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Danaher (DHR) EQ Update- 9/20 Qtr.

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 of 4- (Acceptable)

DHR closed the Cytiva deal on March 30, 2020. The timing of the deal proved to be beneficial as conditions in the Life Sciences market have been supercharged in the current COVID environment, growing more than 35% in the quarter. This helped drive non-GAAP EPS to $1.72 in the quarter, 36 cps ahead of estimates.

We continue to rate DHR's earnings quality as Acceptable, but visibility has been clouded due the Cytiva deal and now the unusual growth it is providing. We expect to get a clearer picture in the quarters ahead.

Items that Deteriorated

- DHR closed the Cytiva deal on March 30, 2020. Of the $20.7 billion purchase price, $10.2 billion was booked as goodwill and therefore is not amortized. Another $10.7 billion was booked as intangible assets consisting largely of developed technology, customer relationships, and trade names which are being amortized over an average life of 17 years. However, the company adds this amortization back to its non-GAAP earnings figures. In the 12/20 quarter, pretax amortization of 45 cps (approximately

36 cps after tax) compared to non-GAAP earnings of $1.72. We disagree with the principal of ignoring the cost of acquisitions by disregarding amortization expense.
(Concern level: MEDIUM)

- Non-GAAP adjustments included a 31 cps pretax charge from acquisition-related fair value adjustments to inventory and deferred revenue, incremental transaction costs, and integration preparations costs. This is the first sizeable charge related to the deal which closed in the 4/3/20 quarter. Given the size and scope of the acquisition, we are not overly concerned by the charge and therefore assign it a small level of concern. Should future quarters feature continuing integration charges, we will become more skeptical.
(Concern level: LOW)

Other Items

- On a housekeeping level, we observe that the company only provides a breakout of non-GAAP impacts on a per share basis. Many companies include a breakout of items by expense line and the overwhelming majority at least on operating income and net income levels. We believe a more detailed non-GAAP disclosure would be very helpful to analysts.

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.

Disclosure

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