

## McDonalds Corp.(MCD)

**\$206.49** (As of 08/13/20)

Price Target (6-12 Months): **\$217.00**

Long Term: 6-12 Months

**Zacks Recommendation:**
**Neutral**

(Since: 04/04/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

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

**3-Hold**

Zacks Style Scores:

VGM:F

Value: D

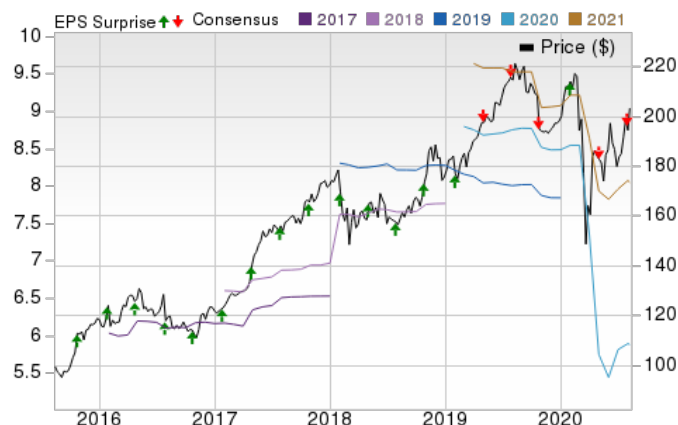
Growth: D

Momentum: C

### Summary

Shares of McDonald's have outperformed the industry so far this year. Notably, the company is benefiting from increase in drive-thru sales. Recently, it reported mixed second-quarter 2020 results, wherein the bottom line missed the Zacks Consensus Estimate but the top line beat the same. However, both earnings and revenues declined year over year. Results in the quarter were hurt by the coronavirus pandemic. However, its increased focus on delivery and accelerated deployment of EOTF restaurants in the United States is commendable. Additionally, the company is making every effort to drive growth in international markets as well. Of late, earning estimates for 2020 have increased. The company witnessed continued improvement in results throughout the second quarter. As of Jun 30, 2020, most of the company's restaurants are open globally.

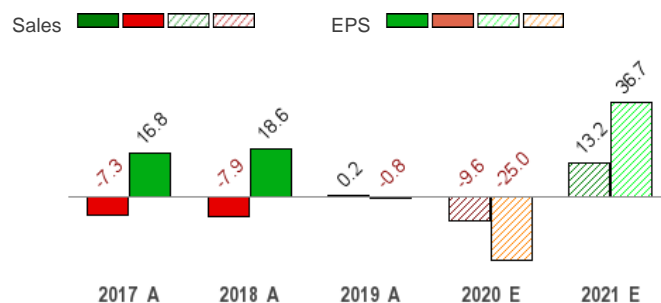
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$221.02 - \$124.23
20 Day Average Volume (sh)	3,017,404
Market Cap	\$153.6 B
YTD Price Change	4.5%
Beta	0.65
Dividend / Div Yld	\$5.00 / 2.4%
Industry	<a href="#">Retail - Restaurants</a>
Zacks Industry Rank	Top 49% (123 out of 252)

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



Last EPS Surprise	-13.2%
Last Sales Surprise	1.7%
EPS F1 Est- 4 week change	1.1%
Expected Report Date	10/27/2020
Earnings ESP	0.1%
P/E TTM	33.3
P/E F1	35.1
PEG F1	4.8
P/S TTM	8.0

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	4,997 E	5,282 E	5,694 E	5,634 E	21,556 E
2020	4,714 A	3,762 A	5,235 E	5,372 E	19,047 E
2019	4,956 A	5,341 A	5,431 A	5,349 A	21,077 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.73 E	\$2.01 E	\$2.23 E	\$2.12 E	\$8.04 E
2020	\$1.47 A	\$0.66 A	\$1.81 E	\$1.87 E	\$5.88 E
2019	\$1.72 A	\$2.05 A	\$2.11 A	\$1.97 A	\$7.84 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 08/13/2020. The reports text is as of 08/14/2020.

## Overview

Founded in 1948, Oak Brook, IL-based McDonald's is a leading fast-food chain that currently operates roughly 38,000 restaurants in more than 100 countries. The company mainly operates and franchises quick-service restaurants (QSRs) under the McDonald's brand. Nearly 93% of the company's restaurant worldwide are owned and operated by independent local business men as well as women. The company's revenues include sales by company-operated restaurants and fees from restaurants, which are managed by franchisees.

The business is managed as a distinct geographic segment.

Beginning Jan 1, 2019, the company had begun operating its results under a new organizational structure.

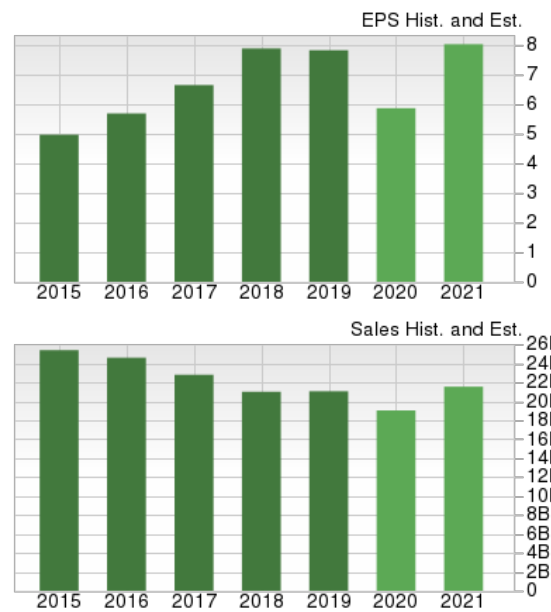
U.S. – This is the company's largest segment (accounting for 37.2% of total revenues in 2019). The segment remains unchanged despite the new organizational structure.

International Operated segment (54.1% of total revenues in 2019) – The segment comprises wholly-owned markets, or countries where the company operates. It operates in Australia, Canada, France, Germany, Italy, the Netherlands, Russia, Spain and the U.K.

International Developmental Licensed Markets (8.7% of total revenues in 2019) – The segment comprises primarily developmental license and affiliate markets in the McDonald's system. Corporate activities are also part of this segment.

As of Jul 2, the company has reopened 14,000 restaurants out of 22,000 restaurants in the United States. However owing to the rising number of coronavirus cases, the company has halted the reopening of additional dining rooms by 21 days.

Coming to international markets, most of the restaurants in France, Italy, Spain, United Kingdom, Australia and Germany have resumed operations. Notably, the restaurants are operating with drive-thru and delivery services, and dining room access with limited capacity.



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## Reasons To Buy:

▲ **Strong Brand Recognition:** McDonald's is the world's largest chain of fast-food restaurants with presence in more than 100 countries. Its offerings have reached the billion-dollar brand status through sustained product innovation and geographic expansion. With an almost 10% share of the global informal-eating-out market, there is ample scope for it to grow in the future as it boasts a scale advantage compared to its peers. Growing guest counts remains the company's top priority and it intends to regain customers by focusing on food quality, convenience and value. Moreover, McDonald's expects its velocity accelerators of Experience of the Future, digital and delivery to drive growth over the long term. Given various initiatives undertaken to drive growth, the stock has a decent upside potential.

McDonald's efforts to strengthen its position through various sales initiatives along with increased focus on franchising bode well

In 2018, McDonald's had completed the conversion of 4,500 restaurants to Experience of the Future' (EOTF) restaurants. Moreover, the company had completed the conversion of 2,000 restaurants to EOTF during 2019. Management announced that it has converted approximately 10,000 restaurants to EOTF or about 70% of the estate. For 2020, the company has reduced capital expenditure from \$2.4 billion to nearly \$1.6 billion. The company will spend nearly half of the amount for the U.S. business, which includes completion of approximately 900 EOTF projects.

▲ **Focuses on Delivery to Drive Sales:** During the coronavirus pandemic the company is focusing on drive-thru, delivery & take-away. Prior to the coronavirus outbreak, drive-thru accounted for about two-thirds of all sales in the United States. Drive-thru now accounts for approximately 90% of sales. Moreover, McDonald's continues to roll out mobile order and pay, with a new curbside check-in option. It has already launched the option in nearly all 20,000 U.S. restaurants. To provide enhanced experience and convenience to customers, McDonald's is increasingly focusing on delivery. The company provides delivery from more than 27,000 restaurants in above 75 countries. In third-quarter 2019, it partnered with Grubhub for the rollout of McDelivery to nearly 500 restaurants in the NYC and Tri-State area. It also partnered with DoorDash.

The company announced that Australia posted positive comps for May and June driven by strong drive-thru and delivery performance. The country has doubled its delivery sales mix to approximately 10% of sales. The company is witnessing increase in delivery and digital transactions per restaurants. It witnessed continued improvement in results throughout the second quarter. As of Jun 30, 2020, most of the company's restaurants are open globally.

▲ **Efforts to Attract Customers in International Markets:** McDonald's strategic efforts in the international markets continue to drive comps higher. McDonald's is consistently trying to improve its performance in the International Operated Markets including Australia, Canada, France, Germany and the UK. The company intends to drive comps growth in these markets through introduction of value meals, customizing the menu to local customer tastes, reimagining of restaurants, efficient marketing and promotions, improved service and increased convenience via delivery. With the roll-out of self-order kiosks, digital menu boards, table service, and the mobile app, customers are offered more choices and flexibility as the company progresses toward its Experience of the Future initiative, which is based on adding technology to its eateries. Notably, the converted restaurants are now seeing even stronger financial results than those who have not yet made the switch.

▲ **Solid Expansion Efforts:** McDonald's believes that there is a huge opportunity to grow all its brands globally by expanding its presence in existing markets and entering new markets. The company's expansion efforts continue to drive performance. Currently, it has more than 39,020 restaurants worldwide. Despite the coronavirus pandemic, the company opened about 150 restaurants through June. The company is also confident about the opening 400 new restaurants in China this year.

▲ **Re-franchising Strategy Safeguards Earnings:** Management's re-franchising strategy involves a shift to a greater percentage of franchised restaurants. Notably, in January 2017, the company entered into a strategic partnership and sold the control of its Chinese business, thereby reducing its own share to 20%. The company intends to add over 1,500 stores more in the region within the next five years. Currently, nearly 95% of the company's restaurants are franchised. In addition to the sale of its assets in China, McDonald's is looking for similar deals in markets of South Korea, Japan and South-east Asia. In fact, it has already completed several other important refranchising transactions since November 2016, including Singapore, Malaysia, the Nordics and Taiwan. These partnerships are part of the company's efforts to streamline its business and focus on the quality of its offerings, which should further increase the attractiveness of McDonald's business. Thus, these deals will have an upside impact on its earnings and margins as the company is expected to gain from trimming its overall cost of operations and preserving its capital. The reduction in ownership, i.e. re-franchising, weighs on near-term revenues, as it replaces company-operated sales by franchised sales. However, over the long term, it will reduce the company's capital requirements and facilitate earnings per share growth and ROE expansion. Going forward, the company aims to continue optimizing its ownership mix by refranchising restaurants in certain of its large mature markets, like the United States.

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## Reasons To Sell:

- ▼ **Coronavirus to Hurt Traffic:** McDonald's results in the coming quarters are likely to be impacted by the coronavirus outbreak. Although the company has reopened most of its restaurants, it is likely to witness dismal traffic due the social distancing protocols.
- ▼ **Comps Decline in Q2 Due to Coronavirus:** The company's comps declined for the second straight quarter after reporting positive comps in the preceding 19 quarters. In the second quarter, global comps declined 23.9%, against a gain of 6.5% in the prior-year quarter. In first-quarter 2020, comps were down 3.4%.
- ▼ **High Debt a Concern:** A strong balance sheet will help the company tide over the ongoing crisis. At the end of Jun 30, 2020, the company's long-term debt stands at \$34.7 billion, compared with \$38 billion as of Mar 31, 2020. Although debt has declined sequentially its is still very high. Moreover, the company ended second-quarter 2020 with cash and cash equivalent of \$3.3 billion, compared with \$5.3 billion at the end of first-quarter 2020, which may not be enough to manage the high-debt level.
- ▼ **Negative Currency Translation:** With about 55% of McDonald's operating income coming from the International operated segment, its earnings remain susceptible to negative currency translation. Meanwhile, foreign currency translation had a negative impact of 1 cent per share during the second-quarter 2020. Foreign currency headwinds had a negative impact of 21 cents in 2019.
- ▼ **High Costs:** Apart from minimum wage increases, additional health care costs related to 'Obamacare' in the United States also raise labor costs. Further, costs associated with brand positioning in all the key markets and ongoing investments in initiatives might weigh on margins, at least in the near term.
- ▼ **Macro-Economic Pressure:** The company is grappling with difficulties like decelerating growth in Asia along with weakness in some parts of Europe, where the economic/political conditions are expected to be further challenging post Brexit. Meanwhile, over the past few quarters, the U.S. restaurant space has not been too enticing for investors. Despite economic growth, somewhat lower energy prices and higher income, consumers increased their spending only modestly on dining out, which resulted in low consumption over the past few quarters. This is because, along with wage growth, inflation is also on the rise, which translates to lower real income and thus less disposable income. The situation has taken a worse turn, thanks to higher health care costs and tightened credit availability in the United States. Moreover, as consumers demand high-quality products at lower prices, it is pushing grocery stores to decrease their food prices in order to remain competitive. This is resulting in a bigger gap between food-at-home and food-away-from-home indices.
- ▼ **Cutthroat Competition:** Competition among fast-casual restaurants is expected to remain fierce with respect to price, service, location and concept, which may adversely impact McDonald's restaurant operating margins and profits. The company is facing competition from Wendy's that operate under almost similar business models and offer similar products. Chipotle Mexican Grill, a provider of healthier menu options, poses significant competition for McDonald's, especially when consumers in the United States are opting for healthier menu options instead of fast food. Moreover, other restaurateurs like Yum! Brands, Inc.'s Taco Bell, Dunkin' Brands Group, Inc. and Jack in the Box Inc. are also cashing in on the popularity of the breakfast platter thereby giving McDonald's a run for its money in this space also.

High labor costs and currency headwinds are major concerns. Moreover, revenues have been under pressure for quite some time due to strategic refranchising initiative.

## Last Earnings Report

### McDonald's Q2 Earnings Miss Estimates, Comps Down

McDonald's reported mixed second-quarter 2020 results, wherein the bottom line missed the Zacks Consensus Estimate but the top line beat the same. However, both earnings and revenues declined year over year. Results in the quarter were impacted by the coronavirus pandemic. Limited operations and change in consumer behavior also hurt the company's performance.

However, robust drive-thru presence and its investments in delivery and digital over the past few years have aided the company during the current scenario. The company witnessed continued improvement in results throughout the second quarter. As of Jun 30, 2020, most of the company's restaurants are open globally.

The company reported adjusted earnings of 66 cents per share, which missed the consensus of 76 cents. Moreover, the bottom line declined 68% year over year. Meanwhile, foreign currency translation had a negative impact of 1 cent per share on earnings in the quarter under review.

Quarter Ending **06/2020**

Report Date	<b>Jul 28, 2020</b>
Sales Surprise	<b>1.73%</b>
EPS Surprise	<b>-13.16%</b>
Quarterly EPS	<b>0.66</b>
Annual EPS (TTM)	<b>6.21</b>

### Revenues & Comps Discussion

In the second quarter, revenues of \$3,761.5 million beat the Zacks Consensus Estimate of \$3,698 million. However, the figure declined 30% year over year. This downtrend can primarily be attributed to the coronavirus pandemic. Moreover, on a constant-currency basis, the top line decreased 29% on a year-over-year basis.

At company-operated restaurants, revenues came in at \$1,593.7 million, down 34% year over year. Moreover, the same at franchise-operated restaurants slumped 29% to \$2,088 million.

In the quarter global comps declined 23.9%, against a gain of 6.5% in the prior-year quarter. Comps declined for the second straight quarter after reporting positive comps in the trailing 19 quarters. In first-quarter 2020, comps were down 3.4%.

### Solid Comps Across Segments

**U.S.:** Comps at this segment declined 8.7% in the second quarter, against a gain of 5.7% rise in the prior-year quarter. However, the company witnessed sequentially improvement in comps throughout the quarter. At the end of April, May and June comps were down 19.2%, 5.1% and 2.3%, respectively.

**International Operated Markets:** Comps at this segment declined 41.4% year over year, against a gain of 6.6% in the year-ago quarter. Comps were hurt by temporary restaurant closures and limited operations, particularly in the U.K. and France. However, the company witnessed positive comps in Australia in May and June driven by drive-thru performance.

**International Developmental Licensed Segment:** The segment's comparable sales decreased 24.2% in the second quarter. In the prior-year quarter, the segment's comps had risen 6.5%. Comps were negatively impacted by temporary restaurant closures across nearly all geographies, primarily in Latin America.

## Recent News

### McDonald's Halts Reopening of Dining Rooms for 21 Days – Jul 1, 2020

McDonald's recently halted the reopening of additional dining rooms in the United States by 21 days on account of rising number of coronavirus cases. Over the last two weeks, the country has witnessed an increase of 65% in coronavirus cases. However, restaurants with reopened dining rooms are likely to consult local and state officials on whether to cease the dining rooms services again.

### McDonald's Provides Business Update Amid Coronavirus Pandemic – Jun 16, 2020

McDonald's recently provided an update on financial performance amid the COVID-19 pandemic. Notably, with dining rooms reopening and strong digital and delivery system, the company is optimistic about its response to the global crisis. With 95% of the restaurants operating all over the world, McDonald's has been witnessing sequential improvement in comparable sales.

## Valuation

McDonald's shares have gained 4.5% in year-to-date period but declined 6.7% in the trailing 12-month period. Stocks in the Zacks sub-industry are down 0.7%, but the sector is up 40.8%, in the year-to-date period. Over the past year, the Zacks sub-industry is down 7.3%, but the sector is up by 27.9%.

The S&P 500 index is up by 4.6% in the year-to-date period and 18.6% in the past year.

The stock is currently trading at 28.6X forward 12-month earnings, which compares to 31.77X for the Zacks sub-industry, 33.47X for the Zacks sector and 22.87X for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.15X and as low as 15.78X, with a 5-year median of 22.12X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$217 price target reflects 30.09X trailing 12-month earnings.

The table below shows summary valuation data for MCD.

Valuation Multiples - MCD					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	28.6	31.77	33.47	22.87
	5-Year High	31.15	34.04	34.76	22.87
	5-Year Low	15.78	20.49	19.08	15.25
	5-Year Median	22.12	23.09	23.17	17.58
P/S F12M	Current	7.45	3.76	1.26	3.7
	5-Year High	7.96	3.93	1.26	3.7
	5-Year Low	3.5	2.81	0.82	2.53
	5-Year Median	6.07	3.32	0.97	3.05
EV/EBITDA TTM	Current	22.66	22.69	19.68	12.72
	5-Year High	22.66	22.69	19.75	12.84
	5-Year Low	10.76	11.94	11.13	8.24
	5-Year Median	14.76	14.36	12.95	10.9

As of 08/13/2020

## Industry Analysis Zacks Industry Rank: Top 49% (123 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
Papa Johns International, Inc. (PZZA)	Outperform	1
Bloomin Brands, Inc. (BLMN)	Neutral	3
Chipotle Mexican Grill, Inc. (CMG)	Neutral	3
Darden Restaurants, Inc. (DRI)	Neutral	3
Restaurant Brands International Inc. (QSR)	Neutral	3
Starbucks Corporation (SBUX)	Neutral	3
Yum Brands, Inc. (YUM)	Neutral	3
Yum China Holdings Inc. (YUMC)	Neutral	3

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	MCD	X Industry	S&P 500	SBUX	WING	YUMC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	F	-	-	D	B	A
Market Cap	153.65 B	383.95 M	23.58 B	92.37 B	4.66 B	20.53 B
# of Analysts	16	6	14	14	10	6
Dividend Yield	2.42%	0.00%	1.68%	2.08%	0.28%	0.66%
Value Score	D	-	-	D	F	C
Cash/Price	0.04	0.13	0.07	0.05	0.01	0.08
EV/EBITDA	18.17	13.01	13.34	17.69	98.43	13.17
PEG Ratio	4.80	4.57	2.99	6.02	11.55	4.95
Price/Book (P/B)	NA	2.32	3.20	NA	NA	6.26
Price/Cash Flow (P/CF)	20.43	8.55	12.83	19.16	161.01	17.69
P/E (F1)	35.23	39.41	21.99	82.74	127.01	47.01
Price/Sales (P/S)	7.98	0.83	2.53	3.84	20.74	2.57
Earnings Yield	2.85%	0.87%	4.35%	1.20%	0.79%	2.13%
Debt/Equity	-4.98	1.28	0.77	-2.59	-1.61	0.01
Cash Flow (\$/share)	10.11	1.81	6.94	4.12	0.98	3.08
Growth Score	D	-	-	D	A	A
Hist. EPS Growth (3-5 yrs)	10.16%	3.47%	10.41%	8.80%	14.01%	1.84%
Proj. EPS Growth (F1/F0)	-25.02%	-66.06%	-6.32%	-66.25%	69.73%	-38.39%
Curr. Cash Flow Growth	-0.99%	3.07%	5.20%	5.49%	-7.19%	10.09%
Hist. Cash Flow Growth (3-5 yrs)	1.88%	5.23%	8.55%	12.19%	18.99%	25.34%
Current Ratio	0.91	1.04	1.33	0.95	1.42	1.34
Debt/Capital	NA%	74.56%	44.59%	NA	NA	1.09%
Net Margin	24.78%	-0.23%	10.13%	5.56%	12.73%	6.33%
Return on Equity	-52.78%	-10.35%	14.51%	-22.26%	-14.61%	16.35%
Sales/Assets	0.40	0.87	0.51	0.93	1.24	1.18
Proj. Sales Growth (F1/F0)	-9.63%	-7.96%	-1.43%	-12.00%	19.84%	-9.32%
Momentum Score	C	-	-	B	A	A
Daily Price Chg	0.23%	0.00%	-0.44%	-0.34%	2.53%	-0.86%
1 Week Price Chg	5.31%	3.68%	2.30%	-0.97%	6.14%	4.12%
4 Week Price Chg	8.16%	6.22%	4.38%	6.22%	18.56%	5.18%
12 Week Price Chg	11.57%	14.14%	13.59%	1.24%	29.79%	14.58%
52 Week Price Chg	-5.40%	-24.76%	5.75%	-17.28%	59.29%	27.82%
20 Day Average Volume	3,017,404	309,938	1,984,154	8,277,641	662,072	1,558,592
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	1.14%	4.82%	2.08%	20.87%	20.64%	3.73%
(F1) EPS Est 12 week change	6.24%	13.33%	2.66%	-21.73%	21.71%	7.59%
(Q1) EPS Est Mthly Chg	8.19%	10.79%	0.94%	12.54%	27.56%	-12.50%



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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>D</b>
Growth Score	<b>D</b>
Momentum Score	<b>C</b>
VGM Score	<b>F</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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