

## ON Semiconductor (ON)

**\$25.06** (As of 01/02/20)

Price Target (6-12 Months): **\$27.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 10/07/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

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

**4-Sell**

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: C

### Summary

ON Semi benefits from improving demand for image sensors, ADAS, power management products, wireless charging, and SiC products. Further, strength in medium voltage MOSFETs is helping the company to foray into key global markets, including 5G. Moreover, robust capabilities of high and medium voltage power modules, including IGBTs, modules and FETs hold promise. Also, ongoing momentum in ADAS and LEDs design wins are likely to act as a tailwind. Notably, shares of ON Semi have outperformed the industry in the past year. However, soft demand from industrial and automotive end-markets is a headwind for the company. This was a drag on its earnings and revenues during the third quarter of 2019. Moreover, sluggishness in demand from smartphone vertical remains a concern. The company also provided bleak fourth-quarter revenue guidance.

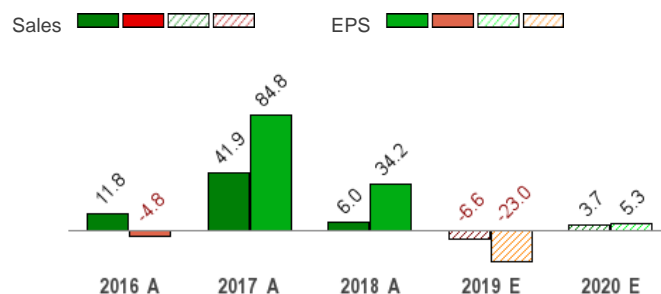
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$25.08 - \$15.84
20 Day Average Volume (sh)	3,170,294
Market Cap	\$10.3 B
YTD Price Change	2.8%
Beta	2.23
Dividend / Div Yld	\$0.00 / 0.0%
Industry	<a href="#">Semiconductor - Analog and Mixed</a>
Zacks Industry Rank	Bottom 26% (188 out of 253)

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



Last EPS Surprise	-8.3%
Last Sales Surprise	0.1%
EPS F1 Est- 4 week change	-0.3%
Expected Report Date	02/07/2020
Earnings ESP	0.0%
P/E TTM	14.7
P/E F1	15.8
PEG F1	2.2
P/S TTM	1.8

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,353 E	1,407 E	1,467 E	1,465 E	5,693 E
2019	1,387 A	1,348 A	1,382 A	1,376 E	5,492 E
2018	1,378 A	1,456 A	1,542 A	1,503 A	5,878 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.31 E	\$0.37 E	\$0.44 E	\$0.45 E	\$1.59 E
2019	\$0.43 A	\$0.42 A	\$0.33 A	\$0.33 E	\$1.51 E
2018	\$0.40 A	\$0.46 A	\$0.57 A	\$0.53 A	\$1.96 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 01/02/2020. The reports text is as of 01/03/2020.

## Overview

Phoenix, AZ-based ON Semiconductor Corporation is an original equipment manufacturer (OEM) of a broad range of discrete and embedded semiconductor components.

The company was spun off from Motorola in Aug 1999, and went public through an IPO in May 2000.

ON Semi's product lines include discretes, such as bipolar transistors, diodes, filters, FETs, rectifiers and thyristors.

ON Semi's acquisition of Fairchild Semiconductor International makes it a leader in the power semiconductor space. Moreover, the company's acquisitions of Cypress Semiconductor's CMOS Image Sensor Business Unit, SANYO Semiconductor, AMI Semiconductor, Analog Devices' power PC controller business, CMD, Catalyst, and SoundDesign gave it new technical capabilities, some custom ASIC products, higher-margin products, exposure to new end markets and greater product breadth.

The **power management** product line includes AC-DC controllers and regulators, DC-DC converters and regulators, drivers, thermal managers, and voltage controllers, references and supervisors.

The **logic** product line includes clocking, memory, differential logic and standard logic products.

**Signal processing** products include amplifiers and comparators, analog switches, digital potentiometers, DSP systems and interfaces.

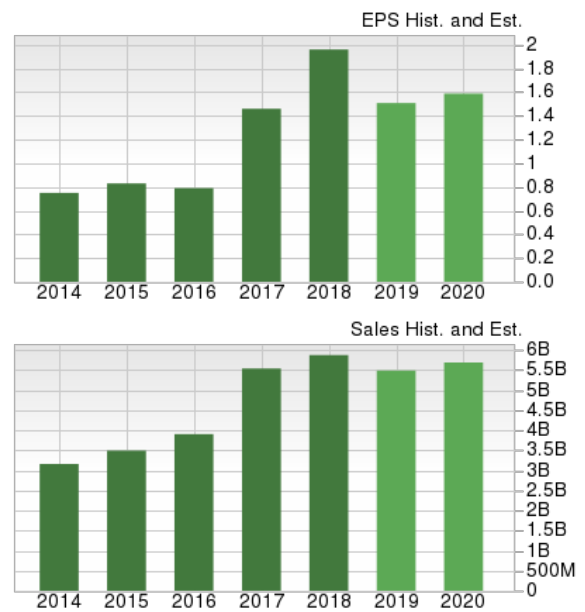
The company also offers **custom** application specific integrated circuits (ASICs), foundry services and memory products.

Customers include OEMs, electronic manufacturing service (EMS) providers and distributors. Top OEM customers include Motorola, Delta, Hewlett-Packard, Samsung, Siemens, Apple, Dell, Nokia, Intel, Sony, Continental Automotive Systems, DaimlerChrysler, Delphi, TRW and Visteon.

Top distributor customers include Arrow, Avnet, EBV Elektronik, Future, Solomon Enterprise and World Peace. Top EMS customers are Flextronics, Jabil and Celestica.

In 2018, non-GAAP revenues grew 9.1% over 2017 to \$5.878 billion.

ON Semi generated 14.7% of total revenues in fiscal 2018 from the United States. The company's largest customer accounted for around 5% of total revenues in 2018.



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## Reasons To Buy:

- ▲ ON Semi is seeing **strengthening demand** across most end markets as evident from its bookings trends over the last few quarters. The company's backlog grew in each of the last four quarters and since it generates just a fifth of sales from turns, backlog growth is a good indicator of sustained demand. Also, distributor inventories, increased in the last quarter and resales remained strong. The design win momentum that the company is seeing also remained encouraging.
- ▲ ON Semi's **automotive segment** is a strong growth driver for the company. Unit growth, share gains, attractive product offerings, rising content along with decreasing oil prices contribute to revenues. During the last quarter, the automotive segment registered a few impressive design wins for ADAS and rear view cameras with leading OEMs in the Americas, Europe and South Korea. Also the company is focused on investing in growth areas such as ADAS and wireless charging in the automotive business to broaden its exposure. This will further enhance its performance and help it deliver strong results. Given rising demand, ON Semi launched three new image sensors for ADAS and rear view applications. Also demand for image sensors, MOSFET's, Smart FET's, led drivers, wireless battery free sensing solution, parking sensor interface and power supply products is strong. The product launches in the automotive end market for next generation automobile designs augur well for the top line.
- ▲ ON Semi is **active on the M&A front**. The company's acquisitions of Cypress Semiconductor's CMOS Image Sensor Business Unit, SANYO Semiconductor, AMI Semiconductor, Analog Devices' power PC controller business, CMD, Catalyst, and SoundDesign gave it new technical capabilities, some custom ASIC products, higher-margin products, exposure to new end markets and greater product breadth. ON Semi's acquisition of Fairchild Semiconductor International makes it a leader in the power semiconductor space. The deal will help the company diversify across many markets with a planned focus on smartphone, automotive and industrial end markets. ON Semi has also acquired Quantenna Communications (June 2019), which is engaged in providing high performance Wi-Fi solutions. The transaction is anticipated to strengthen the company's connectivity portfolio and enable it to better address Industrial and Automotive end markets.
- ▲ ON Semi has **successfully integrated big acquisitions like AMIS** in the past, so it shouldn't have trouble with the integration. Management expects Fairchild acquisition to be immediately accretive to non GAAP earnings and free cash flow. Further gains are expected within a few quarters of close. Annual cost savings of at least \$150 million are expected within 18 months of closing. We believe that ON Semi can drive new socket opportunities by leveraging these acquisitions, thus generating top-line growth.
- ▲ ON Semi has a very **well diversified business**. The company generates a significant percentage of revenues from each of the computing, consumer, industrial, communications and automotive markets. This mitigates the impact of seasonality typical of any of the markets, resulting in balanced growth through the year. Moreover, this diversity also helps the company to offset any weakness in a particular market by growth in others.

Improving end markets, acquisitions, product breadth, diversification across end markets and geographies, and the benefits of restructuring actions are positives.

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## Reasons To Sell:

- ▼ ON Semi has a **significant debt burden**, but management has been dealing with the difficult situation through consistent repayments and refinancing actions. The acquisition of Fairchild will add more debt that the company will again have to bring down. Interest payments will continue to have a significant impact on net earnings. The company exited the third-quarter with net debt balance amounting to \$2.69 billion. A high debt position increases the risk profile of the business.
- ▼ ON Semi has made a number of **acquisitions** in the past, but the two acquisitions that were completed in 2008 were perhaps the most significant. Integration of AMIS continued right up to 2010, even after years from the date the acquisition was completed. SANYO Semiconductor was another difficult acquisition and while it recently turned incremental to earnings, the margin impact may not be positive, given that it is a lagging edge facility. Consistent acquisition of companies is a distraction for management until the integration activities are completed. Moreover, we note that the buyouts negatively impacted the company's balance sheet in the form of high level of goodwill and net intangible assets, which comprised of 26.8% of total assets as of Sep 27, 2019.
- ▼ ON Semi faces significant **competition** in all of the served markets. Being a maker of building block components of a general purpose nature, competition comes from every kind of integrated circuit manufacturer. The automotive market in Japan is particularly competitive, where the company has to get designed in at an early stage. This is mainly because Japanese automotive customers have a preference for local makers that sometimes makes it difficult to operate.
- ▼ ON Semi's restructuring actions will likely have a positive impact on margins over the next year or so. Further, its recent acquisitions have increased its exposure to industrial, automotive and consumer markets that have helped it diversify away from a sluggish computing market. Some of these markets can generate higher margins than the traditional business, which is a positive. The company also stands to benefit from share gains within the computing business, considering the increasing dollar content at Intel's new process architecture. However, the company is considering cutting down utilization, as broader markets are witnessing weaker demand trends. This will invariably lead to poorer fixed cost absorption, thus **eroding margins**.
- ▼ ON Semi derives significant proportion of revenues from outside the United States (almost 85.3% of total revenues in fiscal 2018), subjecting the company to **exchange rate volatility**. Unfavorable movement in exchange rates of foreign currencies like Hong Kong dollar, euro, pound sterling, and Singapore Dollar, among others, related to the U.S. dollar can adversely impact results and undermine its growth potential to some extent. Further, imposition of tariffs owing to trade war between the United States and China is anticipated to negatively impact growth prospects. The macroeconomic uncertainty has impacted investors' confidence and is likely to weigh on the company's performance.

The significant debt position, integration risks from acquisitions, rising spend on restructuring initiatives and ever-increasing competition remain major headwinds.

## Last Earnings Report

### ON Semiconductor Q3 Earnings Miss, Revenues Top Estimates

ON Semiconductor Corporation reported third-quarter 2019 non-GAAP earnings of 33 cents per share, which lagged the Zacks Consensus Estimate by 8.3%. Notably, the figure declined 42% from the year-ago quarter's level.

Revenues of \$1.382 billion beat the Zacks Consensus Estimate of \$1.381 billion and declined 10% on a year-over-year basis. Notably, the figure was within management's guidance of \$1.355-\$1.405 billion. Soft demand from industrial and automotive end-markets led to revenue decline.

Quarter Ending **09/2019**

Report Date	Oct 27, 2019
Sales Surprise	0.09%
EPS Surprise	-8.33%
Quarterly EPS	0.33
Annual EPS (TTM)	1.71

### Top-Line Details

#### Business Units Metrics:

ON Semiconductor has three business units — Power Solutions Group (revenues of \$687.9 million), Analog Solutions Group (revenues of \$508.9 million) and Intelligent Sensing Group (revenues of \$185 million).

#### End-Market Metrics:

**Automotive** (32.3% of revenues) end-market revenues were approximately \$445.9 million, down 3.3% year over year. Weakness in Asia and EMEA as well as broad-based softness in automotive market put pressure on segmental revenues.

Nonetheless, management noted that revenues from Greater China improved sequentially. Further, the company is banking on strong demand for its image sensors, ADAS, power management products, wireless charging, power MOSFETs and Silicon Carbide (SiC) products. Continued growth in ADAS and LEDs design wins are likely to be a tailwind going ahead.

Notably, the company holds a competitive edge over its peers when it comes to delivering a comprehensive image sensor solution for autonomous driving applications and ADAS. The solution features exhaustive range of pixel densities which include 1, 2, and 8 megapixels on a single platform.

**Industrial/Medical/Mil-Aero** (25.4%) end-market revenues declined 12.9% year over year to \$350.5 million on broad-based soft demand.

Nevertheless, the company's latest platform of products that include high and medium voltage power modules, including IGBTs, modules and FETs hold promise. The products are aimed to provide higher efficiency.

**Communications** (19.9%) end-market revenues declined almost 8% year over year to \$274.7 million on sluggishness in demand from smartphone vertical.

Nonetheless, management is banking on strength in medium voltage MOSFETs, which is aiding the company to foray into key global markets, including 5G infrastructure.

**Consumer** (11.3%) end-market revenues came in at \$156.9 million. The figure declined 26.2% from the year-ago quarter's level, primarily due to weakness in consumer electronics and white-goods segment.

**Computing** (11.1%) declined 7.9% year over year to \$153.9 million. Notably, strength in server solutions domain couldn't mitigate the downside. Management noted that improving supply of Intel's processors facilitated sequential growth.

### Margins in Detail

Non-GAAP gross margin of 35.8% contracted 290 basis points (bps) on a year-over-year basis. Management attributes the decline to one-time adjustment pertaining to a customer matter and pressure on ASPs.

Non-GAAP operating expenses fell 2.3% from the year-ago quarter's figure to \$314.3 million. However, as a percentage of revenues, the figure expanded 180 bps on a year-over-year basis to 22.7%.

Non-GAAP operating margin contracted 480 bps on a year-over-year basis to 13%, thanks to lower gross margin.

### Balance Sheet & Cash Flow

As on Sep 27 2019, ON Semiconductor had cash and cash equivalents of approximately \$928.7 million, up from \$885.2 million in the last reported quarter.

The company exited the third quarter with total debt (including current portion) amounting to \$3.615 billion, down from \$3.657 billion in the last reported quarter.

During the reported quarter, cash from operations came in at \$242.2 million compared with the previous quarter's figure of \$222.4 million. The company also generated free cash flow of \$130.5 million compared with \$68.9 million reported in the previous quarter.

The company repurchased approximately 764K shares worth \$13 million in the reported quarter. IP settlement litigation with Power Integrations and debt refinancing, limited share buybacks during the third quarter.

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**Guidance**

For the fourth quarter, ON Semiconductor forecasts revenues in the range of \$1.350-\$1.400 billion.

Management expects revenues from Automotive and Computing end-markets to improve sequentially in the fourth quarter. Revenues from Industrial end-market are anticipated to remain flat on a quarter-over-quarter basis. Meanwhile, Communications and Consumer end-markets are anticipated to decline sequentially in the third quarter.

For the fourth quarter, non-GAAP gross margin is projected in the range of 35.7-36.7%. Non-GAAP operating expenses are expected in the range of \$312-\$328 million.

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## Recent News

On **Oct 20, 2019**, ON Semiconductor announced that shipments of its AR0132AT image sensors, which are utilized to enhance performance of driver assistance applications, has crossed over 100 million units. The sensors have been implemented by SUBARU CORPORATION, to power its robust driver support system, EyeSight.

On **Oct 15, 2019**, ON Semiconductor announced collaboration with Almotive to build prototype sensor fusion platforms to power automotive applications.

On **Oct 10, 2019**, ON Semiconductor announced that its Wi-Fi chipset from Quantenna Connectivity Solutions division has been implemented by Europe-based broadband service provider, Orange France in its latest gateway— Livebox 5.

## Valuation

ON Semiconductor shares are up 26.4% in the past six-month period and 51.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 16.7% and 14.1% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and sector are up 52.8% and 37%, respectively.

The S&P 500 index is up 10.3% in the past six-month period and 30.2% in the past year.

The stock is currently trading at 16.61X forward 12-month earnings, which compares to 23.32X for the Zacks sub-industry, 23.44X for the Zacks sector and 19.24X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.61X and as low as 7.52X, with a 5-year median of 11.22X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$27 price target reflects 17.9X forward 12-month earnings.

The table below shows summary valuation data for ON

Valuation Multiples -ON					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	16.61	23.32	23.44	19.24
	5-Year High	16.61	23.32	23.44	19.34
	5-Year Low	7.52	13.42	16.86	15.17
	5-Year Median	11.22	18.09	19.11	17.44
P/S F12M	Current	1.87	4.74	3.62	3.49
	5-Year High	2.00	4.74	3.62	3.49
	5-Year Low	0.82	2.81	2.29	2.54
	5-Year Median	1.29	3.68	2.99	3.00
EV/Sales TTM	Current	2.18	5.21	4.25	3.26
	5-Year High	2.37	5.21	4.25	3.30
	5-Year Low	0.90	3.13	2.54	2.14
	5-Year Median	1.82	4.34	3.42	2.79

As of 01/02/2020

## Industry Analysis Zacks Industry Rank: Bottom 26% (188 out of 253)



## Top Peers

Broadcom Inc. (AVGO)	Neutral
Diodes Incorporated (DIOD)	Neutral
Infineon Technologies AG (IFNNY)	Neutral
Monolithic Power Systems, Inc. (MPWR)	Neutral
STMicroelectronics N.V. (STM)	Neutral
Texas Instruments Incorporated (TXN)	Neutral
Vishay Intertechnology, Inc. (VSH)	Neutral
Analog Devices, Inc. (ADI)	Underperform

Industry Comparison Industry: Semiconductor - Analog And Mixed				Industry Peers		
	ON Neutral	X Industry	S&P 500	ADI Underperform	AVGO Neutral	DIOD Neutral
<b>VGM Score</b>	<b>C</b>	-	-	<b>C</b>	<b>C</b>	<b>A</b>
Market Cap	10.29 B	6.48 B	23.76 B	44.35 B	128.24 B	2.92 B
# of Analysts	10	9	13	13	13	1
Dividend Yield	0.00%	0.00%	1.78%	1.79%	4.03%	0.00%
<b>Value Score</b>	<b>B</b>	-	-	<b>D</b>	<b>C</b>	<b>B</b>
Cash/Price	0.09	0.09	0.04	0.01	0.04	0.08
EV/EBITDA	8.67	19.51	13.97	19.36	16.17	10.51
PEG Ratio	2.16	2.03	2.02	2.03	1.30	NA
Price/Book (P/B)	3.18	4.78	3.38	3.79	NA	2.71
Price/Cash Flow (P/CF)	7.72	18.94	13.70	16.23	9.49	12.68
P/E (F1)	15.41	31.08	18.83	25.17	13.95	19.76
Price/Sales (P/S)	1.83	5.48	2.68	7.40	5.68	2.32
Earnings Yield	6.34%	3.25%	5.30%	3.97%	7.17%	5.06%
Debt/Equity	0.89	0.55	0.72	0.44	-214.36	0.08
Cash Flow (\$/share)	3.25	2.86	6.94	7.42	33.97	4.52
<b>Growth Score</b>	<b>D</b>	-	-	<b>C</b>	<b>B</b>	<b>A</b>
Hist. EPS Growth (3-5 yrs)	25.92%	15.13%	10.56%	21.84%	28.58%	24.92%
Proj. EPS Growth (F1/F0)	5.31%	11.70%	7.41%	-7.10%	8.51%	0.00%
Curr. Cash Flow Growth	20.30%	-6.04%	14.83%	-9.88%	7.86%	36.97%
Hist. Cash Flow Growth (3-5 yrs)	24.07%	25.11%	9.00%	24.75%	48.32%	11.81%
Current Ratio	1.54	3.49	1.23	1.32	1.44	2.56
Debt/Capital	47.05%	35.79%	42.92%	30.72%	54.64%	7.55%
Net Margin	5.71%	5.11%	11.08%	22.75%	12.06%	10.74%
Return on Equity	21.95%	12.94%	17.10%	16.39%	46.16%	14.60%
Sales/Assets	0.70	0.49	0.55	0.28	0.32	0.79
Proj. Sales Growth (F1/F0)	3.66%	2.46%	4.20%	-5.46%	10.72%	-0.67%
<b>Momentum Score</b>	<b>C</b>	-	-	<b>A</b>	<b>D</b>	<b>C</b>
Daily Price Chg	2.79%	1.64%	0.33%	1.34%	2.02%	1.65%
1 Week Price Chg	1.53%	0.78%	0.13%	-0.31%	-0.77%	3.61%
4 Week Price Chg	15.75%	10.54%	3.31%	6.17%	3.60%	22.10%
12 Week Price Chg	38.76%	15.38%	9.70%	11.06%	17.47%	43.11%
52 Week Price Chg	60.13%	61.19%	30.28%	49.18%	39.59%	90.05%
20 Day Average Volume	3,170,294	494,441	1,603,615	1,637,117	2,329,526	356,908
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.25%	0.00%	0.00%	0.05%	-1.83%	0.00%
(F1) EPS Est 12 week change	-4.62%	-8.45%	-0.57%	-9.78%	-1.83%	0.00%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-7.03%	0.00%



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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

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

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

Value Score	<b>B</b>
Growth Score	<b>D</b>
Momentum Score	<b>C</b>
VGM Score	<b>C</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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