

Central Garden & Pet (CENT)

\$31.16 (As of 12/30/19)

Price Target (6-12 Months): **\$26.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 11/27/19)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:B

Value: D

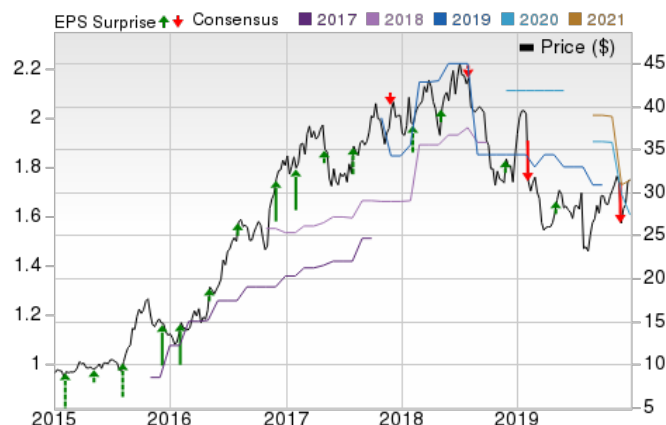
Growth: A

Momentum: B

Summary

Shares of Central Garden & Pet have slid and underperformed the industry in the past one year. The stock came under pressure following fourth-quarter fiscal 2019 results, wherein the bottom line missed the Zacks Consensus Estimate, while sales surpassed the same. Although net sales grew, earnings per share fell on a year-over-year basis. Management hinted that the timing of the 2018 acquisition of the highly-seasonal Bell Nursery business, along with sluggishness in animal health businesses owing to bad weather, inventory write-offs, and increase in the number of shares outstanding impacted the results. Going into first-quarter fiscal 2020, management expects to report loss of 10-15 cents a share due to unfavorable timing of orders in the Garden segment, continued challenges in the animal health businesses and higher corporate expenses.

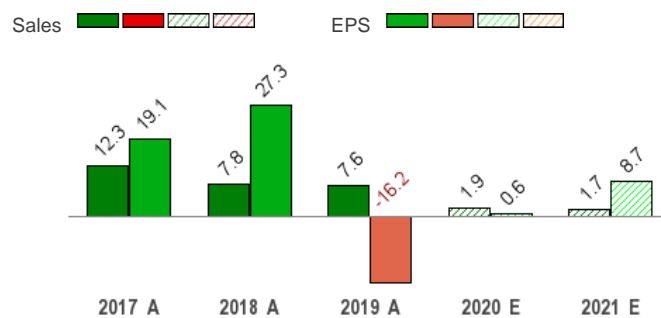
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$40.59 - \$22.40
20 Day Average Volume (sh)	89,883
Market Cap	\$1.7 B
YTD Price Change	-9.6%
Beta	-0.11
Dividend / Div Yld	\$0.00 / 0.0%
Industry	<u>Consumer Products - Discretionary</u>
Zacks Industry Rank	Bottom 11% (226 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-76.5%
Last Sales Surprise	4.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/05/2020
Earnings ESP	0.0%
P/E TTM	19.6
P/E F1	19.4
PEG F1	2.7
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	492 E	710 E	732 E	561 E	2,470 E
2020	472 E	695 E	719 E	543 E	2,429 E
2019	462 A	674 A	707 A	541 A	2,383 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.14 E	-\$0.09 E	\$0.76 E	\$0.88 E	\$1.75 E
2020	\$0.16 E	-\$0.12 E	\$0.74 E	\$0.84 E	\$1.61 E
2019	\$0.03 A	\$0.72 A	\$0.80 A	\$0.04 A	\$1.60 A

*Quarterly figures may not add up to annual.

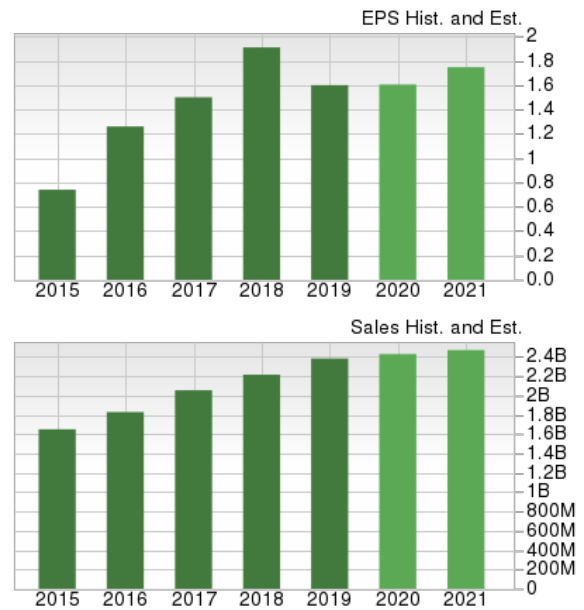
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 12/30/2019. The reports text is as of 12/31/2019.

Overview

Central Garden & Pet Co. is a leading producer and marketer of premium and value-oriented products focused toward the lawn & garden and pet supplies markets in the U.S. The company offers its products to mass merchants, home improvement centers, lawn and garden nurseries, grocery stores, specialty pet stores, veterinarians' municipalities, and other individual animal buyers. Central Garden & Pet has emerged as one of the largest suppliers of pet and garden products to Wal-Mart, Home Depot, Lowe's and PetSmart through a combination of strategic acquisitions and organic growth. The CA-based company has two operating segments: Pet Products and Garden Products.

Pet Segment (58% of Fiscal 2019 total sales): This segment offers food and accessories for dogs, cats, birds, small animals, fishes, horses and livestock under brands, such as Adams, Aqueon, Avoderm, Cadet, Farnam, Four Paws, Kaytee, K&H Pet Products, Nylabone, Pinnacle, TFH, Zilla, Comfort Zone and Coralife.

Garden Segment (42% of Fiscal 2019 total sales): This segment offers both proprietary and nonproprietary grass seeds, herbicides, insecticides, pesticides, decorative outdoor lifestyle and lighting products. The segment markets its products under brands such as AMDRO, Ironite, Pennington, Sevin, Over-N-Out, Smart Seed and The Rebels.



Reasons To Sell:

- ▼ **Dismal Stock Performance:** Shares of Central Garden & Pet have tumbled 9.6% and underperformed the industry that increased 2.4% in the past one year. The stock recently came under pressure following the company's fourth-quarter fiscal 2019 results, wherein the bottom line not only missed the Zacks Consensus Estimate but also fell year over year. Management hinted that the company's acquisitions of highly-seasonal Bell Nursery business along with sluggishness in animal health businesses owing to bad weather, inventory write-offs and increase in the number of shares outstanding impacted the results. The company posted adjusted earnings of 4 cents a share that lagged the Zacks Consensus Estimate of 17 cents. Moreover, the bottom line declined year over year. Earnings per share decreased 60% from 10 cents reported in the year-ago period. We note that higher cost of goods sold and occupancy (up 10.4%) and SG&A expenses (up 6.9%) coupled with increase in the number of shares outstanding might have weighed on the bottom line.
- ▼ **Disappointing Q1 & FY20 Bottom-Line Projection:** Management expects to incur loss of 10-15 cents per share during the first quarter owing to unfavorable timing of orders in the Garden segment, continued sluggishness in the animal health businesses and increase in corporate expenses. Again, Central Garden & Pet anticipates fiscal 2020 earnings to be in line or slightly above fiscal 2019 reported figure of \$1.61. Increased investments in demand creation capabilities to drive long-term sustainable growth and challenges in animal health businesses will be headwinds to earnings growth for the year.
- ▼ **Rising SG&A Expenses May Hurt Profit:** Central Garden & Pet is grappling with rising costs. Any deleverage in SG&A expenses has a direct bearing on the company's profitability. We note that SG&A costs have increased 6.9% in fourth-quarter fiscal 2019, following a hike of 6.5%, 1.8% and 9.8% in the third, second and the first quarters, respectively. Persistence of such a dismal trend may hurt the company's profitability in the future. SG&A expenses increased \$43.9 million, or 8.6% to \$551.9 million in fiscal 2019 from \$508.0 million in fiscal 2018. The rise in SG&A expenses was due to increases in both selling and delivery expense and warehouse and administrative expense. Selling and delivery expense increased mainly due to recent buyouts and secondarily owing to increased delivery spend partially offset by reduced marketing and media spend. Warehouse and administrative expense increased on account of recent acquisitions as well as increased bad debt expense within the Pet segment.
- ▼ **Seasonality of Garden Segment:** Gardening is generally limited to the period between spring to summer, which makes the garden business highly seasonal in nature. A major part of the sales occurs during the second and third fiscal quarters. Failure to perform during the season is likely to have a significant impact on the company's yearly financials. In fiscal 2019, approximately 69% of Garden segment's net sales and 58% of total net sales occurred during the second and third quarters.
- ▼ **Tough competition:** The company operates in highly-competitive markets. It faces intense competition from regional and national firms on grounds of price, product quality, number of products offered, brand awareness and customer service. The company's growth and success depend on its ability to offer high-quality distinguished products at a competitive price. The company's lawn and garden products compete against national and regional products and private label products produced by various suppliers. The company turf and forage grass seed products, fertilizers, pesticides and combination products compete primarily against products marketed by The Scotts Miracle-Gro Company ("Scotts"). Additionally, Spectrum Brands is a strong competitor in yard and household insecticides. The company's branded pet products compete against national and regional branded products and private label products produced by various suppliers. The company's largest competitors in the product categories are Spectrum Brands and Hartz Mountain. The segment's sales and logistics operations compete with Animal Supply Co., Phillips Pet Food & Supplies and a number of smaller local and regional distributors.
- ▼ **Decline in Consumers' Discretionary Spending:** The company's customers remain sensitive to macroeconomic factors including interest rate hikes, increase in fuel and energy costs, credit availability, unemployment levels, and high household debt levels, which may negatively impact their discretionary spending, and in turn the company's top and bottom lines.
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High SG&A trend may affect the bottom line in the near term. Also, softness in the Pet segment's animal health businesses remain a concern.

Risks

- **Decent Top Line Performance:** Central Garden & Pet continues to witness decent top-line performance. After increasing 7.4% during the third quarter of fiscal 2019, net sales rose 7.7% to \$540.7 million in the fourth quarter. The reported figure came ahead of the Zacks Consensus Estimate of \$518 million. Meanwhile, organic sales grew 4.6% during the quarter under review, backed by solid performances in the Garden and Pet segments. Net sales for the Pet segment increased 4.9% to \$355.9 million owing to the inclusion of the C&S acquisition as well as organic growth. Again, the metric improved 13.4% to \$184.8 million at the Garden segment aided by the acquisition of Arden but primarily driven by organic growth. The company believes that the U.S. pet supplies market will increase in the long term due to favorable demographic and leisure trends, while gardening is one of the most popular leisure activities.
- **Healthy Commercial Relationship:** Being the leading producer of garden and pet supplies products in the U.S. with a diversified portfolio of brands has aided Central Garden & Pet in developing healthy commercial relationships with giant retailers such as PetSmart, PETCO, Walmart, Home Depot and Lowe's. We believe this provides the company significant opportunity to drive growth. Walmart, the company's largest customer, accounted about. Sales to Walmart represented approximately 28%, 29% and 31%, sales to Lowe's represented about 22%, 21% and 21%, and sales to Home Depot represented roughly 29%, 27% and 20% of Garden segment's net sales in fiscal 2019, 2018 and 2017, respectively.

Walmart, the company's largest customer, accounted about 16% of total company net sales in each of the fiscal years 2019, 2018 and 2017. Home Depot, the second largest customer, reflected approximately 12%, 11% and 8% of our total company net sales in fiscal 2019, 2018 and 2017, respectively. Moreover, other prominent customers include Lowe's, Costco and PetSmart, and together with Walmart and Home Depot, represented for approximately 49% of net sales in fiscal 2019, 48% in fiscal 2018 and 44% in fiscal 2017.

- **Acquisitions Playing Key Role:** Central Garden & Pet company has been a disciplined buyer in the garden and pet areas and has concluded more than 50 acquisitions since 1992. The company through buyouts also look to enhance manufacturing capabilities, operating synergies, or developing distribution network. In the last two years, the company has bought four new businesses including entering into the live plant and outdoor seat cushion businesses. In this regard, Central Garden & Pet acquired C&S Products in May 2019, which will complement its existing wild bird feed business. Prior to this, the company acquired the remaining 55% stake at Arden Companies in February 2019. Earlier, the company bought Bell Nursery, a leading grower and distributor of live flowers and plants in March 2018, while the same year in April, it acquired General Pet Supply, a supplier of pet food and supplies. The company also purchased two small wholesale distributors of fish and small animals during fiscal 2018.
 - **A Complete Metamorphosis:** Central Garden & Pet's effective inventory management is helping it to optimize merchandise levels in accordance with sales trends and is also facilitating in optimum utilization of its working capital. Further, the company intends to evolve into an integrated, multi-brand company by restructuring and reorganizing operating units and consolidating facilities. The company is steadily making strides in advancing its digital capabilities to focus on e-commerce and optimizing supply chain. The company is also expanding its data analytics capability to improve and accelerate business insight. Management revealed plans to lower cost of goods sold and administrative spending by 1-2% annually via cost-containment efforts.
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Last Earnings Report

Central Garden & Pet's Q4 Earnings Lag Estimates, Sales Beat

Quarter Ending **09/2019**

Central Garden & Pet Company reported fourth-quarter fiscal 2019 results, wherein the bottom line missed the Zacks Consensus Estimate, while sales surpassed the same. Although net sales improved on a year-over-year basis, earnings per share declined from the year-ago period.

Per management, the company's acquisitions of highly-seasonal Bell Nursery business along with sluggishness in animal health businesses owing to bad weather, inventory write-offs and increase in the number of shares outstanding affected results.

Report Date	Nov 26, 2019
Sales Surprise	4.35%
EPS Surprise	-76.47%
Quarterly EPS	0.04
Annual EPS (TTM)	1.59

Let's Delve Deep

The company posted adjusted earnings of 4 cents a share that lagged the Zacks Consensus Estimate of 17 cents. Moreover, the bottom line declined year over year. Earnings per share decreased 60% from 10 cents reported in the year-ago period. We note that higher cost of goods sold and occupancy (up 10.4%) and SG&A expenses (up 6.9%) coupled with increase in the number of shares outstanding might have weighed on the bottom line.

This California-based company, which recently acquired C&S, reported net sales of \$540.7 million that beat the Zacks Consensus Estimate of \$518 million. Further, the metric rose 7.7% from the year-ago period. Meanwhile, organic sales grew 4.6% during the quarter under review, backed by solid performances in the Garden and Pet segments.

Gross profit increased nearly 1% to \$148.5 million, whereas gross margin contracted 180 basis points to 27.5%. Gross margin contraction can be attributable to inventory write-off in the Pet segment as well as unfavorable mix in the Garden segment.

Operating income came in at \$10.9 million, down 40.3% from the prior-year quarter, while operating margin contracted 160 basis points to 2%.

Segment Details

Net sales at the **Pet segment** advanced 4.9% year over year to \$355.9 million, driven by the acquisition of C&S and organic growth. Organic sales increased 2.2%, owing to solid gains in the dog & cat and wild bird businesses along with higher sales of other manufacturers products. On the other hand, aquatics and live fish businesses witnessed soft sales. Sales across the segment's branded products grew 3.9% to \$272.3 million, while across manufacturers' products the metric increased 8.3% to \$83.6 million. The segment's operating income decreased 3.8% year over year to \$30.9 million, while operating margin contracted 80 basis points to 8.7%. The metrics were hurt by dismal performances in animal health and pet bedding businesses.

At the **Garden segment**, net sales advanced 13.4% to \$184.8 million, backed by the buyout of Arden Companies and strong organic growth. Organic sales grew 9.7% on the back of solid sales of other manufacturers' products along with gains from the wild bird, grass seed, and live plants businesses. The Garden segment's branded product sales came in at \$142.7 million, up 7.1%, while sales of other manufacturers' products grew 42.2% to \$42.1 million. The segment reported operating income of \$0.3 million, down more than five-folds from \$1.6 million in the year-ago quarter. Also, operating margin contracted 80 basis points to 0.2% on account of acquisitions of Arden Companies and unfavourable mix of products.

Financial Details

Central Garden & Pet ended the quarter with cash and cash equivalents of \$497.7 million and total long-term debt of \$693.2 million compared with \$482.1 million and \$692.2 million, respectively, in the prior-year period. Shareholders' equity at the end of the period was \$996 million, excluding non-controlling interest of \$170,000.

Cash flow from operating activities came in at roughly \$112.2 million in the reported quarter. Moreover, the company bought back 1.8 million shares. As of Sep 28, 2019, the company had \$100 million remaining under its share repurchase program. Additionally, it has 1.2 million shares remaining under the equity dilution authorization.

Net interest expenses decreased to \$8.1 million during the reported quarter from \$8.9 million in the prior-year period. Management incurred capital expenditures of \$11 million during the quarter under review. For fiscal 2020, capital expenditure is expected to be higher than \$32 million recorded in fiscal 2019.

Guidance

Management anticipates fiscal 2020 earnings to be in line or slightly above fiscal 2019 reported figure of \$1.61. Increased investments in demand creation capabilities to drive long-term sustainable growth and challenges in animal health businesses are likely to weigh on the fiscal 2020 bottom line. For the first quarter, management expects to incur loss of 10-15 cents per share owing to unfavorable timing of orders in the Garden segment, continued sluggishness in the animal health businesses and increase in corporate expenses.

Valuation

Central Garden & Pet shares are down 9.6% over the trailing 12-month period. Stocks in the Zacks sub-industry is up 2.4% while the Zacks Consumer - Discretionary sector is up 29.4%, over the past year.

The S&P 500 index is up 28% in the past year.

The stock is currently trading at 18.99X forward 12-month earnings, which compares to 15.74X for the Zacks sub-industry, 20.41X for the Zacks sector and 18.76X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.29X and as low as 12.2X, with a 5-year median of 18.73X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$26 price target reflects 15.85X forward 12-month earnings.

The table below shows summary valuation data for CENT

Valuation Multiples - CENT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.99	15.74	20.41	18.76
	5-Year High	26.29	26.92	23.34	19.34
	5-Year Low	12.2	10.4	16.17	15.17
	5-Year Median	18.73	20.49	20.07	17.44
P/S F12M	Current	0.71	0.63	2.32	3.41
	5-Year High	1.05	1.17	3.19	3.41
	5-Year Low	0.26	0.54	1.81	2.54
	5-Year Median	0.72	0.91	2.56	3
EV/EBITDA TTM	Current	9.53	7.64	12.77	12.01
	5-Year High	14.97	22.3	17.77	12.86
	5-Year Low	6.47	7.27	11.08	8.49
	5-Year Median	9.64	12.37	12.44	10.65

As of 12/30/2019

Industry Analysis Zacks Industry Rank: Bottom 11% (226 out of 253)



Top Peers

Aphria Inc. (APHA)	Outperform
Chewy Inc. (CHWY)	Neutral
General Mills, Inc. (GIS)	Neutral
Hengan International Group Co., Ltd. Unsponsored ADR (HEGIY)	Neutral
Prestige Consumer Healthcare Inc. (PBH)	Neutral
The J. M. Smucker Company (SJM)	Neutral
Party City Holdco Inc. (PRTY)	Underperform
Spectrum Brands Holdings Inc. (SPB)	Underperform

Industry Comparison Industry: Consumer Products - Discretionary				Industry Peers		
	CENT Underperform	X Industry	S&P 500	CHWY Neutral	GIS Neutral	SPB Underperform
VGM Score	B	-	-	F	A	A
Market Cap	1.74 B	175.02 M	23.75 B	11.36 B	31.90 B	3.11 B
# of Analysts	4	1	13	6	7	3
Dividend Yield	0.00%	0.00%	1.79%	0.00%	3.72%	2.64%
Value Score	D	-	-	D	A	A
Cash/Price	0.29	0.08	0.04	0.01	0.02	0.20
EV/EBITDA	8.97	8.64	13.92	NA	13.12	12.68
PEG Ratio	2.69	1.99	2.12	NA	2.22	0.93
Price/Book (P/B)	1.76	1.71	3.32	NA	3.98	1.82
Price/Cash Flow (P/CF)	12.08	6.37	13.73	NA	12.37	6.37
P/E (F1)	19.30	16.77	19.56	NA	15.54	17.53
Price/Sales (P/S)	0.73	0.59	2.67	NA	1.90	0.82
Earnings Yield	5.17%	5.90%	5.10%	-2.21%	6.43%	5.70%
Debt/Equity	0.70	0.31	0.72	-0.52	1.37	1.30
Cash Flow (\$/share)	2.58	1.28	6.94	NA	4.26	9.99
Growth Score	A	-	-	D	C	A
Hist. EPS Growth (3-5 yrs)	30.26%	4.24%	10.53%	NA	2.82%	NA
Proj. EPS Growth (F1/F0)	0.31%	1.68%	6.30%	NA	5.41%	27.04%
Curr. Cash Flow Growth	-4.06%	-4.06%	14.83%	NA	5.47%	64.31%
Hist. Cash Flow Growth (3-5 yrs)	21.71%	12.05%	9.00%	NA	1.32%	16.24%
Current Ratio	4.69	1.53	1.23	0.56	0.61	1.45
Debt/Capital	41.03%	41.03%	42.99%	NA	57.73%	56.48%
Net Margin	3.89%	-0.32%	11.08%	NA	12.62%	12.32%
Return on Equity	9.26%	7.54%	17.10%	NA	27.33%	7.17%
Sales/Assets	1.18	1.13	0.55	NA	0.55	0.64
Proj. Sales Growth (F1/F0)	1.93%	0.00%	2.86%	NA	2.14%	1.42%
Momentum Score	B	-	-	F	B	F
Daily Price Chg	-0.80%	0.00%	-0.43%	-0.49%	-0.85%	0.03%
1 Week Price Chg	0.48%	0.00%	0.13%	-1.55%	-0.17%	0.22%
4 Week Price Chg	16.23%	0.00%	2.78%	19.56%	-1.38%	1.30%
12 Week Price Chg	6.09%	-9.92%	8.67%	6.62%	-3.23%	31.98%
52 Week Price Chg	-9.55%	-18.01%	27.07%	NA	35.44%	50.72%
20 Day Average Volume	89,883	30,381	1,731,328	3,879,359	3,919,082	469,380
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-10.47%	0.67%	-2.24%
(F1) EPS Est 12 week change	-15.64%	-6.86%	0.14%	-10.47%	0.81%	-6.03%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-22.58%	-5.23%	-12.61%

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	D
Growth Score	A
Momentum Score	B
VGM Score	B

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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