BEHIND
THE NUMBERS
Quality of Earnings Analysis

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Behind the Numbers 3Q 2023 Focus List

Top Risks

Company	EQ Rating	Date Added	
Cloudflare, Inc. (NET)	2- (Weak)	7/8/2022	p. 3
DoorDash, Inc. (DASH)	2- Weak)	10/3/2023	p. 5
Marvell Technology, Inc. (MRVL)	3- (Minor Concern)	10/3/2023	p. 7
Post Holdings, Inc. (POST)	3- (Minor Concern)	3/30/2022	p. 8
Teva Pharmaceutical Industries Limited (TEVA)	2- (Weak)	10/3/2023	p.10

On Deck Risks

Company	EQ Rating	Date Added	
Altria Group (MO)	2- (Weak)	10/3/2023	p.12
Cintas Corporation (CTAS)	3- (Minor Concern)	12/2/2022	p.12
International Business Machines Corporation (IBM)	2- (Weak)	3/12/2021	p.12
Iron Mountain Incorporated (IRM)	1-(Strong Concern)	12/4/2020	p.12
Mohawk Industries, Inc. (MHK)	2- (Weak)	9/27/2022	p.12
Okta, Inc. (OKTA)	2- (Weak)	7/14/2023	p.13

Top Values

Company	EQ Rating	Date Added	
AT&T Inc. (T)	5+ (Strong)	10/3/2023	p.14
Stanley Black & Decker, Inc. (SWK)	3- (Minor Concern)	10/3/2022	p.16
United Rentals, Inc. (URI)	4+ (Acceptable)	12/13/2021	p.18
Warner Bros. Discovery, Inc. (WBD)	3+ (Minor Concern)	5/8/2023	p.20
WESCO International Inc. (WCC)	5- (Strong)	5/15/2023	p.22

On Deck Values

Company	EQ Rating	Date Added	
Air Lease Corporation (AL)	4+ (Acceptable)	10/3/2023	p.24
Ball Corporation (BALL)	3- (Minor Concern)	9/27/2022	p.24
Costco Wholesale Corporation (COST)	*5+ (Strong)*	10/3/2023	p.24
Otis Worldwide Corporation (OTIS)	5+ (Strong)	10/3/2023	p.24
Philip Morris International (PM)	*4- (Acceptable)*	4/23/2023	p.24
Starwood Properties Trust, Inc. (STWD)	*5+ (Strong)*	10/3/2023	p.25

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 Risks and Top Values 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.

Cloudflare, Inc. (NET)

Date Added	7/8/2022
Market Cap	$21.3 B
PE (fwd)	Na
Short %	6.4%
Current EQ Rating	3- (Minor Concern)

NET continues to beat forecasts, but much of this looks orchestrated rather than natural. One of the largest sources of earnings is higher interest income on its cash. That's real income but hardly an operating source of earnings nor something worth paying NET's 170x P/E for. NET does not even post positive cash flow from operations without adding back stock compensation:

- NET came into 2023 forecasting a 36% tax rate and posted a 12.4% tax rate for 1Q23 adding 2 cents to EPS. It lowered the forecast to 9% and then 2Q23 came in at 3.9% adding another 0.5 cents.

- NET adds back stock compensation to non-GAAP earnings. The long-term goal with sales growth is for stock compensation to be no higher than 20% of sales. Last quarter NET bumped it from 21.3% to 23.2%. The increase added 1.6 cents to EPS. From the 20% goal, NET picked up 2.7 cents here.

- The long-term goal is to have adjusted R&D (no stock compensation) at 18%-20% of sales. At the end of 2022, NET was at the low end of that goal at 18%. For 2023, it has operated below 18%. 100bp is 0.9 cents in EPS and NET came in at 17.2% for 2Q23.

- The long-term goal for adjusted gross margin is 74%-75%. This also is above-plan for 2Q23 at 77.7% adding 1.7 cents to EPS. That may not be sustainable.

- The interest income mentioned above was 4.2 cents of NET's reported 10 cents in non-GAAP EPS.

- Amortization of capitalized commissions and customer acquisition costs is not rising at the same rate as sales. That is giving earnings a minor benefit too. That could become a larger headwind going forward.

- Even guidance seems to be pointing to some of these margin gains in the last quarter being unsustainable. NET is forecasting sales to rise sequentially by 7% in 3Q and 8% in 4Q. Yet, it is calling for EPS to be flat to down from 2Q's results.

- Receivables are higher than normal by about 5 days. Deferred Revenue also had a large jump in 2Q23 of 10 days sequentially. It may be tough to keep that level of growth coming.

DoorDash, Inc. (DASH)

Date Added	10/3/2023
Market Cap	$31.3 B
PE (fwd)	60.6
Short %	4.79%
Current EQ Rating	2- (Weak)

DASH grew enormously during Covid and has a cash-generating model that appeals to many seeing it in the early innings of a long-term growth story. It beat non-GAAP estimates by 21 cents last quarter. The company still loses money – despite the Covid jumpstart - and the non-GAAP accounting is aggressive. At 52x forward non-GAAP EPS of $1.31 adjusted for the $10/share in cash, DASH likely cannot absorb much bad news:

- DASH adds back litigation costs which rose to $49 million last quarter and was 13 cents added to non-GAAP EPS vs. the normal 5 cents. Both government agencies and its own drivers are pushing back on independent contractor classification. We don't see this going away and it could ultimately boost DASH's operating costs. Settlements are happening already with $100 million paid in California and Massachusetts.

- Inflation has already helped boost revenues because DASH gets paid a percentage of merchant sales. Going forward, it may lead to fewer sales per customer and lower tips to drivers causing drivers to demand a higher delivery fee. It can also cause customers to trade down to cheaper menu items. All of that negatively impacts revenues.

- Competition may also lead to lower fees from merchants, DASH paying more to drivers, and DASH boosting incentives to customers and drivers. All of those are netted against gross revenues. DASH is reporting revenue of 13% of gross market order volume. If 50bp of that is lost to higher driver pay or lower merchant fees, it costs DASH $75 million per quarter, or 19 cents in EPS. Last quarter, it appears inflation added 7 cents to EPS sequentially as the higher dollar figure for orders likely had flat driver fees per order.

- Merchants may require more advertising, which DASH has cut, that would boost operating costs. DASH's advertising was arguably at least $25 million light last quarter which added 6 cents to EPS.

- Without adding back stock compensation, DASH is unprofitable and has negative adjusted EBITDA and negative free cash flow in most quarters. The amount of

unexpensed stock compensation is $2.4 billion and the total amount of stock compensation is rising. At the end of 2021 and early 2022, it was about 10% of revenues. It's now about 14.5% with the 450bp rise adding about 25 cents to non-GAAP EPS per quarter. Estimates for the year ended 12/23 are for $1.31, so here's about $1.00 of that. The amount of stock compensation as a percentage of sales dipped in 1Q23 and added some quality to the EPS. But it did not last, as in 2Q23 the ratio jumped from 1Q23 accounting for as much as 18 cents of the 21-cent beat.

Marvell Technology, Inc. (MRVL)

Date Added	10/3/2023
Market Cap	$46.7 B
PE (fwd)	35
Short %	1.8%
Current EQ Rating	3- (Minor Concern)

MRVL has become popular for AI-related chips. The problem is that area is still small and growth is being offset by falling sales in other divisions. It has been beating or missing forecasts by only 1-2 cents and there appears to be several areas for concern.

- Share compensation is rising in dollar terms and as a percentage of sales which is added back to non-GAAP EPS. We consider this low-quality earnings growth and the increase added 2.5 cents and 2.7 cents to 1Q24 and 2Q24. It has risen from 9% of sales to 11.4% in just a few quarters.

- Accruals for returns, price discounts, price protection, and rebates rose considerably in the last four quarters which net against sales to reduce sales and margins. This is helping or hurting quarterly EPS by about 7 cents in our view for the last several quarters.

- MRVL relies heavily on distributors to sell inventory. Its reserve for returns, discounts, and price protection is at $502 million, up from $387 million y/y. That is more than one-third of sales. The weakness in sales for non-AI products is the problem and finished goods inventory is at high levels. MRVL also calls out inventory obsolescence as a key risk to watch.

- We believe MRVL overpaid for foundry capacity when the semiconductor market was hot and in short supply. It has to pay for much of this even if it does not produce more chips. High inventories across the industry make this a risk for more margin pressure. Gross margins are already falling.

- Free cash flow is overstated because MRVL records technology licensing fees in the financing section of cash flow. Cash flow is already under pressure and those recurring fees hinder its ability to repurchase shares.

- Warranties are worth watching. This cost has been immaterial for MRVL and was suddenly a $59 million item last quarter that hurt EPS by 6 cents.

Post Holdings, Inc. (POST)

Date Added	3/30/2022
Market Cap	$5.3 B
PE (fwd)	17.5
Short %	4.5%
Current EQ Rating	3- (Minor Concern)

POST has been topping estimates solely by boosting prices higher than inflation justifies. Its ROI runs about 6%-7% making its growth through acquisition story difficult to maintain as borrowing costs increase. At 18x forward EPS, POST doesn't seem that expensive until the recent inflation is normalized. Conceptually, for an $86 stock price, POST is expecting adjusted EPS of $4.91, but this company was earning only $1-$2 per share before it took all the pricing gains.

- Pricing gains are already weakening but are still running ahead of higher costs largely due to freight costs declining.

	3Q23	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Pricing	$117.1	$229.8	$231.2	$234.8	$190.7	$85.1	$89.5
Raw Materials	$35.5	$160.4	$142.7	$111.7	$123.7	$51.6	$46.5
Manufacturing	$26.1	$23.1	$14.4	$20.6	$27.1	$23.7	$23.4
Freight	-23.4	-$21.0	$0.0	$19.5	$27.4	$34.0	$27.7
Net Pricing	$78.9	$67.3	$74.1	$83.0	$12.5	-$24.2	-$8.1

- Freight costs may be reversing now with oil at $100 again and that could be a big headwind. Total EPS in 3Q23 from excess pricing was 91 cents of the reported $1.52. Falling freight was 30 cents of the 91 cents. POST could see the freight costs reverse quickly.

- Egg prices have declined from $5.30/dozen to $1.16 this year. We believe price hikes on eggs were $30 million of the $117 million, or 35 cents of EPS. The consumer brands unit had $57 million in higher pricing y/y – yet key costs are wheat and corn. Both are down 30% in cost this year. The collapse in raw material costs was already seen in the table above with cost inflation dropping from $160 million to $35 million sequentially last quarter. Don't forget – POST uses FIFO accounting for inventories which hurts margins when costs are declining.

- POST has helped recent earnings by cutting advertising. Yet it said last quarter that it sees that more advertising is necessary because competitors are boosting spending. This could be a rising cost as pricing gains evaporate. Next quarter is the toughest comp coming on pricing too.

- As price hikes fall, POST cannot look at volumes to save the situation. Its four units posted -6%, -5%, 2%, and -11% y/y volume change last quarter and -4%, -3%, 6%, and -7% year-to-date so the negative trend is accelerating.

- POST has $7.9 billion in Goodwill and Intangible assets. Those could see impairments. When the last test was conducted, POST noted that its forecasted value of Goodwill exceeded the carrying amount by only 6.5% for cheese and dairy products and 8.5% for the Refrigerated Retail unit. Other Goodwill was said to have passed the test by at least 10%.

Teva Pharmaceuticals Industries Limited (TEVA)

Date Added	3/30/2022
Market Cap	$11.4 B
PE (fwd)	4.5
Short %	1.5%
Current EQ Rating	2- (Weak)

TEVA has low-quality items throughout the financial statements. Adjusting for these issues makes TEVA's reported results look far worse. This is a company that is often cheered for improving its balance sheet and reaching settlements on opioids. We think that the picture is far from improving:

- The settlements still must be paid. TEVA does not factor in these accrued settlements as debt. We think debt to EBITDA is a full turn higher:

	2Q23	1Q23	4Q22	3Q22	2Q22
TEVA Net Debt	$18,009	$18,548	$18,411	$19,041	$20,024
Accrued Litigation	$4,704	$4,299	$4,186	$4,077	$3,928
Actual Debt	$22,713	$22,847	$22,597	$23,118	$23,952
TTM Adj EBITDA	$4,353	$4,362	$4,598	$4,731	$4,812
Debt/EBITDA	3.83	4.25	4.00	4.02	4.16
Actual Debt/EBITDA	5.22	5.24	4.91	4.89	4.98

- Sales allowances have been a big source of earnings and EBITDA but are not helping as much as in the past. Sales allowances are established to reflect lower selling prices on product already in the channel and discounts offered to Medicaid or insurance companies, large volume purchases, returns, etc. The reserve amounts to 40%-45% of gross sales. TEVA has steadily drawn this allowance down by billions of dollars in recent years, helping earnings and EBITDA. In recent quarters, TEVA has started to see this earnings source both help and hurt. It simply isn't falling as much anymore:

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
New Allowance	$3,243	$3,098	$3,298	$3,147	$3,382	$3,088
Used Allowance	$3,121	$3,552	$3,146	$3,379	$3,309	$3,517
EBIT/EBITDA Impact	$122	-$454	$152	-$232	$73	-$429
EPS impact	-$0.09	$0.34	-$0.12	$0.19	-$0.06	$0.32

In the last 4 quarters, TEVA's non-GAAP EPS was $2.26. It had 32 cents come from this area. But note in the table above that in the last 6 quarters, the change in the reserve has been both a headwind and tailwind to earnings. In prior years, it was almost always a large tailwind. Also, EBITDA for the last 4 quarters was $4.35 billion. It falls to $3.94 billion without this.

- TEVA lives in court. Its operating model involves challenging other company's patents and protecting its own. However, it adds back the recurring legal expenses to both non-GAAP EPS and EBITDA. It also adds back payments it is obligated to make and impairments that occur regularly and TEVA still has $23 billion of Goodwill and Intangibles to test for impairment:

	2Q23	1Q23	4Q22	3Q22	2Q22
EBITDA	-$346	$306	-$550	$740	-$590
Impairments	$774	$188	$1,445	$28	$810
Legal bills	$462	$233	$34	$195	$729
1st Adj. EBITDA	$890	$727	$929	$963	$949
Restructuring	$10	$56	$30	$25	$35
Equity Comp	$30	$32	$36	$26	$39
Contingent Payments	$70	$20	$63	$6	$61
Other items	$125	$63	$182	$70	$51
TEVA Adj. EBITDA	$1125	$899	$1,240	$1,089	$1,134

Last quarter's non-GAAP EPS was 56 cents – adding back the legal costs was 35 cents and the contingent payments were 5 cents. Also, notice that without adding back those two recurring cash payments – EBITDA declines to only $583 million from $1.125 billion. Trailing 4-quarter EBITDA was $4.35 billion. Adjusting for the contingent payments, legal costs, and the sales allowances – EBITDA would only be $2.86 billion. How good does TEVA look under that scenario with adjusted debt-to-EBITDA of 8.0x?

On Deck Risks

Altria Group, Inc. (MO)

MO faces further acceleration of smoking volume decay from PM's '24 roll-out, more potential menthol bans, and now higher gas prices. Expect write down in *Skoal*. MO continues to add back litigation costs to non-GAAP results to beat forecasts.

Cintas Corporation (CTAS)

CTAS picked up 10 cps y/y on higher First Aid margins that fell sequentially. Inventory reserves are falling and adding 4.5 cps per 100bp drop. Pricing power may be tough to keep.

International Business Machines Corporation (IBM)

IBM's 2Q23 benefitted by 2 cps from deprecation falling below forecast, 2 cps from cuts to advertising, 5 cps from cutting extended warranty accruals, and R&D coming in almost flat added 4.5 cps. Gross margin was helped by the financing unit – where IBM reversed past accruals in 1Q.

Iron Mountain Incorporated (IRM)

IRM does not cover its dividend with actual cash flow. It is beating estimates by ignoring principal payments on finance leases, fulfillment costs, and lower maintenance spending. It cannot afford its growth spending, but without that, the EBITDA multiple contracts.

Mohawk Industries, Inc. (MHK)

MHK gained 8 cps from cutting A/R allowances. Last Q was helped by late sales that boosted A/R as customers destock now. Amortization of capitalized costs is helping as much as 4-6 cps. Warranty accruals are at low levels.

Okta, Inc. (OKTA)

OKTA's 2Q24 picked up 4 cps from lower depreciation, 8 cps in interest income, 6 cps from higher capitalized commissions, and it cut R&D as a percentage of sales.

Top Values

AT&T, Inc. (T)

Date Added	10/3/2023
Market Cap	$107.4 B
PE (fwd)	6.1
Short %	1.6%
Current EQ Rating	4+ (Acceptbale)

T remains a very cheap stock at 6x EPS, 5.6x EBITDA and it comes with a 7.6% yield that consumes only half the free cash flow this year of $16+ billion. That forecast has been confirmed multiple times throughout the year. In 2024, capital spending should decline by about $4 billion and make free cash flow $20+ billion without any growth, further supporting the dividend payout.

- T continues to focus on retiring debt, which stood at $132 billion after 2Q23. It should decline in 3Q and 4Q and then at least $10 billion in 2024 and 2025. Arguably, reaching the goal of debt/EBITDA of 2.5x should only require about $20 billion in debt retirement. Every $7.2 billion paid down should transfer $1 of enterprise value to the stock even without multiple expansion. That $1 and $1.12 dividend is a 14% return per year and assuming $10 billion in debt repayment, the return jumps to 17%.

- There is a solid case to make for growth as well. The broadband roll-out is happening faster than originally planned due to the higher capital spending. Initial customers are low-margin because of the high infrastructure costs. However, incremental customers come online with minimal extra costs. Plus, broadband pricing has been strong and AT&T could receive cash flow from the infrastructure legislation in 2024 too. That is not in the forecasts yet.

- T has $6 billion in cost reductions in place – not all of that is annualized into results yet. That is still a good tailwind through 2024. It has another $2 billion expected to come from retiring more copper lines. For a company with $43 billion in EBITDA, those are some big targets for future earnings growth. Again, the stock can still trade for 5.6x EBITDA, and every $1.2-$1.3 billion in higher EBITDA adds another $1 to the stock value. Now you have a dividend with a 3-month duration for 7.6% of return, $1 return from cost-cutting already identified for 6.8% of return, and $1.35-$1.40 from debt repayment for 9.5% of

return. That's a 24% potential return – without forecasting any multiple expansion or higher income/EBITDA in mobility or broadband.

- AT&T beat 2Q23 forecasts by 3 cents. That came despite over 3 cents in headwinds from interest rate-related items such as lower capitalized interest as spectrum went into service, higher securitization fees, and higher interest costs on pensions.

Stanley Black & Decker, Inc. (SWK)

Date Added	10/3/2023
Market Cap	$12.8 B
PE (fwd)	79.8
Short %	5.7%
Current EQ Rating	3- (Minor Concern)

SWK has been digging its way out of an inventory overhang for several quarters. At the same time, its customers continue to de-stock inventory due to poor consumer buying. So, SWK has the added problem of trying to reduce inventory as sales volumes are showing negative growth. There are some signs of improvement and between the $2 billion cost savings plan and the likelihood of gross margins to normalize from the current 23.6% to a more normal 35%, - SWK has the potential to add $2-$3 to quarterly EPS, which last quarter was -$0.11. At $83, the stock is selling for 7-10x normal earnings.

- Inventory levels continue to show improvement:

SWK Inv.	**7/1/23**	**4/1/23**	**12/31/22**	**10/1/22**	**7/2/22**	**4/2/22**	**1/1/22**	**10/2/21**
Finished Product	$3,257	$3,472	$3,461	$3,840	$4,115	$4,023	$3,486	$2,777
Work in Progress	$238	$260	$339	$357	$456	$429	$395	$350
Raw Materials	$1,787	$1,928	$2,062	$2,150	$2,065	$1,816	$1,539	$1,007
Total Inventory	$5,283	$5,660	$5,861	$6,347	$6,636	$6,268	$5,420	$4,134
DSI Finished	93.4	102.0	97.4	112.7	117.5	116.5	111.1	98.6
DSI Wrk Progress	6.8	7.6	9.5	10.5	13	12.4	12.6	12.4
DSI Raw Mat	51.2	56.7	58.0	63.1	59.0	52.6	49.1	35.7
Total DSI	**151.4**	**166.3**	**164.9**	**186.3**	**189.5**	**181.5**	**172.8**	**146.7**

- SWK is getting inventory levels down despite customers destocking and it continued negative volume trends. However, volume improved last quarter – albeit against some easy comps:

SWK Vol.	**7/1/23**	**4/1/23**	**12/31/22**	**10/1/22**	**7/2/22**	**4/2/22**	**1/1/22**	**10/2/21**
Overall	-5%	-11%	-10%	-10%	-13%	-6%	-8%	8%
Tools/Outdoor	-6%	-13%	-12%	-12%	-16%	-6%	-8%	11%
Industrial	-1%	-2%	1%	5%	4%	-5%	-9%	-1%

- Margins are also starting to improve with upticks in gross margin and reductions in SG&A:

SWK Margin	7/1/23	4/1/23	12/31/22	10/1/22	7/2/22	4/2/22	1/1/22	10/2/21
Adj Gross Margin	23.6%	23.1%	19.5%	24.7%	27.9%	31.3%	29.0%	32.3%
Ad SG&A %	19.5%	20.5%	18.3%	18.4%	18.7%	19.8%	20.1%	20.0%

The key to understand is that SWK is still running at less than full capacity producing new products which is deleveraging margins as fixed costs are absorbed by fewer units. Also, it is liquidating higher-cost inventory which was built up during inflation and expensing it under LIFO into the negative volume growth market which is hurting margins. Together, SWK quantifies that as 400-500bp of margin. Even based on the subdued sales figure, that is $0.88-$1.09 in EPS for the quarter. Guidance calls for that to end by the end of 2023. SWK has eliminated poor-selling SKUs and the cost savings are helping SG&A improve as well. The run rate of cost savings is expected to reach $1 billion by 4Q23. It was $430 million after 1Q. Even the $430 million is about 50 cents per quarter.

- SWK did see warranty accruals rise again. This had been a tailwind for earnings in prior periods. It rose to $46.8 million in 2Q23 from $39.1 million y/y and $39.3 million sequentially. It hurt EPS by 4 cents but may be a sign business is growing again.

- SWK did pick up 7.5 cents from lower stock compensation in 2Q23 quarter vs. the 24-cent beat. This is an expense that likely will start to rise again as the situation continues to improve.

United Rentals, Inc. (URI)

Date Added	12/13/2021
Market Cap	$30.3 B
PE (fwd)	11.1
Short %	4.0%
Current EQ Rating	4+ (Acceptable)

URI is a beneficiary of sizeable construction projects such as new semiconductor plants, chemical plants, new toll roads, bridges, etc. receiving federal funds. This should fuel growth for several years. The stock sold off earlier this year because the market was concerned about its acquisition of Ahern lowering margins. That fear appeared overblown in our view. With EPS of $40, URI is only 6x EBITDA and 11x earnings, with strong earnings growth.

- Adjustments to non-GAAP earnings are reasonable and all relate to acquisitions. URI adds back amortization of acquired intangibles, restructuring charges, the impact on depreciation of marking acquired assets to Fair Market Value and changing the effective life assumptions to match URI's policy, and the impact of Fair Market Value of acquired assets that are sold. This was only $1.30 of the reported $9.88 in 2Q23. It is worth noting that the restructuring charges normally vanish quickly.

- EBITDA is an overstated figure because a key part of URI's business model is buying new rental equipment and selling it within 6-10 years. That recycles capital and keeps its fleet young and in demand. The net capital spending is not discretionary and makes some of depreciation effectively a cash cost of about $2.0-$2.5 billion in most years. This would make Debt-to-EBITDA about 2.3x vs. 1.6x. It would make the total value 8.0-8.5x adjusted EBITDA.

- Ahern's margins are already improving with URI's integration. It started out as a lower-margin company as a stand-alone entity. And, it did not have as many overlapping sites as past deals, so URI kept more of the real estate open.

Adj. EBITDA %	Combined '23 URI and Ahern	Pro forma '22 Combined	URI stand alone Actual '22	Ahern stand alone Actual '22
2Q	47.7%	46.4%	47.3%	35.6%
1Q	45.8%	44.2%	45.1%	33.0%

- Gross margin on rentals is improving too. The EBITDA figure above removes the depreciation and thus ignores the impact of marking up the acquired equipment to fair market value and boosting deprecation expense.

Rental Gross Marg.	Combined '23 URI and Ahern	Pro forma '22 Combined	URI stand alone Actual '22	Ahern stand alone Actual '22
2Q	39.3%	39.1%	40.7%	18.3%
1Q	36.6%	36.5%	38.3%	13.7%

URI is still underperforming its stand-alone figure by 140bp from 2Q22, but it is starting to widen the y/y change on a pro forma basis. As the marked-up equipment is sold and replaced, the gross margin should improve over time.

Warner Bros. Discovery, Inc. (WBD)

Date Added	7/14/2023
Market Cap	$26.5 B
PE (fwd)	12.2
Short %	4.4%
Current EQ Rating	3+ (Minor Concern)

WBD completed the merger 18 months ago. It came in identifying no revenue synergies and $2 billion of cost cuts. It has already achieved $3 billion in cost cuts and targeting $5 billion-plus, has boosted revenues with streaming price-hikes, and had the *Barbie* movie in 3Q23. EBITDA of $10.7-$11.0 billion for 2023 has several areas to improve going forward, and the stock is only trading at 6.5x the impaired EBITDA. Simply having the $5 billion in cost cuts fully in place, should get EBITDA closer to $15 billion, giving WBD a multiple of under 5x.

- Advertising remains impaired – down about $1 billion from original forecasts. This is an economically sensitive item, but there are reasons to expect this to improve going forward. WBD rebuilt its sales team that is now in place. The first year of ad sales began before the merger and after the merger, WBD canceled several weak shows. That situation is more normalized now. It has added more advertising to the *Max* streaming service. It also has easier comps going forward and the biggest quarter 2Q22 included the Olympics. WBD has added some baseball playoffs for 4Q23 too:

Network Adv	4Q	3Q	2Q	1Q
2023			$2,448	$2,237
2022	$2,226	$1,944	$2,802	$2,632
2021	$2,683	$2,268		

- Free cash flow is improving quickly. Numerous restructuring charges in 2022 and early 2023 hurt free cash flow by $1.5 billion which are largely complete. Guidance is for at least $5 billion of free cash flow for 2023. The biggest item that impacts this is the interest payments on the acquisition debt in 1Q and 3Q of nearly $900 million. Guidance for $1.7 billion in free cash flow for 3Q23 is quite a jump:

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Cash Ops	$2,014	-$631	$2,846	$124	$1,011	$323
Cap Ex	$292	$299	$364	$316	$222	$85
Free Cash	$1,722	-$930	$2,482	-$192	$789	$238
Wrk Cap	-$2,734	-$5,930	-$2,450	-$3,806	-$3,594	-$1,132
Amtz content	$4,638	$4,723	$2,720	$4,850	$5,618	$973

- Debt is also declining and after a $2.7 billion debt tender early in 3Q23, should be about $42 billion – down $10 billion from 2Q22. Debt/EBITDA has declined from over 5x and should finish 2023 at less than 4x. The rising EBITDA should help free cash flow too and at $15 billion WBD could be at 2.5x by retiring only another $5 billion of debt. Every $2.4 billion in debt payment, should move $1 of enterprise value to the share price without the valuation multiple changing.

- Streaming has reached profitability years ahead of schedule under the new management. It raised prices and more advertising here. The international roll-out begins in 2024 too.

Max EBITDA	4Q	3Q	2Q	1Q
2023			-$3	$50
2022	-$217	-$634	-$558	-$654
2021	-$728	-$309		

- The writers' strike dominated the news for several months. New content creation can return at this point. WBD thought it would save about $200-$300 million in cash flow during the strike now that that spending will return. That does not look like a deal killer to us.

- Our view is that WBD can post significant growth rates in the next 2-3 years just from the cost savings that are already identified and many of which are in place but have not annualized yet. Streaming profitability could expand as well. Advertising could become a tailwind and add to EBITDA too as the tough comps have passed. Much of the WBD library has traded hands multiple times in the past at multiples higher than 6x. Much of management's stock deals are priced in the $20s and $30s. Reaching $25 per share on $15 billion in EBITDA would still involve a multiple of less than 7x.

WESCO International, Inc. (WCC)

Date Added	7/14/2023
Market Cap	$7.4 B
PE (fwd)	9.3
Short %	4.6%
Current EQ Rating	5- (Strong)

WCC is trading for 8-9x EPS and <7x EBITDA and has a growing business – Its utility business grew volumes by 4%, communications by 6%, and electrical was down 6% on volume as customers worked down some inventories – but industrial construction backlogs are huge. We regard some of the concerns as temporary not a permanent situation. Primarily, supply shortages flipped quickly to having months of delayed orders all arrive in early 2023. This ballooned inventory and consumed cash:

- Inventory is already being worked down and releasing cash. There continues to be volume growth, which should help inventory levels to decline further. Inventory in the channel should be declining now too. Communications destocking started a year ago and should be largely complete. The government semiconductor and infrastructure money is also arriving in late 2023 and 2024.

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22	4Q21	3Q21
Inventories	$3,584	$3,730	$3,499	$3,490	$3,166	$2,881	$2,666	$2,570
DSIs	72.4	77.8	74.2	75.7	67.1	66.8	63.5	61.1

- With volume growth, WCC could see some margin expansion. Most costs are fixed in the short-run and running more volume over those costs creates margin leverage. A 1% change in margins is worth 16 cents per quarter in EPS.

- A key area of recent weakness for WCC is suppliers. WCC and its customers both working down inventory slows its own ordering. That means fewer volume rebates from suppliers. WCC pointed to this costing it about 40bp of margin, or 55-60 cents in annual EPS headwind this year. We expect this to correct during 2023.

- Pricing is likely to face some pressure – it was a 3% positive factor on sales in 2Q23. However, for many of the 2022 quarters, WCC sales were being hurt by 2% because it didn't ship orders until it could fill the complete order which pushed some sales into the future. A transition to lower pricing could be completed in two-three quarters in our view.

Our sensitivity analysis shows that if volume growth dropped to zero it would cost WCC about 8%-10% of its earnings. However, if volume grows – that offsets the pricing loss and earnings may only decline 2%-3% and could actually grow if the volume growth occurs. WCC has a solid history of topping forecasts for cross-selling customers with the actual results already 3x the original guidance.

- WCC's earnings quality is high – only adding back integration costs, gains/losses, and accelerated amortization. It does not add back stock compensation or acquired amortization. It posts profits with both GAAP and non-GAAP results. The adjustment last quarter was only 30 cents of the $3.71 total. The adjustments were for integration and restructuring.

On Deck Values

Air Lease (AL)

AL saw plane sales return in 2Q adding 40 cps to income and interest spread is above normal levels. Book value of $54 is understated by potential insurance claims and FMV value of aircraft being higher than what is on the balance sheet.

Ball Corporation (BALL)

Selling Aerospace will help the balance sheet. Falling inventory and production will help cash flow too. Lower depreciation should lap this quarter as a headwind.

Costco (COST)

COST said last week that it's more a question of "when" not "if" they boost membership fees. These are 55% of income and a $10 increase is worth $1.25 in EPS.

Otis Worldwide Corporation (OTIS)

Only non-GAAP adjustment to EPS is minor restructuring. OTIS continues to add digitization to reduce service visits and help margins by 40-50 bps per year. It locked in deals from suppliers that caused payables to rise – but not problematic.

Philip Morris International Inc. (PM)

The recent EPS beat came from a lower tax rate which should reverse. FX headwinds also grew. However, the roll-out of heated tobacco in the US could be a game changer in '24.

Starwood Property Trust, Inc. (STWD)

STWD has resisted putting money to work, which is a drag on EPS as is workout situations that are costing it about 5-cents a quarter that have planned exits. It still beat forecasts. Special servicing should see income ramp up and bring STWD new deals.

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.

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