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Colgate-Palmolive (CL) EQ Update- 3/19 Qtr.

Current EQ Rating*	Previous EQ Rating
3+	3-

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

We increase our earnings quality rating to a 3+ (Minor Concern) from a 3- (Minor Concern).

CL has experienced a small rally after topping EPS targets by a penny in the 3/19 quarter. We continue to doubt the company can experience much in the way of growth with organic volume growth of 3% in the quarter coming from a 2% increase in prices and only a 1% increase in volume.

- Meanwhile, adjusted gross margin fell by 110 bps from higher raw material, packaging, and FX more than offsetting the beneficial impact of cost savings and price increases.

- At the operating line, adjusted operating margin fell by 180 bps as a 60 bps increase in advertising expense added to the gross margin erosion.

- The company continues to expect its current restructuring program to be complete by the end of 2019. However, given the poor growth and cost pressures, we will be surprised if another round of restructuring spending is not announced before then.

- Cash flow remains an issue as operating cash flow continues to decline and lower capex is the only factor allowing the company to maintain positive free cash flow growth. Free cash flow after dividend and buyback is a negative $235 million with the reduced share count adding a much-needed 1.5% tailwind to EPS growth.

- Despite the fundamental negatives that remain, we are raising our earnings quality rating as the growth in days sales of inventory has flattened out.

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.

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