BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Ford Motor Company (F) – EQ Review

Current EQ Rating*	Previous EQ Rating
4-	na

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

We initiate earnings quality coverage of F with a rating of 4- (Acceptable) indicating acceptable but possibly worsening quality.

Overall, we see very little to be alarmed about Ford for accounting quality reasons, presentation, or using accounting techniques to pad results. Inventory levels are up and the company is picking up some pricing via hyper-inflation from South America. However, the valuation is only 6.8x trailing EPS with a yield of 6.7%. Also, the dividend only consumes about 27% of trailing 12 months free cash flow and Ford is not devoting cash flow to repurchasing shares.

We do think investors may want to monitor incentive levels changing per vehicle and whether Ford's low valuation based on earnings is due to a high percentage of sales of trucks as evolving government standards on safety, fuel economy, and emission levels may work against trucks and unwind some operating leverage in margins. At this point, the balance sheet is strong and many of the rising costs can be absorbed. However, if some of the potential risks hurt sales much, the income could start to fall quickly. So, while we see the balance sheet and low valuation as cushions, there is a significant risk that Ford is downgraded to a 3 or even a 2 rating:

- Debt and liquidity look strong at Ford. The Auto unit has a net cash position even assuming the entire pension is funded.

- The pension underfunding is minor and the cash funding is expected to come in at only $650 million this year. Ford did get a modest boost to income of about $150 million by increasing the discount rate to compute obligations but lowering the rate to compute interest cost and service cost last year.

- Ford Credit is near the low end of the target leverage ratio. Over 30% of loans are very short term to dealers with strong credit ratings. Only half total loans extend beyond one-year. Ford Credit also has a large cash position. Bad debt figures are very low and improving.

- JV exposure has been costing the company earnings of late, but much of that is non-cash. Despite a decline in income of over $1 billion in recent years, the maximum exposure to covering debt for Ford is only $237 million.

- We are not concerned with trade receivables but do think inventories are higher than normal after growing faster than sales for several quarters. Margin pressure could be a risk in this area.

- Accrued liabilities from extended service contracts, warranties, other non-cash expenses have helped add over $1 billion per year to cash flow of late. These are not an issue except, this source of cash flow may decline if sales drop.

- The forthcoming changes requiring lower emission levels, lower CO2 levels, higher gas mileage by the federal government, California, and Europe through the year 2025 – could be a problem for Ford. Many of these goals would be difficult to navigate while selling trucks and SUVs which is 81% of US sales. Ford specifically states that bigger vehicles generate greater profits. The different standards can also mean more parts, different engines, different fuels and the building of multiple versions of the same car. All of that may cost more money per unit as well as require higher selling incentives to entice people to buy some of those models.

- We already seeing evidence that many costs that would be tied to these various new regulations are already rising faster than sales such as R&D, subsidized interest expense, subsidized residual values, and warranty payments. We think that is why the Auto unit is seeing a squeeze on operating profits already.

- Investors may also want to focus on how much higher pricing has helped in recent years. Ford has boosted prices, especially in the US to offset rising costs. Those costs include steel and tariffs, but also labor and warranties. Pricing was slow to pick up and lagged the economy and may lead commodities down if costs actually do retreat. However, we doubt that Ford would see much decline in labor or warranties. Most importantly, even with higher volumes and pricing – they still have not fully offset the higher costs or FX losses.

Overall Debt and Liquidity of the Balance Sheet Looks in Great Shape

While Ford has three main units, we are going to focus on automotive and credit as the far and away dominant areas compared to mobility. In that regard, the automotive unit supports its own operations and the others. It actually as a net cash position even assuming it had to pay all pension underfunding:

Ford Auto	2Q19
Cash	$9.4
Securities	$13.7
Financed Debt	$14.0
Net cash	$9.1
Pensions	$5.7

We should add that the pensions are only underfunded by 6% in the US and 12% in the rest of the world. A minor tick against Ford, the US plans saw an increase in the discount rate to compute Pension Benefit Obligations last year from 3.60% to 4.29%, that helped some. Plus, the company cut its discount rate to calculate service cost and interest cost at the same time. That saved it about $150 million in pension cost last year. The non-US pension liabilities are being calculated on a 2.48% discount rate, so that explains some of the underfunding there. Pension expense is sometimes even income in recent years and the company expects to contribute $650 in cash in 2019. Pensions do not appear to be a problem.

Ford Credit has a leverage ratio of 8.3x at this time – toward the low-end of the 8-9x range Ford targets. Ford Auto has agreements to provide more capital to Ford Credit if the leverage ratio exceeds 11.5x and maintain a minimum equity balance of $500 million. Ford Credit also has access to $3 billion of credit on Ford's credit lines if necessary.

A high percentage of Ford Credit receivables are to dealers to finance inventory for short periods of time and the credit quality is strong with 95% of lending focused at Ford's best credit dealers. Other assets at Credit are loans and leases to consumers with terms generally 3-5 years and are secured by the car or truck.

Ford Credit	**2Q19**	**4Q18**
Dealer Loans	$33.9	$34.4
Consumer Loan	$74.2	$76.1
Allowance	$0.5	$0.6
Net Loans	$107.6	$109.9
Short term	$53.8	$54.4
Long term	$53.8	$55.5

Ford Credit also has $14.9 billion in cash and securities on hand. We will also note that many loans are securitized but Ford keeps them on the balance sheet. Of the dealer loans shown above, $25.9 billion have been securitized and consumer loans have $39.3 billion in securitizations now. It may be possible to complete more securitizations if needed to raise additional cash.

The bad debt reserves are 0.5% of receivables and the total past due is only 0.8% with the bulk still under 60 days. The problem loans are actually decreasing slightly. One could make the case that, loan losses are likely to move up more than down – however, even back in 2010, the loss reserves were 1.0%.

Finally, joint ventures have seen income drop considerably in recent years. In 2018, the income fell $1.29 billion to become a loss of $110 million. In 2016 and 2015, the JVs were earning about $1.4 billion. While that is often non-cash earnings and that impact EPS, Ford lists the maximum loss potential it would have to pay for JVs is $237 million as of 12/31/2018. The drop in income is sizable, the potential loss looks more than manageable.

Working Capital Bears Some Watching

Inventories are higher in dollar terms of the last two years and have also added 5-6 days of COGS over that time:

Ford Inv last 4Qs	2Q19	1Q19	4Q18	3Q18
Inventory	$12.4	$12.3	$11.2	$12.8
DSI	33.7	33.2	30.7	34.5

Ford Inv prior 1 yr	2Q18	1Q18	4Q17	3Q17
Inventory	$12.6	$12.4	$11.2	$11.3
DSI	34.5	31.6	36.0	31.6

Ford Inv prior 2 yr	2Q17	1Q17	4Q16	3Q16
Inventory	$11.1	$10.5	$8.9	$10.2
DSI	28.5	27.5	31.3	28.4

We think this area is a concern as sales have started to turn down and inventories, while slightly lower, have not declined too much:

	2Q19	1Q19	4Q18	3Q18	2Q18
Sales y/y chg	-0.2%	-4.1%	6.8%	3.3%	-2.3%
Inv y/y chg	-1.0%	-0.3%	0.4%	13.7%	13.3%

This looks like an obvious place to expect some margin pressure as inventories have been growing faster than sales for some time and DSIs are inflated.

We do not see much reason for concern in Trade Receivables. There was a slight pick up as the economy gained strength and that appears to have leveled off now.

Ford A/R last 4Qs	2Q19	1Q19	4Q18	3Q18
Receivables	$10.9	$12.0	$11.2	$11.2
DSO	25.7	28.9	23.1	27.2

Ford A/R prior 1 yr	2Q18	1Q18	4Q17	3Q17
Receivables	$11.0	$12.4	$10.6	$10.3
DSO	25.9	28.5	23.4	25.7

Ford A/R prior 2 yr	2Q17	1Q17	4Q16	3Q16
Receivables	$10.2	$10.7	$11.1	$10.0
DSO	23.3	24.9	30.3	23.7

Another item that is worth watching is accrued liabilities:

Work Cap Change	2018	2017	2016
Trade Rec.	-$2.4	-$0.8	-$1.4
Accts Rec.	-$2.2	-$2.3	-$2.9
Inventory	-$0.8	-$1.0	-$0.8
A/P & accruals	$6.6	$6.1	$6.8
Total	$1.1	$2.0	$1.6

We would expect payables and inventory to move in tandem and they are. But Ford is also routinely picking up over $1 billion in cash from operations from accrued liabilities. Some of this related to selling warranties and extended service plans. Others can be related to reserve allowances that aren't cash expenses. These are legitimate items and there is nothing wrong with the accounting procedures. However, that is an area that could reverse quickly if sales drop and more claims are paid than new warranties/service deals sold for example and hurt cash flow.

Some Risk Factors that Are Worth Watching

We want to discuss some areas of the income statement that may be under pressure from various government actions. This section will be a quick primer on several trends that are times working against each other and could result in Ford having more problems and higher costs related to vehicle design, having to create more models of the same vehicle, offer more incentives essentially pressure sales and margins. We will admit that often we are a bit jaded about risk factor sections as some companies report items with some absurd risks with very minor possibilities of occurring such as "If the world-wide power grid goes down or all world trade stops – we could face difficulty in manufacturing or selling our products."

In the case of Ford, some of the risks we found have timeframes in the next 5 years and could have big impacts on Ford's inventory line up and manufacturing costs:

- There are different standards on emission levels allowed by the Federal Government and the State of California, with California being tighter than the Federal rules. There are other states that have matched California's standards as well. Both sets of standards are currently set to get tougher annually through 2025.

- California wants 15% of vehicles sold in the state to be Zero Emission by 2025 – meaning battery/electric cars instead of gasoline/diesel.

- The European Union has another set of CO2 emission standards that will also tighten in the near future. These may require more equipment to be installed on new cars to treat exhaust and can wipe out the cost advantage of diesel over gasoline.

- The EPA has a rule in place for a 50mpg standard for 2025 models and California may want to set its own standard here too.

- At the same time, there are federal safety laws requiring vehicles meet higher safety tests.

There are a number of problems for Ford as these laws are tightened and enforced. Reducing emissions can mean smaller engines and thus smaller cars. Higher mileage also normally means smaller cars with smaller engines and less weight. The problem is bigger cars – especially trucks is where Ford makes its income. The company notes this is in the 10-K also:

> *"Our financial results depend on the profitability of the vehicles we sell, which may vary significantly by vehicle line. In general, larger vehicles tend to command higher prices and be more profitable than smaller vehicles, both across and within vehicle segments. For example, in North America, our larger, more profitable vehicles had an average contribution margin that was about 140% of our total average*

contribution margin across all vehicles, whereas our smaller vehicles had significantly lower contribution margins."

Here were Ford's 2018 US sales by vehicle type – 46% trucks and 35% SUVs:

US Units (000s)	2018
Trucks	1,139
SUVs	872
Cars	486
Net Loans	2,497

Also, if factories have to be changed more frequently to make different parts and assemble different versions of the same vehicle – a gas-powered version, diesel-powered version, a hybrid version, an electric version and each may require different tweaks to chassis, and body design or many different parts – they will cost more to build. Plus, Ford has to estimate the demand for each one. One version may sell out, another may be ignored requiring Ford to ramp up sales incentives and discounts to move the vehicles and thus total sales in dollars declines while total costs rise.

We think with the emphasis on the 2025 models and we have the 2020 models out now – there will continue to be more discussion and focus on what these new rules may do to Ford's margins. Some rough sensitivity analysis – If Ford lost $500 per US vehicle in a combination of higher costs and higher sales incentives – it would cut income for US auto operations by $1.25 billion. All of North America's auto operations for Ford had $7.6 billion in income last year.

Some Components of Contra-Sales and Costs Already Rising Faster than Sales

Auto Sales	2018	2017	2016	2015
Sales	$148.3	$145.7	$141.5	$140.6
Growth	1.8%	3.0%	0.6%	

If the company has to do more engineering and add more parts and new technology, to meet new government standards – that costs more in R&D and already is:

	2018	2017	2016	2015
R&D	$8.2	$8.0	$7.3	$6.7
Growth	2.5%	9.6%	9.0%	

Newer parts may break and do not have a history of operation. Also, additional parts added to cars may break and need to be repaired. We do not have an issue with how Ford accrues for warranties, which normally exceeds payments. But notice how the payment of claims is rising:

	2018	2017	2016	2015
Warranties	$4.4	$3.5	$3.3	$2.8
Growth	26.1%	5.2%	15.3%	

Then, less desirable cars often need incentives to move them. This can be cash-back offers or discounts. It can also mean 0% financing. Plus, cars that need incentives to be sold at retail, often have lower values later on. Ford accounts for actions here as reductions to sales. Again, we do not have a problem with their accounting there. We found two sets of numbers that show support payments to Ford Credit to pay for discounted interest rates on loans and support higher residual values to lower the monthly payment to consumers. We want to be clear, reporting both sets of numbers maybe double counting – but we are more concerned with the growth rate:

Incentives	2018	2017	2016	2015
Paid to F. Credit	$6.8	$6.1	$5.3	$4.5
Growth	11.5%	15.1%	17.8%	

Incentives	2018	2017	2016	2015
Int. Subsidy	$2.4	$2.0	$1.6	$1.3
Growth	20.0%	25.0%	23.1%	
Depr. Subsidy	$2.4	$2.1	$1.9	$1.5
Growth	14.3%	10.5%	26.7%	

Is Ford Overly Dependent on Taking Pricing?

Just looking at the recent results, Ford has been boosting prices in response to rising materials costs, losses on FX and falling income from JVs. This is a bit further than an EQ report normally goes, but we were curious just how exposed Ford may be on income if they simply cannot sell so many trucks in the US. We're just thinking bigger picture here:

Y/Y EBIT Stats	2Q19	2018	2017	2016
US Pricing	$445	$425	$175	-$334
ROW Pricing	$400	$1,546	$420	$277
US Volume	-$128	$1,587	$264	$28
ROW Volume	$105	-$555	$396	$624
Total P/V	**$822**	**$3,003**	**$1,255**	**$595**
Costs	**-$367**	**-$3,965**	**-$1,887**	**-$1,258**
FX	-$245	-$409	-$811	$81
JVs	$4	-$1,291	-$523	$0

Ford can certainly argue that materials costs are up and tariffs add to that. Much of the cost increases are higher warranties as we outlined above and commodities. Plus, FX has been a bigger issue of late too. We agree that if the economy slowed – it should lower commodity prices and perhaps FX will recover too – but we doubt labor and warranties decline very much. Plus, if pricing couldn't offset higher costs amid increasing demand – wouldn't pricing lead the way down too and fall more than commodities?

It just looks to like much of the pricing is coming from the US (and South America of late). It was a good year for volume in 2018, but it didn't last long. Cost increases are routinely exceeding the benefits of higher pricing and volumes. In 2016, the reason pricing was negative in the US was incentives exceeded price increases.

There may be more operating leverage to the downside than to the upside if commodity prices retreat again.

MOWI ASA (MHGVY) 2Q19 Update
Maintain BUY

We are maintaining our BUY recommendation on MHGVY. The company beat on revenue and missed on EPS by €0.01. The stock is trading on what we still see as depressed EPS (19x) and depressed EBITDA (13x). The yield is 4.7%. The company is targeting an optimum debt level of €1.4 billion vs. the current €1.1 billion. So, it may still raise €300 million in external capital going forward and has the credit lines in place. This appears likely to support some higher working capital investment that the company is forecasting along with higher volumes and demand. If it does, the target level for Debt/EBITDA on current figures would only be 1.4x.

The company's dividend is €550 million per year and maintenance capital spending is about €180 million per year, so cash from operations needs to top €730 million. On a trailing twelve months, it is €738 million plus €21 million in dividends received on investments and that is after paying 84% of expected cash taxes for the year in the 1H19. We believe there are several levers to move cash from operations significantly above that figure. In looking at 2Q19 results, we see solid growth in volumes, some new operations have come online, and demand growth continues. There should be some pressure on pricing in some areas of the business during the 3Q. However, long-term growth in demand appears to set Mowi up for better pricing and volumes at the same time several new areas of growth investment are targeting better cost control.

In updating several of the catalysts and issues we highlighted in the original report, we see the following from 2Q19:

- **Demand growth continues in nearly all key places. The EU is the largest market and grew 3.6% y/y for the last 12 months. The US is the second-largest and half the size of the EU and grew at 5.3% for the last 12 months.** Russia and China are seeing growth slow – but in the case of Russia – it often loses out to higher bidders on price for salmon and China/Hong Kong issues appear to be impacting demand there now. Also, China is a market that is tied to purchasing very large fish. **The net result appears to be that world demand is still growing faster than recent supply growth** and the increase in supply going to value-added product should also offset supply going to traditional fresh salmon markets.

- **Supply has been restrained for 2017 and 2018. 2019 is seeing some recovery, at 4%-7% growth and the industry is looking at 4% in 2020.**

- **Mowi is taking share with volume growth 26% in 2Q19, guidance for 3% growth in 3Q and 8% in 4Q.** Mowi has bought more licenses in Norway, enjoyed Norway's regulator boosting growth quotas on existing licenses, and is planning to develop more.

- **Pricing on salmon moves inversely with supply growth and in tandem with fish size, yet Mowi saw minimal pricing contraction in posting its highest 2Q EBIT ever. It is guiding to some areas of weaker pricing in 3Q** based on earlier harvesting, which means smaller fish. That is a common event in a few areas in any given quarter and seldom broad-based.

- **Mowi continues to invest in improving pricing and reducing costs.** Its new capacity for fish feed in Scotland opened in 2Q and boosted capacity at Mowi from 520 tons to 590 tons – that will control costs. It continues to invest in growth for more freshwater fish raising pens to reduce parasite issues, more seawater pens to boost volume, and more consumer product capacity to increase prices.

- **Cash flow should continue to improve.** This year, Mowi is expecting to invest €115 million in working capital to support growth, over €100 million in growth capital spending, higher volume should help, and of the forecast for €160 million in tax payments, it already paid €135 million in the 1H19.

- **The NOK is still almost 9-to-1-against the dollar, which remains a catalyst should it recover to 7-8 NOK-to-USD but still below the historic 5-to-1. The salmon market will always be volatile quarter to quarter** and vary by region. However, the long-term growth remains well-founded.

Demand Growth Continues and Moves Up with Supply

Mowi has 20% of the world farmed-salmon market based on its 430,000 tons of volume against the industry's 2.2 million. Industry demand growth was over 6% for 2Q19 and just under 5% for the last twelve months. Salmon is still a luxury product and two years of poor industry supply growth caused the market to move supply away from less lucrative markets.

Demand Growth	% of Mrk	3m y/y	12m y/y 2Q19	12m y/y 2Q18	12m y/y 2Q17	12m y/y 2Q16
Eur. Union	44.0%	7.8%	3.6%	4.4%	-6.5%	2.0%
USA	20.0%	3.3%	5.3%	11.6%	-4.9%	10.4%
Asia	13.1%	4.7%	1.5%	16.0%	-3.5%	7.1%
World	100.0%	6.4%	4.7%	8.6%	-6.7%	2.6%

As the supply has recovered, many areas denied salmon have seen a surge in demand growth such as Eastern Europe moving from 3.5% growth in the last 12 months to 11% for 2Q or non-China/Japan/Korea Asia moving from -6.4% to 14.4% in the trailing 12 months to 2Q19.

	3m y/y 2Q19	3m y/y 2Q18	3m y/y 2Q17	3m y/y 2Q16
Supply Growth	8.3%	5.2%	3.9%	-8.8%

The supply growth is expected to be about 5.5% this year and 4% next year according to forecasts supplied by Mowi. It still looks like demand growth is stronger than supply increases.

Mowi Is Taking More Share

As Chilean volume has recovered at Mowi, it has seen 2019 pick up much faster than the industry as a whole. Mowi volume is up 26% y/y in 1H19 and guidance is for 3% y/y in 3Q and 8% for 4Q19. We do not see the 3Q estimate as an issue. The 3Q18 was the highest volume quarter last year and Mowi's toughest comp:

Mowi Vol	4Q	3Q	2Q	1Q
2018	105.8	109.9	78.3	81.2
2019	114.4e	113.0e	98.0	104.1
y/y Growth	8.1%e	2.8%e	25.2%	28.2%

Even with the higher supply, pricing held strong compared to all-time highs in 2Q18. Market spot prices were only about 10% lower y/y. Plus, Mowi sells part of its supply with longer-term contracts that use average prices over time and smooth out spot price changes. Normally, when pricing is rising, the contract prices lag and vice versa. Plus, Mowi continues to produce a very high percentage of superior quality salmon which helps on pricing. The result is pricing against the market stays strong for Mowi and improved y/y:

Mowi 2Q Pricing	Norway	Scotland	Canada	Chile
2018	91%	97%	96%	91%
2019	100%	108%	99%	100%

It should still grow much faster than the industry. Mowi expanded its licenses in Norway in 2018, it also had Norway award higher biomass per pen that should add about 2% supply in Mowi's largest market. The company bought four more licenses in Norway during the 2Q that will add about 4% more its total there.

During the quarter, Mowi was awarded 5 of the 6 licenses for a new fish pen concept. Later, it sought to lower the cost by building it with steel and Norway's regulatory agency didn't approve the design change. That's in limbo now and the reason for the design change was to lower the total cost of the operation. We know nothing more than that from the call – but this doesn't sound like the biggest hurdle to overcome in our view. Plus, Norway is still forecasting that it will more than double its total supply over the next decade.

The company did guide that it has harvested smaller fish in 3Q from parts of Norway. Smaller fish size normally means lower selling prices and the smaller fish didn't leverage the fixed costs as much as larger fish do. Thus, it guided to a higher cost/lower price situation for 3Q in Norway. That will impact volume in 3Q too.

Mowi Is Still Investing to Reduce Costs and Improve Volumes

Maintenance capital spending is €180 million and Mowi will spend €290 million this year. It completed the new feed operation in Scotland in 2Q which boosts feed volume capacity from 170,000 tons to 240,000. Mowi now has feed capacity of 590,000 tons. Producing its own feed helps control costs and also enables the company to show exactly what the fish ate throughout its life. That helps boost selling prices and produce more contracts with customers.

It is also spending money this year to build more freshwater raising pens. This lets the fish grow larger and stronger before they face exposure to health issues like sea lice in salt water.

That reduces the cost of treatment for lice, and treatment methods can also cause fish to eat less and grow more slowly.

Mowi is rebuilding a new smoked salmon facility too that will boost its supply of Value-Added consumer products. That should help on pricing and remove some more of the market swings from salmon pricing from the equation. With new licenses, new plants adding to volume, the company also anticipates growing its working capital to support more organic growth.

Cash Flow Should Improve

Cash flow is largely a function of volume and pricing producing income. EBITDA is rising in 2019 as a result and that is helping drive Cash from Operations. As noted above, volume should come in higher in 3Q and 4Q both y/y and against 1Q and 2Q. Importantly, Mowi is guiding to €160 million in cash payments for taxes in 2019 – it has already paid €135 million in the first half.

Mowi Cash Flow	2Q19	2Q18	1Q19	1Q18	2018	y/y chg
EBITDA	€248.0	212.8	233.2	194.8	906.2	€73.6
taxes paid	-81.8	-53.3	-53.1	-50.5	n/a	n/a
CFO	€155.7	112.8	265.8	191.8	620.9	€116.9

Working capital typically rises considerably in 4Q and gets released in the 1Q. With the company pointing toward €115 million of increased working capital, that is a strong headwind after having working capital generate about €21 million in cash in the 1H19. It should boost EBITDA at the same time:

Seasonal W/C chg	4Q	3Q	2Q	1Q
2019			-29.6	51.0
2018	-124.9	-18.0	-43.2	38.5
2017	-99.9	-71.9	-3.0	59.6

In our view, the EBITDA is already growing and that should continue. Working capital normally rises in 3Q and 4Q and having most of the cash taxes already paid in 1Q and 2Q should also cushion that working capital growth as cash from operations has already risen in the 1H19 despite those higher payments.

Other Issues Pressuring the Stock Should Eventually Ameliorate

We noted in the original report that the company does a large percentage of its business in Euros and US Dollars. Results are reported in Euros. However, the stock trades in Oslo in Norwegian Krone. The exchange ratio between the NOK and USD remains near the extreme low of 9 to 1 and actually has weakened a bit since July. We still see this as a function of forecasts of future oil prices as that is a large part of the Norway economy. We still believe given that oil prices are over $20 off the lows – the pricing of the NOK remains out of line and it could appreciate a bit to help drive the stock price in dollar terms.

Mowi continues to move forward with its consumer products business. This is smoked salmon, pre-cut frozen filets, packaged fresh sushi as examples. There is pricing pressure in some of the European markets as supply has increased. We believe the market will absorb the supply increase and other markets in Europe also start to accept more product such as Russia. In the US, we still see consumer products as being very early in the roll-out stage for Mowi and it should become much larger than Europe overall. That could be a large source of growing demand for premium-priced products.

With the moving parts of new facilities coming online, the supply of salmon growing modestly faster or slower than demand at times – we're more focused on the total rate of growth here and the fact that Mowi is the largest player in this industry and is well-capitalized to support its growth and efforts to reduce costs than we are on EPS of €0.29 or €0.28 in any given quarter. The larger trends should drive EPS for several years to come in our view and the forecasts show that health trends, the age of the world population with higher incomes, and the flat to down volumes for wild salmon – the demand for farmed raised salmon is expected to double or triple in the coming decade. Plus, it would remain a very modest part of overall diets. It doesn't need to become coffee with the bulk of the population having 5 servings per day. Boosting US per capita consumption by 0.5kg per year would be a huge surge in demand. (When other food companies are planning to put pot in food to fill higher demand – it shouldn't be that difficult to get more people to eat an extra piece of salmon.)

In the meantime, the company pays a 4.7% yield and expects to pay a minimum of 75% of free cash out to shareholders as dividends.

Becton Dickinson (BDX) EQ Update - 6/19 Qtr.

Current EQ Rating*	Previous EQ Rating
4-	4-

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

We are maintaining our earnings quality rating at 4- (Acceptable)

BDX's adjusted EPS of $3.08 beat the consensus estimate by 2 cps in the 6/19 quarter. We did not see any major red flags in the quarter, although the timing of discrete tax items and a significant boost from lower pension expense did call into question the quality of the earnings beat in the quarter.

The Bard acquisition has been lapped for the last two quarters, but results are still being impacted by one-time charges associated with integrating the acquired operations. We do not like the add-back of amortization of acquired intangibles, but this is an industry norm the market accepts. We will be doing more work analyzing charge-adjusted results going forward.

- Management did note in the conference call that the effective tax rate of 12.8% was lower than its full-year guidance of 14%-16% due to the timing of discrete items. However, it also stated that these items were anticipated and included in their full-year guidance of effective tax rate which did not change. For someone modeling a 15% tax rate going into the 6/19 quarter, the lower rate would have boosted EPS by about 8 cps. This benefit would reverse in the upcoming 9/19 quarter should the full-year rate forecast hold.

- Pension expense declined by $9 million (2.5 cps) due to lower service cost and the absence of a $4 million settlement charge last year.

- We note that like virtually all medical and technology companies, BDX elects to add back all amortization of acquired intangibles to its adjust non-GAAP earnings figures. The Bard acquisition makes this a huge number for BDX. The $3.08 in adjusted EPS in the 6/19 quarter included a $1.38 per share add back from purchase accounting adjustments which was essentially all amortization of acquired intangibles.

Roper Technologies (ROP) EQ Update - 6/19 Qtr.

Current EQ Rating*	Previous EQ Rating
4+	4+

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

We are maintaining our earnings quality rating of 4+ (Acceptable).

- Accounts receivable days of sales increased 2.2 days over the year-ago second quarter. Likewise, unbilled receivables jumped by 1.5 on a days of sales basis. These were both likely impacted by the acquisition of Foundry. However, we note that the acquisition occurred early in the quarter (April 18th) so our calculation utilizing quarterly would have included most of the quarter's revenue thus minimizing the impact of the acquisition.

- Nevertheless, our concern with the increase in trade and unbilled receivables is reduced by the fact that contract liabilities and deferred revenues rose by 6 days on a days of sales basis over the year-ago quarter. As such, we do not see any red flags surrounding revenue recognition in the quarter.

- We do note that like most acquiring companies in technology-intensive industries, ROP chooses to add back the amortization of acquired intangibles to adjusted non-GAAP EPS. For the 6/19 quarter, the $3.07 of non-GAAP EPS included 65 cps acquired intangible amortization added back.

Danaher (DHR) EQ Update - 6/19 Qtr.

Current EQ Rating*	Previous EQ Rating
4-	4-

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

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

DHR topped the consensus target in the 6/19 quarter by 3 cps. We saw no significant red flags regarding earnings quality in the period.

- A lower tax rate from discrete items added 2 cps to earnings in the quarter, but to the company's credit, it adjusted that amount out of its non-GAAP numbers.

- Revenue recognition trends remain acceptable with DSOs up only 1 day, unbilled receivables down, and customer deposits/billing in excess of recognized revenue days stable.

- However, the company also continues to add back amortization of acquired intangibles to its non-GAAP results. The non-GAAP EPS of $1.19 included $0.24 of added back amortization of acquired intangibles. This is a typical adjustment, but it overstates adjusted results by not taking into consideration the price the company paid for its acquisitions which are a significant part of the growth strategy at DHR.

- On the subject of acquisitions, the company continues to expect the GE Biopharma acquisition to close on the 12/19 quarter. It has already raised $3 billion with the March offering of common stock and mandatory convertible shares and plan to raise an additional $18 billion in debt to fund the deal.

- Likewise, DHR is still on track to conduct an initial public offering of its dental business which is now referred to as the Envista IPO.

Air Products & Chemicals (APD) EQ Review-6/19 Qtr.

Current EQ Rating*	Previous EQ Rating
4-	4+

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

We are lowering our earnings quality rating on APD to 4- (Acceptable) from 4+ (Acceptable).

APD beat estimates by 4 cps in the 6/19 quarter. However, given the material beneficial swing in other income and the material benefit from lower pension expense, our view of the quality of the earnings beat was diminished.

- On the surface, inventory DSIs jumped by more than 6 days versus a year ago. However, this was influenced by a change to 100% FIFO inventory accounting as well as the modification of a hydrogen supply contract to a tolling arrangement in India under which the company no longer records the cost of goods sold. We are not currently concerned by the inventory level.

- Pension expense fell by 2.6 cps in the quarter largely driven primarily by lower amortization of actuarial loss in the international plans. We view this as a non-operational tailwind that will fade in upcoming quarters.

- Other income experienced a positive 3.2 cps swing primarily due to positive foreign currency impacts. Hedging gains reclassified from AOCI actually declined, indicating to us that these gains were likely related to foreign currency contracts not designated as hedges which the company uses to hedge working capital amounts.

- Adjusted operating margin jumped by 270 bps but we estimate about 80 bps of that was due to the modification of the contract in India to a tolling arrangement which reduced sales but had no impact on profits. The remainder of the increase was due to especially positive pricing.

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.

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