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BEHIND THE NUMBERS
Quality of Earnings Analysis

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Kimberly-Clark Corporation (KMB)
Earnings Quality Update- 3/21 Qtr.

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

We are reducing our earnings quality rating on KMB to 3- (Minor Concern).

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

Summary

KMB's reported non-GAAP EPS missed the consensus estimate by 12 cps in the 3/12 quarter. In addition, sales fell more than $200 million short of targets. The company is facing difficult comps through the first half of the year and rising input prices which it hopes to combat with more cost cuts. Meanwhile, the restructuring program continues to increase in size.

- KMB is facing higher costs in 2021 but is planning on limiting direct pricing increases and relying more on keeping promotional activity low. Remember that promotion spending shows up in results as a reduction to net revenue and is reflected as part of the net pricing impact when analyzing the components of sales growth. Note that the company received an unusually high pricing boost in its Consumer Tissue segment in the 12/20 quarter due to trade promotion activity falling well below the level the company had accrued for earlier in the year. While the company did not quantify the impact, it can be seen in the 6% boost to Consumer Tissue segment sales in the 12/20 quarter in the company's sales growth components disclosure. This 6% boost followed 0% and 1% figures in the 9/20 and 6/20 quarters, respectively. We estimate that if Consumer Tissue pricing had remained flat in

the 12/20 quarter, it would have cost the company about $90 million in pretax profits or about 21 cps. This will make for difficult comps in the 12/21 quarter.

- The company also hopes to limit price increases by absorbing some of the inflationary pressures with more cost cuts. In addition to the 2018 Global Restructuring program, KMB regularly reports significant cost reductions through its FORCE program. The FORCE program is essentially a permanent cost reduction process that has been going on for years. For example, the company claimed $455 million in cost savings from the FORCE program in 2020, $260 million in 2019, and $375 million in 2018. For 2021, the company is projecting $340-$360 million in FORCE savings in 2021. On the positive side, the company does not add back charges related to the FORCE program to non-GAAP results. These are simply excess costs that the company has found to cut. However, we find it amazing that every year they amount to around 3-4% of the company's total operating costs and are incremental to the $465 million in annual cost savings reportedly achieved so far by the 2018 Restructuring plan.

- On the subject of the 2018 Plan, according to commentary in SEC filings, KMB expanded the estimated cost of the program in the 12/20 quarter. Before the 2020 10-K, the company's disclosures indicated it expected to complete the restructuring program in 2021 with total charges coming in at the high end of its $1.7-$1.9 billion estimated range. However, in the 12/20 10-K, the company amended this to between $2.0-$2.1 billion. In the 3/21 quarter, the company incurred $34 million in pretax charges with $30 million of that allocated to the "other exit costs" category. The extension of the program size with most of the increase occurring in an open-ended category make it, in our opinion, more likely that costs that should be viewed as ongoing were included in the charges and added back in non-GAAP results.

- We note that a decline in "other expense" added about 2.3 cps to earnings in the quarter while a decline in "nonoperating expense" added more than a penny. We saw no explanation for these changes.

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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