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Kellogg (K) EQ Update 3/19 Qtr.

Current EQ Rating*	Previous EQ Rating
2+	2-

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

We raise our rating to 2+ (Weak) from 2- (Weak)

While the company will still be dealing with the negative impact of its receivables factoring and payables reverse factoring arrangements unwinding, we consider the overall earnings quality picture for the company to be slightly improving. The company plans to sell off part of the Keebler business which will generate proceeds of $1 billion which the company will use for debt reduction. It remains to be seen if the company can reignite any lasting organic growth from its brand revitalizing efforts.

- Accounts receivable days of sales at the end of the 3/19 quarter based on receivables remaining on the balance sheet fell 0.7 days versus the 3/18 quarter. Sold but outstanding receivable days of sales also fell by a similar amount. The boost to cash flow growth from increasing the pace of selling receivables has played itself out. We do not see how cash flow growth can benefit from working capital management going forward without growth in the rate of factoring.

- Accounts payable days fell by 5 days compared to the year-ago first quarter. This marks two quarters of year-over-year declines, taking away a key source of cash flow growth. Payables in the tracking system rose to 35.8% of total payables from 32.5% a year ago but remained below the peak of 37.6% set in the 9/18 quarter. Payables sold by suppliers under the tracking system were 25.0% of total payables which was slightly above a year ago but well below the 28.9% in the 12/18 quarter. The cash flow boost from this program appears to have run its course.

- Accrued advertising and promotion expense showed a year-over-year decline again despite an increase in revenue. The company experienced exceptionally strong promotional activity in the year-ago quarter, but given its push to revitalize its brands, we would not expect any benefit from lower promotional and advertising spending to last.

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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