BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Citrix Systems (CTXS)

Current EQ Rating*	Previous EQ Rating
4-	4-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

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

We are maintaining our earnings quality rating on CTXS of 4- (Acceptable)

We saw no negative developments in the quarter, but the COVID-19 induced scramble by businesses to set up employees to work from home led to a spike in demand for CTXS's solutions. Some one-time moves made by the company to address the situation have temporarily distorted the trends we discussed in the original report.

- To review, in 2017 CTXS accelerated its push to a cloud-based subscription model and away from perpetual and term service agreements. This resulted in more revenue being paid and booked over time which has a negative impact on reported sales growth and cash flow growth. However, to help customers that were scrambling to get employees set up to work from home, CTXS introduced a limited use on-premises term license product. These contracts amounted to about $47 million of revenue in the quarter which was recognized upfront. The company plans to phase out this license program in April so these revenues will not repeat. The impact of these special licenses can be seen in the huge jump in non-SaaS revenues which were up over 160% in the quarter versus a recent run rate in the 40-50% range. Average contract term also fell to 1.3 days

from 1.7 reflecting the short-term nature of these licenses. Also, the almost 14-day spike in receivable DSOs was likely a result of this phenomenon.

- Demand remained strong in the cloud-based subscription model as growth in subscription SaaS annualized recurring revenue jumped to 50% from 40% in the previous quarter indicating long-term commitments from customers. Much of this was likely existing term and perpetual customers migrating to subscription-based services. The boost to revenue, particularly the upfront recognition of the short-term term license deals, will likely not repeat to the degree seen in the 3/20 quarter. However, longer-term, the new recognition of the value of having a remote-enabled workforce will likely result in more demand for the company's solutions and much of the special term license business may eventually find its way back in the form of subscription deals, although such revenue will be recognized over time.

- We highlighted in our original review that despite more product revenue being deferred, overall deferred revenue has been declining since the bulk of the balance is from service contracts related to perpetual licenses which are declining. The decline in deferred revenue days decelerated to -5 from the -20 range seen in previous quarters as it appears the decline from term service license erosion is becoming offset to a higher degree by revenue deferred under new subscription service contracts.

- Lower stock-based compensation added about 4 cps to EPS in the quarter. Given the huge earnings beat, we are not assigning a high level of concern to this.

- CTXS boosted its allowance for bad debts to 2.6% of gross receivables in the 3/20 quarter from 1.3% in previous periods. We estimate this cost the company a little over 5 cps in the quarter.

- The company entered into an accelerated buyback in January to repurchase $1 billion in shares. In the first quarter, it repurchased $200 million of shares at a price of $115.45. We are not fans of reckless buybacks as managements so often seem to buy back their shares at exorbitant valuations. With the stock price north of $150 a couple of months later, all we can say is "hey, nice call."

Explanation of EQ Rating Scale

Rating	Explanation
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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