BEHIND THE NUMBERS
Quality of Earnings Analysis
March 30, 2021

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Behind the Numbers 1Q '21 Focus List

Top Sells

<u>Canceled Top Sells</u>
RealPage, Inc. (RP)- *canceled due to private equity buyout*

<u>On Deck Sells</u>

Top Buys

<u>On Deck Buys</u>

Summary of Changes to the 1Q'21 BTN Focus List

Added to Top Sells

Removed from Top Sells

RealPage, Inc. (RP)- *canceled due to private equity buyout*

Added to "On Deck" Sells

Added to Top Buys

Removed from Top Buys

Ares Capital (ARCC) – *moved from Top Long to On Deck*
Starwood Property Trust, Inc. (STWD)- *moved from Top Long to On Deck*

Added to "On Deck" Buys

Ares Capital (ARCC) – *moved from Top Long to On Deck*
Starwood Property Trust, Inc. (STWD)- *moved from Top Long to On Deck*

Overview of the BTN Focus List

Our foundational belief at Behind the Numbers is that earnings quality matters. We believe that companies that are resorting to increasingly aggressive accounting such as slashing reserves, taking never-ending restructuring charges, or extending depreciable lives to meet earnings estimates will eventually face a day of reckoning in the form of an unexpected earnings disappointment. Likewise, companies with hidden assets, conservative accounting, or non-operational headwinds that will reverse are likely to produce better than anticipated results. This has been borne out time and again by academic research.

While our Earnings Quality ratings express our level of concern with the reliability and sustainability of a company's reported earnings and cash flows, they do not consider more fundamental factors such as valuation, sources of recent revenue growth, upcoming difficult comps, or other factors which might make an idea timelier. The *BTN Focus List* addresses this by documenting which companies under coverage we believe are getting closer to the point of materially underperforming or overperforming.

The list is divided into Top Sells and Buys along with an "On Deck" list of companies we believe have compelling points but may not warrant being on the top lists due to valuation factors. We will continue to publish the Focus List quarterly and will notify clients of the additions and subtraction to the list made during the quarter by e-mail.

Top Sells

Conagra Brands, Inc. (CAG)- Sell

Date	3/12/2021
Market Cap	$18 B
Target Price	$27
PE (fwd)	14
Short %	2.6%
Current EQ Rating	2+ (Weak)

Points of Concern

- CAG has benefitted from restocking the retail channel for the last two quarters. This was quantified as 600 bps of growth in the 8/20 quarter. While not quantified in the 11/20 quarter, it was likely significant given continued low inventories at key customers. Every 100 bps of extra growth added a penny per share to EPS.

- Pricing also looks unsustainable. Higher prices net of sales promotional activity added 150 bps to growth in the 11/20 quarter following a 410 bps increase in the 8/20 quarter. The company has a history of experiencing pushback from customers when it raises prices faster than retailers pass it along. We also expect higher promotional spending will be necessary which will muffle both sales growth and net pricing.

- A lower tax rate from releasing a tax benefit valuation allowance added 5.2 cps to EPS in the 11/20 quarter. This will not repeat and coupled with 1 cps of net other unusual items, accounted for almost all of the 7 cps earnings beat in the quarter.

- The company has been cutting advertising for years. We expect this to reverse over time with every $6 million increase representing a 1 cps headwind to earnings growth.

- Restructuring charges are a regular feature of the company’s quarters and these costs are added back to non-GAAP results.

International Business Machines Corporation (IBM)- Sell

Date	3/12/2021
Market Cap	$114 B
Target Price	$90
PE (fwd)	12
Short %	3.4%
Current EQ Rating	2- (Weak)

Points of Concern

- We see IBM as a perfect example of a company that has spent decades acquiring and restructuring its way to lower profitability- since 2003, ROI has fallen from 20-22% to 10%.

- A $2 billion charge taken in the 12/20 quarter included costs to restructure contracts. We believe this distorted adjusted earnings as the company enjoyed the benefits of improved profitability while dismissing the costs of concessions incurred to correct unfavorable contracts.

- FCF was flat in the 12/20 quarter but received a $1 billion boost from increased taxes payable which will reverse in 2021.

- Despite management talk of growing sales and margins, revenue is falling at all segments, signings are down, and backlog is falling.

Iron Mountain Incorporated (IRM)- Sell

Date	3/12/2021
Market Cap	$11 B
Target Price	$18
PE (fwd)	14
Short %	12.8%
Current EQ Rating	1-(Strong Concern)

Points of Concern

- IRM is currently our lowest-rated company under coverage which is largely a factor of it regularly "redrawing the target" through repeated changes to the definition of adjusted REIT metrics such as FFO and AFFO. For example, in the 12/20 quarter, it began omitting JV losses, stock compensation, and non-real estate growth capital spending from its calculation of AFFO.

- 12/20 quarter AFFO of $0.60 beat forecasts by 7 cps- but an unexpected tax benefit from the reversal of an allowance added between 7-8 cps and the company beginning to add back stock compensation in its calculation of AFFO added another 1 cps.

- The "other, net" adjustment added 2 cps in the quarter where it usually adds a fraction of a cent.

- The company's definition of AFFO was already aggressive before the 12/20 quarter as it excluded many cash costs including costs to acquire a customer and pick-up/ delivery costs of records. These costs are capitalized and then the amortization is added back to REIT metrics which effectively ignores them entirely. Financing lease payments are also excluded.

- While investors focus on the yield and the headline AFFO dividend coverage of 80%, in reality, the dividend is not covered by internally-generated cash flow. Headline debt to EBITDA is 5.75x- we think that is closer to 6.5x after adjusting for all cash costs.

Keurig Dr Pepper Incorporated (KDP)- Sell

Date	3/12/2021
Market Cap	$47 B
Target Price	$19
PE (fwd)	21
Short %	4.6%
Current EQ Rating	2- (Weak)

Points of Concern

- While viewed by many as a safe staple that is benefitting from a pandemic-induced increase in at-home coffee consumption, we see KDP as a highly leveraged company that is touting its reduction of long-term debt which has, in reality, simply been converted to short-term working capital financing.

- Payables continued to rise in the 12/20 quarter, jumping to 252 days from 234 a year ago. KDP touts a debt/adjusted EBITDA of 3.6x. When we add in the $2.6 billion of factored payables and the credit line called “structured payable”, the ratio jumps to 4.4x.

- Cash flow rose 25% in the 12/20 quarter but this was driven by a $624 million boost from rising payables, a $59 million tax deferral from the CARES Act, and a $52 million lease payment being moved to the financing section. Adjusting for this puts the dividend payout ratio at 85%, significantly ahead of the company’s claim of less than 50%.

- A return of marketing spending in 2021 will be another drag on cash flow. It cut $200 million from this category in 2020. ROI on adjusted EBITDA is under 9%

- Latin America's results continue to be overstated from adjusting out negative FX but keeping the inflation-boosted price increases.

- Rising operating lease costs from the sale-leaseback transactions should begin hitting in the 3/21 and 9/21 quarters.

Mondelez International, Inc. (MDLZ)- Sell

Date	3/12/2021
Market Cap	$79 B
Target Price	$42
PE (fwd)	20
Short %	1.0%
Current EQ Rating	2- (Weak)

Points of Concern

- The company has been raising prices faster than inflation to drive growth, but this appeared to end in the 12/20 quarter. Now the company expects inflation to accelerate in 2021. However, pricing amounts to half of the company's forecasted 3% organic growth. In the past, rising prices have been met with declining volumes and MDLZ is already faced with especially tough comps.

- MDLZ is not leveraging gross margins despite strong growth in 2020 from big volume gains. This included a 6.3% volume gain in North America compared to years of negative growth. Pricing has also exceeded commodity inflation. Neither situation is likely to repeat which could result in a sizeable headwind in 2021.

- Recent sales growth may have also received a boost from lower promotional spending which is recorded as a reduction to sales.

- Marketing costs rose 17% in 2H'20 and that is expected to continue into 2021.

- Other headwinds for 1H'21 include poor results for emerging markets in non-BRIC countries and a potentially higher tax rate,

- The company expects to fund a share buyback in 2021 to help boost EPS growth. However, cash flow will likely face a material working capital headwind in 2021.

Patterson Companies Incorporated (PDCO)- Sell

Date	3/12/2021
Market Cap	$3 B
Target Price	$23
PE (fwd)	16
Short %	8.4%
Current EQ Rating	3- (Minor Concern)

Points of Concern

- PDCO beat estimates by 7 cps in the 12/20 quarter but it picked up 2.3 cps from a lower tax rate, 1.6 cps from higher investment income, 2.3 cps from lower travel expense, 0.7 cps from lower stock compensation, and 0.9 cps from lower depreciation.

- Operating margin improved by 30 bps in 2020- but lower depreciation, stock compensation, and travel expenses boosted margin by 31 bps.

- Of the $95 million in sales growth in the 12/20 quarter, $33 million came from higher COVID-related supplies. We expect sales of these products such as hand sanitizers and cleaning products will evaporate going forward as they become fully available in retail channels again.

- Sales also benefitted from new animal care products which were aided by channel stocking and a pandemic-induced surge in pet adoptions. Animal-related sales rose 8.5%- it is usually 3%.

- Gains/Losses from selling receivables can add 50 bps or more to a quarter at a company with operating margins under 5%.

- Deferred Purchase Price receivables boosted cash flow in the quarter by $46 million.

- An increase in private label sales may limit the benefits of rebates and incentives.

Sealed Air Corporation (SEE)- Sell

Date	3/12/2021
Market Cap	$7 B
Target Price	$32
PE (fwd)	13
Short %	1.4%
Current EQ Rating	2- (Weak)

Points of Concern

- SEE beat estimates by 10 cps in the 12/20 quarter but 6.3 cps came from a lower than expected tax rate, 2 cps from non-recurring vaccine rollout business, and 2 cps in consulting charge add-backs.

- There have been 10 straight quarters of positive price/cost where customers allow higher prices to cover rising commodity costs. While there was a $7 million reversal of this trend in the 12/20 quarter, we believe there is much more to come as customers push back. SEE was up $179 million in price/cost and has guided in the past to $70 million headwinds in early 2020 that never materialized.

- Segment disclosures are constantly changed, making it difficult to gauge the true growth of these assets.

- Organic sales growth has artificially benefitted from adding back negative Latin American FX while leaving in the inflation-induced price increases. South America's $39 million growth accounted for essentially all of the company's reported growth in 2020 despite being only 5% of total sales. However, this benefit is wiped out when taking into consideration the negative FX impact.

- The IRS has proposed disallowing a 2014 deduction which could result in a $525 million cash payment. While the company is appealing, a negative outcome could drive debt/EBITDA from 3.1 to 3.6.

TransDigm Group Incorporated (TDG)- Sell

Date	3/12/2021
Market Cap	$33 B
Target Price	$480
PE (fwd)	52
Short %	3.5%
Current EQ Rating	2- (Weak)

Points of Concern

TDG's adjusted EPS of $1.97 missed estimates by 4 cps. However,

- The tax code in 2019 changed to limit the deduction of interest expense to 30% of EBITDA. The CARES Act made that 50% for 2020 and 2021. That meant TDG could use all its $1 billion in interest expense as a tax shield in 2020 and it should be possible again in 2021. That is helping EPS by about $1.27. The CARES Act provision expires in 2022, dropping the limit back to 30%, and the tax code changes in 2022 to base the calculation off of EBIT instead of EBITDA. That should result in a negative tax swing in 2022 of close to $3.00 per share compared to 2021.

- Loss contract reserves occur when TDG makes an acquisition and determines there are money-losing contracts in place compared to what they would earn under current market conditions. It sets up a reserve to address the difference and amortizes it against GAAP earnings. That amortization is added back for adjusted EPS. The auditor highlighted that establishing this reserve is highly dependent on management assumptions, outlook, and guidance. In a quarter when TDG missed forecasts, it added back a larger amortization figure than the year before which helped EPS by 9 cents.

- TDG continues to add back recurring costs. It is a serial acquirer but views numerous acquisition-related costs as one-time in nature. Without acquisitions, TDG has about 2%-3% organic growth. It also adds back stock compensation and the assorted tax implications of it and dividend equivalent charges. They pay stock compensation every quarter even without acquisitions. Just the stock compensation was about 25% of 2020's adjusted EPS.

- Goodwill and intangibles are not being expensed in most cases and when they are amortized it is over a very long time of 20+ years. These two assets are the largest items on the balance sheet and TDG has not taken an impairment despite the drop-off in air travel. It seems unlikely future cash flow has not been impaired given that many older planes have been grounded and many may retire much earlier than forecast. Younger planes that are cheaper to operate and require less maintenance have picked up the slack and that hurts demand. We still expect this risk to be high at TDG.

- Even before COVID setbacks, the high interest expense created a wide divergence between EBITDA and cash from operations. It is why TDG had to borrow money to fund acquisitions and dividends.

- We think the divergence between EBITDA and cash flow from operations will get wider with cash flow under pressure to fund higher working capital, repay deferred FICA taxes, pay higher income taxes as interest expense becomes a smaller tax shield, and perhaps if interest rates rise over time. That becomes another drag on cash flow that doesn't impact EBITDA. Effectively, we see the cost of debt rising for TDG.

- If the cash flow cannot carry the same amount of debt, we think TDG could see pressure to lower debt levels beyond relying solely on the adjusted EBITDA figure recovering over time. That could impact TDG's ability to do deals and pay dividends.

“On Deck” Sells

These are companies under coverage with material problems but are not currently on the Top Sell list due to valuation or timing factors.

Altria Group, Inc (MO)

Current EQ rating: 3- (Minor Concern)

Problems include:

- Management admits that cigarettes are a dying business, but oral tobacco comes with its own health problems and cannibalizes existing products. Initial stocking growth proves unsustainable.

- ABI seems ripe for a write-down.

- The buyback has stopped and cash flow and debt will continue to pressure it.

- There is pressure from the FDA to ban menthol as well as upcoming graphic health warnings for cigarette packs. This, plus eliminating e-cigarettes and flavored tobacco, could dramatically reduce the number of new smokers. COVID was likely a temporary reprieve.

Ball Corporation (BLL)

Current EQ rating: 3- (Minor Concern)

Problems include:

- Cash flow has received a huge boost from increased factoring of receivables which exceed those left on the balance sheet. While the sequential pace of factoring has slowed, we remain concerned this will turn to a cash flow headwind over the next year which could complicate the company’s aggressive capital spending plans.

- Depreciation is down versus a year ago despite an increase in PPE. This should reverse over the next year as new plant and equipment is brought online.

Henry Schein, Inc. (HSIC)

Current EQ rating: 3- (Minor Concern)

Problems include:

- A restructuring program originally intended to eliminate stranded costs from the Animal Health spin-off is now being extended into 20201 due to the "business environment brought on by the COVID-19 pandemic."

- While offering a "floor" guidance for non-GAAP EPS of $3.51 for 2021, the company declined to offer GAAP guidance as it cannot estimate what restructuring costs will be. It seems strange it can estimate the beneficial impact on adjusted profits but not the amount of the charges.

- An unexpectedly low tax rate added 10 cps to the 12/20 quarter while an impairment charge cost it 7 cps. The 3 cps net benefit was key to the 1 cps earnings beat.

TreeHouse Foods, Inc. (THS)

Current EQ rating: 3- (Minor Concern)

- THS met consensus estimates in the 12/20 quarter, but it reversed 12 cps of tax valuation allowances during 2020 and the bulk appears to have benefitted the 12/20 quarter.

- COVID restocking drove an increase in volume of $40.3 million in the 12/20 quarter compared to only $4.2 million in the 9/20 quarter. This will likely not repeat.

- Despite a company with $4.4 billion in sales cutting $600 million in less profitable SKUs in the last two years, adjusted gross margins have declined.

- Rising receivables factoring has boosted cash flows, but it is near its facility limit.

Top Buys

Air Lease Corp. (AL)- Buy

Date	3/12/2021
Market Cap	$6 B
Target Price	$65
PE (fwd)	11
Short %	5.9%
Current EQ Rating	4+ (Acceptable)

Main Positives

- Despite weak air travel, AL has not experienced impairment of its fleet as its planes are in high demand from customers looking for newer, more efficient aircraft to add as they retire less efficient models.

- Collection rates improved to 88% in the 12/20 quarter compared to 86% in the 9/20 quarter. Deferrals continue to be repaid at acceptable rates with $96 million of the $240 million outstanding deferrals having been collected at the end of the 12/20 quarter.

- AL typically adds 80 new aircraft per year to its fleet, but it cut deliveries to 26 in 2020. The company spent a net $2.5 billion on new aircraft in 2020 which is less than half a typical year. This has resulted in the company enjoying a stockpile of $1.7 billion in cash and $6 billion in untapped credit lines which gives the company options for ways to boost EPS in 2021 independent from the airline market recovering. For example, retiring $1 billion in debt generates 7 cps in quarterly EPS while retiring 20 million shares at $50 adds 23 cps per quarter.

Risks

- More deferrals are likely which can include extending the lease term or a sale-leaseback for additional planes for the client. Such deals result in more lease revenue in the long run but could pressure payments in 2021.

- More delivery delays from Airbus and Boeing this could pressure EPS from fewer aircraft sales.

AT&T Inc. (T)- Buy

Date	3/12/2021
Market Cap	$210 B
Target Price	$40
PE (fwd)	9
Short %	1.6%
Current EQ Rating	4+ (Acceptable)

Main Positives

We see the sum of the parts of AT&T exceeding $40 per share with the potential for a 7% dividend yield. Investors were overly focused on DirectTV and miss the growing wireless, broadband, and Warner businesses. DirecTV is being spun out of results via a JV whereby DirecTV sold a 30% stake and will use the cash received to pay for its latest spectrum purchase.

- Mobility revenue has been hurt by lower roaming fees and late fees which were waved during the pandemic. While these are not expected to recover until late 2021, adjusted results show growth in Wireless was already up to 2% in the 12/20 quarter.

- 5G, HBO Max, and FirstNet have all helped to drive new subscriber growth and churn has dropped. New equipment sales have also jumped with new 5G phones.

- The outlook for cash flow growth looks positive. When adjusting for $2.2 million in sold receivables in 2020, guidance implies more than 7% growth in cash flow from operations.

- A return to film releases at Warner, sports programming, the absence of $2 billion in expenses rolling out HBO Max in 2020, and $4 billion of 2020 pandemic costs which are largely non-repeating will all help EBITDA growth in 2021.

- Debt is likely to decline by $10 billion in 2021 which could lower debt/EBITDA to 2.5x even without growth in EBITDA.

Macquarie Infrastructure Corporation (MIC)- Buy

Date	3/12/2021
Market Cap	$3 B
Target Price	$40
PE (fwd)	64
Short %	7.7%
Current EQ Rating	na

Main Positives

- MIC is in the process of selling the company off. We see the sum of the parts as being worth between $38-$40.

- EBITDA Guidance for Atlantic Aviation is $220-240 million in 2021. A multiple of 16x yields a value of $3.85 billion. A pre-pandemic EBITDA of $276 million implies a $4.4 billion value. The company hopes to construct a deal that will not incur capital gains taxes on Atlantic.

- 10x EBITDA for MIC Hawaii gives a value of $321 million assuming a 21% tax rate.

- Free cash flow from Atlantic and MIC could add another $4-$5 per share to value.

- Netted against $1 billion in debt at Atlantic and $194 million at MIC Hawaii minus management fees gives a value for the whole company of around $38-$40 per share. We see this as a buy below $32.5.

Mowi ASA (MHGVY)- Buy

Date	3/12/2021
Market Cap	$13 B
Target Price	$29
PE (fwd)	89
Short %	-
Current EQ Rating	4+ (Acceptable)

Main Positives

MOWI has risen considerably since December. With pricing set to rebound and the dividend returning, we believe it has more room to run.

- Volume has remained strong but salmon pricing has been as depressed by pandemic-depressed demand from China which has led to higher supply in other markets. Pricing in 2020 was between €4-5 per kg from mid-March. Historically, pricing is above €6 per kg. Adding €1 per kg, would almost double EBITDA in 2020 from €505 million to over €900 million.

- Automation, improved procurement, and working to lower biologic expense resulted in €35 million in cost cuts in 2020 with another €25 million targeted for 2021.

- Free cash flow was €187 million in 2020. Lower cash cost guidance alone implies a €76 million increase in 2021. The sale of DESS will add €114 million in the first quarter to the €100 million in cash already on hand.

- The dividend has returned and is targeted to be 50% of underlying EPS. When debt is below €1.4 billion, the company will pay more and buy back shares. Historically, the company has paid a 6% yield which we believe will return.

National Instruments Corporation (NATI)- Buy

Date	3/12/2021
Market Cap	$6 B
Target Price	$50
PE (fwd)	27
Short %	2.7%
Current EQ Rating	5- (Strong)

Main Positives

- NATI has purposefully been carrying higher inventory levels to meet an upsurge in demand. This worked well in the 12/20 quarter as sales rose 19% and DSIs dropped by 37 days.

- The company has continued to invest in R&D during the pandemic which should help drive future growth.

- The company has capitalized less in software costs which leads to higher earnings quality. Also, the lower capitalized balance will mean less amortization in upcoming quarters.

Texas Instruments Incorporated (TXN)- Buy

Date	3/12/2021
Market Cap	$161 B
Target Price	$200
PE (fwd)	26
Short %	1.6%
Current EQ Rating	5+ (Strong)

Main Positives

- TXN maintains higher inventory levels as a matter of practice. The company uses a consignment method for inventory held at distributors under which the inventory stays on TXN's books. This is conservative as TXN cannot artificially boost sales by "stuffing the channel."

- Higher inventory also allows the company to have product available when competitors do not and producing at higher volumes keeps cost per unit low. This worked well in the fourth quarter as strong demand caused a sales upside and sizeable margin leverage.

- The company consistently spends generously on R&D which allows it to remain competitive.

- Acquisitions are few and far between and intangibles are not a material part of the balance sheet. If TXN amortized goodwill over 40 years it would only penalize EPS by about 2%. That compares to around 30% for most chip-makers

UnitedHealth Group Incorporated (UNH)- Buy

Date	3/12/2021
Market Cap	$334 B
Target Price	$380
PE (fwd)	19
Short %	0.6%
Current EQ Rating	5- (Strong)

Main Positives

- COVID provided a windfall for a couple of quarters as premiums were flat, while many patients did not use medical care. The return to normal did not produce a huge negative swing of medical care rising above past rates. Medical ratios were fairly close to pre-COVID in 4Q and have room to improve after 1Q21.

- An ACA tax boosted UNH's rate from 21% to 24% last year. That tax has expired and should create a tailwind for EPS in 2021.

- Cash flow should get a boost from rebates going forward. UNH accrues for rebates as it collects premiums and rebates become part of non-cash income. Given the lag of patients using the insurance to hit rebate targets, it has taken longer for UNH to bill for the rebates and collect them. The A/R balance is much higher than pre-COVID and represents pent-up future cash flow.

- There will be tough headwinds from the first half of 2020 for comps, but that situation is expected and should not lead to disappointments.

“On Deck” Buys

Below are companies with strong earnings quality, but valuations and timing considerations limit the current upside.

Starwood Property Trust (STWD)

Current EQ rating: 5+ (Strong)

STWD was featured as a Top Buy on the 12/4/20 Focus List. After returning almost 30% including the 4Q dividend, we are dropping STWD to “on deck” due to limited upside. We could still see the company selling above $27 as we continue to see value.

- STWD owns property which extends the duration of the portfolio and also provides depreciation expense which lowers GAAP earnings and the required REIT dividend payout. This allows for more cash to be retained and invested.
- 95% of commercial mortgage loans float. STWD has added LIBOR floors to its loans which protects income during times of low interest rates but allows participation if rates increase.
- Non-GAAP accounting is relatively clean with the company adding back non-cash gains although it does add back management fees and does not deduct for maintenance capex.

Ares Capital (ARCC)

Current EQ rating: 5- (Strong)

ARCC was also featured as a Top Buy in the 12/4 Focus List. The company has generated a total return in excess of 10% but is now selling above book value which will limit upside for now. Nevertheless, we leave ARCC ‘On Deck” given the strength in the portfolio, wise use of capital, and the potential for special dividends.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

Disclosure

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