BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Procter & Gamble (PG) EQ Update- 3/19 Qtr.

Current EQ Rating*	Previous EQ Rating
3-	3-

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

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

- The company continued to warn in its 10-Q for the 3/19 quarter that the fair value of the Shave Care goodwill and Gillette intangibles is eroding and remains susceptible to impairment. The combined carrying value was $35 billion as of March 2019. Disclosures show a 25 bps change in either discount rate or short-term and residual growth rate estimates could reduce the fair value for 6%.

- Advertising expense as a percentage of sales fell on an absolute basis and by 50 bps as a percentage of sales. The company indicated this was due to scale and savings an agency compensation, but also due to new accounting requirements that resulted in certain marketing costs now being classified as a reduction to sales rather than SG&A expense. This has the effect of decreasing advertising as a percentage of sales even if the amount of spending remained flat.

- Days payable jumped over 4 days versus the year-ago quarter partly driven by a continued extension of supplier payments terms.

- Our ongoing concerns with PG include ongoing restructuring charges and free cash flow not covering the dividend and the buyback. When including cash generated by the exercise of stock options, the shortfall is more than covered, but we consider this an unreliable source of cash flow. Interestingly, the number of shares declined by only 0.3% year-over-year in the 3/19 quarter due to an increased number of shares issued to satisfy stock options.

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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