BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Ball Corp (BLL) EQ Update-3/19 Qtr.

Current EQ Rating*	Previous EQ Rating
2-	2-

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

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

BLL's adjusted EPS of $0.49 missed consensus estimates by 2 cps. We continue to see multiple items of concern in the company's results.

- BLL's first quarter effective GAAP tax rate of 7.1% was lower than anticipated courtesy of excess benefits for share-based compensation. At the end of 2018, the company forecasted a 24% effective rate for all of 2019. Adjusted pre-tax earnings were $187 million and adjusted taxes were approximately $30 million, implying a 16% adjusted effective tax rate. If the adjusted tax rate had been 24%, we estimate it would have taken over 4 cps off earnings per share.

- The company is forecasting net debt to be about $6 billion at the end of 2019. Free cash flow is expected to be in excess of $1 billion, but management plans to spend $850 million on buybacks through the remainder of 2019 ($1 billion for the full year) and $185 million on dividends. Debt levels have reached their target level of before the Rexam acquisition. We find it interesting when a company openly commits to doing the full buyback for the year in May as it is essentially an admission that share price is not a consideration in the decision. Note that the 4.2% reduction in share count is adding a material tailwind to EPS growth.

- Accounts receivable securitizations continued to skyrocket with receivables sold but outstanding finishing the quarter at $1 billion, up from $589 million at the end of the 3/18 quarter. This likely gave an enormous boost to cash flow growth. Sold but outstanding receivables balances have flattened out in the last three quarters and we remain concerned that cash flow growth from receivables sales will fall off in 2019.

- In addition, the receivables sales appear to be masking an acceleration in the buildup of receivables. If we add back sold but outstanding receivable to trade receivables on the balance sheet plus an estimate of the China beverage packaging accounts receivable moved to held for sale during the quarter, it appears that receivable DSOs at the end of the 3/19 quarter jumped about 6 days over the year-ago quarter. We also note that the unbilled receivables portion of receivables on the balance sheet increased disproportionately as well. The jump in receivables could be an indication of the extension of more generous payment terms to drive revenue growth in the period.

- The company has warned that deteriorating conditions in China have eroded the value of goodwill associated with the Asia Pacific and AMEA segments and further deterioration could result in the need for a write-down. Carrying value is currently $78 million and $101 million, respectively. With the sales of the Chinese assets on the schedule for the second half of the year, we do not expect this to be a relevant issue.

- Pension expense fell $6 million versus the year-ago quarter from a lower recognition of actuarial loss. We view this as a non-operational benefit that added a little over a penny per share to EPS.

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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