BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

July 30, 2020 | www.btnresearch.com

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Kimberly-Clark (KMB) EQ Update- 6/20 Qtr

Current EQ Rating*	Previous EQ Rating
3-	3-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

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

We maintain our earnings quality rating of 3- (Minor Concern)

- On the surface, inventory DSIs in the 6/20 quarter rose by 4 days over the year-ago quarter. However, this is an example of how simply looking at the result of a ratio can be misleading. Inventory balances fell by 1.6% YOY yet sales increased slightly. However, the DSI calculation utilizes cost of sales which fell by $273 million. Some of this decline was due to larger restructuring charges last year. After adjustment for that, the DSI increase fell to 3.7 days. However, cost of sales also benefitted from $80 million in lower commodities costs (primarily pulp) and significant costs savings from its FORCE and restructuring programs. While we don't know the exact impact on cost of sales, it was obviously significant. Therefore, we are not concerned by the elevated headline DSI increase. In fact, management indicated it was working to rebuild inventories to meet demand in the next quarter.

- Our biggest concern regarding KMB is the ongoing restructuring charges which have been approximately 10% of non-GAAP earnings for the last several quarters. This period has not been an exception as new programs have emerged every couple of years and we are skeptical that the current program will be the last. As noted above, cost savings have been a significant boost to results with total cost savings in the

6/20 quarter reportedly amounting to $175 million. However, large charges always carry the potential for operational expenses to be lumped in and dismissed by analysts.

- In addition, we have previously flagged KMB for low advertising expense versus its peers which the company is currently correcting by ramping up its promotional spending. This is expected to increase further in the second half of the year with plans calling for more than 60 bps of sales increase in spending.

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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