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EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Becton, Dickinson, & Co. (BDX) EQ Update- 6/20 Qtr.

Current EQ Rating*	Previous EQ Rating
3-	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 maintaining our rating of 3- (Minor Concern)

BDX beat earnings estimates by 13 cps in the quarter but missed revenue targets by more than $100 million and gave disappointing guidance, leading to an approximate 10% stock price decline. We did not see much in the way of new earnings quality developments, but do note the following items:

- BDX maintains a receivables factoring program but in most quarters the amount of derecognized receivables is too immaterial to report. However, as we covered in our last review of BDX, the company increased its factoring activity in the 12/19 quarter. This trend continued over the last two quarters with receivables that had been factored but still outstanding at the end of the quarter amounting to 7.5, 5.3, and 7.1 days of sales for the 6/20, 3/20, and 12/19 quarter, respectively. Total receivable DSOs adjusted for these amounts were up by 8.1 days in the 6/20 quarter after climbing 2.6 and 3.3 days in the 3/20 and 12/19 quarters, respectively. The acceleration in the increase in adjusted DSOs in the most recent quarter was likely driven by the 11% decline in the revenue in the period. Still, the trend of rising adjusted DSOs is a concern that should be monitored closely going forward.

- Related to the above matter, the company noted in its liquidity discussion in the 10-Q that operating cash flow for the 9-month period ended 6/20 was up slightly with working capital being a drag. However, it cited "lower levels of trade receivables" as being a positive. Note that the boost in cash from receivables was due to the increased rate of factoring which benefitted cash flow growth by more than $300 million. As we have discussed before, we have nothing against reasonable utilization of receivables factoring if investors realize that the benefit to cash flow growth will expire after a year unless the company accelerates its pace of factoring.

- Inventory DSIs jumped by 17 days over the year-ago period. This is likely a reflection of a slowdown in demand for elective procedures which should return in the next couple of quarters. Also, 3 days of the increase came from an increase in materials DSIs which likely reflects the company gearing up for testing demand.

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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