

LabCorp (LH)

\$195.28 (As of 02/17/20)

Price Target (6-12 Months): **\$205.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/08/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: B

Summary

LabCorp exited the fourth quarter of 2019 with better-than-expected results. Its Diagnostics grew organically despite additional price reductions due to PAMA and the loss of exclusivity in two managed care contracts. In the last reported quarter, it also exhibited strong underlying and organic growth across its Drug Development business banking on solid execution of three fundamental strategies. Currently the company remains on track to deliver \$200 million of net savings by the end of 2021 from Diagnostics' Launchpad initiative. This apart, the Covance LaunchPad initiative is well on track. Over the past six months, shares of LabCorp have outpaced its industry. However, the disposition of businesses and the implementation of the PAMA dented growth. Unfavorable currency transaction continues to remain as a major headwind.

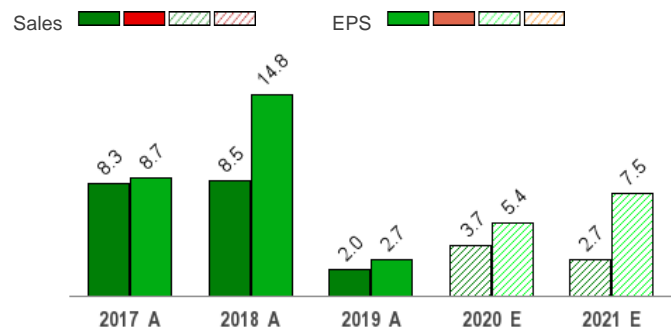
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$196.36 - \$140.53
20 Day Average Volume (sh)	628,510
Market Cap	\$19.0 B
YTD Price Change	15.4%
Beta	1.07
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Medical - Dental Supplies
Zacks Industry Rank	Top 43% (109 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.1%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	NA
Earnings ESP	-3.4%
P/E TTM	17.3
P/E F1	16.4
PEG F1	1.9
P/S TTM	1.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					12,309 E
2020	2,904 E	2,991 E	3,024 E	3,028 E	11,982 E
2019	2,791 A	2,882 A	2,929 A	2,953 A	11,555 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.77 E	\$3.31 E	\$3.33 E	\$3.52 E	\$12.83 E
2020	\$2.72 E	\$3.12 E	\$3.03 E	\$3.00 E	\$11.93 E
2019	\$2.62 A	\$2.93 A	\$2.90 A	\$2.86 A	\$11.32 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 02/17/2020. The reports text is as of 02/18/2020.

Overview

Headquartered in Burlington, NC, Laboratory Corporation of America Holdings or LabCorp is a leading healthcare diagnostics company, providing comprehensive clinical laboratory services and end-to-end drug development support.

In 2015, LabCorp acquired NJ based Covance, a drug development services company providing a wide range of early stage and late stage product development services on a worldwide basis primarily to the pharmaceutical and biotechnology industries. With this, currently LabCorp reports under two operating segments:

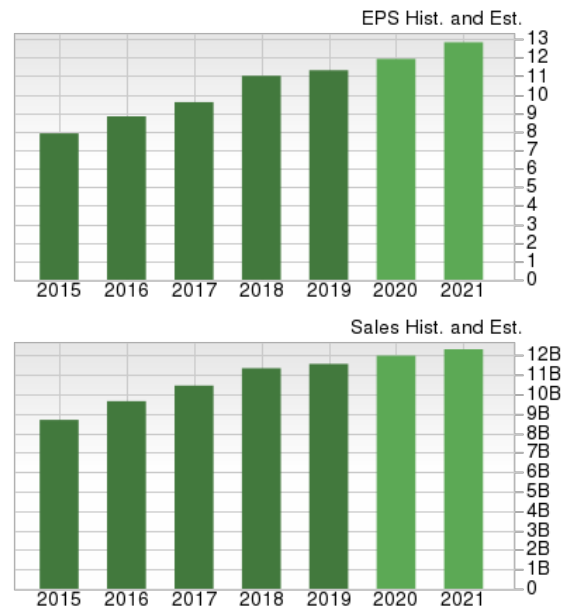
LabCorp Diagnostics (61% of total revenues in 2019): Includes LabCorp's legacy business except for its clinical trial services business, which is now part of Covance Drug Development, and includes the nutritional chemistry and food safety business, which was previously part of Covance. This business registered 0.4% revenue decline in 2019 from the year-ago period.

Covance Drug Development (39%): Includes Covance's legacy business except for its nutritional chemistry and food safety business, which is now part of LabCorp Diagnostics, and includes LabCorp's legacy clinical trial services business. This business reported 6.1% revenue growth in 2018.

Company Strategy

LabCorp has adopted a five-pillar strategy to achieve growth in its businesses . These five strategic pillars are:

- Deploy capital to investments
- Enhance IT capabilities to improve physician, patient experience
- Improve efficiency to remain the most efficient and highest value provider of laboratory services
- Continue scientific innovation to offer tests at reasonable pricing
- Development of alternative delivery models to improve patient outcome and reduce cost of care



Reasons To Buy:

- ▲ **Share Price Movement:** Over the past six months, shares of LabCorp increased 15.8% against the industry's 2.1% fall. LabCorp exited the fourth quarter on a strong note, with better-than-expected results. In the quarter, the company reported strong underlying performance and organic revenue growth across both Diagnostics and Drug Development businesses banking on solid execution of three fundamental strategies which are delivering advanced diagnostics, bringing new medicines to patients faster and using technology to improve patient care. During the quarter, Diagnostics business grew organically in terms of both revenue and volume despite additional price reductions due to Protecting Access to Medicare Act (PAMA) and the loss of exclusivity in two of the company's largest managed care contracts. Currently the company remains on track to deliver \$200 million of net savings by the end of 2021 from Diagnostics' Launchpad initiative.

Covance Drug Development also grew organically despite adverse impact of foreign currency translation. Of late, the company enhanced Covance's offerings through strategic acquisitions like MI Bioresearch that brings specialized preclinical capabilities in cell and gene therapy and oncology testing. The company is also hopeful about its business swap transaction with Envigo. The transaction provides Covance with enhanced global non-clinical research capabilities, while maintaining access to a bigger research models and services through a multi-year renewable supply agreement. This apart, the Covance LaunchPad initiative is well on track to deliver \$150 million of net savings by the end of 2020.

The solid revenue and earnings outlook for 2019 holds optimism indicating improving industry trends along with ongoing positive synergy from the Covance integration.

- ▲ **Covance Drug Development Expands Well:** LabCorp's Covance Drug Development is the only CRO to combine early development, central lab and clinical services in an end-to-end offering. Under this business, LabCorp is full on force to expand the company's range of diagnostic offerings and create a new industry leader in both laboratory testing and CRO spaces who will act as a leading provider of medical testing besides operating as a premier full-service drug development organization. Chiltern integration has significantly strengthened the company's strategic position in clinical development and is accelerating revenue and profit growth within Covance.

In this regard, of late, LabCorp is enhancing Covance's offerings through strategic acquisitions. The acquisition of MI Bioresearch is expected to create opportunity for Covance to move from preclinical to clinical development. We are also optimistic about the company's plans to acquire Regulatory and Clinical Research Institute (RCRI), a device focused CRO with strong regulatory consulting expertise.

In addition, the company has progressed with the Covance LaunchPad initiative. At the end of 2019, LabCorp remains on track to deliver \$150 million of net savings from Covance LaunchPad by the end of 2020. This apart, the company has completed the \$30 million in cost synergies from the integration of Chiltern that it had committed to deliver in 2020 and expects to achieve \$10 million in net cost synergies from the integration of Envigo by the end of 2021.

- ▲ **LaunchPad in Diagnostics May Help Rebound Growth:** On the heels of a successful execution of the company's LaunchPad cost saving initiative in its drug development business, LabCorp has now introduced this program within its Diagnostics arm which is facing severe headwinds over the recent term. This Phase II of LaunchPad initiative in Diagnostics is expected to deliver \$200 million of savings by the end of 2021. This initiative focuses on eliminating manual processes; digitizing the business; using technology to improve quality, operations and service; enhancing the consumer experience and bringing LabCorp's services closer to the customer. Phase II of LaunchPad is expected to streamline its business, unlock new avenues for growth and contribute to improvement in the long-term margins.

- ▲ **Meaningful Acquisitions to Add Value:** LabCorp continues to add complementary capabilities through targeted acquisitions. The latest in the list is an innovative business swap transaction with Envigo, a provider of nonclinical contract research services and research models. In this transaction, the company has purchased Envigo's non-clinical contract research service business, while sell them Covance Research Products business. The company also enhanced its value by acquiring the diagnostic clinical laboratory testing business of South Bend Medical Foundation (SBMF), considerably enhancing the scope of local services that LabCorp offers to hospitals, physicians, and patients across Indiana, Michigan, Ohio, and Illinois.

- ▲ **Strategic Plans to Drive Growth:** As part of its three key strategic plans, LabCorp is working hard on new innovations with academic institutions in order to capture the growing lab testing market with its advanced assays and tools. In Diagnostics, the company successfully continues to provide the foundation for new collaborations with health systems, large physician groups and managed care partners. LabCorp has also created growth opportunities in women's health, medical drug monitoring, genetics and oncology testing, as well as in critical collaborations with players like Thermo Fisher, Walgreens and 23andMe. Also, its partnerships with UnitedHealthcare and Aetna have helped LabCorp to become a contracted laboratory provider for all major national plans.

Within Covance Drug Development, the company's ongoing strategic investments in precision medicine, therapeutic expertise, FSP solutions and biologic drug development capabilities continue to increase its win rate with existing partners and new customers. The acquisition of Chiltern is significantly strengthening LabCorp's strategic position in clinical development and accelerating revenue and profit growth within Covance. This apart, the company's recent strategic technology contract with QIAGEN is expected to garner positive outcome down the line.

- ▲ **Progress on Strategic Collaborations:** LabCorp has strengthened its foothold in the diagnostics space through both organic and inorganic means and plans to collaborate with leading companies and academic institutions to provide a wider portfolio of tests. Among the company's recent alliances, worth mentioning are the company's team ups with UnitedHealthcare and Aetna which have helped LabCorp to become a contracted laboratory provider for all major national plans. Jul 1, 2019 onward, all of the LabCorp brands are included in the UnitedHealthcare's preferred lab network. The company is optimistic about the opportunity to grow volume with UnitedHealthcare through the PLN in 2020 and beyond. Further, in Jan 2020, LabCorp partnered with Thermo Fisher to adopt the latter's Ion Torrent Genexus System and Oncomine Precision Assay for use in research and development of companion diagnostics as well as other future oncology and precision medicine applications. The company is also progressing well under its broad collaboration agreement with Walgreens on patient engagement, health and wellness offerings and creation of a next-generation CRO.

- ▲ **Stable Liquidity Position:** LabCorp is well capitalized having exited 2019 with cash and cash equivalents of \$337.5 million compared with \$426.8 million in the year-ago period. The company has been using its cash balance to make strategic acquisitions and has been rewarding

its shareholders through share repurchases. LabCorp noted interest in acquisitions in the field of contract research and pathology, including hematopathology, at an attractive valuation. In the fourth quarter, the company returned \$50 million to shareholders via share repurchases. LabCorp currently has \$900 million of authorization remaining under its existing share buyback plan.

The company's cash flow trends also remain robust. Cumulative cash flow from operating activities at the end of 2019 was \$1.44 billion, up from \$1.31 billion a year ago. Additionally, free cash flow at the end of 2019 was \$1.04 billion, up 13% from the year-ago period.

In addition, free cash flow guidance for 2020 has been anticipated in the band of \$950 million-\$1.05 billion. Going forward, LabCorp expects to deploy half of the free cash flow to acquisitions and half to share buybacks.

Reasons To Sell:

- ▼ **Exposed to Currency Headwind:** With LabCorp deriving a huge share of its revenues internationally, it remains highly exposed to currency fluctuations. Unfavorable currency movements have been a major dampener over the last few quarters, as in the case of other important MedTech players too. While the trend has shown some sort of improvement in the reported quarter, sustainability remains a matter of question. In the fourth quarter, revenue dropped 20 basis points on account of unfavorable foreign currency translation.
- ▼ **Competitive Landscape:** LabCorp faces intense competition from its major competitor, Quest Diagnostics, and other commercial laboratories and hospitals. In a \$55 billion U.S. lab market, hospitals control an estimated 55% of the diagnostic test market, compared to LabCorp's 10% share. While pricing is an important factor in choosing a testing lab, hospital-affiliated physicians expect a high level of service, including accurate and rapid turnaround of testing results. As a result, LabCorp and other commercial labs compete with hospital-affiliated labs primarily on the basis of quality of service.
- ▼ **Reimbursement Cut to Have a Negative Impact:** Changes in governmental regulations had a significant impact on LabCorp's operations. Particularly, in the last couple of years, the company faced several reimbursement issues hurting its revenues. The company is concerned about the CMS' (Centers for Medicare & Medicaid Services) latest Medicare reimbursement reduction as a result of the implementation of Protecting Access to Medicare Act (PAMA). Notably, 2018 was the opening year operating under the clinical IP schedule.

While the company currently appreciates that congress finally passed the LAB Act back which has delayed the next PAMA date of reporting period by 1 year until 2021, regrettably, the legislation did not halt the reimbursement cuts that went into effect in 2019. Meanwhile we note that, in the fourth quarter 2019, PAMA had a negative impact of 130 basis points on the company's gross margin within Drug Development business.

The current economic uncertainty including challenging volume environment for testing laboratories and utilization weaknesses are looming headwinds.

Last Earnings Report

Lower Medicare and Medicaid Pricing Dent LabCorp's Growth in Q4

LabCorp reported fourth-quarter 2019 adjusted earnings per share of \$2.86, up 13.5% from the year-ago quarter. Also, the bottom line surpassed the Zacks Consensus Estimate by 2.1%.

The quarter's adjustments exclude non-recurring items like venture fund investment related gains and loss on sale of certain assets, among others.

On a reported basis, net earnings were \$2.32 per share, surging 48.7% from the year-earlier figure.

For 2019, adjusted EPS came in at \$11.32, up 2.7% year over year. The figure beat the Zacks Consensus Estimate by 0.6%.

Revenues in the quarter under review grew 5.7% year over year to \$2.95 billion. The top line also beat the Zacks Consensus Estimate by 0.7%.

The upside in revenues was driven by acquisition-related growth of 4.5% and organic growth of 2.3% (considering 0.9% adverse impact of lower Medicare and Medicaid pricing as a result of implementation of Protecting Access to Medicare Act or PAMA), partially offset by the disposition of businesses of 0.6% and negative foreign currency translation of 0.2%.

For 2019, revenues came in at \$11.55 billion, up 1.9% year over year. The top line also beat the Zacks Consensus Estimate by 0.2%.

Quarter in Detail

In the fourth quarter, LabCorp Diagnostics reported revenues of \$1.76 billion, reflecting a 3.7% uptick year over year. The upside primarily resulted from 0.8% organic growth and 3.5% contribution from acquisitions, offset by a 0.5% headwind from business dispositions. Organic revenue growth in the quarter was impacted by 1.5% due to the implementation of the PAMA.

Excluding business dispositions, the company witnessed a 2.6% rise in total volume (measured by requisition) and 1.6% improvement in revenue per requisition in the fourth quarter.

Covance Drug Development revenues improved 9.3% to \$1.20 billion in the fourth quarter buoyed by a 6.0% contribution from acquisitions and 4.5% of organic growth, partially offset by a 0.9% impact owing to the disposition of the Covance Research Products business and 0.4% due to adverse foreign currency translation.

Margins

Gross margin grew 8 bps to 27.9% during the fourth quarter. Also, adjusted operating income rose 8.3% year over year to \$407 million. However, adjusted operating margin expanded 30 bps from the year-ago quarter to 13.8%.

Cash Position

LabCorp exited 2019 with cash and cash equivalents of \$337.5 million compared with \$426.8 million in the year-ago period. Cumulative cash flow from operating activities at the end of 2019 was \$1.44 billion, up from \$1.31 billion a year ago. Additionally, free cash flow at the end of 2019 was \$1.04 billion, up 13% from the year-ago period.

In the fourth quarter, the company returned \$50 million to shareholders via share repurchases. LabCorp currently has \$900 million of authorization remaining under its existing share buyback plan.

2020 Outlook

The company has provided its 2020 guidance.

Revenue growth has been estimated at 4.0% to 6.0% over 2019 revenues of \$11.55 billion. The Zacks Consensus Estimate for current-year revenues is pegged at \$11.93 billion.

Adjusted earnings estimate for 2020 has been estimated within \$11.75 to \$12.15 per share, suggesting an increase of 3.8% to 7.3% over 2019 adjusted earnings of \$11.32. The Zacks Consensus Estimate for the same is pegged at \$11.94 for the same.

Free cash flow is predicted to be \$950 million-\$1.05 billion (unchanged).

Quarter Ending 12/2019

Report Date	Feb 13, 2020
Sales Surprise	0.86%
EPS Surprise	2.14%
Quarterly EPS	2.86
Annual EPS (TTM)	11.31

Recent News

On **Jan 14, 2020**, LabCorp announced it will adopt the Ion Torrent Genexus System and OncoPrint Precision Assay for use in research and development of companion diagnostics as well as other future oncology and precision medicine applications. The potential for future deployment of the system and test across its network of laboratories and partner facilities will also be evaluated by LabCorp.

On **Jan 13, 2020**, LabCorp introduced its focused and coordinated suite of cell and gene therapy development solutions from Covance, its drug development business. These solutions are designed to reduce time and risk for sponsors at each phase and across the full continuum of their therapy development needs in one of the industry's fastest-growing segments.

Valuation

LabCorp shares are up 15.4% in the year to date period and up 30.4% in the trailing 12-month periods. Stocks in the Zacks sub-industry and Zacks Medical sector are up 6.6% and 2.3% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 1.6% and sector is up 4.4%.

The S&P 500 index is up 5.2% in the year to date period and up 23.3% in the past year.

The stock is currently trading at 16.2X Forward 12-months earnings, which compares to 18.4X for the Zacks sub-industry, 21.4X for the Zacks sector and 19.4X for the S&P 500 index.

Over the past five years, the stock has traded as high as 17.1X and as low as 10.8X, with a 5-year median 14.4X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$205 price target reflects 17x forward 12-months earnings.

The table below shows summary valuation data for LH.

Valuation Multiples - LH					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	16.21	18.42	21.36	19.35
	5-Year High	17.11	19.99	21.36	19.35
	5-Year Low	10.75	13.70	15.83	15.18
	5-Year Median	14.40	16.67	18.89	17.47
P/S F12M	Current	1.58	0.37	2.84	3.58
	5-Year High	1.69	0.37	3.83	3.58
	5-Year Low	1.06	0.23	2.45	2.54
	5-Year Median	1.41	0.28	2.97	3.00
P/B TTM	Current	2.51	4.70	4.63	4.68
	5-Year High	3.84	4.93	5.04	4.68
	5-Year Low	1.68	2.53	3.44	2.85
	5-Year Median	2.50	3.46	4.31	3.62

As of 02/14/2020

Industry Analysis Zacks Industry Rank: Top 43% (109 out of 255)



Top Peers

DaVita Inc. (DVA)	Outperform
Align Technology, Inc. (ALGN)	Neutral
Bio-Rad Laboratories, Inc. (BIO)	Neutral
Quest Diagnostics Incorporated (DGX)	Neutral
Exact Sciences Corporation (EXAS)	Neutral
Myriad Genetics, Inc. (MYGN)	Neutral
NeoGenomics, Inc. (NEO)	Neutral
OPKO Health, Inc. (OPK)	Neutral

Industry Comparison Industry: Medical - Dental Supplies				Industry Peers		
	LH Neutral	X Industry	S&P 500	DGX Neutral	EXAS Neutral	NEO Neutral
VGM Score	B	-	-	B	F	C
Market Cap	18.96 B	1.92 B	24.61 B	15.20 B	12.75 B	3.57 B
# of Analysts	9	5	13	9	8	5
Dividend Yield	0.00%	0.00%	1.78%	1.88%	0.00%	0.00%
Value Score	B	-	-	C	D	D
Cash/Price	0.02	0.06	0.04	0.08	0.09	0.05
EV/EBITDA	12.27	12.22	14.06	11.38	-130.09	108.59
PEG Ratio	1.86	2.09	2.09	2.24	NA	NA
Price/Book (P/B)	2.62	4.25	3.29	2.67	17.03	7.14
Price/Cash Flow (P/CF)	11.71	13.05	13.65	12.41	NA	105.67
P/E (F1)	15.92	21.74	19.21	16.96	NA	91.88
Price/Sales (P/S)	1.64	1.73	2.70	1.97	14.55	9.43
Earnings Yield	6.11%	3.62%	5.19%	5.89%	-1.36%	1.08%
Debt/Equity	0.93	0.32	0.71	0.70	0.67	0.24
Cash Flow (\$/share)	16.68	1.80	6.92	9.09	-0.99	0.32
Growth Score	B	-	-	B	F	B
Hist. EPS Growth (3-5 yrs)	11.29%	8.88%	10.85%	8.95%	NA	56.53%
Proj. EPS Growth (F1/F0)	5.39%	11.78%	7.17%	1.42%	10.40%	33.81%
Curr. Cash Flow Growth	9.98%	9.29%	8.56%	10.66%	20.69%	-21.26%
Hist. Cash Flow Growth (3-5 yrs)	14.10%	12.65%	8.36%	6.08%	NA	36.02%
Current Ratio	1.17	1.67	1.23	1.25	2.75	4.24
Debt/Capital	48.26%	26.85%	42.91%	41.55%	40.09%	19.56%
Net Margin	7.13%	4.08%	11.81%	11.10%	-9.59%	0.55%
Return on Equity	15.59%	15.76%	16.86%	16.15%	-28.15%	4.60%
Sales/Assets	0.66	1.02	0.54	0.64	0.49	0.62
Proj. Sales Growth (F1/F0)	3.20%	5.42%	3.85%	2.08%	85.79%	11.69%
Momentum Score	B	-	-	C	F	D
Daily Price Chg	0.28%	0.00%	0.06%	0.62%	3.61%	-0.06%
1 Week Price Chg	3.95%	0.59%	2.47%	0.70%	2.14%	-3.29%
4 Week Price Chg	9.87%	1.19%	0.59%	5.36%	9.36%	4.85%
12 Week Price Chg	15.07%	7.76%	6.98%	7.63%	24.25%	39.34%
52 Week Price Chg	33.06%	7.42%	16.62%	31.99%	11.42%	96.10%
20 Day Average Volume	628,510	311,996	2,020,569	939,878	1,702,915	735,156
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.01%	-207.41%	0.00%
(F1) EPS Est 4 week change	-0.08%	0.00%	-0.05%	-1.33%	-200.00%	0.00%
(F1) EPS Est 12 week change	-0.10%	0.00%	-0.17%	-1.29%	-177.55%	0.00%
(Q1) EPS Est Mthly Chg	-0.25%	0.00%	-0.24%	-2.94%	-153.13%	0.00%

Zacks Style Scores

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

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

Value Score	B
Growth Score	B
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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