BEHIND THE NUMBERS

EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Ball Corp. (BLL) EQ Update 9/19 Qtr.

Current EQ Rating*	Previous EQ Rating
2-	2-

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 a more detailed explanation of the EQ Review Rating scale, please refer to the end of this report

We are maintaining our earnings quality rating of 2- (Weak).

BLL once again missed its EPS targets in the 9/19 quarter with the adjusted figure of $0.70 falling 2 cps below the consensus target.

- Reported trade receivables DSOs fell by 4 days in the 9/19 quarter versus the 9/18 quarter. However, after adjustment for factored receivables that were outstanding at the end of the period, DSOs jumped by over 2 days. Analysis of receivables is complicated by past divestitures and moving assets to held for sale, but the company noted in its 10-Q that after adjustment for the sale of the US steel packaging business in 2018, the China beverage packaging business, and the transfer of the Argentina steel aerosol business assets to held for sale status, DSOs increased "from 42 days in 2018 to 49 days in 2019."

- A 2-3 days increase in DSOs would be less concerning for a company that is growing its sales base. However, BLL's total sales are flat. Aluminum can volume was up about 4%, but this was largely offset by lower pass-through of aluminum costs. The company continues to report it is struggling with lower inventory and production issues to meet demand for its aluminum packaging products. In such an environment, an increase in DSO calls into question the quality of reported revenues. We also note that the 9/19 quarter ended on a Monday versus a Sunday in the year-ago period which should have improved collections.

- Unbilled receivable days also climbed by 4 days in the 9/19 quarter versus the year-ago period. As we have noted in past reviews, this may be driven by the increase in Aerospace sales recognized under long-term contracts in the mix. However, we are skeptical that that is driving the entire increase in unbilled receivables as the growth in unbilled receivables outran the growth in Aerospace sales in the 9/19 quarter. This may be an indication of more aggressive revenue recognition of non-Aerospace revenues and this trend should be monitored going forward.

Receivables Sales and Adjusted DSOs Continue to Rise

One of our key concerns with BLL has been its increased use of receivables factoring. The table below shows the calculation of trade receivable days of sales adjusted for outstanding sold receivables that have been removed from the balance sheet as well as unbilled receivable days:

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Sales	$2,953	$3,017	$2,785	$2,803
Gross Trade Receivables	$922	$1,017	$958	$812
Gross Unbilled Receivables	$491	$503	$477	$478
Outstanding Sold Receivables	$1,145	$1,092	$1,008	$1,022
Gross Trade Receivable DSO	28.5	30.8	31.4	26.4
Factored Receivable DSO	35.4	33.0	33.0	33.3
Gross Trade +Factored DSO	63.9	63.8	64.4	59.7
Unbilled DSO	15.2	15.2	15.6	15.6

	9/30/2018	6/30/2018	3/31/2018	12/31/2017
Sales	$2,946	$3,101	$2,785	$2,747
Gross Trade Receivables	$1,052	$1,259	$1,332	$1,206
Gross Unbilled Receivables	$359	$390	$429	$147
Outstanding Sold Receivables	$942	$838	$589	$561
Gross Trade Receivable DSO	32.6	37.0	43.6	40.1
Factored Receivable DSO	29.2	24.7	19.3	18.6
Gross Trade +Factored DSO	61.8	61.7	62.9	58.7
Unbilled DSO	11.1	11.5	14.1	4.9

Trade receivables declined year-over-year from 32.6 to 28.5. However, the increase in factored but still outstanding receivables more than offset this, resulting in a 2-days increase in adjusted DSOs. Note that our figures above do not take into consideration the impact of the sale of the US steel food and aerosol business in 2018, the sale of the China beverage packaging business, or the transfer of the Argentina steel aerosol business assets to held for sale as of the end of the 9/19 quarter. However, the company noted in its liquidity section of its 10-Q that taking these items into consideration, DSO jumped from "42 days in 2018 to 49 days in 2019" indicating a definite increasing trend in receivables.

Meanwhile, unbilled DSOs increased by more than 4 days over the year-ago quarter. Some of this increase may be due to rising aerospace sales which involve long-term contracts that result in more unbilled receivables being generated relative to sales. However, we are skeptical that this accounts for all of the increase. The following table shows a DSO calculation using Aerospace sales and the total unbilled receivables balance:

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Aerospace sales	$374	$379	$328	$359
Unbilled Receivables DSOs on Aerospace Sales	119.8	121.1	132.7	121.5

	9/30/2018	6/30/2018	3/31/2018
Aerospace sales	$283	$290	$264
Unbilled Receivables DSOs on Aerospace Sales	115.8	122.7	148.3

We want to point out that the above DSO number is relatively meaningless on an absolute basis since the unbilled receivables balance contains amounts relating to non-Aerospace sales. Also, we would point out that the timing of recognition of a non-Aerospace contract will have a magnified impact on a DSO figure utilizing the smaller Aerospace sales base. Regardless, we do believe the relative trend in our unbilled aerospace DSO is informative and a large year-over-year increase like the one observed in the 9/19 quarter may indicate more aggressive revenue recognition in non-Aerospace sales. This metric should be monitored going forward looking for signs of a trend.

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.

Disclosure

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