

Thermo Fisher Scientific (TMO) EQ Update- 3/20 Qtr.

Current EQ Rating*	Previous EQ Rating
4+	3-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "-" sign indicates deterioration

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

We upgrade our earnings quality rating to 4+ (Acceptable) from 3- (Minor Concern)

We downgraded our earnings quality rating on TMO after our review of the 9/19 quarter based on a jump in receivables and contract assets and minor benefits from cuts to bad debt allowances and warranty expense. While the allowance cut and lower warranty expense remained mild tailwinds in the 3/20 quarter, the company more than beat estimates without them. Also, our concern regarding receivables has decreased prompting us to upgrade our rating.

- The allowance for doubtful accounts fell to 2.2% of gross receivables from 2.7% in the year-ago quarter and 2.3% in the previous quarter. Provision expense jumped by \$8 million but this was largely offset by a \$6 million increase in write-offs. It would still take approximately 5 cps to return the allowance percentage back to the high 2% range.

- Lower warranty expense added almost a penny per share to EPS in the quarter.
- Accounts receivables DSO jumped by more than 3 days over the year-ago quarter and contract assets jump by more than a day. However, this could have been driven by testing revenues jumping late in the quarter which greatly reduced our concern.
- Inventory DSI jumped by 5.7 days. Such an increase would usually be a red flag, but the increase was centered in raw materials and is likely due to the company gearing up for future test demand.
- TMO entered into an agreement to buy QIAGEN for \$11.5 billion on March 3. Details of the transaction were not disclosed in the 10-Q but we will review the allocation of the purchase price and treatment of intangibles when information is available.

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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