BEHIND THE NUMBERS
Quality of Earnings Analysis
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Stanley Black & Decker, Inc. (SWK)
Earnings Quality Update- 3/21 Qtr. Preview

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

We are raising our earnings quality rating on SWK to a 4+ (Acceptable)

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

Summary

SWK reported adjusted EPS of $3.13 which was 56 cps ahead of consensus with sales over $200 million higher than expected. This was despite the fact that the adjusted effective tax rate was 20% vs. 12.5%. SWK had forecast a 15% tax rate for 2021 so we believe this higher rate could have cost the company around 20 cps versus analysts' models which makes the beat even more impressive.

In addition to the beat, the company raised its 2021 non-GAAP EPS guidance to between $10.70-$11.00 from its previous $9.70-$10.30 range. The first half of 2021 features a huge tailwind from easy comps, but these will turn very difficult in the second half of the year when results will compare to the rapid pandemic-induced DIY sales from the back half of 2020. It is beyond the scope of this analysis to assess whether management's optimistic sales forecast is achievable. Nevertheless, we are raising our earnings quality rating to 4+ (Acceptable) as the acquisition-related add-backs are declining and cash flow conversion remains strong.

We note these other items from the quarter:

- EPS was boosted by about 4 cps from a decline in provision for bad debts as a percentage of sales compared to last year's quarter in which the company built reserves at the onset of the pandemic.

- Lower warranty provision as a percentage of sales added about 1.5 cps to earnings. However, the warranty allowance as a percentage of trailing 12-month revenue remains in line with the historical trend so we are not concerned at this point. This should be monitored going forward for unusual activity.

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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