BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Becton, Dickinson (BDX) EQ Review Update-9/18 Quarter

Current EQ Rating*	Previous EQ Rating
4-	4-

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

We maintain our EQ Review rating of BDX at 4- (Acceptable)

- Our review of the 9/18 10-K and fourth quarter turned up no significant changes with regards to earnings quality.

- We note that the 12/18 quarter will be the final quarter before the Bard acquisition is lapped which will lead to more informative comparisons starting in the 3/19 quarter.

Impact of Mandatory Convertible Preferred Shares

We remind investors that in connection with the acquisition of Bard, BDX issued 2.475 million shares of mandatory convertible preferred shares in the form of depository rights which entitle the owner to a 1/20 share of the convertible preferred. Par value was $1,000 and the shares pay a dividend of 6.125%. They are convertible into 11.7-14.0 million shares of BDX based on a conversion formula which takes into consideration the price of BDX stock prior to conversion with a mandatory conversion date of May 2020. The company disclosed that 11.675 million shares related to the convertibles were excluded from EPS in the fourth quarter of fiscal 2018 as they were anti-dilutive which was the case in the last several quarters. The convertibles are currently well in the money at the current share price, but the generous dividend rate may delay conversion. Management forecasted a fully diluted share count in fiscal 2019 of 275 million shares, up from 265 million at the end of fiscal 2018.

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 recent 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.

Disclosure

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