BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

January 10, 2019 | www.btnresearch.com

Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

Roper Technologies (ROP) EQ Review

Current EQ Rating*	Previous EQ Rating
4+	NA

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

We initiate coverage of ROP with a rating of 4+ (Acceptable)

ROP reported adjusted EPS of $3.09 in the 9/18 quarter, a full 15 cps ahead of the consensus target. The effective tax rate for the 9/18 quarter was 21.5%. Management stated in the conference call that the tax rate was "a little bit lower than we expected coming into the quarter." The effective rate in the 6/18 quarter was 23.1% and the company expects an effective rate of 23% in the 12/18 quarter. If we use 23% as a proxy for the expected rate going into the 9/18 quarter, we estimate that the lower than expected tax rate added about 6 cps to earnings which still implies a strong earnings beat for the period. Management also increased its range of forecasted EPS for 2018 to $11.69-11.76 from the previous $11.40-11.56.

Overall, ROP's recent earnings quality appears high and we note following observations on the quarter:

- Accounts receivable and unbilled receivable days of sales have declined slightly. This takes into consideration the impact of acquisitions, the reclassification of Gatan assets as held for sale, and the impact of the adoption of ASC 606.

- Deferred revenue days have been tracking roughly in-line. Like the declining receivables balance, this bodes well for the quality of recent reported revenue growth.

We note that the main factor keeping us from giving ROP a rating of 5 (Strong) is the high degree of deferred revenue and resulting estimates utilized in its accounting for revenue.

Revenue Recognition Metrics Are Solid

ROP's software business as well as its project-based businesses result in significant amounts of revenue being recognized over time as service are performed. This makes the ongoing monitoring of receivables, unbilled receivables and deferred revenue particularly important. The following table shows the calculation of ROP's accounts receivable and unbilled receivables days of sales (DSO) for the last eight quarters:

	9/30/2018	6/30/2018	3/31/2018	12/31/2017
Sales	$1,318.70	$1,293.70	$1,202.50	$1,226.57
Accounts Receivable	$671.70	$669.30	$631.20	$641.70
Unbilled Receivables	$176.10	$180.00	$157.60	$143.60
Total Receivables	$847.80	$849.30	$788.80	$785.30
Accounts Receivable DSOs	46.5	47.2	47.9	47.7
Unbilled Receivables DSO	12.2	12.7	12.0	10.7
Total Receivable DSO	58.7	59.9	59.9	58.4

	9/30/2017	6/30/2017	3/31/2017	12/31/2016
Sales	$1,159.90	$1,134.70	$1,086.31	$1,010.80
Accounts Receivable	$603.87	$576.36	$549.84	$619.85
Unbilled Receivables	$157.85	$146.94	$143.59	$129.97
Total Receivables	$761.70	$723.30	$693.40	$749.80
Accounts Receivable DSOs	47.5	46.3	46.2	56.0
Unbilled Receivables DSOs	12.4	11.8	12.1	11.7
Total Receivable DSOs	59.9	58.2	58.2	67.7

We see that both accounts receivables days of sales and unbilled receivables days of sales declined sequentially and year-over-year in the 9/18 quarter. In addition, the company disclosed that its adoption of ASC 606 beginning in the first quarter of 2018 had the impact of accelerating the recognition of certain revenues related to multiple-element software deals. This had the effect of increasing unbilled receivables by almost $3 million as of 1/1/18 compared to the balance calculated under the old method on 12/31/17. This implies that the 9/18 unbilled receivables balance would have been lifted by the accounting change compared to the 9/17 balance which was calculated under the old method. In addition, the receivables balances were likely boosted by the June 2018 acquisitions of PowerPlan and ConceptShare and the July 2018 acquisitions of BillBlast. However, some of this was likely offset by the reclassification of the Gatan assets to "held for sale" status in the 6/18 quarter.

Meanwhile, deferred revenue days of sales continue to trend roughly in-line:

	9/30/2018	6/30/2018	3/31/2018	12/31/2017
Sales	$1,318.70	$1,293.70	$1,202.50	$1,226.57
ST Deferred Revenue	$613.80	$620.00	$584.70	$566.40
Sales YOY growth	13.7%	14.0%	10.7%	21.3%
Deferred Revenue Days	42.5	43.7	44.4	42.1

	9/30/2017	6/30/2017	3/31/2017	12/31/2016
Sales	$1,159.90	$1,134.70	$1,086.31	$1,010.80
ST Deferred Revenue	$534.56	$516.36	$513.82	$488.40
Sales YOY growth	22.7%	21.8%	20.4%	7.1%
Deferred Revenue Days	42.1	41.5	43.2	44.1

While deferred revenue days fell by a little more than 1 day sequentially, it increased compared to the year-ago quarter.

Under ASC 606, ROP began reporting a current and non-current contract liability account which is available for the last four quarters. This account consists mostly of deferred revenue plus billings in excess of revenues, and customer deposits. ROP disclosed in its 9/18 10-Q that acquisitions added $26 million to its net contract liabilities, which was offset by $12.8 million from the reclassification of Gatan's assets and liabilities as "held for sale." Therefore, the net impact was likely immaterial to the trend in short-term deferred revenue.

In addition, as with unbilled receivables which was discussed above, the adoption of ASC 606 in the first quarter of 2018 resulted in a $13.5 million reduction of deferred revenue on 1/1/18 as compared to deferred revenue under the old method on 12/31/2017. This implies a reducing effect on the 9/18 deferred revenue relative to the 9/17 balance which is calculated under the old method.

All things considered, the quality of ROP's revenue growth appears to be high, and we will continue to monitor the trends in these accounts going forward.

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.

Disclosure

BTN Research is a research publication structured to provide analytical research to the financial community. Behind the Numbers, LLC is not rendering investment advice based on investment portfolios and is not registered as an investment adviser in any jurisdiction. Information included in this report is derived from many sources believed to be reliable (including SEC filings and other public records), but no representation is made that it is accurate or complete, or that errors, if discovered, will be corrected.

The authors of this report have not audited the financial statements of the companies discussed and do not represent that they are serving as independent public accountants with respect to them. They have not audited the statements and therefore do not express an opinion on them. Other CPAs, unaffiliated with Mr. Middleswart, may or may not have audited the financial statements. The authors also have not conducted a thorough "review" of the financial statements as defined by standards established by the AICPA.

This report is not intended, and shall not constitute, and nothing contained herein shall be construed as, an offer to sell or a solicitation of an offer to buy any securities referred to in this report, or a "BUY" or "SELL" recommendation. Rather, this research is intended to identify issues that investors should be aware of for them to assess their own opinion of positive or negative potential.

Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them may have a position in, and from time-to-time purchase or sell any of the securities mentioned in this report. Initial positions will not be taken by any of the aforementioned parties until after the report is distributed to clients, unless otherwise disclosed. It is possible that a position could be held by Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them for stocks that are mentioned in an update, or a BTN Thursday Thoughts.