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BEHIND THE NUMBERS
Quality of Earnings Analysis

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Ball Corp. (BLL)
Earnings Quality Update- 3/21 Qtr.

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

We maintain our earnings quality rating of BLL at 3- (Minor Concern).

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

Summary

BLL reported adjusted EPS of $0.72 which beat the consensus estimate by 5 cps. The company continues to spend to build capacity. BLL had 100 billion in unit capacity in 2019 and ended 2020 with 107 billion. It will add another 15 billion units of capacity in 2021 with a total expansion to 125 billion expected to be complete by 2023. Management has indicated that current sales are constrained by capacity and it will be able to sell all the new cans at attractive prices.

The buildout of additional capacity has resulted in elevated capex. Capex was $1.1 billion in 2020 and is expected to be $1.5 billion in 2021. This is almost 3 times the $500-$800 million range from 2018 and 2019. When the new lines are up and running, the company expects cash flow to double by 2025. If all this happens according to plan, the company will be able to pay off the debt generated to pay for expansion which currently sits at 3.3x EBITDA. However, if there are unexpected hiccups, we believe risk is increased by the company's heavy use of factoring receivables and increasing payables to help boost cash flow in the short run.

- Estimated factored receivables declined by over $100 million sequentially and were roughly flat on a days-of-sales basis. As we noted in the last review, the YOY growth in

factored receivables appears to be topping which could be a headwind to cash flow growth in the second half of the year. BLL has essentially utilized its factoring program to help boost cash flow in the short run as it spends heavily on building new capacity. The growth in factored balances has essentially been flat in the last three quarters. The YOY boost to rising factored balances will be up in the second half unless the company further expands its use of the program. This may be difficult to do with the limit already at $1.6 billion.

- Accounts payable days jumped to 121 from 107 a year ago and 109 in the 3/19 quarter. We estimate this could have added more than $400 million to cash flow growth in the quarter. We will be watching to see if the company tries to further extend payables during the remainder of the year to help fill the cash flow gap.

- The buildout in capacity has led to an increase in PPE on the balance sheet. However, depreciation expense has remained flat despite the company opening its new lines in Ft. Worth, Texas and Rome, as well as its new Glendale, Arizona plant in 2020. As more plants are brought online in 2021, depreciation expense cannot help but catch up to the increase in PPE. We estimate that if depreciation expense as a percentage of gross PPE increases to the pre-buildup level, it could cost 8 cps per share in incremental quarterly depreciation expense. We are not sure if any of this is included in the company's $50 million in forecasted startup costs for 2021.

- The effective tax rate fell to 15.2% in the 3/21 quarter which added about a penny per share to EPS. The company is now forecasting an 18% rate for full-year 2021 which should result in relatively even YOY tax rate comparisons for the next couple of quarters.

- The company's contracts have pass-through provisions which should help protect it from rising aluminum prices. Still, management warned on the call that other factors of production will be impacting by inflation.

Supporting Detail

Factored Receivables Have Levelled Out

We have been following the ramp-up in factored receivables for the last several quarters. The following table shows trade and unbilled receivable DSOs and estimated outstanding factored

receivable DSOs for the last eight quarters. Note that we arrive at our estimate of outstanding factored receivables by taking the difference between the limits of the factoring facilities and the amounts outstanding under the facility at the end of the quarter.

	3/31/2021	12/31/2020	9/30/2020	6/30/2020
Sales	$3,125	$3,102	$3,093	$2,801
Net Trade + Unbilled	$1,640	$1,344	$1,418	$1,447
DSO	47.2	39.9	42.2	47.0
Outstanding Factored Receivables	$1,252	$1,368	$1,316	$1,073
Factored DSO	36.1	40.6	39.1	34.9
Adjusted Receivables	$2,892	$2,712	$2,734	$2,520
Adjusted DSO	83.3	80.4	81.3	81.9

	3/31/2020	12/31/2019	9/30/2019	6/30/2019
Sales	$2,785	$2,719	$2,953	$3,017
Net Trade + Unbilled	$1,417	$1,186	$1,405	$1,511
DSO	46.3	40.1	43.8	45.6
Outstanding Sold Receivables	$1,098	$1,170	$1,145	$1,092
Factored DSO	35.9	39.6	35.7	32.9
Adjusted Receivables	$2,515	$2,356	$2,550	$2,603
Adjusted DSO	82.2	79.7	79.4	78.5

On the bright side, YOY growth in DSOs including factored amounts has been steady the last couple of quarters, so the company is not masking a ramp-up in receivables by removing them from the balance sheet.

However, we can see that outstanding factored receivables ranged between $1 billion to $1.5 billion from the 6/19 quarter to the 6/20 quarter before jumping to the $1.3 billion level in the 9/20 quarter. This led to a big YOY jump in factored receivable DSOs in the 9/20 quarter and to a lesser degree in the 12/20 quarter. The increased use of factoring has been a boost to cash flow growth as the receipt of cash is accelerated. However, factored receivables showed a slight sequential decline in the 3/21 quarter and if BLL does not ramp up factoring again, the boost to cash flow growth will begin to wane, especially after it laps the big jump in factoring in the 9/20 quarter. This may be tough to do with the limit of the current facility already at $1.6 billion.

Payables Jump

The following table shows the days payable outstanding (DPO) calculation for the last twelve quarters:

	3/31/2021	12/31/2020	9/30/2020	6/30/2020
Trade Accounts Payable	$3,355	$3,430	$2,832	$2,699
Cost of Products Sold	$2,493	$2,448	$2,430	$2,230
DPO	121.1	128.9	107.2	110.1

	3/31/2020	12/31/2019	9/30/2019	6/30/2019
Trade Accounts Payable	$2,613	$3,136	$2,658	$2,739
Cost of Products Sold	$2,215	$2,159	$2,363	$2,428
DPO	107.4	133.6	103.5	102.7

	3/31/2019	12/31/2018	9/30/2018	6/30/2018
Trade Accounts Payable	$2,739	$3,095	$2,953	$2,739
Cost of Products Sold	$2,253	$2,246	$2,362	$2,484
DPO	109.4	126.8	115.0	100.3

Accounts payable typically falls $400-$500 million sequentially in the first quarter. However, the balance declined by only $75 million in the 3/21 period. This would have added well over $400 million to cash flow growth in the quarter. DPOs have not been significantly out of line with historical trends in the previous three quarters. We will be watching to see if the company attempts to keep extending payables as a form of short-term financing to cover its cash flow shortfall.

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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