BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

November 6, 2020 | www.btnresearch.com

Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

Contents

Mondelez International (MDLZ) EQ Update- 9/20 Qtr. p. 1
EPR Properties (EPR)- EQ Update- 9/20 Qtr. p. 8
Starwood Property Trust (STWD)- Maintain BUY p.14
LyondellBasell (LYB)- Maintain BUY p.16
RealPage (RP)- EQ Update- 9/20 Qtr. p.19
Mowi (MHGVY)- Maintain BUY p.23
Avery Dennison (AVY)- EQ Update- 9/20 Qtr. p.25
Citrix Systems (CTXS)- EQ Update- 9/20 Qtr. p.27
Stryker (SYK) EQ Update- 9/20 Qtr. p.32
Illinois Tool Works (ITW)- 9/20 Qtr. p.34

Mondelez International (MDLZ) 3Q'20 Update
Cancel SELL, Raise EQ Rating to 2+ (Weak)

We are canceling our SELL rating and reiterate our earnings quality rating of 2- (Weak)

MDLZ's adjusted EPS was flat y/y at $0.63 and beat forecasts by 1-cent. The earnings quality looks better than in the past. MDLZ is boosting marketing again, which we expected as a headwind. SG&A was up $22 million which was 1-cent in lower EPS. SG&A included COVID, Marketing, and Promotional costs. Cuts in that area helped MDLZ beat in 2Q forecasts. There were 8-cents in FX hedging gains, but MDLZ adjusted those out. It picked up about 1% of its reported topline growth from restocking the pipeline that won't repeat. Using the adjusted margin and tax rate – the 1% stocking revenue produced about

0.6-cents in EPS. We also applaud that MDLZ is reducing its holdings in Keurig Dr Pepper, which is we believe uses several short-lived levers in to drive its results and define its balance sheet.

What improved?

- Inventory growth less likely to be a headwind for cash flow in 4Q as it was in 3Q.
- Guidance for 2020 looks more than reasonable with a sales growth below the rate of the firsts 9-months and only 5% EPS growth. It may be tough to miss.
- Selling some of Keurig Dr Pepper raised cash that effectively covered the Give & Go acquisition.
- We consider the accounting at KDP to be weak and MDLZ pulling cash out here is good source of cash.

What deteriorated?

- We estimate that MDLZ earned 2-cents in EPS by taking much more pricing than cost inflation justified. We question if the client base will accept this.
- MDLZ is expecting higher cost inflation for 4Q and may not be able to pass it through.
- We consider marketing a positive investment – but MDLZ benefited from cuts in this area during 2Q and it has now begun to be spent again and should be an EPS headwind.
- The growth rate slowed and had 1% of sales from channel stocking. Comps get tougher and the COVID bump is losing steam.

What to watch

- Cash flow remains tight to cover the dividend and repurchases.
- MDLZ has already stretched payables and factored receivables to raise cash.
- Gum business is hurt by lack of travel – it could be a growth area as it recovers.
- Latin America still helps organic growth, but the FX continues to make that source of growth very low-quality in our view.

The Stretching of Working Capital in 2Q Reversed and Normalized

We noted last quarter that MDLZ picked up considerable cash flow from working capital. Plus, much of it came from stretching payables. With COVID, some of that is not surprising. As we expected, the situation reversed in 3Q and cash flow saw the effects of building working capital back:

	3Q20	2Q20	1Q20
Cash from Ops	$757	$1,274	$284
Cash from W/C	-$348	$624	-$740
Cash flow before W/C	$1,105	$650	$1,024

Also while working capital grew, the days outstanding returned to the normal stats:

	3Q20	2Q20	1Q20	4Q19	3Q19	2Q19	1Q19	4Q18
DSPs	127.5	139.3	119.1	128.6	126.5	134.9	128.7	125.2
DSIs	64.7	69.1	52.3	55.9	65.2	69.4	60.6	56.0
DSOs	34.1	30.6	35.8	29.2	35.8	32.8	38.8	30.5
DSOs Sold	10.7	10.6	11.4	10.0	10.7	10.7	11.3	11.0

There is some seasonality to working capital, but the 5-days growth in payables in 2Q was a red flag for us while at the same time receivables days were falling. We still have an issue with some sources of MDLZ cash flow. For example, when payables are already 120+ days, can you stretch them much further to unlock cash? Also, the company has already tapped receivables for cash by factoring some. Those are the types of cash-generating moves that can occur once.

We were more alarmed after 2Q that inventories were too low in dollar terms and MDLZ was noting that the inventory in the channel was too low also. The company guided to rising inventories in 3Q as a cash flow headwind. That happened- inventories on the balance sheet grew $130 million. Also, MDLZ noted that 1% of its sales in 3Q was restocking the trade channel. That's another $66 million. That restocking won't repeat either as sales growth, but the MDLZ is already cut 4Q guidance on sales to 3% after 3Q's 4.4% organic growth.

Also, MDLZ is pointing to inventories being in good shape now. On the earnings, when asked about further inventory growth, it was reported, "On inventory levels, there are

obviously puts and takes. I would say, we got to a more normalized level at the end of Q3. Overall, I think we are in a decent situation."

Much of this has simply corrected already and guidance specifically acknowledges that the benefits will not repeat. Thus, the headwinds of working capital may not pose a major threat for MDLZ.

North American Volumes Are Losing Some COVID Bump

After 2Q20 results, we called out the North American volume gains of 7.4% that occurred with a longer period of lock-down than 1Q, Easter, and still some pantry stocking. The volume growth added $127.7 million to North American sales.

We did not think that would recur and 3Q20 saw volume growth fall to 4.2% or $76.6 million. Plus, we know that MDLZ benefited from stocking the channel for 1% of total sales. That may be about $18 million overstated in terms of sustainability.

Biscuits are about 80%-90% of North American sales. Adjusted for acquisitions, these rose 16.5% in 2Q and only 8.5% in 3Q. That's still impressive but is declining quickly. We should also note that North America actually has a positive comp to go against in 4Q at the same time it already restocked the channel. The growth here could slow further:

North Am.	3Q20	2Q20	1Q20	4Q19	3Q19	2Q19	1Q19	4Q18
Price	2.1%	3.6%	1.2%	1.9%	1.9%	3.5%	3.0%	2.9%
Mix	4.2%	7.4%	12.1%	1.2%	0.6%	-1.0%	-1.5%	-2.1%

We Still Worry MDLZ is Taking Too Much Pricing vs. Cost Inflation

Given that the large retailers often compete on price and are aware of what commodity prices are doing as well as MDLZ, we think they will take notice of MDLZ pushing price hikes that may not be warranted. At a minimum, MDLZ may find it tougher to take more pricing with those customers and there may be pressure to reverse some of the pricing already taken. When we look at the quarters for 2020, 3Q stands out:

Op. Income	3Q20	2Q20	1Q20
Price hikes	$129	$120	$119
Cost Inflation	-$63	-$102	-$108
Net boost	$66	$18	$11
Volume	$53	-$60	$125

- 1Q saw all the panic buying and volume soared. Yet MDLZ essentially pushed through pricing close to inflation levels.

- 2Q was still major COVID issues and low inventories in the channel. MDLZ still did not get much net pricing and volumes fell.

- 3Q had channel stocking help volumes, but it still took much larger amount of net pricing. **If the amount of pricing should have been closer to $20 million instead of $66 million, MDLZ picked up 2-cents in EPS in this area that may not repeat.**

MDLZ said the same thing on its conference call:

> *"Nevertheless, **we see some cost pressures, particularly in the U.S. since elevated demand**. And the need we have to improve on shelf availability is causing some extra logistics cost. We have been hearing also by competitors and others that there is a pressure we are feeling this as well. **As we buy a portion of our transportation on the spot market. And as I said, inflation is quite high.** In addition, **we are running out of some positive for exchanges in Latin America.** In other words, and I would say, **gross profit will be more muted in terms of growth in Q4 versus the 6% you have just seen in Q3."***

Latin American Pricing Continues to Skew Reported Organic Growth

We have talked about this quite a bit and even MDLZ is admitting it now and calling out Argentina's hyperinflation. Essentially, the largest source of pricing power continues to come from Latin America. It's losing volume even in COVID, so this is not a healthy market at all in our view. Yet, it continues to report good organic growth before FX. The problem is the FX losses continue to overwhelm the actual results.

3Q Sales	Price	Vol.	Organic	FX	Actual
Latin Am	8.2%	-5.1%	3.1%	-20.2%	-17.1%
Emerg Mrks	1.4%	3.9%	5.3%	-8.4%	-3.1%
All MDLZ	2.0%	2.4%	4.4%	-1.4%	3.0%

Selling Some of KDP Is a Positive in Our View

During 2020, and mostly in the 3Q – MDLZ cut its ownership in KDP from 13.6% to 11.2% and pulled $962 million in cash out of the investment. It also pulled $394 million from JDE taking that ownership down from 26.4% to 22.9%. We urge clients to read our reports on KDP. The company appears to have considerable debt issues given:

- It has extended accounts payables to about 250 days and used that cash to retire funded debt.
- Stretching payables has provided a high percentage of recent cash flow from operations too.
- The effective debt to EBITDA is closer to 4.5x and the bulk of the debt is only guaranteed by the Dr. Pepper assets which essentially makes it much higher again.
- KDP also reduced forecasts and has driven earnings by cutting marketing.

MDLZ adjusts the gains realized out of non-GAAP earnings – so that is conservative too. We also think pulling $1.36 billion in cash out of these deals helps the overall liquidity and helps cover the dividend and debt service. In 2020, this cash essentially funded the entire Give & Go acquisition of $1.14 billion in April.

The dividend coverage at MDLZ is still tight in our view, but if it can monetize more of these assets for cash it may not be as dire:

	9mths 20	9mths 19
Cash from Ops	$2,315	$1,882
Cap-Exp.	$630	$686
Free Cash Flow	$1,685	$1,196
Dividend	$1,227	$1,131
Dividend %	73%	95%
Stock Repo.	$720	$1,143

We still see MDLZ as a company that has tight coverage on the dividend and it certainly isn't covering stock repurchases from free cash flow. That is why MDLZ continues to borrow more money and has a Net Debt to EBITDA of 3.22x. With about $8 billion in market value from these two investments that can to sold to generate additional cash, the situation looks better.

We have talked about this tight coverage before. We do not believe MDLZ can afford a $1.6 billion dividend and $1.5-$2.0 billion in stock repurchases per year. In the past the stock purchases of $2 billion were helping EPS growth by 3%-4%. As the repurchase fell to $1.5 billion in 2019, EPS growth from this was only 1.9%. For 3Q20, the repurchase helped EPS growth by only 1.25%.

That is why guidance for 2020 only calls for 3% sales growth (down from 3.9%) for the first 9-months and EPS growth of 5%.

EPR Properties (EPR) 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)

It appears that 3Q may represent the bottom of COVID issues for EPR, thus we are keeping the same rating even with several issues in the quarter. We would need to see the improvement continuing in 4Q too. The company's rent collection is covering costs at this point to essentially have zero cash burn while it still has $1 billion in cash and liquidity on hand. We were expecting the dividend to return in 1Q21, but with many movie theaters remaining closed due to a delay in new blockbuster releases or operating below capacity with fewer movies – EPR is behind where we expected results to be at this point as closed theaters have been an issue into 3Q and 4Q20. We now expect a dividend to return later in 2021. It's still a REIT that will have to pay out a high percentage of earnings.

Changes in the accounting for Cineworld rent was the bulk of the drop in reported figures as converting that client to recognizing rent as received in cash meant EPR wrote off receivables as a reduction to revenue of $49.8 million. They missed forecasts by $42 million – this is the reason and actually beat forecasts. It also was a $0.67 hit to FFO, which came in at -$0.16 against forecasts of $0.45 – so the change in Cineworld rent recognition accounts for that shortfall too and beat forecasts there:

What improved?

- Cash rent being received is running high enough that EPR is not in a cash burn situation. It still has $1 billion in liquidity and appears to have survived COVID.

- Adjusting for rent receivables that were written down against revenues – revenue was basically flat in 3Q and 2Q at $105 million
- That is with nearly all non-theater properties open and 90% of properties either needed no rent deferrals/restructuring or have been addressed.

What deteriorated?

- Cineworld – the number two theater partner with EPR is only operating 2 of 53 theaters due to studios delaying the release of larger-budget movies. Cineworld may require greater rent relief.
- EPR converted its accounting of Cineworld to recognizing rent when received in cash – which led to the write-off of Cineworld receivables against revenue of $49.8 million or 67-cents per share.
- Other amendments for clients involved deferring 3-5 months of rent that will be paid over the life of the lease starting early in 2021. Given the lack of movies, these deferrals may stretch into more months and the commencement of repayment may not begin until later in 2021.
- Several other one-time items impacted 3Q. Several appear to incorporate a worst-case scenario such as reserving 100% against a note receivable or a deferred tax asset – it may set up EPR for some future income if these are partially reversed.

What to watch

- EPR stretched its covenant deferrals with the bank until the end of 2021 (from 1Q21). Part of this deferral stops EPR from paying a common dividend. We think once theaters are operating more regularly, EPR will opt out of the deferral with the banks.
- With 2020 movies hitting in 2021 along with others already planned for next year, the theaters may recover quicker once they have more content.
- EPR noted that it has dealt with 90% of clients at this point – it guided that rent could drop 5%-7% pre-COVID levels. If Cineworld does not require rent relief beyond deferrals, that projection may be too negative.

Rent Collection, Agreements, Deferrals

The biggest issue for EPR is movie studios delaying releases of blockbuster films until late 2020 and into 2021 due to COVID. As a result, movie theaters are either remaining closed or operating at low occupancy given a lack of movies to show. That sets up well for 2021, but it has made 2020 worse for longer.

The non-theater properties – except an indoor water park in NY are all open and several are even outperforming 2019 numbers as people simply want to get out of the house. All the ski resorts are expected to open on time too.

Cash collections as a percentage of what is due has been rising steadily:

3Q Sales	Oct	Sept	Aug	July
% of cash received	43%	48%	40%	35%

The 43% in October is due to EPR changing its treatment of Cineworld's Regal theaters – we'll discuss below. EPR expects to collect 40%-50% of cash due during 4Q. The key to that is the breakeven cash collection to prevent cash burn is about 46%. Thus, EPR appears to be past the worst of the COVID issues and unlikely to be losing cash going forward as it waits for theaters to reopen.

- Cineworld has only 2 of 53 properties with EPR that are open. EPR believes it may need to restructure the deal it has with Cineworld or simply continue to defer rent for a longer period. They restructured the deal with AMC in the 2Q and deferred rent, lowered base rent initially, and extended the length of the lease. Something similar could happen with Cineworld.

- Revenue at EPR is recognized as due from a tenant. Thus, revenue leads to a receivable being set up and then when cash is received, the receivable falls. **Because they are uncertain of Cineworld's collection status – EPR converted its recognition of revenue from Cineworld to a policy of recognizing revenue only as cash is received.** This is the same situation they moved to with AMC in 2Q. **As a result, the Cineworld receivables were eliminated and were charged against revenues. The receivables totaled $49.8 million ($0.67 per share) and writing them off against revenue in the 3Q is why revenue saw such a large drop in 3Q.** Reported rental revenue was $55.6

million in 3Q, but $105 million before the receivable write-down. In 2Q, rental revenue was $105 million before a $7.5 million receivable write-down.

- Reporting rent when collected in cash is actually a more conservative accounting policy. But the lag impact of receivables had to be cleared and that is what this move did.

- **Cineworld and EPR have not reworked their agreement. We speculated this was a risk last quarter and it could follow similar terms of the AMC deal** which included a 21% reduction in rent along with higher rent increases in the future. It also included 6-months (July-December of 2020) where rent would be 15% of revenues rather than a fixed rent figure. Also, deferred rent from April-June would be amortized into rent over the longer lease term starting in 2021. **Thinking a similar approach may happen with Cineworld – EPR said it could see a permanent rent reduction level of 5%-7% of pre-COVID rents.**

- **Many of the theaters had rent deferred by EPR in April for a few months with the idea that they would be in a more normal operating period in the fall. The deferred rent was expected to be amortized into rent starting in 2021. EPR is thinking those deferred rent payments may be further pushed out before beginning.** Keep in mind, these deferrals were not going to double the client's rent. The goal was to repay 3 months of rent over several years. That source of earnings may not kick in during 1Q21.

Overall, it looks like EPR is getting to near the end of this situation. There should be some movies for the holidays that start to get theaters moving again. They have already addressed 90% of rent issues and 19 of the top 20 clients are paying them now or have a new agreement. There could be more deferred rent before 2021 and the commencement of deferred rent may be delayed longer. And the key to us is the company's cash collection rate is high enough that there is not a cash burn so it still has $1 billion in cash and liquidity available.

EPR also extended the covenant waivers on its bank lines through the end of 2021. These waivers allow them to pay their preferred dividends – but a common dividend is only feasible if required to maintain REIT status. Thus, the return of a dividend is probably more likely to happen in 3Q21 instead of 1Q21.

Several Other Items Impacted 3Q results as Well

In 3Q, EPR reported that FFO was -$0.51 and AFFO was $0.04 per share. We can see several items that appear one-time in nature that negatively impacted both figures.

- $5.7 million credit loss – this is to fully reserve a note receivable from a client. This hurts EPS and FFO but was added back to Adjusted FFO for 8-cents. We would regard this as taking advantage of COVID and simply clearing the decks writing a note to zero. If anything is recovered, it will help future EPS.

- $11.6 million impairment – this was on two Eat & Play properties where the remaining lease appears too short to fully recover the carrying value. This impairment was added back to FFO and AFFO for 15-cents. Hopefully, this real estate can generate future cash flows beyond the current lease. This should reduce depreciation slightly going forward which helps EPS but doesn't impact either FFO or AFFO.

- $18.4 million allowance reserve against deferred tax assets on Canadian theaters as EPR is not certain it will get to use the tax assets in the future. This was only added back to AFFO for 24-cents. We see this as taking advantage of COVID again. We would not be surprised if post-COVID there are future earnings here and some of the tax benefits can be used. This could be an allowance that partially reverses into income in the future.

- The receivable write-off against revenue from Cineworld was not added back to any of the metrics – that was 67-cents. However, AFFO did add back the part considered straight-line rent of $18 million or 24-cents.

- AFFO also subtracts a maintenance capital spending figure. It jumped in the 3Q as part of its transfer of CLA properties to another operator. This is normally about $2 million per quarter and jumped to $9 million. The $7 million increase cost AFFO about 9-cents. We see this as a one-time event.

A more realistic FFO figure to us would add back the tax allowance and the Cineworld receivable write off. It already adds back the impairment of assets figure. That would be an FFO of $0.40 instead of -$0.51. The company adds back some transaction costs of 4-

cents and the credit loss of 8-cents to $0.52 but omits the Receivable charge against revenues and reports -$0.16.

A more realistic AFFO figure would add back all the receivablse charge, not just the straight-line rent portion, and the 1-time maintenance spending increase of 9-cents. That would make AFFO rise from $0.04 to $0.56.

Negatively impacting all metrics was revenue lost as the Kartrite waterpark property was closed in NY during the summer. That reduced other income by about $11.3 million and other expense by about $9 million or a net $2.3 million – about 3-cents. That property is more seasonal and likely won't be producing any revenue in 4Q or 1Q.

Starwood Property Trust (STWD) 3Q20 Update
Maintain BUY

We are maintaining our BUY recommendation on STWD. It beat forecasts by 3-cents and Core EPS out-earned the dividend too. At a 13% yield, trading at a discount to asset value and even GAAP book value – we still like the future here. We see several points that we have made in recent updates starting to develop that should help earnings growth more:

- **More money is going back to work. Early this year, STWD was holding much more cash than normal to preserve liquidity.** Cash is a drag on earnings as does not generate yield. When STWD was holding $800 million in cash – it noted that was about $600 million too high. It has since put $400 million back to work in 3Q. There is a period when deals haven't closed yet or are not producing yield for the full quarter. However, for STWD, **$400 million fully at work is worth about 3-cents in additional core EPS/quarter.**

- **The Special Servicing unit continues to ramp-up with close to $9 billion in active cases vs. $5 billion at the end of 2019.** This unit fixes problem loans in the market and earns fees. With COVID, there is more business available to restructure loans or repossess property and resell it. The fees are earned on a lagging basis as the work is complete. With a rising backlog – it should be a source of lumpy but rising income for STWD:

	3Q20	2Q20	1Q20	4Q19
Servicing Fees	$13.7	$15.6	$6.4	$12.0
Active Cases	$8,825	$8,038	$5,550	$5,085
REO	$3,245	$3,338	$3,450	$3,335

The Real Estate Owned portion can generate higher fees as there is more work involved but can take longer to realize it. It is part of the $8.8 billion of active cases. STWD comments that fees can take 18-24 months in some cases so this could provide higher income for many quarters to come. $3 million in higher servicing fees adds 1-cent to EPS.

- **Non-QM Residential has the potential to expand returns.** These are loans with high FICO scores over 700 with low LTV ratios in the 60s. STWD has been buying these at a discount and securitizing them at par and booking gains. The market is now over par for these loans, but it is at the stage where the **early securitization trusts are refinancing**. The loans are paid down to even less LTV, and **the trust has financing of 3%. STWD will roll the loans to a new trust at a lower rate with more loans**. They will not have the same gains on sale with new loans, but the lower financing will push up the rate of return. Also, in a trust with some more seasoned loans with even lower LTVs – STWD may hold more of the junior tranche.

- **STWD continues to be well-positioned for rising or falling interest rates**. Of the $9.8 billion in the loan book, $7.1 billion have 145bp Libor floors. That is also helping earnings and they still get upside if rates increase. It should still be in a position to add 1-cent in quarterly EPS from a 100bp move up in rates and close to 3-cents on a 200bp move up. That book is not seeing many loan problems either. They had three interest deferrals in 2Q, all hotels, and all have been repaid. STWD continues to collect about 97%-98% of interest as scheduled. They have only 0.5% exposure to San Francisco and <4% exposure to NYC. They derisked the only NYC hotel loan by selling the mezzanine loan and buying part of the first mortgage.

- **Liquidity is good shape with $8.1 billion available and unencumbered assets of $2.9 billion. STWD has already raised the money to repay its February debt too.** Its property book continues to appreciate and it has boosted the return by refinancing the property multiple times at lower rates. The longer duration there also solidifies the core EPS as well.

LyondellBasell Industries (LYB) 3Q'20 Update
Maintain BUY

We are maintaining our BUY recommendation on LYB after EPS of $1.27 beat forecasts by 14-cents. Earnings are clean as well. Because LYB deals with petrochemicals that have volatile prices it marks them to the lower of cost or market every quarter. It removed a 40-cent benefit for LCM in the quarter. It also took an impairment on its refinery and it did add that charge back. That's the extent of the adjustments. Volumes were basically flat y/y for 3Q so demand is strong at this point and growing.

- We expect inventory to increase still. LYB is acknowledging this also after 3Q. The DSIs actually look high at the moment, but that is due to low cost of goods. It appears that LYB is light by about $500 million in inventory:

	3Q20	2Q20	1Q20	4Q19
Inventory	$4,005	$3,768	$3,973	$4,588
COGS	$5,885	$4,894	$6,868	$7,044
DSIs	62.1	70.3	52.8	59.4

	3Q19	2Q19	1Q!9	4Q18
Inventory	$4,446	$4,685	$4,496	$4,515
COGS	$7,269	$7,542	$7,446	$7,728
DSIs	55.8	56.7	55.1	53.3

Rebuilding some inventory should consume some cash flow going forward. We noted that LYB had enjoyed cash flow from having working capital drop in 1Q and 2Q – it became a cash drain for 3Q:

	3Q20	2Q20	1Q20
Cash from Ops	$827	$1,292	$542
Chg in A/R	-$335	$483	$4
Chg in Inv	-11	342	121
Chg in A/P	$395	$280	-$356
Chg in Other	-$51	$280	-$356
Work Cap. Chg	-$2	$1,385	-$587

When asked if LYB would have a seasonal slowdown that often happens is 4Q and the CEO noted inventory building would likely happen under that circumstance as demand is too strong for the level they are carrying now, *"likely if there's some slowdown in demand, certainly, we, as a company,* ***will take the opportunity to rebuild some inventory. We're at very, very low levels today and really kind of hand to mouth on many products****."*

- **We had speculated that rebuilding inventories and higher demand may crimp margins a bit as it could mean higher raw material prices. LYB is actually seeing that raw materials remain in overabundance.** It noted that 500,000 barrels of ethane are still being rejected by the market so supply exceeds demand. Further, if natural gas prices increase with winter, it could stimulate more drilling and thus NGLs would rise too.

  At the same time, demand is growing and the industry is low on inventory. Demand in China is exceeding its production and imports are up there. That should help margins with firmer pricing. Gross margins in 2018 were 15%-17%, they bottomed in 1Q20 at 8% and has been 12% and 13% in 2Q20 and 3Q20. **The margins are not getting squeezed as demand rises at this point.**

- **The impairment of the refinery is understandable. LYB marked down the value of the refinery by $582 million to a carrying value of $560 million.** This is due to a lack of heavy sour crude. Normally a larger part of the profits per barrel at LYB's refinery comes from buying heavy crude at a discount to light/intermediate crude. There has been a shift in supply with the latter exceeding demand and pushing down the price while there is less new drilling for heavy sour crude – pushing up its price. The spread is much smaller.

  Also, while miles driven is recovering, demand for jet fuel remains much lower than pre-COVID. That is also hurting prices and revenues for the refinery. We have discussed in the past that this is the smallest part of LYB's business. This impairment was the primary adjustment to reported EPS. **Going forward, LYB will benefit from lower depreciation on the refinery. We estimate that will add 3-5-cents to quarterly EPS.**

- LYB acquired 50% of two JVs of existing properties. One is in China – Bora deal for $472 million. The second is in Louisiana – Sasol for $2 billion that should close in

4Q. The rationale for both deals is adding capacity in a quicker manner to deal with rising demand and avoiding the various pitfalls and delays that can come from building new assets with capital spending.

- The net result is to expect capital spending to decline and Free cash flow increase from that along with the cash flow of these projects.
- LYB will focus on its dividend but will devote cash flow that would have gone toward share repurchases to rapid debt repayament from the Sasol deal.
- Debt is $11.6 billion and will become $13.6b when the Sasol deal closes. Trailing EBITDA is $3.6 billion so the debt ratio is 3.8x before adding in any JV income.
- Pre-COVID EBITDA was normally about $5.5-$6.0 billion, which would be a 2.5x debt ratio returning to those days and volumes were flat y/y in 3Q already.
- The Bora deal will retire debt at the JV level first – so LYB does not expect to receive dividends from Bora for two years.

- The PO/TBA project has been delayed until the end of 2022 – about one year. That delay preserved cash during COVID. Also one of the big uses for the TBA products is for fuel additives. That is a market that is depressed with COVID so the delay makes sense. The downside is that is adding to construction activities and tariffs have added to the cost of the project as well. LYB is estimating this project could come in 30% over initial projected cost. That will reduce the ROI to about 10%. That could set LYB up for a future impairment on this project.

RealPage (RP) EQ Update- 9/20 Qtr.

Current EQ Rating*	Previous EQ Rating
2-	2-

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 2- (Weak)

Results for 3Q were much cleaner than in the recent past. RP beat forecasts of adjusted 45-cents by 7-cents. And it didn't do it by guiding to higher product development and marketing costs and then actually cutting them like in 2Q. The company did guide to $4 million of COVID related savings and came in at $7 million but that $3 million is only 2-cents of EPS. Guidance did not look very strong calling for sequential revenue to be lower by $2-$6 million and adjusted EPS of 46-50 cents for 4Q.

What Improved?

- RP said on the call that expects to be much less active in making acquisitions in 2021 and thereafter. We are stunned as it has been a serial acquirer and makes several deals per year.
- Their acquisition accounting is our biggest problem with RP's earnings quality because it doesn't run any of it through adjusted earnings.

What deteriorated

- Customer deposits fell in 3Q by just over $30 million. This is from customers who pay rent online and RP sends the cash to the apartment owner.

- Residential services like this have been the fastest-growing part of revenue and it accelerated under COVID. We don't have the 10-Q yet to see what 3Q's residential services revenue growth was. A decline could indicate that this area of revenue growth may slow going forward.

- If RP spends less on acquisitions, will it need to ramp up internal product development spending? That would improve earnings quality – but product development spending was $34 million last quarter compared to $1.6 billion deals where RP adds back every nickel of cost and amortization to adjusted earnings.

Hyper Residential Services Growth May Not Be Sustainable

With COVID, more people went to online bill-paying. RP has software and web-portals that allow residents at apartments to pay their rent online, their utility bills online, buy renters insurance, and send in maintenance requests online.

This had been an area growing in the high-teens for RP in recent years that accelerated in 1Q to 23% and to 28% in 2Q20. We think that may have been part of the reason for the revenue beat in 3Q too. We're familiar with online rent payment and it requires residents to pay a fee to use it, thus it's cheaper to pay with a check or use online banking to do it for free. Hearing the conference call, RP was very focused that the future will be one of more people continuing to work from home forever and this will be a growth area.

Customer deposits are basically the rent payments that RP collects and then transmits to the apartment owner. In looking at their results, customer deposits dropped noticeably in 3Q20. They fell $30.6 million in the period from 2Q and stand at $232.6 million. That's a 12% drop from 2Q for what has become the fastest-growing revenue item. This was a huge cash flow headwind for 3Q:

	3Q20	3Q19
Cash From Ops	$50.4	$112.8
Chg in Deposits	-$30.6	$45.5
CFO w/o Deposits	$81.0	$67.3

This bears watching if to see if it continues and it may have played a role in the guidance for lower sequential revenue growth.

Acquisitions Continue and an Interesting Comment on the Call

RP has always been a serial acquirer in our view. It adds new tech features and software products through its many acquisitions. We have always viewed this as a way for RP to keep R&D and many of the programming costs off the income statement. Instead, you just buy the tech you need on the cash flow statement.

RP then assigns a great deal of the purchase price to goodwill which is not amortized and it doesn't penalize earnings. The rest of the intangibles are amortized but added back as non-cash expense for adjusted earnings. And any transaction costs or integration costs are added back too in adjusted earnings. Magically RP gets new product and higher revenue and it cost absolutely nothing to create according to adjusted earnings. This is one of our biggest issues with RP's accounting as the deals clearly consume cash and RP has few years with free cash flow, but adjusted earnings keep rising expense-free:

	3Q20	2019	2018	2017	2016
Cash from Oper.	$50.4	$317.0	$244.8	$140.3	$129.4
Capital Spend.	$18.6	$51.9	$50.9	$49.8	$75.2
Acquisitions	$70.2	$665.8	$307.0	$658.4	$72.1
Free Cash Flow	-$38.4	-$400.7	-$113.1	-$567.9	-$18.0

Adjusted Earnings show that ignoring this large cash cost of acquisitions is a major part of boosting GAAP earnings. Again, without goodwill amortization, this still doesn't show the full extent of the problem. Goodwill is $1.7 billion. The intangibles being amortized and added back are only $350 million.

	3Q20	2019	2018	2017
GAAP Pretax	$20.4	$60.6	$34.3	$15.2
Amortization	$25.4	$80.8	$71.7	$39.9
Acq. Expense	$1.7	$4.8	$2.4	$16.6
Stock Comp	$15.8	$62.6	$50.6	$45.8
Adj. Pretax	$68.7	$223.4	$183.7	$127.1

There are more adjustments going on, but it is obvious that adjusted income is several multiples higher than reported earnings and a big part of that is ignoring all cash costs of acquisitions.

On the conference call, it was noted that investors can expect M&A activity to decline in 2021 and thereafter too.

That was an astonishing statement to us as RP has made several dozen deals in the last few years. When we look at what they have been spending on acquisitions, it makes us think "all that could have been going through the income statement as Product Development costs and wages." We'll have to see what happens, but if RP brings more development in house rather than buying it, it could see operating expenses increase. Plus, it would tough to claim that should be added back because they would be cash expenses. By comparison to the $1.6 billion spent on deals in recent years – RP's own product development expenses were only $34 million last quarter. The adjustments to EPS would get smaller and earnings quality would improve if this becomes the new future. It could also mean lower earnings overall.

MOWI (MHGVY) 3Q'20 Update
Maintain BUY

3Q20 looked much like 2Q20 with MOWI suffering from lower pricing – down 11% in Europe and 20% in the Americas. **We are keeping our Buy recommendation as several levers appear close to balance and could move in MOWI's favor going forward.** In particular, the Biomass valuation adjustment went up in 3Q after two large mark-downs in 1Q and 2Q. This adjustment is made every quarter based on expected pricing, what the total cost to raise the fish will be, and estimated volume at the time of sale, Here are some signs of movement in the right direction:

- **Supply and Demand were essentially equal** – and within this are several other positives

Market Balance	3Q20	2Q20	1Q20	4Q19
Supply growth	4.8%	3.3%	2.3%	3.5%
Demand growth	4.8%	1.3%	0.4%	3.6%

  - Demand growth is accelerating through the year and the biggest markets – Europe and the US were up 7.2% and 14.3%.
  - The quarter was hurt due to problems in China and still a lack of air transport.
  - The largest source of supply was again Chile at 15.6%.
  - Going forward, Chile's supply growth should stall as their new stockings are down 2% y/y.
  - Forecasts for supply growth in 2021 are -1% to +3% and demand may be exceeding that

- **Lack of restaurants continued to hurt demand.** Many restaurants remained closed or only open for take-out or outdoor dining. Retail demand in home preparation or various consumer products like smoked salmon or sushi saw strong demand. Losing food service is a -5% to -10% loss of demand when netted against the rise in retail sales.

Cons Prod	3Q20	3Q19	2Q20	2Q19	Asia 2Q20	Asia 2Q19	Asia 2Q20	Asia 2Q19
Revenues	648.1	640.4	652.4	648.4	71.1	87.3	79.3	91.6
Op EBIT	21.2	13.8	23.3	7.5	1.5	1.9	1.1	2.6
Margin	3.3%	2.2%	3.6%	1.2%	2.1%	2.2%	1.4%	2.8%

Consumer products continue to show improving results even as the roll-out in the US is still very new. Plus, lack of air transport has hurt sales of consumer products in Asia just like sales of normal salmon. Given the history in Europe, Mowi believes it will hold higher sales of consumer products and recover sales in Asia and foodservice.

- **Pricing has a large amount of ground to recover, which should drive earnings along with a forecast that demand could exceed supply in 2021 and FX normalization.**

    - Salmon from Norway is normally €6-7/kg – it's in the €3's now but is starting to bounce up.
    - Salmon in the Americas is normally about $5/lb – it's about $3.50 now
    - Some of this is the excess supply also gets sold into the markets it's easiest to get to – Europe and the US. As more markets and transport become available – more supply will move to Asia and should boost prices in Europe and the US.
    - FX for Norway plays a role too. MOWI operates in Euros and many other players in NOK. The NOK depreciated against the Euro during COVID which allows others to sell at lower prices. It is starting to correct but is still 11 to 1 instead of the normal 9.5 to 1 ratio.
    - Over time, this nets to zero. The farmers using NOK will effectively see their feed costs rise more due to FX, but the fish they are selling take 3-years to grow and much of that cost occurred before the COVID impact on FX. During this year, MOWI was hurt by lower selling prices but enjoyed lower feed costs for future fish. This should lead to better margins going forward too.

Avery Dennison 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)

AVY beat the consensus estimates by 41 cps in the 9/20 quarter. While lower stock-based compensation and a lower tax rate could have accounted for more than 15 cps of that upside, there is still a sizeable beat left after considering that.

What deteriorated?

- Stock-based compensation expense fell by more than 12 cps in the quarter. We do not view this as sustainable and consider it a low-quality source of profit growth. However, the benefit relative to the size of the earnings beat tempers our level of concern.
  (Concern level: MEDIUM)

- The adjusted non-GAAP tax rate fell to 23.6% from 24.1% a year ago. The company has guided for a 24% annual rate and we assume the tax rate was likely below most analysts' models. We estimate the decline added about 5 cps to earnings in the period. Again, given the size of the beat, we are not overly concerned.
  (Concern level: LOW)

What improved?

- Inventory DSI rose by just 1.5 days versus the year-ago level with all of the increase due to raw materials. AVY let inventory levels build in the previous two quarters to

assure adequate stocks to meet COVID-induced demand and they have now returned to a level near the historical norm.

What to watch

- AVY has taken restructuring charges in the last several years. However, we have not flagged these as a significant concern given the relatively small size and the fact that they are mostly tied to specific severance programs. We will continue to monitor the charges for change in scope and composition.

Citrix Systems 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)

CTXS reported non-GAAP EPS of $1.38 in the 9/20 quarter which was 13 cps ahead of consensus targets. Revenue came in about 1% higher than the hurdle. The company guided to full-year revenue of $3.34 billion which was slightly ahead of the consensus view of $3.27 billion. Likewise, EPS guidance was for $6.20-$6.40 with the then-consensus outlook falling at the low end of that range at $6.18. Despite the seemingly strong results, the stock has been pummeled by the market largely due to disappointing growth in its SaaS subscription bookings as customers appear to be reluctant to make long-term subscription license commitments in the current environment. Whether this will be temporary is beyond the scope of this report. However, from a pure earnings quality perspective, we view the increase in deferred revenues and unbilled revenue as positives.

What deteriorated?

- We note that quarterly cash from operations declined to $112 million from $147 million in the year-ago quarter. Cash flow growth is key given the shift to longer-term contracts being billed upfront. The main culprit for the decline was an approximate 45% million decline in cash from receivables as DSOs rose by 14 days. We suspect this is a matter of the timing of collections in the current environment and expect a reversal in the next quarter.
  (Concern level: LOW)

What improved?

- Deferred revenue days of sales rose in the quarter for the first time since the shift to subscription deals began. Previously, the expiration of maintenance contracts under perpetual licenses was driving down deferred revenue faster than new subscription deals were adding to it. This has appeared to reverse.

- While growth in annualized recurring SaaS revenue disappointed in the quarter, subscription ARR (annualized recurring revenue) growth remained north of 50% as did the growth in unbilled revenue. Going forward, any reversal in deferred revenue growth or unbilled revenue growth should be viewed with caution.

What to watch

- Ironically, if the company had experienced stronger subscription-based bookings in the 9/20 quarter, revenue growth would likely have been weaker as more of these revenues would have been deferred. The company has warned that the 3/21 quarter will face a difficult sales comp given that the 3/20 quarter contained an unusual degree of perpetual deals from customers rushing to adopt remote work applications at the start of COVID. These were recognized upfront and provided a more immediate boost to revenue.

- Rising stock-based compensation was a 10 cps drag on EPS growth in the quarter.

SaaS Revenue Growth Disappoints, but Deferred Revenue Rose

The key to the CTXS story is the company's shift to subscription-based cloud revenue which is recognized over time from on-premises software which is recognized upfront. Despite CTXS beating EPS forecasts and guiding towards a strong fourth quarter, the market punished the stock due to a deceleration in the growth of SaaS (software as a service) cloud-based subscription bookings. The following table shows

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Subscription ARR	$1,027	$949	$837	$743
SaaS ARR	$630	$590	$555	$520
Total ARR	$1,657	$1,539	$1,392	$1,263
Subscription ARR growth	52.8%	54.6%	50.3%	40.7%
SaaS ARR growth	36.1%	41.1%	48.0%	48.6%
Total ARR Growth	46.0%	49.1%	49.4%	43.8%

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Subscription ARR	$672	$614	$557	$528
SaaS ARR	$463	$418	$375	$350
Total ARR	$1,135	$1,032	$932	$878

ARR (annualized recurring revenue) represents the annualized value of all of the company's subscription contracts as of the end of the quarter. We see that total ARR growth fell to 46% due to a marked deceleration in the growth of SaaS ARR which has continued for three quarters. This seems to be the key point of concern for the market as it indicates that fewer customers are migrating to the long-term, cloud-based subscription services and are opting instead for on-premises licenses This is causing some to doubt the longer-term growth story of moving to a more sustainable, predictable revenue source. However, there is also the possibility that customers are simply delaying making a long-term commitment in the current environment and will make a move to cloud-based contracts later. Making that determination is beyond the scope of this EQ Review.

Despite the disappointment in SaaS growth, the company saw its deferred revenue days of sales increase for the first time since the switch to cloud-based services began:

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
SaaS Subscription Revenue	$138.000	$131.000	$122.000	$113.000
Support and Services Revenue	$417.348	$425.546	$419.851	$439.584
Total Estimated Revenue Booked Over Time	$555.348	$556.546	$541.851	$552.584
Total Deferred Revenue	$1,692.304	$1,787.630	$1,754.803	$1,795.791
Total Deferred Revenue Days of Sales	280.4	292.3	294.7	299.0

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
SaaS Subscription Revenue	$101.000	$91.000	$85.000	$78.000
Support and Services Revenue	$441.971	$452.210	$442.515	$461.299
Total Estimated Revenue Booked Over Time	$542.971	$543.210	$527.515	$539.299
Total Deferred Revenue	$1,615.572	$1,744.714	$1,756.717	$1,834.572
Total Deferred Revenue Days of Sales	273.7	292.3	299.7	313.0

The table above shows that total deferred revenue days of estimated revenue booked over time increased to 280 days from 273 in the year-ago quarter. Remember that in addition to subscription revenue that has been deferred, deferred revenue also contains deferred amounts from maintenance contracts tied to perpetual licenses. As customers have moved away from perpetual licenses, these maintenance deferrals have declined and more than offset the increase in revenue deferred under new subscription agreements. However, CTXS has appeared to reach an inflection point where deferred revenue is now increasing as new subscriptions build. We view this as a positive for earnings quality.

Ironically, the slowdown in SaaS revenue is likely resulting in higher sales growth than would be posted if more long-term subscriptions were signed. This is due to the on-premises revenue being recognized upfront rather than over time. The company has even warned that the first quarter may see a slowdown in revenue growth as the 3/20 quarter saw an increase in perpetual deals due to customers flocking to its remote working solutions in response to the onset of COVID shutdowns.

Remaining Contract Value Continues to Grow

While the company prefers to draw attention to ARR, by adding unearned revenue and unbilled revenue we can get another perspective of the total value of revenue under contract that has yet to be recognized. The following table shows this breakdown for the last 8 quarters:

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Unbilled Revenue	$916	$867	$779	$705
growth	63.8%	79.0%	104.8%	108.2%
Total Deferred Revenue	$1,692	$1,788	$1,755	$1,796
growth	4.7%	2.5%	-0.1%	-2.1%
Total	$2,608	$2,655	$2,534	$2,501
growth	19.9%	19.1%	18.6%	15.1%

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Unbilled Revenue	$559	$484	$380	$338
Total Deferred Revenue	$1,616	$1,745	$1,757	$1,835
Total	$2,175	$2,229	$2,137	$2,173

We see that deferred revenue growth turned positive in the last two quarters as discussed above. Also, unbilled revenue growth is still growing north of 60%, driven by the signing up of long-term subscription deals. While SaaS ARR growth may have disappointed, the growth in the pool of future revenues under contract is far from lackluster.

Stryker (SYK) EQ Update- 9/20 Qtr.

Current EQ Rating*	Previous EQ Rating
4+	3-

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 raising our earnings quality rating to 4+ (Acceptable)

SYK blew earnings estimates away in the 9/20 quarter with adjusted earnings of $2.14 which was 71 cps ahead of the consensus. Our previous concerns with SYK centered around rising receivables balances, rising inventories, and adding back amortization of acquired intangibles to non-GAAP EPS. We saw improvement in the former two issues which prompted the upgrade in rating.

What improved?

- Inventory balances ended the 9/20 quarter essentially flat sequentially. Management noted that gross margin took a mild hit from lower than normal production levels although manufacturing activity improved from the previous quarter. While DSIs of 249 days were ten days above the year-ago depressed level, they compare favorably with the pre-COVID trend. The company seems to be in a good position as elective procedure volume is already beginning to pick up.

- We had previously cited concerns with rising receivable DSOs which we were skeptical could all be attributed to acquisitions. However, DSOs settled back to just under 60 days. This was almost 3 days below the year-ago level and in-line with 2018 and 2019 levels.

What to watch

- Med-tech companies are starting to awaken from the COVID dormancy as elective procedures return. Like most companies, SYK has slashed discretionary spending such as travel, promotional activity, and hiring. Management noted in the call that R&D spending came in less than planned at 6.1% of sales on an adjusted basis. This was not a meaningful contributor to the earnings beat. However, the company is ramping up hiring and other spending again which will offset some of the benefit of re-leveraging a rising sales base. As such, the company still did not offer guidance for the fourth quarter.

- Like many companies in the med-tech field, SYK adds back amortization of acquired intangibles to its non-GAAP results. Amortization typically amounts to about 12% of non-GAAP operating income. With that in mind, the Wright Medical deal is expected to close during the fourth quarter. We will review the allocation of costs and amortization periods when data is available.

Illinois Tool Works (ITW) EQ Update- 9/20 Qtr.

Current EQ Rating*	Previous EQ Rating
4+	3-

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 raising our earnings quality rating to 4+ (Acceptable)

ITW reported EPS of $1.83 which was 38 cps ahead of the consensus estimate. We are raising our earnings quality rating reflecting the company's strong working capital positions and lack of unusual items in the quarter.

What improved?

- ITW's inventories have essentially tracked flat over the last three COVID-impacted quarters. The sequential increase in sales activity left DSIs at the end of the 9/20 quarter at 55- level with a year ago and in line with historical experience.

- We have noted some small one-time items in the past that have helped the company make earnings estimates such as lower than expected tax rates and unusual jumps in other income. There were no such unusual items in the 9/20 quarter, let alone anything to explain the 38 cps beat.

What to watch

- ITW suspended the buyback in the quarter to conserve cash in the current environment. However, ITW has a history of spending all its free cash flow and more on the buyback. In 2019, the lower share count was providing almost 4% of reported

EPS growth so any prolonged reduction in repurchases will have a meaningful impact on reported growth.

- ITW does not offer a non-GAAP earnings presentation in its press release with countless, material adjustments to arrive at "real" earnings. We view this as a positive for earnings quality. However, we do note that ITW has an ongoing restructuring program which results in management often citing higher restructuring costs as hindering margin growth. It even presents the impact of restructuring costs on margins in its 10-Qs and has occasionally cites the EPS impact in conference call discussions. While not as egregious as some companies who regularly adjust earnings upwards by 5-10% for "one-time" charges, we find the adjusted margin numbers distracting given the perpetual nature of the activity.

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

Behind the Numbers, LLC is an independent research firm 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. All research is based on fundamental analysis using publicly available information including SEC filed documents, company presentations, annual reports, earnings call transcripts, as well as those of competitors, customers, and suppliers. Other information sources include mass market and industry news resources. These sources are believed to be reliable, but no representation is made that they are accurate or complete, or that errors, if discovered, will be corrected. Behind the Numbers, LLC does not use company sources beyond what they have publicly written or discussed in presentations or media interviews. Behind the Numbers does not use or subscribe to expert networks. All employees are aware of this policy and adhere to it.

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.