BEHIND THE NUMBERS

EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

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Contents

Conagra Brands – 1Q '20 Maintain SELL

We are maintaining our SELL on CAG after F1Q20 results. The company beat forecasts on EPS, but it misses a fair amount of the time too and often does on revenue like it did again last quarter. **After last quarter, we think investors should be concerned with the inventory levels rising above historic levels at the same time they are posting negative sales growth** in many key product lines. The three main parts of the Pinnacle Foods acquisition have all posted sizeable sales declines since being acquired by CAG and weakness in the Legacy CAG brands continued through 1Q too.

The bull case for CAG is that it will boost sales with higher prices, gross margin as it culls lower margin products and invigorates brands with new products, and operating margins with cost-cutting. A year before the Pinnacle deal and now a year after the Pinnacle deal – we are seeing scant evidence that this blueprint is at work beyond a couple of quarters when matched against a very weak comp the year before.

- Value over Volume has led to 0% or negative change in volume five times in the last eight quarters.

- Gross Margin is not rising either – it has not been higher y/y the last 5 quarters in a row, and had two modest increases of 20bp in F2018 sandwiching quarters of -160bp and -100bp.

- The most common reason given on the last call for better sales growth in the future was easy comps will be key.

- All three main units of the Pinnacle deal and three of Conagra's main brands have all shown problems of late in losing market share and large drops in sales. This is not a simple cost-cutting program anymore – CAG has to rebuild major sources of revenue.

- Inventories jumped in 1Q20 to very high levels. Even dealing with seasonality, DSIs look at least 10 days too high. We do not believe this is related to inflation as raw materials DSIs are flat.

- CAG is still selling heavily to discount retailers – yet it needs to move extra volumes in our view and wants to boost prices. This looks like an area for disappointment next quarter.

- The cost-cutting efforts of late do not look sustainable to us. The bulk if not more than 100% of cost-cutting in recent quarters has come from reductions in advertising and stock compensation. The company announced that it plans to ramp up marketing more and it is essentially done with headcount reductions.

Where are the Results for Value over Volume?

The goal that CAG always discusses is Value over Volume. It is willing to concede lower margin sales in return for better pricing. The price hikes should also drive up gross margin. However, isolating the Legacy CAG organic growth figures – this is not happening beyond shedding volumes:

CAG	1Q20	1Q19	1Q18
Volume	-2.5%	0.0%	-5.3%
Price/Mix	0.8%	1.2%	2.3%
Organic Growth	-1.7%	1.2%	-3.0%
Gross Margin chg.	-30bp	-60bp	+26bp

For the last three first quarters, CAG has seen at best flat volumes and gross margin pressure. In the last eight quarters, volume has only been positive twice. On top of that, the only time pricing offsets the poor volume is when they match against a big negative the year before. The company cannot even post a positive y/y figure against a 2% comp:

Legacy CAG Vol. Chg.	4Q	3Q	2Q	1Q
F 2019	-1.2%	1.2%	-2.2%	0.0%
F 2018	-0.1%	-2.8%	1.7%	-5.3%

Legacy CAG Organic Chg.	4Q	3Q	2Q	1Q
F 2019	-0.7%	1.9%	-1.6%	1.2%
F 2018	2.0%	-2.2%	2.3%	-3.0%

The problem we see is there is little evidence that the higher prices are driving margins higher at all. Losing 50-100bp of gross margin against flat to negative sales doesn't grow earnings. Also, their touted goal is to shed low margin business. Look at 2018 before the Pinnacle deal – CAG was taking much greater hits in gross margin against flat sales.

Legacy CAG Gross Margin Change	4Q	3Q	2Q	1Q
F 2019	-100bp	-20bp	-58bp	-65bp
F 2018	+20bp	-160bp	-100bp	+20bp

It is probably worth noting as well that throughout the last earnings call, when asked "what will actually help sales going forward?" – there were six mentions by management that they are counting on "easy comps" to help. That is not the real long-term solution in our minds.

Other examples of value over volume strategy in specific products also do not point to much success:

- In 4Q19, the company raised prices on Hunt's canned tomatoes and Chef Boyardee while store-brands did not. The result was sales dropped meaningfully with the higher prices – 50% of the organic sales decline in 4Q came here. In 1Q20, Hunt's and Chef Boyardee did not recover and 68% of the organic sales decline came here. Hunt's fell 10.7% and 8.9% y/y in the two quarters. Chef Boyardee fell 6.7% y/y in both quarters. What is the solution? Welcome to 1988 – they are going to hold higher prices and give out more "promotional support" to help drive volumes. After two horrible quarters, CAG thinks sales will return in the 2H of 2020.

- In 4Q19, CAG rolled out new Marie Calendar's products and boosted prices as competitors lowered prices. CAG saw sales fall 20%, the competitor grew sales by 75%. Guess what had no mention on the 1Q20 call? That's right, Marie Calendar's! CAG did continue to blame weakness in some of the frozen food on major retailer transitioning many of the frozen foods – which CAG considers temporary. To us, it sounds like CAG is part of that transition – with its goal to rapidly remade products. It also sounds like since it conceded market share to the competition, it's not the competition that's going to be given less shelf space in the near future. It caught our eyes too that the company made this comment in the last call, "We plan to build upon our category-leading position in frozen by introducing our strongest innovation slate to date throughout the balance of fiscal 2020…with premium, nutritious ingredients and increasing sustainability, all at **affordable price points**." CAG has been all about having higher prices to drive growth.

- Wish-Bone Salad Dressing was purchased by Pinnacle Foods in 2013. Pinnacle reported negative sales growth for Wish-Bone in 2015, 2016, and 2017. We know during 2018, CAG showed us Wish-Bone sales were falling more than 20% from 2017 levels with distribution down over 30% at times. In fiscal 2019, CAG showed Wish-Bone down 15%-20% against 2018's figures and finally after all these easy comps, Wish-Bone just posted a single quarter of basically flat results. In 2013, Pinnacle paid 3x the $190 million of sales at Wish-Bone. From the rough figures we have seen on its sales, it does not take much effort to ballpark sales at Wish-Bone are currently at $90-$100 million. And the plan is to fix this business by raising prices too?

- Duncan Hines and Birdseye were also key parts of the Pinnacle Foods deal. Both were showing declining and negative sales growth y/y before the deal and that has accelerated after the deal. At the time, CAG assured investors that what made this acquisition easy was Pinnacle had strong brands and there was no need to fix revenue – just cut duplicate costs. The first quarter of the deal saw significant revenue problems. Both brands have been posting negative growth rates for a year and that continues now. CAG has talked that it sees signs that they may stabilize in another two quarters and is talking about new products. In the meantime, the margins at Pinnacle continue to drag down CAG.

Inventories Point to More Gross Margin Pressure

As CAG continues to talk about its plans to boost prices, investors should remember that one-quarter of its sales are to Walmart. Kroger is another huge grocer that has been investing in lower prices for its customers. At the same time, while CAG also claims it wants value over volume – it has a considerable amount of volume to move at this time:

	1Q20	4Q19	3Q19	2Q19
Inventory	$1,755.7	$1,563.3	$1,638.6	$1,729.7
DSI	92.8	74.9	76.5	92.5

	1Q19	4Q18	3Q18	2Q18
Inventory	$1,108.5	$988.7	$1,016.7	$1,059.2
DSI	76.1	64.9	66.5	63.8

	1Q18	4Q17	3Q17	2Q17
Inventory	$1,068.8	$927.9	$1,046.4	$1,113.7
DSI	75.9	63.5	70.2	70.5

There is definitely some seasonality to the business and inventories are highest coming out of 1Q. Also, ignore the 2Q19, that was the quarter that included only a few weeks of Pinnacle Foods sales.

However, we believe inventories are running at least 10 days too high based on past results and a company that actively is working to maximize cash flow and digest an acquisition. Also keep in mind that at this point, no acquisitions have been made while CAG made three small divestitures: Del Monte's Canadian canned fruit/vegetables, Wesson Oil, and Gelit frozen pasta.

It also does not look like inflation in raw materials catching up – the growth is all in finished goods. Raw materials have held in the same 13-14-day range for two years.

	1Q20	4Q19	3Q19	2Q19
Raw DSI	13.9	13.1	13.1	14.2
Fin Gds DSI	67.0	52.5	51.5	63.1

	1Q19	4Q18	3Q18	2Q18
Raw DSI	13.1	13.3	14.0	12.3
Fin Gds DSI	53.7	42.5	42.3	41.1

While we expect higher inventories after 1Q, the current levels appear higher than normal. CAG is trying to sell higher volumes at higher prices to discount customers who want lower prices and have limited shelf space. We think this points sales pressure at CAG and more pressure on gross margins.

Conagra Also Touts its Cost Cutting Skills Too – We're Still Skeptical That the Cuts Are Sustainable

In the last four quarters, CAG has posted essentially no sales growth and lost gross margin in every quarter. However, the company is touting that its restructuring and cost-cutting are working well. Operating margins have been up for three of the last four quarters and more than offset the weakness in gross margins:

CAG Adj Op Margin	1Q20	4Q19	3Q19	2Q19
Adj Margin	15.7%	13.2%	16.3%	17.5%
Adj Margin Yr Ago	14.6%	13.9%	15.0%	15.7%
Y/Y change	1.1%	-0.7%	1.3%	1.8%

The problem we see is they are cutting advertising and have not booked as much stock compensation – which accounts for nearly all this improvement:

Advertising	1Q20	4Q19	3Q19	2Q19
Adv $	$45.3	$73.9	$67.4	$69.4
Adv $ year ago	$42.7	$59.5	$78.2	$86.0
Adv in bp	189	283	249	291
Adv in bp year ago	233	303	392	396
Adv cut bp	-44	-20	-143	-105

Stock Comp	1Q20	4Q19	3Q19	2Q19
Stock C. $	$10.2	$11.2	$3.8	$7.3
S/C $ year ago	$11.4	$11.2	$9.0	$9.5
S/C in bp	43	43	14	31
S/C in bp year ago	62	57	45	44
Adv cut bp	-19	-14	-31	-13

So, if we look at 3Q19, CAG reported adjusted operating margin was up 130bp, but it picked up 174bp from cuts to advertising and stock compensation. In 1Q20, more than half the 110bp improvement came from reduced advertising and stock compensation.

We doubt anyone should expect either of these cuts to continue. People like being paid, so we'd expect the stock compensation to rise again. At the same time, the company is touting that it will boost marketing across many channels – not just vendor investments that are accounted for as reductions to net sales.

We would expect head-count reduction after the merger to help some – and CAG announced on the call that is now substantially complete and do not expect much of a tailwind for margins in that area going forward.

Consumer Staples Industry Review -Part 2
Earnings Quality Comparison

In Part 1 of our review of the consumer staples group, we examined factors impacting the free cash flow growth and dividend growth sustainability of PG, CLX, KMB, CL, and CHD. In this part, we will do a direct comparison of the earnings quality of these companies.

We have covered each of these names in past earnings quality review (EQ Reviews). For an explanation of the EQ Review scoring scale, please see the end of this report. We will say upfront that we see problems with all of the companies in this group and would not consider any of them to be an enthusiastic BUY. However, for those clients who need exposure to the segment, we offer the following observations about the relative strengths and weaknesses of each to aid in decisions regarding relative position weights.

Clorox (CLX)

We view CLX as having the overall cleanest quality of reported earnings and cash flow characteristics comparable to the group in addition to having one of the highest dividend yields and growth rates. Based on our review of the 6/19 quarter, we raised our EQ Rating on the stock to 3+ (Minor Concerns) from 3- (Minor Concerns).

Positives:

- Recent cash flow growth jumps from 1.6% to 7% after adjustment from pension contributions.
- CLX's days payable are some of the lowest in the group at 52 making it less at risk for a backlash from suppliers and providing room for cash flow growth.
- A recent large buyback has boosted EPS growth but management has made no commitment to continue to spend beyond the dividend and free cash flow.

- CLX has not engaged in large, ongoing restructuring charges in recent years as have PG, KMB and CL.
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Negatives:

- Debt is manageable but has risen to 2 times EBITDA on recent acquisitions. Future acquisitions could compete with growing the dividend.
- The allowance for doubtful accounts fell from 1.2% of gross receivables to 0.6% during the fiscal year ended 6/19. This added about 2 cps to the full-year EPS growth.
- Inventory has risen some and management expects to work inventory down in the back half of the year. While there is a risk of a drain from discounting, this could also be a boost to cash flow growth.

Procter & Gamble (PG)

We currently have an EQ Rating of 3+ (Minor Concern) on PG.

Positives

- The company has one of the highest levels of R&D and advertising spending in the group and has large recent accruals for promotional spending.
- PG assumes a discount rate of 1.9% in calculating its pension liability which is one of the lowest we have seen. The company should be less exposed to a pension liability increase should interest rates continue to fall and benefit if they rise.
- Debt is only 1.1x EBITDA.

Negatives

- PG takes huge restructuring charges almost every year that regularly amount to 5-10% of adjusted earnings. This clouds the overall quality of the company's earnings given the possibility of lumping ongoing expenses into the charges.
- The company has stretched its suppliers more than any in the group with days payable approaching 115 days. This source of cash flow growth must be nearing an end and the company has an increased risk of a backlash from suppliers.

- The share buyback adds 3-4% to EPS growth every year but the buyback more than consumes free cash after the dividend. This is currently made up for by cash from exercise of stock options which is a low-quality source of cash.
- Inventory days jumped by 3 in the 6/19 quarter, but management attributed to new product launches. We are not overly concerned.

Colgate-Palmolive (CL)

We currently have an EQ Rating of 3- (Minor Concern) on CL.

Positives

- The dividend consumes 60% of free cash flow which is the lowest among PG, KMB, and CLX.

Negatives

- Like PG, restructuring charges are a regular feature in the company's results, reducing overall earnings quality.
- Inventory DSI jumped by 5 days in the 6/19 quarter with no explanation.
- Capital spending has been declining as a percentage of sales and management had further reduced forecasts for 2019 over the last two quarters. The estimated average age of PPE appears to be reasonable, but the boost to free cash flow growth should be seen as temporary.
- Research and development spending is one of the lowest in the group which could be a minor headwind should the company have to increase spending to remain competitive.

Kimberly-Clark (KMB)

Our review of the 6.19 quarter prompted us to lower our EQ Rating on KMB to 3- (Minor Concerns) from 3+ (Minor Concerns).

Positives

- While we hesitate to list restructurings as a positive, we do note that headline cash flow growth has been hit hard by the large cash restructuring payments in the last few quarters. As this subsides, KMB's cash flow should return and the dividend should go back to consuming a more industry norm mid 60%. The market should react well as that happens.

Negatives

- KMB is another serial restructurer which clouds adjusted earning quality.
- KMB's advertising spending as a percentage of sales is considerably lower than its peers. As the company struggles to post positive sales comps, we expect higher advertising spending and more aggressive promotional activity will be required.
- Inventory days jumped by 4 days in the 6/19 quarter which management blamed on supply chain restructuring. This is a reasonable explanation and we expect to see this reverse in a few quarters.
- As we noted in the cash flow review, days payables jumped by almost 7 days which provided a boost to cash flow growth. With DSP at 88, the company is not as aggressive as PG at stretching suppliers but we are skeptical this can continue to benefit cash flow growth.

Church & Dwight (CHD)

Our review of the 6/19 quarter prompted us to reduce our EQ Review rating to 2- (Weak) from 3- (Minor Concerns)

CHD does not compare well with this group as it is more dependent on growth through acquisition and thus spends more of its cash in that direction rather than paying a large dividend.

However, we also see several problems that are increasing our concern level with the stock

Positives

- The company does not have regular restructuring charges in its earnings.

Negatives

- We have noted before that the company's practice of factoring receivables with no quarterly disclosure and minimal annual disclosure erodes the company's quality of earnings.
- DSI jumped by 2.5 days despite the fact that the change to FIFO from LIFO has now lapped. Also, the company did not book inventory with the second quarter purchase of Flawless and is only recording the net cash received during a five-month transition period directly to sales. This should not impact the DSI calculation either.
- R&D expense has fallen as a percentage of sales the last two quarters.
- The company paid an upfront price of $475 million for Flawless but contingency payouts could go as high as $425 million. The company increased its estimated liability for contingency payments resulting in a 1 cps charge in the quarter which was adjusted out of non-GAAP earnings.
- The company disclosed in the 6/19 10-Q that it was reporting a 2 cps gain (adjusted out of non-GAAP EPS).

Restructuring Charges

Ongoing restructuring charges are always a significant item of concern given the potential for earnings manipulation. It is common for companies to undertake major reorganization projects which can include such activities as unusually large layoffs, plant shutdowns, and consolidations, asset write-offs or installation of new computer systems. These activities are designed to improve future profitability but involve large current charges and cash expenditures. These charges are usually classified as "one-time" charges on the income statement or at the very least added back to non-GAAP charge adjusted EPS. There are two major points of concern with this. From a conceptual viewpoint, analysts should not be quick to dismiss large charges as somehow not real expenses. They very often represent the cost of previous company misjudgments such as the write-off and divestiture of an ill-fated acquisition.

Second, from an earnings quality standpoint, restructuring charges give management a great deal of leeway into what get's included as a non-operational, one-time expense. For example, a company may claim that a large part of management's time was spent working on the restructuring and choose to classify a portion of management's pay in the period as a restructuring charge. When ongoing operating expenses are lumped into the charges, it can overstate the profitability of adjusted results.

Ongoing restructuring charges have been common in the consumer staples group for decades. We attribute this to the fact that this is an inherently slow growth, zero-sum industry with an increasingly more powerful customer base. One of the major drivers of growth is a company's ability to take share from its peers. Therefore, managements are forever looking for ways to push the idea of growth through cost reduction and conceivably are faced with the temptation to pass along to make results look as attractive as possible.

When assessing a company's restructuring programs, we examine several factors into consideration.

- Size- the larger the charge relative to reported income, the greater the chance that a material amount of ongoing expenses could have been included in the charge.

- Regularity- we are very skeptical of companies that take material restructuring charges almost every year. Investors should be asking why charges are being represented as "one-time" if they are happening all the time.

- The makeup of the charge- is there any indication from descriptions of the charge that operational items are being included?

The following tables show a breakdown of restructuring charges for the last three years as a percentage of adjusted net income for the last three years for each of the companies we are comparing.

Kimberly-Clark

Restructuring Charges

	6/30/2019	6/30/2018	6/30/2017
T12 After Tax Restructuring Charges	$467	$530	$16
T12 Cash Restructuring Spending	$309	$158	$20
T12 Non-GAAP Net Income	$2,303	$2,283	$2,165
T12 Restructuring Charges % of Adjusted Net Income	20.3%	23.2%	0.7%

For decades we have watched KMB regularly report large restructuring charges. When one restructuring program ended, it was not long before a new one was announced. The above table shows the relatively small 2014 Restructuring Program in 2017 which was quickly followed by the current 2018 Global Restructuring Program which the company describes as follows:

> *"The 2018 Global Restructuring Program will reduce our structural cost base by streamlining and simplifying our manufacturing supply chain and overhead organization. The program will make our overhead organization structure and manufacturing supply chain less complex and more efficient. We expect to close or sell approximately 10 manufacturing facilities and expand production capacity at several others. We expect to exit or divest some lower-margin businesses that generate approximately 1 percent of our net sales. The sales are concentrated in our consumer tissue business segment. The restructuring is expected to impact all of our business segments and our organizations in all major geographies. Workforce reductions are expected to be in the range of 5,000 to 5,500 . Certain capital appropriations under the 2018 Global Restructuring Program are being finalized. Accounting for actions related to each appropriation will commence when the appropriation is authorized for execution."*

The 2018 program is expected to be completed by the end of 2020 and result in 1.7-$1.9 billion in pretax charges. As the table above shows, the current amounts represent a whopping 20%+ of charge-adjusted earnings. This was an unusually large program for KMB, as the large pulp and tissue business restructuring in fiscal 2011 represented approximately 18% of adjusted earnings while the pulp restructuring and European strategic changes together amounted to about 16% of charge-adjusted earnings in 2012. The following table showing the impact of charges for the last ten fiscal years shows the extent to which material restructuring charges are an ongoing part of KMB's earnings:

KMB	Reported EPS	Restructuring	Adj. EPS
2018	$4.03	$2.24	$6.61
2017	$6.40		$6.23
2016	$5.99	$0.07	$6.03
2015	$2.77	$0.11	$5.76
2014	$4.04	$0.33	$5.51
2013	$5.53	$0.17	$5.24
2012	$4.42	$0.83	$5.25
2011	$3.99	$0.73	$4.80
2010	$4.45		$4.68
2009	$4.52	$0.00	$4.52

Procter & Gamble

Restructuring Charges

	6/30/2019	6/30/2018	6/30/2017
Total T12 Restructuring Charges (regular + incremental)	$754	$1,070	$754
T12 Cash Restructuring Spending	$468	$395	$619
T12 Pretax Incremental Restructuring Charges	$403	$725	$399
Incremental % of Total	53.4%	67.8%	52.9%
T12 After Tax Incremental Restructuring Charges	$354	$610	$279
T12 Non-GAAP Net Income	$11,877	$11,204	$10,732
T12 Restructuring Charges % of Adjusted Net Income	3.0%	5.4%	2.6%

P&G is another serial restructurer where "one-time" restructuring charges are a hallmark of reported results to the point that the company limits its adjustments to non-GAAP earnings to "incremental restructuring" charges. The company describes the process as follows:

> *"The Company has historically incurred an ongoing annual level of restructuring-type activities to maintain a competitive cost structure, including manufacturing and workforce optimization. Before-tax costs incurred under the ongoing program have generally ranged from $250 to $500 annually. In fiscal 2012, the Company initiated an incremental restructuring program (covering fiscal 2012 through 2017) as part of a productivity and cost savings plan to reduce costs in the areas of supply chain, research and development, marketing activities and overhead expenses. The*

productivity and cost savings plan was designed to accelerate cost reductions by streamlining management decision making, manufacturing and other work processes in order to help fund the Company's growth strategy."

While PG's non-GAAP EPS numbers only add back the amounts of charges considered "incremental", the company quantifies the entire restructuring charge which seemingly invites analysts to consider those somehow non-operational.

In addition, we view the practice of designating incremental charges while disclosing the total charge opens up a new level of potential manipulation. The table above shows total pretax incremental restructuring charges as a percentage of total restructuring charges. We regularly track this statistic for signs of the company classifying a larger percentage as incremental, thus benefitting non-GAAP earnings. The percentage declined in the 2019 period which reduced that concern for recent periods.

We also show above that incremental charges regularly run 3-5% of adjusted net income. However, an analyst adding back all of the restructuring charges would be boosted "operating" by roughly double that amount. The following table shows just PG's incremental restructuring charges per share have run between 2.8% and to more than 5% of adjusted EPS for 8 of the last ten years:

PG	Reported EPS	Incremental Restructuring	Adj. EPS
2019	$1.43	$0.13	$4.52
2018	$3.67	$0.23	$4.22
2017	$3.69	$0.18	$3.67
2016	$3.49	$0.18	$3.67
2015	$2.84	$0.17	$3.76
2014	$3.93	$0.12	$4.22
2013	$3.83	$0.18	$4.02
2012	$3.66	$0.20	$3.85
2011	$3.93	$0.00	$3.87
2010	$4.11	$0.00	$3.67

In terms of the composition of the charge, the charges have been split into roughly equal thirds between separations (employee severance), asset-related costs (write-downs) and "other." The "other" portion is a particular area of interest for the potential to containing charges that could arguably be deemed operating expenses.

Colgate-Palmolive

Restructuring Charges

	6/30/2019	6/30/2018	6/30/2017
T12 After Tax Restructuring Charges	$107	$171	$232
T12 Cash Restructuring Spending	$112	$240	$241
T12 Non-GAAP Net Income	$2,462	$2,632	$2,560
T12 Restructuring Charges % of Adjusted Net Income	4.3%	6.5%	9.1%

A final name from the consumer staple group that has logged a long history of regular charges is CL. The company's' Global Growth and Efficiency Program began all the way back in the fourth quarter of 2012.

> *"The Company's restructuring program known as the "Global Growth and Efficiency Program" runs through December 31, 2019 . The program's initiatives are expected to help the Company ensure sustained solid worldwide growth in unit volume, organic sales, operating profit and earnings per share and to enhance its global leadership positions in its core businesses. Implementation of the Global Growth and Efficiency Program remains on track and is in its final year .The initiatives under the Global Growth and Efficiency Program are focused on the following areas:*
> *▪ Expanding Commercial Hubs*
> *▪ Extending Shared Business Services and Streamlining Global Functions*
> *▪ Optimizing Global Supply Chain and Facilities"*

We note this is a particularly broad-based description as opposed to many plans that are specific to major divestitures or strategic initiatives. Total costs are expected to be $1.82-$1.87 billion. Note that this plan has been expanded multiple times. For example, estimated total charges for the plan as of the 2015 10-K were $1.285-$1.435 billion.

Categories within the charges include employee-related costs including severance and pension (45%), asset-related costs including incremental depreciation and impairments (55%), implementation costs resulting from exit activities (30%) and "implementation of new strategies" (20%). We note the last two categories are particularly broad and could seemingly contain costs such as management time devoted to restructuring activities.

As with PG and KMB, we can see that restructuring charges have been a regular feature in the company's results over the last ten years:

CL	Reported EPS	Restructuring	Adj. EPS
2018	$2.75	$0.15	$2.97
2017	$2.28	$0.28	$2.87
2016	$2.72	$0.19	$2.81
2015	$1.52	$0.20	$2.81
2014	$2.36	$0.23	$2.93
2013	$2.38	$0.30	$2.84
2012	$2.57	$0.07	$2.68
2011	$2.47	$0.15	$2.51
2010	$2.16	0.06	$2.42
2009	$1.83	$0.10	$1.93

Church & Dwight and Clorox

Neither CHD or CLX has recorded major restructuring charges in the last three years.

Research and Development

We took a quick look at the research and development spending for all the group members. Some disclose this information quarterly while others only disclose in the 10-Ks. The following table shows trailing 12-month R&D as a percentage of sales for each:

T12 R&D % of Sales

	6/30/2019	3/31/2019	12/31/2018	9/30/2018	6/30/2018	3/31/2018	12/31/2017	9/30/2017	6/30/2017
Procter & Gamble	2.7%				2.9%				2.9%
Clorox	2.2%	2.2%	2.1%	2.1%	2.2%	2.2%	2.2%	2.3%	2.3%
Kimberly-Clark			1.7%				1.7%		
Colgate-Palmolive			1.8%				1.8%		
Church & Dwight	2.2%	2.2%	2.2%	2.1%	2.0%	2.0%	1.9%	1.8%	1.8%

Items of note include:

- CL and KMB have the lowest level of R&D spending in the group which could foreshadow the need to increase spending in the future.

- CHD has been ramping up its R&D spending, but some of this could be driven by acquisitions like Waterpik which carry a higher technology component than the company's traditional product line. Thus, we believe higher R&D spending could be required for the company to stay competitive

- PG's results have benefitted from a decline in R&D spending. For the full year ended 6/19, the lower R&D percentage could have added about 2 cps to earnings growth. This was less than 3% of the total adjusted EPS growth in the period so it is not been a significant tailwind.

Advertising Spending

As with R&D spending, most of the company's in the group only disclose advertising on an annual basis in the 10-K. The following table shows trailing 12-month advertising as a percentage of sales as well as the accrual for promotional and advertising on a days of sales basis:

T12 Advertising % of Sales & Accrual Days of Sales

	6/30/2019	3/31/2019	12/31/2018	9/30/2018	6/30/2018	3/31/2018	12/31/2017	9/30/2017
Procter & Gamble								
Adv. Expense % of Sales	10.0%				10.6%			
Accrued Adv/Promo Days	22.9				17.7			
Clorox								
Adv. Expense % of Sales	9.8%				9.3%			
Accrued Adv/Promo Days	6.4				4.9			
Kimberly-Clark								
Adv. Expense % of Sales			3.5%				3.5%	
Accrued Adv/Promo Days			12.7*				12.3*	
Colgate-Palmolive								
Adv. Expense % of Sales			10.2%				10.2%	
Accrued Adv/Promo Days			11.6				12.0	
Church & Dwight								
Adv. Expense % of Sales	11.2%	11.5%	11.7%	11.6%	11.6%	11.9%	12.0%	12.4%
Accrued Adv/Promo Days	10.4	9.6	9.9	10.1	11.1	10.4	9.6	10.2

*advertising and rebate accruals combined

- While PG's advertising spending fell as a percentage of sales, its promotional accruals increased significantly, indicating it shifted from traditional print and TV advertising to more coupons and in-store promotional activity which is recorded as a reduction of sales.

- We also see that CLX has been more aggressive in both advertising and promotional activity in the last year.

- While most members of the group run their advertising spend at about 10-11%, KMB is the outlier with by far the lowest spending in its peer group. KMB may rely more on such promotional programs, but it is definitely paying those costs. We note that while stable in the last fiscal year, KMB's advertising spend has falled gradually from almost 4% over the last five years. The company is struggling to post positive comp growth. Management noted higher advertising costs in the 6/19 quarter and we would not be surprised to see this trend continue.

- CL's advertising and promotional accruals were flat with the industry norm in fiscal 2018.

- While CHD's advertising and accruals are in-line with the industry, its advertising spend has been declining on a quarterly basis for some time which cannot continue to boost EPS. We will discuss this issue more below.

Inventory Methods

Procter & Gamble

Inventory Method
FIFO

Inventory DSI Trends

	06/30/2019	03/31/2019	12/31/2018	09/30/2018	06/30/2018	03/31/2018
Materials and Supplies	$1,289	$1,415	$1,524	$1,429	$1,335	$1,415
Work in Process	$612	$617	$593	$600	$588	$617
Finished Goods	$3,116	$3,326	$3,164	$3,153	$2,815	$3,175
Total Inventory	$5,017	$5,358	$5,281	$5,182	$4,738	$5,207
Materials and Supplies DSI	13.2	15.3	15.6	15.4	13.4	15.4
Work in Process DSI	6.2	6.7	6.1	6.5	5.9	6.7
Finished Goods DSI	31.8	36.0	32.4	33.9	28.3	34.6
Total DSI	51.2	58.0	54.0	55.7	47.7	56.7

- PG utilizes FIFO accounting for all of its inventories. This will inflate its inventory balances and understate cost of sales in periods of rising raw materials prices more so than its peers that utilize LIFO for some inventories.

- As we noted in our EQ Review of the 6/19 quarter, DSIs jumped approximately 3 days in the quarter which management attributed to support of new products. We are currently not alarmed by the increase.

Clorox

Inventory Method
34% LIFO, 66% FIFO

Inventory DSI Trends

	6/30/2019	3/31/2019	12/31/2018	9/30/2018	6/30/2018	3/31/2018
Finished Goods	$411	$445	$467	$408	$395	$415
Raw Materials & Pack.	$125	$136	$135	$135	$129	$114
Work in Process	$6	$6	$7	$7	$9	$5
LIFO Reserve	-$30	-$31	-$31	-$31	-$27	-$26

Finished Goods DSI	42.0	46.2	51.3	42.1	38.1	43.6
Raw Materials & Pack. DSI	12.8	14.1	14.8	13.9	12.4	12.0
Work in Process DSI	0.6	0.6	0.8	0.7	0.9	0.5
LIFO Reserve DSI	-3.1	-3.2	-3.4	-3.2	-2.6	-2.7
Total DSI	52.3	57.8	63.5	53.5	48.8	53.4

- CLX uses LIFO for about 35% of its inventories. This provides for a more immediate reflection of rising raw materials prices on the income statement than FIFO.

- We have noted in past reviews that CLX's inventory days have been rising and that we are somewhat skeptical that it is all due to the 4/2/18 Nutranext acquisition. Our concern has increased given that the acquisition has now lapped and yet DSI still jumped 3.5 days year-over-year in the 6/19 quarter. However, management has committed to working down inventory in the back half of the year.

Kimberly-Clark

Inventory Method
LIFO for most US (35%),
FIFO for the remainder

Inventory DSI Trends

	6/30/2019	3/31/2019	12/31/2018	9/30/2018	6/30/2018	3/31/2018
Raw Materials	$337	$344	$362	$335	$333	$352
Work in Process	$230	$212	$214	$226	$207	$203
Finished Goods	$1,203	$1,219	$1,153	$1,114	$1,107	$1,097
Supplies and Other	$267	$278	$275	$279	$280	$304
LIFO Reserve	-$181	-$196	-$191	-$184	-$177	-$178
Total Inventory	$1,856	$1,857	$1,813	$1,770	$1,750	$1,778

Raw Materials DSI	9.9	9.8	10.4	9.7	9.6	9.4
Work in Process DSI	6.8	6.0	6.2	6.5	6.0	5.4
Finished Goods DSI	35.3	34.7	33.2	32.1	32.1	29.4
Supplies and Other DSI	7.8	7.9	7.9	8.0	8.1	8.1
LIFO Reserve DSI	-5.3	-5.6	-5.5	-5.3	-5.1	-4.8
Total DSI	54.5	52.9	52.2	51.0	50.7	47.6

- KMB utilizes the LIFO method for most US inventories and FIFO for the remainder, similar to CL and CLX.

- We have noted in previous EQ reviews that KMB's inventories have been rising. Management has attributed this to supply chain restructurings. Both the trend and the explanation continued into the 6/19 quarter. The inventory disruption will likely continue over the next few quarters.

Colgate-Palmolive

Inventory Method
FIFO-75%, LIFO-25%

Inventory DSI Trends

	6/30/2019	3/31/2019	12/31/2018	9/30/2018	6/30/2018	3/31/2018
Raw Materials	$258	$242	$253	$248	$251	$258
Work in Process	$42	$43	$37	$40	$45	$49
Finished Goods	$1,022	$993	$960	$957	$958	$1,005
Total Inventory	$1,322	$1,278	$1,250	$1,245	$1,254	$1,312
Raw Materials DSI	15.1	13.8	14.8	14.4	14.5	14.8
Work in Process DSI	2.5	2.5	2.2	2.3	2.6	2.8
Finished Goods DSI	59.9	56.7	56.2	55.4	55.2	57.5
Total DSI	77.4	73.0	73.2	72.1	72.2	75.1

- CL utilizes LIFO for 25% of its inventories which is in line- with KMB and CLX.
- We noted in our EQ Review of the 6/19 quarter that DSIs jumped over 5 days over the year-ago period with the increase centered in finished goods. Management did not offer an explanation in the conference call or the 10-Q. We will keep an eye on the 9/19 quarter and will be concerned with any indication that the trend is continuing.

Church & Dwight

Inventory Method
FIFO

Inventory DSI Trends

	06/30/2019	03/31/2019	12/31/2018	09/30/2018	06/30/2018	03/31/2018
Raw Materials & Supplies	$85	$82	$84	$86	$88	$89
Work in Process	$35	$36	$34	$33	$32	$35
Finished Goods	$281	$282	$264	$272	$250	$234
Total Inventory	$402	$400	$383	$391	$369	$357
Raw Materials & Supplies DSI	13.0	13.0	12.8	13.5	13.9	14.6
Work in Process DSI	5.3	5.7	5.2	5.2	5.1	5.7
Finished Goods DSI	42.9	44.8	40.2	42.9	39.7	38.5
Total DSI	61.3	63.5	58.2	61.7	58.8	58.8

CHD switched to the FIFO method of accounting for 100% of its inventories in the 6/18 quarter. Previously, the company utilized LIFO for 20% of its inventory balances. We discussed this in previous EQ Reviews. The switch to 100% FIFO would have boosted inventory levels as newer, higher-priced inventories were kept on the balance sheet longer. However, we were skeptical that the switch could have added more than a day to DSIs. The accounting change lapped in the 6/19 quarter, so it did not contribute at all to the observed 2.5-day increase in DSI.

While the company did make a large acquisition in the 6/19 quarter (Flawless), the company will be purchasing the inventory at a later date after a five-month transition period in which it will book net cash received from Flawless as sales. Therefore, there should be no impact on the DSI calculation as a result of the deal.

Pension Assumptions

The following table shows the basic assumptions used by the group members to calculate their pension benefit obligations and their periodic pension costs.

					Asset Mix			
	as of:	PBO Disc Rate	Expense Disc Rate	Expense Return	Cash	Equity	Debt	Other
Procter & Gamble	6/19	1.9%	2.5%	6.6%	1.0%	36.0%	63.0%	
Clorox	6/19	3.4%	4.1%	4.3%		17.0%	83.0%	
Kimberly -Clark	12/18	3.4%	3.2%	4.5%	2.0%	19.8%	65.9%	12.2%
Colgate-Palmolive	12/18	4.4%-US 2.8% Intl	3.7%-US 2.5%-Intl	6.7%-US 4.0%-Intl	1.8%-US 1.8%-Intl	18.9%-US 27.6% Intl	60.9%-US 38.6%-Intl	18.4%-US 32.0% Intl

Items of note:

- PG has one of the lowest discount rates to calculate its PBO that we have seen. Some of the difference will come from the data being 6 months later in the cases of KMB and CL but regardless, this is a very low discount rate which results in a higher estimated liability all else equal. Therefore, the other companies are more exposed to an increase in their pension liabilities as their assumptions begin to reflect lower interest rates.

- On the other end of the discount rate spectrum, CL has the highest assumed rate for its US plan leaving it more exposed to lower rates.

- CL and PG's assumed rate of returns are notably higher than their peers, but this is a reflection of their larger exposures to equity, real estate, and alternative asset classes.

Quick Reviews of CLX, KMB and CHD Quarters

Our current EQ Rating on PG after the 6/19 quarter is 3+ (Minor Concern) and 3- (Minor Concern) for CL.

Clorox

We are raising our EQ Review rating to 3+(Minor Concerns) from 3- (Minor Concerns).

- Accounts Receivables DSO jumped by 3 days over the year-ago quarter. However, we are not overly concerned given that the quarter ended on a Sunday which could have slowed collections. We will watch the 9/19 quarter for any contribution in the trend.

- CLX's allowance for doubtful accounts fell to 0.6% of gross receivables from 1.2% last year. This would have added about 2 cps to EPS growth for the full year.

Kimberly-Clark

We lower our EQ Rating to 3- (Minor Concerns) from 3+ (Minor Concerns) given the ongoing buildup in inventory and the lack of visibility into earnings given the large restructuring charges.

- Accounts receivables DSO rose by just over 2 days versus the year-ago quarter which management blamed on timing issues and the quarter ending on a Sunday. It expects this to reverse in the back half of the year.

- As we noted above, the trend of rising inventory DSI continued into the quarter with DSI jumping by almost 4 days. Management stated that this was due to supply chain restructuring as it shuts certain plants down and ramps up production elsewhere.

This explanation makes sense and we expect the inventory issue to begin to clear up in the next few quarters.

Church & Dwight

We are lowering our EQ Rating on CHD to 2- (Weak) from 3- (Minor Concerns).

- DSI jumped by 2.5 days despite the fact that the change to FIFO from LIFO has now lapped. Also, the company did not book inventory with the second quarter purchase of Flawless and is only recording the net cash received during a five-month transition period directly to sales. This should not impact the DSI calculation either.

- The company paid an upfront price of $475 million for Flawless but contingency payouts could go as high as $425 million. The company increased its estimated liability for contingency payments resulting in a 1 cps charge in the quarter which was adjusted out of non-GAAP earnings.

- The company disclosed in the 6/19 10-Q that it was reporting a 2 cps gain (adjusted out of non-GAAP EPS).

- We have noted before that the company's practice of factoring receivables with no quarterly disclosure and minimal annual disclosure erodes the company's quality of earnings.

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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