BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH
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Autodesk (ADSK) EQ Update- 9/20 Qtr.

Current EQ Rating*	Previous EQ Rating
4+	3-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

*For an explanation of the EQ Review Rating scale, please refer to the end of this report

We are raising our earnings quality rating to 4+ (Acceptable) from 3- (Minor Concern)

ADSK reported adjusted EPS of $1.04 which was 8 cps ahead of the consensus.

Our main reason for not rating ADSK a 4 in our initial review was our concern that the decline in signing multi-year deals would force the company to lower free cash flow forecasts for the full year. During the third quarter, the company did cut the top end of its free cash flow forecasts which reduces our concern for a material negative surprise in this area.

What improved?

- As we expected, accounts receivables DSOs declined by over 4 days versus the year-ago period as the company normalized payment terms in early August after previously extending them to 60 days at the height of the COVID lockdowns.

What deteriorated?

- Billings declined from the year-ago quarter by almost 1%. While management stated that this was ahead of expectations, it still lowered the top end of its estimated range for full-year billings down to $4.130 from the previous quarter's $4.170. We noted in our original review that the uncertainty of the current environment has resulted in customers electing to forego signing multi-year deals which are paid upfront. This has a negative impact on billings, deferred revenue, and cash flows.

- Our biggest concern in our original review was that the company would have to lower its full-year free cash flow forecasts as a result of the decline in multi-year deals resulting in less cash received upfront. The top end of the forecast was lowered in the third quarter from $1.400 billion to $1.360 billion. The midpoint of the guidance implies free cash flow of about $620 million in the fourth quarter which is a slight decline from the year-ago level of $684 million. This does not seem overly optimistic assuming multi-year signings don't deteriorate further.

What to watch

- Amortization of costs to obtain contracts fell by $1.4 million despite an increase in the balance of capitalized contract costs. As noted in our original review, we are not especially concerned by this trend at the moment since revenue is shifting to longer-term deals which would result in a longer period over which to amortize these costs. Also, we estimate that if amortization as a percentage of the average capitalized balance had remained even with a year ago, it would have only shaved about 1.5 cps off earnings. We will continue to monitor this going forward.

- ADSK's adjusted effective tax rate has been running around 16% for the last three quarters which is down about 200 bps from last year. The company has been forecasting this rate clearly in its presentations, so we do not consider it an unexpected benefit. Nevertheless, this approximate 2.5 cps headwind will expire after the fourth quarter.

- Stock-based compensation is rising and ADSK adds this expense back to non-GAAP earnings. This amounted to 44 cps of the adjusted $1.04 reported in the quarter.

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 Concerns"	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 may 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 the next quarter. 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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