

## Costco Wholesale (COST)

**\$303.00** (As of 04/30/20)

Price Target (6-12 Months): **\$326.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 12/06/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**2-Buy**

Zacks Style Scores:

VGM:A

Value: B

Growth: B

Momentum: C

### Summary

Shares of Costco have risen and outpaced the industry in a year. The company's growth strategies, better price management, sturdy comps performance and strong membership trends reinforce its position. We believe that the company's business model and commitment toward opening membership warehouses will continue to drive traffic. Moreover, with the wave of digital transformation, Costco is rapidly adopting the omni-channel mantra to provide a seamless shopping experience, whether online or in-stores. Such concerted efforts have been favoring comps. Comps grew 9.6%, while sales improved 11.7% in the month of March due to coronavirus-induced panic buying as consumers stock up essential items. However, any higher investments or aggressive pricing strategy may hurt margins. Also, rising SG&A expenses and stiff competition pose concerns.

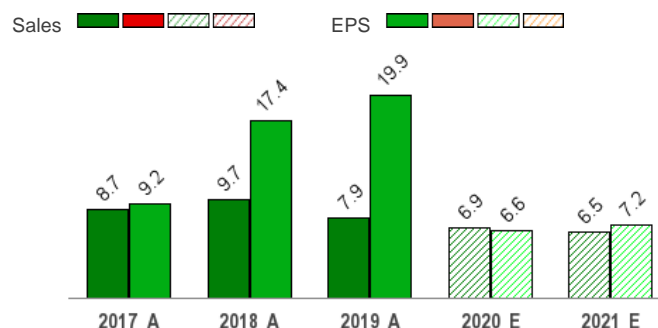
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$325.26 - \$233.05</b>
20 Day Average Volume (sh)	<b>3,343,904</b>
Market Cap	<b>\$135.6 B</b>
YTD Price Change	<b>4.5%</b>
Beta	<b>0.75</b>
Dividend / Div Yld	<b>\$2.80 / 0.8%</b>
Industry	<b>Retail - Discount Stores</b>
Zacks Industry Rank	<b>Bottom 42% (147 out of 253)</b>

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>1.5%</b>
Last Sales Surprise	<b>1.8%</b>
EPS F1 Est- 4 week change	<b>-0.8%</b>
Expected Report Date	<b>06/04/2020</b>
Earnings ESP	<b>-4.5%</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	39,754 E	41,353 E	40,316 E	54,796 E	173,718 E
2020	37,040 A	39,072 A	37,596 E	49,940 E	163,172 E
2019	35,069 A	35,396 A	34,740 A	47,498 A	152,703 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.94 E	\$2.26 E	\$2.20 E	\$3.02 E	\$9.36 E
2020	\$1.73 A	\$2.10 A	\$2.02 E	\$2.77 E	\$8.73 E
2019	\$1.61 A	\$2.01 A	\$1.89 A	\$2.69 A	\$8.19 A

\*Quarterly figures may not add up to annual.

P/E TTM	<b>36.5</b>
P/E F1	<b>34.7</b>
PEG F1	<b>4.1</b>
P/S TTM	<b>0.9</b>

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/30/2020. The reports text is as of 05/01/2020.

## Overview

Based in Issaquah, Washington, Costco Wholesale Corporation sells high volumes of foods and general merchandise (including household products and appliances) at discounted prices through membership warehouses. It is one of the largest warehouse club operators in the United States. The company also operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, Taiwan and Japan.

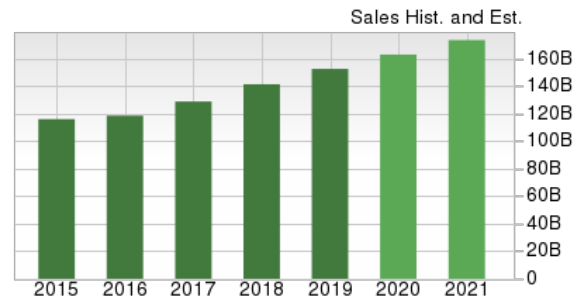
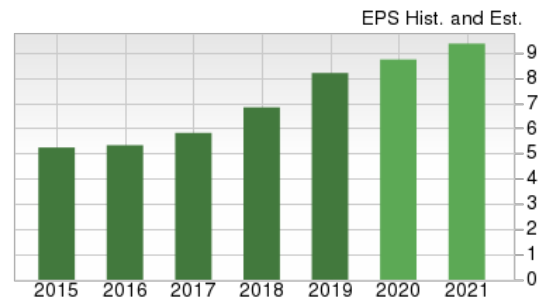
The company's warehouses offer an array of low-priced nationally branded and select private labeled products in a wide range of merchandise categories. Costco offers three types of memberships to its customers: Business, Gold Star (individual), and Executive.

As of April 16, 2020, Costco operates 787 warehouses, comprising 547 in the United States and Puerto Rico, 100 in Canada, 39 in Mexico, 29 in the United Kingdom, 26 in Japan, 16 in Korea, 13 in Taiwan, 12 in Australia, two in Spain, and one each in Iceland, France and China.

Costco generates revenue from two sources: 1) Store sales (Net sales; 97.8% of fiscal 2019 total revenue) and 2) Membership fees (MFI; 2.2% of fiscal 2019 total revenue).

Costco offers myriad varieties of food products as well as a vast range of household and lifestyle products, stationeries and appliances. The company also sells gasoline to customers at cheap prices and offers merchandise in the following categories:

- 1) Food and Sundries (including dry foods, packaged foods, groceries, snack foods, candy, alcoholic and nonalcoholic beverages, and cleaning supplies)
- 2) Hardlines (including major appliances, electronics, health and beauty aids, hardware, and garden and patio)
- 3) Fresh Foods (including meat, produce, deli, and bakery)
- 4) Softlines (including apparel and small appliances)
- 5) Ancillary (including gasoline and pharmacy businesses).



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## Reasons To Buy:

▲ **Impressive Comps Performance Help Lift Stock:** In the evolving retail ecosystem, Costco has been able to create a niche for itself on the back of growth strategies, better price management, strong membership trends and increasing penetration of e-commerce business. Certainly, these helped the company to continue with its decent comparable sales run. Definitely, improving job prospects and rising disposable income have also aided the performance. Investors are encouraged by the company's healthy comparable sales and sales run. Markedly, shares of the company have increased 27.1% in a year compared with the industry's rise of 15.1%. Notably, comparable sales for the month of March rose 9.6% following an increase of 12.1% and 6.6% in February and January, respectively. Meanwhile, net sales improved 11.7%, 13.8% and 8% in the months of March, February and January, respectively. As consumers stock up food and essentials items in the wake of coronavirus outbreak, overall sales shot up in the month of March.

The company's strategy to sell products at heavily discounted prices has helped it to remain on a growth track as cash-strapped customers continue to reckon Costco as a viable option for low-cost necessities.

▲ **A Dominant Warehouse Retailer:** We believe that Costco continues to be one of the dominant retail wholesalers based on the breadth and quality of merchandise offered. The company's strategy to sell products at heavily discounted prices has helped it to remain on a growth track as cash-strapped customers continue to reckon Costco as a viable option for low-cost necessities. In the wake of the fast-spreading coronavirus, the company is witnessing increasing demand for toilet paper, disinfectants, packaged water and related food staples. Costco is employing the Zest Fresh solution to augment its Fresh Food Supply Chain. Zest Fresh lower waste by 50%, increase shelf life of the food and allows the company to offer low prices on fresh food. A differentiated product range enables Costco to provide an upscale shopping experience for its members, resulting in market share gains and higher sales per square foot.

▲ **Increasing E-Commerce Penetration:** The company is also gradually expanding its e-commerce capabilities in the U.S., Canada, the United Kingdom, Mexico, Korea, Taiwan, Japan, and Australia. To drive its online sales, the company launched CostcoGrocery to deliver non-perishable items to buyer's home, and expanded same day grocery delivery service in collaboration with Instacart. These delivery systems have been yielding favorably and driving more traffic. The company has also launched same day prescription Rx delivery and same-day alcohol delivery through Instacart. Costco acquired Innovent Solutions, a leading provider of third-party end-to-end logistics solutions, for a purchase price of \$1 billion from Transform Holdco. The buyout will boost Costco's e-commerce capabilities and facilitate it to sell "big and bulky" items such as appliances, furniture, mattresses, televisions, grills, patio, fitness equipment and wine cellars. We note that e-commerce comparable sales advanced 48.3% during the month of March. Going ahead, the company plans to continue improving online merchandise and discovering ways to further enrich shopping experience.

▲ **Concentrating on Enhancing Global Footprint:** We are also encouraged by Costco's expansion strategy. The company has one of the highest square footage growth in the industry, and remains committed to opening new clubs in the domestic and international markets. In our view, the company's diversification strategy is a natural hedge against risks that may arise in specific markets. The company opened 23, 29, 26, 21 and 25 locations in fiscal 2015, 2016, 2017, 2018 and 2019, respectively. During the first quarter of fiscal 2020, the company had three new openings in the United States — business center in Dallas, Texas and two additional Costco warehouses in Connecticut and Minnesota. There were no new openings during the second quarter. The company has planned two net new openings in the third quarter and 11-13 openings in the fourth quarter.

▲ **Enough Liquidity:** Even with a long-term debt (including operating lease liabilities) of \$7,545 million, as of Feb 16, 2020, Costco looks quite comfortable from liquidity point of view. The company's cash & equivalents (including short term investments) were \$8,715 million at the end of the second quarter of fiscal 2020. Moreover, at the end of the quarter, the company's debt-to-capitalization ratio was a respectable 0.32 compared with 0.56 for its industry. Also, the company's debt-to-capitalization has improved from 0.36 at the end of the preceding quarter. Moreover, the company's times interest earned ratio stands at 33.6 better than the industry's ratio of 30.3. The times-interest-earned ratio is very important for some companies, as it measures a company's ability to meet its debt obligations based on its current income.

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## Reasons To Sell:

- ▼ **Stock Looks Little Stretched:** Considering price-to-earnings (P/E) ratio, Costco looks pretty overvalued when compared with the industry as well as the S&P 500. The stock has a trailing 12-month P/E ratio of 36.52, which is above the median level of 35.57 but below the high level of 38.95 scaled in the past one year. On the contrary, the trailing 12-month P/E ratio for the industry and the S&P 500 is 23.65 and 17.80, respectively.
- ▼ **Stiff Competition:** Costco faces stiff competition from BJ's Wholesale Club and Sam's Club, a division of Wal-Mart Stores. These two rivals follow similar business models as they market high volumes of merchandise at low prices in a membership-only warehouse clubs. Sam's Club, in particular, poses the biggest threat to Costco as both primarily target professionals and small-business owners who typically make bulk purchases. Analysts pointed that any incremental investments or aggressive pricing strategy may hurt margins.
- ▼ **Rising SG&A Expenses May Strain Margins:** We note that SG&A expenses and merchandise costs increased 8.1% and 10.9%, respectively, during the second quarter of fiscal 2020, following an increase of 7.4% and 5.3% in the preceding quarter. In the first, second, third and fourth quarters of fiscal 2019, SG&A expenses rose 7.8%, 7.1%, 6.8% and 9.9%, while merchandise costs rose 10.9%, 6.9%, 7.5% and 6.8%, respectively.
- ▼ **Macroeconomic Headwinds:** The company's customers are very sensitive to macroeconomic factors including interest rate hikes, increase in fuel and energy costs, sluggishness in the housing market, unemployment levels, and high household debt levels, which may affect their spending levels. Moreover, due to exposure to international markets, Costco remains prone to currency fluctuations.

Stiff competition from both brick-and-mortar stores and online retailers and cautious consumer spending may hurt Costco's performance. Moreover, it remains prone to currency fluctuations.

## Last Earnings Report

### Costco's Q2 Earnings Surpass Estimates, Increase Y/Y

Costco Wholesale Corporation posted fifth straight quarter of positive earnings surprise, when it reported second-quarter fiscal 2020 results. Total revenues also surpassed the Zacks Consensus Estimate, after missing the same in the preceding quarter. Notably, both the top and the bottom line continued to register year-over-year improvement. The company also delivered decent comparable sales growth across all regions.

With Thanksgiving happening a week later this year compared with the prior year, second-quarter total and comparable sales were favorably impacted by roughly 0.5%. Moreover, management highlighted that e-commerce sales were positively impacted by an estimated 11 percentage points.

Quite apparent, Costco's better price management and strong membership trends have been playing a crucial role in driving comparable sales.

### Q2 Earnings & Sales Picture

The company reported earnings of \$2.10 per share. The quarterly earnings not only came ahead of the Zacks Consensus Estimate of \$2.07 but also improved 4.5% from the year-ago quarter figure.

Total revenues, which include net sales and membership fee, came in at \$39,072 million, up 10.4% from the prior-year quarter. The figure also beat the Zacks Consensus Estimate of \$38,366 million.

In the reported quarter, the company's e-commerce comparable sales rose 28.4% year over year. Excluding the effect of gasoline prices and foreign exchange, the same exhibited an improvement of 28% year over year.

With the prevailing trend of digital transformation in the sector, retailers are rapidly adopting the omni-channel mantra to provide a seamless shopping experience online and in stores. Costco operates e-commerce sites in the United States, Canada, the U.K., Mexico, Korea, Taiwan, Japan and Australia.

### Delving Deeper

Costco's net sales grew 10.5% to \$38,256 million, while membership fee increased 6.3% to \$816 million. Comparable sales for the reported quarter improved 8.9%, reflecting an increase of 9.1%, 8.9% and 7.9% in the United States, Canada and Other International locations, respectively.

Excluding the impact of foreign currency fluctuations and gasoline prices, the company witnessed comparable sales growth of 7.9% during the quarter. Notably, the United States, Canada and Other International locations registered comparable sales growth of 8.1%, 6.8% and 7.1%, respectively.

Traffic or shopping frequency rose 5.9% globally and 6.1% in the United States. Average transaction improved 2.9% on a year-over-year basis.

The company witnessed comparable sales growth of 12.1% for the month of February. Further, net sales rose 13.8% year over year to \$12.20 billion. E-commerce comparable sales surged 22.6% in the month under review.

Operating income in the quarter increased 5.2% year over year to \$1,266 million, while operating margin (as a percentage of total revenues) shrunk 20 bps to 3.2%.

### Store Update

Costco operates 786 warehouses, comprising 547 in the United States and Puerto Rico, 100 in Canada, 39 in Mexico, 29 in the United Kingdom, 26 in Japan, 16 in Korea, 13 in Taiwan, 11 in Australia, two in Spain, and one each in Iceland, France and China. There were no new openings during the second quarter. The company has planned two net new openings in the third quarter and 11-13 openings in the fourth quarter.

### Financial Aspects

Costco ended the reported quarter with cash and cash equivalents of \$7,786 million and long-term debt (excluding current portion) of \$5,099 million. The company's shareholders' equity was \$16,614 million, excluding non-controlling interests of \$385 million.

Management incurred capital expenditures of \$545 million during the quarter under review, and plans to spend approximately \$3 billion during the fiscal year.

Quarter Ending **02/2020**

Report Date	Mar 05, 2020
Sales Surprise	1.84%
EPS Surprise	1.45%
Quarterly EPS	2.10
Annual EPS (TTM)	8.41

## Recent News

### Costco Announces \$4 Billion Debt Offering – April 16, 2020

Costco announced the pricing of its offering of \$4 billion aggregate principal amount of senior unsecured notes. The notes consist of the following tranches \$1.25 billion principal amount of 1.375% notes due June 20, 2027; \$1.75 billion principal amount of 1.6% notes due April 20, 2030 and \$1 billion principal amount of 1.75 % notes due April 20, 2032. The company intends to utilize the proceeds to repay senior notes and for general corporate purposes.

### Costco Hikes Dividend – April 15, 2020

Costco announced an increase in its quarterly dividend. The company's board of directors raised the dividend by 7.7% to 70 cents a share, which is payable on May 15, 2020.

### Costco's March Comps Rise – April 8, 2020

Costco's overall sales shot up in the month of March. Comparable sales for the month of March — the five weeks ended April 5, 2020 — rose 9.6%. Notably, comps for March reflect an increase of 10.7% in the United States, 1.2% in Canada and 12.2% in Other International locations, respectively. Meanwhile net sales improved 11.7% to \$15.49 billion during the month under review, following a rise of 13.8% and 8% in February and January, respectively. We note that the company's e-commerce comparable sales surged 48.3% in the month of March.

## Valuation

Costco shares are up 4.4% in the year-to-date period and nearly 27.1% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 7% but the Zacks Retail-Wholesale sector is up 0.3% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 15.1% and 5.9%, respectively.

The S&P 500 index is down 11.4% in the year-to-date period and 2.5% in the past year.

The stock is currently trading at 33.58X forward 12-month earnings, which compares to 25.62X for the Zacks sub-industry, 28.26X for the Zacks sector and 20.17X for the S&P 500 index.

Over the past five years, the stock has traded as high as 36.89X and as low as 23.46X, with a 5-year median of 27.31X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$326 price target reflects 35.59X forward 12-month earnings.

The table below shows summary valuation data for COST

Valuation Multiples - COST					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	33.58	25.62	28.26	20.17
	5-Year High	36.89	25.62	28.26	20.17
	5-Year Low	23.46	17.95	19.06	15.19
	5-Year Median	27.31	20.07	23.16	17.45
P/S F12M	Current	0.8	1.34	1.01	3.21
	5-Year High	0.86	1.39	1.11	3.44
	5-Year Low	0.46	0.94	0.8	2.54
	5-Year Median	0.57	1.12	0.93	3.01
EV/EBITDA TTM	Current	21.6	17.85	15.41	10.45
	5-Year High	23.01	19.86	16.31	12.87
	5-Year Low	12.44	10.91	10.9	8.27
	5-Year Median	14.99	13.54	12.55	10.78

As of 04/29/2020

## Industry Analysis Zacks Industry Rank: Bottom 42% (147 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
Amazon.com, Inc. (AMZN)	Neutral	3
Burlington Stores, Inc. (BURL)	Neutral	4
Dollar General Corporation (DG)	Neutral	2
Dollar Tree, Inc. (DLTR)	Neutral	3
Target Corporation (TGT)	Neutral	3
Tuesday Morning Corp. (TUES)	Neutral	3
Walmart Inc. (WMT)	Neutral	2
Big Lots, Inc. (BIG)	Underperform	3

Industry Comparison Industry: Retail - Discount Stores				Industry Peers		
	COST	X Industry	S&P 500	DG	DLTR	TGT
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	2	-	-	2	3	3
VGM Score	A	-	-	A	A	A
Market Cap	135.60 B	16.02 B	20.82 B	43.96 B	19.15 B	56.03 B
# of Analysts	10	8	14	23	10	12
Dividend Yield	0.85%	0.84%	2.07%	0.82%	0.00%	2.36%
Value Score	B	-	-	B	B	B
Cash/Price	0.06	0.05	0.06	0.01	0.03	0.05
EV/EBITDA	20.98	13.71	12.12	19.40	12.18	9.22
PEG Ratio	4.14	2.72	2.51	1.92	1.57	2.61
Price/Book (P/B)	7.98	4.80	2.74	6.57	3.06	4.80
Price/Cash Flow (P/CF)	26.37	14.52	11.23	19.65	9.11	9.63
P/E (F1)	34.71	26.32	19.26	23.42	16.83	20.51
Price/Sales (P/S)	0.86	0.81	2.16	1.58	0.81	0.72
Earnings Yield	2.84%	3.42%	5.03%	4.27%	5.94%	4.88%
Debt/Equity	0.44	1.46	0.72	1.60	1.36	1.15
Cash Flow (\$/share)	11.64	6.38	7.01	8.90	8.87	11.64
Growth Score	B	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	12.09%	12.09%	10.88%	13.67%	18.69%	7.09%
Proj. EPS Growth (F1/F0)	6.54%	-22.32%	-6.94%	10.88%	0.92%	-14.48%
Curr. Cash Flow Growth	14.92%	9.68%	5.92%	9.68%	-55.39%	10.26%
Hist. Cash Flow Growth (3-5 yrs)	10.65%	8.54%	8.55%	9.69%	19.78%	3.95%
Current Ratio	1.04	1.19	1.23	1.14	1.20	0.89
Debt/Capital	30.74%	59.24%	43.90%	61.55%	57.61%	53.50%
Net Margin	2.39%	4.38%	11.15%	6.17%	3.50%	4.20%
Return on Equity	23.41%	24.73%	16.47%	26.04%	19.71%	28.46%
Sales/Assets	3.34	1.76	0.54	1.25	1.21	1.85
Proj. Sales Growth (F1/F0)	6.86%	0.72%	-1.52%	8.92%	4.34%	4.18%
Momentum Score	C	-	-	A	D	F
Daily Price Chg	0.70%	2.08%	2.91%	-2.03%	0.09%	0.09%
1 Week Price Chg	-2.32%	-4.69%	-1.74%	-3.37%	-8.80%	-4.94%
4 Week Price Chg	7.08%	23.35%	21.33%	14.13%	10.86%	17.67%
12 Week Price Chg	-0.60%	-13.46%	-16.28%	11.15%	-8.85%	-2.97%
52 Week Price Chg	27.11%	-1.61%	-7.57%	41.17%	-26.26%	48.14%
20 Day Average Volume	3,343,904	2,237,269	2,658,107	2,475,245	2,451,465	5,835,374
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.02%	0.00%	-16.63%
(F1) EPS Est 4 week change	-0.76%	-4.57%	-6.32%	0.45%	-4.57%	-17.05%
(F1) EPS Est 12 week change	1.38%	-27.16%	-12.93%	0.52%	-8.15%	-20.03%
(Q1) EPS Est Mthly Chg	-2.92%	-11.90%	-11.84%	2.40%	-11.90%	-41.06%



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## 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.

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### 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>B</b>
Growth Score	<b>B</b>
Momentum Score	<b>C</b>
VGM Score	<b>B</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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### Disclosures

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