BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

February 14, 2019 | www.btnresearch.com

Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

Mondelez Intl. (MDLZ) EQ Update-12/18 Quarter

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 maintain our EQ rating on MDLZ at 2- (Weak).

After review of the 2018 10-K, we update our points of concern as follows:

- Factored accounts receivable in the 12/18 quarter were flat with the year-ago level on a days-of-sales basis, implying the acceleration of the use of factoring has faded. However, total adjusted receivable DSOs fell 5 days from the year-ago quarter which seems unsustainable. Movements in accounts receivable were a $257 million source of cash in 2018 compared to a $24 million ***use*** of cash in 2017 which illustrates how large a tailwind the company has been receiving from squeezing receivables.

- Accounts payable days rose by 5 days over the year-ago quarter but the margin of growth continues to narrow. With the company now taking three months to pay suppliers, we are skeptical of how much room for improvement is left from this source of cash flow growth. Movement in payables was for 2018 added $236 million to cash flow compared to $5 million a year ago.

- Inventory DSIs rose by 2 days over the 12/17 quarter, but the finished goods percentage flattened out which lessens our concern.

Accounts Receivable Factoring Declines, but Receivables Reduction Seems Unsustainable

One of our major concerns regarding MDLZ was its rapid expansion of receivables factoring which was providing a large boost to cash flow growth. The following table shows the calculation of total trade receivables and factored receivables days of sales for the last eight quarters. "Adjusted receivables" refers to trade receivables on the balance sheet plus receivables that have been sold but are still outstanding at the end of the period.

	12/31/2018	9/30/2018	6/30/2018	3/31/2018
Sales	$6,773	$6,288	$6,112	$6,765
Trade Receivables	$2,262	$2,732	$2,416	$3,113
Factored Receivables	$819	$769	$719	$866
Adjusted Receivables	$3,081	$3,501	$3,135	$3,979
Adjusted Receivable DSOs	41.5	50.8	46.8	53.7
Factored Receivable DSOs	11.0	11.2	10.7	11.7

	12/31/2017	9/30/2017	6/30/2017	3/31/2017
Sales	$6,966	$6,530	$5,986	$6,414
Trade Receivables	$2,691	$2,981	$2,395	$3,035
Factored Receivables	$843	$650	$594	$630
Adjusted Receivables	$3,534	$3,631	$2,989	$3,665
Adjusted Receivable DSOs	46.3	50.7	45.6	52.1
Factored Receivable DSOs	11.0	9.1	9.1	9.0

On the bright side, year-over-year growth in factored receivables days of sales has leveled off, indicating the company has stopped accelerating the utilization of its factoring program. By itself, this would have taken away a significant tailwind to operating cash flow growth. However, we find it interesting that in the same quarter that the company cut back on factoring, its total adjusted receivables DSO fell by more than 5 days compared to the year-ago quarter (41.5 vs. 46.3). This could be an indication that the company accelerated the collection activity of its retained receivables during the quarter to offset the scaling back of factoring. We are skeptical that this sudden jump represents a sustainable rate of improvement. Keep in mind that accounts receivable was a $257 million source of cash in 2018 compared to a $24 million ***use*** of cash in 2017.

Payables Continue to Rise- but Growth Is Decelerating

While MDLZ appears to be getting more aggressive in collecting its invoices, it continues to take more time to pay its suppliers. The following table shows the calculation of days payable for the last eight quarters:

	12/31/2018	9/30/2018	6/30/2018	03/31/2018
COGS	$4,224	$3,874	$3,572	$3,916
Accounts payable	$5,794	$5,374	$5,248	$5,727
COGS YOY growth	-2.1%	-2.7%	-2.7%	0.5%
Accounts payable YOY growth	1.6%	4.6%	4.7%	16.9%
Accounts payable DSPs	125.2	126.6	134.1	133.4

	12/31/2017	09/30/2017	06/30/2017	03/31/2017
COGS	$4,313	$3,981	$3,672	$3,896
Accounts payable	$5,705	$5,139	$5,012	$4,897
COGS YOY growth	3.2%	1.9%	-3.0%	-0.6%
Accounts payable YOY growth	7.3%	5.2%	9.9%	2.5%
Accounts payable DSPs	120.7	117.8	124.5	114.7

Days payable jumped in the 12/18 quarter by almost 5 days over last year's fourth quarter. However, the size of the year-over-year jumps is narrowing. With the time to pay suppliers at three months, we remain skeptical of how long the company can continue to stretch this number in a world where it takes a third as long to collect from its customers. Note that movement in payables generated $236 million in cash flow in 2018 compared to only $5 million in 2017.

Inventory Days up 2, but Finished Goods Concentration Stabilizes

We highlighted a 3-day year-over-year increase in inventory days (DSI) in our review of the 9/18 quarter which was magnified by a 120 bps increase in finished goods as a percentage of total inventory. DSIs in the 12/18 quarter jump by 2 days over the 12/17 quarter, but the finished good percentage was roughly flat with the year-ago level, reducing the level of concern.

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 recent 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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