

The Wendys Company (WEN)

\$21.45 (As of 08/24/20)

Price Target (6-12 Months): **\$23.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/07/18)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: C

Growth: D

Momentum: F

Summary

Shares of Wendy's have underperformed the industry so far this year. The company reported second-quarter fiscal 2020 results, wherein the bottom line surpassed the Zacks Consensus Estimate but the top line lagged the same. However, the top and the bottom line declined 7.6% and 33.3%, respectively, on a year-over-year basis. Comps also declined in the quarter mainly due to labor rate inflation and dismal traffic on account of the coronavirus pandemic. However, initiatives like menu innovation, technological upgrades, international expansion and re-imaging of units are likely to benefit the company. Also, the company's transition to a franchised business model bodes well. Notably, earnings estimates for 2020 have moved up over the past 30 days, depicting analyst optimism regarding the stock's earnings growth potential.

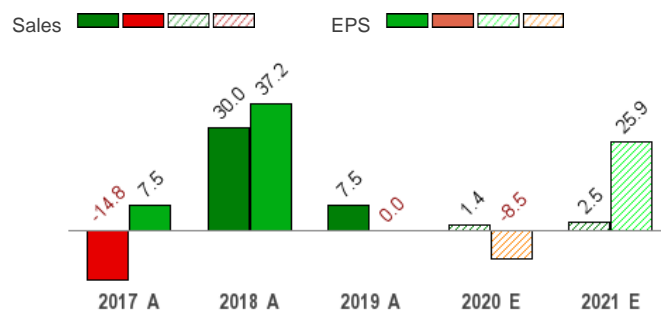
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$24.04 - \$6.82
20 Day Average Volume (sh)	3,938,541
Market Cap	\$4.8 B
YTD Price Change	-3.4%
Beta	1.24
Dividend / Div Yld	\$0.20 / 0.9%
Industry	Retail - Restaurants
Zacks Industry Rank	Top 48% (122 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	20.0%
Last Sales Surprise	-0.6%
EPS F1 Est- 4 week change	1.1%
Expected Report Date	11/04/2020
Earnings ESP	0.0%
P/E TTM	44.7
P/E F1	39.7
PEG F1	2.8
P/S TTM	2.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	420 E	438 E	462 E	459 E	1,777 E
2020	405 A	402 A	453 E	471 E	1,733 E
2019	409 A	435 A	438 A	427 A	1,709 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.13 E	\$0.18 E	\$0.20 E	\$0.18 E	\$0.68 E
2020	\$0.09 A	\$0.12 A	\$0.16 E	\$0.17 E	\$0.54 E
2019	\$0.14 A	\$0.18 A	\$0.19 A	\$0.08 A	\$0.59 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 08/24/2020. The reports text is as of 08/25/2020.

Overview

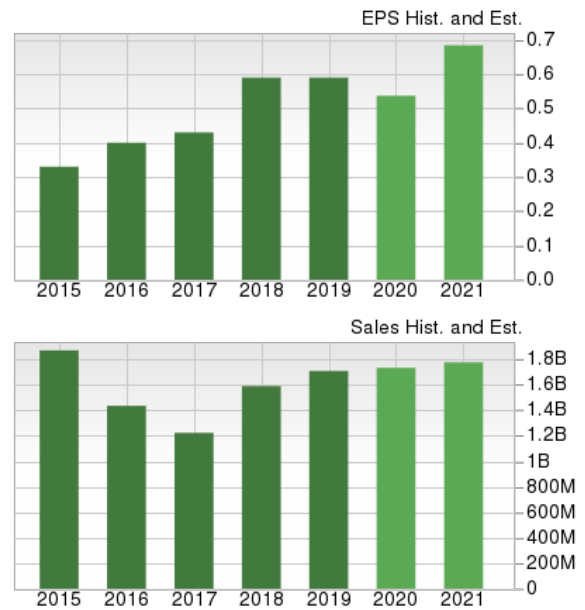
The Wendy's Company, the world's third-largest quick-service restaurant company, operates through its subsidiary holding company — Wendy's Restaurants, LLC. The fast-food chain through its subsidiary operates as a franchisor of the Wendy's restaurant system. As of Jun 28, 2020, The Wendy's system included more than 6,800 franchisees and company-operated restaurants in the United States and 30 other countries.

In 2019, the company realigned its management and operating structure to increase efficiencies and accelerate long-term growth. This eventually led to the combination of its Canadian business with its International segment and separating its real estate and development operations into its own segment. As a result, the company now operates under the following three segments, namely Wendy's U.S., Wendy's International and Global Real Estate & Development.

The company derives revenues from two principal sources: sales at company-operated restaurants and franchise-related revenues — including royalties, national advertising funds contributions, rents and franchise fees received from Wendy's franchised restaurants.

The Wendy's menu features hamburgers; chicken breast sandwiches and wraps; chicken nuggets; chili, baked and French-fried potatoes; freshly prepared salads; soft drinks and Frosty desserts.

On Sep 29, 2019, the company completed its merger with Triarc in an all-stock transaction in which Wendy's shareholders received 4.25 shares of Wendy's/Arby's Class A common stock for each Wendy's common share owned.



Reasons To Buy:

▲ **Strong International Presence & Expansion Efforts:** Wendy's is steadfast in expanding its presence globally. The company's international business is thus poised to be a driver of growth in the future. The company has growth plans and partnerships in Argentina, the Philippines and Japan. Further, Wendy's has long-term development agreements with franchisees in Singapore, the Middle East, North Africa, the Russian Federation, the Eastern Caribbean, Argentina, Japan, Georgia, the Republic of Azerbaijan, Ecuador and Chile. Additionally, the company is exploring growth opportunities in China and other key international markets. Despite the pandemic, the company has made significant progress with respect to restaurant openings in the United Kingdom, with plans of rollout in the first half of 2021.

The company's initiatives like menu innovation, technological upgrades, international expansion and re-imaging of units should help boost the top line

Notably, the company anticipates the count to increase to 1500 restaurants internationally and double its sales to approximately \$2 billion by 2024. These less saturated emerging markets offer the company enormous growth opportunities. They have significant growth potential due to their relatively low per-capita consumption. Markedly, with a strong pipeline of locations along with a talent team in place, the company is optimistic toward growth opportunities in international markets. During the second quarter of 2020, Wendy's had 22 global restaurant openings with an increase of one net new unit.

▲ **Transition to a Franchised Business Model:** Wendy's is benefiting from its transition to a franchised business model. In 2017, the company had several first-time builders and doubled the number of franchises from 2015 by building new restaurants. Though the reduction in ownership has been weighing on revenues over the past few quarters, we believe franchising a large chunk of its system will lower Wendy's general and administrative expenses and thereby boost earnings. Moreover, over the long term, it would generate a higher return on equity by lowering capital requirements. This would also boost free cash flow, thereby enhancing shareholder return. In 2018, the company's top line benefited from the Franchise flip that occurred in 2017.

Moving forward, the company plans to continue facilitating franchisee-to-franchisee restaurant transfers through its buy-and-flip strategy. This strategy ensures that restaurants are put in the hands of well-capitalized franchisees, committed to long-term growth. In 2018, Wendy's facilitated 96 Franchise Flips. In 2020, the company expects to complete approximately 100 Franchise Flips, which will further strengthen its franchise base. It also plans to re-franchise its company-operated New York market in 2020. The company expects these restaurants under the franchisees to unlock significant growth in this market.

▲ **Re-imaging Restaurants to Improve Guest Experience:** Wendy's remains on track to achieve at least 70% of its Image Activation goal as part of the brand transformation initiative. This program has gained traction in the recent past, leading to increased traffic and higher sales at its restaurants. At the end of 2018, 50% of the global system featured the brand's new image. Interestingly, as a result of this re-imaging, customers have seen some bold designs and friendlier restaurant teams.

▲ **Focus on Product Innovation:** The company's brand transformation initiative also includes menu innovation, promotional offers and bold new packaging, intended for boosting sales. Meanwhile, the practice of offering customized sandwiches made on order and serving hamburgers made of never-frozen beef would continue to drive sales for the company. We expect the company's solid menu pipeline, limited time offers (LTO), marketing initiatives and increased emphasis on core and price value offerings, to maintain the trend. During the fourth quarter of 2019, Wendy's created a differentiated menu featuring Baconator, Frosty-ccino and Honey Butter Chicken Biscuit to its breakfast line-up, which is expected to drive sales. During the second quarter of 2020, the company added Spicy Chicken Value Sandwich to its menu under its "4 for \$4" platform.

Moreover, the company will transition to 100% cage-free eggs for its breakfast items served at U.S and Canadian locations by 2020. The company also intends to eliminate the use of gestation stalls from its pork supply chain by 2022. These efforts will make the company popular among health-conscious diners. All in all, Wendy's expects that its balanced marketing approach, new restaurant development and reimagining of restaurants are all key catalysts.

▲ **Focus on Technology Utilization:** Wendy's is capitalizing on the benefits of technology. It is investing in areas like mobile payment, mobile ordering and customer self-order kiosks that provide benefits such as consumer convenience, increased customer count, higher check and faster speed of service. We expect these measures to help the company to maintain the trend of positive comps going forward. In addition to improving overall customer convenience, these are likely to drive additional output during peak hours as well as provide labor leverage. In the second quarter of 2020, it had roughly 5% of its sales coming through digital channels, which more than doubled from the prior-year levels.

On the mobile ordering front, Wendy's is progressing rapidly to ensure that the facility is can unravel additional prospects around convenience – through mobile grab-and-go and curbside delivery, plus loyalty. In fact, delivery continues to be a major initiative by the company. The company boosted its delivery channel by collaborating with Grubhub in the month of February and Postmates in the month of March 2020. During the second quarter of 2020, the company successfully added Uber Eats, making it accessible by all major delivery providers in the United States. Moreover, the company launched its loyalty program in July, in order to boost its customer frequency.

Reasons To Sell:

▼ **Coronavirus Impact:** The outbreak of coronavirus in China is expected to materially affect the company's operating and financial results for full-year 2020. The company has been undertaking numerous measures to protect employees, customers and business partners. Although, most of the stores in China have re-opened after coronavirus-led shutdown traffic are still well below pre-outbreak level. Even though markets in Canada, Puerto Rico and New Zealand are catching up, complete recovery is likely to take time.

Higher costs, incremental capital spending, along with fickle consumer demand remain potent headwinds

The company's systemwide same-restaurant sales were substantially affected by the pandemic during the fiscal second quarter. Global system-wide sales — including company-operated and franchise restaurants — were \$2.6 million in the reported quarter, down 6.4% from the prior-year quarter. U.S. system-wide sales were \$2.4 million in the quarter, down 4% year over year. Moreover, system-wide sales in the International segment amounted to \$0.2 million in the quarter, down 26.9% from the prior-year quarter level.

▼ **High Debt a Concern:** At the end of Jun 28, 2020, the company's long-term debt stood at \$2.2 billion, almost flat with the March-end level. Notably, the company's debt-to-capitalization was 88.7% compared with 89.4% at March-end. However, the company ended second-quarter fiscal 2020 with cash and cash equivalent of \$338 million compared with \$385.5 million at the end of first-quarter fiscal 2020, which may not be enough to manage the high-debt level.

▼ **Rising Costs:** The Affordable Care Act, commonly known as Obamacare, would continue to have an adverse impact on restaurant operators. That is, the restaurant operators will have to continue shouldering increased labor costs, which in turn will hurt margins.

Meanwhile, in order to compensate for these costs, the company is taking steps to re-align and re-invest resources. Though these initiatives might benefit Wendy's over the long term, these are expected to increase costs in the near term, thereby hurting margins. The company would also have to improve its focus on cost savings and increasing same-restaurant sales in order to cope up with inflations.

For the third quarter of fiscal 2020, the company expects commodity inflation in the range of high-mid to high single digits. For fiscal 2020, commodity inflation is expected at 3%, while labor inflation is projected at 4%.

▼ **Incremental Capital Spending Owing to Re-imaging:** Wendy's would incur additional capital expenditure in the coming years in a bid to boost the re-imaging program. This might lower free cash flow in the near term. Though the company has transitioned toward a franchise-based model that downscales capital expenditure, it will take time to reap benefits.

▼ **Industry Susceptible to Consumer Discretionary Spending:** Wendy's operates in the retail restaurant space that is highly dependent on consumer discretionary spending. Consumers' propensity to spend largely depends on the overall macroeconomic scenario. Although higher disposable income and increased wages are favoring the industry right now, it can change with the slightest disruption in the economy. The company, therefore, is highly vulnerable to the inconsistent nature of consumer discretionary spending. If it does not make pragmatic use of advanced technologies to innovate across value chains, it has high chances of fading out like many other restaurant retailers.

Last Earnings Report

Wendy's Q2 Earnings Beat Estimates, Revenues Miss

Wendy's reported second-quarter fiscal 2020 results, wherein the bottom line surpassed the Zacks Consensus Estimate but the top line lagged the same. However, both the metrics declined on a year over year basis.

Although the company's same-restaurant sales declined in the quarter due to the pandemic, it witnessed robust growth in July courtesy of robust breakfast and digital businesses. In July, same-restaurant sales witnessed growth of high-single digit.

Quarter Ending **06/2020**

Report Date	Aug 05, 2020
Sales Surprise	-0.57%
EPS Surprise	20.00%
Quarterly EPS	0.12
Annual EPS (TTM)	0.48

Delving Deeper

Adjusted earnings of 12 cents per share beat the Zacks Consensus Estimate of 10 cents by 20%. However, the bottom line plunged 33.3% year over year, primarily due to decline in adjusted EBITDA.

Quarterly revenues of \$402.3 million missed the consensus mark of \$405 million. The top line also declined by 7.6% from the year-ago quarter's figure. The downside can primarily be attributed to fall sales at company-operated restaurants and decrease in franchisee royalty revenues, owing to the COVID-19 pandemic.

Meanwhile, same-restaurant sales at International restaurants (excluding Venezuela and Argentina) declined 18.4% against 3.9% growth in the year-ago quarter. Comps at Global restaurants declined 5.8%, against 1.6% growth in the prior-year quarter. Moreover, comps in U.S. witnessed decline of 4.4% against 1.3% growth in the year-ago quarter.

System-Wide Sales Discussion

Global system-wide sales — including company-operated and franchise restaurants — were \$2.6 million in the reported quarter, down 6.4% from the prior-year quarter. U.S. system-wide sales were \$2.4 million in the quarter, down 4% year over year. However, system-wide sales in the International segment amounted to \$0.2 million in the quarter, down 26.9% from the prior-year quarter level.

Operating Highlights

Company-operated restaurant margin was 14.4% in the reported quarter compared with 16.5% in the year-ago quarter. The decline was mainly due to labor rate inflation and dismal traffic on account of the coronavirus pandemic. This was partially mitigated by positive impact of the company's new breakfast daypart in the United States.

General and administrative expenses in the quarter were \$48.6 million, down 4.3% from \$50.8 million recorded in the prior-year quarter. The decrease was primarily due to lower travel related expenses due to the pandemic.

Quarterly operating profit amounted to \$60.7 million, down 24.7% from the year-ago quarter's reported figure. Also, net income of \$24.9 million slumped 23.1% from \$32.4 million in the year-ago quarter. The decrease was primarily due to dismal operating profit.

Adjusted EBITDA declined 17.3% to \$97.4 million from the prior-year quarter, given a decrease in company-operated restaurant margin and franchise royalty revenues and fees, decline in net rental income, and investment in breakfast advertising of nearly \$2.2 million.

Balance Sheet

Cash and cash equivalents as of Jun 28, 2020 were \$338 million compared with \$300.2 million on Dec 29, 2019.

Inventories at the end of the second quarter amounted to \$4.4 million, up from \$3.9 million at 2019-end. Long-term debt was 2,238.7 million as of Jun 28, 2020 compared with \$2,257.6 million on Dec 29, 2019.

The company declared dividend of 5 cents per share, payable on Sep 15, 2020, to shareholders of record as of Sep 1, 2020. The number of common shares outstanding as of Jul 9, 2020 was 223.8 million. The company also announced it intends to resume share repurchases in 2020.

Other Developments

In the quarter under review, Wendy's had 22 global restaurant openings with an increase of one net new unit. The company is likely to open restaurants in the U.K. in the first half of 2021.

Recent News

Wendy's Sales Improve as Beef Supply Normalizes Through May – Jun 8, 2020

Wendy's has provided an update on operations, May sales and beef supply. The company noted that global same-restaurant sales improved every week throughout May. In fact, it improved in low-single digits during the last week.

Valuation

Wendy's shares are down 3.5% in the year-to-date period and 0.4% over the trailing 12 months. Stocks in the Zacks sub-industry are up 0.5% and stocks in the Zacks Retail-Wholesale sector are up by 33% in the year-to-date period. Over the past year, the Zacks sub-industry is down by 6.8%, while sector is up by 44.1%.

The S&P 500 index is up by 5.4% in the year-to-date period and 18.3% in the past year.

The stock is currently trading at 33.9X forward 12-month earnings, which compares to 31.66X for the Zacks sub-industry, 33.21X for the Zacks sector and 22.83X for the S&P 500 index.

Over the past five years, the stock has traded as high as 44.54x and as low as 11.46x, with a 5-year median of 28.16x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$23 price target reflects 36.5x forward 12-month earnings.

The table below shows summary valuation data for WEN.

Valuation Multiples - WEN					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	33.9	31.66	33.21	22.83
	5-Year High	44.54	34.04	34.77	22.83
	5-Year Low	11.46	20.49	19.08	15.25
	5-Year Median	28.16	23.09	23.47	17.58
P/S F12M	Current	2.73	3.79	1.27	3.7
	5-Year High	3.34	3.93	1.27	3.7
	5-Year Low	0.91	2.81	0.82	2.53
	5-Year Median	2.56	3.32	0.97	3.05
P/CF	Current	29.46	32.13	17.84	15.88
	5-Year High	32.71	32.17	17.87	22.73
	5-Year Low	6.01	8.61	11.01	11.7
	5-Year Median	16.85	16.85	13.22	16.37

As of 08/24/2020

Industry Analysis Zacks Industry Rank: Top 48% (122 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Papa Johns International, Inc. (PZZA)	Outperform	1
BJs Restaurants, Inc. (BJRI)	Neutral	3
Dunkin Brands Group, Inc. (DNKN)	Neutral	3
J d Wetherspoon Plc (JDWPY)	Neutral	4
DaveBusters Entertainment, Inc. (PLAY)	Neutral	4
Red Robin Gourmet Burgers, Inc. (RRGB)	Neutral	3
RESTAURANT GRP (RSTGF)	Neutral	3
Carrols Restaurant Group, Inc. (TAST)	Neutral	2

Industry Comparison Industry: Retail - Restaurants

	WEN	X Industry	S&P 500	DNKN	PZZA	RRGB
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Outperform	Neutral
Zacks Rank (Short Term)	3	-	-	3	1	3
VGM Score	D	-	-	D	D	B
Market Cap	4.80 B	382.18 M	23.81 B	6.02 B	3.26 B	141.89 M
# of Analysts	14	6	14	11	8	4
Dividend Yield	0.93%	0.00%	1.64%	0.00%	0.91%	0.00%
Value Score	C	-	-	C	F	B
Cash/Price	0.08	0.13	0.07	0.10	0.02	0.19
EV/EBITDA	19.18	13.02	13.37	17.72	49.88	9.64
PEG Ratio	2.73	3.71	3.02	2.93	8.78	NA
Price/Book (P/B)	9.92	2.30	3.17	NA	NA	0.75
Price/Cash Flow (P/CF)	18.25	8.76	12.77	19.39	32.73	1.18
P/E (F1)	39.39	37.52	21.72	27.18	70.23	NA
Price/Sales (P/S)	2.87	0.82	2.48	4.62	1.93	0.13
Earnings Yield	2.52%	0.87%	4.44%	3.68%	1.42%	-123.55%
Debt/Equity	7.46	1.21	0.76	-5.73	-1.55	4.13
Cash Flow (\$/share)	1.18	1.81	6.93	3.77	3.04	7.72
Growth Score	D	-	-	C	A	C
Hist. EPS Growth (3-5 yrs)	12.38%	3.03%	10.41%	11.83%	-18.64%	-24.46%
Proj. EPS Growth (F1/F0)	-8.96%	-66.06%	-5.05%	-15.11%	20.94%	-1,919.03%
Curr. Cash Flow Growth	-0.70%	3.07%	5.20%	5.44%	8.17%	-15.30%
Hist. Cash Flow Growth (3-5 yrs)	-1.18%	5.23%	8.50%	5.81%	-2.98%	-0.74%
Current Ratio	1.42	1.06	1.33	1.60	0.98	0.52
Debt/Capital	88.18%	71.82%	44.50%	NA	NA	80.51%
Net Margin	6.70%	-0.23%	10.13%	16.79%	1.32%	-22.56%
Return on Equity	21.11%	-10.35%	14.66%	-38.22%	-15.73%	-52.03%
Sales/Assets	0.33	0.87	0.51	0.34	2.30	0.92
Proj. Sales Growth (F1/F0)	1.43%	-6.05%	-1.45%	-6.61%	10.98%	-32.02%
Momentum Score	F	-	-	C	C	C
Daily Price Chg	-1.56%	0.23%	1.32%	0.41%	-0.19%	4.94%
1 Week Price Chg	-0.91%	0.00%	-1.45%	1.56%	3.56%	-10.40%
4 Week Price Chg	-9.95%	7.61%	3.38%	3.09%	5.33%	8.30%
12 Week Price Chg	-2.05%	9.23%	7.69%	11.75%	24.79%	-34.17%
52 Week Price Chg	-0.37%	-24.26%	3.85%	-12.40%	126.79%	-73.45%
20 Day Average Volume	3,938,541	310,035	1,873,293	895,516	549,059	1,107,422
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	1.08%	2.74%	1.00%	4.67%	11.20%	-3.68%
(F1) EPS Est 12 week change	4.01%	20.74%	3.40%	6.36%	17.59%	-85.49%
(Q1) EPS Est Mthly Chg	-7.72%	8.86%	0.00%	11.42%	7.33%	12.60%

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	C
Growth Score	D
Momentum Score	F
VGM Score	D

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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