BEHIND THE NUMBERS

EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Clorox (CLX) EQ Review Update- 6/18 Quarter

Current EQ Rating*	Previous EQ Rating
4-	NA

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

We initiate coverage of Clorox (CLX) with a 4+ (Acceptable) rating.

CLX topped consensus EPS targets by 9 cps in the 6/18 quarter. After a review of the 10-K, we have little in the way of significant concerns with CLX's earnings quality. However, we do observe that results continue to benefit from lower advertising expense which will likely become a headwind in the upcoming quarters.

Advertising Continued to Decline in the Quarter

The trend of lower advertising expenditures continued into the 6/18 quarter, as shown in the following table:

	6/30/2018	3/31/2018	12/31/2017	9/30/2017
Sales	$1,691	$1,517	$1,416	$1,500
Advertising Expense	$146	$150	$140	$134
% of sales	8.6%	9.9%	9.9%	8.9%

	6/30/2017	3/31/2017	12/31/2016	9/30/2016
Sales	$1,647	$1,477	$1,406	$1,443
Advertising Expense	$182	$161	$128	$128
% of sales	11.1%	10.9%	9.1%	8.9%

As we pointed out in the previous quarter's review, the 6/18 and 3/18 quarters were easy comparisons due to unusually high advertising spend in the corresponding year-ago periods. However, the sequential decline in advertising expense in the 6/18 quarter does look unusual. Management still expects advertising for 2019 to come in at 10% of sales which will require an increase in the current pace of spending, implying a potentially difficult comparison in the upcoming 9/18 quarter. At the very least, the tailwind experienced in the last 2 quarters will disappear going forward. This is more of a fundamental issue than an earnings quality issue, which is why we chose to rate the company a 4 rather than a 3.

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 recent 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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