BEHIND THE NUMBERS
Quality of Earnings Analysis
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Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

www.btnresearch.com

Ball Corporation (BLL)
Earnings Quality Review- 9/21 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are maintaining our earnings quality rating of BLL of 3- (Minor Concern) and maintain our On Deck Sell rating.

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

Summary

BLL reported non-GAAP EPS of $0.94 in the 9/21 quarter which fell 4 cps short of the consensus target. However, the adjusted effective tax rate was 11.6%. The company attributed thelower tax rate to higher R&D tax credits. Going into the quarter BLL was forecasting a full-year tax rate of 17% which is closer to what most analysts were likely expecting. We estimate this added about 7 cps of unexpected benefit to the quarter so we view the miss as worse than it appears at first glance..

We continue to see working capital issues as well:

- Cash from operations for the 9 months ended 9/21 rose by $531 million. This was penalized by a $400 million increase in the drain from growth in receivables but was more than offset by an unusual jump in accounts payable.

- Outstanding factored receivables fell to $1.27 billion in the 9/21 quarter from $1.37 billion in the year-ago quarter and $1.47 billion in the 6/21 quarter. The limit on the factoring program also declined slightly from the previous quarter. This decline in factoring activity is notable as an expansion in receivables factoring has been a key source of financing the company's aggressive capacity expansion.

- The non-GAAP add-back for "business consolidation and other activities" jumped to $141 million. However, this included $130 million of pension settlement charges which reduces our concern.

Factored Receivables Are Declining…but Payables are Rising

BLL reported a $531 million increase in cash from operations in the nine months ended 9/21. While the company does not itemize the impact of each working capital component on cash flow, we can estimate them by using balance sheet data which is shown in the table below. This will be skewed somewhat by acquisitions and divestitures but the impact should not be meaningful in the periods presented.

for 9 months ended:	2021	2020	difference
Cash from Operations- 9 months	$876	$345	$531
Cash flow from receivables	-$632	-$232	-$400
Cash flow from payables	$780	-$304	$1,084
Cash flow from inventories	-$285	-$35	-$250
Impact of Working Capital	-$137	-$571	$434

We can see that reported cash from operations for the nine months ended 9/21 rose to $876 million from $345 million in the year-ago period. This was boosted by a $111 million decline in pension contributions. However, the largest contributor to the increase was an oversized increase in account payable. We will take a closer look at the receivable and payable components below:

Accounts Receivable

One of our key concerns with BLL has been the company's rapidly accelerating use of receivables factoring to boost operating cash flows over the last couple of years as it spends heavily on its capacity expansion. However, factored receivables declined in the 9/21 quarter on both a sequential and YOY basis. The following table shows trade and unbilled receivables on the balance sheet, factored receivables, and adjusted receivables which combines the two. (We remind readers that we estimate outstanding factored receivables by taking the difference between the limit of the factoring facility and the amount available for sale under the facility and the end of the quarter.

	9/30/2021	6/30/2021	3/31/2021	12/31/2020
Sales	$3,553	$3,459	$3,125	$3,102
Net Trade + Unbilled	$1,976	$2,102	$1,640	$1,344
DSO	**51.2**	**55.3**	**47.2**	**39.9**
Outstanding Factored Receivables	$1,270	$1,473	$1,252	$1,368
Factored DSO	**32.9**	**38.8**	**36.1**	**40.6**
Adjusted Receivables	$3,246	$3,575	$2,892	$2,712
Adjusted DSO	84.1	94.1	83.3	80.4

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Sales	$3,093	$2,801	$2,785	$2,719
Net Trade + Unbilled	$1,418	$1,447	$1,417	$1,186
DSO	**42.2**	**47.0**	**46.3**	**40.1**
Outstanding Factored Receivables	$1,316	$1,073	$1,098	$1,170
Factored DSO	**39.1**	**34.9**	**35.9**	**39.6**
Adjusted Receivables	$2,734	$2,520	$2,515	$2,356
Adjusted DSO	81.3	81.9	82.2	79.7

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Sales	$2,953	$3,017	$2,785	$2,803
Net Trade + Unbilled	$1,405	$1,511	$1,426	$1,280
DSO	**43.8**	**45.6**	**46.1**	**42.0**
Outstanding Factored Receivables	$1,145	$1,092	$1,008	$1,022
Factored DSO	**35.7**	**32.9**	**32.6**	**33.5**
Adjusted Receivables	$2,550	$2,603	$2,434	$2,302
Adjusted DSO	79.4	78.5	78.7	75.6

Outstanding factored receivables fell by $98 million in the nine months ended 9/21. This compares to a $146 million increase in the comparable year-ago period. This implies an approximate $250 million drag on cash flow growth for the nine months ended 9/21 just from a decline in the pace of factoring receivables. Also, in the first nine months of 2021, receivables left on the balance sheet rose by $632 million. This would have been influenced by the decline in factoring as fewer receivables would have been removed from the balance sheet. However, there was still a rapid increase in receivables after adjusting for the $98 million decline in factoring.

The decline in receivables factoring bears watching as it could be signaling the end to this source of cash flow growth. The following table shows the limit of the receivables factoring program for the last several quarters:

	9/30/2021	6/30/2021	3/31/2021	12/31/2020
Limit of Factoring Facility	$1,700	$1,800	$1,600	$1,600

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Limit of Factoring Facility	$1,500	$1,300	$1,300	$1,400

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Limit of Factoring Facility	$1,300	$1,280	$1,200	$1,200

The limit of the factoring facility declined sequentially from the 6/21 quarter. However, this is not the first decline in the last three years so it is not a clear sign that the company is having problems with its receivables financing but given the decline in the outstanding factored balance in the September quarter, it warrants special attention in the next quarter.

Accounts Payable

	9/30/2021	6/30/2021	3/31/2021	12/31/2020
Trade Accounts Payable	$4,210	$3,961	$3,355	$3,430
Cost of Products Sold	$2,851	$2,760	$2,493	$2,448
DPOs	135.9	130.6	121.1	128.9

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Trade Accounts Payable	$2,832	$2,699	$2,613	$3,136
Cost of Products Sold	$2,430	$2,230	$2,215	$2,159
DPOs	107.2	110.1	107.4	133.6

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Trade Accounts Payable	$2,658	$2,739	$2,739	$3,095
Cost of Products Sold	$2,363	$2,428	$2,253	$2,246
DPOs	103.5	102.7	109.4	126.8

We see that payables rose by $780 million in the first nine months of 2021 compared to a $304 million decline in the year-ago period. This boosted cash from operations by $780 million in the nine months ended 9/21 versus payables being a $304 million use of cash in the year-ago period. Some of the increase in payables would have been due to company struggling to rebuild inventories with higher-cost materials. However, as we see in the following table, inventories did not rise nearly as dramatically as payables:

	9/30/2021	6/30/2021	3/31/2021	12/31/2020
Trade Accounts Payable	$4,210	$3,961	$3,355	$3,430
Total Inventory	$1,638	$1,490	$1,399	$1,353
Payables/Inventory	2.6	2.7	2.4	2.5

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Trade Accounts Payable	$2,832	$2,699	$2,613	$3,136
Total Inventory	$1,309	$1,388	$1,354	$1,274
Payables/Inventory	2.2	1.9	1.9	2.5

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Trade Accounts Payable	$2,658	$2,739	$2,739	$3,095
Total Inventory	$1,180	$1,183	$1,275	$1,271
Payables/Inventory	2.3	2.3	2.1	2.4

For the last three quarters, payables/inventory has been higher than the year-ago period which we take as evidence that the company is taking longer to pay its suppliers. This is another short-term boost to cash flows that will reverse at some point.

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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