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EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH
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Thermo Fisher Scientific (TMO) EQ Review Update-9/18 Quarter

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 are maintaining our *EQ Review* rating on Thermo Fisher (TMO) at 4+ (Acceptable).

TMO reported adjusted EPS of $2.62 for the 9/18 quarter, 7 cps ahead of the consensus targets.

- We estimated a lower-than-expected adjusted tax rate could have added as much as 2.6 cps to EPS in the period but did not account for a significant portion of the earnings beat.

- Inventory balances adjusted for ASC 606 still look good.

Lower Adjusted Tax Rate Added 2.6 CPS

TMO's adjusted tax rate for the 9/18 quarter was 11.5%. Management made the following comment during the conference call:

> Stephen Williams:
> *"We delivered $0.12 more adjusted earnings per share in Q3 than we had assumed at the midpoint of our previous guidance. This is driven by $0.10 stronger operational performance and $0.05 better below-the-line driven by FX, lower interest costs and lower tax."*

Later in the call:

"Our adjusted tax rate in the quarter was 11.5%, down 30 basis points versus last year, primarily due to the impact of U.S. tax reform. The adjusted tax rate was lower than last quarter due to the timing of discrete tax planning items."

The adjusted tax rate fell sequentially to 11.5% from 12.3% in the 6/18 quarter. With management's comments above in mind, if we assume the entire sequential decline in the rate was unexpected, that only amounts to an EPS benefit of about 2.6 cents which is far less than the reported earnings beat. We also doubt the entire decline was unexpected given that management stated in the last call that the 12.3% rate was higher due to the timing of tax initiatives. Therefore, we are not concerned that the earnings beat was overstated due to the tax rate.

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.

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