BEHIND THE NUMBERS
Quality of Earnings Analysis

February 26, 2021

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Roper Technologies (ROP) Earnings Quality Update
12/20 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We downgrade our earnings quality rating to 4- (Acceptable)

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

Summary

ROP reported adjusted EPS of $3.56 in the 12/20 quarter which was 7 cps ahead of the consensus. Our downgrade largely reflects the ongoing string of acquisitions which is leading to both a buildup in debt and an increase in the add-back of intangible amortization to non-GAAP earnings.

What improved?

- We regularly monitor deferred and unbilled revenue growth relative to Application and Network segment revenues. While acquisitions can distort these trends, we currently see no material signs of the company becoming more aggressive in recognizing revenue.

What eroded?

- ROP continues to push forward with acquisitions which is powering growth and transitioning the company to more of a software company and less of an industrial. However, this is driving up net debt which now stands at 4.7 times adjusted EBITDA, (not including pro-forma impact of recent acquisitions.) There is no buyback to be cut and free cash flow before acquisitions is more than sufficient to provide for debt reduction which reduces the concern level some.

- We are most concerned by growth through acquisition strategies when there is no underlying organic growth and the company is spending capital just to drive the top line in the short-run. Virtually all ROP's revenue acquired in the last couple of years has been in the software/tech area. Using pre-pandemic 2019 results as a proxy, organic Application Software revenue and organic Network Software & Systems each rose by 5%. This makes growing by acquisition less of a concern, but we will continue to monitor this going forward. ROP supports dozens of seemingly unrelated software products which would seem to make growing organically more of a challenge. For example, its *Link Logistics* business provides software solutions to connect trucking capacity in Canada while its *Vertaforce* product provides cloud-based software solutions for practice management for insurance companies. Where is the synergy to be gained in those areas?

- The real concern from an earnings quality standpoint is the degree to which acquisitions have led to a buildup in goodwill and intangibles which now account for 90% of total assets. Goodwill amounts to over 65% of these assets and is not amortized. Amortization on the remainder is added back to non-GAAP results which ignores the cost of the acquisitions. The amortization add-back exceeded 30% of non-GAAP EPS in the 12/20 quarter so the distortion is growing.

- The company's adjusted tax rate for the quarter was 19.9%, below the 21.6% of last year's fourth quarter. This added almost 7 cps to earnings growth in the period, accounting for about 40% of the reported EPS growth. The 19.9% was in-line with company guidance for the quarter, so it should not be viewed as contributing to the earnings beat.

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 Concern)- 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 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 upcoming quarters. 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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