BEHIND THE NUMBERS
Quality of Earnings Analysis
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Kimberly-Clark Corporation (KMB)
Earnings Quality Update- 9/21 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are maintaining our earnings quality rating of 2- (Weak) and maintain our On Deck Sell rating

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

Summary

KMB reported another disappointing quarter with non-GAAP EPS of $1.62 falling 3 cps below Wall Street targets. The company also lowered the midpoint of its full-year outlook for non-GAAP EPS to $6.15 from prior guidance of $6.78. The 2021 organic revenue growth outlook was reduced to -1% to -2% from the previous 0% to -2% range.

So far this year, guidance was cut y 63 cps after the September quarter, 65 cps after the June quarter, and 45 cps after the March quarter. Keep in mind that after the disappointing quarter in March, the stock price fell to $129 which put it selling at 17 times the 2021 estimate. In the March quarter, the company was calling for higher costs to ease in the second half of the year. Since then it has raised its outlook for key input costs, now calling for an increase of $1.4-$1.5 billion in 2021, up from an outlook of $1.2-$1.3 billion at the end of the second quarter. It also stated it the press release that “it is becoming clear they [higher input costs] are not likely to be resolved quickly.” However, the current stock price of $32 is 22 times the 2021 estimate- a 30% increase in valuation from March with a much darker outlook ahead.

We also continue to see signs of weak earnings quality in the quarter.

- The company has once again expanded the expected size of the 2018 Restructuring Plan. Total charges are now expected to be $2.1-$2.2 billion (up from the previous $2.0-$2.1 forecast.) Interestingly, total expected annual savings are now projected to be $550 million to $560 million compared to the previous $540-$560 million estimate. So, a $100 million increase in plan spending did not raise the top end of the expected annual savings goals at all.

- Remember that KMB cuts costs under the heading of both its 2018 Plan whose costs are added back to non-GAAP results and its FORCE plan which includes ongoing cost savings with no costs added back to non-GAAP figures. After the September quarter, KMB lowered the midpoint of the range of total 2021 cost savings by $10 million to $530 million. This included a $5 million increase in the midpoint of expected 2021 savings from the 2018 Plan (range of $130 million to $140 million) which was more than offset by a $15 million ***reduction*** in the midpoint of expected FORCE savings (range of $390 million to $400 million.) The company explained on the call that its forecasted FORCE savings were confounded by production inefficiencies and other disruptions driven by supply chain and employment-related interruptions.

- Stock-based compensation expense moved to a credit of $12 million in the 9/21 quarter from an expense of $47 million in the year-ago quarter. This added almost 14 cps to earnings in the quarter. Management stated in the conference call that this was related to reduced forecasts impacting the outlook for incentive compensation as well as a true-up adjustment. This benefit will disappear in the fourth quarter.

- The company also reduced its forecast for the buyback to $400 million from a previous range of $400 million to $450 million. Capex guidance was also reduced to $1 billion-$1.1 billion from the previous range of $1.1 billion to $1.2 billion. Remember that before Covid, KMB seldom covered the buyback with free cash after the dividend.

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 Concern)- 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 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 upcoming quarters. 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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