BEHIND THE NUMBERS
Quality of Earnings Analysis
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Behind the Numbers

Companies in this Issue

Post Holdings (POST)
Earnings Quality Update

We are keeping our earnings quality coverage of POST at 2- (Weak).

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

Summary

POST's adjusted EPS of $1.63 beat estimates by 25 cents for 4Q23 ending in September. Many of the unsustainable items we have pointed to are appearing and POST's fiscal 2024 guidance is flat – adjusted EBITDA of $1.2-$1.26 billion vs. $1.23 billion in fiscal 2023. Pricing inflated results in fiscal 2023 as POST took more pricing than raw material inflation justified. Normally, POST earns about $2.00-$2.50 in adjusted EPS vs. the $5.34 it just reported. We can find over $2 of EPS that looks very much at risk:

- Consider that in 2023, POST took $591 million in price hikes against raw material cost inflation of only $308 million for an outsized net pick-up of $283 million. Adjusted operating income was up y/y by $243 million.

	4Q23	3Q23	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Pricing	$12.9	$117.1	$229.8	$231.2	$234.8	$190.7	$85.1	$89.5
Raw Materials	-$30.5	$35.5	$160.4	$142.7	$111.7	$123.7	$51.6	$46.5
Manufacturing	$46.6*	$26.1	$23.1	$14.4	$20.6	$27.1	$23.7	$23.4
Freight	-20.6	-23.4	-$21.0	$0.0	$19.5	$27.4	$34.0	$27.7
Net Pricing	$8.4	$78.9	$67.3	$74.1	$83.0	$12.5	-$24.2	-$8.1

**$46.6 includes $6.6 in employee costs and $5.2 in warehousing cost*

- Pointing to pricing reversing is POST itself as it believes its Food Service segment will settle into adjusted EBITDA levels of $95 million per quarter. That is much lower than 2023 levels but actually much higher than pre-Covid:

Food Service	4Q23	3Q23	2Q23	1Q23	F23	F22	F21	F20	F19
Adj EBITDA	$117.0	$144.5	$110.0	$109.0	$480.5	$292.3	$197.0	$144.0	$310.0
Pricing	-$49.4	$26.1	$126.6	$142.6	$218.2	$339.3	$69.3		
Raw Materials	-$51.9	-$6.3	$107.4	$90.9	$140.1	$236.2	$80.5		

  - In 2019 and 2020 – POST made no mention of raw material costs and reported that all sales change was due to volume, not pricing.

  - Going to $95 million would already be a $100 million loss of EBITDA – of $5.34 in adjusted EPS POST just reported, this would cost it $1.18.

  - We can see that cumulative Pricing vs. Raw Materials are up $170 million for Fiscal 2021-23. This may have further to go than $100 million in lost income.

- A huge part of the pricing at Food Service was related to egg prices in calendar 2022 that have since plummeted. The Refrigerated Retail segment also has egg products and in terms of pricing exceeding raw material inflation – this segment has picked up $54.7 in excess pricing over raw materials. Every $10 million that POST could lose here is another 11.8 cents in headwind.

- Volume growth has really decelerated here already and pricing last quarter was only 1.8%:

Refrig Retail	4Q23	3Q23	2Q23	1Q23	4Q22	3Q22	2Q22
Volumes	-8.2%	-11.0%	-11.0%	-4.6%	-7.1%	2.2%	1.9%

- This unit took a $42.2 million impairment for goodwill "*driven primarily by narrowing of the price gap between branded and private label competitors, resulting in distribution losses and declining profitability.*"

- POST is also seeing a rise in promotional spending (which nets against sales and effectively reduces pricing). It only reports advertising once a year but that is rising too with plans for that to continue. Pre-Covid, POST was spending about $125-$150 on advertising, it was down to only $93 million in fiscal 2022 and rebounded to $124 million last year. $10 million of headwind here is 12 cents of EPS.

- POST noted that it is being hurt by a decline in SNAP benefits and customers are trading down to lower-priced products and reducing the number of shopping trips. None of that sounds healthy for more pricing gains or reversing falling volume.

- POST also wants to switch to more cage-free eggs. That may help it hold onto some pricing gains, but it should also cost more.

- As volume growth is negative at the other two units as well, inventory levels are up. That could further pressure pricing at all segments:

	4Q23	3Q23	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Inv DSIs	52.1	52.2	44.4	47.7	42.6	41.1	45.2	56.7
Inventory $	$790	$779	$594	$597	$549	$525	$518	$622
Consumer Vol	-6.2%	-5.7%	-6.2%	-1.2%				
Weetabix Vol	2.0%	-4.7%	-2.3%	-1.1%				

- Some of the dollar amount of inventory growth is related to the acquired Pet Food companies.

- Remember that POST uses FIFO accounting so it will be selling inventory purchased at higher prices as pricing comes under pressure.

- Gross margin was up the last two quarters as pricing continued as raw material inflation stalled. We believe that reverses as competition forces pricing lower.

- Some other potential headwinds for earnings in fiscal 2024:

  - Interest income was up with interest rates. However, POST also had $345 million in cash related to its SPAC through the end of May 2023, which is 8 months of the fiscal year. We estimate this added $11-$12 million to interest income or 13-14 cents that may not recur.

  - Diesel costs have dropped since June 2022. They are now rising again since June 2023. This was a $65 million tailwind to earnings in fiscal 2023, or 77 cents. We expect this to continue for the December quarter but believe this will be a much smaller tailwind for all of fiscal 2024.

  - Storage and warehousing costs historically have been about $170 million per year. This jumped to $204 million in 2022 and $263 million in 2023 and may keep rising as well.

- Historically, POST has an ROI of about 5%-6%. Even with this huge pricing gain, ROI was only 8.4% in fiscal 2023 against 6.3% in 2022. (We used POST's adjusted EBITDA and subtracted Depreciation and Amortization for operating income divided by L-T Debt and Equity). EPS was $5.34 in fiscal 2023- how much of that could be lost? If POST loses $2-$3 in EPS, the $84 stock price doesn't look so cheap.

- Keep in mind too, that POST has B+ credit rating, and B+ debt is trading about 8.7%-9.0% now. Acquisitions tend to get ugly when the financing costs exceed the ROI. POST may have simply benefitted from the abnormal period of ultra-low interest rates. Confirming its higher cost of capital – POST noted that it repurchased $150 million of its debt at a 13% discount because it was trading at a higher yield than the coupon.

- Looking at the low ROI and noting that POST already took an impairment for Goodwill in fiscal 2023 – we think it is important to realize that POST has $4.5 billion in other Goodwill and $3.2 billion of Intangibles.

    - The company noted that it estimates that the fair value of all Intangibles exceeds their carrying value by at least 11% vs. 23% in September 2022.

    - Goodwill for Weetabix would have triggered a write-down if the discount rate rose by 50bp.

    - Refrigerated Retail exceeds its Goodwill valuation by only 8.5% and the rest of Goodwill exceeds its value by at least 10%.

    - It would not take too much negative pricing or more negative volumes to cause more impairments.

United Rentals (URI) Earnings Quality Update

We are keeping our earnings quality coverage of URI at 4+ (Acceptable).

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

Summary

United Rentals' adjusted 3Q23 EPS of $11.73 beat estimates by 56 cents. It is about to lap the Ahern acquisition from December 2022, which spooked the market earlier because it was a lower-margin business. URI has seen solid improvement there.

- EPS was helped by 13 cents from lower share compensation.

- Productivity growth is still positive but the growth rate has dropped off. This measures price increases and the amount of time equipment is on rental. URI has pointed to some political delays on projects but it expects mega projects like semiconductor plants and airports to provide more growth in 2024.

Fleet Productivity Growth	4Q	3Q	2Q	1Q
2023		1.5%	2.1%	5.9%
2022	5.9%	8.9%	11.3%	13.0%
2021	10.3%	13.5%	17.8%	-0.5%

- URI has ramped up used equipment sales in 2023. This is driving earnings and clearing out some of the inventory adjustments made on acquired equipment, which were marked up to fair-market value when acquired. URI backs this out of adjusted EPS and it has been a higher figure in 2023 helping adjusted EPS. The higher level of used equipment sales could help productivity if some of the fleet was being used less often before being sold.

	3Q23	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Adj EPS	$11.73	$9.88	$7.95	$9.74	$9.27	$7.86	$5.73
EPS from mark-up	$0.23	$0.25	$0.44	$0.12	$0.05	$0.05	$0.06
EPS Gross Profit Used Sales	$1.98	$2.13	$2.04	$2.58	$1.19	$1.01	$1.19

- Used equipment sales jumped noticeably in 4Q22 and have remained higher in 2023. This is adding about 80-100 cents to recent quarterly EPS

- We have talked about the markup of inventory values before. It penalizes GAAP earnings and URI adds it back. The positives are assigning more of the acquisition price to PP&E is more conservative and results in faster expensing than having it go to intangibles or goodwill plus with URI's business model of turning over equipment, this issue goes away fairly quickly.

- Taken in total, URI is getting $2.20 - $2.70 in adjusted EPS from this source vs. $1.06-$1.25 last year. This source of EPS growth may not continue at this level.

- The sale of used equipment is also helping free cash flow – even with higher capital spending. It is interesting to note that URI has already spent $3.1 billion on new rental equipment YTD against a forecast of $3.4-$3.55 billion, which could make for a very strong 4Q on free cash flow. Higher free cash flow has led to more share repurchases. This added 30 cents to EPS in 3Q23 y/y.

	3Q23	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
CFO	$1,062	$1,289	$939	$1,251	$1,142	$1,154	$886
Rental Eq Purchased	-$1,030	-$1,251	-$797	-$980	-$1,102	-$872	-$482
Non Eq CapX	-$88	-$106	-$73	-$72	-$59	-$68	-$55
Sales of Rental Eq	**$366**	**$382**	**$388**	**$409**	**$181**	**$164**	**$211**
Sales non Rental assets	$18	$16	$12	$9	$6	$4	$5
Insurance Proceeds	$11	$10	$9	$7	$8	$10	$7
Free Cash Flow	$339	$340	$478	$624	$176	$392	$572

- Integration of Ahern continues and URI noted that much of the work is complete. We see that EBITDA margins are now up y/y vs. pro forma results. Gross Margin ticked down in 3Q. The biggest difference between EBITDA and Gross Margin is depreciation. That continues to be negatively impacted by the markups of Ahern equipment. We will continue to watch this, but the sale of more used equipment that has been marked up may see this correct too.

Adj. EBITDA %	Combined '23 URI and Ahern	Pro forma '22 Combined	URI stand alone Actual '22	Ahern stand alone Actual '22
3Q	49.1%	48.9%	49.9%	35.4%
2Q	47.7%	46.4%	47.3%	35.6%
1Q	45.8%	44.2%	45.1%	33.0%

Rental Gross Margin	Combined '23 URI and Ahern	Pro forma '22 Combined	URI stand alone Actual '22	Ahern stand alone Actual '22
3Q	41.9%	42.7%	44.3%	21.7%
2Q	39.3%	39.1%	40.7%	18.3%
1Q	36.6%	36.5%	38.3%	13.7%

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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