BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

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Treehouse Foods (THS) EQ Update- 9/20 Qtr.

Current EQ Rating*	Previous EQ Rating
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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 3- (Minor Concern)

THS picked up one of the smallest bumps from COVID that we have seen among food/consumer product companies and it's now largely gone with sales up only 0.7% in 3Q. To be fair, it lost some restaurant sales – but that is a much smaller part of the business. The company missed its sales forecast for 3Q but beat on EPS by 10-cents. We would argue the EPS beat is of lower quality as THS added back 6-cents for COVID costs that exceeded what it earned in incremental gross profit from COVID demand. It also added back 23-cents in taxes on 28-cents of adjustment items. Much of this is COVID-related too from the

CARES Act. Even with COVID demand and some margin gains – ROI is still only 8.2%. We think margin gains may disappear as well. When we look at what improved at THS, much of it looks temporary.

What improved?

- Debt to adjusted EBITDA fell from 4.0x at the start of the year to 3.7x after 3Q20 (we are not adding back stock compensation.). Debt is not down much, only $53 million, but higher EBITDA helped the ratio.

- Favorable mix drove gross margin up 120 and 160bp in the last two quarters. This is due to fewer lower-margin restaurant sales and more retail sales with COVID. Adjusted EPS rose from 55-cents to 71-cents, and the 160bp of margin added 23-cents.

What deteriorated?

- The COVID sales bump looks gone already. Volume rose $32 million in 1Q20 and $39 million for 2Q20. It only rose $4 million in 3Q20. And, in 3Q THS started to benefit from restocking channel inventories.

- Sales growth of 0.7% looks even worse when compared to another easy comp of -4.4% from 3Q19. Guidance is calling for basically flat sales in 4Q with more channel stocking and another easy comp.

- Capital spending is still running below initial guidance of $135 million, which was already projected as a reduction from $147 million in 2019.

- Cash flow improved by $119 million through 3-quarters. However, $23 million is due to less of a working capital drag and $81 million from a change in deferred taxes. Plus, THS is benefitting by $20-$25 million by deferring payroll taxes.

What to Watch?

- Gross margin gains are due largely to lost restaurant sales which are lower margin. Going forward, some of those sales should recover and pressure margin.

- Sales growth is being helped in 3Q and 4Q by restocking the retail channel. That should mean sales growth may slow more and THS isn't seeing much growth at all now.

- Selling and Distribution costs are flat as a percentage of sales. That is with lower fuel costs pushing down freight costs. We believe THS may have also reduced marketing further during COVID which would help Selling costs.

- Other G&A costs are also not leveraging even with COVID helping sales in 1Q and 2Q.

- Cash flow may not get as much help from declining inventories from 3Q to 4Q as normal. Inventories are starting at a lower level to end 3Q and the company is working to build channel inventories.

- Cash flow will be helped in 4Q by a $73.5 million income tax refund from the CARES Act.

- THS will purchase another pasta company in 4Q or 1Q. Will this set off more restructuring?

Sales Growth Is Still Very Poor

For a food company that primarily sells through retail stores – THS had one of the poorest COVID bumps we have seen. The company attributes this to losing some sales to the Food-Away-From-Home market (restaurants). To us that looks like a fairly small part of total sales. In the 3Q presentation, THS noted that source of demand was down 22%, but it was a smaller part of sales change than retail demand being about 3x larger for net pricing change and only grew at 7%. On top of that, THS has had amazingly easy comps this year:

Sales Trends	3Q20	2Q20	1Q20
Volume	$4.2	$38.7	$32.3
Price	$2.7	-$1.7	-$5.5
Organic Growth	$6.9	$37.0	$26.8
Growth Rate	0.7%	3.6%	2.6%
2019 Organic growth	-4.4%	-6.7%	-6.1%

- 3Q20 Meal Prep down 2.0% as they couldn't offset food-away-from-home declines
- 3Q20 Snacks/Bev. Up 5.2% helped by pricing and COVID demand
- 2Q20 Meal Prep up 1.8% with COVID demand, higher retail demand, offsetting restaurants
- 2Q20 Snacks/Bev. Up 7.0% due to COVID
- 1Q20 Meal Prep up 0.5% with COVID demand
- 1Q20 Snacks/Bev. Up 6.0% with COVID

They had negative comps to grow against all year and still didn't post much with COVID tailwinds in our view. Guidance for 4Q has several issues to watch:

- Guidance is for $1.11-$1.17 billion in sales against $1.14b last year – a range of -2.6% to 2.6%.
- The comp is another easy one -3.8% from 4Q19.
- THS expects to benefit from retail stocking of many SKUs in the quarter also.

Here is what the CEO said on the conference call about SKUs:

> "***In April, responding to sharp increases in demand, we worked with our customers to simplify and prioritize certain SKUs.*** *This had two important impacts: first, it allowed us to better serve our customers' needs and keep their shelves stocked with private label basics; second, this simplification enabled us to run more physical cases through our plants, driving profitability and cash flow. The trade-off of these benefits*

was a temporary decline in private label share in measured channels of about 200 basis points in the second quarter. You'll also recall that on our last call, ***<u>we detailed our efforts to return those deprioritized SKUs into production and that we would be shipping about 80% of those SKUs by the end of August.</u>*** *That process has played out expected, and unit share is beginning to recover as we thought. In fact, the most recent shared data shows that private label penetration has returned to May levels, which means private label share for our categories has risen by 150 basis points.* ***<u>We anticipate this trend will continue."</u>***

We have seen several other companies talking about similar plans. Retail shelves were emptied early in the COVID process and in 3Q, there was finally a chance to start building inventories in the channel again. THS started this process late in 3Q and should see it continue in 4Q. It will get listed as organic growth, but we are not going to consider it sustainable. Eventually, the stocks will be rebuilt and organic growth will more closely resemble what is actually sold to consumers.

We also think investors should note that some of this should have helped 3Q sales but look at volume up only $4.2 million. It looks to us that the COVID bump is already gone here.

Gross Margin Improved but Can It Last?

As we noted in the original report, gross margin has been falling for years despite all the restructuring at THS. In 2020, there are still several one-time items that hurt gross profit. COVID is the largest one. It is worth noting that COVID costs exceed their COVID bump. As noted above, THS added a net $32 million and $39 million in sales volume in 1Q and 2Q. At a 19% gross margin that is only $6-$7 million in incremental gross profit. THS is spending over $26 million on COVID expenses and calling $17 million a one-time expense. If just $7-10 million more of that spending is permanent for wage increases, cleaning procedures, and supplies – that is 70-100bp of gross margin at risk.

Gross Margins	3Q20	3Q19	2Q20	2Q19	1Q20	1Q19
COVID	$17.3	$0.0	$17.8	$0.0	$0.9	$0.0
Restructuring	$0.2	$0.6	$0.0	$0.2	$0.7	$3.0
Chg. Regulations	$0.0	$4.0	$0.4	$0.0	-$0.1	$0.0
Withdrawal from Multi-Emp. Plans	$0.0	$0.0	$0.0	$4.1	$0.0	$0.0
Depreciation Adj.	$0.2	$0.1	$0.0	$0.2	$0.0	$1.4
One-time Items	$17.7	$4.7	$18.2	$4.5	$1.5	$4.4
Adjusted Gross Margin	19.7%	18.1%	20.1%	18.9%	18.1%	18.8%

The other reasons we do not believe gross margin gains will hold are the company's explanations for the improvement. In both 2Q and 3Q, THS said that it benefited from favorable mix of sales – meaning they had more retail sales and less to restaurants where margins are lower. At some point, that should swing back and give the company more low-margin sales. THS also said that its margins benefitted from higher volume leveraging fixed costs for manufacturing and distribution as well. But, it is also known that THS is selling more volume now to restock the channel – that will likely end in 4Q. We should also point out that in 2Q and 3Q, as THS worked with retailers to focus on producing more volume of only about 20% of its SKUs – that should have helped make manufacturing more efficient as well. Now, the other 80% of SKUs are being made again.

In 1Q when the bulk of the quarter did not have COVID demand, margins were down. THS said that was due to unfavorable pricing and unfavorable mix as it had more lower-margin business. It appears to us that is an area that should bounce back and pressure margins again.

Margins Are Not Being Helped by Selling and G&A Costs – It's all Gross Margin

The company has cut Selling and Distribution costs along with G&A costs as part of its restructuring. Selling used to be about 7% of sales and dropped to 6%. G&A was 5.5% and fell to 5.1% in recent years. However, the change has stalled:

Other Costs	3Q20	3Q19	2Q20	2Q19	1Q20	1Q19
Selling & Dist. Adj.	$59.8	$60.0	$62.7	$59.8	$64.4	$70.2
S&D % Sales	5.7%	5.7%	6.0%	5.8%	5.9%	6.6%
G&A Adjusted	$50.1	$50.9	$61.9	$59.4	$63.0	$60.6
G&A % Sales	4.8%	4.8%	5.9%	5.8%	5.8%	5.7%

These are adjusted to add back items like COVID, restructuring, litigation, etc. We are surprised that with higher sales, there isn't some more leveraging of costs. Instead, costs have remained flat to even slightly up as a percentage of sales. The company reported that freight rates fell and that helped selling and distribution. In 1Q20, it had a larger change by moving away from spot market freight deals y/y and that change was already in place for other 2019 quarters. THS says that it has watched costs very closely as the reason G&A is largely flat as a percentage of sales – but again, if they could not leverage the cost base with higher COVID demand – when can they?

The company only discloses information on marketing and R&D in the 10-K. We know that THS was cutting its allowance for marketing in recent years and it flows through selling and distribution costs.

	2019	2018	2017
Marketing Allowance	$32.9	$45.7	$56.9
% Sales	0.8%	1.0%	1.2%

From 2017-2019, they cut this allowance by 40bp. We know that many other food companies have been able to cut marketing during COVID. If THS was able to do the same, we would argue that freight costs may actually be up on a permanent basis as we expect marketing to return. Also, lower freight costs are likely partially tied to fuel costs being lower in 2020 vs. 2019. So again, if selling and distribution is flat as a percentage of sales – there are three potential headwinds for this cost going forward: higher marketing, higher fuel costs, and loss of COVID-driven sales.

Research and Development spending had already dropped by $9 million from 2017 to 2019 and added 13bp to margin. This could be a headwind for G&A also along with losing some of the COVID sales.

Cash Flow from Drawing Down Working Capital Appears Over

As we pointed out in the original report, THS produced over $350 million in cash flow by pulling down working capital from 2017-19. A big part of this was selling receivables. We did not believe it could continue pulling cash out of working capital. So far in 2020, it has been a sizeable drag:

Working Cap.	3Q20	2Q20	1Q20
Receivables	-$2.2	$28.8	-$24.0
Inventory	-$35.3	-$85.5	$1.1
Prepaid Exp.	-$27.8	$0.7	-$60.4
Payables	-$8.6	$18.4	$39.7
Accrued Exp.	-$11.1	$43.0	-$11.1
Cash from W/C	-$85.0	$5.4	-$54.7
Cash from Ops	$1.2	$54.8	$68.5
Cap Exp.	$18.3	$3.0	$27.3
Software	$4.3	$3.8	$3.8
Free Cash Flow	-$21.4	$29.3	$37.4

Seasonally, inventories normally drop in 4Q. DSIs are 71 now coming out of 3Q, which is low historically. They usually fall as much as 20 days. We are not sure that will happen this year as THS is rebuilding channel inventories and the drop in DSI is to 55-60 days and they are starting at a lower level. We estimate that a drop to 55-60 days would mean inventories would fall to $555-$605 million from the current $664 million. That is not going to offset the drag working capital has already been this year of -$134 million:

Inventory	4Q	3Q	2Q	1Q
DSIs 2020		70.7	67.5	55.1
DSIs 2019	54.3	73.6	73.1	89.5
DSIs 2018	59.6	78.2	70.6	68.7

Additional points to consider about cash flow and sustainability:

- Capital spending is coming in light from forecasts of $135 million for 2020. So far only $79 million has been spent. Historically, capital spending is above $150 million so this may be a headwind for free cash flow in 2021.

- Cash flow looks better this year through three quarters at $124.5 million vs. $5.8 million in 2019. Of that, working capital was less of a drag by $22.9 million and there was a positive swing in cash flow of $80.7 million 2020 for deferred taxes.

- Cash flow in 2020 is benefitting from deferring payroll taxes of $20-$25 million from the CARES Act. That will become a headwind in 2021 and 2022 when that deferred amount is repaid.

- The CARES Act also helped THS realize a tax refund of $73.5 million – which has largely hit in the 4Q. Through 3Q, total COVID spending has been $36 million at THS and it has realized $25 million in tax benefits in that area.

- THS continues to benefit from slow-paying banks on collected receivables that have been sold. This balance finally dipped y/y in 3Q dropping from 70% of the total to 55%.

	3Q20	2Q20	1Q20	4Q19	3Q19	2Q19	1Q19
Receivables Sold	$226.7	$200.1	$229.8	$243.0	$196.2	$184.5	$148.7
Payable Due on Sold A/R Collected	$123.6	$131.3	$106.7	$158.3	$136.6	$70.5	$97.5
% Owed	54.5%	65.6%	46.4%	65.1%	69.6%	38.2%	65.6%

salesforce.com (CRM) EQ Update- 10/20 Qtr.

Current EQ Rating*	Previous EQ Rating
3-	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

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We are lowering our earnings quality rating to 3- (Minor Concern)

CRM posted non-GAAP EPS of $1.74 for the third fiscal quarter ended 10/20. This was well ahead of the company's post-2Q guidance of $0.73-$0.74. However, CRM's sizeable strategic investment portfolio must be marked to market every period as per ASU 2016-01, and the company does not attempt to estimate the quarterly gain or loss it will incur from investments when giving guidance. In the 10/20 quarter, the company enjoyed $0.86 per share in unrealized gains on investments, largely triggered by the IPO of Snowflake during the quarter. Even after this adjustment, the company soundly beat its original targets for the quarter by 12-14 cps. The company raised guidance for the full year to $4.62-$4.63, an approximate 3 cps increase after adjusting for the investment gain.

The reduction in our rating largely centers around the potential for the Slack deal to magnify the distortion caused by the company adding back the amortization of acquired intangibles to its non-GAAP results.

What deteriorated?

- We took issue with the company adding back amortization of acquired intangibles to its non-GAAP results in our original review. The announcement of the $27 billion Slack acquisition will only cause this practice to distort adjusted earnings more. CRM continues to post high teens organic revenue and RPO growth, so it is not a typical serial acquirer relying on acquisitions to drive the top line. However, the company admits that part of its innovation comes from the technology it picks up in its deals. If it had to develop Tableau's data analytics capabilities or Slack's messaging technology on its own, it would have incurred R&D expenses it could not add back to results. For perspective, the amortization of intangibles is trending about 25% of adjusted operating profits. Using the Tableau deal as a guide, our "back of the envelope" estimate for the developed technology amortization from the Slack deal exceeds $700 million per year with another $280 million for customer relationships.

- CRM bought Vlocity for $1.38 billion in July. Over $1 billion was assigned to goodwill and will not be amortized, and $473 million was assigned to intangibles. While the amortization periods of 4 years for developed technology and 8 years for customer relationships seem reasonable, the company will add back the amortization of intangibles to non-GAAP EPS.

- Also, CRM adds back stock-based compensation which amounts to another 50-60% of adjusted operating income. These amounts are also partly related to acquisitions as CRM issues options to the employees of companies it acquires.

What to watch

- We covered in our original review how unearned revenue days of sales were declining YOY. Our concern level was low given that the 8/19 acquisition of Tableau introduced more license revenue to the mix which is recognized upfront. Also, the company temporarily changed billing frequencies for new customers to help in the COVID environment. The YOY decline in unearned revenue days decelerated to 5 days from 8 and 12 in the previous two quarters. With the Tableau deal fully- lapped, we will be watching for the trend in deferred revenue days to normalize absent any other external impacts, although the likely consolidation of Slack in the back half of next year will make tracking the trend difficult.

- The Snowflake IPO-related gain in the 10/20 quarter serves as a reminder of how much the company's net earnings figures can be impacted by these non-operational amounts.

Slack Deal- Expensive, but Future Non-GAAP Will Not Reflect Cost

Recent CRM headlines have all focused on the company's December 1 announcement of its $27 billion cash and stock acquisition of Slack. Some talk of huge synergies and an ability to more aggressively challenge Microsoft. Some question whether an acquisition was necessary and wonder if a partnership would have sufficed. Such questions are beyond the scope of our EQ Review, but no one questions that the deal was expensive at over 30 times revenues and an almost 50% premium to the pre-announcement market price for Slack. Our concern is that like previous deals, the company's non-GAAP accounting will eliminate the actual cost of the deal to shareholders.

One of our concerns with CRM was its industry-typical practice of adding back both amortization of acquired intangibles and stock based-compensation to its adjusted earnings figures. The organic revenue growth rate and growth in its remaining performance obligation (RPO) remain in the high teens, but CRM is still making sizeable acquisitions to drive growth and add capabilities. These have included the $15 billion Tableau deal in 2019, the $7 billion Mulesoft deal in 2018, and the recent $1.4 billion Vlocity deal. While CRM is not a typical serial acquirer that has no organic growth without buying it, acquisitions are an obvious part of its strategy and it depends on them to give it access to the technology it needs to drive its overall growth strategy. The company admitted this in its recent 10-Q:

> *"**We drive innovation organically and, to a lesser extent, through acquisitions,** such as our recent acquisition of Vlocity in June 2020 and our pending acquisition of Slack Technologies, Inc. ("Slack"), which was signed in December 2020 and is expected to close in the second quarter of fiscal 2022."*

At approximately 17% of sales, CRM's R&D spending is already among the highest in the software space. However, if it had to develop the messaging technology of Slack or the data analytics capability of Tableau, it would have had to spend even more on R&D. Therefore, ignoring the estimated cost of this technology in the form of intangible amortization by adding this back to GAAP earnings is overstating the company's true earnings.

Consider amortization of intangibles relative to non-GAAP operating income for the last eight quarters:

	10/31/2020	7/31/2020	4/30/2020	1/31/2020
Non-GAAP Operating Income	$1,073	$1,040	$635	$745
Amortization of Intangible Assets	$283	$284	$271	$270
% of Non-GAAP Operating Income	26.4%	27.3%	42.7%	36.2%

	10/31/2019	7/31/2019	4/30/2019	1/31/2019
Non-GAAP Operating Income	$874	$573	$682	$596
Amortization of Intangible Assets	$266	$127	$129	$130
% of Non-GAAP Operating Income	30.4%	22.2%	18.9%	21.8%

Operating profit would be much lower if we viewed the cost of acquiring the technology that is vitally important to the company's strategy as a real expense.

The Slack acquisition is not set to close until 2Q' 22 so we do not know how the purchase price will be allocated to various asset classes, but we think it is interesting to consider. The $26 billion equity value of the deal is almost $25 billion larger than the current book value of Slack which is a decent estimate of the value of goodwill and intangibles the deal will create. This is similar to the percentage of the Tableau purchase price that was allocated to intangible assets. In that deal, 23% of the purchase price was allocated to intangible assets with 62% of that allocated to developed technology. This is being amortized over 5 years (which we would argue is on the long side). Utilizing similar percentages for Slack, we get a "back of the envelope" estimate for the amortization of Slack technology assets of $700 million per year. In our scenario, another $280 million of amortization would be generated by customer relationship assets which we would argue the company would have to spend if it had to develop these from the ground up. It seems clear to us that these amounts should be considered real costs when assessing what the company is earning for shareholders.

One positive thing we note about the company's non-GAAP results as it pertains to acquisitions is that CRM does not constantly add back restructuring and integration costs related to acquired operations. We will view it as a definite negative if we begin to see such charges pop up going forward.

Stock-Based Compensation Continues to Rise

CRM also adds back stock-based compensation expense to non-GAAP results. This amount is even larger relative to adjusted operating income than amortization- and it is rising:

	10/31/2020	7/31/2020	4/30/2020	1/31/2020
Non-GAAP Operating Income	$1,073	$1,040	$635	$745
Stock-based expense	$566	$578	$504	$511
% of Non-GAAP Operating Income	52.7%	55.6%	79.4%	68.6%

	10/31/2019	7/31/2019	4/30/2019	1/31/2019
Non-GAAP Operating Income	$874	$573	$682	$596
Stock-based expense	$543	$388	$343	$329
% of Non-GAAP Operating Income	62.1%	67.7%	50.3%	55.2%

This expense can also be viewed as partially related to acquisitions as the company adopts the options programs of the companies it acquires. We can see the increase in expense generated by the Tableau deal in the 10/19 quarter above. Our argument regarding whether options are real expenses is to consider what would happen if the company took them away from employees and did not replace them with cash compensation.

Autodesk (ADSK) 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

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We are raising our earnings quality rating to 4+ (Acceptable) from 3- (Minor Concern)

ADSK reported adjusted EPS of $1.04 which was 8 cps ahead of the consensus.

Our main reason for not rating ADSK a 4 in our initial review was our concern that the decline in signing multi-year deals would force the company to lower free cash flow forecasts for the full year. During the third quarter, the company did cut the top end of its free cash flow forecasts which reduces our concern for a material negative surprise in this area.

What improved?

- As we expected, accounts receivables DSOs declined by over 4 days versus the year-ago period as the company normalized payment terms in early August after previously extending them to 60 days at the height of the COVID lockdowns.

What deteriorated?

- Billings declined from the year-ago quarter by almost 1%. While management stated that this was ahead of expectations, it still lowered the top end of its estimated range for full-year billings down to $4.130 from the previous quarter's $4.170. We noted in our original review that the uncertainty of the current environment has resulted in customers electing to forego signing multi-year deals which are paid upfront. This has a negative impact on billings, deferred revenue, and cash flows.

- Our biggest concern in our original review was that the company would have to lower its full-year free cash flow forecasts as a result of the decline in multi-year deals resulting in less cash received upfront. The top end of the forecast was lowered in the third quarter from $1.400 billion to $1.360 billion. The midpoint of the guidance implies free cash flow of about $620 million in the fourth quarter which is a slight decline from the year-ago level of $684 million. This does not seem overly optimistic assuming multi-year signings don't deteriorate further.

What to watch

- Amortization of costs to obtain contracts fell by $1.4 million despite an increase in the balance of capitalized contract costs. As noted in our original review, we are not especially concerned by this trend at the moment since revenue is shifting to longer-term deals which would result in a longer period over which to amortize these costs. Also, we estimate that if amortization as a percentage of the average capitalized balance had remained even with a year ago, it would have only shaved about 1.5 cps off earnings. We will continue to monitor this going forward.

- ADSK's adjusted effective tax rate has been running around 16% for the last three quarters which is down about 200 bps from last year. The company has been forecasting this rate clearly in its presentations, so we do not consider it an unexpected benefit. Nevertheless, this approximate 2.5 cps headwind will expire after the fourth quarter.

- Stock-based compensation is rising and ADSK adds this expense back to non-GAAP earnings. This amounted to 44 cps of the adjusted $1.04 reported in the quarter.

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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