BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Stanley Black & Decker (SWK) EQ Update- 3/19 Qtr.

Current EQ Rating*	Previous EQ Rating
4-	4-

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

We maintain our rating of 4- (Acceptable).

- SWK's inventory days continued to climb in the quarter, rising by almost 9 days over the year-ago period. Management continues to attribute this to preparation for new product launches, stating in the conference call that "*Tools & Storage continues to carry high levels of inventory to support the ongoing Craftsman rollout and other brand transitions that we are currently executing across the channels."* We are still not concerned by higher inventory given the nature of the Craftsman launch and management has indicated we will see a moderation in working capital during the remainder of the year.

- After discontinuing its sales of accounts receivable at the end of 2017, the company restarted its receivables sales program in October of 2018. Trade receivables are transferred to a wholly-owned bankruptcy remote subsidiary which in turn sells receivables to a third-party financial institution. Receivables sold are derecognized from the balance sheet and all related cash flows are reported in the operating section of the cash flow statement. Derecognized receivables only amounted to $25 million at the end of the 3/19 quarter and DSOs adjusted for those amounts still showed a decline versus last year. We are therefore not currently concerned at this point the factoring program is being used to mask a buildup in receivables.

- Provision expense for doubtful accounts jumped to $18.3 million in the 3/19 quarter from $6.8 million in the 3/18 quarter. This helped drive the allowance for bad debts to 6% of gross receivables compared to 4% a year ago. We saw no mention of what drove the increase, but the spike in provision expense would have provided an approximate 6 cps headwind to EPS growth in the quarter.

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 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

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