

Illinois Tool Works (ITW)

\$167.51 (As of 04/29/20)

Price Target (6-12 Months): **\$176.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/27/18)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: D

Growth: A

Momentum: D

Summary

In the past month, Illinois Tool's shares have outperformed the industry. The company is poised to gain from a diversified business structure, enterprise initiatives and the policy of rewarding shareholders handsomely. For 2020, the company expects operating margin to benefit from a 100-basis point contribution from enterprise initiatives. It is likely to buy back shares worth \$2 billion during the year. Total revenues are anticipated within \$13.8-14.1 billion, suggesting a decline of 2% to flat year over year. Divestitures and product line simplification (PLS) initiatives will likely have adverse impacts of 1% and 0.5% on sales, respectively. Forex woes will likely hurt sales by 1%. Worryingly, the company faces risks from high debts. In the past 60 days, earnings estimates for both 2020 and 2021 have been revised downward.

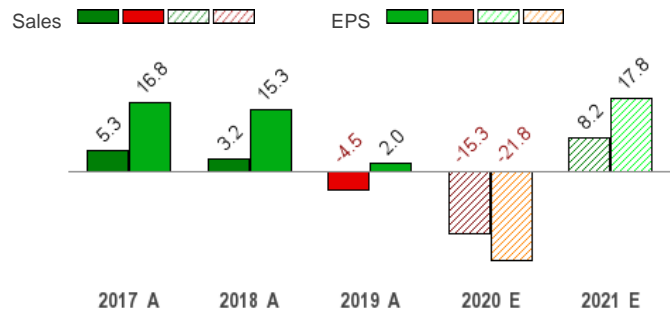
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|--|
| 52 Week High-Low | \$190.85 - \$115.94 |
| 20 Day Average Volume (sh) | 1,397,809 |
| Market Cap | \$53.2 B |
| YTD Price Change | -6.8% |
| Beta | 1.17 |
| Dividend / Div Yld | \$4.28 / 2.6% |
| Industry | Manufacturing - General Industrial |
| Zacks Industry Rank | Bottom 17% (209 out of 253) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|------------|
| Last EPS Surprise | 1.6% |
| Last Sales Surprise | 0.6% |
| EPS F1 Est- 4 week change | -14.2% |
| Expected Report Date | 05/05/2020 |
| Earnings ESP | -0.9% |
| P/E TTM | 21.7 |
| P/E F1 | 27.6 |
| PEG F1 | 3.6 |
| P/S TTM | 3.8 |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|---------|---------|---------|---------|----------|
| 2021 | 3,323 E | 3,188 E | 3,234 E | 3,438 E | 12,934 E |
| 2020 | 3,334 E | 2,648 E | 2,817 E | 3,164 E | 11,955 E |
| 2019 | 3,552 A | 3,609 A | 3,479 A | 3,469 A | 14,109 A |

EPS Estimates

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|----------|----------|----------|----------|----------|
| 2021 | \$1.74 E | \$1.79 E | \$1.84 E | \$1.95 E | \$7.14 E |
| 2020 | \$1.71 E | \$1.18 E | \$1.45 E | \$1.62 E | \$6.06 E |
| 2019 | \$1.81 A | \$2.00 A | \$2.04 A | \$1.88 A | \$7.75 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 04/29/2020. The reports text is as of 04/30/2020.

Overview

Headquartered in Glenview, IL, Illinois Tool Works Inc. is a worldwide manufacturer of highly engineered products and specialty systems. The company's diversified range of industrial products and equipment are sold in 55 countries. The company operates through seven operating business segments. A brief discussion is given below:

Test & Measurement and Electronics (15% of 2019 total segmental revenues): This segment deals with the production of equipment, consumables and related software for testing and measuring materials and structures, and equipment and consumables used in the production of electronic subassemblies and microelectronics. Products are mainly used in automotive original equipment manufacturers and tiers, general industrial, consumer durables and other markets.

Automotive OEM (21.7%): This segment produces fasteners and components for automotive-related applications. Products are mainly used by original equipment manufacturers in the automotive industry.

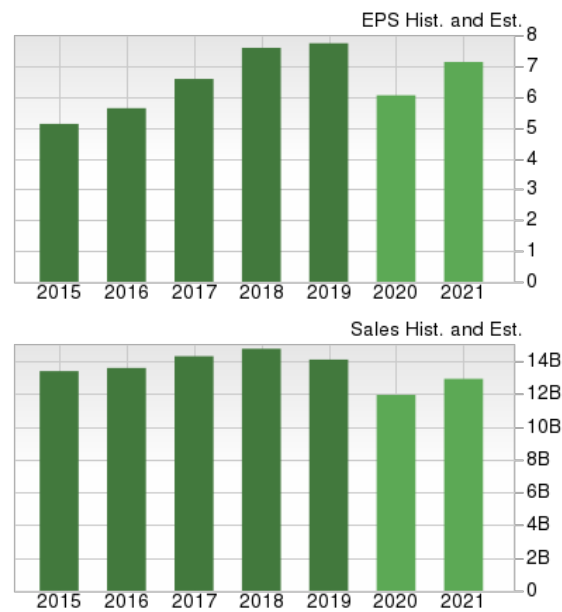
Polymers & Fluids (11.8%): This segment produces lubrication and cutting fluids, sealants, janitorial and hygiene products, adhesives, and fluids and polymers. It serves customers in general industrial, automotive aftermarket and other markets.

Food Equipment (15.5%): This segment is responsible for production and offering of commercial food equipment and related services. Customers mainly belong to restaurant, food retail and food service markets.

Welding (11.6%): This segment manufactures arc welding equipment, consumables and accessories. Products are mainly used in general industrial, fabrication, energy, construction, industrial capital goods, and other markets.

Construction Products (11.5%): This segment produces construction-fastening systems and truss products for commercial construction, residential construction and renovation markets.

Specialty Products (12.9%): This segment produces product coding and marking equipment and consumables, beverage packaging equipment and consumables, and appliance components and fasteners.



Reasons To Buy:

▲ In the past month, Illinois Tool's shares have increased 17.8% compared with the industry's growth of 14.9%. In the fourth quarter of 2019, the company's earnings surpassed estimates by 1.62%. On a year-over-year basis, the bottom line also improved 2.7% from the year-ago figure, mainly owing to margin improvement and a 2.6% fall in share count. Notably, enterprise initiatives contributed 130 bps to the operating margin in the fourth quarter. Notably, the company introduced the Enterprise Strategy including Business Structure Simplification, Portfolio Management and Strategic Sourcing in 2012. Business Structure Simplification and Portfolio Management strategies strengthened the company's organic sales while Strategic Sourcing helped manage costs and improved margins. For 2020, Illinois Tool anticipates continued benefits from these measures, aiding the operating margin by 100 bps. The company predicts operating margin of 24.5-25%.

▲ Illinois Tool remains committed to rewarding its shareholders substantially through dividend payments and share buybacks. In the fourth quarter, it repurchased shares worth \$375 million and paid out dividends of \$1.07 per share to its stockholders. For 2019, the company returned funds worth \$2.8 billion to its shareholders including share buybacks of \$1.5 billion. Quarterly dividend rate was hiked 7% in August 2019. For 2020, the company anticipates buying back roughly \$2 billion shares including \$500 million of repurchase for offsetting the dilutive impact of divestitures completed in 2019.

▲ Illinois Tool operates 87 business divisions under seven reportable segments. Of the total, the company believes that seven divisions are long-term growth challenged and hence, it is intending to divest those. It believes that the potential divestitures of these divisions, as and when completed, will boost organic sales growth by 50 bps and add 100 bps to operating margin. Impact on earnings is predicted to be neutral. In 2020, the company plans to sell off businesses with revenues totalling \$1 billion. In addition, the company set long-term targets, which reflect strength of its unique business model, non-imitable diversified business portfolio and highly skilled management team. Between 2019 and 2023, the company anticipates achieving organic revenue growth of 3-5%. Operating margin is predicted to be roughly 28% and earnings per share are likely to rise 7-10%. Further, after-tax return on invested capital is projected to be approximately 40%. Free cash flow will likely be more than 100% of net income. Dividend payout ratio is expected to be roughly 50%.

Benefits of enterprise policies, rewards to shareholders in forms of dividends and share buybacks, and a diversified business portfolio will likely work in Illinois Tool's favor, going forward.

Reasons To Sell:

- ▼ On a P/E (TTM) basis, Illinois Tool's shares currently seem to be overvalued compared with the industry, with respective tallies of 21.67x and 19.48x. The company's earnings estimates have been lowered in the past 60 days, reflecting bearish sentiments for the stock. Earnings estimates for 2020 and 2021 are pegged at \$6.06 and \$7.14, suggesting decline of 23.1% and 14.9%, respectively. This gives investors reasons to be cautious about the stock.
- ▼ In the fourth quarter of 2019, the company's revenues declined 3.1% year over year. Organically, sales declined 1.6% year over year due to soft demand in the quarter. Notably, the company's organic performance in the Automotive OEM segment was adversely impacted by strike at General Motors. In addition, organic performance was weak in Welding, Polymers & Fluids, Construction Products and Specialty Products segments. Also, PLS initiatives had 0.6% adverse impact on the quarter's organic sales. For 2020, the company expects total revenues to be \$13.8-14.1 billion, suggesting a decline of 2% to flat from \$14.1 billion reported in 2019. Divestitures and PLS initiatives will have adverse impacts of 1% and 0.5%, respectively.
- ▼ The company generates a substantial portion of revenues from international operations. Although international businesses provide geographical diversity, these expose it to unfavorable movements in foreign currencies and geopolitical issues. Also, higher contribution from international operations is detrimental to operating margin expansion as foreign sales usually carry lower margins compared with domestic sales. In fourth-quarter 2019, impact of negative foreign exchange lowered sales by 1%. Also, international business in the quarter was down 1% year over year while that North America declined 2%. For 2020, forex woes are predicted to adversely influence revenues growth by 1% and earnings by 10 cents per share. In addition, a highly leveraged balance sheet can inflate Illinois Tool's financial obligations and subsequently hurt profitability. In five years (2015-2019), the company's long-term debt increased 2.4% (CAGR). Long-term debt balance at the end of the fourth quarter of 2019 was \$7,754 million, reflecting an increase of 28.6% from the 2018 level. Also, the company seems to be more leveraged than the industry. The stock's long-term debt-to-capital is 71.9%, higher than the industry's 50.9%.

Weak revenues, forex woes and high debts might dampen Illinois Tool's profitability in the upcoming quarters.

Last Earnings Report

Illinois Tool Q4 Earnings and Sales Beat Estimates

Illinois Tool delivered better-than-expected results for fourth-quarter 2019 with a positive earnings surprise of 1.62%.

The industrial tool maker's adjusted earnings in the reported quarter were \$1.88 per share, surpassing the Zacks Consensus Estimate of \$1.85. The results excluded 11-cents gain from divestitures.

Also, the bottom line increased 2.7% year over year, driven by margin improvement and a 2.6% fall in share count. However, forex woes and higher restructuring charges had an adverse impact of 6 cents.

For 2019, the company's adjusted earnings (excluding divestitures gains of 9 cents) were \$7.65 per share, increasing 0.7% from the year-ago figure. Also, the results surpassed the Zacks Consensus Estimate of \$7.61.

Segmental Revenues

Illinois Tool generated revenues of \$3,469 million in the reported quarter, reflecting a decline of 3.1% from the year-ago figure. Top-line results were affected by a 1% impact of unfavorable foreign currency movement, 0.5% from divestitures, and a 1.6% drop in organic sales.

Notably, PLS initiatives had an adverse 0.6% impact on organic sales, and General Motors Company strike had a negative impact of 0.5%.

However, the top line surpassed the Zacks Consensus Estimate of \$3,447 million by 0.6%.

Illinois Tool reports revenues under the segments discussed below:

Test & Measurement and Electronics' revenues in the fourth quarter increased 2.6% year over year to \$552 million. Revenues from **Automotive OEM** declined 6.7% to \$725 million. **Food Equipment** generated revenues of \$571 million, increasing 0.7% year over year.

Welding revenues were \$387 million, declining 6.5% year over year. **Construction Products'** revenues were down 3.3% to \$384 million. Further, revenues of \$446 million from **Specialty Products** reflect a decline of 4.6%. **Polymers & Fluids'** revenues of \$408 million declined 3.3% year over year.

For 2019, the company's revenues were \$14.1 billion, reflecting a 4.5% decline from the previous year.

Margin Profile

In the reported quarter, Illinois Tool's cost of sales declined 3.5% year over year to \$2,022 million. It represented 58.3% of the quarter's revenues versus 58.6% in the year-ago quarter. Selling, administrative, and research and development expenses grew 1.4% year over year to \$586 million. It represented 16.9% of the fourth quarter's revenues.

Excluding restructuring charges, operating margin was 24.1%, up 10 basis points (bps) year over year. Enterprise initiatives contributed 130 bps to operating margin and price/costs had a positive impact of 30 bps. Interest expenses in the quarter declined 19% year over year to \$51 million.

Balance Sheet and Cash Flow

Exiting the fourth quarter, Illinois Tool had cash and cash equivalents of \$1,981 million, up 8.5% from \$1,825 million recorded at the end of the last reported quarter. Long-term debt increased 1.5% sequentially to \$7,754 million.

In the fourth quarter, the company generated net cash of \$774 million from operating activities, reflecting a decline of 4.3% from the year-ago quarter. Capital spending on the purchase of plant and equipment was \$82 million, same as the previous-year quarter. Free cash flow was \$692 million, reflecting a year-over-year decrease of 4.8%.

In the fourth quarter of 2019, the company bought back \$375 million worth of common shares. Moreover, its rewards to shareholders amounted to \$2.8 billion in 2019, including share buybacks of \$1.5 billion.

Outlook

For 2020, Illinois Tool projects GAAP earnings of \$7.65-\$8.05 per share.

The company anticipates organic revenues to be flat to up 2% in the year. Forex woes will likely have a 1% adverse impact on revenue growth and divestitures will have similar impacts too. PLS initiatives will likely have an adverse impact of 0.5%.

Total revenues will likely be \$13.8-14.1 billion, suggesting a decline of 2% to flat from \$14.1 billion reported in 2019.

The company expects operating margin of 24.5-25%. The results will likely gain from roughly 100 bps of contributions from enterprise initiatives. Effective tax rate will likely be 23.5-24.5%.

Free cash flow will likely be more than 100% of net income. The company is likely to buy back shares worth \$2 billion in the year.

Quarter Ending 12/2019

| Report Date | Jan 31, 2020 |
|------------------|--------------|
| Sales Surprise | 0.63% |
| EPS Surprise | 1.62% |
| Quarterly EPS | 1.88 |
| Annual EPS (TTM) | 7.73 |

Recent News

Dividend

On **Apr 15, 2020**, Illinois Tool paid a quarterly cash dividend of \$1.07 per share to shareholders of record as of Mar 31.

Valuation

Illinois Tool's shares are down 6.7% and up 8.5% in the year-to-date and the trailing 12-month periods, respectively. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are down 14.9% and 17.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 9% and 15.1%, respectively.

The S&P 500 index has declined 8.8% year to date and grew 0.2% in the past year.

The stock is currently trading at 26.11x forward 12-month earnings per share, which compares to 23.67x for the Zacks sub-industry, 18.57x for the Zacks sector and 20.81x for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.11x and as low as 14.63x, with a 5-year median of 18.78x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$176 price target reflects 27.42x forward 12-month earnings per share.

The table below shows summary valuation data for ITW.

| Valuation Multiples - ITW | | | | | |
|---------------------------|---------------|-------|--------------|--------|---------|
| | | Stock | Sub-Industry | Sector | S&P 500 |
| P/E F12M | Current | 26.11 | 23.67 | 18.57 | 20.81 |
| | 5-Year High | 26.11 | 23.67 | 19.93 | 20.81 |
| | 5-Year Low | 14.63 | 15.6 | 12.55 | 15.19 |
| | 5-Year Median | 18.78 | 19.44 | 16.65 | 17.45 |
| EV/EBITDA F12M | Current | 17.8 | 10.72 | 13.52 | 10.96 |
| | 5-Year High | 17.88 | 14.04 | 18.17 | 14.17 |
| | 5-Year Low | 9.56 | 8.2 | 10.58 | 9.07 |
| | 5-Year Median | 12.86 | 11.08 | 14.08 | 10.85 |
| EV/Sales F12M | Current | 4.56 | 2.41 | 2.31 | 2.59 |
| | 5-Year High | 4.74 | 3.28 | 3.12 | 3.52 |
| | 5-Year Low | 2.51 | 1.81 | 1.76 | 2.3 |
| | 5-Year Median | 3.57 | 2.59 | 2.29 | 2.81 |

As of 04/29/2020

Industry Analysis Zacks Industry Rank: Bottom 17% (209 out of 253)



Top Peers

| Company (Ticker) | Rec | Rank |
|---|--------------|------|
| Colfax Corporation (CFX) | Neutral | 4 |
| Dover Corporation (DOV) | Neutral | 4 |
| Eaton Corporation, PLC (ETN) | Neutral | 4 |
| General Electric Company (GE) | Neutral | 3 |
| Lincoln Electric Holdings, Inc. (LECO) | Neutral | 4 |
| The Middleby Corporation (MIDD) | Neutral | 3 |
| Parker-Hannifin Corporation (PH) | Neutral | 4 |
| Applied Industrial Technologies, Inc. (AIT) | Underperform | 4 |

| Industry Comparison Industry: Manufacturing - General Industrial | | | | Industry Peers | | |
|--|-----------|------------|-----------|----------------|-----------|-------------|
| | ITW | X Industry | S&P 500 | AIT | DOV | GE |
| Zacks Recommendation (Long Term) | Neutral | - | - | Underperform | Neutral | Neutral |
| Zacks Rank (Short Term) | 3 | - | - | 4 | 4 | 3 |
| VGM Score | C | - | - | A | F | B |
| Market Cap | 53.19 B | 1.14 B | 20.82 B | 2.19 B | 13.86 B | 57.52 B |
| # of Analysts | 10 | 2 | 14 | 2 | 7 | 8 |
| Dividend Yield | 2.56% | 0.00% | 2.07% | 2.26% | 2.04% | 0.61% |
| Value Score | D | - | - | A | D | A |
| Cash/Price | 0.04 | 0.08 | 0.06 | 0.07 | 0.04 | 1.55 |
| EV/EBITDA | 14.98 | 10.64 | 12.12 | 8.86 | 13.15 | 3.91 |
| PEG Ratio | 3.50 | 2.38 | 2.51 | NA | 1.79 | 3.39 |
| Price/Book (P/B) | 17.77 | 1.68 | 2.74 | 2.28 | 4.65 | 1.92 |
| Price/Cash Flow (P/CF) | 18.25 | 9.60 | 11.23 | 8.13 | 12.23 | 5.10 |
| P/E (F1) | 26.92 | 20.59 | 19.26 | 15.86 | 20.59 | 19.50 |
| Price/Sales (P/S) | 3.77 | 1.06 | 2.16 | 0.63 | 1.96 | 0.58 |
| Earnings Yield | 3.62% | 4.63% | 5.03% | 6.31% | 4.86% | 5.17% |
| Debt/Equity | 2.56 | 0.50 | 0.72 | 0.91 | 0.99 | 2.36 |
| Cash Flow (\$/share) | 9.18 | 2.74 | 7.01 | 6.96 | 7.88 | 1.29 |
| Growth Score | A | - | - | B | D | D |
| Hist. EPS Growth (3-5 yrs) | 11.96% | 8.17% | 10.88% | 13.61% | 14.55% | -20.84% |
| Proj. EPS Growth (F1/F0) | -21.82% | -20.53% | -6.94% | -19.05% | -21.13% | -48.08% |
| Curr. Cash Flow Growth | -2.44% | 1.78% | 5.92% | 35.35% | 10.20% | -8.00% |
| Hist. Cash Flow Growth (3-5 yrs) | 4.24% | 4.95% | 8.55% | 13.96% | 1.28% | -12.27% |
| Current Ratio | 2.90 | 2.04 | 1.23 | 2.72 | 1.29 | 1.70 |
| Debt/Capital | 71.90% | 33.54% | 43.90% | 47.61% | 49.85% | 70.19% |
| Net Margin | 17.87% | 6.43% | 11.15% | 3.85% | 10.59% | -2.39% |
| Return on Equity | 81.83% | 10.81% | 16.47% | 17.79% | 29.80% | 13.52% |
| Sales/Assets | 0.93 | 0.77 | 0.54 | 1.46 | 0.81 | 0.35 |
| Proj. Sales Growth (F1/F0) | -15.27% | -6.97% | -1.52% | -5.41% | -10.52% | -18.58% |
| Momentum Score | D | - | - | A | F | B |
| Daily Price Chg | 0.62% | 3.58% | 2.91% | 8.20% | 1.48% | -3.24% |
| 1 Week Price Chg | -0.22% | 0.00% | -1.74% | 2.64% | 2.80% | -8.48% |
| 4 Week Price Chg | 22.03% | 17.65% | 21.33% | 30.85% | 20.42% | -6.53% |
| 12 Week Price Chg | -9.82% | -21.56% | -16.28% | -17.04% | -19.21% | -48.83% |
| 52 Week Price Chg | 8.53% | -27.95% | -7.57% | -4.76% | -1.05% | -34.85% |
| 20 Day Average Volume | 1,397,809 | 72,908 | 2,658,107 | 211,538 | 1,077,691 | 112,354,640 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | 0.00% | -0.66% | 0.00% |
| (F1) EPS Est 4 week change | -14.24% | -14.24% | -6.32% | 0.00% | -19.02% | -22.86% |
| (F1) EPS Est 12 week change | -23.36% | -25.66% | -12.93% | -16.98% | -25.10% | -45.57% |
| (Q1) EPS Est Mthly Chg | -28.74% | -26.57% | -11.84% | 0.00% | -40.43% | -44.12% |

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 | D |
| VGM Score | C |

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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