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

Behind the Numbers

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Air Lease Corp. (AL)
Earnings Quality Update

We are maintaining our earnings quality rating of AL at 4+ (Acceptable).

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

Summary

Air Lease's (AL) 1Q23 adjusted EPS of $1.50 handily beat forecasts by 30 cents. We still believe AL should trade at or above its book value of $53 as we believe the book value is understated. Several items still impacted EPS:

- Transitioning planes results in the recognition of security deposits and maintenance reserves. In 1Q23, this was $34.6 million in revenue from transitioning 11 planes to new leases. In 1Q22, this was $59.6 million as AL recognized these items for the Russian planes that were nationalized. In adjusted EPS, this was a 22-cent headwind for AL.

- SG&A continues to be elevated with higher insurance premiums of $4 million or 4 cents per share. SG&A also saw $6 million of expense related to airline restructurings that resulted in the transitioning of the planes to new leases described above, or 5 cents.

- Deferred rent from Covid is no longer being quantified, but AL says customers are paying on time and it is likely this source of revenue was lower y/y simply due to less of it being outstanding. At the end of 4Q, this was $148 million and was likely down about $5-$6 million y/y in what was received in 1Q23 for a headwind of about 5 cents. As this deferred rent is repaid, this source of revenue will vanish.

- Gain on aircraft sales is a lumpy item and rose from $4.4 million to $8.8 million y/y for 1Q23, giving AL 4 cents in EPS. Guidance is for aircraft sales to be higher in 2023 with another $1-$2 billion of sales later this year.

- Share count was down by 2 million and helped EPS by 4 cents.

Overall in the quarter, results are moving in the right direction. EPS fell y/y from $1.76 to $1.50, but much of that was due to losing the Russian planes last year. The security deposit income from those planes recognized last year was over 50 cents.

We Still Believe Book Value is Understated

- AL is trading for $37-$38 vs. reported book value of $53.

- Potential insurance payments on the Russian planes still represent over $5 in book value that could return.

- There should still be about $1 in book value from the repayment of deferred rent that has not shown up yet.

- The values for new and young planes are rising. Demand is high and there is a shortage of new planes from Boeing and Airbus. AL is booking gains on sales. Every 1% change in the value of its depreciated planes is worth about $2 in book value.

- AL also has early delivery slots for new planes. Everyone's plane orders are delayed, but airlines ordering planes for 2028 that may arrive in 2033 may be willing to pay AL to trade delivery positions on some planes.

The Interest Spread Remains Compelling

- While the market focuses on rising interest rates and believes that will squeeze AL – it is missing many points.

- The bulk of AL's interest cost is fixed as are existing leases. So that spread is locked in. As leases roll over, the price can rise for the new lease. Also, new delivery contracts have lease escalation clauses that boost the lease cost until the plane is actually delivered. AL's revenue is growing also with 88% fixed rate debt, its cost of funding there is up only 22 bps in the last year.

- The market also overlooks the spread – AL is a BBB credit and many of its customers are B-rated. A year ago, the spread between the two was 270 bps. Today it's 335 bps. AL is making more money on new activity. Also, BBB credit is 5.40% now. But AL's cost of fixed-rate debt is only 3.20%. That is boosting the spread too.

- Only about 12% of debt rolls over in any given year, which matches the 7-10 year maturity cycle for plane leases. We believe AL will maintain its spread, even management notes that its history is doing 10-year deals with assets that have 25-year lives. They realize that during those longer periods, there will be multiple swings in oil prices, economic conditions, interest rates, etc.

- When credit is tighter, it should further help AL by leading more airlines to lease rather than buy planes. That increases the size of AL's market.

Church & Dwight Co., Inc. (CHD)
Earnings Quality Update

We are raising our earnings quality rating to 4+ (Acceptable) from 3+ (Minor Concern)

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

Summary

CHD's EPS of $0.85 per share for the first quarter topped estimates by 8 cps. Organic sales growth of 5.7% was remarkably better than the company's admittedly conservative outlook of 1%. We continue to regard CHD's earnings quality as one of the highest in the group. The improvement in inventory and rising advertising investments prompt us to raise our earnings quality rating to 4+ (Acceptable). However, we caution that the stock has outperformed most of its peers over the last few months so the near-term upside may be limited.

- **Much of the sales outperformance was a result of organic volumes which were flat after being down several quarters.** CHD saw pricing/mix rise by 5.7% which is much less aggressive than most other consumer products peers. However, keep in mind that the company is expecting negative volumes in 2Q as fill rates in 1Q jumped to 93% versus only 72% a year ago whereas fill rates were up to 85% by 2Q22 leaving less room for improvement.

- **Advertising was up to 8.6% of sales vs 7.9% last year which the company attributed to the higher fill rates.** This higher advertising likely paved the way for the better-than-expected volume performance. The advertising percentage is lumpy from quarter-to-quarter with most occurring in 4Q. The company expects full-year 2023 advertising to hit 10.5%, up from 10% last year with an eye towards hitting its more normal 11% in 2024.

- **Inventory has improved as they have worked off excess discretionary product inventory.** DSI was 72.8 versus 72.4 last year. However, the company typically sees a 4 to 5-day sequential jump in DSI in the first quarter and this year it only rose by 1.4 days.

- **Flawless remains something to watch.** The company noted on the call that *"[Flawless] Retail inventories are moving slower than we expected. That's partly have an impact on our inventory reserves for -- limiting inventory on our end, but we think we've appropriately captured that from here, and we're moving forward."* Flawless has already been the subject of a $441 million writedown in early 2022 so any more underperformance could result in more writedowns. However, there is only $46 million left on the books at this point so exposure is limited.

- **Waterpik also warrants scrutiny**. Management noted that Waterpik hit sales targets for the first quarter. However, the brands struggled during the pandemic and the company warned in the 10-Q that as of 10/22, the fair value of the intangibles of $644.7 million exceeded the carrying value by only 7%.

- **Vitamins sales have been lagging which the company has blamed on supply chain problems.** However, management noted on the call that they met their sales plan for the first quarter

- **The biggest big-picture risk we see with CHD versus its peers remains how much growth is generated via acquisition.** It is therefore a noteworthy positive that TheraBreath and Hero, the two most recently acquired brands, are enjoying rapid growth and market share gains.

- **CHD maintains both value and premium brands and it noted once again that it is seeing a meaningful trade-down from consumers.** This does not bode well for branded players planning to push through more price hikes.

Sealed Air Corporation (SEE)
Earnings Quality Update

We are reducing our earnings quality rating of SEE to 1- (Strong Concern).

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

Summary

Sealed Air's (SEE) adjusted 1Q23 EPS of $0.74 missed estimates by 3 cents. It also declined y/y from $1.12. There are reasons to see that it was even worse with more to come:

- Guidance is for a 26%-27% tax rate for 2023. 1Q23 was only 24%, which added 2-3 cents to adjusted EPS.

- SEE added another penny via share count for another stealth cut in guidance. Share count guidance for 2023 EPS was 146 million shares. In 1Q23, the share count was only 144.8 million. That already added another 1 cent to EPS in 1Q23. SEE held EPS guidance flat after cutting share guidance to now 145 million shares, but the share count was already 144.4 million at the end of April.

- We have been warning that excessive pricing vs. FX hits was unlikely to last. In the Americas unit with significant inflation from Latin America, SEE saw pricing of $54.2 million vs. -$10.6 million in FX in 4Q22. For 1Q23, this cost SEE 1 cent as pricing was only $11.0 million against FX of -$12.5 million. This finally flipped on them.

- Minor cuts and increases in inventory obsolescence, bad debt expense, share compensation, and profit sharing all netted out to $0.2 million cut y/y and we considered that neutral.

We are cutting the rating again to 1 based on SEE's continued changes in the transparency of its reporting. In the past, SEE has routinely created new divisions and then rolled them back up within a few quarters to make apples-to-apples comparisons almost impossible. **SEE used to report the net impact of its pricing change vs. material cost change every quarter. Three quarters ago, that changed to a new metric that also added**

in other operating cost changes. Now after two quarters of that metric – all reporting in the earnings release and presentation of Price/Cost metrics are gone.

We are also cutting the rating because the conference calls remain full of references to double-digit growth of products, customers cannot get enough of SEE's offerings to boost their own sales and margins, all the restructuring and product redesigns, etc – even though customers are destocking their SEE inventory. **We looked at their organic growth for volume going back to 2016 – this company isn't showing much growth at all:**

	2022	2021	2020	2019	2018	2017	2016
Food Volume	-2.0%	4.0%	0.2%	1.1%	2.2%	3.8%	2.0%
Food Index	111.7%	114.0%	109.6%	109.4%	108.2%	105.9%	102.0%
Protective Volume	-11.1%	7.7%	0.8%	-3.9%	0.3%	5.7%	1.5%
Protective Index	99.8%	112.3%	104.2%	103.4%	107.6%	107.3%	101.5%

Food is just under 60% of sales and it is a 1.4-2.0% growth business. Protective at just over 40% of sales hasn't grown at all since 2015. It has a positive year and then gives it all back.

What to Watch

- Watch out for components of SEE's guidance – which it can use to beat forecasts. We talked above about the tax rate already being lower than forecast and the share count is also already lower than guidance. We have the Liquibox allocation now and it will own it for 11 months this year. Depreciation & Amortization is forecast at $275 million for 2023 vs. $185 million in 2022 and $186 million in 2021.

  New intangible amortization should be $30 million. Only $101 million was allocated to PP&E. If two-thirds goes to machinery & equipment and is depreciated over 5 years (SEE uses 5-10 years for this), that's $12 million and another $34 million as buildings over 10 years (SEE uses 10-40 years for this) is $3 million more. That's a $45 million increase from the acquisition, and SEE is forecasting a $90 million increase.

Capital spending is expected to jump $100 million y/y. At most, that adds $20 million in depreciation. That still leaves $25 million in higher forecasted D&A unaccounted for– SEE has at least 13 cents in EPS to play with here.

- Guidance also calls for $275 million in interest expense for 2023. Even with the new securitized receivables and the new Liquibox debt – we only compute interest expense at about $250 million. Here's another $25 million of forecast costs that may not occur, which is another 13 cents in EPS to play with to "beat" guidance.

- Inventory DSIs are at 92 days, the highest in years. That inventory was built during higher inflation. SEE uses FIFO and average cost accounting so SEE may need to expense that as its prices turn down. It is still reporting that customers are destocking SEE products. **(See below for detail).**

- Margins are already under pressure – with Food down 200bp y/y and Protective down 470bp. SEE is only forecasting 1% pricing for the year now (after posting 3% for 1Q). The 1% forecast is based on the prior price hikes that have not anniversaried yet, thus pricing could fall through the rest of the year. The volumes were not that weak for food for SEE to blame the lack of operating leverage for the margin decay. **(See below for detail).**

- Pricing is likely to decline faster than many expect. SEE has contracts that set pricing for some of its sales tied to commodity indices. The pricing resets on about a 6-month lag. SEE is forecasting about $50 million in commodity price declines now. **(See below for detail).**

- Prepaid expenses and other current assets jumped sequentially from $57.5 million to $193.8 million in 1Q23.

Prepaid Exp/Curr Assets	4Q	3Q	2Q	1Q
2023				$194
2022	$58	$66	$64	$50
2021	$50	$66	$58	$47
2020	$54	$55	$103	$134

This does not look like a problem. $15.8 million is due to the Liquibox acquisition. Also, SEE historically does not use its securitization lines very often, but it raised $47.0 million in cash with its US program and $86.5 million on its European program in 1Q23. Those programs are now maxed out as a source of cash. When those are used, receivables are transferred to prepaid expenses and other current assets on the balance sheet. Without these items, this account would have looked fairly normal at $44.5 million

Inventory Should Pressure Margins More

Not only are sales volumes declining but inventory levels are increasing in dollar terms. That may include unit growth as well given the normal seasonal jump in inventory levels:

Inventory in $	4Q	3Q	2Q	1Q
2023				$967
2022	$866	$962	$933	$844
2021	$726	$741	$731	$652
2020	$541	$631	$638	$568
2019	$570	$618	$596	$597

Inventory in days available were already running much higher than pre-Covid times and now lept again in 1Q23:

Inventory DSI	4Q	3Q	2Q	1Q
2023				92.2
2022	81.2	91.6	86.6	80.7
2021	63.2	68.0	71.7	67.8
2020	54.3	69.7	76.3	66.0
2019	60.3	68.8	69.3	71.9

Keep three things in mind when considering what could happen here:

- SEE uses FIFO and average cost accounting. The inventory they built up happened at higher commodity prices. SEE will be pushing through higher-cost items into weak markets that are overstocked.

- Volumes are already weak – customers do not need new inventory and probably will not accept any more price hikes. SEE has mentioned on the last two earnings calls that customers are destocking the inventory levels already purchased from SEE.

	1Q23	4Q22	3Q22	2Q22	1Q22
Food Volume chg	-2.6%	-3.2%	-3.5%	-2.4%	-0.4%
Protective Vol. chg	-18.2%	-19.9%	-12.1%	-7.6%	13.0%

SEE said last week that it expects destocking to end by mid-year:

> *"From the inventory level of customer, we've been in direct dialog with our major channel partners, and they have started destocking actually last year. And at this point in Q1, they are largely over through destocking at their target level. The piece of the business, APS and also some smaller customers, the destocking continue. We do anticipate that go through Q2 and will be more or less over around midyear."*

- Margins are already declining at both units. SEE is blaming this on losing operating leverage because wages and other fixed costs are being spread over less volume. We doubt this changes in the near future either as SEE tries to work down more inventory over lower volumes:

y/y chg basis pts	1Q23	4Q22	3Q22	2Q22	1Q22
Food EBITDA margin	-200	-20	110	-70	-30
Prot. EBITDA margin	-470	-10	230	250	30

Pricing May Decline Faster Than Many Expect

SEE's growth has been driven by price increases in the last several quarters. Even SEE now says that 2023 will only see 1% pricing growth:

> *"So on* ***the full year guidance we are expecting roughly 1% up on pricing, and that's coming from the carryover pricing from prior year.*** *And from a year-over-year perspective, it's primarily hitting this first half. On the full year guidance of net price realization, which includes not only the*

resin cost but also labor and nonlabor inflation, we're anticipating a negative $40 million to $50 million in total, which is primarily driven by the high labor and non-labor [indiscernible] of approximately $150 million. On the direct material side, we do anticipate resin on a year-over-year basis to be favorable, particularly on the commodity resin side. ***We're thinking commodity resin is a 10% down year-over-year with specialty resin up 5%. And overall, from a dollar perspective, roughly, say $45 million to $50 million is favorable on the direct materials for the full year."***

Investors should remember that SEE has contracts with many clients that track commodity prices and reset pricing on a six-month lag. Here is the explanation in from the 10-K:

> ***"A portion of our sales prices, specifically within Food's North American and APAC business, is determined using formula based pricing which reflects changes in underlying raw material indices. On average, formula based pricing lags raw material cost movement by approximately six months.*** *We may experience a benefit (when resin prices decrease) or detriment (when resin prices increase) to our cost of sales before those price changes are reflected in our selling prices."*
>
> *"SEE often offers rebates to customers in their contracts that are related to the amount of materials purchased. We believe that this form of variable consideration should only be allocated to materials because the entire amount of variable consideration relates to the customer's purchase of and our efforts to provide materials.* ***Additionally, Sealed Air has many contracts that have pricing tied to third-party indices. We believe that variability from index-based pricing should be allocated specifically to materials because the pricing formulas in these contracts are related to the cost to produce materials."***

We have been noting that SEE has benefitted on pricing because it was taking pricing that exceeded material cost inflation for some time. We thought they were over $200 million in excess pricing. SEE used to refer to this as its price/cost ratio and it published the statistic in its earnings presentations. This item suddenly vanished in 1Q23 and the definition was changed in 3Q22 to add labor costs as well:

	2Q22	1Q22	4Q21	3Q21	2Q21	1Q21	4Q20	3Q20
Price/Cost EBITDA	$114	$98	$36	-$18	-$36	-$18	-$7	$9

	4Q22	3Q22	2Q22	1Q22
Net Price Realiz	$25	$71	n/a	n/a
Price/Cost			$114	$98
Higher Op. Costs		_	-$58	-$30
Net Pricing	$25	$71	$56	$68

We believe this already turned negative for 1Q23 and was part of the reason for the margin decline. And note above how the formulas automatically move on a six-month lag and even SEE is confirming lower material costs. It looks as though SEE will have its pricing reset lower going forward.

Pricing was up 3% in the 1Q against a forecast of 1% for the year. That could mean pricing turns negative going forward. Losing 1% of pricing is a $50 million impact for SEE, or 26 cents in EPS.

Starwood Property Trust, Inc. (STWD)
Earnings Quality Update

We are maintaining our earnings quality rating of STWD at 5+ (Strong).

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

Summary

STWD's 1Q23 distributable earnings (DE) of 49 cents missed forecasts by 1 cent. This remains a misunderstood stock in our view as it trades for < 80% of book value and a yield of 11.5%. Some headwinds for earnings are self-imposed as STWD hoards liquidity to take advantage of markets turning.

- The market continues to view STWD primarily as a financing agent for US commercial office space. That simply isn't true as US office space is only 10% of their total lending base. STWD also has few NYC loans (about 2% of commercial lending or $337 million) and none in San Francisco. Even before Covid, STWD was getting out of those areas due to valuations and focusing on areas with population growth and limited supply.

- Not only is there little exposure to US office space in troubled markets, STWD is only lending 60% on the value of the properties where it has loans. STWD matches durations and it uses more fixed-cost debt and has interest rate floors on the loans. So rising rates boost the spread, but falling rates do not hurt income as much. Plus, with the use of securitizations, CLOs, A-Notes, STWD has minimal exposure to mark-to-market events.

- Real Estate Owned and Non-Accruals are being resolved. STWD has loans of 50%-60% of the value of the properties. Given where the market is for putting new money to work, STWD estimates that it would add 7.5-10.0 cents to quarterly earnings. Their goal is to see much of this resolved over the next 6 months and there are bids coming in and letters of intent being signed that at or above STWD's loan amounts.

- The next round of rent increases for the property segment is expected to be announced in May and start taking effect in July. The higher rents should help earnings but have a larger impact on the fair market value for the property, which would boost book value.

- What impresses us is for the last six quarters, office space loans have been in the news as terrible investments – especially in the last three quarters. During this time, there have been multiple rate hikes too. Plus, CECL (Current Estimated Credit Loss model) has required STWD to double its loss reserve to 49 cents per share. Plus, STWD paid out 48 cents/quarter in dividends or $2.88 which reduces book value. And, we know STWD has had several quarters when it held excess liquidity to be defensive which was a drag on earnings as was real estate being sold. Yet, book value is up:

	1Q23	4Q22	3Q22	2Q22	1Q22	4Q21
Un-depreciated Book Value	$21.37	$21.70	$21.69	$21.51	$20.46	$20.74

- The servicing business should also pick up going forward. There is now $107 billion in loans where STWD has been named as the servicer with only $5 billion actively being resolved. There were more commercial loans in 2013-16 that will be maturing going forward too. STWD gets paid when these deals are resolved. If it's a simple refinancing, that's not especially profitable. But given where many banks are now, a higher percentage may require a different capital structure and finding partners to invest. That could move up the profitability per project for STWD. This could be a growing source of income in late 2023-26. Looking at the 1-cent miss for 1Q23 earnings – it looks like lower volumes played a role here as well as the quarter not reporting the closing of any resolutions for a y/y drop of 5 cents for the investing/servicing unit.

	1Q23	4Q22	3Q22	2Q22	1Q22	4Q21
Invest/Spec Service	$0.04	$0.10	$0.10	$0.11	$0.09	$0.15

Warner Bros. Discovery, Inc. (WBD)
Earnings Quality Update

We are raising our earnings quality rating of WBD from 3- to 3+ (Minor Concern).

We are also raising WBD from an On-Deck Value to the Top Value list

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

Summary

WBD continues to see considerable “noise” from restructuring in its numbers and is still reporting largely proforma figures for comparisons as the merger did not happen until 2Q22. However, we are seeing enough improvement at this point to raise our view. This is not a quarter-to-quarter story and we will focus on the larger issues here regarding restructuring, cash flow, earnings, and debt.

1Q23 results still reflect much of the noise and Discovery did not own Warner Brothers until after 1Q22, so here is what we are seeing:

- Restructuring and impairment charges are expected to be $4.1-$5.3 billion. $3.8 billion have already happened by the end of 1Q23. The bulk of this is done.

- Cash costs for the restructuring were forecast at $1.0-$1.5 billion. Through 4Q22, the cash costs were $800 million. After 1Q23, WBD has spent $1.2 billion of the cash costs. After 4Q22, it was forecast that cash restructuring spending was likely to come in near the higher end of the expected range. There may be another $200 million.

- DTC or streaming is another change that has sped up its forecast. The EBITDA loss was $2.1 billion in 2022. DTC was expected to lose money in 2023 and break even in 2024. It just posted $50 million in positive EBITDA for 1Q23 and new guidance is a profitable 2023 and 2024 now.

- The streaming customer count is rising before the relaunch of Max this month and ARPU is flat to up. WBD did note that there remains a big opportunity for improvement by reducing churn in that unit but is not factoring that in yet.

- Synergies are rising too. WBD boosted the forecast for synergies to $4 billion during late 2022 and it expects a $2 billion impact to be seen in 2023 for EBITDA.

- The downside is advertising remains weaker than before the merger. On a proforma basis, advertising dropped by $789 million from 2021 to 2022 and is down $395 million y/y in 1Q23. Some of that is a tough comp vs. the Olympics for 1Q22. WBD sees some turnaround in areas but is not baking in a bounce in advertising as part of guidance. There should be benefits to advertising from having a new market overall with Max and there are some new advertisers signed there for HBO exclusive programming. Also, WBD reworked the sales team in 2Q and 3Q of 2022 and it was canceling programming. 2023 should not face those headwinds and could help WBD results.

- We also want to note that 2022 free cash flow had a headwind of $350 million due to receivables and 1Q23 had another $500 million headwind.

- From April 2022-March 2023, Free Cash Flow was $2.1 billion. That figure was impaired by $1.2 billion in cash restructuring costs, a large headwind in receivables, and a sizable loss with streaming EBITDA of over $2 billion. Studios were also basically flat in 2022 vs. 2021 despite WBD canceling the release of several movies. Forecasts are only for $4 billion in free cash flow for 2023. WBD can get there by simply having the $2 billion in synergies appear that 2022's actions set up along with the $2.1 billion in trailing 12-months free cash flow. A swing in streaming EBITDA, more movie releases in 2023, and lower cash restructuring payments should all combine to make the guidance conservative.

- EBITDA was $9.2 billion in 2022 and the forecast is for $11.0-$11.5 billion. If it picks up the $2 billion in synergies this target looks very doable too. Swinging the streaming from EBTIDA of -$2.1 billion to a positive figure should help too as should more studio releases. We believe this forecast could be raised during 2023.

- Net debt is $46.3 billion – with $11.5 billion in EBITDA – debt will be 4.0x. The forecast is still for $14 billion in EBITDA in 2024, which lowers debt to only 3.3x.

- WBD is trading for 6.8x the $11.5 billion EBITDA figure and 5.5x the $14.0 billion EBITDA figure for 2024. Paramount (PARA) is trading for 8.6x its trailing figure with a higher debt multiple. Netflix (NFLX) is trading at over 20x. WBD has some great libraries and assets. At 9x $14 billion and no debt reduction, this stock would be > $30 vs. $13.

- Plus, advertising is a wild card, but it won't stay below normal levels forever. There is likely another $1 billion in EBITDA here that WBD does not have factored into forecasts.

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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