

The Kroger Co.(KR)

\$34.15 (As of 07/20/20)

Price Target (6-12 Months): **\$39.00**

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 06/16/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: B

Summary

Shares of Kroger have risen and outpaced the industry in the past six months. The company has been benefiting from coronavirus-induced demand, as evident from first-quarter fiscal 2020 results, wherein both top and bottom lines not only beat the Zacks Consensus Estimate but also improved significantly from the prior-year period. Notably, this was the second straight quarter of positive earnings surprise. Kroger, which operates in the thin-margin grocery industry, has been making every effort to strengthen position not only with respect to products but also in terms of the way consumers prefer shopping grocery. Notably, the company's "Restock Kroger" program involving investments in omni-channel platform, identifying margin-rich alternative profit streams, merchandise optimization, and lowering of expenses has been gaining traction.

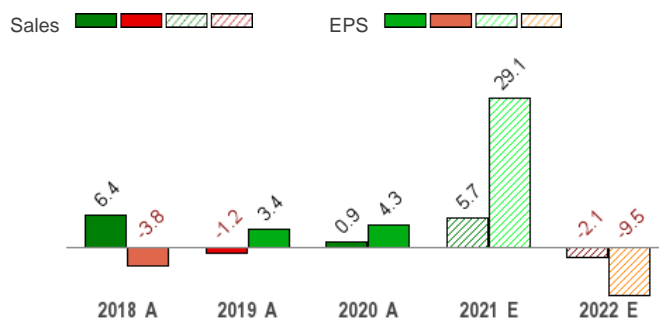
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$36.84 - \$20.70
20 Day Average Volume (sh)	9,773,605
Market Cap	\$26.6 B
YTD Price Change	17.8%
Beta	0.38
Dividend / Div Yld	\$0.72 / 1.9%
Industry	Retail - Supermarkets
Zacks Industry Rank	Top 28% (71 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	8.9%
Last Sales Surprise	1.5%
EPS F1 Est- 4 week change	4.7%
Expected Report Date	09/10/2020
Earnings ESP	7.2%
P/E TTM	12.7
P/E F1	12.0
PEG F1	1.6
P/S TTM	0.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	36,613 E	28,243 E	28,322 E	29,311 E	126,549 E
2021	41,549 A	29,663 E	28,473 E	29,574 E	129,222 E
2020	37,251 A	28,168 A	27,974 A	28,893 A	122,286 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.84 E	\$0.52 E	\$0.60 E	\$0.66 E	\$2.57 E
2021	\$1.22 A	\$0.50 E	\$0.54 E	\$0.59 E	\$2.84 E
2020	\$0.72 A	\$0.44 A	\$0.47 A	\$0.57 A	\$2.20 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 07/20/2020. The reports text is as of 07/21/2020.

Overview

The Kroger Co. (KR), which operates in the thin-margin grocery industry, has been undergoing a complete makeover, not only with respect to products but also in terms of the way consumers prefer shopping grocery. The company is launching plant-based products as well as eyeing technological expansion. It acquired meal kit company Home Chef and partnered with British online grocery delivery firm Ocado that reinforces its position in the online ordering, automated fulfillment and home delivery space. It has also introduced grocery delivery service Kroger Ship and inked a deal with driverless car company Nuro.

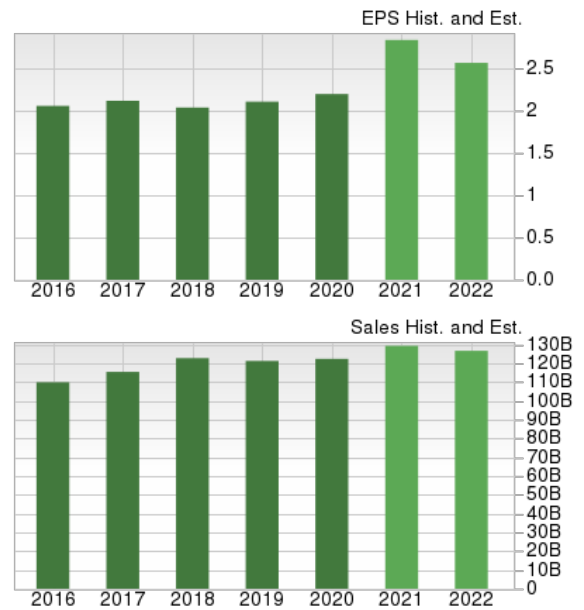
The Cincinnati, Ohio-based company operates 2,764 retail food stores under banners including Kroger, City Market, Dillons, Food 4 Less, Fred Meyer, Fry's, Harris Teeter, Jay C, King Soopers, Mariano's, Pick 'n Save, QFC, Ralphs and Smith's. Out of these, 2,270 are pharmacies and 1,537 are fuel centers. Further, it also manufactures and processes certain food products that are sold in its supermarkets.

Kroger's supermarket and multi-department stores operate under four formats combo stores (combination of food and drug stores), multi-department stores, marketplace stores, and price impact warehouses. The combo stores include natural food and organic sections, pharmacies, general merchandise, and pet centers, as well as offer perishables items such as fresh seafood and organic produce.

The multi-department stores offer a collection of general merchandise products such as apparel, home fashion and furnishings, electronics, automotive products, toys, and fine jewelry. The marketplace stores include full-service grocery and pharmacy departments and a general merchandise area that includes outdoor living products, electronics, home goods, and toys.

The combo stores, multi department stores, and marketplace stores also have fuel centers. The price impact warehouse offers grocery, health, and beauty care items.

Additionally, the company operates 37 food production plants, mainly bakeries and dairies. These supply roughly 32% of Our Brands units and 43% of the grocery category Our Brands units sold in its supermarkets; the remaining Our Brands items are produced by other manufacturers.



Reasons To Buy:

- ▲ **Impressive Q1 Performance:** Kroger came up with first-quarter fiscal 2020 results, wherein both top and bottom lines not only beat the Zacks Consensus Estimate but also improved significantly from the prior-year period. Notably, this was the second straight quarter of positive earnings surprise. Driven largely by coronavirus-led demand, the company registered a sharp rise in sales across both brick-&-mortar stores and digital channels. Understanding the need of the hour, the company offered a no-contact delivery option, low-contact pickup service and ship-to-home orders. It also waived pickup fees with no minimum purchase requirements and continued to expand contactless payment solutions like Kroger Pay. Kroger has been making prudent investments to bolster omni-channel operations, improve supply chain and increase manpower to ensure swift customer service amid such challenging times. Notably, shares of Kroger have risen 20.4% in the past six months compared with the industry's gain of 13.3%.

A dominant position among the nation's largest grocery retailers enables Kroger to boost its market share by expanding store base, introducing new items and digital coupons.
- ▲ **Strategic Endeavors:** A dominant position among the nation's largest grocery retailers enables Kroger to boost market share by introducing new items such as plant-based products, digital coupons, order online pick up in store and smart shopping lists. The company's Customer 1st strategy enriches the consumers shopping experience and convinces them of returning to the store. Notably, the company has been expanding contact-free payment solutions like Scan, Bag and Go and Kroger Pay. The company is doing everything to meet the rising demand for Pickup orders that help in minimizing person-to-person interaction. For the smooth functioning of the system, the company is deploying more e-commerce staff, adding more order pick-up slots and implemented a pickup-only store location in Cincinnati. The company started accepting Supplemental Nutrition Assistance Program (SNAP) benefits for pickup orders. We note that digital sales surged 92% during the first quarter of fiscal 2020, while pickup or delivery reached 97% of Kroger households (2,000 pickup locations and 2,400 delivery locations).
- ▲ **Major Buyouts & Partnership:** Management continues to deploy capital to concentrate more on remodels, merchandising, and other viable projects to overcome competition in the grocery space. The industry is undergoing a fundamental change with technology playing a key role as focus shifts to online shopping. In this regard, Kroger acquired meal kit provider Home Chef. The company also expanded its Home Chef Express meal kits nationwide. This apart, the company partnered with British online grocery delivery company Ocado that reinforces its position in the online ordering, automated fulfillment and home delivery space. Kroger is aggressively working toward more convenient grocery delivery options. In this regard, the company has started using Nuro's fully autonomous, driverless vehicles for grocery delivery services. In order to further strengthen its digital operations, Kroger joined forces with Alibaba to launch "Our Brands" through the latter's Tmall platform. Also, the company has entered into a partnership with Walgreens to explore new ways to reach consumers. Kroger in association with ClusterTruck introduced an on-demand meal delivery service namely Kroger Delivery Kitchen. Kroger's other strategic acquisitions includes Vitacost.com, an online retailer of vitamins and health-oriented products; and Harris Teeter, a grocery chain. The company also acquired Roundy's, the grocery store operator.
- ▲ **"Restock Kroger" Program:** The company's "Restock Kroger" program involving investments in omni-channel platform, identifying margin-rich alternative profit streams, merchandise optimization, and lowering of expenses has been gaining traction. Management is targeting margin-rich alternative profit streams such as Kroger Personal Finance, Media, and Customer Data Insights. Under the program, the company is also passing the benefit of cost containment to customers by lowering prices. The company attained more than \$1 billion of cost savings in fiscal 2019, and still expects to achieve a vast majority of the targeted \$1 billion of savings for fiscal 2020. As a part of the program, the company is making investments in space optimization, store remodels and technology advancements. The company also launched a grocery delivery service "Kroger Ship". The company is making an incremental investment in associates — wages, training and development, customers and infrastructure. Kroger commenced "We Are Local" campaign; new restaurant concept, Kitchen 1883; and added product lines under "Our Brands". During the first quarter of fiscal 2020, "Our Brands" sales grew 21.1%. We note that the company introduced 758 Our Brands items during the fiscal 2019. The company also introduced 39 new Our Brands Plant-Based products in fiscal 2019.
- ▲ **Optimistic About FY20:** Although management did not reiterate or provide new projection for fiscal 2020 owing to the pandemic, it expects the company to surpass the guidance shared on Apr 1. The company had earlier projected fiscal 2020 earnings between \$2.30 and \$2.40 per share, identical sales, excluding fuel, to be above 2.25% and adjusted FIFO operating profit in the band \$3-\$3.1 billion. No wonder, management anticipates identical sales, excluding fuel, to increase at an elevated level during the second quarter, although tapering from the trends the company has witnessed so far in the quarter. Impressively, Kroger envisions second-quarter earnings per share to be up in the mid-to-high single digit range.

Risks

- **Deleverage in OG&A Expenses a Concern:** Any deleverage in operating, general and administrative expenses may hurt margins. During the first quarter of fiscal 2020, operating, general and administrative expenses rose 21.5% from the year-ago period, whereas as a percentage of sales, the same increased 150 basis points to 18.5%. Again, management stated that incremental investments and pressure on its fuel business may hurt the bottom line during the second quarter. The company is seeing a decline in year-over-year gallons. Taking into account the fuel performance in the second quarter, management envisions headwind of anywhere between \$50 million and \$100 million. Again, Kroger is increasing associate wages by approximately \$800 million per year through the end of 2020, and this is \$300 million more than the original plan.
 - **Debt Analysis:** Kroger ended first-quarter fiscal 2020 with long-term debt (including finance leases and operating lease liabilities) of \$18,616 million, which showcased an increased 1.4% on a sequential basis. Moreover, its debt-to-capitalization ratio is quite high when compared with its industry. The company's debt-to-capitalization ratio was 0.69 at the end of the quarter compared with that of the industry's 0.48. Also, its times interest earned ratio of 5.4 is below that of the industry's 8.4. Notably, the company ended the quarter with cash and cash equivalents of \$3,868 million and current debt (including finance leases and operating lease liabilities) of \$1,764 million.
 - **Intense Competition & Promotional Activities:** Stiff competition, volatility in food prices and an aggressive promotional environment are the primary headwinds with which Kroger is encountering. The grocery business is highly competitive and fragmented, and Kroger faces intense competition from big players such as Amazon, Walmart and Safeway, other conventional retailers and specialty gourmet retailers with respect to price, store expansion and promotional activities. This may dent the company's sales and margins.
 - **Macroeconomic Volatility:** Kroger's performance remains vulnerable to volatile economic conditions. Being a consumer-driven company, the results are likely to be impacted by factors affecting consumer spending and consumer confidence. To this end, unfavorable changes in employment levels, credit availability, housing market scenario, interest and tax rates, and general business conditions, among others, may hurt consumer spending.
 - **Failure to Renegotiate Contracts:** Most of Kroger's employees are protected by approximately 300 collective bargaining agreements with the unions. Should the company fail to renegotiate new contracts on their expiration with the unions, it could lead to work stoppages and operational disruptions. Kroger contributes to various pension plans arising under collective bargaining agreements. The unfunded nature of these plans could also lower its debt rating.
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Last Earnings Report

Kroger's Q1 Earnings Surpass Estimates, Increase Y/Y

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Driven largely by coronavirus-led demand, Kroger registered a sharp rise in sales across both brick-&-mortar stores and digital channels. Understanding the need of the hour, the company offered a no-contact delivery option, low-contact pickup service and ship-to-home orders. It also waived pickup fees with no minimum purchase requirements and continued to expand contactless payment solutions like Kroger Pay. Also, the company implemented pickup-only location in Cincinnati. Kroger has been making prudent investments to bolster omni-channel operations, improve supply chain and increase manpower to ensure swift customer service amid such challenging times.

Quarter Ending **04/2020**

Report Date	Jun 18, 2020
Sales Surprise	1.50%
EPS Surprise	8.93%
Quarterly EPS	1.22
Annual EPS (TTM)	2.70

Let's Introspect

Kroger posted adjusted earnings of \$1.22 per share that surpassed the Zacks Consensus Estimate of \$1.12 and increased sharply from 72 cents reported in the prior-year quarter.

Total sales of \$41,549 million came ahead of the Zacks Consensus Estimate of \$40,934 million. The metric increased 11.5% year over year. Excluding fuel and dispositions, top line improved 19.1% from the year-ago period. The company's digital sales surged 92%, while identical sales, without fuel, grew 19% compared with 22% and 2%, respectively, reported in the preceding quarter.

Courtesy of unprecedented demand for products across grocery and fresh departments identical sales, without fuel remained higher in April and May, both up about 20%, as customers continue to eat more at home. In the first three weeks of the second quarter, digital sales were up in triple-digits.

Management anticipates identical sales, excluding fuel, to increase at an elevated level during the second quarter, although tapering from the trends the company has witnessed so far in the quarter. Impressively, Kroger envisions second-quarter earnings per share to be up in the mid-to-high single digit range.

We note that gross margin increased 210 basis points to 24.3%. FIFO gross margin, excluding fuel, expanded 44 basis points from the year-ago period owing to sales leverage related to shrink, transportation, warehousing and advertising expenditures. Adjusted FIFO operating profit came in at \$1,453 million, up from \$957 million reported in the year-ago period.

Although management did not reiterate or provide new projection for fiscal 2020, it expects the company to surpass the guidance shared on Apr 1. The company had earlier projected fiscal 2020 earnings between \$2.30 and \$2.40 per share, identical sales, excluding fuel, to be above 2.25% and adjusted FIFO operating profit in the band \$3-\$3.1 billion.

Other Financial Aspects

Kroger ended the quarter with cash of \$425 million, total debt of \$13,471 million, and shareowners' equity of \$9,328 million. Net total debt decreased by \$2,255 million over the last four quarters. Management still expects to incur capital expenditure of between \$3.2 billion and \$3.4 billion in fiscal 2020.

Wrapping Up

Kroger, which operates in the thin-margin grocery industry, has been making every effort to strengthen position not only with respect to products but also in terms of the way consumers prefer shopping grocery. The company has been focusing on plant-based products and eyeing technological expansion. Notably, the company's "Restock Kroger" program involving investments in omni-channel platform, identifying margin-rich alternative profit streams, merchandise optimization, and lowering of expenses has been gaining traction.

Recent News

Kroger's Home Chef Joins Forces with Impossible Foods – Jul 14, 2020

Kroger's subsidiary Home Chef has collaborated with Impossible Foods. Adding more versatility to Home Chef's offering, this alliance allows meat lovers to swap traditional animal-based proteins for the plant-based Impossible Burger. With this collaboration, Home Chef becomes the first meal kit-delivery company that offers Impossible Burger. This is in resonance with Home Chef's "Customize It" feature, allowing consumers with options to swap, upgrade and double up on proteins, as well as select the number of servings of each recipe.

Valuation

Kroger shares are up 17.8% in the year-to-date period and nearly 63.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are up 10.5% and 24.1%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 17.9% and 29.8%, respectively.

The S&P 500 index is up 0.3% in the year-to-date period and 8.7% in the past year.

The stock is currently trading at 12.59X forward 12-month earnings, which compares to 23.43X for the Zacks sub-industry, 34.35X for the Zacks sector and 22.83X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.67X and as low as 9.24X, with a 5-year median of 13.13X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$39 price target reflects 14.48X forward 12-month earnings.

The table below shows summary valuation data for KR

Valuation Multiples - KR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	12.59	23.43	34.35	22.83
	5-Year High	19.67	23.43	34.35	22.83
	5-Year Low	9.24	14.08	19.07	15.25
	5-Year Median	13.13	17.23	23.42	17.52
P/S F12M	Current	0.21	0.5	1.2	3.58
	5-Year High	0.36	0.5	1.2	3.58
	5-Year Low	0.13	0.31	0.82	2.53
	5-Year Median	0.2	0.41	0.97	3.02
EV/EBITDA TTM	Current	7.02	11.68	17.95	11.98
	5-Year High	10.87	11.71	18.37	12.86
	5-Year Low	5.45	5.87	11.12	8.25
	5-Year Median	7.65	7.22	12.91	10.88

As of 07/20/2020

Industry Analysis Zacks Industry Rank: Top 28% (71 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Companhia Brasileira de Distribuicao (CBD)	Neutral	3
Costco Wholesale Corporation (COST)	Neutral	3
Carrefour SA (CRRFY)	Neutral	3
Dollar Tree, Inc. (DLTR)	Neutral	3
Marks and Spencer Group PLC (MAKSY)	Neutral	3
Target Corporation (TGT)	Neutral	3
Tesco PLC (TSCDY)	Neutral	4
Walmart Inc. (WMT)	Neutral	3

Industry Comparison Industry: Retail - Supermarkets				Industry Peers		
	KR	X Industry	S&P 500	COST	TGT	WMT
Zacks Recommendation (Long Term)	Outperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	1	-	-	3	3	3
VGM Score	A	-	-	A	A	B
Market Cap	26.57 B	4.46 B	22.29 B	144.16 B	59.91 B	372.55 B
# of Analysts	9	4.5	14	10	12	14
Dividend Yield	1.87%	1.67%	1.85%	0.86%	2.20%	1.64%
Value Score	A	-	-	B	B	B
Cash/Price	0.15	0.16	0.06	0.08	0.08	0.04
EV/EBITDA	7.08	6.86	13.06	22.24	9.86	12.48
PEG Ratio	1.61	2.47	2.98	4.60	4.00	4.73
Price/Book (P/B)	2.88	1.17	3.12	8.38	5.36	5.03
Price/Cash Flow (P/CF)	5.39	6.07	12.03	28.04	10.29	14.85
P/E (F1)	12.02	18.42	22.15	38.60	24.18	26.67
Price/Sales (P/S)	0.21	0.23	2.35	0.90	0.75	0.70
Earnings Yield	8.32%	5.49%	4.30%	2.59%	4.14%	3.75%
Debt/Equity	2.02	0.96	0.75	0.59	1.46	0.85
Cash Flow (\$/share)	6.34	3.80	6.94	11.64	11.64	8.85
Growth Score	A	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	2.71%	0.97%	10.82%	12.69%	5.85%	1.81%
Proj. EPS Growth (F1/F0)	29.14%	-3.84%	-9.08%	3.27%	-22.44%	0.00%
Curr. Cash Flow Growth	20.55%	7.30%	5.51%	14.92%	10.26%	-0.12%
Hist. Cash Flow Growth (3-5 yrs)	6.44%	3.98%	8.55%	10.65%	3.95%	-0.31%
Current Ratio	0.83	0.83	1.30	1.11	1.01	0.77
Debt/Capital	66.93%	49.23%	44.41%	37.07%	59.37%	46.01%
Net Margin	1.66%	1.78%	10.54%	2.31%	3.46%	2.81%
Return on Equity	24.62%	15.21%	15.74%	22.60%	24.17%	18.33%
Sales/Assets	2.78	2.23	0.54	3.26	1.85	2.27
Proj. Sales Growth (F1/F0)	5.67%	0.00%	-2.36%	7.38%	5.95%	4.07%
Momentum Score	B	-	-	B	B	F
Daily Price Chg	0.89%	-0.20%	-0.77%	0.53%	-1.52%	-0.20%
1 Week Price Chg	1.23%	0.81%	3.82%	-0.44%	2.36%	0.81%
4 Week Price Chg	6.49%	2.59%	2.71%	8.67%	-2.13%	8.05%
12 Week Price Chg	2.61%	2.47%	9.79%	5.74%	9.05%	2.47%
52 Week Price Chg	63.71%	-6.39%	-3.79%	16.54%	37.38%	16.53%
20 Day Average Volume	9,773,605	107,885	2,095,914	2,285,138	3,225,675	9,524,416
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.06%
(F1) EPS Est 4 week change	4.74%	0.00%	0.09%	0.06%	0.00%	-0.06%
(F1) EPS Est 12 week change	15.23%	-7.42%	-4.60%	-3.07%	-24.40%	-3.50%
(Q1) EPS Est Mthly Chg	3.38%	0.00%	0.00%	0.61%	0.00%	-0.14%

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	A
Growth Score	A
Momentum Score	B
VGM Score	A

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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