

Net Element Inc. (NETE-NASDAQ)**NETE: Management Buys Stock to Fund Working Capital While Debt is Renegotiated****OUTLOOK**

Net Element is a software and services company, in global online payments. It operates a small merchant processor in the US and a mobile payment processor in Russia. It just acquired PayOnline, a market leader in the Russian Federation in online payments.

The company is looking to restructure its current debt at more favorable terms, which could aid its valuation.

Current Recommendation	BUY
Prior Recommendation	BUY
Date of Last Change	10/15/14
Current Price (09/16/15)	\$0.20
Target Price	\$1.05

SUMMARY DATA

52-Week High	\$2.99
52-Week Low	\$0.14
One-Year Return (%)	-93.4
Beta	0.77
Average Daily Volume (sh)	1,912,877

Shares Outstanding (mil)	67
Market Capitalization (\$mil)	\$13
Short Interest Ratio (days)	0.29
Institutional Ownership (%)	2
Insider Ownership (%)	26

Annual Cash Dividend	\$0.00
Dividend Yield (%)	0.00

5-Yr. Historical Growth Rates	
Sales (%)	254.3
Earnings Per Share (%)	N/A
Dividend (%)	0

P/E using TTM EPS	N/M
P/E using 2015 Estimate	N/M
P/E using 2016 Estimate	N/M

Zacks Rank	4
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Risk Level	High
Type of Stock	Small-Value
Industry	Internet Commerce
Zacks Rank in Industry	21 of 28

ZACKS ESTIMATES**Revenue**

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2013	0.9 A	5.6 A	6.5 A	5.8 A	18.7 A
2014	4.8 A	4.9 A	6.0 A	5.4 A	21.2 A
2015	5.5 A	6.9 A	8.3 E	8.8 E	29.5 E
2016					39.1 E

Earnings per Share

(Non-GAAP EPS before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2013	-\$0.10 A	-\$0.11 A	-\$0.11 A	-\$0.12 A	-\$0.44 A
2014	-\$0.11 A	-\$0.07 A	-\$0.05 A	-\$0.00 A	-\$0.19 A
2015	-\$0.04 A	-\$0.06 A	-\$0.04 E	-\$0.03 E	-\$0.15 E
2016					-\$0.06 E

Zacks Projected EPS Growth Rate - Next 5 Years **25%**

Equity Raise Gives Company Runway As Debt is Renegotiated

The hardest part about valuing Net Element is trying to calculate and project the share count and estimate if the company is growing fast enough to keep up with the dilution. As management tries to renegotiate its debt terms for \$5 million, it has issued a PIPE offering that has been bought by management and members of the board. The company issued 11.6 million in common stock at \$0.14 and 11.6 million options. Combined with the PIK dividends we are now estimating that the company will have fully diluted shares of near 130 million by year-end. This puts the company at a \$26 million market cap and a \$24 million enterprise value. By adding to the share count, we are reducing the estimated EPS loss per share going forward.

Catalysts To Share Price Increase

It is possible that the biggest factor depressing the stock price will cease, and that is the constant selling of 20% of the daily trading volume that the preferred stock holders have been restricted to selling. Once they are fully converted and the selling pressure ends, the stock should move closer to the real value of the company. Given the current state of affairs, we believe this will happen before year-end, giving the company a good chance of moving up over \$1 a share and becoming back into compliance with NASDAQ. Investors are afraid that the company will have to do a reverse split to stay in compliance and that also is weighing on the stock.

Secondly we expect the company to have the debt renegotiation completed before year-end. The recent capital raise gives the company more than a quarter of cash burn to solve this. Company filings show the Net Element is now in renegotiation talks, and that is why the cash is still in escrow and not available to the company. The company has extended the date and if nothing is resolved, by September 30, 2015, the deal will be automatically cancelled and the \$5 million returned. We hope that the company will be able to negotiate a change that is beneficial to common shareholders, and the stock price, or find some other form of financing in addition to this recent capital raise.

Third the third quarter results should show that the company is growing steadily and not very far from cash breakeven.

Fourth, there is the possibility that the company may find credit card portfolios to buy which will add even more to revenues. The company has a completely separate source of financing targeted specifically for this.

Valuation Is Based on Fully Diluted Shares

Given the complicated financing, shares outstanding each quarter will vary greatly depending on share price, we can only look to the end point shares outstanding at the end of the year. With what we know, we expect the fully diluted shares outstanding to be **approximately 130 million shares** at that time. At \$0.20 a share this is a **market capitalization of \$26 million**. Based on 2015 estimated revenues Of \$30 million, that is or **0.9 times market cap to sales-- an inexpensive valuation based on comparables trading at 4.3 times**. By 2016, revenues could be as high as \$40 million for another 30% increase.

If the company could reach the average valuation of its peer, its common stock could be worth \$1.05 per share twelve months from now based on an industry average valuation of approximately 4.3xs enterprise value to sales and using 2016 sales.

Q3 2015

We expect the company to continue to grow revenues sequentially and improve margins. The company will benefit from a full quarter of PayOnline revenue. In Q2, the company booked only \$0.3 million in the quarter due to the timing of closing the deal. In Q1 a full quarter would have showed revenues of \$1.2 million for PayOnline. We are therefore forecasting a contribution of \$1.4 million in Q3 for PayOnline. Total revenues are estimated to be \$8.3 million versus \$6.0 million in 2015, up 37%. More revenues from that business should also improve gross margins via product mix.

We expect continuing losses as the company invests to grow the business as shown in our model. In addition, if the company does cancel its debt, there will be a reversal of the \$2 million gain taken in Q2 for change in fair value and settlement of beneficial conversion derivative and another possible \$2 million in balance sheet adjustment resulting in large one time non-cash loss.

A Recap on PayOnline—A Major Mobile Payment Company in Russia

On March 17, 2015, the company announced it entered into a binding offer letter to purchase PayOnline based in Moscow from SD Ventures, for \$3.6 million in cash, \$3.6 million in restricted stock, plus the possibility of another \$1.28 million in stock based on earn-out hurdles. PayOnline financials were consolidated with Net Element as of May 20, 2015. The earn-out is based on PayOnline reaching a certain EBITDA for certain post-closing periods, multiplied by 1.35, and will be paid in March 2016 based on 2015 results. The cash was funded by the sale of stock backed up with \$7 million of its \$10 million line of credit. There are a number of synergies between the two companies and each hopes to expand geographically into each other's current business territories.

PayOnline is a processor of online payments and works with four or five major banks in Commonwealth of Independent States, Europe and Asia. It has 10 million active customers and more than 3,000 merchants. It has a high level of fraud protection, works with MasterCard and Visa and is integrated into travel platforms such as SABER, Galileo and GDS. In addition to online web-based payments the company also has a mobile app that provides a wallet that can be used for person-to-person payments.

INVESTMENT THESIS

- Net Element is growth company in the payments industry that should benefit from the adoption of mobile and online payments in the US and Russia and ultimately globally.
- The new CEO took his former company, Unified Payments, from 0 to \$67 million in revenues in two years. We believe he has the experience and drive to replicate this success with Net Element.
- The company has an increasingly robust platform to create a global payment system complete with merchant from end and should be able to expand geographically.
- We believe the company could grow to \$30 million in revenues in 2015 through a combination of internal growth as well as acquisitions and partnerships.

- If NETE achieves our forecasts without further common stock dilution than that already predicted and no incremental debt, we believe its common stock could be worth \$1.05 per share twelve months from now based on an industry average valuation of approximately 4.3xs enterprise value.

VALUATION

There are a number of public companies in the merchant acquiring/processing business. The largest is Cielo with a \$21 B enterprise value located in Brazil. The smallest is we are using is Qiwi, who runs payment systems in the Russian Federation and is based in Moscow and has a \$596 million enterprise value. The rest are located in the US. All are profitable and we expect that NETE will have to meet that hurdle in order to be awarded a comparable value. If we take the average enterprise value to sales of this group of companies of 4.3 times sales and apply it to the revenues we expect Net Element to generate next year, and its fully diluted share count next year, and turn that back to price per share we get a conservative current share value of \$0.82. If the company grows another 30% next year, the stock could move to \$1.05 in 2016. This is down significantly from our previous price target due to stock dilution as well as a decline in the valuation of the comparable companies.

Company	Ticker	Revenue		EBIDTA Margin	Enterprise Value / Sales		Included in Average?	Enterprise Value
		2015E	LTM		2015E	LTM		
Cielo	CIOXY	NA	\$2,390	47%	NA	8.6x	n	20,550
Vantiv	VNTV	\$1,650	\$2,920	24%	5.7x	3.2x	y	9,390
Total System Services	TSS	\$2,710	\$2,610	29%	3.6x	3.7x	y	9,670
Global Payments	GPN	\$2,357	\$2,770	21%	3.9x	3.3x	y	9,110
EVERTEC	EVTC	\$372	\$367	46%	5.5x	5.6x	y	2,040
Heartland Payment System	HPY	\$806	\$2,480	13%	3.4x	1.1x	y	2,740
Qiwi	QIWI	\$170	\$150	32%	3.5x	4.0x	y	596
Average				28%	4.3x	3.5x		\$5,591

Net Element YoY growth	Projected Revenue		EBITDA Margin	Enterprise Value / Sales		Valuation Range	
	2015E	LTM		2015E	LTM	Low	High
	\$29	\$24	NM	4.3x	3.5x	\$83	\$125

Conclusion of Enterprise Value	\$104,173,645
Market Value	\$106,337,354
Shares Outstanding	130,000,000
Price per Share	\$0.82

RISKS

- We believe it is possible holders of preferred stock have been avid sellers regardless of stock price or valuation and are a risk to market pricing.
- The company is losing money and may not be able to reach profitability or maintain positive cash flow.
- The company is involved in a number of lawsuits with former management.
- The Russian mobile and online payment market is still in its infancy and there is no assurance the country will adopt this method to pay for goods and services.
- Future acquisitions may not be successfully integrated operationally or technologically. Purchased portfolios may not yield expected profits.
- The merchant acquirer market in the US is competitive and larger companies have an advantage due to economies of scale.
- Operations in Russia and the United Federation face considerable political risk and may be prohibited from certain transactions by governments.
- Currency, particularly the ruble, has fluctuated dramatically and could affect reported earnings and operations.
- It is currently impossible to predict Net Element's future shares outstanding either primary or fully diluted due to the methodology used to issue dividends to the preferred holders, which is based on stock price. We have made an attempt, but actual number may vary greatly as the stock price fluctuates.

PAYONLINE HISTORICAL INCOME STATEMENT

		Q1 2014	Q2 2014	Q1 2015	Q2 2015	2013	2014
Net Revenues	\$	1,390,235	1,815,570	1,202,878	1,205,310	5,997,495	6,729,228
Yr-to-yr				-13.5%	-33.6%		12.2%
Direct expenses:							
Bank commissions		947,362	NA	802,092	NA	4,047,877	4,595,623
Employee salaries and related benefits		249,875	NA	139,276	NA	966,162	814,121
Technology consulting and maintenance		22,431	NA	19,817	NA	46,586	86,475
Professional fees and other consulting expenses		17,171	NA	42,300	NA	96,101	225,598
Marketing expenses		9,411	NA	44,048	NA	306,613	201,176
Lease expenses		68,050	NA	34,019	NA	298,651	216,876
Communications		8,996	NA	6,191	NA	49,165	38,938
Depreciation expenses		5,416	NA	3,908	NA	16,528	20,112
Amortization expenses		12,522	NA	14,729	NA	37,506	65,714
Other direct expenses		58,305	NA	22,024	NA	54,151	36,075
Total direct expenses		1,399,539	NA	1,128,404	NA	5,919,340	6,300,709
Yr-to-yr				-19.4%			6.4%
Net Revenues less Direct Expenses	\$	9,304		74,474		58,155	428,520
Yr-to-yr				700.5%			636.9%

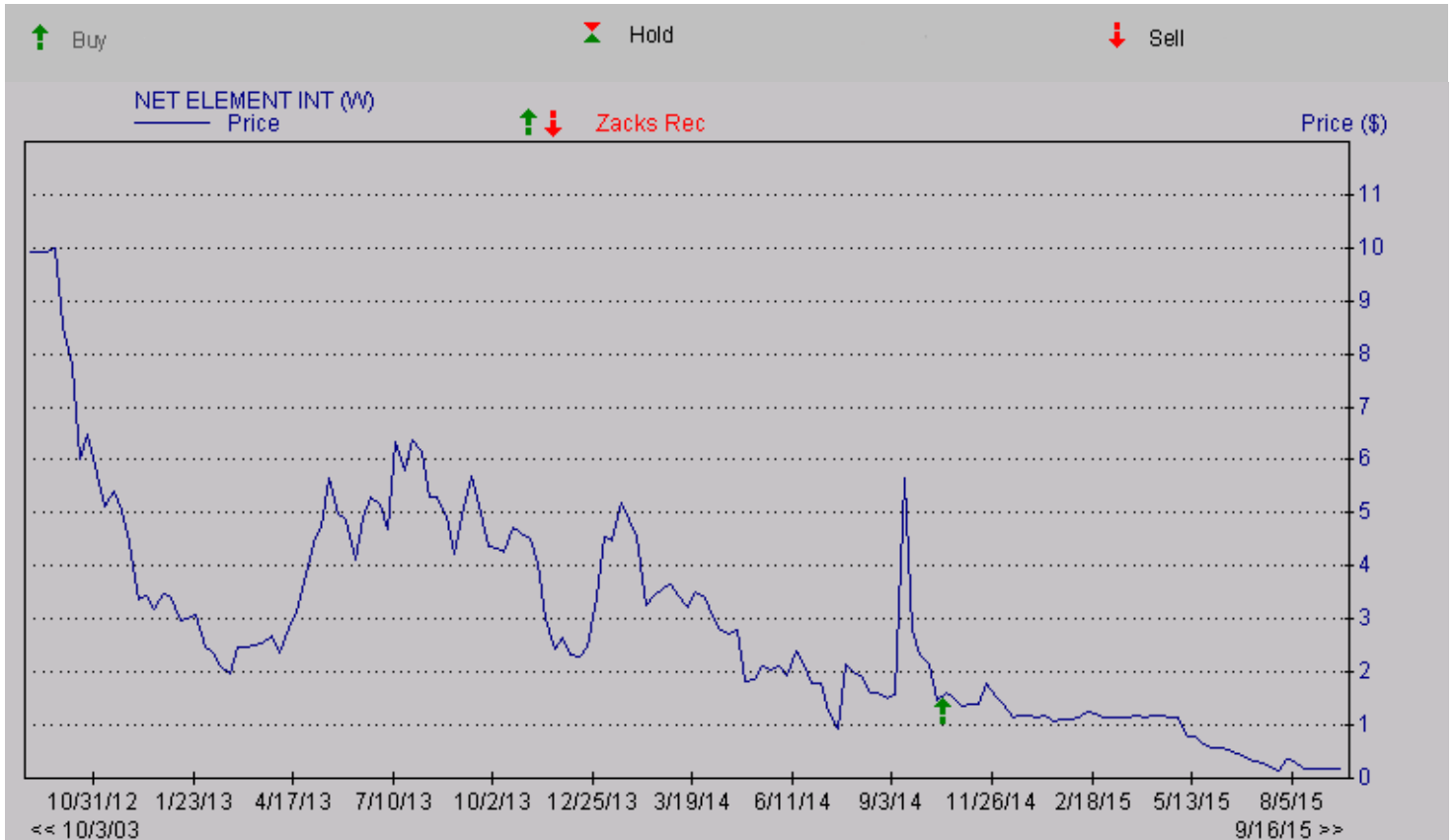
BALANCE SHEET

	June 30, 2015	March 31, 2015	% Change
Current assets:			
Cash	\$675,231	\$766,279	-12%
Funds in Escrow	\$5,000,000	\$0	
Accounts receivable, net	3,493,939	3,275,720	7%
Advances to aggregators, net	113,841	0	
Prepaid expenses and other assets	768,663	755,674	2%
Total current assets	10,051,674	4,797,673	110%
Fixed assets, net	137,583	60,850	126%
Intangible assets, net	8,651,527	2,273,695	281%
Goodwill	6,671,750	6,671,750	0%
Other long term	288,283	225,189	28%
Total assets	25,800,817	14,029,157	84%
Current liabilities:			
Accounts payable	\$3,217,611	\$3,398,814	-5%
Deferred revenue	241,304	437,625	-45%
Accrued expenses	2,747,967	2,372,425	16%
BCF derivative liabilities	368,571	0	
Warrant derivative liability	3,623,182	0	
Short term notes payable (net of discount)	277,778	0	
Notes payable (current portion)	318,405	318,405	0%
Due to related parties	83,257	125,000	-33%
Total current liabilities	10,878,075	6,652,269	64%
Notes payable (non-current portion)	3,646,595	3,646,595	0%
Total liabilities	14,524,670	10,298,864	41%
Series A Convertible Preferred stock	2,832,082	0	
STOCKHOLDERS' DEFICIT			
Common stock	5,761	4,618	25%
Paid in capital	144,416,472	137,290,970	5%
Stock subscription	(1,111,130)	(1,111,130)	0%
Accumulated other comprehensive income (loss)	(1,475,981)	(1,359,628)	9%
Accumulated deficit	(133,645,034)	(131,355,552)	2%
Noncontrolling interest	253,977	261,015	-3%
Total stockholders' deficit	11,276,147	3,730,293	202%
Total liabilities and stockholders' deficit	25,800,817	14,029,157	84%
Net Cash	4,995,791	322,874	1447%
Current and Quick Ratio	0.9	0.7	28%
Working Capital	(826,401)	(1,854,596)	-55%

INCOME STATEMENT

	31-Mar-14	30-Jun-14	30-Sep-14	31-Dec-14	31-Mar-15	30-Jun-15	30-Sep-15 (est.)	31-Dec-15 (est.)	2014	2015E	2016E
Credit card processing	\$4.1	\$4.6	\$5.6	\$5.2	\$5.2	\$6.3	\$6.5	6.6	\$19.4	\$24.59	\$30.10
Yr-over-yr Growth	NM	-0.6%	1.0%	10.9%	26.5%	37.1%	16.8%	28.6%	31.0%	26.8%	22.4%
Mobile payments	0.8	0.3	0.5	0.250	0.363	0.331	0.4	0.5	1.8	1.5	2.0
Yr-over-yr Growth	-13.6%	-66.3%	-54.4%	-75.2%	-51.6%	-2.1%	-24.1%	99.7%	-54.4%	-14.2%	29.5%
PayOnline	1.4	NA	NA	NA	0.0	0.3	1.4	1.6		3.3	7.0
Total revenues	4.8	4.9	6.0	5.4	5.5	6.9	8.3	8.8	21.2	29.5	39.1
Yr-to-yr Growth	457.9%	-12.4%	-7.6%	-5.9%	14.4%	40.6%	36.9%	62.2%	13.0%	39.1%	32.6%
Costs and expenses:											
Cost of revenues	3.5	3.3	4.7	4.3	4.6	5.5	6.3	6.5	15.9	22.9	26.0
Gross Margin	1.3	1.6	1.3	1.1	0.9	1.4	2.0	2.3	5.3	6.6	13.1
% of Sales	27.1%	31.9%	21.7%	20.7%	16.7%	20.8%	23.6%	26.0%	25.1%	22.4%	28.0%
G&A	3.1	2.5	2.4	3.2	2.6	3.2	3.6	3.6	11.4	13.0	18.0
Provision for loan losses	0.1	(1.5)	0.1	0.1	0.0	0.1	0.0	0.0	(1.2)	0.1	0.0
Depreciation and amortization	0.6	0.6	0.7	0.5	0.4	0.6	0.6	0.6	2.4	2.3	2.4
One-time charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total operating expenses	3.8	1.6	3.3	3.8	3.1	3.9	4.2	4.2	12.6	15.5	20.4
Loss from operations	(2.5)	(0.1)	(1.9)	(2.7)	(2.2)	(2.5)	(2.3)	(1.9)	(7.2)	(8.9)	(7.3)
Loss from operations ex-one time	(2.5)	(1.3)	(1.9)	(2.7)	(2.2)	(2.5)	(2.3)	(1.9)	(8.4)	(8.9)	(7.3)
Interest expense, net	(1.1)	(1.8)	(0.8)	(0.1)	(0.1)	(1.3)	(1.3)	(1.3)	(3.7)	(4.0)	0.8
Other expense	(0.0)	(0.0)	(0.1)	(0.1)	0.0	(0.0)	0.0	0.0	(0.2)	(0.0)	0.0
Gain on asset disposal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gain on change in conversion derivative	0.0	0.0	0.0	0.0	0.0	2.0	0.0	0.0	0.0	2.0	0.0
One-time charges	0.0	3.2	(2.1)	(0.1)	0.0	0.0	0.0	0.0	1.0	0.0	0.0
Total non-operating expenses	(1.1)	1.4	(3.0)	(0.2)	(0.1)	0.7	(1.3)	(1.3)	(2.9)	(1.9)	0.8
Loss from continuing operations before tax	(3.6)	1.3	(4.9)	(3.0)	(2.2)	(1.8)	(3.6)	(3.2)	(10.1)	(12.9)	(6.5)
Income tax provision	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loss from continuing operations	(3.6)	1.3	(4.9)	(3.0)	(2.2)	(1.8)	(3.6)	(3.2)	(10.2)	(12.9)	(6.5)
Minority interest	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net loss	(3.6)	1.3	(4.9)	(3.0)	(2.2)	(1.8)	(3.6)	(3.2)	(10.2)	(12.9)	(6.5)
Preferred dividend	0.0	0.0	0.0	0.0	0.0	(0.5)	(0.5)	(0.5)	0.0	(1.6)	0.0
Net loss to common stock		1.3	(4.9)	(3.0)	(2.2)	(2.3)	(4.1)	(3.8)	(10.2)	(12.4)	(6.5)
Foreign currency translation gain (loss)	1.3	(0.1)	(0.3)	(2.0)	(0.1)	(0.1)	0.0	0.0	(1.1)	0.0	0.0
Comprehensive loss	(2.3)	1.2	(4.6)	(4.9)	(2.3)	(1.9)	(3.6)	(3.2)	(11.3)	(12.9)	(6.5)
Earnings ex-one time charge	(2.2)	(1.9)	(2.7)	(3.0)	(2.3)	(3.8)	(3.6)	(3.2)	(11.2)	(12.9)	(6.5)
Stock-based compensation	0.1	0.7	0.5	3.0	0.6	0.6	0.5	0.5	4.3	2.2	2.0
Adjusted Non-GAAP Earnings	(3.6)	(1.2)	(2.2)	0.0	(1.7)	(3.2)	(3.1)	(2.7)	(6.9)	(10.7)	(4.5)
Yr-to-yr Growth	25%	-62%	-34%	-101%	-51%	172%	37%	-7999%	-64%	54%	
GAAP EPS	(\$0.09)	\$0.04	(\$0.12)	(\$0.11)	(\$0.05)	(\$0.04)	(\$0.04)	(\$0.03)	(\$0.27)	(\$0.19)	(\$0.08)
Total loss per share	(\$0.11)	\$0.04	(\$0.12)	(\$0.11)	(\$0.05)	(\$0.04)	(\$0.04)	(\$0.03)	(\$0.27)	(\$0.19)	(\$0.08)
Loss per share ex-one time	(\$0.07)	(\$0.06)	(\$0.12)	(\$0.11)	(\$0.05)	(\$0.06)	(\$0.04)	(\$0.03)	(\$0.27)	(\$0.19)	(\$0.08)
Fully dil. Loss per share ex-one time	(\$0.05)	(\$0.05)	(\$0.10)	(\$0.09)	(\$0.04)	(\$0.06)	(\$0.03)	(\$0.03)	(\$0.24)	(\$0.14)	(\$0.05)
Non-GAAP EPS	(\$0.11)	(\$0.04)	(\$0.06)	\$0.00	(\$0.04)	(\$0.06)	(\$0.04)	(\$0.03)	(\$0.19)	(\$0.15)	(\$0.06)
Yr-to-yr Growth									-73%	-17%	-64%
Share outstanding	32.4	32.4	39.3	44.8	46.1	49.7	82.9	96.5	37.3	68.8	80.0
Yr-to-yr Growth	15%	15%	40%	53%	42%	54%	111%	116%	31%	85%	16%
Fully diluted shares	41.3	41.3	48.3	53.7	55.1	67.8	110.5	127.9	46.3	90.3	127.9
Yr-to-yr Growth	11%	11%	30%	40%	33%	64%	129%	138%	24%	95%	42%

HISTORICAL ZACKS RECOMMENDATIONS



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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- 24.1%, Hold/Neutral- 59.3%, Sell/Underperform – 13.6%. Data is as of midnight on the business day immediately prior to this publication.