BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

January 10, 2019 www.btnresearch.com

Charles River Laboratories (CRL) EQ Update- 9/18 Quarter

Current EQ Rating*	Previous EQ Rating
4+	4+

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

We are maintaining our rating on CRL at 4+ (Acceptable)

CRL reported adjusted EPS of $1.53 which was 15 cps ahead of the consensus estimate. This included 8 cps in gains from venture capital investments. Management is forecasting a 10 cps loss from its venture capital investments for the fourth quarter so this benefit will essentially reverse itself before the end of the year.

- Overall, we consider the earnings quality of the quarter to be strong. Revenue recognition trends remain healthy as client receivable and unbilled receivable days of sales declined from year-ago levels.

- Likewise, short-term deferred revenue days of sales increased slightly over last year. Long-term deferred revenue rose sequentially.

Revenue Recognition Trends Remain Healthy

As the following table shows, both client receivables and unbilled receivables on a days-of-sales basis continued the downward trend started in the 6/18 quarter. Short-term deferred revenue days also showed a slight uptick on a year-over-year basis:

.	9/29/2018	6/30/2018	3/31/2018	12/30/2017
Client Receivables	$376.30	$372.36	$343.55	$335.84
Unbilled Receivables	$113.31	$108.58	$98.80	$96.30
Total Receivables	$489.61	$480.94	$442.35	$432.14
Short-Term Deferred Revenue	$140.76	$130.39	$98.47	$117.57
Customer Contract Deposits	$44.59	$37.54	$23.57	$0.00
Client Receivable DSOs	58.7	58.1	63.5	64.0
Unbilled Receivables DSOs	17.7	16.9	18.3	18.4
Total Receivable DSOs	76.3	75.0	81.7	82.4
Short Term Deferred Revenue Days	21.9	20.3	18.2	22.4
Receivables DSOs less S/T Def. Rev. Days	54.4	54.7	63.5	60.0

	9/30/2017	6/30/2017	4/01/2017	12/31/2016
Client Receivables	$321.47	$306.24	$301.25	$284.00
Unbilled Receivables	$103.39	$94.52	$84.84	$82.20
Total Receivables	$424.86	$400.75	$386.09	$366.20
Short-Term Deferred Revenue	$108.98	$119.34	$127.59	$127.73
Customer Contract Deposits	NA	NA	NA	NA
Client Receivable DSOs	63.2	59.6	61.7	55.5
Unbilled Receivables DSOs	20.3	18.4	17.4	16.1
Total Receivable DSOs	83.5	78.0	79.0	71.6
Short Term Deferred Revenue Days	21.4	23.2	26.1	25.0
Receivables DSOs less S/T Def. Rev. Days	62.1	54.7	52.9	46.6

In addition, long-term deferred revenue continued to increase:

	9/29/2018	6/30/2018	3/31/2018	12/30/2017
Sales	$585.30	$585.30	$493.97	$478.48
Long-Term Deferred Revenue	$178.33	$141.72	$108.79	$125.88
Days of Sales	27.8	22.1	20.1	24.0

Note that the company only recently began disclosing the long-term portion of deferred revenue under ASC 606. Year-over-year trends will be more informative when available in 2019.

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.

Disclosure

BTN Research is a research publication structured to provide analytical research to the financial community. Behind the Numbers, LLC is not rendering investment advice based on investment portfolios and is not registered as an investment adviser in any jurisdiction. Information included in this report is derived from many sources believed to be reliable (including SEC filings and other public records), but no representation is made that it is accurate or complete, or that errors, if discovered, will be corrected.

The authors of this report have not audited the financial statements of the companies discussed and do not represent that they are serving as independent public accountants with respect to them. They have not audited the statements and therefore do not express an opinion on them. Other CPAs, unaffiliated with Mr. Middleswart, may or may not have audited the financial statements. The authors also have not conducted a thorough "review" of the financial statements as defined by standards established by the AICPA.

This report is not intended, and shall not constitute, and nothing contained herein shall be construed as, an offer to sell or a solicitation of an offer to buy any securities referred to in this report, or a "BUY" or "SELL" recommendation. Rather, this research is intended to identify issues that investors should be aware of for them to assess their own opinion of positive or negative potential.

Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them may have a position in, and from time-to-time purchase or sell any of the securities mentioned in this report. Initial positions will not be taken by any of the aforementioned parties until after the report is distributed to clients, unless otherwise disclosed. It is possible that a position could be held by Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them for stocks that are mentioned in an update, or a BTN Thursday Thoughts.