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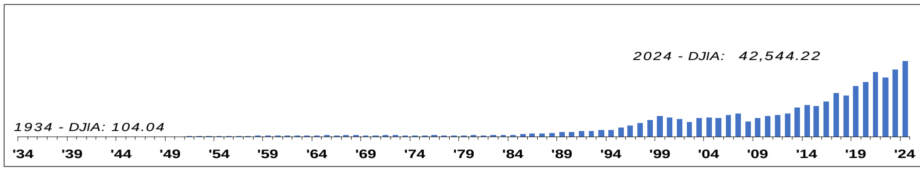
MARKET DIGEST



THURSDAY, MAY 8, 2025
MAY 7, DJIA: 41,113.97
UP 284.97

Good Morning. This is the Market Digest for Thursday, May 8, 2025, with analysis of the financial markets and comments on **Coca-Cola Co., GE HealthCare Technologies Inc., Southern Co., Advanced Micro Devices Inc., Arista Networks Inc., IDEX Corp., Nasdaq Inc., Otis Worldwide Corp., Interpublic Group of Companies Inc., Jacobs Solutions Inc. and PepsiCo Inc.**

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MARKET REVIEW:

More Turbulence Ahead: Our Monthly Survey of the Economy, Interest Rates, and Stocks

The stock market was uncommonly volatile in April, first diving on “Liberation Day” (April 2) and then gradually recovering as the administration moderated its stance. Early days of the month were characterized by sharp selloffs reminiscent of the market crashing toward recession in 2008 or plunging on COVID-19 shutdown fears in 2020. The S&P 500, which on 4/8/25 was down 11.2% for the month, finished with a 0.8% decline for all of April 2025. Positive stock momentum carried into May, fueled by a better-than-expected jobs report — even as crushing triple-digit tariffs on Chinese goods kicked in on 5/2/25.

Amid a range of economic and geopolitical cross-currents, the driving force in the stock market this year has been tariffs and, even more so, tariff talk. As the administration softened its tone on tariffs, the stock market rallied back. Stocks remain far from recapturing year-opening levels and even further away from establishing new all-time highs. But the recent recovery took some panic out the market. We are now seeing selling days that do not turn into routs, as was the case earlier in April.

Yet investors are not celebrating the comeback in stocks. The market bravado of 2024 appears to be gone. Institutional investors who were inclined to buy every dip in 2023-2024 now seem trigger-ready to sell every rally, even though the S&P 500 recently recorded its longest string of up days in over 20 years.

The Economy, Interest Rates, and Earnings

In the first quarter of 2025, gross domestic product was shaped by corporate actions taken in response to early tariffs and in advance of anticipated much steeper tariffs. Trade policy from the administration continues to coalesce, with the White House reportedly working on deals with a multitude of nations and some announced tariffs being paused or pushed out. We expect this uncertainty to impact GDP growth in the next few quarters.

The first (advanced) report of first-quarter 2025 GDP showed a decline of 0.3%, following growth of 2.4% in 4Q24. The consensus estimate was for growth of 0.4%. First-quarter GDP was distorted by a massive spike in imports, which are a subtraction to the calculation of GDP. Government spending also decreased, mainly reflecting a pause in defense spending. These subtractions to GDP were partly offset by increases in private inventories, business spending, consumer spending, and exports.

The policies of the second Trump administration represent a major change from those of the Biden administration, and pressure from tariffs on 1Q25 GDP was well-anticipated. Imports increased 41.3% in 1Q25, overwhelming 1.8% growth in exports. The value of imported goods in 1Q25 increased $333 billion from 4Q24, for an annualized and seasonally adjusted $4.02 billion in the first quarter versus about $3.65 billion in 4Q24. The vast majority of these imports were goods. Imports represented a 5.03 percentage-point reduction to 1Q25 GDP growth.

The surge in imports was reflected in the change in private inventories, which added 2.25 percentage-points to 1Q25 GDP. This volatile category increased 0.06 basis points in 2024 after subtracting 41 basis points in 2023 during the Supply Chain Crisis

Argus Economics expects GDP to grow in the remaining quarters of 2025 for two reasons. The export-import balance is likely to normalize and in the near term will favor exports (additive to growth) as first-quarter imports are worked down. And the key growth categories of personal consumption expenditures (PCE) and business spending were positive in the first quarter.

PCE for 1Q25 rose 1.8% and contributed 1.21 percentage-points to GDP in the period. Durable goods spending declined while non-durables spending rose. The large category of services spending increased a healthy 2.4%. We expect PCE within the GDP accounts to continue to send conflicting signals in 2025, while remaining in the 1%-3% range as the eventual tariff regime becomes settled and established.

Non-residential fixed investment, the proxy for corporate capital spending, rose by 9.8% in 1Q25. This category, which grew in the 6%-7% range over 2023-24, got a boost in 1Q25 as companies sought to invest in their infrastructure before tariff turbulence became too intense. Non-residential fixed investment added 1.29 percentage points to 1Q25 GDP.

Overall government spending was down 1.4% in 1Q25 and subtracted 25 basis points from first-quarter GDP growth. The driver was not DOGE job cuts, but an 8% decline in defense spending, which led to a 5.1% decline in total federal spending. State and local government spending edged higher by 0.8%.

The price index for gross domestic purchases increased 3.4% for 1Q25, after rising 2.4% in 2024. And the PCE price index advanced 3.6%, up from 2.5% in 2024. The Fed needs both GDP growth and lower price increases if it is to cut rates going forward.

Elsewhere, the economy has flashed positive signs based on jobs growth and corporate earnings. The U.S. economy generated 177,000 new jobs in April, better than the consensus call of 130,000. Even with March and February non-farm payrolls revised lower, three-month average jobs growth was a healthy 155,000 and not much below the full-year 2024 average of 166,000.

The Labor Department’s diffusion index for April indicated that more than half of 250 private industries are hiring. The unemployment rate held at 4.2% for April, in line with the March level. Average hourly earnings grew 3.8% annually. Annual wage growth continues to run above inflation but has moved below 4.0%, and the premium to inflation has narrowed.

Industrial production decreased 0.3% in March from revised 0.8% growth in February. On the upside, industrial production increased 5.5% for the full first quarter of 2025. Manufacturing production rose 0.3% in March after 1.0% growth in February. Mining rose 0.6%, while formerly strong utilities declined 5.8% on mild weather. Capacity utilization stepped down to 77.8% and was 1.8 percentage points below the long-run average.

The small business optimism index from the National Federation of Independent Business (NFIB) reached a six-year high of 105.1 in December 2024 in anticipation of a change to a more business-friendly administration. That optimism has been dented, and the index fell to 102.8 in January 2025, to 100.7 in February, and further to 97.4 in March. Sales expectations and business conditions contributed the most to the decline. Fewer small business owners are planning capital investments in the next few months.

The ISM manufacturing PMI remained below 50 for April, but at 48.7 actually ticked up from 47.9 for March. That could signal that purchasing managers are anticipating that tariffs will begin to compel companies to downscale overseas manufacturing and onshore more production.

Consumers appear to be concerned that tariffs could lead to higher inflation. The University of Michigan Consumer Sentiment Index for April 2025 fell to 52.2, the fourth-lowest reading since the series began in 1952. The Conference Board’s Consumer Confidence Index for April 2025 declined to 86.0. The Expectations Index, based on consumers’ short-term outlook for income, business, and labor market conditions, dropped to 54.4, the lowest level since 2011. According to the Conference Board, the current level is well below the threshold of 80 that usually signals a recession ahead.

The Bureau of Economic Analysis within the Commerce Department reported that personal incomes rose 0.5% in March 2025, following growth of 0.7% in February. Personal consumption expenditures (PCE) rose 0.7% for the month after rising 0.5% in February.

The Atlanta Fed's GDPNow model, which forecast negative 1Q25 GDP, is currently estimating that second-quarter GDP will grow 1.1%. That is consistent with the outlook from Argus for low-level but positive GDP growth for the remainder of 2025, with a modest uptick in 2026.

Argus Chief Economist Chris Graja, CFA, is modeling GDP growth of 0.5% for 2025, down from his recent 1.3% forecast. Following the negative print for 1Q25, Chris expects GDP to grow 0.2% in 2Q25, 0.8% in 3Q25, and 1.5% growth in 4Q25. Argus believes GDP growth is likely to remain positive in 2026, but we have reduced our GDP growth forecast for the year to 1.8% from a prior 1.9%.

The Federal Reserve raised interest rates more than five percentage points between March 2022 and July 2023. After holding rates steady for eight straight meetings, the Fed at its mid-September 2024 FOMC meeting cut interest rates by 50 basis points (bps). The central bank then cut the fed funds rate by 25 bps at its November and its December FOMC meetings.

The federal open market committee (FOMC) of the U.S. Federal Reserve concluded its March 2025 meeting at mid-month and, as expected, maintained its fed funds target at the 4.25%-4.50% level. This marked a second straight meeting in which the Fed stood pat, after 100 bps of cuts in fall 2024. Ahead of the mid-May FOMC meeting, investors broadly expect the Fed to stand pat once again.

The Trump administration is mindful that tariff policies can cause near-term softening in economic activity. The administration would like the central bank to lower rates as a means of offsetting tariff impacts, and the president has been vocal in calling for rate cuts. After calling Jerome Powell a "major loser" and saying the central bank was making a mistake by not immediately cutting interest rates, the president then moderated his stance and said he has "no intention" of seeking to fire the Fed chair. Investors believe Treasury secretary Scott Bessent and other administration officials persuaded the president to back down by citing rapid deterioration in the Treasury market and in the dollar.

The Fed had been generally sanguine about the economy in the past two years, but now appears to be acknowledging there are new strains in the outlook. In mid-April, Fed Chairman Powell acknowledged that the central bank could find itself in a dilemma as it seeks to be control inflation and support economic growth. After earlier saying that "uncertainty around the economic outlook has increased," the Fed chairman signaled that patience (i.e., inaction) was the best near-term course.

Investors will be watching if the May meeting triggers any changes in the Fed's so-called "dot plot," which signals its intentions for interest-rate policy in the intermediate term. The dot plot released after the March FOMC meeting predicted two rate cuts in 2025 and two in 2026. FOMC voting members were not unanimous in their predictions, as four members voted for just one cut in 2025 while four voted for no cuts.

The central bank also lowered its forecast economic growth and raised its forecasts for unemployment and inflation. As of March, the Fed forecast GDP growth forecast for 2025 of 1.7%; an unemployment rate of 4.4% exiting 2025; and core PCE inflation at the end of 2025 of 2.8%. These are slightly less-favorable forecasts, consistent with slowing growth, but not recession.

Where the Fed goes from here may be require further progress on inflation, which is stubbornly stalled above the Fed's 2% target range. The Fed is cognizant that tariffs historically are associated with higher goods price. Were inflation to rise from current levels, we believe this Fed would not hesitate to return to neutral or even to restrictive monetary policy, i.e., start raising rates again.

The Consumer Price Index dipped 0.1% month over month in March 2025. All-items CPI was up 2.4% over the preceding 12 months. Core CPI was up 0.1% month over month and up 2.8% from March 2024. All of these readings represented improvement from the February CPI.

The Fed's preferred inflation gauge, the Core PCE Price Index, was unchanged for March after rising 0.5% in February. This metric was up 2.6% on an annual basis, compared with 3.0% year over year in February.

Bond yields, which hit multi-month lows following the Fed's September 2024 rate cut, have been volatile ever since. Over the past month, maturities at the short end of the curve had tended to move slightly lower, and those at the long end of the curve have moved slightly higher. The 10-year Treasury yield was 4.33% as of the end of April 2025, compared with 4.27% as of the end of March 2025. The long yield reached a low of 3.75% as of September 2024, while the cycle peak for the 10-year yield was around 4.9% in October 2023. The two-year Treasury yield was 3.83% as of the end of April 2025, versus 3.89% as of the end of March 2025. The two-year yield reached a cycle low of 3.55% in September 2024; the peak level was 5.2% as of October 2023.

Notwithstanding current noise in the market, Argus expects short-term yields to move lower from current levels. Long yields over time are expected to widen their relative premium to short yields. We likely have seen an end to twos-10s inversion in this cycle, although the three-month yield was level with the long yield at end of April.

With the Fed is in "no hurry" to cut interest rates further, Argus Fixed Income Strategist Kevin Heal continues to model two quarter-point rate cuts in 2025. Two cuts in 2025 would bring the central tendency in fed funds to 3.75%-4.0% by December 2025. Argus also acknowledges the possibility that the Fed holds rates unchanged in 2025, as it continues to monitor the economy, employment, and inflation.

Calendar first-quarter 2025 earnings season is well along, and as usual earnings are surprising to the upside. The blended EPS growth estimates from FactSet, Refinitiv, and Bloomberg have all ticked 500 to 600 basis points higher than they were at the beginning of 1Q25 earnings season, as upside surprises displace conservative estimates in the blended tally.

With a little a little less than three-quarters (73%) of component companies having reported, FactSet is estimating a 12.8% blended growth rate for S&P 500 earnings from continuing operations for 1Q25. That is up from 10.1% a week earlier, when about one-third of companies had reported 1Q results. Refinitiv is estimating 13.6% EPS growth on a blended basis, while Bloomberg is right around 12%; both were in the 9%-11% range a week earlier.

About three-quarters of companies to date have surpassed Street expectations; early in reporting season, that percentage was closer to 70%. On a long-term basis (past 10 years), about three-quarters of companies reporting EPS growth have surprised to the upside.

Additionally, the magnitude of the EPS beat jumped meaningfully higher, to around 9%. That is better than the 7% long-term average and now also in line with than the 9% intermediate-term average.

While the earnings year is off to a strong start with first-quarter results, we are becoming more guarded in our growth assumptions for 2025 and 2026. Across Wall Street, analysts have dialed down 2Q25 EPS expectations by two to three percentage points. At the same time, we look for EPS growth to continue. We expect the AI transformation to drive growth in Communication Services, Information Technology, and Consumer Discretionary. We look for growth to slow in defensive sectors but potentially to pick up in Energy.

We have made no changes in our forecast of S&P 500 earnings from continuing operations for 2025 or 2026. For 2025, our forecast for S&P 500 earnings from continuing operations is $276, implying full-year EPS growth of 12%. For 2026, our estimate is $307, which assumes EPS growth of 11%. Once the 1Q25 EPS season is concluded, we will assess the earnings outlook, with a bias to reducing our growth forecasts by a few percentage points to reflect the heightened uncertainty in the intermediate-term outlook.

Domestic and Global Markets

Stocks hit their 2025 trading year lows in the immediate aftermath of President Trump's "Liberation Day" tariffs announced on 4/2/25. At a closing lows of 4,983 on 4/8/25, at the height of tariff panic, the S&P 500 was down 15.3% year-to-date and 18.9% below its all-time closing high of 6,147 from February 2025. At its low near 15,267 on that date, the Nasdaq was down 20.9% year to date and 24.4% below its all-time closing high.

The stock market enjoyed a strong second half of April, and as of early May the various indices had recaptured all or nearly all of the post-Liberation Day decline. At the end of April 2025, the S&P 500 was down 2.9% YTD after being down 4.8% at the end of March. The Nasdaq was down 6.7% YTD at the end of April after being down 10.1% at the end of March. The Dow Jones Industrial Average was the only of the three major indices to lose ground, ending April down 2.4% for the year after ending March with a 1.9% year-to-date decline.

Wilshire Large Cap Growth was down 57% as of April-end, versus unchanged for Wilshire Large Cap Value. The Russell 2000 was down 9.0% year to date, even though these smaller, domestic-facing companies are expected to be less impacted by tariffs.

The Barclays Bloomberg U.S. Bond Index, which finished 2024 with a 0.9% gain, was up 2.2% year to date as of the end of the April. Bond returns bounced around all through 2024, and there is no reason to assume they will be stable in 2025.

With April now over, the stock market is showing very different sector leadership in 2Q25 compared with 1Q25. During the first quarter, the best-performing sectors were defensive, rate sensitive, and/or provided inflation protection. Winning sectors in 1Q25 included Energy, Utilities, Staples, Healthcare, and Materials. The worst first-quarter sectors were Information Technology, Consumer Discretionary, and Communication Services, all down 6%-12%.

Those last three sectors tend to offer the best growth prospects and apparently have become attractive to investors on weakness. The best-performing sector in 2Q25 to date is Information Technology, up 5.5% as of 5/2/25. Also as of that date, Consumer Discretionary had a 2.0% gain. Utilities, Real Estate, Financial, and Industrial were all break-even to up 2% for second quarter to date. Energy, the first-quarter winner, was down 11.7% for 2Q25, as energy prices continue to sink. Healthcare has also given back its first-quarter gain and was down 5.0% for 2Q25, with leading health insurers getting crushed.

Despite weakness in growth sectors in 1Q25 and weakness in defensive, rate-sensitive, cyclical, and inflation-protection sectors in 2Q25, the majority of sectors have climbed out of the red and into the green for 2025 to date. Consumer Staples and Utilities were both higher by more than 6% YTD as of 5/2/25. Real Estate was up 3.8%, Financial was up 3.5%, and Industrials were up 2.5%. Also positive were Materials and Healthcare.

Thanks to its April bounce-back, Information Technology (down 8.2% YTD) is no longer 2025's worst sector. That distinction belongs to Consumer Discretionary, which was down 12.2% as of early May. Discretionary, which bounced higher in the 2024 second half on hopes that the Fed's rate-cutting campaign would stimulate big-ticket purchases, has weakened in 2025 on fears that tariffs would cause costs and prices on big-ticket items to balloon. Expensive items such as vehicles, homes, and appliances tend to be built with parts and components sourced from all over the world via highly complex supply chains. Forecasting the final costs and prices for such items is pretty much impossible when the tariff landscape is changing every day.

As of this writing, seven of the 11 sectors are now in positive territory for 2025 year to date. Even if traditional leadership remains absent, this level of breadth is positive for a broad market reversal and then a rally over the coming months and quarters.

For much of 4Q24 and all of 1Q25, investors rotated away from traditional growth leadership and toward defensive, interest-rate-sensitive, and cyclical sectors. We have seen a bit of reversal in the second quarter, with growth coming back into favor on stock-price weakness for well-known names including MSFT, META, and GOOGL. Sector leaders in Information Technology and Communication Services have been helped by well-above-consensus earnings for calendar 1Q25.

Information Technology exited April 2025 with a 30.3% weighting. That is below its 31% reading entering 2025, though above its weighting of 29.2% a year earlier. Communication Services at 9.3% of S&P 500 sector weight is below peaks exceeding 10%, though up 20 bps from 9.1% a year ago. Consumer Discretionary, another growth sector that has wavered in and out of investors' favor, is at 10.3% of the market or even with its level a year ago.

Financial has gained the most weight on a relative basis over the past year. The sector represented 14.5% of S&P 500 sector weight as of April 2025, compared with 13.1% as of April 2024. Healthcare has lost the most weight on a relative basis over the past year, representing 10.8% of S&P 500 sector weight as of April 2025, compared with 12.3% a year ago. Over that period, the weighting differential between Financial and Healthcare has gone from 80 bps a year ago to 430 bps currently.

Both of the interest-rate-sensitive sectors have gained weight over the past year. Utilities have gone from 2.3% of the market to 2.6%; and Real Estate has gone from 2.2% of the market to 2.3%. After Healthcare, the sector with the most notable share loss is Energy. From 4.1% a year ago, Energy was down to 3.2% of S&P sector weight as of April 2025. The president is seeking to offset the impact of higher goods prices by encouraging domestic energy production and thus lower gasoline prices. The combination of increasing global caution and higher production is keeping oil prices low and Energy sector earnings negative.

The major rotation away from growth and toward defensive and rate-sensitive may be winding down after dominating the stock market for more than six months. Investors may take more of a bargain-hunter's approach for the remainder of 2025, with less regard to sector trends.

Like the U.S. market, global stocks did better in 2023 than they did in 2022; and most carried that momentum across 2024. In 2025, overseas markets are doing better than the U.S. market. Within our composite of global bourses, just two markets (the U.S. and Japan) are down YTD; the remaining seven are positive for the year. Some of the worst markets in 2024, such as Mexico, are doing better in 2025. Conversely, some of 2024's winners, such as India and the U.S., are struggling in 2025.

In terms of our themes, resources economies are up 9.6% and lead the pack. BRICs-minus-Russia are up 7.0% year to date after rising 4.2% in 2024. Americas markets are up 6.4% as Canada and Mexico offset a weak U.S. Asian markets are up 2.9%. Mature economies, which led in 2024 and 2023, are up just 1.7%, reflecting weakness in Japan and the U.S.

Conclusion

The multi-year pattern of higher highs has been replaced in the 2025 year-to-date by a pattern of lower lows. This includes key lows in mid-March and in early April in the wake of President Trump's tariff announcements. If the market is able resume its climb, key markers for the S&P 500 would be the close at 5,671 just before "Liberation Day." On 5/2/25, the index hit that level, effectively cancelling the entire Liberation Day selloff. Another key target would be the close at 5,777 on 3/25/25.

Currently, key tariff negotiations reportedly are underway with Japan, India, and other nations. By all accounts, any negotiations with China are at the lowest level. The outcome of the elections in Canada could result in a hawkish, anti-American tone from our northern neighbor. Outcomes from these events, or a stray posting from the president on Truth Social, could knock the market back down toward its lows. If the market does pitch lower from here, red flag zone would be the 4/21/25 close at 5,158 and the year-to-date low at 4,982 from 4/8/25. But for now, the market mood is improved from one month ago. (Jim Kelleher, CFA, Director of Research)

COCA-COLA CO. (NYSE: KO, $72.40) .... BUY

KO: Raising target price

* KO shares have outperformed over the past quarter, rising 14% compared to a decline of 7% for the S&P 500 and a gain of 7% for the industry ETF IYK.
* Coca-Cola recently reported 1Q25 earnings that topped consensus expectations.
* Our revised target price of $82, raised from $80, implies a multiple of 26-times our 2026 EPS estimate.

ANALYSIS

INVESTMENT THESIS

Our rating on Focus List selection Coca-Cola Co. (NYSE: KO) is BUY. The company is focused on meeting the consumer where they are geographically and financially. KO has introduced varied pack, bottle and can sizes to be available and visible to different types of consumers. The company has a total beverage portfolio with diversified products in different categories. This wide portfolio shields KO from some of the impacts of poor consumer sentiment. Coca-Cola has driven growth through excitement and engagement around the brand. It has partnered and collaborated with several brands including Bacardi and Jack Daniel's to create innovative products that draw interest and drive sales. It is also focused on profiting from opportunities in developing and emerging markets by taking a local approach to a global business. Through this approach, it is emphasizing that its products are produced in local facilities close to where they are sold and capitalizing on local events such as the Lunar New Year in China. Management has signaled confidence in the future with a 5% dividend hike.

From a technical standpoint, the shares have been in a bullish pattern of higher highs and higher lows since December 2024. On the fundamentals, the stock trades at 23-times our 2026 EPS forecast, above the peer average of 21. Given the combination of international opportunities, varied pack sizes and strong portfolio of diversified brands, our rating remains BUY. Our revised target price of $82, raised from $80, implies a multiple of 26-times our 2026 EPS estimate.

RECENT DEVELOPMENTS

KO shares have outperformed over the past quarter, rising 14% compared to a decline of 7% for the S&P 500 and a gain of 7% for the industry ETF IYK. Over the past year, the shares have risen 16%, compared to gains of 9% for the index and 6% for the industry. Over the past five years, the shares have climbed 57%, versus gains of 92% for the index and 76% for the industry. The beta on KO is 0.42.

Coca-Cola recently reported 1Q25 earnings that topped consensus expectations. The company posted revenue of $11.1 billion, down 2%. On an organic basis, revenue was up 6%, reflecting a 5% contribution from price/mix, 2% higher case volume, and 1% higher concentrate sales, partially offset by impacts from currency and divestitures. First-quarter adjusted EPS of $0.73 rose 1%, exceeding the consensus forecast of $0.72. The adjusted gross margin widened by 30 basis points to 62.6%, while the adjusted operating margin widened by 140 basis points to 33.8%.

Along with 1Q results, management updated its 2025 guidance. It continues to project organic revenue growth of 5%-6%. Management noted it expects a 2%-3% currency headwind on comparable net revenues, down from a 3%-4% headwind. It now expects adjusted EPS growth of 5%-6%, up from the previous expectation of 2%-3%. It continues to project free cash flow of $9.5 billion with capital expenditure of $2.2 billion, or about 5% of FY24 revenue.

EARNINGS & GROWTH ANALYSIS

Coca-Cola reports its results in five segments: EMEA (23% of 1Q revenue), Latin America (13%), North America (38%), Asia Pacific (13%), and Bottling Investments (13%).

Organic sales growth was positive in all five segments. By segment, organic sales were up 7% in EMEA; 13% in Latin America; 3% in North America; 7% in Asia Pacific; and 2% in Bottling Investments. Growth was primarily driven by price/mix.

Volume grew in two of the five segments. By segment, volume rose 3% in EMEA and 6% in Asia Pacific. Volume was flat in Latin America. Volume declined 3% in North America and 26% in Bottling Investments, due to the impact of refranchising bottling operations.

Management keeps an eye on margins. The first-quarter gross margin widened by 30 basis points to 62.6%, while the adjusted operating margin widened by 140 basis points to 33.8%. Margins were driven by strong organic top-line growth, effective cost management, and the effects of the refranchising bottling operations, partly offset by currency headwinds.

Coca-Cola has a history of growth and profitability. The company's revenues have grown 43% over the past five years, and adjusted operating profit has grown 44%. The adjusted operating margin has ranged from 28.7% to 29.9% over that time period.

Based on recent trends and management's guidance, we are raising our 2025 adjusted EPS estimate to $3.05 from $2.95. Our estimate is at the top of management's guidance range and implies growth of 6%. We expect growth to continue in 2026 and are raising our adjusted EPS estimate to $3.20 from $3.15. Our five-year earnings growth rate forecast is 6%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Coca-Cola is Medium-High, the second-highest point on our five-point scale. The company receives above-average scores on our criteria of fixed-cost coverage, profitability, and debt levels.

At the end of 1Q, KO had cash and cash equivalents of $8.4 billion. The company had long-term debt of $43.5 billion, up from $42.4 billion at the end of 2024, and a debt/total capitalization ratio of 61%. Operating income in the first quarter covered interest expense by a factor of 10.

Coca-Cola repurchases stock. In the first quarter, it repurchased 4.3 million shares for approximately $279 million. In 2024, the company repurchased approximately $1.8 billion of its stock. As of March 31, 2025, there were 72.1 million shares available for repurchase remaining on the authorization.

Coca-Cola pays a dividend. In February 2025, the company raised the dividend 5% to $2.04 per share, for a yield of 2.8%. KO has raised its dividend for 63 consecutive years, and we believe the dividend is secure and likely to grow. Our dividend estimates are $2.04 (raised from $2.02) for 2025 and $2.12 (raised from $2.10) for 2026.

MANAGEMENT & RISKS

James Quincey serves as Coca-Cola's CEO and chairman. Mr. Quincey was appointed CEO in 2017 and chairman in 2019. John Murphy has served as the company's CFO since 2019.

The company continues to refranchise its bottling operations. In February, it completed its sale of the Coca-Cola Beverages Philippines, Inc. to Coca-Cola Europacific Partners and Aboitiz Equity Ventures Inc., with the transaction valued at $1.8 billion. The company also refranchised its bottling operations in Vietnam, in Bangladesh, and in certain territories in India. Management expects these refranchising actions to further enable KO to develop a strong global footprint with a local touch in markets around the world.

As a major multinational corporation, Coca-Cola is exposed to substantial currency and commodity price risk. A bigger concern is that the company's core products are perceived as being unhealthy. There are growing concerns about obesity and the harm caused by sugar-sweetened beverages that may hurt demand for many of the company's core products. Harvard professor Vasanti Malik, who co-authored a paper on health issues related to sugary drinks told the New York Times that the "optimal intake of sugar-sweetened drinks is zero." The company is offering no-sugar versions of some of its most popular brands and smaller serving sizes to reduce total sugar content. Unfortunately, the press on "diet" beverages is not much better; a professor of pediatrics, also writing in the Times, said that a recent study and some of the related news stories on diet soda lacked important context and caused more worry than was warranted. Philadelphia, for example, has a tax of 1.5 cents an ounce on sweetened beverages, which adds about $1 to the price of a 2-liter bottle of Coke. Media reports said that sales of sweetened drinks dropped by 55% in Philadelphia; they increased by 38% in areas just outside the city. The Federal court ruled against a San Francisco ordinance to put a warning label on sugary drinks. The company has recently launched Coke Energy and Coke Plus Coffee. It is also putting more emphasis on tea. The company is also increasing its efforts to recycle the millions of plastic bottles and aluminum cans it produces.

Coke could be affected significantly if its independent bottlers run into credit or financial problems, or if the company's business interests do not align with the interests of bottling partners. It would also suffer if it is unable to defend its intellectual property rights, particularly as it expands to more emerging markets.

COMPANY DESCRIPTION

Coca-Cola, based in Atlanta, is a leading producer of soda, juices and juice drinks, and ready-to-drink teas and coffees. The company distributes its products in more than 200 countries. Core brands include Coca-Cola, Diet Coke, Sprite, Fanta, Coca-Cola Zero, Vitaminwater, Powerade, and Minute Maid. KO's operating groups are Europe, Middle East & Africa; Latin America; North America; Asia Pacific; Bottling Investments; and Corporate. The company sells beverage concentrates or syrups and finished beverages. The company has approximately 69,700 employees. The shares are a component of the S&P 500.

VALUATION

We believe KO shares are attractively valued at current prices near $72, near the top of their 52-week range of $60-$74. The shares have been in a bullish pattern of higher highs and higher lows since December 2024.

On the fundamentals, the stock trades at 23-times our 2026 EPS forecast, above the peer average of 21. The price/sales multiple of 6.6 is above the peer average of 4.9, while the dividend yield of about 2.8% is below the peer average of 3.2%. Given the combination of international opportunities, varied pack sizes and strong portfolio of diversified brands, our rating remains BUY. Our revised target price of $82, raised from $80, implies a multiple of 26-times our 2026 EPS estimate.

On May 7, BUY-rated KO closed at $72.40, up $0.68. (Taylor Conrad, 5/7/25)

GE HEALTHCARE TECHNOLOGIES INC. (NGS: GEHC, $68.82) .... BUY

GEHC: Operational excellence drives strong revenue growth despite tariff impact

* The company's ability to drive topline growth and mitigate tariffs underscores our conviction in the BUY rating for GEHC.
* New products are contributing to higher profit margins. GEHC is incorporating digital and AI capabilities across its product portfolio to enhance stickiness with customers and increase recurring revenue from its installed base of diagnostics equipment.
* Still, despite mitigation that reduces the impact of tariffs, the company sees a $475 million net impact to EBIT margin in 2025. We are cutting our estimates for adjusted EPS to $4.17 from $4.73 for 2025 and to $4.70 from $5.24 for 2026.
* Given the macroeconomic factors and recent market volatility, we are lowering the price target to $90 from $110.

ANALYSIS

INVESTMENT THESIS

Our BUY rating on Focus List selection GE HealthCare Technologies Inc. (NGS: GEHC) is highlighted by management's solid execution to produce strong financial and operational results in the first two years following its separation from General Electric Co. As an independent company, GEHC is focusing its capital on new product launches and M&A. In our view, an improved management and commercial execution will lead to higher operating margins. GEHC provides advanced medical devices and related products that help screen, diagnose, treat, and monitor patients. It also focuses on precision care by utilizing new imaging and ultrasound technologies to bring diagnosis and treatments to individuals. We have a positive view of GE HealthCare Technologies, highlighted by its ability to navigate trade tariffs.

RECENT DEVELOPMENTS

A positive takeaway from the 1Q25 results is that demand from customers is strong. Revenue growth was ahead of expectations. New orders grew 10% organically. The book-to-bill ratio was a healthy 1.09 times.

On the negative side, management affirmed that trade tariffs will eat into profits. The company has estimated a $475 million impact to the adjusted EBIT margin for 2025. With mitigation efforts partly offsetting the tariffs impact, GEHC expects $0.85 of net tariffs impact to adjusted EPS in 2025.

For 1Q25 (results reported April 30), adjusted EPS was $1.01, beating the consensus estimate by $0.09 and increasing 12.2% from the prior-year quarter. GAAP net income was $564 million or $1.23 per share, compared to $374 million or $0.81 per share in 1Q24.

Revenue was $4.777 billion, increasing 3% reported and 4% organic. Adjusted gross margin was 42.9%, up 80 basis points. This was driven by higher volume and favorable mix from higher margin new products. The adjusted EBIT margin was 15.0%, up 30 basis points. The 1Q25 results included a $0.05 per share impact due to tariffs.

Within the business' segments, topline growth was led by Pharmaceutical Diagnostics (8% organic growth) and Imaging (+5%). PDx segment margin was 32.4%, up 270 basis points. Imaging segment margin was 9.3%, up 130 basis points.

The PDx segment makes contrast agents and radiotracers for imaging and molecular diagnostics. This segment has recently launched two products that will contribute to growth and margins, Flyrcado and Vizamyl.

In April, GEHC launched in the U.S. Flyrcado, a radiotracer imaging agent for scans using positron emission tomography (PET). Flyrcado is used in a medical imaging test called myocardial perfusion that measures how well blood flows through the heart muscle. It is used to diagnose and monitor conditions that affect blood flow to the heart, such as coronary artery disease, heart attack, and angina. Flyrcado has a longer half-life than other cardiac PET tracers, providing greater accessibility and convenience to providers and patients.

Another growth contributor for PDx is the recently launched Vizamyl, a radioactive diagnostic agent indicated for PET imaging of the brain to estimate beta amyloid plaque levels in adult patients with cognitive impairment who are being evaluated for Alzheimer's disease (AD) or other causes of cognitive decline. With several AD therapies already approved and more on the way, we expect demand for Vizamyl to increase as clinicians and patients seek diagnostic tools for accurate assessment of cognitive decline. Vizamyl is the only PET imaging tracer for detection of amyloid approved by the FDA for visual interpretation of color images.

GEHC is incorporating digital and AI capabilities across its product portfolio to enhance stickiness with customers and increase recurring revenue from its installed base of diagnostics equipment.

GEHC is deploying an array of mitigation efforts to offset tariffs. The company has a global manufacturing footprint with 43 sites in 17 countries. It also has a very significant U.S. manufacturing base. It has the resources and capacity to shift production to reduce the impact of tariffs. It has a sizable presence in China, which represented about 12% of revenue in 2024.

The company is decreasing imports between China and the U.S. for both finished products and components. It will increase multi-sourcing of supplies and components. It is pursuing decreases to materials pricing as well as selective pricing actions for its products. And it is tightly managing operating expenses.

GEHC estimates that bilateral U.S. and China tariffs account for 75% of its total net tariffs impact. It is also assuming U.S. tariffs and reciprocal tariffs with the rest of the world, announced on April 2, would return to pre-pause levels on July 9. It expects Mexico and Canada tariffs to remain in place, with USMCA exemptions for eligible imports.

GEHC has taken actions to mitigate over 50% of its gross tariff exposure, including supply chain optimization. Given the mitigation actions, the company expects the tariffs impact to be lessened in 2026, compared to 2025.

EARNINGS & GROWTH ANALYSIS

GEHC updated its 2025 guidance. To account for the impact of tariffs, it now expects adjusted EPS of $3.90-$4.10 (down from a prior view of $4.61-$4.75). It expects adjusted EBIT margin of 14.2%-14.4%, down from a prior view of 16.7%-16.8%.

Its guidance for organic revenue growth, 2%-3%, is unchanged.

Based on the updated guidance, we are cutting our estimates for adjusted EPS to $4.17 from $4.73 for 2025 and to $4.70 from $5.24 for 2026.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on GE HealthCare is Medium. Cash from continuing operations for 2024 was $1.955 billion, compared to $2.101 billion in 2023. Cash flow from continued operations for 2024 was $1.042 billion, compared to $1.051 billion in the prior year.

The dividend is an annualized $0.14 for a yield of 0.2%. The company recently raised the dividend 16%. Our dividend estimates are $0.14 for 2025 and $0.16 for 2026.

Given the company's financial strength and increasing cash flow from operations, we think that GEHC has the resources to support the dividend. Still, we believe the company is focusing its capital allocation on organic and inorganic investments (M&A) and deleveraging the balance sheet.

MANAGEMENT & RISKS

Peter J. Arduini is the president and CEO of GE HealthCare and previously served as CEO of medical device manufacturer Integra LifeSciences. The CFO is James Saccaro.

There are risks to owning GEHC shares. Competition is a threat, as the industry includes rivals such as Philips, Siemens, and Hologic. The company operates internationally and is thus subject to changes in global economic conditions as well as to negative currency effects. The company also faces risks related to the integration of acquired businesses.

COMPANY DESCRIPTION

GE HealthCare Technologies Inc., formerly part of General Electric, provides healthcare products and technologies worldwide. The company has four segments: Imaging, Ultrasound, Patient Care Solutions, and Pharmaceutical Diagnostics. GEHC has 50,000 employees. GE HealthCare was spun out of General Electric and began trading as an independent company in December 2022.

VALUATION

GEHC trades at 14.8-times our 2026 adjusted EPS estimate, below the average multiple of 22.3 for our coverage universe of MedTech stocks. Given the company's outlook for top-line growth and margin expansion, we consider the valuation attractive.

On May 7, BUY-rated GEHC closed at $68.82, up $1.73. (David Toung, 5/7/25)

SOUTHERN CO. (NYSE: SO, $92.11) .... BUY

SO: Utility delivers solid results and 3% dividend increase

* Adjusted earnings increase 19% over 1Q24 and the quarterly dividend was raised to $0.74.
* SO reported 1Q25 adjusted earnings of $1.23 per share, compared with $1.03 in 1Q24. Helping to drive results were wholesale electric sales and traditional utility operations.
* Management is guiding for adjusted EPS of $0.85 in 2Q25. News of the double-digit decrease in earnings could create a buying opportunity.
* The region has solid demographics and management reports an 11% increase in data center electricity usage.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on Focus List selection Southern Co. (NYSE: SO). The shares can trade on fundamentals as well as follow sector trends and we are raising our target price to $98, up from $95. Southern is one of the largest U.S. utilities, with a well-run base of regulated assets and a presence in states with favorable population trends, such as Georgia. The company faced delays and cost overruns in the construction of its two new Vogtle nuclear-generating plants. However, Vogtle 3 became operational in July 2023, and Vogtle 4 became fully operational in April 2024.

Southern Co. has wholesale and retail electric operations and natural gas operations. The utility has long-term growth potential based on a growing number of residential, commercial, and tech customers with the region expected to see growth in data center demand. SO is poised for solid annual fundamental growth and its performance should allow it to fully participate in historical sector rotation trends when interest rates fall. Southern is retiring its coal-fired plants and increasing its use of renewables ? a shift in the generation mix that should lead to favorable regulatory rates and cost recoveries. The utility also offers consistent dividend growth and, with recent annual increases around 3%, the shares could appeal to income investors.

RECENT DEVELOPMENTS

SO shares have outperformed over the past three months, with a gain near 10% versus a gain of 4% for the Utility ETF IDU, and a decline of 7.6% for the S&P 500. Over the past year, the shares are up over 22% compared with gains near 18% for the IDU and 8.5% for the S&P 500.

Southern reported a 19% increase in adjusted earnings compared with 1Q24. Adjusted net income in 1Q25 was $1.4 billion or $1.23 per share, up from $1.1 billion or $1.03 per share in 1Q24. Results topped the consensus estimate of $1.20 per share. Retail regulatory impacts positively impacted earnings by $0.25 per share, while strong wholesale electric operations improved earnings by $0.10 per share. After facing storms in 2024, weather also positively impacted results by $0.08 per share.

Revenues in 1Q25 increased 17% from a year ago. For the first quarter, total operating revenue was $7.8 billion, up from $6.6 billion in 1Q24. Higher revenues for traditional electric operations drove results. Total operating expenses increased 16.6% to $5.8 billion, compared with $4.9 billion in 1Q24. Operating income for the first quarter was just over $2 billion versus $1.7 billion in 1Q24. Fuel and purchased power costs increased to $1.5 billion from $1.2 billion a year ago. Interest expense in 1Q25 was $714 million versus $665 million in 1Q24.

Southern Company has a five-year capital expenditure plan to $63 billion, with the potential to increase the budget further by as much as $15 billion. About $9 billion is earmarked for regulated gas utilities and just over $50 billion for state-regulated electric.

The new Vogtle nuclear reactors at Georgia Power will help drive long-term growth. Vogtle 3 became operational in July 2023, and Vogtle 4 entered service at the end of April 2024. In addition to the nuclear plants, Southern plans to add 9.5 gigawatts of clean energy generation to its state-regulated electric utilities through 2030. Nuclear generation accounted for 17% of Southern’s fuel mix in 2023, and the utility expects nuclear energy to grow to 19% by the end of 2024. Through 2028, 97% of capital is earmarked for state regulated utilities.

Along with earnings, management reiterated its 2025 adjusted earnings guidance of $4.20-$4.30 per share. The company has been projecting 7% rate base growth and 8% retail sales growth for its regulated utilities. Guidance for 2Q25 is adjusted earnings per share of $0.85, which estimates a 23% decline from earnings of $1.10 in 2Q24.

EARNINGS & GROWTH ANALYSIS

Electricity operations drove first-quarter results. For 1Q25, retail electric fuel revenues increased 20% to $1.2 billion while non-fuel retail revenues increased 15.5% to $3.4 billion compared with 1Q24. Wholesale revenue increased 30% to $744 million, up from $571 million a year ago. Total electricity sales by KW hours increased 4.2% with residential retail sales up 6.4% and commercial retail sales up 3.3% compared with the same quarter a year ago. Wholesale electric KW sales were up 6.8% versus 1Q24. The utility continues to see customer growth with a 1.1% increase for traditional regulated subsidiaries versus a year ago.

Southern Company reports results for its key subsidiaries as compared with a year ago. For 1Q25, net income available for shareholders increased for most of its subsidiary segments as follows: Alabama Power, up 12.6%; Georgia Power, up 36.4%; Mississippi Power, up 10%; Southern Power, down 9.4%; and Southern Company Gas, up 2.2%. Gas revenue also increased for 1Q25 to $1.8 billion, up almost 8% from $1.7 billion in 1Q24.

Southern Company primarily serves Georgia, Alabama, and Mississippi. The company offers gas and electric services, which can help decrease earnings volatility. The region has favorable long-term demographics and is a growing region for population growth, especially for seniors seeking less saturated coastal locations. The Atlanta area, in general, is a key location for industry and tech growth. Last year, regulated gas customers increased by almost 1% compared with 2023 and similar growth is expected in 2025. The positive demographics are likely driving the company’s projections that they could see as much as 8% retail sales growth and 7% regulated rate base growth. Management recently projected potential load pipeline growth of 50GW, largely for Georgia Power. Currently about 10 GW are for committed demand. As for data centers, Southern Company estimates about 80% of GW in its long-term pipeline could be from data center growth.

Southern Company’s earnings in 2024 were boosted by positive regulatory effects, including rate increases and regulatory rate recovery, which we expect to continue into 2025. This is in contrast to the negative effect in the past from construction delays involved with SO’s two nuclear generators. With the nuclear generating plants in place, the company is maintaining an aggressive capital expenditure budget of about $60 billion over the next five years with 95% earmarked for regulated business. The capital cost recovery will benefit from an above-average ROE of 10.5%. And while some utilities can temporarily benefit from lower fuel and purchased power costs, such as some energy prices in 2024, nuclear generation offers increased efficiencies that can provide additional cost savings. Southern management is guiding toward above-peer earnings growth, which we believe is achievable.

The company felt a significant impact from the September hurricane, which was the most damaging storm that the region has ever faced. The region had 1.5 million customers without power and had about 1,500 miles of downed power lines. Although the damage was extensive, the utility’s response was robust, with about 95% of customers restored to power within eight days. Regulators review response performance in determining storm recovery costs. Management was already guiding to a slower 2H24 but higher annual growth than peers and the company’s projections were solid. The region is expected to see a return to normal weather and storm patterns in 2025.

The company is also improving its generation mix through coal-plant retirements and an increased focus on renewables. It targets net-zero greenhouse-gas emissions by 2050. The company is adding renewables and is currently seeking bids for an estimated 13GW of additional generating capacity from renewable sources. We also have a favorable view of the company’s debt management and commitment to long-term infrastructure improvements.

We are maintaining our 2025 adjusted earnings estimate of $4.30 and our 2026 estimate of $4.60 per share.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Southern is Medium, the midpoint on our five-point scale. S&P rates SO’s credit as A-/negative, Moody’s as Baa2/stable, and Fitch as BBB+/stable.

Cash and equivalents at the end of 1Q25 were $2.3 billion, up from $1.1 billion at the end of 2024. The net value of plant and equipment at the end of 1Q25 was $106 billion, up from $105 billion at the end of 2024 and $100 billion at the end of 2023. Total long-term debt at the end of 1Q25 rose to $62.9 billion, up from $58.8 at the end of 4Q24. The long-term debt/capitalization ratio was 63%, up from $62% at the end of 2024 and slightly above the peer average of about 60%.

The company had about $271 million of long-term debt maturing in 2025. The weighted-average debt maturity is about 15.5 years.

The utility has increased its dividend for 24 consecutive years. The company’s latest hike is about 3% to $0.74 per quarter, payable in June. This follows similar increases in 2024 and 2023. The current yield of about 3.3% is in line with the peer average of 3.4%. Our dividend estimates are $2.94 for 2025 and $3.00 for 2026.

MANAGEMENT & RISKS

Chris Womack is the chairman, president, and CEO of Southern Company. Dan Tucker is the CFO.

Southern has faced earnings pressure related to high costs and delays at its two new nuclear reactors. The second unit was connected to the grid during 1Q24, and became fully operational at the end of April 2024. Other risks include commodity-price fluctuations, the effect of adverse weather on revenue, regulatory risk, and potential environmental and safety liabilities. Utilities may also face interest-rate risk when funding acquisitions. Income stocks such as utilities are sensitive to movements in bond rates; when interest rates begin to rise, utility yields also tend to rise.

COMPANY DESCRIPTION

Southern Company is an electric and gas utility and wholesaler with nine million customers and 41,000 megawatts of generating capacity. Electric customers are primarily located in Mississippi, Alabama, and Georgia. Its gas utilities provide distribution and wholesale gas services to about 4.4 million regulated customers with operations in Georgia, Tennessee, Illinois, and Virginia. The company also offers digital wireless and fiber-optic services.

In 2024, electric revenues accounted for about 80% of consolidated revenues, of which retail electricity accounted for about 65%. Its largest utility, Georgia Power, accounted for about 40% of 2024 revenue. The company also reports fuel and non-fuel retail electric revenues for reporting purposes.

SO's 2023 fuel mix is 52% gas, 17% coal, 17% nuclear, and 14% renewables. It is working to achieve net-zero greenhouse-gas emissions by 2050, later than peers without coal generation. The company has faced rising costs and pandemic delays with these reactors – the first U.S. nuclear units built in the last 30 years. Vogtle 3 became operational in July 2023, and Vogtle 4 became fully operational in April 2024. The company also faced setbacks with its now written-off Kemper County "clean coal" plant, which resulted in more than $5.0 billion in cost overruns and damaged its reputation. SO shares are a component of the S&P 500. The company's market cap is $101 billion.

INDUSTRY

Our rating on the Utilities sector is Over-Weight. Utilities typically tend to do well in periods of declining interest rates, or even in advance of cuts in the fed funds rate by the central bank, as investors anticipate the changing environment. Utilities were the third-best sector in both 2007 and 2008, both years characterized by declining interest rates. Investors may have been skewing defensive in that highly challenging period that culminated in the 2008-2009 recession.

As of the end of March, the sector accounted for 2.5% of the S&P 500. Over the past five years, the weighting has ranged from 2% to 4%. The sector includes the electric, gas, and water utility industries. The sector was outperforming, with a gain of 4.1%. It underperformed in 2024, with a gain of 19.6% versus a gain of 23.3% for the S&P 500.

The sector's P/E ratio on projected 2025 EPS was 17, below the market multiple. Yields of 2.2% were above the market average. The sector's smoothed earnings growth rate of 5% was below the market average.

Utilities in the U.S. have other positives in their favor. These include strong regulatory return on infrastructure investments, most notably to support the growing power needs of data centers in support of the AI revolution. We believe investors will continue to favor Utilities as the Fed's rate-cutting cycle plays out, and we recommend an over-weight position of 0.5%-1.0% above the current 2.4% benchmark weight within balanced equity portfolios.

VALUATION

The shares can trade on negative earnings and management is guiding for an unfavorable 2Q25 comparison with 2Q24, which could create a buying opportunity. The shares are currently trading near the top of their 52-week range of $75-$94. While earnings slowed in 2H24, in part due to diminishing regulatory effects, annual earnings and revenues showed solid growth. We expect solid fundamental growth overall in 2025 and 2026.

Southern shares are trading at 21.9-times our 2025 non-GAAP EPS estimate, compared with the peer average of 19.3-times and the stock's five-year average P/E of 19.0-times. The PEG multiple is 2.9, which is in line with the average for utility peers. The shares are trading in-line with peers for their price/sales metrics, but above peers for their EV/EBITDA multiples. We believe the shares merit a premium compared to peers based on the company's better-than-expected earnings growth and the long-term expansion of the customer base at its regulated utilities. In addition, earnings should react to the fading of headwinds created by past construction delays, as the last Vogtle reactor provides service and generation efficiency improves.

The company also has a record of steady dividend growth and a yield of about 3.3%. We expect Southern Company's strong fundamental growth to allow the shares to fully participate in positive sector trends if interest rates decline as the year progresses. Our target price is $98, up from $95.

On May 7, BUY-rated SO closed at $92.11, up $0.89. (Marie Ferguson, 5/7/25)

ADVANCED MICRO DEVICES INC. (NGS: AMD, $100.36)... BUY

AMD: Data Center growth, inventory charges due to China

* AMD delivered 1Q25 revenue and non-GAAP EPS ahead of consensus estimates, with both rising in double-digits year over year. Non-GAAP results for 2Q25 will be impacted by $800 million in inventory reserves due to new export controls.
* The company is ramping shipments of AI accelerators and will be releasing new AI products in 2H25 as it seeks to strengthen its presence in generative AI.
* Despite the dynamic macro and regulatory environment, AMD believes its differentiated portfolio and consistent execution position the company for strong growth in 2025.
* We are reiterating our BUY rating and our 12-month target price of $160.

ANALYSIS

INVESTMENT THESIS

BUY-rated Advanced Micro Devices Inc. (NGS: AMD) edged up less than 1% in a rising market on 5/7/25 after the company posted revenue and non-GAAP EPS ahead of consensus estimates. Management noted that 2Q25 non-GAAP results will be impacted by $800 million in inventory reserves due to new export controls. These restrictions are also likely to impact upcoming quarters.

Both sales and adjusted EPS for 1Q25 grew in double-digit percentages year over year, extending year-end 2024 strength after single-digit growth in the first half of 2Q24. First-quarter 2025 revenue rose 36% from a year earlier, while non-GAAP EPS was up 56% from 1Q24.

Excitement around AMD’s products for the generative AI opportunity has driven the stock in the past two years. The company’s current AI product family features the latest iterations of its Instinct MI300 series accelerator group. During 1Q25, Data Center (DC) rose 57% annually and was better than consensus expectations. Growth was driven by ongoing ramp of AMD Instinct GPU products.

The company is currently the next-largest competitor in the GPU space, after Nvidia. AMD generated about $5 billion in annual GPU sales in 2024, with at least $3 billion coming in the second half. But Nvidia’s GPU revenue is at least 20-times that of AMD. The company expects first-half 2025 AI sales to roughly match 2H24 levels, as it goes through a product transition in advance of new AI products due in the second half of 2025.

AMD’s client PC business delivered 68% annual growth and edged down a less than seasonal 1% sequentially from the holiday quarter. In the CPU space, AMD is competing with Intel and others with fifth-generation EPYC processors for demanding enterprise and HPC workloads and third-generation Ryzen AI 3000 series processors for AI PCs. We also look for a midyear refresh of the CPU lineup for PCs and servers.

Gaming was down in double-digit percentages on a year-over-year basis, but Embedded limited its decline to 3% annually – its best performance since 2Q23. The gaming business, down almost 60% in 4Q24, is likely to remain weak pending new generation consoles from Sony (PlayStation) and Microsoft (Xbox) – neither of which are scheduled. Embedded should continue to gain strength in 2025, based on timing of inventory normalization and demand recovery in industrial markets and assuming limited disruption from tariffs. Both markets could recover in 2025, but Gaming, in particular, will be growing off a very low base.

Despite the dynamic macro and regulatory environment, AMD’s differentiated portfolio and consistent execution position the company for strong growth in 2025, according to CEO Dr. Lisa Su. In past years, AMD has gained meaningful global market share in CPUs for data Center and client at Intel’s expense. It is now taking aim at Nvidia in the GPU compute space for AI, although its market share deeply lags the leader. Share gains in client and in data center CPUs, market leadership in console gaming, and the much-enhanced embedded business all position AMD for long-term growth exceeding that of the peer group.

In our view, AMD’s beaten-down share price does not fully reflect the company’s long-term revenue and margin growth potential, and its ongoing market share gains at Intel’s – and potentially at NVidia’s – expense. We are reiterating our BUY rating and our 12-month target price of $160.

RECENT DEVELOPMENTS

AMD is down 18% year-to-date in 2025, while the peer group is down 15%. AMD declined 21% in 2024, while the Argus semiconductor peer group advanced 12%. AMD soared by 128% in 2023, while the peer group rose 67%; declined 55% in 2022, while peers fell 36%; advanced 57% in 2021 versus a 34% gain for the peer group; and rose 100% in 2020, while peers advanced 49%.

For 1Q25, Advanced Micro Devices reported revenue of $7.44 billion, which was up 36% year over year and down a less than seasonal 3% sequentially from the holiday quarter. Revenue topped the $7.1 billion midpoint of the $6.8-$7.4 billion guidance range, and was above the consensus estimate of $7.12 billion. Non-GAAP profit totaled $0.96 per diluted share, up 56% from a year earlier and down $0.13 sequentially. AMD management does not provide explicit EPS guidance. The Street had projected non-GAAP EPS of $0.93 for 1Q25.

Despite the dynamic macro and regulatory environment, AMD's differentiated portfolio and consistent execution position the company for strong growth in 2025, according to CEO Dr. Lisa Su. The company displayed significant operating leverage, according to CFO Jean Hu, as the overall company and particularly the AI business gains scale. Despite the uncertain environment, AMD continues to invest in R&D and in go-to-market initiatives, positioning the company for long-term growth.

In a recent SEC filing, AMD stated on 4/15/25 the company completed its initial assessment of a new license requirement implemented by the U.S. government for the export of certain semiconductor products to China. The export control applies to AMD's MI308 products, which are AI accelerators. The company will apply for licenses to ship to greater China but there is no assurance that licenses will be granted. Upon release of 1Q25 results, the company indicated that 2Q25 non-GAAP results will be impacted by $800 million in inventory reserves due to new export controls. These restrictions are also likely to impact upcoming quarters.

Despite restrictions on Chinese business, AMD continues to experience overall strong demand across most its product line including CPUs for compute and GPUs for AI acceleration. Embedded, which provides solutions for industrial and other applications, in 1Q25 enjoyed its best quarter in nearly two years. The gaming business remains soft given the lack of a refresh for industry-leading Xbox and PlayStation consoles from Microsoft and Sony. We believe both Embedded and Gaming will return to annual growth by year-end 2025, although tariff uncertainty could complicate those markets.

CEO Dr. Lisa Su has called 2024 a transformative year for AMD, setting the stage for strong growth particularly in AI data center in 2025. Data Center revenue of $12.6 billion for 2024 almost doubled from $6.5 billion in 2023 as EPYC processor adoption accelerated. AMD generated more than $5 billion of AMD Instinct accelerator (GPU) revenue in 2024 including $3 billion in the second half of the year.

AMD expects first-half 2025 AI revenue to be little changed from 2H24 levels, due to what the CEO called product transitions. The company anticipates higher AI sales levels in 2H25 after it issues new products at mid-year. Even with a strong second half, AMD is likely to grow AI revenue in the low-20% range for 2025, at a time when rival Nvidia is growing in high-double-digit percentages. We are now estimating 2025 Data Center revenue of about $15 billion, which would be up 21% from 2024.

At its "Advancing AI" event in fall 2024, AMD laid out its comprehensive strategy for AI spanning Data Center, AI PCs, networking and more. AMD has built a strategy and AI eco-system based around what its portfolio of training and inference engines; open software solutions; and Cluster-level systems design based on its newly acquired systems asset. In the evolving AI landscape, innovation is moving from silicon to nodes (servers), to racks, and to clusters in the hyperscale data center. AMD's approach to this opportunity is systems-based and includes both hardware and software.

For data center servers, AMD in 2024 announced availability for its fifth-generation EPYC processors (Turin). In the GPU space, AMD has its family of Instinct Accelerators. For networking, AMD has its Pensando product and is working within Ultra Ethernet Consortium protocols. AMD's open-source software solution, ROCm, is challenging Nvidia's CUDA.

On 3/31/25, AMD closed the acquisition of ZT Systems, which provides AI and general purpose infrastructure for the global hyperscale providers. AMD expects the combination to enable a new class of end-to-end solutions encompassing AMD CPU, GPU, and networking silicon, AMD ROCm software, rack-scale system capabilities. It will also accelerate the design of deployment of AMD-powered AI infrastructure at scale optimized for the cloud.

AMD is engaged with multiple potential strategic partners to acquire ZT Systems' U.S.-based data center infrastructure manufacturing business. AMD is disposing of this business to avoid competing with its customers. Specifically, AMD intends to install its chips into ZT servers, then spin the business off so that it is not competing with server customers such as Dell, HPE, and Super Micro Computer.

Data Center primarily includes EPYC server CPUs, GPUs, data processing units (DPUs) and FPGA and SoC families that came from the Xilinx acquisition. For 1Q25, Data Center revenue of $3.67 billion (49% of total) was up 57% year over year and down 5% sequentially from record levels in 4Q24. Data Center operating profit of $932 million advanced 72% from a year earlier while moderating sequentially. AMD Data Center margin of 25.4% for 1Q25 expanded from 23.1% in 1Q24.

Data center growth continues to be driven by the strong ramp of Instinct GPU shipments and growth in EPYC CPU sales. Fifth generation "Turin" EPYC CPUs come in 3 nm process node, have up to 192 cores and 384 threads, and power up to 5GHz. The company has stated that based on prior generations, EPYC has attained 31% market share in server CPUs as of year-end 2024, after having just 2% share in 2018.

EPYC is available on 350-plus OEM server platforms and is being used for as many as 1,000 cloud instances. EPYC is in use by all the hyperscale CSPs, including AWS, Alibaba, Azure, Google Cloud, IBM Cloud, Oracle, Tencent, and Meta.

AMD Instinct MI300 accelerator shipments include its latest iteration MI325X and MI350 series. MI300 Instinct GPUs, according to the company, are powering the most popular Generative AI platforms from Microsoft, OpenAI, Meta, and others. The MI350 series is due in 2025.

Client includes CPUs, accelerated processing units (APUs) that integrate microprocessors with graphics processors, and chipsets for desktop and notebook PCs. Client revenue of $2.29 billion (31% of total) for 1Q25 rose 68% annually and declined a less-than-seasonal 1% sequentially from the holiday quarter. Client posted an operating profit of $496 million for 1Q25, up 109% from 1Q24 and up sequentially from 4Q24 on a richer mix. Client operating margin of 21.6% in 1Q25 improved from 17.3% in 1Q24 and expanded sequentially from 21.4% in 4Q24.

Strength in Client was led by strong demand for latest-generation Ryzen processors. These include Zen 5-based Ryzen PRO 7000 Series processors for desktops with RDNA 2 integrated graphics; and Ryzen 8000 Series Mobile processors including Ryzen 8000G series with an integrated AI engine.

Client growth was also driven by significant and ongoing ramp of third-generation Ryzen AI 3000 series processors for notebooks. For desktops, the upcoming Ryzen 9000 series processors on AM5 motherboards are expected to enhance performance and energy efficiency across productivity, gaming, and content creation. AMD is executing on its multi-year Ryzen AI roadmap to enable the new generation of AI PCs that it believes will redefine the PC experience.

AMD has gained meaningful global market share in CPUs for the data center and client space in the past several years, mainly at Intel's expense. AMD's share of x86 CPUs in both client and data center applications is in the 35%-40% range. As recently as 2017, AMD's all-in x86 CPU market share was below 20%.

Client is revving up after a dormant period, while Data Center is strengthening on cloud service provider focus on AI and recovery in enterprise. The other two businesses at AMD face intermediate-term challenges, with Gaming suffering from a stagnant console cycle, and Embedded Processing from weakness and inventory rebalancing in industrial and automotive end markets.

The Embedded segment includes a variety of CPUs, GPUs, FPGAs, adaptive SoCs, and Adaptive Compute Acceleration Platform (ACAP) products. For 1Q25, embedded revenue of $823 million (11% of the total) declined 3% from a year earlier, representing the most moderate year-over-year decline since 2Q23, when this business last grew on an annual basis. Embedded operating profit of $28 million was down 4% compared to a year earlier; the segment margin was 39.9% in 1Q25, down from 40.4% for 1Q24.

Key categories served by Embedded include aerospace-defense, industrial, medical, and semiconductor test & measurement, and communications infrastructure. AMD has announced multiple wins within the automotive space, including ADAS and LiDAR for semi-autonomous driving. AMD Embedded revenue declined by 33% for 2024. We look for this business to grow in low double-digit percentages in 2025, although tariffs represent a wild card that could inhibit recovery in industrial and particularly in automotive.

The Gaming segment primarily includes discreet graphics processing units (GPUs) under the Radeon name along with semi-custom SoC products and development services. Gaming revenue of $647 million (9% of total) for 1Q25 was down 30% year-over-year though up 15% sequentially following 23% sequential growth in the holiday quarter of 4Q24.

In Gaming, semi-custom revenue SoC sales declined as Sony and Microsoft reduced channel inventory. Given the almost six-year-old console cycle, semi-custom is likely to remain depressed until new consoles are available, and none are firmly scheduled. Radeon series GPUs for the PC market were also depressed as AMD prepared for transition to new GPUs based on RDNA 4 architecture. These new Radeon RX 9079 XT and RX 9070 graphics cards are now available. AMD gaming revenue declined by 58% for 2024. While management expects this business to grow in 2025, it will be off an extremely low base.

Following a full-year 2023 revenue decline of 4%, AMD's revenue grew by 14% in 2024. The company is confident it can grow sales and adjusted profits in strong double-digit percentages in 2025. AMD has gained meaningful global market share in CPUs for data center and client at Intel's expense. It is now taking aim at Nvidia in the GPU compute space for AI.

EARNINGS & GROWTH ANALYSIS

For 1Q25, Advanced Micro Devices reported revenue of $7.44 billion, which was up 36% year-over-year and down a less than seasonal 3% sequentially from the holiday quarter. Revenue topped the $7.1 billion midpoint of the $6.8-$7.4 billion guidance range, and was above the consensus estimate of $7.12 billion.

The non-GAAP gross margin was 53.7% for 1Q25 versus 54.1% for 4Q24 and 52.3% a year earlier. The non-GAAP operating margin was 23.9% for 1Q25 versus 26.5% for 4Q24 and 20.5% a year earlier.

Non-GAAP EPS totaled $0.96 per diluted share, up 56% from a year earlier and down $0.13 sequentially. AMD management does not provide explicit EPS guidance. The Street had projected non-GAAP EPS of $0.93 for 1Q25.

For all of 2024, revenue of $25.9 billion increased 14% from 2023, while non-GAAP EPS of $3.32 increased 25% from 2023.

For 2Q25, AMD guided for revenue of $7.1-$7.7 billion, which at the $7.4 billion midpoint is consistent with high-20% annual growth and no change on a sequential decline. The adjusted gross margin is forecast to be 43.0%, inclusive of the approximately $800 million in charges for inventory reserve related to new export controls. Along with other elements of line-item guidance, AMD's 1Q25 guidance is consistent with EPS of $0.60-$0.70, which at midpoint would be down 5% from a year earlier.

Our full-year 2025 non-GAAP EPS estimate, in addition to assuming $800 in inventory reserves in 2Q25, assumes an additional $700 million in inventory reserves spread out across 3Q25 and 4Q25.

We are lowering our non-GAAP EPS estimate for 2025 to $4.04 per diluted share from $5.10. We are reducing our preliminary non-GAAP EPS projection for 2026 to $6.04 per diluted share from an initial $6.10. We regard our estimates as fluid and subject to revision. Our five-year non-GAAP annualized EPS growth rate forecast remains 15%, among the highest in Argus Technology coverage.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on AMD is Medium-High. AMD has successfully restructured its debt, which is helping reduce interest costs. The company has swung to a net cash position from a net debt position and has stepped up shareholder returns.

AMD issued debt partly to acquire ZT Systems. Cash from debt proceeds was still on the balance sheet as of 3/31/25 when the balance sheet for 1Q25 was finalized.

AMD's cash position was $7.31 billion at the end of 1Q25. Cash was $5.13 billion at the end of 2024, $6.48 billion at the end of 2023, $5.91 billion at the end of 2022 (reflecting the addition of Xilinx gross cash), and $3.61 billion at the end of 2021.

Total debt was $4.16 billion as of the end of 1Q25. Debt was $1.72 billion as of the end of 2024, $4.16 billion as of the end of 2023, $2.47 billion as of the end of 2022 (reflecting the addition of Xilinx gross debt), and $313 million as of the end of 2021.

Net cash was $3.40 billion at the end of 2024. Net cash was $4.0 billion at the end of 2023, $3.45 billion at the end of 2022, $3.29 billion at the end of 2021, and $1.96 billion at the end of 2020. Prior to mid-2019, AMD was in a net debt position for multiple years.

Cash flow from operations was $3.04 billion in 2024. Cash flow from operations was $1.67 billion in 2023, $3.57 billion in 2022, $3.52 billion in 2021, and $1.07 billion in 2020.

In May 2022, AMD announced an $8 billion share-repurchase authorization, in addition to the $4 billion authorization announced in 2021. Previously, share repurchases were used primarily to offset dilution from stock-based compensation.

We do not expect AMD to pay a dividend in 2025 or 2026.

MANAGEMENT & RISKS

Lisa Su became CEO in October 2014 and was elevated to chairman of the board in 2023. Also in 2023, longtime finance industry professional Jean Hu became CFO, replacing Devinder Kumar who retired. Jean Hu previously served in the CFO role (and at times as interim CEO) at QLogic, Conexant, and Marvell, along with other postings.

In April 2023, AMD named Jack Hyun as SVP and General Manager of Computing & Graphics. Victor Peng, former Xilinx CEO and current AMD vice president, retired in August 2024. Executive transitions have largely been non-events at AMD and underscore the company's long-term planning and strategy.

The company's IP monetization strategy, as well as success in EE&SC, have contributed to growth. The pandemic turned around what had been structural decline in PCs, and AMD appears positioned for continued market share gains at the expense of Intel, which is wrestling with production issues.

The acquisition of Xilinx for $35 billion carries multiple risks, including potential issues with cultural integration, a misreading of end-market outlooks, and potential end-market cannibalization. We believe these risks are worth the TAM opportunities afforded by XLNX. The all-stock nature of the deal also eliminates the potential for a cumbersome debt burden. The deal diluted the share base, but AMD acquired growing and higher-margin assets that have not been dilutive. Additionally, Xilinx's application acceleration tools further AMD's progress in AI and the cloud data center.

A main risk for AMD, as for other semiconductor companies, is the possibility of a general economic downturn and a corresponding dip in technology hardware sales due to inflation and rising interest rates. We believe that AMD has the financial strength, market leadership, and growth characteristics to weather this storm and emerge a stronger player. We also believe the percentage of hours worked away from the office will continue to increase. That should drive long-term demand for personal PCs served by AMD CPUs, for data center CPUs to manage fast-growing data traffic, and for GPUs for gaming applications.

AMD has been betting heavily on nontraditional businesses, including embedded, micro-server, and semi-custom (gaming console). Simultaneously, AMD is supporting both stand-alone CPU and GPU lines, as well as its APU line that combines compute and graphics processing on a single die.

COMPANY DESCRIPTION

Advanced Micro Devices is the number-two player in x86-based microprocessors, behind Intel, and, with the 2008 acquisition of ATI, a top player in graphic processors. It now competes with Nvidia in the GPU processor space for AI applications. In 2021, Advanced Micro Devices acquired Xilinx, expanding its presence in embedded computing and data center. In 2025, AMD acquired ZT systems, which provides AI and general purpose infrastructure for the global hyperscale providers.

VALUATION

AMD shares are trading at 24.4-times our 2025 non-GAAP EPS estimate and at 16.3-times our 2026 projection. AMD trades at a two-year forward P/E of 20.4, below the multiple of 41.5 for the 2020-2024 period. The two-year-forward relative P/E of 1.05 is also below the historical average of 1.97 for 2020-2024. A historical comparable valuation for AMD indicates value in the $220s, in a stable trend and above current prices.

Peer-group analysis suggests that AMD deserves to trade at a slight premium to peers on absolute and relative P/E; our peer-indicated value in the $120s has fallen along with semiconductor peers during the 2025 IT sector correction. Our discounted free cash flow model renders a fair value in the $300s. Blending these approaches, we arrive at a value above $255, below peaks in the $290s though well above current prices.

For the long term, we are encouraged by the progress of EPYC in cloud and enterprise data center, the success of Ryzen CPUs for desktop and notebook PCs, and the outlook for AMD's Radeon GPUs in PC gaming. The XLNX deal added high-growth complementary assets that help accelerate AMD's growth in the cloud data center. MI300 accelerators and ROCm software represent important new growth opportunities as the age of generative AI continues to unfold. And Pensando and ZT allow AMD to offer a complete suite of products and services for the age of AI.

In our view, current prices do not fully reflect AMD's revenue and margin growth potential, or ongoing market share gains at Intel's expense – and now, potentially, at NVidia's expense. We are reiterating our BUY rating and 12-month target price of $160.

On May 7, BUY-rated AMD closed at $100.36, up $1.74. (Jim Kelleher, CFA, 5/7/25)

ARISTA NETWORKS INC. (NYSE: ANET, $86.45).. BUY

ANET: Expanding AI opportunity, reiterating $130 target price

* Arista Networks exceeded top-line guidance and consensus sales and non-GAAP EPS estimates for 1Q25. The stock sold off on 2Q25 guidance despite it being above consensus and consistent with a second straight $2 billion-plus revenue quarter.
* First-quarter 2025 sales rose 28% to 2.00 billion, and non-GAAP EPS rose 30% to $0.65, in a quarter in which most networking-equipment peers experienced lower demand year over year.
* The arrival of generative AIs has led to accelerating growth in cloud-based data center networking. Arista is delivering optimal networking platforms for AI applications.
* Arista is successfully managing through macroeconomic weakness and expanding its solutions set and TAM. The company completed a 4-for-1 stock split in December 2024.

ANALYSIS

INVESTMENT THESIS

BUY-rated Arista Networks Inc. (NYSE: ANET) fell 6% in a mixed market on 5/7/25 despite the company reporting strong growth in sales, including its first-ever $2 billion-plus revenue quarter, and stronger growth in adjusted EPS. Sales guidance of $2.1 billion for 2Q25 was above the pre-reporting consensus but may have missed the “whisper” number, causing the stock selloff.

Management noted that Arista achieved its first $2 billion quarter just 11 quarters after first hitting $1 billion in revenue in a three-month period. Following 30%-plus revenue growth in 2023 and 20% growth in 2024, Arista in February 2025 narrowed its top-line growth guidance to 17% for 2025, up from initial guidance in the 15%-17% range. Given the macro uncertainties, the company reiterated its 2025 top-line growth guidance as of May 2025. Non-GAAP gross margin guidance for the year is in a wide range of 60%-63%, which encompasses multiple tariff scenarios. Arista has a habit of outperforming its internal guidance, and we believe the company is positioned to outpace its $8.2 billion revenue goal for 2025.

After 100%-plus growth in cloud titan spending in 2022, cloud titan spending grew in the 20% range in 2023, with rising momentum into year-end. Cloud titan spending accounted for just under half of total 2024 revenue and grew more than 30% year over year. During 2024, accelerating enterprise demand for generative AI led to strengthening growth in cloud-based data center networking in support of large language models (LLMs) delivered as a service.

As the leader in enterprise and data center cloud networking, Arista is uniquely positioned to benefit from this unfolding opportunity and meaningful TAM expansion. In June 2024, Arista introduced its Etherlink platforms with a range of solutions including AI back-end networking for very large AI clusters.

Beyond cloud titans, Arista is seeing strength in its other customer verticals, including enterprise data center clients and service providers (now including Apple). Over the past two years, Arista has supplemented its focus on AI cloud, carrier, and large-enterprise customers with products for the campus and mainstream switching market. The company continues to offer new campus WAN routing solutions.

Arista Networks split its stock 4-for-1 late in 2024 in response to exceptional market performance over the past several years. Although stock splits are regarded as arithmetic events, in our experience companies that split their stocks signal strength to institutional investors and broaden their appeal to retail investors, resulting in additional upside.

Arista in our view appears positioned for sustained annual revenue and EPS growth in coming years. Having navigated the supply-chain crisis and a prolonged IP battle with Cisco, Arista is now successfully managing through macroeconomic weakness, customer caution, cost inflation, and lingering supply issues. Despite outperformance in ANET during 2023 and 2024, we recommend adding to or establishing positions on broad-market weakness. We regard Arista as a premier long-term holding in the cloud networking space. We are reiterating our BUY rating and our split-adjusted 12-month target price of $130.

RECENT DEVELOPMENTS

ANET is down 18% year-to-date in 2025, while immediate peers are down 5%. Arista rose 88% in 2024, while the peer group of cloud, social, mobile, and internet service companies in Argus coverage advanced 26% for the year. Arista rose 94% in 2023, while immediate peers advanced 70%; declined 16% in 2022, while immediate peers dropped 43%; soared by 98% in 2021, vs. 10% for immediate peers; and rose 43% in 2020, versus an 89% gain for peers.

For 1Q25, Arista reported revenue of $2.00 billion, which was up 28% year over year and 4% sequentially. Revenue came in above the high end of management's $1.93-$1.97 billion guidance range and topped the $1.97 billion consensus forecast. Non-GAAP earnings of $0.65 per diluted share were up 30% annually and flat sequentially. Non-GAAP EPS beat the consensus call of $0.59. Management does not provide formal non-GAAP EPS guidance; based on top-line and margin guidance, we had modeled 4Q24 EPS in the $0.56-$0.62 range.

During 1Q25, product sales of $1.69 billion (84% of total) increased 27% annually and 5% sequentially. Software & Services revenue (16% of total) was up 29% annually and down 3% quarter over quarter. U.S. sales (80%) of total were up 27% annually and down 1% sequentially. International sales (20% of total) were up 29% annually and a sharp 32% sequentially, reflecting a strong rebound in Asia-Pacific sales.

CEO and now chairperson Jayshree Ullal believes Arista has emerged into the top tier of AI networking leaders. The company in 2024 far exceeded its initial sales growth and margin targets. The key driver to this accelerating performance, according to the CEO, has been "the momentum of generative AI." Cloud Titans are driving accelerating creation of AI clusters for LLM training and inference and are also leading in delivery of AI-as-a-service. Cloud titan revenue amounted to 48% of 2024 sales compared with just 28% of revenue in 2023.

Arista, according to the CEO, is redefining the future of data-driven networking. Cloud and AI momentum continues and, despite the uncertain macroenvironment, management remains confident that the company can generate $750 million in front-end AI revenue in 2025. Arista is progressing well with all four of major cloud titan customer and continues to add new ones as well. Meta Platforms and Microsoft represented together represented over one-third of total 2024 revenue. Google Cloud and now Oracle are also major cloud customers for Arista's AI networking solutions.

At Nvidia's GTC 2025, CEO Jensen Huang stated plans to refresh the GPU roadmap every 12 to 18 months. Arista, CEO Ullal stated, "intends to be the premier and preferred scale-out network for all of those GPUs and accelerators." Collective Communications Libraries (CCLs) of GPUs try to discover underlying networking topology using localization techniques. Accelerated compute is challenging that model. Arista's Etherlink portfolio brings a single point of network control and visibility to identify and localize performance issues. As the size of AI clusters exceeds 50,000 or even 100,000 XPUs, deploying Arista spine and left network architecture becomes "vital," according to the company.

Arista is developing new products for the branch and campus opportunity. Enterprise continues to regain momentum, with the CEO highlighting a new opportunity in the U.S. federal sector even as most companies are seeing deal pushouts. The company is executing well and is "aiming for $10 billion in annual revenue and beyond sooner than we previously expected," the CEO stated.

Arista regards itself as the pure-play network innovator for the next era of data-driven, client-to-cloud AI networking. The company sees a total available market opportunity of at least $70 billion. Following the company's tenth anniversary as a public company in June 2024, Arista outlined its plans for "Arista 2.0" for 2025.

Management believes that networks are emerging as the epicenter of mission-critical transactions and that the Arista 2.0 strategy is resonating with customers. The company's networking platforms are foundational as customers seek to migrate from siloed networks and compute to "centers of data," which could be an actual data center, a wide area network, a campus implementation, or an AI center.

In June 2024, Arista launched its Etherlink AI platforms. These platforms are compatible with technology from the Ultra Ethernet Consortium, validating the migration from InfiniBand to Ethernet. At the heart of Arista's architecture is EOS software stack for multi-modal data sets, the company's state-oriented, network data lake.

In terms of product categories, Core Cloud AI & Data Center accounted for about 65% of 2024 revenue. Products in this category are built on a highly differentiated and extensible OS stack and deployed across 10 gigabit (G), 25G, 100G, 200G, 400G and now 800G Ethernet speeds. Arista stated it is gaining share in the higher end of 100G, 200G, and 400G ports to a number one position of 40% market share. The 400G customer base now exceeds 1,000 customers as of year-end 2024.

Arista expects 800G Ethernet to emerge as the leading solution for AI back-end clusters in 2025. Arista is "optimistic" about achieving its goal of $1.5 billion in AI revenue in 2025, according to the CEO, which includes $750 million in AI back-end clusters and $70 million in AI front end.

Arista's AI network portfolio consists of three product families and over 20 Etherlink switches. The distributed EtherLink 7700 is used for two-tier networks with up to 10,000 GPU clusters. The Arista 7700 R4 and "flagship" 7800 AI Spine switch, according to SVP Engineering John McCool, have entered into production and together with the 7700 and 7060 X6 "provide our customers with the broadest set of 800 Gbps Ethernet products for their AI networks."

The Etherlink AI platform family has a range of switches in fixed, modular, and distributed configurations. Products in the 7060 series include 400Gbps and 800Gbps fixed and modular switches with up to 51.2 Terabits per second (Tbps) of capacity. The 7800R4 series high performance 8000 R4 AI Spine is the fourth generation of Arista's flagship 7800 series and supports up to 460 Tbps in a single chassis.

The 7700R4 Distributed Etherlink Switch (DES), according to the company, provides a "novel" third approach to AI back-end networks, scaling out the 7800R4 to support up to 32,000 accelerators (GPUs) in a logical single-hop topology. The 7700R4, according to the CEO, represents the first in a new series of ultra-scalable intelligent distributed systems "that can deliver the highest consistent throughput for very large AI clusters." The entire Etherlink platform is in trials and will soon move into qualifications with customers.

The Network Adjacencies market, which includes Routing, Routing-Displacement, and the cognitive AI-driven Campus, represented 18% of total revenue in 2024. Campus customers are responding positively to cognitive wireless "zero-touch" provisioning, network identity, and threat mitigation solutions. While the 2024 headline was about generative AI, Arista continues to diversify its business globally with multiple use cases and verticals.

EARNINGS & GROWTH ANALYSIS

In December 2024, Arista split its stock 4-for-1. We have adjusted all historical and forward per-share earnings and per-share dividends for the company to reflect the split.

For 1Q25, Arista reported revenue of $2.00 billion, which was up 28% year over year and 4% sequentially. Revenue came in above the high end of management's $1.93-$1.97 billion guidance range and topped the $1.97 billion consensus forecast.

The non-GAAP gross margin tightened to 64.1% in 1Q25 from 64.2% in 4Q24 and from 64.2% a year earlier. The non-GAAP operating margin was 47.8% in 1Q125 vs. 47.0% in 4Q24 and 47.3% a year earlier.

Non-GAAP earnings of $0.65 per diluted share were up 30% annually and flat sequentially. Non-GAAP EPS beat the consensus call of $0.59. Management does not provide formal non-GAAP EPS guidance; based on top-line and margin guidance, we had modeled 4Q24 EPS in the $0.56-$0.62 range.

For all of 2024, revenue of $7.00 billion rose 20% from $5.86 billion in 2023. Split-adjusted non-GAAP earnings were $2.27 per diluted share for 2024, up 31% from $1.73 per diluted share in 2023.

For 2Q25, Arista is modeling revenue of approximately $2.1 billion, which would be up 24% year over year and 5% sequentially. Management expects a non-GAAP gross margin of 63% and a non-GAAP operating margin of 46%. Based on these inputs and other elements of our line-item modeling, we believe that Arista can earn $0.58-$0.66 per share in 2Q25, which would imply low-20% annual growth.

Arista in February 2025 narrowed its top-line growth guidance to 17% for 2025, from initial guidance in the 15%-17% range. Given the macro uncertainties, the company reiterated its 2025 topline growth guidance as of May 2025. Non-GAAP gross margin guidance for the year is in a wide range of 60%-63%, which encompasses multiple tariff scenarios.

We are raising our split-adjusted non-GAAP EPS projection for 2025 to $2.65 per diluted share from $2.55. We are raising our 2026 non-GAAP EPS forecast to $3.01 per diluted share from an initial $2.95. We regard our estimates as fluid and subject to revision based on the pace of AI penetration within the cloud networking.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Arista is High. The company's rapid sales growth, which is increasingly software-driven, throws off substantial cash. Debt is less than 10% of cash, and the company has stepped up its shareholder return program with a major share repurchase authorization.

Cash & investments were $8.15 billion at the end of 1Q25. Cash & investments were 8.30 billion at the end of 2024, $5.0 billion at the end of 2023, $3.03 billion at the end of 2022, and $3.41 billion at the end of 2021.

Total debt was $656 million at the end of 1Q25. Total debt was $441 million at the end of 2024, $283 million at the end of 2023, $175 million at the end of 2022, and $143 million at the end of 2021.

The debt/total capital ratio was 4.2% at the end of 2024. Debt/cap was 3.5% at the end of 2023, 3.9% at the end of 2022, 3.6% at the end of 2021, and 9.5% at the end of 2020. Those debt/cap ratios are well below the communications equipment industry average in the low 20% range.

Cash flow from operations was $3.71 billion in 2024. Cash flow from operations was $2.03 billion in 2023, $1.02 billion in 2022, $1.02 billion in 2021, and $735 million in 2020.

Arista repurchases mainly to offset share-base expansion due to stock-based compensation.

The company has never paid a dividend, and we do not expect it to implement one for 2025 or 2026.

MANAGEMENT & RISKS

Jayshree Ullal has served as president and CEO of Arista since October 2008 and is now chairperson of the board. Chantelle Breithaupt became CFO in February 2024, replacing long-time CFO Ita Brennan. The new CFO brings 25 years of experience as a financial executive.

Andreas Bechtolsheim, an Arista founder who had served as the company's chairman since 2004, transitioned off the board and into the chief architect role. Ken Duda, another Arista founder, joined the board and has become Chief Technology Officer. Hugh Holbrook was promoted to Chief Development Officer, taking over the role from Mr. Bechtolsheim. Chief Platform Officer John McCool and Group VP Ken Kiser will take responsibility for cloud, AI, and tech initiatives, operations and sales.

Former COO Anshul Sadana has left the company and will not be replaced as Arista seeks to "flatten" its leadership team. The company also named new leadership in global enterprise and service provider markets. These multiple C-level changes, to prepare Arista for the age of AI networking, were executed in a seamless process that did not cause a ripple in the stock.

A main risk for Arista, as for other networking gear companies, is the possibility of a general economic downturn and a corresponding dip in demand for networking gear, inventory congestion, and a cyclical slowdown in orders. Those risks have been amplified by the pandemic, the supply chain crisis, and now global macro-economic slowing. We believe that Arista has the financial strength, market leadership, and growth characteristics to weather this storm and emerge a stronger player.

Arista investors face customer concentration risk, as several large customers account for a significant portion of the company's revenue, as well as risks from intense competition and changes in technology that could reduce demand for the company's products. Arista may also be hurt by supply shortages and adverse currency movements.

COMPANY DESCRIPTION

Arista Networks is a leading supplier of cloud networking solutions for internet companies, cloud service providers, and next-generation data centers. It generates the largest portion of its revenue from switching products that incorporate its Extensible Operating System (EOS) software.

VALUATION

ANET shares trade at 34.2-times our 2025 non-GAAP EPS estimate and at 30.2-times our 2026 projection. The average two-year forward P/E of 32.2 is below the five-year historical P/E (2020-2024) of 44.6. On a two-year-forward basis, ANET trades at a relative P/E of 1.67, below its historical relative P/E of 2.07. Historical comparable analysis indicates a value in the $120s, near current prices and in a clearly rising trend.

Compared to a diverse peer group that includes equipment vendors as well as cloud service providers, ANET trades at premiums on most-priced-based valuation metrics. We believe those premiums are well deserved given its disruptive business model. Our peer-indicated value in the $180s is in a rising trend despite the tech stock correction.

Our more forward-looking discounted free cash flow model values ANET in the low $200s in a clearly rising trend. Our blended fair value estimate in the high-$170s is in a rising trend and remains well above current prices. Appreciation to our split-adjusted 12-month target price of $130 implies a potential risk-adjusted return in excess of our forecast market return and is thus consistent with a BUY rating.

On May 7, BUY-rated ANET closed at $86.45, down $4.32. (Jim Kelleher, CFA, 5/7/25)

IDEX CORP. (NYSE: IEX, $180.09)... HOLD

IEX: Looking for more favorable entry point

* IEX shares have underperformed the market year-to-date, declining 14% while the S&P 500 has fallen 5%.
* Business has turned south, with IDEX recently reporting 1Q adjusted EPS down 7% from the prior year.
* Orders in the problematic Healthcare segment are starting to improve, though.
* We may look to move this stock back to the BUY list if this positive trend in orders turns into better sales growth that can help offset the expected impact of tariffs.

ANALYSIS

INVESTMENT THESIS

Our rating on IDEX Corp. (NYSE: IEX) is HOLD. This well-managed diversified industrial company has a long record of earnings and dividend growth. We think the company – which designs and manufactures fluidics systems and specialty engineered products for a range of industrial end markets, including healthcare, transportation, food, water, and energy – is well positioned for the future. However, recent sales and order growth have slowed in two key segments – Fluid & Metering and Health & Science Technologies – due to industry slowdowns and project delays. The stock, from a technical perspective, is now in a bearish pattern. On a fundamental basis, the shares are trading at 20-times our 2026 EPS estimate, at the low end of the historical range of 20-33. Compared to the peer group (DHR, ECL, FTV, ROP, XYL, BMI), the shares are trading at discount multiples, which we think is appropriate given the growth trends. We may look to move this stock back to the BUY list if recent positive trends in orders turn into improved sales growth.

RECENT DEVELOPMENTS

IEX shares have underperformed the market year-to-date, declining 14% while the S&P 500 has fallen 5%. Over the past year, the shares have also underperformed, declining 19% while the S&P 500 has risen 8%. The IEX shares have also underperformed the index and the industrial sector ETF IYJ over the past year and the past five years. The beta on IEX is 0.95.

IDEX recently reported 1Q adjusted EPS that fell 7% from the prior year but topped consensus forecasts. Adjusted diluted EPS came to $1.75, ahead of the consensus forecast of $1.64. Organic revenue declined 1% year over year to $814 million. The adjusted EBITDA margin narrowed by 50 basis points year over year to 25.5%.

Along with the results, management reiterated guidance for 2025. Management expects adjusted EPS of $8.10-$8.45. Management also forecasts a 1%-3% increase in organic revenue growth. Last year, the company earned $7.89 per share on an adjusted basis.

Management noted during the 1Q conference call that it estimates the impact of tariffs to reduce demand later in the year.

The company is continually refining its portfolio of assets. In 4Q, it acquired Mott Corporation, an engineering company that manufactures filters and fluid flow products. Mott has been integrated into IDEX's Health & Science Technologies group.

EARNINGS & GROWTH ANALYSIS

IDEX has a track record of delivering mid-to-high single digit growth, including 4% CAGR for sales, 5.5% for EBITDA, and 8% for adjusted EPS.

IDEX has three operating segments: Fluid & Metering Technologies (FMT, 36% of 1Q25 sales); Health & Science Technologies (HSC, 42%); and Fire & Safety/Diversified Products (FSDP, 22%). Recent trends and outlooks in these businesses are summarized below.

First-quarter organic sales declined 4% year over year for FMT. In FSDP, organic sales rose 5%. HST organic sales remained weak, flat year over year, but management noted that orders picked up for the third quarter in a row.

On the expense side, the 1Q adjusted EBITDA margin narrowed by 50 basis points year over year to 25.5%. Margins widened in only FMT. Management's target EBITDA margin ratio range in 2025 is 27.5-28.0% and has announced another $20 million of savings that it can achieve this year. Last year, the company's adjusted EBITDA margin was 26.7%, down 80 basis points year over year and below management's EBITDA ratio target of 26.9%-27.2%.

Turning to our estimates, and based on expected sales and margin trends, as well as recent orders trends and management's guidance, we are lowering our 2025 adjusted EPS estimate to $8.25 from $8.45. Our estimate is near the midpoint of management's revised guidance range, and implies an EPS increase of 5% year over year. We expect growth to continue in 2026, as improved orders lead to better sales, but are trimming our preliminary adjusted EPS estimate to $8.85 from $9.15 to reflect the lower 2025 EPS base. Our long-term EPS growth rate is 8%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on IDEX Corp. is Medium-High, the second-highest rank on our five-point scale. The company typically scores above average on our key financial strength criteria of debt levels, fixed-cost coverage, cash flow generation, and profitability.

IDEX ended its most recent fiscal year with cash of $620 million. Debt was $2.0 billion at quarter-end, and the debt/cap ratio was 35%. Operating income covered interest expense by a factor of 20 last year. The company had a healthy adjusted EBITDA margin of approximately 27% in its most recent year.

IDEX has paid 109 consecutive regular quarterly cash dividends. In May 2024, the board raised the payout by 5% to $0.69 per share or $2.76 annually, for a yield of about 1.3%. We think the dividend is secure and likely to grow. Management has targeted a 30-35% dividend payout ratio. Our dividend estimates are $2.91 for 2025 and $3.06 for 2026.

MANAGEMENT & RISKS

Eric D. Ashleman is the company's CEO. Previously, he had served as COO and president. Mr. Ashleman succeeded Andrew K. Silvernail, who had been CEO for nine years. Abhi Khandelwal is the CFO. Katrina L. Helmkamp is the non-executive chairman.

The company's financial targets include consistent double-digit earnings growth, strong cash flow, and superior return on invested capital.

The company has a history of growth through acquisitions. In 2Q23, IDEX completed its acquisition of Iridian Spectral Technologies, a global leader in designing and manufacturing thin-film, multi-layer optical filters, for CAN$150 million. Iridian was integrated into the Health & Science Technology segment.

IEX investors face risks, including the risk that management will not be able to profitably integrate acquired companies. IEX investors also face risks related to the cyclicality of the company's businesses and end markets; intense competition; and economic, political, and other risks associated with its foreign operations. In addition, we note that goodwill and intangibles represent a high proportion of total assets.

COMPANY DESCRIPTION

IDEX Corp. designs and manufactures fluidics systems and specialty engineered products for a range of industrial end markets, including healthcare, transportation, food, water, and energy. The shares are a component of the S&P 500. The company has approximately 9,000 employees.

INDUSTRY

Our rating on the Industrial sector is Market-Weight. Although valuations are attractive, that mainly reflects weak share prices. In a high interest-rate environment, enterprise demand for industrial solutions has softened and may take time to recover.

As of the end of March, the sector accounted for 8.5% of S&P 500 market capitalization. Over the past five years, the weighting has ranged from 8% to 12%. The sector includes industries such as transportation, aerospace & defense, heavy machinery, and electrical equipment.

The sector was outperforming the market with a loss of 0.5%. It underperformed the market in 2024, with a gain of 15.6% compared to a gain of 23.3% for the S&P 500. The sector's P/E ratio on projected 2025 EPS was 19, above the market multiple. Yields of 0.9% were below the market average. The sector's smoothed earnings growth rate of 7% was below the market average.

VALUATION

We think that IEX shares are fairly valued at recent prices near $180, below the midpoint of the 52-week range of $153-$238. From a technical standpoint, the shares have been in a bearish pattern of lower highs and lower lows since March 2024.

On a fundamental basis, in terms of valuation, the shares are trading at 20-times our 2026 EPS estimate, at the low end of the historical range of 20-33. Compared to the peer group (DHR, ECL, FTV, ROP, XYL), the shares are trading at discount multiples, which we think is reasonable given the company's earnings trajectory.

On May 7, HOLD-rated IEX closed at $180.09, up $0.55. (John Eade, 5/7/25)

NASDAQ INC. (NGS: NDAQ, $78.57) .... BUY

NDAQ: Record level of index products

* We believe that the company's business fundamentals are strong and expect Nasdaq to benefit from an expanding range of data services as well as growth in equity-related trading and ETF index revenues.
* The company recently reported 1Q25 non-GAAP EPS of $0.79, up from $0.63 a year earlier. Net revenue rose 10.7% to $1.24 billion
* In April 2025, the board raised the dividend 14% to $1.08 annually for a yield of about 1.4%.
* Based on our expectations for growth in recurring revenues from data and information services and reduced reliance on transaction revenue, we believe that a BUY rating remains appropriate.

ANALYSIS

INVESTMENT THESIS

We are reiterating our BUY rating and target price of $88 on exchange operator and data services provider Nasdaq Inc. (NGS: NDAQ). We believe that the company's business fundamentals are strong and expect Nasdaq to benefit from an expanding range of data services as well as growth in equity-related trading and ETF index revenues, offset by the near-term costs and integration of the Adenza acquisition. We are also encouraged by the recent 13% hike in the dividend to $0.27.

NDAQ continues to launch new licensed index products. Assets under management (AUM) in exchange-traded products (ETPs) benchmarked to proprietary indices totaled a record $662 billion at the end of the first quarter, up 35% from the prior year, primarily due to higher equity values and net inflows.

In 1Q25, Nasdaq maintained its position as the premier U.S. exchange for IPO issuance, pricing 35 IPOs and raising nearly $5 billion.

Based on our expectations for growth in recurring revenues from data and information services and reduced reliance on transaction revenue, we believe that a BUY rating remains appropriate.

RECENT DEVELOPMENTS

Over the past year, NDAQ shares have risen 27% compared to an increase of 8% for the broad market. NDAQ shares comprise 3.8% of the iShares U.S. Broker-Dealers ETF IAI, and approximately 13.4% of the available float is held in various ETFs. The beta on NDAQ is 0.84.

The company recently reported 1Q25 non-GAAP EPS of $0.79, up from $0.63 a year earlier. Net revenue rose 10.7% to $1.24 billion. Operating expenses fell 3% to $690 million. The operating margin improved to 55% from 53% in the prior year.

In July 2024, NDAQ announced a secondary public offering by an affiliate of funds managed by Thoma Bravo of approximately 42 million shares at a price of $65.30. Nasdaq did not receive any proceeds from the sale. Thoma Bravo will hold 7.4% of Nasdaq's outstanding shares.

In March, NDAQ announced a secondary offering by Borse Dubai of approximately 27 million shares at a price of $59. Nasdaq didn't receive any proceeds from the sale. Borse Dubai now holds just over 10% of Nasdaq's outstanding shares.

In November 2023, Nasdaq closed its acquisition for $10.5 billion of Adenza, a software provider to the capital markets industry. Adenza is a combination of two software brands, Calypso and AxiomSL. Calypso provides end-to-end treasury, risk, and collateral management services, and AxiomSL provides regulatory and compliance software. Following the acquisition, the seller, private equity firm Thoma Bravo, has become a shareholder and has a seat on Nasdaq's board of directors. NDAQ projects net expense synergies of $80 million by the end of the second year and long-term revenue synergies of $100 million.

In 4Q23, the company updated its corporate structure and reorganized its reported results. Previously NDAQ had reported results from Market Platforms (Trading Services and Marketplace Technology); Capital Access Platforms (Data & Listing Services, Index, and Workflow & Insights); and Anti-Financial Crime. As of 4Q23, the company now reports results from Market Services (Trading Services); Capital Access Platforms (Data & Listing Services, Index, and Workflow & Insights); and Financial Technology (Regulatory Technology and Capital Markets Technology).

EARNINGS & GROWTH ANALYSIS

NDAQ organizes its businesses into three divisions: Capital Access Platforms, Financial Technology, and Market Services. We look at recent trends and outlooks for these businesses and their segments below.

Capital Access Platforms net revenue of $515 million accounted for 42% of NDAQ's net 1Q revenues. Data and Listing Services (16% of overall net revenue) revenue of $192 million was up 4% from the prior year, primarily due to growth in data sales and usage. Index (16%) revenue rose 26% to $183 million due to higher AUM in Nasdaq-linked products. Workflow and Insights (10%) revenue rose 4% to $130 million due to growth in Analytics.

Financial Technology net revenue of $432 million accounted for 35% of NDAQ's net 1Q revenues. Regulatory Technology (8% of overall net revenue) revenue increased to $101 million due to increased AxiomSL and Surveillance subscriptions. Capital Markets Technology (21%) revenue rose to $254 million, driven by increases in Calypso subscriptions. Financial Crime Management (6%) revenue rose 21% to $77 million.

Market Services record net revenue of $281 million accounted for 23% of NDAQ's net 1Q revenue. NDAQ reported record cash equites and derivatives volume.

Overall, annualized recurring revenues increased 8% pro forma to $2.83 billion. Annualized SaaS revenues increased 14% to $1.05 billion.

Along with the 1Q results, management provided near-term guidance. For 2025, it expects non-GAAP operating expenses of $2.265 billion-$2.325 billion and an effective tax rate of 22.5%-24.5%. NDAQ also provided a three to five year growth outlook for the Total Solutions segment. The company projects 5%-8% growth in Capital Access Platforms and 10%-14% growth in Financial Technology. Non-GAAP operating expenses are projected to rise by 5%-8%. No outlook was given for Market Services and total net revenue.

Based on recent results, growth in recurring revenues and increases in ETP AUM offset by expenses and integration of the Adenza acquisition, we are inching up our 2025 estimate to $3.24 from $3.22 and maintaining our 2026 EPS estimate of $3.63.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Nasdaq Inc. is Medium. Debt issuance to finance the Adenza acquisition included $4.25 billion of U.S. dollar–denominated debt with maturities spread across 2-, 5-, 10-, 30-, and 40-year terms, and a $750 million euro-denominated bond maturing in eight years. At the end of 4Q24, total long-term debt was $8.9 billion, down from $9.1 billion at December 31, 2024. On March 31, Moody's upgraded Nasdaq's senior unsecured debt to Baa1 from Baa2.

In April 2025, the board raised the dividend 14% to $1.08 annually for a yield of about 1.4%. Our dividend estimates are $1.06 for 2025 and $1.20 for 2026. The company intends to steadily increase the dividend and have a payout ratio of 35%-38% in three to four years.

The company has a share repurchase program. In September 2023, it raised its share repurchase authorization to $2.0 billion. In 1Q, the company repurchased shares totaling $115 million. As of March 31 there was $1.6 billion remaining under the current authorization.

MANAGEMENT & RISKS

Adena T. Friedman has been the CEO of Nasdaq since January 1, 2017, and chair of the board of directors since January 1, 2023. Sarah Youngwood is the CFO, having previously served as CFO for UBS Group.

The company provides operating expense and tax rate guidance to investors but does not provide EPS guidance.

Investors in NDAQ shares face numerous risks.

The company's performance is affected by changes in equity and commodity prices as well as by changes in market volatility. The company also has relatively high fixed costs and would suffer significant margin erosion if trading volume declined sharply and stayed low for an extended period.

Nasdaq also faces intense competition from other exchanges, which is likely to increase in the near term. In order to maintain its competitive position, the company needs to invest heavily in new technology and in its workforce. It must also protect its intellectual property.

The derivatives and commodities trading industry is subject to legal and regulatory developments that could hurt trading and clearing volumes and raise the overall cost of doing business. The clearing business faces counterparty risk as well as scrutiny from regulators who believe that clearing houses may be a systemically risky part of the financial system.

COMPANY DESCRIPTION

Nasdaq Inc. is a provider of trading, clearing, exchange technology, regulatory, securities listing, information, and public company services. It operates in three segments: Capital Access Platforms, Financial Technology, and Market Services.

INDUSTRY

Our rating on the Financial sector is Over-Weight. The Fed's extended rate hike campaign is expanding banks' net interest margins. We also look for recovery in fee-based businesses, bond issuance, and M&A as the rate cycle winds down. At the same time, with inflation running hot, companies may cut back on hiring and investments, and thus on business loans.

As of the end of December, the sector accounted for 13.6% of the S&P 500. Over the past five years, the weighting has ranged from 10% to 15%. The sector was outperforming the market with a gain of 28.4%. It underperformed the market in 2023, with a gain of 9.9% compared to a gain of 24.2% for the S&P 500.

The sector's P/E ratio on projected 2025 EPS was 17, below the market multiple. Yields of 1.1% were below to the market average. The sector's smoothed earnings growth rate of 8% was below the market average.

VALUATION

We think that investors will continue to focus on NDAQ's growth in the pricing/analytics business, strong trading volumes, and increasing AUM in ETPs; however, we expect IPO issuance to be muted in 2Q25 as the new administration implements its policies. On the positive side, in the long term, we believe that recent acquisitions will provide a recurring revenue stream and stabilize earnings. We also expect further growth in the licensing of proprietary indices, investment analytics, and investor relations and environmental, social, and governance services.

At current prices around $79, Nasdaq shares are trading near the high point of their 52-week range of $58-$84. They are also trading at 24-times our revised 2025 EPS estimate, near the midpoint of the historical range in the high teens to high 20s. We believe that NDAQ deserves a higher multiple based on the company's strong growth prospects and the shift to recurring-revenue businesses and that a BUY rating remains appropriate. Our target price of $88 assumes a multiple of 27-times.

On May 7, BUY-rated NDAQ closed at $78.57, up $0.49. (Kevin Heal, 5/7/25)

OTIS WORLDWIDE CORP. (NYSE: OTIS, $97.32).. BUY

OTIS: Expected growth in high margin, tariff-free services

* OTIS shares have returned 7% over the past year compared to advances of 18% for the S&P 500 and 13% for the Industrial segment ETF IYJ.
* We expect growth in the company's higher margin Services segment from its new focus on maintenance, repair, and modernization on a growing installed base.
* These aftermarket services are exempt from tariffs and provide an opportunity for Otis to accelerate growth, especially in China where aging equipment should lead to high demand.
* Management has signaled confidence in the company by expanding capacity, raising the dividend by 8% and reiterating its expectations for $800 million in share buybacks this year.

ANALYSIS

INVESTMENT THESIS

Our rating on Otis Worldwide Corp. (NYSE: OTIS) is BUY. Otis is the world's largest manufacturer of elevators, escalators, and moving walkways. It began trading as an independent company in April 2020 and was formerly part of United Technologies. We believe that Otis has the size and scale to compete effectively in global markets. Its large installed base of elevators, escalators, and moving sidewalks as well as its growing modernization and repair businesses for existing units, should provide predictable and growing service revenue while also lending stability to margins. Otis should also benefit from productivity and a cost savings plan that are helping to boost margins.

Management expects growth in its higher margin Services segment from its focus on maintenance, repair and modernization on a growing installed base. These aftermarket services are exempt from tariffs and provide an opportunity for Otis to accelerate growth, especially in China where aging equipment should lead to high demand. On tariffs, the company's exposure is on new equipment in the backlog, which represents about 10% of operating income. While there will be some near-term impacts to earnings, management believes that its previous guidance remains appropriate. For new contracts, Otis will pass on higher costs from tariffs to customers. Management has signaled confidence in the company with an 8% dividend increase and share repurchases. Adjusted cash flow remains strong and has increased every year since the split in 2020. On valuation, the stock is trading at 24-times our 2025 estimate at the bottom of the five-year historical range of 24-31 but above a group of industrial peers. On price/sales, Otis trades at a meaningful discount relative to the peer group. Given the valuation and the company's focus on high margin services, we are maintaining our BUY rating with a target price is $108.

RECENT DEVELOPMENTS

OTIS shares have outperformed the market over the past three months, rising 2% while the S&P 500 has fallen 8%. Over the past year, the shares have returned 4% compared to advances of 9% for the index and 8% for the Industrial segment ETF IYJ. Over the past five years, the shares have gained 82% compared to 91% for the index and 88% for the industry. The beta on OTIS is 0.75.

The company recently reported 1Q25 results that exceeded analyst earnings expectations. Net sales fell 3% to $3.4 billion on a reported basis and were in line with the consensus. Organic sales were flat with the prior year. The adjusted operating margin expanded 40 basis points year over year to 16.7%. Adjusted EPS rose 5% to $0.92 from $0.88 a year earlier and topped the Street estimate of $0.91.

In 4Q, management announced a shift in strategy for its business in China, which now represents 10% of total company revenue. For two decades China had been a high growth market for OTIS during years of elevated construction, though in recent years sales of new equipment has dropped meaningfully. OTIS is now resetting its business in China from a focus on new equipment sales to maintenance, repair, and modernization services. Management believes China's aging installed equipment base (15-25 years old) will lead to strong demand for these aftermarket high margin services that are not subject to tariffs.

Along with the earnings release, Otis updated its 2025 revenue guidance to reflect favorable exchange rates. It now looks for net sales of about $14.7 billion with organic sales of 2% to 4%, up from sales of about $14.25 billion with organic sales of 2% to 4%. The adjusted EPS forecast of $4.00 to $4.10 is unchanged as is management's target for $1.6 billion for free cash flow and $800 million in share buybacks. Guidance excludes tariffs impacts, though management believes that any impacts from tariffs will be more than offset by favorable exchange rates. The services business accounts for about 90% of segment operating income and is not subject to tariffs.

EARNINGS & GROWTH ANALYSIS

Earnings in the quarter reflected a new equipment decline in China that was partially offset by growth in the higher margin Service segment. Otis has two segments, New Equipment (35% of 1Q sales) and Services (65%). The company reports net sales on an organic basis that adjusts for currency translation as well as for acquisitions and divestitures – thus highlighting management's ability to improve underlying results in each segment. The latest quarterly results and segment outlooks are summarized below.

In 1Q, New Equipment revenues decreased 7% versus the prior year. Sales growth in EMEA and APAC were more than offset by a 20% revenue decline in China and a mid-single digit decline in the Americas. The segment operating profit fell 4%, though the operating margin widened by 20 basis points to 5.7%. New Equipment orders declined 1% year over year. For 2025, we now expect new equipment growth to decline slightly.

Services revenue rose 4% year over year on an organic basis, reflecting higher volume and favorable pricing. Modernization sales increased 10% and maintenance and repair sales rose 3%. Segment operating profit rose about 30% and the adjusted operating margin of 24.6% widened by 40 basis points reflecting higher volume, pricing and productivity. In 2025, we expect mid-single digit growth for the segment.

On expenses, the gross profit margin of 30% was consistent with the prior year. SG&A expenses were in line with the prior year and represented 14% of sales, up slightly from 1Q24. The adjusted operating margin rose 40 basis points to 16.7% reflecting a favorable mix. The company expects to save $90 million this year under its Uplift cost savings program with an annual run rate savings of $230 million exiting the year.

Turning to our estimates, based on recent sales, order and margin trends, tariffs and management's guidance, we are lowering our 2025 adjusted EPS estimate to $4.06 from $4.09. Our estimate is above the midpoint of management's guidance range and implies growth of 6% for the year. We look for growth to continue in 2026 and are maintaining our estimate of $4.45.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength ranking on Otis is Medium, the midpoint on our five-point scale. The company receives below-average scores on our financial strength criteria of debt levels, but average or higher scores on fixed-cost coverage, cash flow generation, and profitability.

The company had $1.9 billion in cash and equivalents at the end of the quarter compared to $2.3 billion in 4Q24. Cash from operating activities rose 11% due to shifts in working capital. Free cash flow in the quarter rose about 20% from the prior year.

Total debt was $8.7 billion. Including lease liabilities the debt/capitalization ratio was negative 238%, compared to a negative 225% at the end of the prior year reflecting higher short-term debt and a larger shareholder's deficit.

Otis pays a dividend. In April 2024, the board raised the quarterly dividend by 8% to $0.42 per share or $1.68 annually, for a yield of about 1.7%. The company is targeting a long-term dividend payout ratio of 40% of net income. Our dividend estimates are now $1.68 for 2025 and $1.78 for 2026.

The company has a share repurchase program. During the quarter it bought back $250 million of its shares. In 2024, the company repurchased $1.0 billion, in line with management's goal and about 25% higher than the prior-year period.

MANAGEMENT & RISKS

Judy Marks is the chair, president, and CEO of Otis. Ms. Marks has varied industry and management experience, having worked at IBM, Loral, Lockheed Martin, and Siemens. She joined UTC as president of Otis in 2017. Cristina Mendez is now the CFO following Anurag Maheshwari's departure to 3M. Ms. Mendez joined OTIS in 2022 as SVP of finance in EMEA and brings 15 years of experience as a senior finance executive in global telecommunications to her new role.

The company's competitive advantages include the relationships built over a 160-year-plus history, technological leadership, and an installed base of more than 22 million units that provide a steady and high-margin source of services revenue.

The company's long-term financial goals include low to mid-single digit sales growth and double-digit EPS growth as margins improve and the company buys back stock. The adjusted free cash flow goal is CAGR up high single digits

Investors in OTIS shares face risks. Otis has domestic and international operations that subject the company to changes in local and regional economic conditions, regulatory shifts, and political risks. Indeed, Otis delisted its Russian subsidiary in 2Q22. With 70% of its operations outside of the U.S., the company is exposed to fluctuations in currency. Although Otis is the leader in its industry, it operates in a competitive environment in which rivals may introduce superior technology. Low-cost operators in emerging economies may also seek to compete with Otis via aggressive pricing.

COMPANY DESCRIPTION

Otis is the world's largest elevator and escalator manufacturing, installation, and services company. The company's 72,000 employees operate from more than 1,400 branches and offices and include 40,000 field technicians. It has more than two million maintenance units under contract and operates in 200 countries. Otis was founded in 1853 and is based in Farmington, CT. The shares are a component of the S&P 500.

VALUATION

OTIS shares appear attractively valued at current prices near $96, at the midpoint of their 52-week range of $90-$107. On a technical basis, the shares have been in a neutral trend since March 2024.

On the fundamentals, the stock is trading at 24-times our 2025 EPS forecast at the bottom of its five-year historical range of 24-31 but above 20 for a group of peers that includes IR, DOV and FTV. On price/sales, the shares trade at a multiple of 2.8, at the top of their five-year historical range but meaningfully below the peer group. Given the valuation and the company's focus on high margin services, we are maintaining our BUY rating with a target price is $108.

On May 7, BUY-rated OTIS closed at $97.32, up $1.13. (Kristina Ruggeri, 5/7/25)

INTERPUBLIC GROUP OF COMPANIES INC. (NYSE: IPG, $24.98) .... HOLD

IPG: Maintaining HOLD rating due to pending merger

* Interpublic Group has agreed to be purchased by industry rival Omnicom Inc. IPG expects the deal to be finalized in 2H25.
* We recently downgraded our rating on OMC to HOLD over concerns that the merger could cut into margins and slow earnings, cash flow, and dividend growth over the intermediate term.
* At this juncture, the IPG shares are now likely to trade in tandem with the OMC shares, so a HOLD rating for IPG remains appropriate.

ANALYSIS

INVESTMENT THESIS

Our rating on Interpublic Group of Companies Inc. (NYSE: IPG) is HOLD. IPG is a holding company comprised of numerous advertising agencies and marketing services. We have long seen Interpublic as a well-run company with a strong track record in its industry. In December 2024, IPG agreed to be acquired by peer and rival Omnicom to form the biggest advertising company in the world. The proposed merger gives us pause, however, as we are concerned that integrating the two companies will likely slow earnings, cash flow, and dividend growth. At current prices, the IPG shares are selling at a 4% discount to the implied merger price, signaling to us that there’s a good chance that the merger will close as proposed. At this juncture, the IPG shares are now likely to trade in tandem with the OMC shares, so a HOLD rating for IPG is appropriate as well. If the merger goes through as expected, IPG will operate as a wholly owned subsidiary of Omnicom and will cease to be a public company.

RECENT DEVELOPMENTS

Interpublic Group updated on its proposed acquisition by industry rival Omnicom Inc. (OMC: HOLD). Management says it has made meaningful progress on working out the details of the merger and has strong shareholder support. Management is confident the deal will close in the second half of 2025 and that it will win regulatory approval. The all-stock deal was announced on December 8, 2024. Under the terms of the deal, Interpublic shareholders will receive 0.344 Omnicom shares for each share of IPG common stock they own. Following the close of the transaction, Omnicom shareholders will own 60.6% of the combined company and Interpublic shareholders will own 39.4%, on a fully diluted basis. The deal is expected to be tax-free to shareholders.

Initially, the market reacted positively to the news of the merger, with IPG shares jumping 13%. However, the shares have since dropped well below pre-merger announcement levels.

IPG shares underperformed over the past three months, falling 11% compared to a decline of 8% for the S&P 500. Over the past year, the shares have also underperformed, declining 19%, compared to gains of 9% for the index and 16% for the wide-ranging Communications Services industry ETF VOX. Over the past five years, IPG shares have advanced 45%, compared to gains of 91% for the index and 69% for the industry. The beta on IPG is 0.89.

On April 24, IPG reported 1Q25 results that topped analyst expectations. Adjusted EPS came to $0.33 per share, above the consensus estimate of $0.26, but below the $0.36 reported in the prior-year quarter. Net revenue before billable expenses of $2.0 billion declined 9% versus the prior year on a reported basis, or down 3.6% organically. Adjusted EBITA before restructuring charges and deal costs declined 9% year over year to $187 million and the adjusted EBITA margin on revenue before billable expenses narrowed 10 basis points to 9.3%.

Along with the results, management reaffirmed its revenue outlook for 2025. The company expects a decline in organic revenue for the full year of 1%-2%, due to “sizable” client losses offset by new business momentum. In response, management has initiated a cost savings program and plans for $250 million in savings. It is targeting an EBITA margin of 16.6%.

EARNINGS & GROWTH ANALYSIS

IPG has three reporting segments, all of which saw declines in total revenues from the prior-year quarter. Media, Data, and Engagement Solutions (MD&E) was 45% of 1Q revenue; Integrated Advertising and Creativity Led Solutions (IA&C), 39%; and Specialized Communication and Experimental Solutions (SC&E), 16%. MD&E was the only segment up organically, up 2%. By region in 1Q, Latin America and All Other Markets were the only positive performers, both up 3%. The company’s major markets saw declines, with the U.S. down 4%, the UK down 6%, and Continental Europe down 0.4%. Asia Pacific was down 9%.

Management keeps a close eye on costs. In 1Q, the adjusted EBITA margin on revenue before billable expenses narrowed 10 basis points to 9.3%. Salaries & Related expenses declined to 71% of revenue from the year-earlier quarter, while Office & Other Direct expenses increased to 16% of sales from the year prior. The company took at $203 million restructuring charge it says will lead to future significant cost savings.

Turning to our estimates, based on the company's recent results and recent guidance, we are sticking with our 2025 adjusted EPS estimate of $2.65. Our estimate implies a 4% EPS decline from 2024. We expect the company to return to growth in 2026 and have an adjusted EPS estimate of $2.85. Of course, the 2026 estimate is likely to be moot, assuming the merger is completed.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Interpublic Group is Medium, the middle rank on our five-point scale. The company generates average scores on our main financial strength criteria of fixed-cost coverage, profitability, and debt levels, and below-average scores on cash flow generation.

IPG had $1.9 billion in cash and equivalents at the end of 1Q. Total debt was $2.9 at the end of the quarter, the same as at year-end. Including long-term lease liabilities, the debt/cap ratio was 52% in 1Q.

IPG pays a dividend. In February 2024, it raised its quarterly dividend by 6% to $0.33 or $1.32 annually—marking 13 consecutive years of dividend increases. The current yield is about 5.3%. This February, management held the dividend steady at the $0.33 rate as the merger approaches. Our dividend estimates are $1.32 for 2025 and 2026.

The company also buys back stock. In 2024, the board authorized a $320 million buyback program in addition to the $80 million remaining under a prior authorization. In 2024, it repurchased 7.3 million shares for $230 million. In 1Q, it repurchased 3.4 million shares for $90 million.

MANAGEMENT & RISKS

Philippe Krakowsky has been the company's CEO since January 2021. Ellen Johnson is the CFO. Prior to becoming CFO, Ms. Johnson served as SVP of finance and treasurer. David Thomas is chairman of the board.

In December, IPG agreed to be acquired by peer and rival Omnicom to form the biggest advertising company in the world. This pending merger will need to pass regulatory scrutiny. If it does, IPG will operate as a wholly owned subsidiary of Omnicom and will cease to be a public company. CEO Krakowsky is slated to be a co-COO of the merged company. Omnicom's CEO John Wren will be CEO and chairman of the new company.

Investors in Interpublic face specific risks. IPG, its three major global rivals (WPP Group, Publicis, and Omnicom), and regional and local agencies, compete for market share.

The company's main asset is its people. Management is under constant pressure to reward strong contributors, while simultaneously hitting tight margin targets.

The advertising business is highly cyclical. If the consumer comeback stalls or interest rates rise faster than expected, economic growth could slow, which could cause IPG clients to cut back on their use of the company's services.

COMPANY DESCRIPTION

Interpublic Group of Companies Inc., based in New York, is a holding company comprised of numerous advertising agencies and marketing services companies. Its major agency brands include McCann Worldgroup, FCB, and MullenLowe. IPG agencies provide traditional advertising and media services, as well as marketing services, such as communications, market intelligence, events, public relations, and sports marketing. IPG shares are included in the S&P 500 index. The company has about 5,000 clients and about 52,000 employees.

VALUATION

We think that IPG shares are fairly valued at current prices near $25, near the bottom of their 52-week range of $22-$33. From a technical standpoint, the shares have been in a bearish pattern of lower highs and lower lows since June 2023.

On the fundamentals, the shares offer value. They are trading at 9-times our 2026 EPS estimate, at the low end of the five-year annual average range of 9-22. IPG also pays an attractive dividend with a yield of about 5.3%.

But given the terms of the merger, the shares are now likely to trade in tandem with the OMC shares of Omnicom, which we recently downgraded to HOLD over concerns that the merger could cut into margins and slow earnings, cash flow, and dividend growth for the intermediate term. As such, we now rate the IPG shares with a HOLD as well.

On May 7, HOLD-rated IPG closed at $24.98, down $0.05. (Christine Dooley, 5/7/25)

JACOBS SOLUTIONS INC. (NYSE: J, $119.29) .... BUY

J: Reiterates guidance on strong bookings

* We continue to see progress in Jacobs' long-running turnaround. The spinoff and merger with Amentum closed on September 27.
* The company's solid balance sheet, valuation metrics, and M&A-fueled growth are appealing.
* Jacobs reported fiscal 2Q25 results on May 6. Revenue rose to $2.91 billion from $2.85 billion a year earlier. Adjusted EPS rose to $1.43 from $1.17 in the prior-year period.
* Reflecting the company's strong fiscal second quarter, we are keeping our FY25 estimate at $6.35 and leaving our FY26 estimate at $7.00 per share. Both estimates remain above consensus.

ANALYSIS

INVESTMENT THESIS

Our rating on Jacobs Solutions Inc. (NYSE: J) is BUY. Jacobs is a large-cap provider of technical, professional, and construction services. The company has been restructuring its operations for several years and continues to face both macroeconomic pressures and weakness in important end markets, such as mining. However, we see evidence of a turnaround, and like the company's solid balance sheet, valuation metrics, and M&A-driven growth. Jacobs' backlog is growing, with high-margin orders, and the company is likely to benefit from an eventual increase in U.S. and international infrastructure spending. Our new target price is $140.

RECENT DEVELOPMENTS

On May 6, the company reported fiscal 2Q25 earnings. Reported revenue rose to $2.91 billion from $2.85 billion in the prior-year period, and missed the consensus estimate of $3.0 billion.

The gross margin rose to 25.4% from just over 25% and the operating margin rose to 7.2% from 5.1%. The consensus estimate had called for a gross margin of 26.4% and an operating margin of 9.2%. Adjusted EPS rose to $1.43 from $1.17 a year earlier and topped the consensus estimate of $1.39. The results reflected revenue growth in the Infrastructure & Advanced Facilities division, offset in part by much higher miscellaneous expense. On a GAAP basis, the company earned $0.06, compared to earnings of $1.28 per share in 2Q24.

For FY25, Jacobs continues to expect revenue to grow at a mid-to-high single-digit pace with an adjusted EBITDA margin of 13.8%-14.0%. The company also expects adjusted EPS of $5.85-$6.20 per share and expects free-cash flow conversion to surpass 100% of net income.

As discussed in a previous note, in FY24, revenue rose to $11.50 billion from $10.85 billion in FY23, and EPS rose to $4.79 from $3.05.

On September 27, Jacobs completed the spinoff of its Critical Missions Solutions and Cyber Intelligence government services businesses and merger of the separated businesses into Amentum Holdings, a separately traded public company. The separated businesses are reported as discontinued operations.

EARNINGS & GROWTH ANALYSIS

The company now reports results for two divisions: Infrastructure and Advanced Facilities and PA Consulting. Recent segment trends and outlooks for these divisions are provided below.

In Infrastructure and Advanced Facilities, fiscal 2Q revenue rose more than 1.9% from the prior-year period to $2.60 billion. Operating income fell to $203 million from $204 million, while the operating margin decreased to 7.8% from approximately 8%.

At PA Consulting, revenue increased by $13.7 million to approximately $308 million and operating income rose to $67.3 million from approximately $60.2 million.

The overall backlog increased 20% from the prior year to $22.2 billion and the book-to-bill ratio was 1.3 in the second quarter

The fiscal 2Q25 gross margin rose 40 basis points to 25.4%. The operating margin rose to 7.2% from 5.0% a year earlier.

Following the company's strong fiscal second quarter, we are leaving our FY25 EPS estimate at $6.35. For FY26, we are keeping our estimate at $7.00 per share. Both estimates are above consensus.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Jacobs is Medium, the midpoint on our five-point scale. The company scores well on debt leverage, as its long-term debt/cap ratio of 43.3% is in-line with that of its peers in the construction and engineering industry. The ROE of 9.7% is above the peer average, though the operating margin of 7.3% is below that of other industrial companies. We believe that Jacobs has sufficient liquidity, with just over $1.2 billion in cash and equivalents as of the end of fiscal 2Q25.

In the first-quarter press release, Jacobs raised its dividend to $0.32 from $0.29 per share. Our dividend estimates are $1.25 for FY25 and $1.44 for FY26. The current yield is about 0.9%.

MANAGEMENT & RISKS

Bob Pragada has been CEO and director since January 2023. Steve Demetriou, CEO from 2015 to 2023, now serves as the executive chair. Effective June 3, 2024, Venk Nathamuni was named CFO. Before joining Jacobs, Nathamuni was CFO at Cirrus Logic.

Jacobs faces significant competition and is exposed to cyclical business conditions in the energy, mining, and construction industries. It also generates about 20% of its revenue from U.S. government contracts, which are subject to spending cutbacks and may involve complex regulatory requirements.

The company is sensitive to dollar trends. Looking ahead, we believe the greenback is fully valued and close to a peak. A stable-to-lower dollar would be positive for Industrial sector companies, including Jacobs.

COMPANY DESCRIPTION

Based in Dallas, Jacobs Solutions provides professional services including consulting, technical, scientific and project delivery for the government and private sectors. The company has approximately 60,000 employees. Jacobs acquired PA Consulting (a consultancy that specializes in strategy, technology and innovation) in March 2021. In FY24, Jacobs Solutions generated revenue of $11.5 billion.

VALUATION

We use peer and historical multiple comparisons to value the stock on a fundamental basis. The shares are trading at 17.0-times our FY26 EPS estimate, below the five-year peer average of 25.2-times. On price/sales, the shares are trading at a multiple of 1.4-times, above the midpoint of the five-year range of 0.4 to 1.7-times. The company’s valuation multiples are generally in line with industry averages. Our new target price of $140 assumes a multiple of 20.0-times our FY26 EPS estimate.

On May 7, BUY-rated J closed at $119.29, down $0.18. (John Staszak, CFA, 5/7/25)

PEPSICO INC. (NGS: PEP, $131.91)... HOLD

PEP: Looking for a more favorable entry point

* PEP shares have underperformed over the last quarter, falling 9%, compared to a decline of 8% for the S&P 500 and a gain of 7% for the industry ETF IYK.
* PepsiCo recently reported fiscal 1Q25 earnings that missed the consensus estimate.
* Pepsi has driven sales through price increases, with an average increase of 7% over the past eight quarters, though volume has fallen by an average 2% over the same period.
* In March 2025, Pepsi announced its acquisition of poppi for $1.95 billion.

ANALYSIS

INVESTMENT THESIS

Our rating on PepsiCo Inc. (NGS: PEP) is HOLD. PEP, one of the largest food and beverage companies in the world, has struggled to increase volume. Pepsi has driven sales through price hikes, with an average increase of 7% over the past eight quarters, though volume has fallen by an average of 2% over the same period. We are concerned about consumer sentiment and cautious spending impacting Pepsi's sales, as well as impacts on margins as tariffs elevate costs. Consequently, the earnings outlook for Pepsi has turned negative. On the positive side, we like its better-for-you portfolio, which taps into the health-conscious market with more nutritious products, capitalizing on the growing trend.

From a technical standpoint, the shares have been in a bearish pattern of lower highs and lower lows that dates to October 2024. On the fundamentals, the stock trades at 16-times our 2026 EPS forecast, below the peer average of 21. We think that prospects for less rapid revenue and earnings growth are adequately reflected in the share price. If volumes were to recover sooner than we anticipate, we would consider an upgrade.

Longer term, PepsiCo's digital operations, efficient distribution, strong brands, and improved supply chain are all cause for optimism. We have a favorable view of its recent acquisitions and how they can support volume growth. We also like the long history of dividend growth, most recently raised 5% in February 2025. For these reasons, our long-term rating remains BUY.

RECENT DEVELOPMENTS

PEP shares have underperformed over the last quarter, falling 9%, compared to a decline of 8% for the S&P 500 and a gain of 7% for the industry (ETF IYK). Over the past year, the shares have declined 25%, compared to gains of 9% for the index and 6% for the industry. Over the past five years, the shares have underperformed the index and the industry. The beta on PEP is 0.43.

PepsiCo recently reported fiscal 1Q25 earnings that missed the consensus estimate. The company reported core EPS of $1.48, down 4% from the prior year in constant currency, and just below the consensus forecast of $1.49. Net revenue of $17.9 billion was down 2% on a reported basis but up 1% organically. Sales reflected a 3% higher contribution from pricing, partially offset by a 2% decline in volume. The first-quarter core gross margin remained flat at 55.7%, while the core operating margin narrowed by 50 basis points to 15.6%.

Along with the results, management lowered its 2025 guidance. It continues expect low-single digit organic revenue growth. Management now expects core EPS to be down 3% from the prior year, down from its previous expectation for low-single digit growth. It continues to estimate $8.6 billion in cash returns to shareholders, consisting of $7.6 billion in dividends and $1.0 billion in share buybacks.

The company also grows through acquisitions. In March 2025, Pepsi announced it had entered a definitive agreement to acquire poppi, a prebiotic soda brand with rapid growth, for $1.95 billion. Management noted the price includes $300 million of anticipated cash tax benefits for a net purchase price of $1.65 billion. In January 2025, Pepsi announced it had completed its acquisition of Garza Food Ventures LLC—d.b.a. Siete Foods—for $1.2 billion. Management believes these acquisitions will complement the portfolio and grow its better-for-you offerings.

EARNINGS & GROWTH ANALYSIS

PepsiCo has reorganized its reporting segments and now reports in six segments. In 1Q, as a percentage of revenue, PepsiCo Foods North America (PFNA) accounted for 35%, PepsiCo Beverages North America (PBNA) for 33%, International Beverages Franchise (IB Franchise) for 4%, Europe, Middle East, and Africa (EMEA) for 13%, Latin America Foods (LatAm Foods) for 9%, and Asia Pacific Foods for 6%. We review recent results below.

Organic sales were up in four of the six segments. Organic sales were up 8% in EMEA, 7% in IB Franchise, 3% in LatAm Foods, and 1% in PBNA. Management noted improvements in marketplace performance and continued international strength. This growth was partially offset by a 2% decline in PFNA and a 1% decline in Asia Pacific Foods.

Volume was up in two of the six segments. Volume was up 6% in Asia Pacific Foods and 3% in IB Franchise. These gains were offset by volume declines of 4% in both PFNA and PBNA, and 2% in LatAm Foods. Volume remained flat in EMEA.

Management also keeps an eye on margins. The core gross margin remained flat at 55.7%, while the core operating margin narrowed by 50 basis points to 15.6%. Margins were impacted by planned timing and phasing of certain productivity initiatives, which management expects to accelerate throughout the year.

Pepsi has a history of growth and profitability. The company's revenues have grown 31% over the past five years, and core operating profit has grown 40%. The core operating margin has ranged from 14.3% to 16.0% over that time period.

Turning to our estimates, based on recent trends and management's guidance, we are lowering our 2025 core EPS estimate to $7.95 from $8.45. Our estimate is in line with management's guidance and implies a decline of 3%, as we expect the higher costs associated with tariffs and a tough consumer environment to pressure results. We expect growth in 2026, but are lowering our core EPS estimate to $8.35 from $8.85 to reflect the lower FY25 base. Our long-term earnings growth rate forecast is 6%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on PepsiCo is Medium-High, the second-highest rating on our five-point scale. The company receives above-average scores on our criteria of fixed-cost coverage, profitability, and average scores on debt levels.

The company ended 1Q25 with $8.3 billion in cash and short-term investments, down from $8.5 billion at the end of 2024. Long-term debt of $39.4 billion was up from $37.2 billion at the end of 2024, and long-term debt/capital was 68%. Adjusted operating income covered interest expense by a factor of 11.

PepsiCo pays a dividend. In February 2025, the company raised its annualized dividend by 5% to $5.69 per share, for a yield of approximately 4.2%. The company has paid a dividend for 60 consecutive years and has increased the dividend for 53 straight years. The shares are included in the S&P Dividend Aristocrats group. Our dividend estimates are $5.62 for 2025 and $5.95 in 2026.

MANAGEMENT & RISKS

Ramon Luis Laguarta has served as CEO since 2018 and also became chairman in 2019. James T. Caulfield serves as EVP and CFO.

Pepsi faces challenges from rising costs for commodities and other inputs. Although the company has implemented price increases across its portfolio, it has not been able to fully offset inflation. We note that Pepsi, which sells both food and beverages, is more exposed to agricultural cost inflation than Coca-Cola, which does not have food operations. PepsiCo also faces risks from unfavorable currency effects and could be hurt by strength in the U.S. dollar.

COMPANY DESCRIPTION

PepsiCo, founded in 1898, produces and sells food, snacks, and beverages around the world. The company's brands include Lay's, Santitas, Ruffles, Doritos, Tostitos, Cheetos, Quaker Oatmeal, and Rice-A-Roni; its beverage portfolio includes Pepsi, Mountain Dew, Gatorade, Lipton, Brisk, and various bottled-water products. The company also provides tea and coffee products through a joint venture with Starbucks and Unilever. The company has 319,000 employees. The shares are a component of the S&P 500.

INDUSTRY

Our rating on the Consumer Staples sector is Over-Weight. The sector is showing strong relative stock momentum as investors rotate away from AI and growth and toward defensive, cyclical, and current income. Staples companies have been working for years to streamline operations and supply chains while introducing new products and offering more product variety. In a tariff environment, we expect consumers to prioritize necessities over durable goods. Sector stocks offer above-market current income and are attracting investors with their defensive characteristics in a turbulent market.

As of the end of March, the sector accounted for 6.1% of the S&P 500, at the low end of the five-year range of 5%-12%. The sector was up 4.6%, outperforming the market. It underperformed in 2024, with a gain of 12.0%, compared with a gain of 23.3% for the S&P 500.

The sector's P/E ratio on projected 2025 EPS was 20, above the market multiple. Yields of 2.4% were above the market average. The sector's smoothed earnings growth rate of 4% was below the market average.

VALUATION

We believe that PEP shares are fairly valued at current prices near $131, near the bottom of their 52-week range of $130-$183. From a technical standpoint, the shares have been in a bearish pattern of lower highs and lower lows that dates to October 2024.

On the fundamentals, the stock trades at 16-times our 2026 EPS forecast, below the peer average of 21. The price/sales multiple of 2.0 is below the peer average of 4.9, while the dividend yield of about 4.2% is above the peer average of 3.2%. We think that prospects for less rapid revenue and earnings growth are adequately reflected in the share price. If volumes were to recover sooner than we anticipate, we would consider an upgrade.

On May 7, HOLD-rated PEP closed at $131.91, up $1.17. (Taylor Conrad, 5/7/25)