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EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

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PerkinElmer (PKI) EQ Update- 9/20 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 are raising our earnings quality rating to 3+ (Minor Concern) from 3- (Minor Concern).

PKI reported adjusted EPS of $2.09 in the 9/20 quarter which was 60 cps ahead of the consensus. The increase in our rating reflects the decline in DSOs although we want to see more improvement before upgrading to a 4 (Acceptable).

What improved?

- Accounts receivables days of sales fell to 75 in the 9/20 quarter from 83 in the year-ago period. Our main concern in our original review was an ongoing buildup of receivables through the 3/20 quarter that the company attributed partially to extending more beneficial payment terms to customers. Our upgrade is a reflection of that improvement...

- …however, we are reluctant to move the rating above a 3 at this point as receivables are still notably higher than some industry peers with DSOs between 50-60. Revenue

growth has skyrocketed from COVID-driven demand for the company's diagnostic tests. Ordinarily, we would expect to see a rise in DSOs from such an acceleration in revenue growth, but we suspect the increased demand is allowing the company to tighten its credit terms and improve collections. We will hold off upgrading the rating further until DSOs fall further and hold in a normal environment.

DSOs Declined- But Are Still Relatively High

The main factor in our original 3- (Minor Concern) rating was a steady YOY increase in DSOs through the 4/20 quarter which the company attributed at least in part to better terms extended to customers. The following table shows that DSOs have declined in the last two quarters.

	10/04/2020	7/05/2020	4/05/2020	12/29/2019
Sales	$964.025	$811.718	$652.396	$805.496
Trade Receivables	$797.911	$708.799	$626.150	$725.184
Trade Receivables Days of Sales	75.3	79.5	94.1	81.9

	9/29/2019	6/30/2019	3/31/2019	12/30/2018
Sales	$706.923	$722.517	$648.737	$756.349
Trade Receivables	$646.286	$654.454	$623.927	$632.669
Trade Receivables Days of Sales	83.2	82.4	87.5	76.1

	9/30/2018	7/01/2018	4/01/2018	12/31/2017
Sales	$674.313	$703.362	$643.972	$641.630
Trade Receivables	$551.385	$564.041	$575.740	$552.304
Trade Receivables Days of Sales	74.4	73.0	81.4	78.3

In the conference call, management attributed the decline in DSOs to "improved monthly linearity, process improvements, and COVID-related demand." However, revenue rose by 36% in the 9/20 quarter and 12% in the 6/20 quarter in the COVID-driven rush to the company's diagnostics solutions. In such a sudden acceleration in revenue growth, we would ordinarily expect to see receivables outrun revenue growth and drive an increase in DSOs. This makes us wonder if the increased demand for the company's products allowed it to tighten its credit terms. We also note that the company's current DSO level is still material higher than the 50-60 range reported by peers Mettler-Toledo (MTD) and Bruker

(BRKR). Therefore, we will hold off upgrading to a 4 (Acceptable) until we see DSOs improve further and hold in a more normal market environment.

Explanation of EQ Rating Scale

Rating	Description
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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