

Caterpillar Inc. (CAT)

\$145.85 (As of 01/21/20)

Price Target (6-12 Months): **\$154.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/23/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: B

Growth: D

Momentum: F

Summary

Caterpillar's adjusted earnings per share guidance for 2019 is \$10.59-\$11.09. The mid-point of the range indicates a decline of 3% from 2018. The company anticipates modestly lower sales compared with previous year as dealers continue to lower inventory. It is thus taking steps to reduce production to match dealer demand and will proactively increase production once order levels improve. In the Construction Industries segment, North America will aid growth while China will be a headwind. Improving commodity prices will support capital expenditure in the mining sector, which will drive the Resource Industries segment. Investments in expanded offerings and services, and digital initiatives like e-commerce will also fuel growth. Its cost reduction efforts will help sustain margins despite material cost inflation.

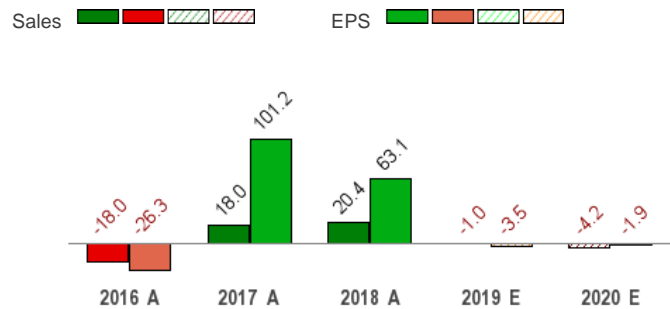
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$150.55 - \$111.75
20 Day Average Volume (sh)	2,155,986
Market Cap	\$80.6 B
YTD Price Change	-1.2%
Beta	1.52
Dividend / Div Yld	\$4.12 / 2.8%
Industry	Manufacturing - Construction and Mining
Zacks Industry Rank	Top 31% (78 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-5.7%
Last Sales Surprise	-4.7%
EPS F1 Est- 4 week change	-0.9%
Expected Report Date	01/31/2020
Earnings ESP	-5.1%
P/E TTM	13.3
P/E F1	13.7
PEG F1	1.1
P/S TTM	1.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	12,405 E	13,568 E	12,232 E	13,101 E	51,922 E
2019	13,466 A	14,432 A	12,758 A	13,586 E	54,191 E
2018	12,859 A	14,011 A	13,510 A	14,342 A	54,722 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$2.55 E	\$2.79 E	\$2.56 E	\$2.37 E	\$10.62 E
2019	\$2.94 A	\$2.83 A	\$2.66 A	\$2.37 E	\$10.83 E
2018	\$2.82 A	\$2.97 A	\$2.86 A	\$2.55 A	\$11.22 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/21/2020. The reports text is as of 01/22/2020.

Overview

Deerfield, IL-based Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines and industrial gas turbines. It is also a leading exporter in the United States. The company has six operating segments, of which four are reportable segments.

Machinery, Energy & Transportation (ME&T) (Accounted for approximately 95% of total revenues in fiscal 2018) includes -

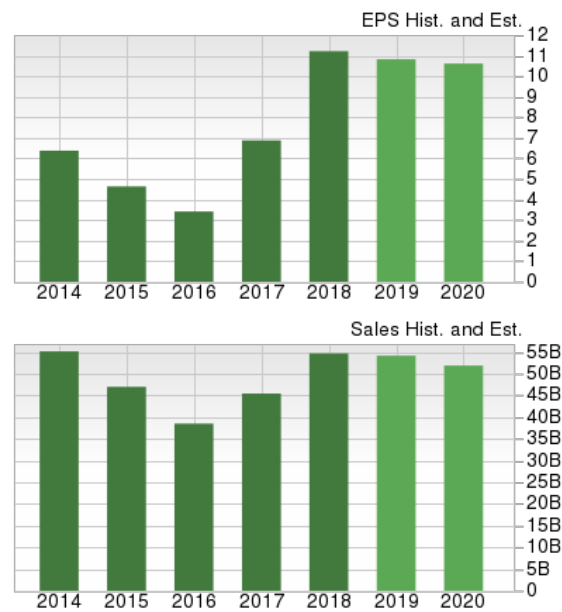
Construction Industries – The segment manufactures machinery utilized in infrastructure, forestry and building construction. The majority of machine sales are generated from traditional construction applications (road, heavy, and general), and the balance from quarry and aggregates, industrial and waste, agriculture and landscaping, and forestry applications. The segment's wide product portfolio is divided into earthmoving, excavation and building construction categories.

Resource Industries – The segment caters to customers using machinery in mining, quarry and aggregates, heavy construction, waste and material handling applications. Resource Industries also develops and sells technology products and services to provide customers fleet management systems, equipment management analytics and autonomous machine capabilities. Products in the segment fall under three broad categories - surface mining, underground mining and material handling, which include support equipment for mining, construction, and quarry and aggregate applications.

Energy & Transportation – This segment supports customers in oil and gas, power generation, marine, rail and industrial applications. The segment offers a range of prime motive power products including reciprocating engines, turbines, locomotives and related parts.

All Other Segments – These segments primarily comprise activities such as the re-manufacturing of CAT engines and components and re-manufacturing services for other companies as well as product management, development, manufacturing, marketing and product support.

Financial Products Segment (5%) – Cat Financial provides retail and wholesale financing alternatives for Caterpillar products to customers and dealers globally.



Reasons To Buy:

- ▲ Caterpillar will continue to monitor end-user demand, commercial shipments, dealer inventory, orders and backlog and plans to adjust production levels accordingly. The company has been successful in reducing the lead times, which allows dealers to maintain lower levels of inventory. Further, shorter lead times enable both the company and its dealers to adapt quickly to changing market conditions. The company is also taking steps to reduce production to match dealer demand and will proactively increase production once order levels improve.
- ▲ For the Construction Industries segment, improvement in residential and non-residential construction in North America, and infrastructure demand is likely to drive revenues. Increasing commodity prices are likely to support capital investment in the mining sector. Quoting activity and end user demand for mining equipment remains positive, which will drive the Resource Industries segment. Capital spend will increase for both equipment replacement cycles and expansions. In the Energy & Transportation segment, power generation, Solar Turbines and Progress Rail are likely to improve.
- ▲ Caterpillar's cash and liquidity position remains strong with the company ending third-quarter 2019 with cash and short-term investments of \$7.9 billion. In the third quarter of 2019, the company repurchased \$1.2 billion of Caterpillar common stock and paid out dividends of \$0.6 billion. So far this fiscal, the company has made share repurchases worth \$3.3 billion. Caterpillar expects around 9% share count reduction by the end of this year. The company also projects capital expenditures of around \$1.2 billion in fiscal 2019. Backed by its significant improvement in financial performance over the last two years, Caterpillar's board of directors authorized a 20% increase in quarterly cash dividend to \$1.03 per share in May. In each of the following four years, Caterpillar anticipates increasing the dividend by at least a high single-digit percentage. Moreover, the company intends to utilize the remaining ME&T free cash flow to repurchase shares on a more consistent basis.
- ▲ In September 2015, Caterpillar set out with significant restructuring and cost reduction initiative, which has now been substantially completed. The plan will likely lower annual operating costs by about \$1.5 billion. Caterpillar is focused on developing a more competitive and flexible cost structure and controlling discretionary spending.
- ▲ Caterpillar continues to focus on customers and on the future by continuing to invest in digital capabilities, connecting assets and jobsites along with developing the next generation of more productive and efficient products. The company plans to fund initiatives that drive long-term profitable growth focused on areas of expanded offerings and services and digital initiatives like e-commerce. It will also focus on connected assets, autonomous machines, and new engine technologies and machine programs. It will use Operating & Execution Model to divert resources to areas that represent the greatest opportunity for return on investments. Caterpillar expects to double ME&T services sales to \$28 billion by 2026 and deliver higher adjusted operating margins through cycles of three to six percentage points above historical performance.

Favorable commodity prices and global need for infrastructure will drive Caterpillar. It should also gain from its focus on cost cutting, and investment in expanded offerings and digital capabilities.

Reasons To Sell:

- ▼ At the end of the third quarter of 2019, Caterpillar's order backlog was at \$14.6 billion, a sequential drop of \$400 million. Order backlog decreased mostly in Construction Industries and Resource Industries. This decline reflects dealers' expectations for lower demand from end markets in the fourth quarter and their desire to reduce inventory levels. This does not bode well for fourth-quarter 2019 top line. For the fourth quarter, Caterpillar expects end-user demand to remain flat and dealers to make further inventory reductions owing to the global economic uncertainty.
- ▼ For 2019, Caterpillar lowered adjusted earnings per share guidance to \$10.59-\$11.09 from the prior guidance of \$11.75-\$12.75. This guidance however excludes a 31 cents per share discrete tax benefit related to U.S. tax reform. The trimmed guidance reflects lower end-user demand as well as dealer reducing their inventory. The company anticipates dealer inventory will be up about \$500 million at 2019-end compared with the prior year. Caterpillar expects modestly lower sales for the year, in contrast to its prior expectation of modest sales growth.
- ▼ The U.S.-China trade tensions and waning global demand seems to have taken its toll on the U.S manufacturing sector. Per the Institute for Supply Management's latest report, the U.S Purchasing Managers' Index (PMI) was 47.2% in December 2019 – the fifth month of contraction in the sector. Moreover, industrial production declined 0.3% in December following a 0.8% growth in November and 0.5% fall in October. Overall, for the fourth quarter, total industrial production declined at an annual rate of 0.5%. This indicates a contraction in the manufacturing sector, which is likely to impact Caterpillar's performance.
- ▼ In the Construction Industries segment, Latin America will continue on its recovery path, but demand will remain relatively low in 2019. Though demand remains steady in EMEA, political and economic uncertainties remain. Continued pressure from competitive pricing in China remains a headwind. Given that China represents about 10% to 15% of the construction industry segment's sales and about 5% to 10% of total Caterpillar sales and revenues, it will be a drag on the company's results.
- ▼ Material cost inflation will continue to affect Caterpillar's margins owing to the implementation of tariffs last year. Further, SG&A and R&D spending will continue to escalate due to investments in growth areas including services and expanded offerings, and some corporate level items.
- ▼ Caterpillar's global retail sales for the three-month period ended November 2019 remained flat year-over-year – the worst performance so far this year. Till October, sales growth was confined in the single-digit territory —levels last witnessed in 2017. The company has average growth rate of 5.3%, on average, during the January-October 2019 period, reflecting a sharp decline from the prior-year figure of 24.7%.

Impact of raw material cost inflation on margins, inventory reduction at its dealers and low end-user demand owing to the global economic uncertainty remain headwinds.

Last Earnings Report

Caterpillar Lags Q3 Earnings Estimates, Trims '19 View

Caterpillar reported third-quarter 2019 adjusted earnings per share of \$2.66 lagging the Zacks Consensus Estimate of \$2.83. The figure also declined 7% from the prior-year quarter's adjusted earnings per share of \$2.86. The ongoing global economic uncertainty and slowdown in the manufacturing sector resulted in dealers reducing their inventories and impacted sales across all the three segments.

Including one-time items, Caterpillar's earnings per share came in at \$2.88 in the prior-year quarter while there were no such adjustments in the reported quarter.

Quarter Ending **09/2019**

Report Date	Oct 23, 2019
Sales Surprise	-4.67%
EPS Surprise	-5.67%
Quarterly EPS	2.66
Annual EPS (TTM)	10.98

Revenues Lag Estimates

The company's third-quarter revenues declined 6% year over year to \$12.8 billion, missing the Zacks Consensus Estimate of \$13.4 billion. Volumes were impacted as dealers reduced their inventories by \$400 million in the reported quarter, after having ramped up inventories by \$800 million in the year-ago quarter. Even though end-user demand was reported to be higher among the three primary segments, it was lower than expectations.

Latin America was the only region to deliver growth in sales of 2% in the July-September quarter. Meanwhile, Asia Pacific, EAME and North America witnessed declines of 13%, 7% and 3%, respectively.

Margins Dip on Lower Sales Volume

In third-quarter 2019, cost of sales decreased 5% year over year to \$8.6 billion on higher manufacturing costs owing to higher variable labor and burden, and warranty expenses and higher material costs, including tariffs. Gross profit contracted 7% to \$4.2 billion on higher manufacturing costs. Gross margin was 32.8% in the reported quarter, down from 33.2% in the prior-year quarter.

Selling, general and administrative (SG&A) expenses decreased 4% to \$1.2 billion. Research and development (R&D) expenses declined 10% from the prior-year quarter figure of \$431 million. Operating profit in the quarter was \$2.02 billion, down 5% from the prior-year quarter. Benefits from favorable price realization and lower SG&A and R&D expense were offset by lower sales volume. Operating margin was 15.8% in the reported quarter, flat year over year.

Segment Performances Disappoint

Machinery and Energy & Transportation (ME&T) sales declined 6% year over year to \$11.97 billion. Construction Industries sales dropped 7% year over year to \$5.29 billion, owing to unfavorable impact from changes in dealer inventories, partially offset by higher end-user demand for construction equipment.

Sales at Resource Industries declined 12% year over year to \$2.3 billion due to changes in dealer inventories, partially mitigated by higher end-user demand for equipment and favorable price realization. Sales of Energy & Transportation segment in the quarter was at \$5.45 billion, a drop of 2% from the prior-year quarter thanks to lower inter-segment engine sales.

The ME&T segment delivered operating profit of \$1.89 billion, a decline of 9% from the year-ago quarter. The Resource Industries segment's operating profit slumped 25% year over year to \$311 million in third-quarter 2019. Construction Industries segment's profit suffered year-over-year drop of 11% to \$940 million. The Energy & Transportation segment, operating profit improved 5% year over year to \$1.02 billion.

Financial Products' revenues went up 2% to \$865 million from the prior-year quarter. Financial Products' profits were \$218 million in the reported quarter, up 8% from \$201 million in the prior-year quarter.

Cash Position

Caterpillar ended third quarter-2019 with cash and short-term investments of \$7.91 billion, down from \$7.86 billion at 2018 end. In the reported quarter, ME&T operating cash flow was an outflow of \$188 million as the company made a \$1.5 billion discretionary pension contribution financed from proceeds of a debt issuance. During third-quarter 2019, the company repurchased \$1.2 billion of its common stock and paid out dividends worth \$0.6 billion.

Backlog Declines

At the end of third-quarter 2019, Caterpillar's backlog was at \$14.6 billion, a sequential drop of \$400 million.

Lowers 2019 Guidance

For the fourth quarter, Caterpillar expects end-user demand to remain flat and dealers to make further inventory reductions owing to the global economic uncertainty.

For 2019, Caterpillar lowered adjusted earnings per share guidance to \$10.59-\$11.09 from the prior guidance of \$11.75-\$12.75. Including 31 cents per share discrete tax benefit related to U.S. tax reform, the guidance is at \$10.90-\$11.40. Caterpillar expects modestly lower sales in 2019.

Caterpillar's continued focus on strategic investments, cost cutting measures, growing services and expanding offerings will deliver long-term profitable growth.

Recent News

Caterpillar's Flat November Sales Mark the Worst in 2019 – Dec 12, 2019

For the three-month period ended November 2019, Caterpillar's global retail sales remained flat compared with the prior year — the worst performance so far this year. North America was the only region to deliver growth of 5%. Sales in Latin America, EAME and Asia Pacific were down 7%, 5% and 4%, respectively.

The Resource Industries segment's sales growth entered the negative territory in November, reflecting a decline of 6%. Sales in Asia Pacific and North America rose 5% and 3%, respectively. However, sales in Latin America and EAME plunged 30% and 16%, respectively. The segment had last suffered a sales decline in 2015.

Sales growth in the Construction Industries segment inched up 2% — the lowest so far this year. Sales improved 10% in Latin America and 7% in North America. Sales in EAME region remained flat with the prior year. Asia Pacific disappointed with a decline of 6% in sales. The segment had last witnessed these levels in 2014.

Sales in the Energy & Transportation segment declined 5%, recording its worst performance so far this year. Sales growth in the Transportation Industrial sector came in at 36%, followed by Industrial and Power Generation and Transportation sectors that reported sales growth of 16% and 9%, respectively. The Oil & Gas sector reported a sales decline of 27%, marking its worst performance in 2019.

Caterpillar Maintains Dividend – Dec 11, 2019

Caterpillar announced that its board of directors voted to maintain the quarterly cash dividend of \$1.03 per share. Since 2009, the company's quarterly cash dividend has more than doubled. Caterpillar has paid out a cash dividend every year since its inception and has paid out a quarterly dividend since 1933.

Valuation

Caterpillar's shares have gone up 10.6% over the trailing 12-month period. Stocks in the Zacks Manufacturing – Construction and Mining industry and the Zacks Industrial Products sector are up 11.5% and 18.8%, respectively, over the past year.

The S&P 500 Index has gained 25.3% in the past year.

The stock is currently trading at 13.68x forward 12-month earnings, which compares with 13.81x for the Zacks sub-industry, 18.41x for the Zacks sector and 19.18x for the S&P 500 Index.

Over the past five years, the stock has traded as high as 32.58x and as low as 8.88x, with a 5-year median of 17.26x.

Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$154 price target reflects 14.44x forward 12-month earnings.

The table below shows summary valuation data for CAT:

Valuation Multiples - CAT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.68	13.81	18.41	19.18
	5-Year High	32.58	30.83	19.91	19.34
	5-Year Low	8.88	9.47	12.6	15.17
	5-Year Median	17.26	16.78	16.54	17.44
P/S F12M	Current	1.55	1.3	2.8	3.57
	5-Year High	2.13	1.64	2.8	3.57
	5-Year Low	0.79	0.71	1.51	2.54
	5-Year Median	1.34	1.11	1.97	3
EV/EBITDA TTM	Current	9.3	8.09	17.25	12.38
	5-Year High	14.14	12.79	17.44	12.86
	5-Year Low	6.78	6.05	10.89	8.48
	5-Year Median	9.51	8.67	14.72	10.67

As of 01/21/2020

Industry Analysis Zacks Industry Rank: Top 31% (78 out of 255)



Top Peers

Arcosa, Inc. (ACA)	Outperform
The Manitowoc Company, Inc. (MTW)	Outperform
CNH Industrial N.V. (CNHI)	Neutral
Deere & Company (DE)	Neutral
H&E Equipment Services, Inc. (HEES)	Neutral
Komatsu Ltd. (KMTUY)	Neutral
Terex Corporation (TEX)	Neutral
Astec Industries, Inc. (ASTE)	Underperform

Industry Comparison Industry: Manufacturing - Construction And Mining				Industry Peers		
	CAT Neutral	X Industry	S&P 500	CNHI Neutral	DE Neutral	KMTUY Neutral
VGM Score	D	-	-	C	B	A
Market Cap	80.61 B	1.56 B	24.43 B	14.54 B	54.32 B	23.36 B
# of Analysts	9	4.5	13	7	10	1
Dividend Yield	2.82%	1.66%	1.75%	0.00%	1.76%	3.38%
Value Score	B	-	-	A	D	A
Cash/Price	0.10	0.10	0.04	0.28	0.08	0.07
EV/EBITDA	8.39	5.40	14.00	9.48	10.58	5.40
PEG Ratio	1.14	1.47	2.06	NA	4.08	1.47
Price/Book (P/B)	5.38	1.43	3.39	2.37	4.76	1.30
Price/Cash Flow (P/CF)	8.85	6.94	13.69	6.04	10.44	6.45
P/E (F1)	13.73	12.89	19.00	12.36	18.27	13.65
Price/Sales (P/S)	1.47	0.79	2.68	0.51	1.38	0.98
Earnings Yield	7.28%	7.79%	5.26%	8.10%	5.47%	7.33%
Debt/Equity	1.71	0.55	0.72	3.90	2.65	0.24
Cash Flow (\$/share)	16.49	3.95	6.94	1.78	16.53	3.72
Growth Score	D	-	-	D	B	B
Hist. EPS Growth (3-5 yrs)	23.01%	10.20%	10.60%	17.68%	12.82%	NA
Proj. EPS Growth (F1/F0)	-1.94%	-9.86%	7.57%	2.53%	-5.00%	-28.74%
Curr. Cash Flow Growth	35.57%	35.57%	14.00%	21.09%	4.09%	17.91%
Hist. Cash Flow Growth (3-5 yrs)	6.65%	7.61%	9.00%	2.13%	3.09%	7.61%
Current Ratio	1.44	1.68	1.23	6.03	2.04	1.68
Debt/Capital	63.05%	35.34%	42.99%	79.63%	72.60%	19.07%
Net Margin	10.99%	3.32%	11.15%	5.46%	8.29%	8.43%
Return on Equity	42.51%	20.66%	17.16%	21.02%	27.11%	12.14%
Sales/Assets	0.70	0.95	0.55	0.62	0.54	0.72
Proj. Sales Growth (F1/F0)	-4.45%	-4.45%	4.05%	-0.24%	-7.50%	-7.05%
Momentum Score	F	-	-	D	B	D
Daily Price Chg	-1.31%	-0.96%	-0.27%	-2.98%	-2.07%	-0.46%
1 Week Price Chg	1.13%	1.13%	2.29%	1.65%	1.60%	1.43%
4 Week Price Chg	-1.11%	-1.03%	2.13%	-3.16%	-1.11%	-0.95%
12 Week Price Chg	3.20%	10.16%	6.99%	-2.45%	-0.89%	-0.41%
52 Week Price Chg	10.29%	5.08%	21.25%	6.97%	8.64%	-2.81%
20 Day Average Volume	2,155,986	123,575	1,415,064	983,775	1,104,996	64,813
(F1) EPS Est 1 week change	-0.34%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.88%	0.00%	0.00%	-0.98%	-0.43%	0.00%
(F1) EPS Est 12 week change	-5.09%	-14.12%	-0.34%	-4.25%	-15.48%	-23.48%
(Q1) EPS Est Mthly Chg	-0.23%	0.00%	0.00%	0.00%	0.00%	NA

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	D
Momentum Score	F
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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