower will be paid a termination fee of $353 million if the deal is called off due to regulatory denial.

Parent Termination Fee.
(i) If this Agreement is terminated (A) pursuant to Section 8.1(b) due to an Adverse Law or Order related to any Antitrust Laws or (B) pursuant to Section 8.1(e), and in the case of clause (B) of this Section 8.2(c)(i), on the date of such termination, all conditions to this Agreement are satisfied (other than those conditions that by their terms are to be satisfied at the Closing, each of which is capable of being satisfied at the Closing), or waived (where permissible pursuant to applicable Law), other than the conditions set forth in Section 7.1(b) (solely in connection with an Adverse Law or Order related to the Antitrust Laws) or Section 7.1(c) (solely in connection with outstanding Required Clearances related to the Antitrust Laws (and not FDI Laws)), and the Company is not then in material breach of any provision of this Agreement where such breach by the Company is the primary cause of the failure of any condition to this Agreement being satisfied, then the Parent shall promptly pay, or cause to be paid, to the Company (x) if such termination was by Parent, prior to or substantially concurrently with, and as a condition to, such termination, or (y) if such termination was by the Company, within two (2) Business Days of such termination, an amount in cash equal to **$353,000,000."**

Using its fully diluted share count the purchase offer equals an enterprise value of $5.4 billion. This is 3.6 times Tower's revenues for 2021. The deal is expected to be accretive to Intel upon close. This acquisition will aid Intel's foundry strategy and give it the capacity and expertise to pursue its expansion plans, particularly in the US where Tower already has fabs in California and Texas. With Intel's cash, it can expand its fabs with far greater ease and speed and provide the demand to fill them. Incremental revenues carry margins over 50%. Licensing arrangements with the Japanese fabs were structured to reduce taxes and increase overall profitability at the expense of gross margins. The deal is expected to close as the companies get regulatory approvals from various countries. We believe all the countries have approved the deal so far except China.

Congress passed the "Creating Helpful Incentives for the Production of Semiconductors for America Act" more commonly known as the CHIPS Act, and it awaits a Presidential signature. The bill allocates $54 billion in subsidies to the American semiconductor industry. We expect Intel to be a beneficiary of these subsidies and in the past Tower expressed hope that it could receive funds to expand its San Antonio campus capacity where it has ample space.

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The Vanguard Group
Senvest Management, LLC
Jennison Associates
Alpine Associates Management
Sand Grove Capital Mgt
TIG Advisors
Harel Insurance
Other

INCOME STATEMENT

	March Q1 22	June Q2 22	Sept Q3 22	Dec Q4 22	March Q1 23	June Q2 23E	Sept Q3 23E	Dec Q4 23E	2021	2022	2023E
REVENUE	421.1	426.2	427.1	403.2	355.6	355.6	359.2	377.1	1,508.2	1,677.6	1,447.5
Yr-to-yr Gr.	21%	18%	10%	-2%	-16%	-17%	-16%	-6%	19%	11%	-14%
OPERATING EXPENSES											
Cost of goods sold	316.5	313.7	302.6	278.5	259.9	266.7	268.3	281.0	1,179.0	1,211.3	1,075.9
Gross Margin	104.6	112.4	124.5	124.7	95.7	88.9	90.9	96.2	329.1	466.3	371.6
% of Sales	24.8%	26.4%	29.2%	30.9%	26.9%	25.0%	25.3%	25.5%	21.8%	27.8%	25.7%
R&D	20.3	20.5	22.4	20.7	19.3	19.5	20.9	21.0	85.4	83.9	80.7
M, G&A	21.3	21.3	18.9	18.9	18.6	18.9	19.1	19.2	77.2	80.3	75.8
One-time charges	0.0	0.0	4.0	(13.6)	(31.7)	0.0	0.0	0.0	0.0	(9.6)	-31.7
Tot Operating Exp.	41.6	41.8	45.3	26.0	6.3	38.4	40.0	40.2	162.6	154.6	156.6
Operating Income	63.1	70.7	79.2	98.7	89.4	50.5	50.9	56.0	166.5	311.7	215.1
Operating Margin	15.0%	16.6%	18.5%	24.5%	25.1%	14.2%	14.2%	14.8%	11%	19%	15%
Yr-to-yr Gr.	94%	108%	79%	77%	42%	-29%	-36%	-43%	54%	68%	-20%
Interest & other non-cash financing	(2.1)	(8.2)	(9.4)	(0.1)	7.0	0.0	0.0	0.0	(11.4)	(19.7)	7.0
Other income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gain from acqusiition	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	60.9	62.5	69.9	98.7	96.4	50.5	50.9	56.0	155.1	292.0	222.1
Profit margin	14.5%	14.7%	16.4%	24.5%	27.1%	14.2%	14.2%	14.8%	10.3%	17.4%	15.3%
Taxes	(5.2)	(4.3)	(3.2)	(12.8)	(15.0)	(4.5)	(4.6)	(5.0)	(1.0)	(25.5)	(29.2)
Tax Rate	8.5%	6.9%	4.5%	13.0%	15.6%	9.0%	9.0%	9.0%	0.7%	8.7%	13.1%
Profit before non-controlling	55.8	58.2	66.7	85.8	81.4	46.0	46.3	50.9	154.1	266.5	192.9
Minority Income	(1.7)	(0.1)	2.5	(2.5)	(10.0)	(0.5)	(0.5)	(0.5)	(4.1)	(1.9)	(11.5)
GAAP Net income	54.0	58.1	69.1	83.3	71.4	45.5	45.8	50.4	150.0	264.6	181.4
Yr-to-yr Gr.	91%	88%	77%	61%	32%	-22%	-34%	-39%	82%	76%	-31%
Non-GAAP Net Income	60.3	64.1	80.2	76.7	62.0	52.5	52.8	57.5	177.15	279.23	203.02
GAAP primary EPS	$0.50	$0.53	$0.63	$0.76	$0.65	$0.41	$0.41	$0.46	$1.39	$2.42	$1.64
Fully diluted GAAP	$0.49	$0.53	$0.62	$0.75	$0.64	$0.41	$0.41	$0.45	$1.37	$2.39	$1.63
Adj Non-GAAP EPS-Fully dil.	**$0.55**	**$0.58**	**$0.72**	**$0.69**	**$0.56**	**$0.47**	**$0.48**	**$0.52**	**$1.61**	**$2.52**	**$1.83**
Yr-to-yr Gr.	78%	70%	76%	25%	2%	-19%	-34%	-25%		56%	-28%
Primary Share Out	108.9	109.1	109.4	109.9	110.0	110.2	110.5	110.8	108.3	109.3	110.3
Fully Diluted GAAP	110.5	110.6	110.8	110.9	111.1	111.1	111.1	111.1	109.8	110.8	111.1
EBITDA	**133.6**	**137.6**	**157.6**	**161.5**	**120.7**	**119.5**	**119.9**	**125.0**	**436.5**	**590.4**	**485.1**
EBITDA Margin	32%	32%	37%	40%	34%	34%	33%	33%	29%	35%	34%
Yr-to-yr Gr.	41%	39%	39%	24%	-10%	-13%	-24%	-23%	11%	22%	-18%

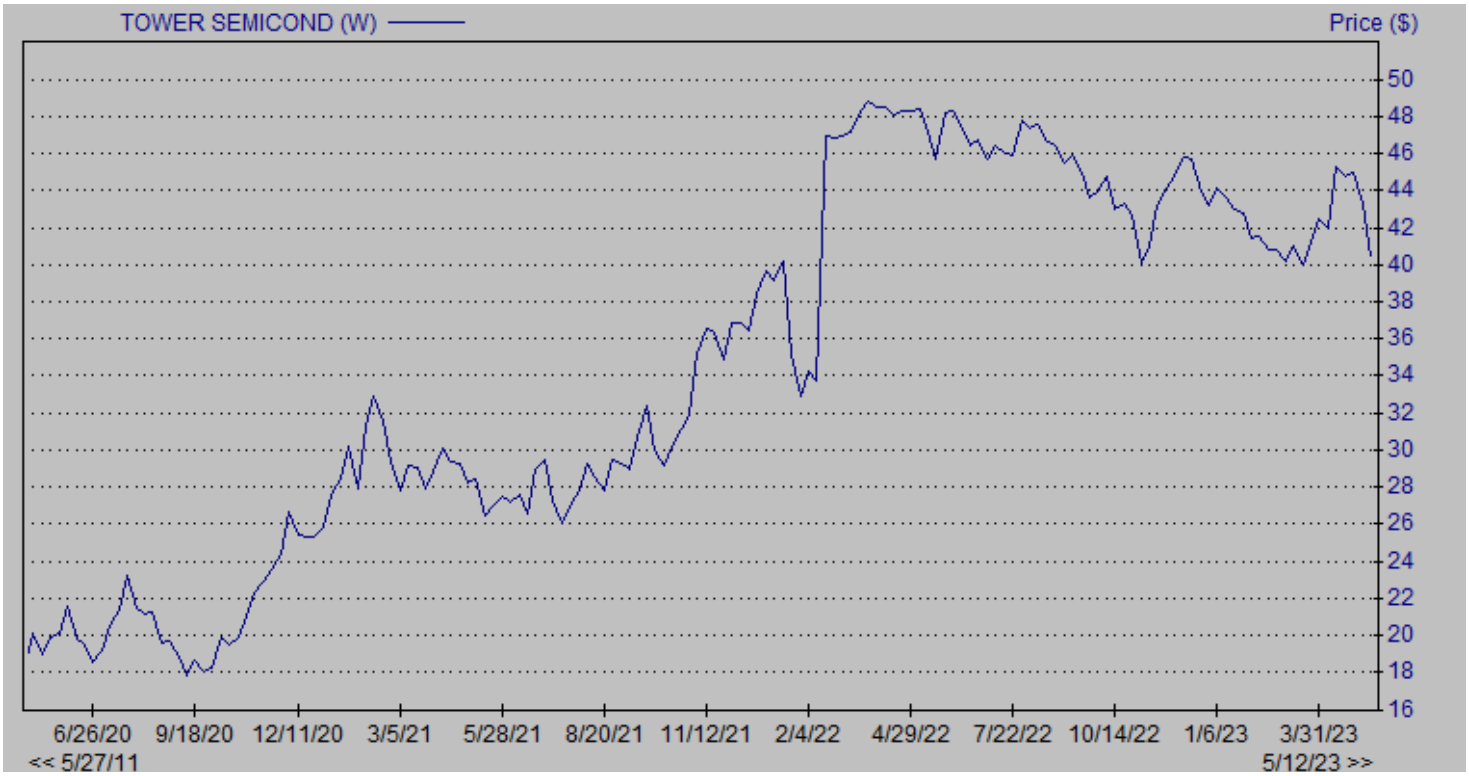
BALANCE SHEET

$ in thousands	Mar 31, 2023	Dec 31,2022	Qtr-Qtr % Change	Mar. 31, 2022	Yr-Yr % Change
CURRENT ASSETS					
Cash and cash equivalents	**$304,934**	**$340,759**	-10.5%	**$203,484**	49.9%
Short term deposits	**469,284**	**495,359**	-5.3%	**402,873**	16.5%
Marketable securities	**171,747**	**169,694**	1.2%	**184,539**	-6.9%
Trade accounts receivable	144,195	152,935	-5.7%	176,443	-18.3%
Inventories	358,715	302,108	18.7%	247,826	44.7%
Other current assets	35,416	34,319	3.2%	41,629	-14.9%
Total current assets	1,484,291	1,495,174	-0.7%	1,256,794	18.1%
LONG-TERM INVESTMENTS	0	0	0.0%	27,235	-100.0%
PROPERTY AND EQUIPMENT, NET	1,009,632	962,258	4.9%	879,781	14.8%
GOODWILL & INTANGIBLE ASSETS, NET	13,540	14,031	-3.5%	16,665	-18.8%
DEFERRED TAX & OTHER ASSETS, NET	69,623	76,145	-8.6%	89,677	-22.4%
TOTAL ASSETS	2,577,086	2,547,608	1.2%	2,270,152	13.5%
CURRENT LIABILITIES					
Short term debt	**42,224**	**62,275**	-32.2%	**78,165**	-46.0%
Trade accounts payable	191,006	150,930	26.6%	109,077	75.1%
Deferred revenue	30,268	38,911	-22.2%	49,444	-38.8%
Other current liabilities	90,637	135,272	-33.0%	87,258	3.9%
Total current liabilities	354,135	387,388	-8.6%	323,944	9.3%
LONG-TERM DEBT	**201,445**	**210,069**	-4.1%	**190,383**	5.8%
LONG-TERM CUSTOMERS' ADVANCES	34,066	40,893	-16.7%	63,872	-46.7%
EMPLOYEE RELATED LIABILITIES	0	0	0.0%	14,626	-100.0%
DEFERRED TAX LIABILITY	11,188	20,717	-46.0%	19,670	-43.1%
Total liabilities	600,834	659,067	-8.8%	612,495	-1.9%
SHAREHOLDERS' EQUITY	1,976,252	1,888,541	4.6%	1,657,657	19.2%
TOTAL LIABILITIES AND EQUITY	$2,577,086	$2,547,608	1.2%	$2,270,152	13.5%
Current Ratio	4.2	3.9	8.6%	3.9	8.0%
Quick Ratio	3.2	3.1	3.2%	3.1	2.0%
Working Capital	1,130,156	1,107,786	2.0%	932,850	21.2%
Debt Percent of Assets	9%	11%	-11.6%	12%	-20.1%
Debt to Equity	0.1	0.1	-14.5%	0.2	-23.9%
Cash and equivalents	945,965	1,005,812	-6.0%	790,896	19.6%
Cash and equivalents per share	$8.60	$9.15	-6.0%	$7.26	18.5%
Debt	243,669	272,344	-10.5%	268,548	-9.3%
Change in cash	(59,847)	134,681	-144.4%	26,250	-328.0%
Change in debt	(28,675)	9,016	-418.0%	(46,292)	-38.1%

CASH FLOW

	Year 2020	3-Mo 31-Mar-21	3-Mo 30-Jun-21	3-Mo 30-Sep-21	3-Mo 31-Dec-21	Year 2021	3-Mo 31-Mar-22	3-Mo 30-Jun-22	3-Mo 30-Sep-22	3-Mo 31-Dec-22	Year 2022	3-Mo 31-Mar-23
CASH FLOWS - OPERATING ACTIVITIES												
Net profit (loss)	$ 83,289	$ 30,514	$ 31,317	$ 40,367	$ 51,877	$ 154,075	$ 55,774	$ 58,173	$ 66,682	$ 85,842	$ 266,471	$ 81,368
Income and non-cash expense items:												
Depreciation and amortization	240,531	62,053	65,482	69,482	73,693	270,710	70,780	67,007	74,958	79,893	292,638	62,387
Effect of fair value measurement on debt	6,645	(3,792)	1,798	779	2,353	1,138	(1,330)	2,276	104	9,312	10,362	(926)
Other expense (income), net	5,215	(4,985)	1,758	1,941	(175)	(1,461)	1,347	560	7,950	(2,923)	6,934	815
Changes in assets and liabilities:												
Trade accounts receivable	(33,087)	(6,274)	18,996	(678)	2,291	14,335	(35,181)	3,578	3,991	12,380	(15,232)	7,413
Other assets	(7,999)	7,082	(16,065)	(4,186)	(13,562)	(26,731)	13,874	(3,355)	527	9,381	20,427	(1,138)
Inventories	(2,891)	(3,407)	(12,077)	(12,553)	(16,155)	(44,192)	(18,328)	(10,630)	(25,510)	(23,423)	(77,891)	(57,420)
Trade accounts payable	(18,576)	(9,266)	(5,302)	(2,100)	(8,336)	(25,004)	30,595	22,415	(15,951)	(57,952)	(20,893)	44,542
Deferred revenue and customers' advances	(3,072)	19,340	(3,133)	19,288	39,029	74,524	3,385	(14,031)	(16,906)	(2,517)	(30,069)	(15,470)
Other current liabilities	347	7,084	12,612	(8,087)	5,241	16,850	15,103	10,974	20,725	14,231	61,033	(45,053)
Employee related liabilities	3,936	(107)	247	(43)	(2,778)	(2,681)	331	26	(220)	2,819	2,956	371
Deferred tax liability, net	2,223	(10,829)	(2,383)	2,764	178	(10,270)	221	1,104	6,052	5,707	13,084	(4,162)
Net cash provided by operating activities	**276,561**	**87,413**	**93,250**	**106,974**	**133,656**	**421,293**	**136,571**	**138,097**	**122,402**	**132,750**	**529,820**	**72,727**
CASH FLOWS - INVESTING ACTIVITIES												
Investments in property and equipment, net	**(256,539)**	**(49,415)**	**(56,184)**	**(87,714)**	**(85,947)**	**(279,260)**	**(80,840)**	**(49,377)**	**(45,134)**	**(38,186)**	**(213,537)**	**(105,245)**
Interest bearing deposits, including designated deposits	(107,070)	(1,611)	(17,055)	6,250	(47,268)	(59,684)	(29,611)	(65,134)	129,257	(150,423)	(115,911)	24,194
Net cash provided by (used in) investing activities	(363,609)	(51,026)	(73,239)	(81,464)	(133,215)	(338,944)	(110,451)	(114,511)	84,123	(188,609)	(329,448)	(81,051)
CASH FLOWS - FINANCING ACTIVITIES												
Exercise of warrants and options	2,512	364	0	46	48	458	44	0	5,469	(5,469)	44	0
Debt repayment	(63,699)	(29,375)	(19,769)	(29,211)	1,040	(77,315)	(30,539)	(8,211)	(28,164)	(11,465)	(78,379)	(28,796)
Proceeds from investment in subsidiary	0	0	0	0	0	0	0	0	0	11,685	11,685	1,932
Net cash used in financing activities	(61,187)	(29,011)	(19,769)	(29,165)	1,088	(76,857)	(30,495)	(8,211)	(22,695)	(5,249)	(66,650)	(26,864)
Effect of foreign exchange rate change	4,357	(3,478)	(68)	(597)	(2,102)	(6,245)	(3,071)	(7,682)	(4,638)	11,498	(3,893)	(637)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(143,878)	3,898	174	(4,252)	(573)	(753)	(7,446)	7,693	179,192	(49,610)	129,829	(35,825)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	355,561	211,683	215,581	215,755	211,503	211,683	210,930	203,484	211,177	390,369	210,930	340,759
CASH AND CASH EQUIVALENTS - END OF PERIOD	211,683	215,581	215,755	211,503	210,930	210,930	203,484	211,177	390,369	340,759	340,759	304,934

HISTORICAL STOCK PRICE



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