BEHIND
THE NUMBERS
Quality of Earnings Analysis

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Stanley Black and Decker, Inc. (SWK)
Earnings Quality Update- 9/21 Qtr.

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

We are downgrading our earnings quality rating of SWK to 3- (Minor Concern)

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

Summary

SWK initially reported non-GAAP EPS for the 9/21 quarter of $2.77. However, a few days after reporting the quarter, the company announced it received a comment letter from the SEC instructing it to utilize the if-converted method to account for its forward stock purchase contracts rather than the treasury stock method. This resulted in an increase to the number of shares utilized in its EPS calculation which would have resulted in 9/21 quarter non-GAAP EPS of $2.71. It also shaved 20 cps off the company's previous guidance for the full year ended 12/21.

Profitability was hit hard in the quarter as adjusted operating margin fell from 17.7% a year ago to 12.2% in the current quarter as raw materials and shipping costs rose. SWK lowered the mid-point of its guidance for the full year to $10.80 from the previous $11.50, down 70 cps. The company noted the following factors behind the lower outlook:

Higher commodity, transit, labor	-1.25 cps
FX impact	-0.15 cps
Change to if converted method	-0.20 cps
Tax rate and other below line items	+0.60 cps
Pricing and cost control	+0.30 cps
	-0.70 cps

Despite the cost pressures, the revised $2.71 per share for the 9/21 quarter was 24 cps ahead of the consensus estimates. However, we identified several times we consider to be non-operational without which the company would have reported disappointing results. This prompts us to reduce our earnings quality rating to 3- (Minor Concern).

What was weak?

- The adjusted tax rate fell to 2% which was down dramatically both from the year-ago level of 17.8% and the 15% full-year rate forecasted by the company after the second quarter's results. If the tax rate had been 15%, we estimate it would have taken over 35 cps off of earnings in the quarter. The company attributed this to benefits from its supply chain initiatives.

- "Other, net" expense fell by 19 cps after adjustment for cost reduction programs and deal transaction costs. The company attributed this to appreciation of Stanley Ventures' investments. We view this as a largely unexpected and low-quality source of growth.

- The provision expense for doubtful accounts fell to 0.08% of sales in the 9/21 quarter from 0.20% in the year-ago quarter. This added about 2.4 cps to earnings in the period. The allowance for doubtful accounts as a percentage of gross receivables was down to 6.5% which is more in line with the low 6% range seen before the pandemic and well below the 8.5% from the 1/21 quarter. The tailwind of lower provision expense looks like it has largely played out.

- Lower pension expense added about 1.5 cps to the quarter. This was largely driven by a decline in the interest cost component due to a lower assumed discount rate. This benefit will likely disappear next year when the assumed discount rate will presumably rise.

What to watch

- SWK is acquiring the remaining 80% of MTD for $1.6 billion and Excel for $375 million. It expects these deals to be finalized over the next few weeks but they are not in the current guidance. The company stated that if the deal closes before year-end it expects to incur an incremental 20-30 cps in transactions, integration and inventory step-up charges. We will be monitoring the development of one-time charges 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 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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