

Walgreens Boots (WBA)

\$54.68 (As of 01/09/20)

Price Target (6-12 Months): **\$57.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 06/06/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

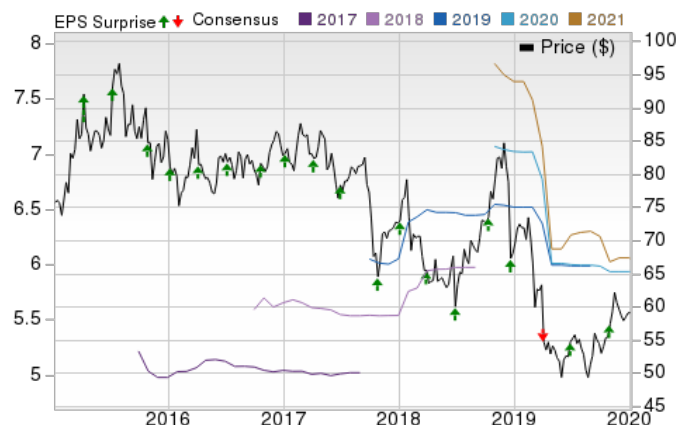
Growth: B

Momentum: D

Summary

Walgreens Boots exited first-quarter fiscal 2020 on a sluggish note. On a brighter note, the Retail Pharmacy USA division saw an uptick in sales during the quarter on account of comparable prescription growth and a strong retail prescription market. Also, a rise in Pharmaceutical Wholesale division sales buoys optimism. The recently-inked agreement with McKesson to create a German joint venture and an exclusive franchise deal in the United Kingdom with Mothercare hold promise. However, the year-over-year decline in adjusted earnings is concerning. Meanwhile, tough market conditions, particularly in retail, have been inducing sluggishness in the Retail Pharmacy International division. Margin pressure is a major overhang as well. Over the past three months, the company has underperformed the broader market.

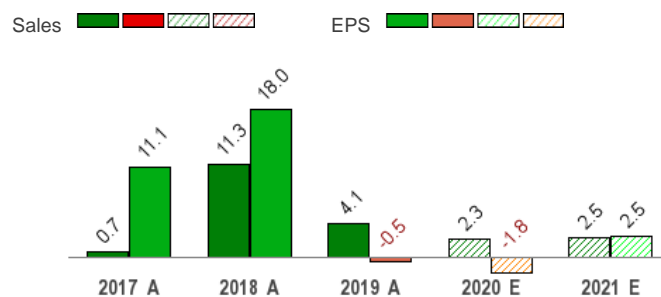
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$74.95 - \$49.03
20 Day Average Volume (sh)	4,989,460
Market Cap	\$48.4 B
YTD Price Change	-7.3%
Beta	0.90
Dividend / Div Yld	\$1.83 / 3.3%
Industry	Retail - Pharmacies and Drug Stores
Zacks Industry Rank	Top 14% (35 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-2.1%
Last Sales Surprise	-0.8%
EPS F1 Est- 4 week change	-0.9%
Expected Report Date	04/07/2020
Earnings ESP	-3.9%
P/E TTM	9.3
P/E F1	9.3
PEG F1	1.1
P/S TTM	0.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	35,573 E	36,235 E	36,488 E	36,005 E	143,512 E
2020	34,339 A	35,223 E	35,379 E	34,798 E	139,984 E
2019	33,793 A	34,528 A	34,591 A	33,954 A	136,866 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.40 E	\$1.56 E	\$1.53 E	\$1.49 E	\$6.03 E
2020	\$1.37 A	\$1.52 E	\$1.52 E	\$1.50 E	\$5.88 E
2019	\$1.46 A	\$1.64 A	\$1.47 A	\$1.43 A	\$5.99 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 01/09/2020. The reports text is as of 01/10/2020.

Overview

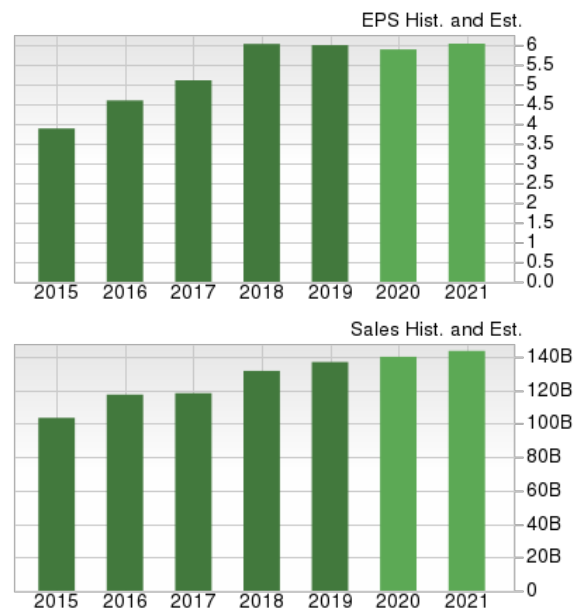
Founded in December 2014, Walgreens Boots Alliance (WBA) is the world's first pharmacy-led, health and wellbeing enterprise. The company has been formed through the combination of Walgreens Co. (WAG) and Alliance Boots. The merger brought together two leading companies with iconic brands, complementary geographic footprints, shared values, and trusted health care services through pharmaceutical wholesaling and community pharmacy care.

The company includes the largest global pharmaceutical wholesaler and distribution network with over 390 distribution centers delivering to more than 230,000 pharmacies, doctors, health centers and hospitals every year across 20 countries. In addition, Walgreens Boots Alliance is the world's largest purchaser of prescription drugs and several other health and wellbeing products. Its portfolio of retail and business brands includes Walgreens, Duane Reade, Boots and Alliance Healthcare, as well as global health and popular beauty product brands such as No7, Botanics, Liz Earle and Soap & Glory.

Segments in Detail

Historically, the legacy Walgreens used to report as one segment, which comprised the performance of Walgreens in the U.S.; its corporate costs and synergies from the Walgreens Boots Alliance Development joint venture, also known as WBAD; and equity earnings from Alliance Boots on a three-month lag. Following the combination of Alliance Boots and the legacy Walgreens, Walgreens Boots eliminated the three-month reporting lag and recast prior period results with no lag.

As Walgreens Boots, management now reports results in three segments: Retail Pharmacy USA (176.43% of total revenues in fiscal 2019), Retail Pharmacy International (8.37%), and Pharmaceutical Wholesale (16.8%). In fiscal 2019, Retail Pharmacy USA segment registered 6.2% growth, Retail Pharmacy International segment registered 1.6% decline and Pharmaceutical Wholesale registered 8% growth from fiscal 2018.



Reasons To Buy:

▲ **New Alliances Look Strategic:** The intensifying competition in the U.S. retail drugstore market has compelled Walgreens Boots to diversify its product offerings. In this line investors are currently looking forward to Walgreens' tie up with Alphabet's life sciences and healthcare segment Verily on multiple projects on chronic ailment. This partnership aims at providing advanced healthcare outcomes to chronic conditions like diabetes at low cost of care. Under the company's recent partnership with Kroger, the company is working on a pilot program at selected Walgreens outlets in Northern Kentucky and Tennessee. The Kroger Express concept will be applied in 50 Walgreens stores and Walgreen's own health and beauty brands will be available in 17 Kroger stores. The partnership has been progressing well through the reported quarter. The initial Kroger Express pilots in Northern Kentucky has been functional for just over one year and the pilot in Knoxville, TN for five months.

Walgreens is also progressing well with its collaboration with LabCorp. The company is planning to open at least 600 LabCorp patient centers across the United States, thereby offering diagnostic lab testing services in the community.

The company has expanded its reach in specialty market segment, by making an equity investment in specialty provider Shields Health Solutions. Walgreens has also inked a strategic alliance with Centene, a leading Medicaid insurer, and RxAdvance, a cloud-based pharmacy benefit manager. Also, the company recently entered into a multi-year Medicare agreement with UnitedHealthcare, which entails a new co-branded Medicare Advantage plan with Walgreens being the exclusive Retail Pharmacy company. Through the first quarter, Walgreens continued to witness solid customer adoption and open up opportunities in Medicare Advantage.

The company also recently inked a first-of-a-kind partnership with Wing to test on-demand drawing delivery, which utilizes Walgreens' previously-announced trial with FedEx for robot delivery.

During the first quarter of fiscal 2020, Walgreens inked an agreement with McKesson to create a German JV. Through this JV, the companies will combine their wholesale operations to generate long-term value across key European markets. The company also recently signed an exclusive franchise deal in the United Kingdom with Mothercare, a British Retail online brand specializing in products for children. Walgreens will be selling Mothercare branded goods across the United Kingdom and online. Walgreens' alliance with Jenny Craig is progressing well and the company is on track to open approximately 100 locations by the end of January 2020.

▲ **Express Script Deal Looks Promising:** In a bid to ensure availability of specialty brand drugs Walgreens Boots has tied up with Express Scripts and announced plans to expand their existing group purchasing efforts. Since biosimilars have the potential to lower production costs, the move is considered to be a prudent and timely one. Specialty medication includes costly and complex drugs and is prescribed on a regular basis. The latest pact is expected to improve Express Scripts' supply chain and make these medicines, including biosimilars, affordable and accessible to patients.

Per a study by SNS Research, approved biosimilars will account for nearly \$22 billion revenues by the end of 2020. Regulatory efforts to reduce healthcare costs are likely to aid this growth. Given the potential that the market holds, we believe the latest move by these two medical behemoths is a strategic and timely one.

▲ **Pharmaceutical Wholesale Division Registers Robust Growth:** The company witnessed consistent solid performance from this segment. The Pharmaceutical Wholesale division's quarterly sales were \$6 billion, up 5.2% year over year. Comparable sales were up 8.3% at CER on growth in the emerging markets and the United Kingdom.

▲ **Strong Balance Sheet:** Walgreens Boots exited the first quarter of fiscal 2020 with cash and cash equivalents of \$811 million compared with \$1.02 billion at the end of fiscal 2019. Long-term debt was \$10.63 billion at the end of the first quarter of fiscal 2020 compared with \$11.09 billion at the end of the fiscal 2019. Net cash provided by operating activities was \$1.1 billion, up from \$460 million in the year-ago period.

Walgreens Boots revised Rite Aid deal is expected to benefit the company more over the long run. The company's strong cash balance position and progress in cost cutting initiatives further boost our confidence in the stock.

Reasons To Sell:

- ▼ **Share price fall:** Sluggish sales in Walgreens Boots' Retail Pharmacy International segment resulted in the drop in share price. The year-over-year decline in adjusted earnings is another cause for concern. Meanwhile, tough market conditions, particularly in retail, a tough competitive landscape and margin pressure have been major dampeners. In the past three months, the stock has climbed 1.3% compared with the broader market's 11.4% rally.
- ▼ **Retail Pharmacy International Business Soft:** Over the recent quarters, Walgreens Boots Retail Pharmacy International division remained soft. Revenues at the Retail Pharmacy International division declined 5.4% on a year-over-year basis to \$2.7 billion in the fiscal first quarter. Sales were down 2.7% at CER due to lower Boots UK sales and declining sales in Chile. According to Walgreens Boots, reimbursement pressure has continued and opportunities for mitigation are lower than expected.
- ▼ **Pressure on Margin Continues:** In the last few years, slowdown in generic introduction has been affecting Walgreens Boots' margins. In addition, of late, increased reimbursement pressure and generic drug cost inflation have been hampering Walgreens' margin on a significant level. Gross profit in the reported quarter fell 4.9% year over year to \$7.26 billion. Gross margin contracted 146 basis points (bps) to 21.1%. Selling, general and administrative (SG&A) expenses were down 26.5% year over year to \$6.26 billion. Operating income deteriorated 39% to \$1 billion. Overall, operating margin contracted 111 bps to 2.9%.

Ongoing generic drug inflation, reimbursement pressure and competitive market offer tough challenges for Walgreens Boots. Also, the fluctuating weak U.S. macroeconomic environment still prevailing might hamper the company's margin.
- ▼ **Competitive Landscape:** Walgreens Boots faces headwinds in the form of increased competition and tough industry conditions. Even though the company continues to grab market share from other traditional drug store retailers, major mass merchants such as Target and Wal-Mart are expanding their pharmacy businesses and enjoying a fair market share. Notably, the retail wing of CVS Caremark witnessed a record market share gain following the termination of the Walgreens-Express Scripts contract. While Walgreens Boots' dull performance is showing signs of improvement with the return of customers, CVS management's commentary of retaining a majority of the client wins raises our concern. There are also risks from other channels, such as supermarkets and mail order operations. In addition, industry conditions remain challenging, as insurers reduce reimbursement rates and increase prescription co-payments.
- ▼ **Additional Challenges:** Under the present weak macroeconomic environment, external factors on which the company has no control whatsoever, might affect consumer confidence as increasing costs coupled with unemployment makes customers more value-driven. Consequently, spending on discretionary items gets affected. We believe this situation will impact same store sales growth. Moreover, the UK referendum and the consequent exit of Britain from the EU have paved the way for volatility in this market, which in turn might hamper Walgreens Boots' business in the region.
- ▼ **Shift in Pharmacy Mix Might Hamper Operational Results:** A shift in the mix of pharmacy prescription volume toward programs offering lower reimbursement rates might adversely affect Walgreens Boots' results of operations. The company's 90-day at retail offering for patients with chronic prescription needs typically is at a lower margin than comparable 30-day prescriptions. Additionally, management has accepted lower reimbursement rates in order to secure preferred relationships with Medicare Part D plans serving senior patients with significant pharmacy needs. If Walgreens Boots fails to generate additional prescription volume and other business from patients participating in these programs that is sufficient to offset the impact of lower reimbursement, it might adversely affect the company's results of operations.

Last Earnings Report

Walgreens Boots Q1 Earnings Lag Estimates, Margins Fall

Walgreens Boots Alliance, Inc. reported adjusted earnings per share of \$1.37 for first-quarter fiscal 2020, down 6.2% year over year (down 5.7% at constant exchange rate or CER). Also, the figure missed the Zacks Consensus Estimate by 2.1%.

Reported earnings per share of 95 cents declined 19.5% on a year-over-year basis.

Sluggishness in Retail Pharmacy International and margin contraction built pressure on the bottom line.

Total Sales

Walgreens Boots recorded total sales of \$34.34 billion in the fiscal first quarter, up 1.6% year over year and 2.3% at constant exchange rate or CER. The top line, however, missed the Zacks Consensus by 0.8%. The year-over-year growth was led by improvement within the Retail Pharmacy USA and Pharmaceutical Wholesale divisions, partially offset by a dull performance by Retail Pharmacy International.

Segments in Detail

Walgreens Boots reports through three segments: Retail Pharmacy USA, Retail Pharmacy International and Pharmaceutical Wholesale.

Retail Pharmacy USA

The segment's sales totaled \$26.1 billion in the first quarter, highlighting an improvement of 1.6% year over year.

Pharmacy sales increased 2.9% from the year-ago quarter on higher brand inflation, prescription volume and growth in central specialty. Pharmacy sales at comparable stores improved 2.5% year over year, while prescriptions filled in comparable stores (adjusted to 30-day equivalents) rose 2.8% in the quarter. Retail sales dipped 2.2% while comparable retail sales slid 0.5% year over year on continued de-emphasis of tobacco.

Retail Pharmacy International

Revenues at the Retail Pharmacy International division declined 5.4% on a year-over-year basis to \$2.7 billion in the fiscal first quarter. Sales were down 2.7% at CER due to lower Boots UK sales and lower sales in Chile.

Comparable pharmacy sales increased 0.6% at CER and comparable retail sales declined 3% at CER in the reported quarter.

Pharmaceutical Wholesale

The Pharmaceutical Wholesale division's quarterly sales were \$6 billion, up 5.2% year over year (comparable sales were up 8.3% at CER on growth in the emerging markets and the United Kingdom).

Margins

Gross profit in the reported quarter fell 4.9% year over year to \$7.26 billion. Gross margin contracted 146 basis points (bps) to 21.1%.

Selling, general and administrative (SG&A) expenses were down 26.5% year over year to \$6.26 billion. Operating income deteriorated 39% to \$1 billion. Overall, operating margin contracted 111 bps to 2.9%.

Financial Condition

Walgreens Boots exited the first quarter of fiscal 2020 with cash and cash equivalents of \$811 million compared with \$1.02 billion at the end of fiscal 2019. Long-term debt was \$10.63 billion at the end of the first quarter of fiscal 2020 compared with \$11.09 billion at the end of the fiscal 2019. Net cash provided by operating activities was \$1.1 billion, up from \$460 million from year-ago period.

Fiscal 2020 Guidance

The company reaffirmed its guidance at roughly flat growth in fiscal 2020 adjusted EPS, on a constant currency basis, with a range of plus or minus 3%. The Zacks Consensus Estimate for fiscal 2020 adjusted earnings per share is currently pegged at \$5.93.

Quarter Ending **11/2019**

Report Date	Jan 08, 2020
Sales Surprise	-0.84%
EPS Surprise	-2.14%
Quarterly EPS	1.37
Annual EPS (TTM)	5.91

Recent News

On **Dec 11, 2019**, Walgreens and Kroger formed group purchasing organization as the companies expanded their collaboration with new joint venture.

On **Oct 1, 2019**, Walgreens signed a retail health clinical collaboration and services deal as well as a retail pharmacy-oriented transaction with Novant Health. Per the agreement, Walgreens will acquire nine of Novant Health's retail pharmacies.

Valuation

Walgreens shares are down 1.7% in the past six-month period and down 23.8% in the trailing 12-month periods. Stocks in the Zacks sub-industry are up 15.2% while the Zacks Medical sector rose 5.9% in the past six-month period. Over the past year, the Zacks sub-industry is down 4.7% while sector is up 19.5%.

The S&P 500 index is up 9% in the past six-month period and increased 24.4% in the past year.

The stock is currently trading at 9.2X Forward 12-months earnings, which compares to 9.9X for the Zacks sub-industry, 25.5X for the Zacks sector and 18.94X for the S&P 500 index.

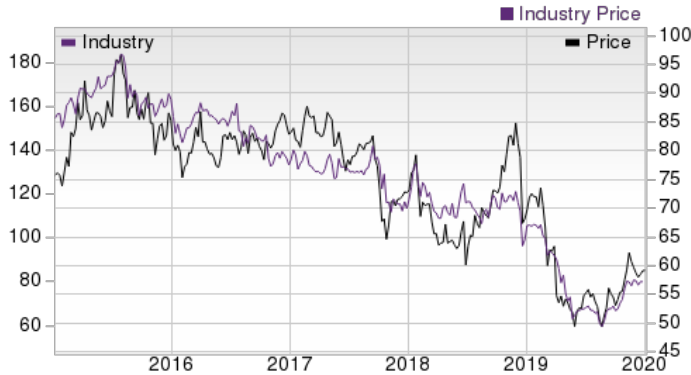
Over the past five years, the stock has traded as high as 23.3X and as low as 8.2X, with a 5-year median 14.7X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$57 price target reflects 9.61X forward 12-months earnings.

The table below shows summary valuation data for WBA

Valuation Multiples -WBA					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	9.15	9.94	25.51	18.94
	5-Year High	23.30	20.64	26.13	19.34
	5-Year Low	8.18	7.72	18.99	15.17
	5-Year Median	14.73	13.86	22.91	17.44
P/S F12M	Current	0.34	0.32	1.08	3.51
	5-Year High	0.93	0.78	1.10	3.51
	5-Year Low	0.32	0.24	0.80	2.54
	5-Year Median	0.68	0.48	0.90	3.00
P/B TTM	Current	2.02	1.44	5.20	4.47
	5-Year High	3.78	3.18	5.82	4.47
	5-Year Low	1.80	1.18	3.58	2.85
	5-Year Median	2.78	2.35	4.79	3.61

As of 1/09/2020

Industry Analysis Zacks Industry Rank: Top 14% (35 out of 254)



Top Peers

Rite Aid Corporation (RAD)	Outperform
Amazon.com, Inc. (AMZN)	Neutral
Cigna Corporation (CI)	Neutral
CVS Health Corporation (CVS)	Neutral
Diplomat Pharmacy, Inc. (DPLO)	Neutral
The Kroger Co. (KR)	Neutral
UnitedHealth Group Incorporated (UNH)	Neutral
Walmart Inc. (WMT)	Neutral

Industry Comparison Industry: Retail - Pharmacies And Drug Stores				Industry Peers		
	WBA Neutral	X Industry	S&P 500	AMZN Neutral	CVS Neutral	WMT Neutral
VGM Score	A	-	-	C	A	B
Market Cap	48.44 B	499.39 M	23.84 B	942.54 B	94.79 B	332.97 B
# of Analysts	10	4.5	13	13	23	14
Dividend Yield	3.35%	0.00%	1.79%	0.00%	2.74%	1.81%
Value Score	A	-	-	D	B	C
Cash/Price	0.02	0.09	0.04	0.05	0.08	0.03
EV/EBITDA	11.00	11.01	13.88	32.89	13.21	15.89
PEG Ratio	1.14	1.34	2.02	2.64	1.55	4.75
Price/Book (P/B)	2.00	2.00	3.33	16.68	1.51	4.25
Price/Cash Flow (P/CF)	6.53	4.56	13.76	36.74	4.56	13.56
P/E (F1)	9.30	10.20	18.76	72.48	10.20	23.55
Price/Sales (P/S)	0.35	0.37	2.63	3.55	0.39	0.64
Earnings Yield	10.75%	8.09%	5.32%	1.38%	9.80%	4.24%
Debt/Equity	1.34	0.36	0.72	0.40	1.32	0.83
Cash Flow (\$/share)	8.38	3.97	6.94	51.74	15.97	8.66
Growth Score	B	-	-	A	A	C
Hist. EPS Growth (3-5 yrs)	13.75%	0.22%	10.56%	116.18%	11.14%	0.13%
Proj. EPS Growth (F1/F0)	-1.82%	23.12%	7.46%	27.90%	1.63%	1.50%
Curr. Cash Flow Growth	-2.42%	0.71%	14.83%	85.21%	87.00%	5.58%
Hist. Cash Flow Growth (3-5 yrs)	11.05%	5.33%	9.00%	48.43%	19.17%	-0.35%
Current Ratio	0.66	0.99	1.23	1.10	0.92	0.81
Debt/Capital	57.22%	56.88%	42.99%	28.45%	56.88%	45.25%
Net Margin	2.69%	-0.02%	11.08%	4.27%	1.83%	2.77%
Return on Equity	21.76%	-11.78%	17.16%	22.52%	15.45%	18.47%
Sales/Assets	1.85	1.77	0.55	1.45	1.14	2.24
Proj. Sales Growth (F1/F0)	2.28%	0.00%	4.16%	18.55%	1.31%	2.21%
Momentum Score	D	-	-	F	D	B
Daily Price Chg	-2.06%	-1.63%	0.39%	0.48%	0.28%	1.03%
1 Week Price Chg	0.10%	0.32%	-0.30%	0.28%	-1.12%	-1.42%
4 Week Price Chg	-6.66%	0.13%	2.38%	7.99%	-1.89%	-2.00%
12 Week Price Chg	-2.25%	17.02%	6.40%	6.35%	9.56%	-2.07%
52 Week Price Chg	-24.56%	-19.02%	22.97%	14.78%	11.15%	23.59%
20 Day Average Volume	4,989,460	1,601,896	1,610,101	3,244,690	4,670,225	4,599,376
(F1) EPS Est 1 week change	-0.89%	0.00%	0.00%	0.00%	-0.02%	0.00%
(F1) EPS Est 4 week change	-0.89%	-0.04%	0.00%	-1.03%	-0.09%	0.11%
(F1) EPS Est 12 week change	-0.80%	-0.77%	-0.50%	-18.91%	-0.74%	1.37%
(Q1) EPS Est Mthly Chg	-5.98%	0.00%	0.00%	-2.70%	0.44%	0.06%

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	B
Momentum Score	D
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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