Eastman Chemical Company (EMN-NYSE)

SUMMARY

We are retaining our Neutral recommendation on Eastman Chemical. The company saw its profit tumble in the fourth-quarter 2014 due to a sizable pension-related loss. Adjusted earnings, however, topped the Zacks Consensus Estimate. Sales rose year over year on gains across most businesses and beat expectations. The company expects adjusted earnings in 2015 to be similar to last year. Eastman Chemical’s diversified chemical portfolio, along with its integrated and diverse downstream businesses, remain its strength. It also benefits from acquisitions, business restructuring, cost-cutting measures and increased capacity additions. However, the company is still exposed to raw material costs, competitive pressures and currency headwinds. The uncertain economic recovery in Europe is also an overhang.

SUMMARY DATA

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ZACKS CONSENSUS ESTIMATES

Revenue Estimates
(In millions of $)

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<tr>
<th></th>
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<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
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<td>(Mar)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>2,440 A</td>
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<td>2,732 E</td>
<td>2,680 E</td>
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<td>2016</td>
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Earnings Per Share Estimates
(EPS is operating earnings before non-recurring items, but including employee stock options expenses)

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<td>(Mar)</td>
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<td>2013</td>
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<td>2016</td>
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*Note: Quarterly EPS may not add up to the annual figure due to rounding-off.

Projected EPS Growth - Next 5 Years %

8%
Eastman Chemical Company, based in Kingsport, Tennessee, manufactures and sells chemicals, plastics and fibers. The company has 16 manufacturing sites in the U.S., Europe and Asia-Pacific, supplying products throughout the world.

The company’s products includes additives, specialty polymers and other raw materials that are integral to the production of paints and coatings, inks, adhesives and other formulated products. It also makes intermediates based on acetyl and oxo chemistries such as acetic anhydride, acetaldehyde, oxo aldehydes and other intermediate products including plasticizers and glycols. Eastman Chemical's other products include performance chemicals, highly specialized copolymers and cellululosic plastics, copolyester cellulosic based products, acetate tow and triacetin plasticizers, and natural and solution-dyed acetate yarns. The company also offers the polyethylene terephthalate (PET) lines, which are used in beverage, food packaging and other applications such as personal care, health care, pharmaceutical, household products and industrial packaging, besides various polymer intermediate derivatives.

Eastman Chemical, in July 2012, completed its acquisition of and Solutia Inc., a global leader in performance materials and specialty chemicals, following the approval of the deal by Solutia's shareholders and satisfaction of all regulatory and other conditions. With the deal closure, Solutia has now become a wholly owned subsidiary of the company. Pursuant to the terms of the cash and stock deal worth roughly $4.8 billion (including assumption of Solutia's debt), Solutia stockholders received $22.00 in cash and 0.12 shares of Eastman Chemical common stock for each Solutia share. Eastman Chemical issued 14,686,067 shares to Solutia shareholders in connection with the acquisition. The company financed the cash portion of the purchase consideration with cash on hand and debt. With the completion of the Solutia acquisition, Eastman Chemical now employs roughly 14,000 people across the globe.

Eastman Chemical realigned its reporting segments following the closure of the acquisition. The new structure has five reporting segments – Additives and Functional Products, Adhesives and Plasticizers, Advanced Materials, Fibers, and Specialty Fluids and Intermediates. Eastman Chemical also made certain changes in executive leadership positions in conjunction with the restructuring of its reporting segments.

Eastman Chemical generated revenues of roughly $9.5 billion in 2014 with Additives and Functional Products, Adhesives and Plasticizers, Advanced Materials, Fibers, and Specialty Fluids and Intermediates segments accounting 19%, 15%, 25%, 15% and 26%, respectively. The U.S. and Canada represented 46% of total revenues while Asia, Europe, Middle East and Africa (EMEA) and Latin America contributing 27%, 22% and 5%, respectively.

**REASONS TO BUY**

- Eastman Chemical benefits from business restructuring initiatives that have reduced cyclicality by 40%. As part of the restructuring, the company sold unprofitable units and closed businesses that could not be sold. The company closed its PET polymer operations in Cosoleacaque, Mexico and Zarate, Argentina. It has also exited the PET business in Europe by selling the PET manufacturing sites in Spain, the Netherlands and the U.K.
In the first half of 2011, Eastman Chemical made progress in its growth initiatives by entering into a joint venture in China for a 30,000-ton acetate tow manufacturing facility, which is now in operation and producing commercial quantities. The company, in July 2012, entered into a joint venture with Sinopec Yangzi Petrochemical Company Limited to build a hydrogenated hydrocarbon resin plant in Nanjing, China. The facility, which is expected come online by end-2015, will expand Eastman Chemical's total capacity for hydrogenated resins by 50%, making it the largest supplier of hydrogenated hydrocarbon resins globally.

The acquisition of Solutia represents a significant step in the company's strategy to boost its presence in the emerging markets. In particular, it should significantly accelerate Eastman Chemical's growth efforts and offer excellent growth opportunities in Asia Pacific. By leveraging infrastructure in the region, Eastman Chemical expects to have a compound annual growth rate in Asia Pacific approaching 10% for the next several years. Eastman Chemical expects the transaction to be accretive to earnings, excluding acquisition-related costs and charges. The company ended 2013 with an annual run rate of little over $100 million in cost synergies from the acquisition and expects additional synergies of $20 million in 2014. Moreover, Eastman Chemical expects to realize significant tax benefits from the acquisition. It also recognizes the potential for meaningful revenue synergies by leveraging technology and business capabilities and overlapping end-markets, particularly in automotive and architecture, of both companies. Eastman Chemical has also bought Commonwealth Laminating & Coating, Inc. which will extend the company's performance films global offerings for solar control window film and protective film applications. Moreover, the acquisition of BP Plc's (BP) aviation turbine engine oil business has enabled Eastman Chemical to better address the needs of the global aviation industry. Moreover, the recently completed purchase of specialty chemical company Taminco Corporation in a deal worth $2.8 billion will fortify the company's foothold in attractive niche end-markets including food, feed and agriculture where Taminco has a strong presence. Eastman Chemical expects the Taminco buy to be accretive to its earnings (barring acquisition-related costs and charges) for 2015 by more than $0.35 per share and for 2016 by over $0.60 per share.

The company, in April 2012, announced the startup of its non-phthalate plasticizer manufacturing facility in Texas City. The facility, which Eastman Chemical bought in mid-2011, will produce Eastman Chemical 168 non-phthalate plasticizer. The company, in Sep 2014, completed the expansion of the overall capacity of Eastman 168 at the site by roughly 15%. With the capacity expansion, the company will be able to serve the growing needs of non-phthalate plasticizers worldwide. Non-phthalate plasticizers are not only used to provide flexibility to polyvinyl chloride (PVC) in a wide variety of applications, but are also used in products, such as toys, food contact materials and medical devices. The plasticizers also cater to end-markets, such as building and construction, health and wellness and infant care. Non-phthalate plasticizers demand remains strong and Eastman Chemical expects the market to require its next phase of capacity expansion by mid-2016. The additional capacity expansion will leverage Eastman Chemical's plants in Texas City and Kingsport. The expansion, which is expected to be a relatively low cost investment, will take the full capacity of Eastman 168 to more than 200,000 tons. Moreover, Eastman Chemical is seeing strong adoption of Tritan copolyester product line and is increasing Tritan capacity at its Kingsport facility by about 27% to 76,000 metric tons from 60,000 metric tons. Eastman Chemical is also expanding capacity for its Therminol heat transfer fluids. The plant expansion will be a new manufacturing facility capable of producing Therminol 66 and other biphenyl based co-products. The facility will increase Eastman Chemical's total capacity for Therminol 66 by more than 50%. With the expansion, Eastman Chemical will be able to meet the demands of its heat transfer fluid customers by providing a continuous supply of its flagship Therminol 66 product.
REASONS TO SELL

- Eastman Chemical relies on certain strategic raw material and energy commodities for its operations and utilizes risk management tools, including hedging, as appropriate, to mitigate short-term market fluctuations in raw material (especially for propane) and energy costs. These risk mitigation measures cannot eliminate all exposure to market fluctuations. The company's margins remain exposed to raw material and energy cost pressure. The company is also exposed to currency headwinds given the strengthening of the U.S. dollar vis-à-vis a basket of currencies, especially against euro. It sees a $0.25-$0.30 per share currency-related earnings headwind in 2015.

- A challenging condition in Europe is still affecting the company's Advanced Materials division. Automobile as well as building and commercial construction markets remain soft in Europe and uncertainty surrounding the timing of recovery in the region remains a concern. Moreover, the company continues to see pricing pressure. Weak demand for adhesives resins in specific markets and soft pricing due to competitive pressure is affecting the Adhesives and Plasticizers segment. The company sees strong competition in this division due to the addition of adhesive resins capacity by competitors. Eastman Chemical is also expected to see lower demand for acetate tow in first-half 2015 due to inventory destocking by customers. Moreover, falling oil prices and lower anticipated demand in heat transfer fluids are expected to affect the company's specialty fluids and intermediates business in 2015.

- Eastman Chemical's business and operating results have been impacted by fluctuating commodity prices, volatile exchange rates, and other challenges that affect the global economy. If the global economy or financial markets again deteriorate or experience significant new disruptions, the company's operations, financial condition, and cash flows could be adversely affected and its ability to access the credit and capital markets under favorable conditions and terms could be inhibited, which may affect its liquidity or ability to pursue growth initiatives.

RECENT NEWS

**Eastman Chemical's Q4 Earnings a Dime Ahead, Profit Tanks** – January 29, 2015

Eastman Chemical topped earnings expectations in fourth-quarter 2014, but its profits slid in the quarter as a sizable loss on pension and postretirement benefit plans more than offset a rise in its sales.

Eastman Chemical's profit (as reported) tumbled around 95% to $16 million or $0.11 per share in the quarter from $346 million or $2.22 per share logged a year ago.

Earnings, excluding pension/postretirement benefit plans loss and other one-time items, were $1.64 per share, topping the Zacks Consensus Estimate of $1.54 while surpassing the year-ago adjusted earnings of $1.35 per share.

For 2014, adjusted earnings of $7.07 per share also came ahead of the Zacks Consensus Estimate of $6.96.

**Revenues and Margins**

Revenues moved up roughly 4% year over year to $2,349 million, beating the Zacks Consensus Estimate of $2,333 million. The company saw higher sales across all segments barring the Adhesives and Plasticizers division in the quarter.
Revenues from the U.S. and Canada rose around 2% year over year to $1,042 million. Sales from Asia-Pacific edged up 0.8% to $654 million. EMEA recorded a 9% rise in sales to $513 million while Latin American revenues leapt 12% to $140 million.

For the full year, revenues rose around 2% year over year to $9,527 million, also beating the Zacks Consensus Estimate of $9522 million.

Operating earnings (excluding one-time items) were $362 million in the quarter, up 10% from $329 million a year ago, aided by higher earnings across the board.

**Segment Review**

Revenues from the Additives and Functional Products division climbed 15% year over year to $488 million in the quarter. The rise is partly attributable to higher coating sales volumes and the acquisition of Taminco Corporation. Coatings sales volumes rose on strong demand across major end-use markets, especially building and construction and transportation.

Adhesives and Plasticizers segment sales fell 2% to $313 million as a result of lower adhesives resins volumes due to limited raw material availability and a decline in plasticizers selling prices.

Revenues from the Advanced Materials unit inched up 1% to $562 million on increased sales volumes of premium products including Eastman Tritan copolyester, interlayers with acoustic properties and window films on sustained market adoption, partly offset by reduced copolyester products selling prices and currency headwinds.

The Fibers segment sales edged up 1% to $371 million, aided by higher acetate flakes volumes to Eastman Chemical's acetate tow joint venture in China and increased acetate tow pricing. This was offset by reduced acetyl chemicals sales volume.

Specialty Fluids and Intermediates division's sales rose 2% to $606 million. Sales rose due to acquired aviation turbine oil and Taminco functional amines products sales, partly offset by reduced prices for olefin-based intermediates and heat transfer fluids and lower volume due to the shutdown of Longview, TX, olefins cracking unit.

**Financials**

Eastman Chemical ended 2014 with cash and cash equivalents of $214 million, down roughly 10% year over year. Long-term debt jumped 70% year over year to $7,248 million. Eastman Chemical generated operating cash flows of $455 million (down 10% year over year) in the reported quarter and $1.4 billion (up 8%) in 2014. It repurchased shares worth $410 million during 2014.

**Outlook**

Eastman Chemical said that it is well placed to gain in 2015 from its strong portfolio of specialty businesses and acquisitions that it made last year. The company, however, added that it is exposed to near-term challenges such as an uncertain global economic environment, oil price volatility and headwinds from a stronger dollar. Eastman Chemical expects earnings per share (excluding non core and non-recurring items) for 2015 to be similar to what it achieved in 2014.
**Eastman Chemical's Q3 Earnings Top, Charges Hit Net** – October 30, 2014

Eastman Chemical saw its profit sag in third-quarter 2014 as hefty impairment and restructuring charges and acquisition-related costs more than offset a rise in its top line.

Eastman Chemical recorded profit (as reported) of $210 million or $1.39 per share in the quarter, a roughly 32% fall from $308 million or $1.97 per share recorded a year ago.

Eastman Chemical took asset impairment and restructuring charges of $60 million (post-tax) in the reported quarter. Earnings, excluding that charge and other one-time items, were $1.89 per share, topping the Zacks Consensus Estimate of $1.80 while coming ahead of the year-ago adjusted earnings of $1.68 per share.

**Revenues and Margins**

Revenues rose roughly 3% year over year to $2,413 million, essentially in line with the Zacks Consensus Estimate. The company saw higher sales across all segments barring the Fibers division in the quarter.

Revenues from the U.S. and Canada moved up around 6% year over year to $1,131 million. Sales from Asia-Pacific dipped 4% to $631 million. EMEA registered an 8% rise in sales to $520 million while Latin American revenues edged up 1% to $131 million.

Operating earnings (excluding one-time items) were $427 million in quarter, up around 5% from $405 million a year ago, aided by higher earnings across Advanced Materials and Adhesives and Plasticizers segments.

**Segment Review**

Revenues from the Additives and Functional Products division rose 3% year over year to $458 million. Higher coatings sales volumes on strong demand across major end-use markets coupled with increased pricing led to higher sales in the reported quarter.

Adhesives and Plasticizers segment sales went up 8% to $347 million, driven by increased adhesives resins volumes on strong end-market demand and higher plasticizers volumes, offsetting a decline in selling prices.

Revenues from the Advanced Materials unit moved up 4% to $604 million on increased sales volumes of premium products including Eastman Tritan copolyester, interlayers with acoustic properties and V-Kool window film.

The Fibers segment was the weak link with sales falling 5% to $346 million, impacted by lower acetate tow volumes that more than offset higher pricing and sales of acetate flake to Eastman Chemical's acetate tow joint venture in China. Acetate tow volume was affected by added industry capacity including the joint venture and flat demand in China.

Specialty Fluids and Intermediates division's sales rose 5% to $650 million. Sales rose due to increased intermediates pricing resulting from lower supply in a number of intermediates product markets. Volumes rose modestly as gains from acquired aviation turbine oil products sales was offset by a decline in intermediates and heat transfer fluids volumes.
Financials

Eastman Chemical ended the quarter with cash and cash equivalents of $212 million, down roughly 5% year over year. Long-term debt rose 3% year over year to $4,563 million. Eastman Chemical generated operating cash flows of $560 million (up 31% year over year) in the reported quarter and repurchased shares worth $50 million.

Outlook

Eastman Chemical expects healthy results in the fourth quarter, supported by continued strong demand and improved product mix. The company now expects earnings per share (excluding non core and non-recurring items) for 2014 to approach $7.00 versus its prior expectations of between $6.70 and $7.00.

Eastman Chemical is expected to gain from its specific actions to drive earnings, its diversified portfolio and end-use markets it serves and continued strong market traction of its premium products.

VALUATION

Currently, shares of Eastman Chemical are trading at 9.9x our 2015 EPS estimate of $7.18. The company’s current trailing 12-month earnings multiple is 10x, compared with the 21.4X average for the peer group and 18.6X for the S&P 500. Over the last five years, shares of Eastman Chemical have traded in the range of 7.6x to 16.4x trailing 12-month earnings. On a P/E basis, the stock is trading at a discount to the peer group. Our long-term Neutral recommendation indicates that it will perform in line with the broader market. Our price target of $74 is based on 10.3x our 2015 earnings estimate.

Key Indicators

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<th>Eastman Chemical Company (EMN)</th>
<th>P/E (F1)</th>
<th>P/E (F2)</th>
<th>Est. 5-Yr EPS Gr%</th>
<th>P/CF (TTM)</th>
<th>P/E (TTM)</th>
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TTM is trailing 12 months; F1 is 2015 and F2 is 2016, CF is operating cash flow

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Earnings Surprise and Estimate Revision History

EASTMAN CHEM CO (W)
Price
EPS Surprises

Price ($) 90 85 80 75 70 65 60 55 50 45 40 35 30 25 20 0
<< 4/25/94

EASTMAN CHEM CO (W)
Price
EPS ($/sh)
2015 Consensus
2013 Consensus
2012 Consensus
2011 Consensus
Price ($) 90 85 80 75 70 65 60 55 50 45 40 35 30 25 20 0
4/16/10 10/10/10 3/18/11 9/2/11 2/7/12 8/3/12 1/2/13 7/5/13 12/23/13 6/6/14 11/21/14 1/30/15
<< 2/1/03

ZACKS INVESTMENT RESEARCH
DISCLOSURES & DEFINITIONS

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Our recommendation for each stock is closely linked to the **Zacks Rank**, which results from a proprietary quantitative model using trends in earnings estimate revisions. This model is proven most effective for judging the timeliness of a stock over the next 1 to 3 months. The model assigns each stock a rank from 1 through 5. Zacks Rank 1 = Strong Buy. Zacks Rank 2 = Buy. Zacks Rank 3 = Hold. Zacks Rank 4 = Sell. Zacks Rank 5 = Strong Sell. We also provide a **Zacks Industry Rank** for each company which provides an idea of the near-term attractiveness of a company's industry group. We have 264 industry groups in total. Thus, the Zacks Industry Rank is a number between 1 and 264. In terms of investment attractiveness, the higher the rank the better. Historically, the top half of the industries has outperformed the general market. In determining **Risk Level**, we rely on a proprietary quantitative model that divides the entire universe of stocks into five groups, based on each stock's historical price volatility. The first group has stocks with the lowest values and are deemed Low Risk, while the 5th group has the highest values and are designated High Risk. Designations of Below-Average Risk, Average Risk, and Above-Average Risk correspond to the second, third, and fourth groups of stocks, respectively.