BEHIND THE NUMBERS
Quality of Earnings Analysis

August 25, 2022

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BTN Thursday Thoughts

Updates and New Developments on Active BTN Ideas

Companies covered in this issue:

Mohawk Industries, Inc. (MHK)
Earnings Quality Update

We are reducing our earnings quality rating on MHK to 2- (Weak).

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

Summary

MHK's non-GAAP EPS of $4.41 was 12 cps ahead of the consensus target while sales came in just $5 million above estimates. However, as is typical for MHK, several unusual accounting-related benefits appear to have boosted earnings by more than the amount of the earnings beat. We have followed MHK for over a decade and regularly see signs of unusual movements in reserves and allowances that could be an indication of earnings management. It is the size and extent of the recent activity which prompts us to downgrade our earnings quality rating to 2- (Weak).

We note the following items:

- Despite revenue rising by $200 million compared to last year's second quarter, the warranty reserve fell by almost $14 million driving the warranty reserve as a percentage of revenue down to 1.3% from the year-ago 1.9%. While we don't know what the actual warranty expense is, we estimate that it would take a charge of about 35 cps to put the reserve back at a more normal 2.2% level. We are not suggesting the 6/22 quarter benefitted by that amount as the reserve has worn down over time. In practice, the company could rebuild the reserve over time and spread the headwind out over a few quarters. (See detail below)

- The allowance for discounts, claims, and doubtful accounts fell to 3.7% of gross trade receivables. This percentage has been declining as the company's reserves return to a more normal level versus the pandemic spike. However, the allowance percentage is now well below its pre-pandemic range. We estimate it would take an 18 cps charge to return the allowance to a normalized level. As with the warranty reserve, rebuilding the sales allowance could be spread over multiple quarters but is still a very meaningful potential headwind. (See detail below)

- The amortization of capitalized costs to obtain contracts as a percentage of average capitalized balances fell to 23.3% in the latest quarter from 26.6% in the year-ago period indicating a longer effective amortization period. It seems that the more recently placed store fixtures are being amortized over a longer time frame than the older ones that are becoming fully amortized. This does not seem like a sustainable trend. We estimate that if the amortization percentage had remained at the year-ago level of 26%, it would have taken about 1.8 cps off of EPS in the second quarter. (See detail below)

- Inventory DSIs in the 6/22 quarter jumped by more than 20 days versus the year-ago period. However, this was due to the company selling out of inventories during the pandemic-driven demand boom and struggling to rebuild in the wake of supply chain disruptions. Management indicated that inventories are still too low and hampering sales growth. We expect to DSIs continue to increase in the next few quarters. (See detail below)

Warranty Reserve Continues to Fall

MHK reserves for expected future warranty costs at the time of sale. The following table shows the calculation of the reserve as a percentage of revenue for the last twelve quarters:

	7/2/2022	4/2/2022	12/31/2021	10/2/2021
Revenue	$3,153.188	$3,015.663	$2,760.737	$2,817.017
Warranty Reserve	$40.942	$41.693	$45.215	$46.346
Warranty Reserve % of Sales	1.3%	1.4%	1.6%	1.6%

	7/3/2021	4/3/2021	12/31/2020	9/26/2020
Revenue	$2,953.833	$2,669.026	$2,641.764	$2,574.870
Warranty Reserve	$54.702	$55.024	$54.692	$53.520
Warranty Reserve % of Sales	1.9%	2.1%	2.1%	2.1%

	6/27/2020	3/28/2020	12/31/2019	9/28/2019
Revenue	$2,049.800	$2,285.763	$2,424.512	$2,519.185
Warranty Reserve	$53.769	$51.983	$49.184	$46.984
Warranty Reserve % of Sales	2.6%	2.3%	2.0%	1.9%

Despite revenue rising by $200 million compared to last year's second quarter, the warranty reserve fell by almost $14 million. This continues a trend of erosion in the warranty reserve in the wake of rising sales. While we don't know what the actual warranty expense is, we estimate that it would take a charge of about 35 cps to put the reserve back at a more normal 2.2% level.

Allowance for Discounts, Claims, and Doubtful Accounts Just Keeps Falling

MHK records its allowances for doubtful accounts, claims, and discounts in the footnotes of its SEC filings as a single contra-account netted against receivables. Despite an increase in receivables and sales, this account has steadily declined in the last four quarters. The following table shows the allowance as a percentage of gross trade receivables for the last sixteen quarters:

	7/2/2022	4/2/2022	12/31/2021	10/2/2021
Gross Customer Trade Receivables	$2,003.358	$1,947.020	$1,721.584	$1,820.757
Allowance for Discounts, Claims, and Doubtful Accounts	$73.653	$73.214	$73.149	$78.221
Allowance % of Gross Receivables	3.7%	3.8%	4.2%	4.3%

	7/3/2021	4/3/2021	12/31/2020	9/26/2020
Gross Customer Trade Receivables	$1,861.788	$1,716.072	$1,591.503	$1,696.515
Allowance for Discounts, Claims, and Doubtful Accounts	$82.165	$86.425	$83.682	$81.851
Allowance % of Gross Receivables	4.4%	5.0%	5.3%	4.8%

	6/27/2020	3/28/2020	12/31/2019	9/28/2019
Gross Customer Trade Receivables	$1,563.110	$1,611.525	$1,491.592	$1,763.435
Allowance for Discounts, Claims, and Doubtful Accounts	$78.872	$64.745	$61.921	$70.457
Allowance % of Gross Receivables	5.0%	4.0%	4.2%	4.0%

	6/29/2019	3/30/2019	12/31/2018	9/29/2018
Gross Customer Trade Receivables	$1,793.551	$1,716.927	$1,562.284	$1,726.925
Allowance for Discounts, Claims, and Doubtful Accounts	$72.782	$72.308	$74.718	$81.566
Allowance % of Gross Receivables	4.1%	4.2%	4.8%	4.7%

Going back this far gives a clear view of how the company increased the allowance during Covid. Like most companies, it has been reducing the allowance in the last few quarters following the spike during the pandemic. However, we can also see that the current allowance percentage of 3.7% has fallen well below the pre-pandemic level above 4%. We don't know what the provision expense is so we can't calculate the exact impact on earnings in the quarter. However, it is logical to assume that the company has enjoyed lower expense as it has let the allowance wear down. We estimate that it would take an approximate 18 cps charge to return the allowance to a pre-pandemic mid-4% range.

Amortization Percentage of Capitalized Contract Costs Still Falling

MHK capitalizes costs to obtain contracts and amortizes them over time when the amortization period is over one year. The company does not give any color on how long the amortization period is. However, we regularly track the amortization expense as a percentage of the average outstanding capitalized balance over time as shown in the following table:

	7/2/2022	4/2/2022	12/31/2021	10/2/2021
Ending Balance Capitalized Contracts	$58.451	$49.042	$49.644	$57.065
Average Capitalized Balance During the Quarter	$53.747	$49.343	$53.355	$57.539
Amortization of Costs to Obtain Contracts	$12.536	$12.340	$17.639	$13.846
Amortization % of Average Capitalized Balance	23.3%	25.0%	33.1%	24.1%

	7/03/2021	4/3/2021	12/31/2020	9/26/2020
Ending Balance Capitalized Contracts	$58.012	$54.544	$59.847	$62.596
Average Capitalized Balance During the Quarter	$56.278	$57.196	$61.222	$62.396
Amortization of Costs to Obtain Contracts	$14.615	$15.581	$17.091	$16.356
Amortization % of Average Capitalized Balance	26.0%	27.2%	27.9%	26.2%

	6/27/2020	3/28/2020	12/31/2019	9/28/2019
Ending Balance Capitalized Contracts	$62.196	$66.965	$69.039	$54.900
Average Capitalized Balance During the Quarter	$64.581	$68.002	$61.970	$61.400
Amortization of Costs to Obtain Contracts	$19.214	$15.540	-$0.070	$14.479
Amortization % of Average Capitalized Balance	29.8%	22.9%	-0.1%	23.6%

Understandably, capitalized costs increased during the pandemic-driven demand for home-improvement materials and have fallen off since then. As a result, we would expect to see a decline in amortization expense. However, the expense is falling noticeably as a percentage of the average outstanding balances. It appears that the more recently placed store fixtures are being amortized over a longer time frame than the older ones that are becoming fully amortized. This does not seem like a sustainable trend. We estimate that if the amortization percentage had remained at the year-ago level of 26%, it would have taken about 1.8 cps off of EPS in the second quarter.

Inventory DSIs Have Increased Rapidly, but Still Are Low

It is worth noting that inventory days of sales jumped by more than 20 days YOY as shown in the following table:

DSI by Inventory Component	7/2/2022	4/2/2022	12/31/2021	10/2/2021
Finished Goods DSI	77.8	72.3	74.6	71.7
In-Progress DSI	7.2	6.8	6.4	6.1
Raw Materials DSI	27.8	25.3	25.4	24.1
Total DSI	112.8	104.5	106.4	101.8
	7/3/2021	4/3/2021	12/31/2020	9/26/2020
Finished Goods DSI	66.1	71.7	69.2	63.8
In-Progress DSI	5.7	6.4	6.4	6.0
Raw Materials DSI	20.5	20.8	20.9	19.9
Total DSI	92.3	98.9	96.5	89.7
	6/27/2020	3/28/2020	12/31/2019	9/28/2019
Finished Goods DSI	74.6	82.3	84.0	81.5
In-Progress DSI	6.4	7.2	7.5	7.5
Raw Materials DSI	23.1	26.3	27.5	27.4
Total DSI	104.1	115.7	119.1	116.4
	6/29/2019	3/30/2019	12/31/2018	9/29/2018
Finished Goods DSI	81.6	79.6	81.6	76.7
In-Progress DSI	7.6	8.2	8.5	8.3
Raw Materials DSI	27.4	26.7	27.9	25.4
Total DSI	116.6	114.5	118.0	110.4

However, we included four years' worth of data to show that despite this increase, DSIs are still not back to their pre-pandemic levels. MHK rapidly sold out of inventories during the pandemic boom and has been struggling to rebuild in the wake of supply chain problems. The company stated on the conference call that “our inventory levels remain historically low and are further limiting our overall sales.” Therefore, we expect to see continued increases in the quarters ahead as the company rebuilds to normal levels.

Cloudflare, Inc. (NET)
Earnings Quality Update

We are maintaining our earnings quality rating of NET at 3- (Acceptable).

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

Summary

We still believe the biggest risks for NET remain its growing negative free cash flow and the inability to reach its long-term forecast of reaching a non-GAAP operating margin of 20% from the current 0%. That forecast may require much more stock-based compensation.

NET's non-GAAP results of 0 cents beat forecasts by 1 cent for 2Q22. We can find the full penny from three non-operating areas:

- Other income which is FX gains or property sale gains added 0.3 cents
- Non-GAAP Interest expense swung to income and added 0.4 cents
- Taxes were lower and added 0.2 cents

As we feared, NET's adjusted EPS of $0.00 vs. -$0.02 in 2Q21 was fueled by ignoring the cost of acquisitions and paying greater amounts of wages with stock. The company remains free cash flow negative despite adding back stock comp and that is getting worse:

	2Q22	**2Q21**
GAAP EPS	-$0.20	-$0.12
Stock Comp	$0.18	$0.08
Amort Acquired Intangibles	$0.02	$0.00
Amort Debt Issue Costs	$0.00	$0.03
Tax Adjustments	$0.00	-$0.02
Non-GAAP EPS	$0.00	-$0.02
Free Cash Flow	-$4.4	-$9.8
Stock Comp	$57.5	$24.1

What Was Weak?

- Free Cash Flow remains poor despite adding back stock compensation.

	2Q 22	1Q 22	4Q 21	3Q 21	2Q 21	1Q 21	4Q 20
T12 Free Cash Flow	-$99.9	-$105.3	-$43.1	-$75.2	-$53.3	-$63.7	-$92.1
T12 Stock Compensation	$169.3	$136.1	$117.3	$93.6	$81.5	$72.0	$63.5

Of all the companies in the security software group, NET is the only one that is reporting negative free cash flow despite adding back stock compensation. OKTA and ZS have positive free cash flow, but would not if they were paying employees entirely in cash. CRWD, PANW, and FTNT have positive free cash flow and still would if paying all cash wages:

- Free Cash Flow also received an unsustainable boost as the company is stretching payables and accrued expenses:

	2Q 22	1Q 22	4Q 21	3Q 21	2Q 21	1Q 21	4Q 20
Accounts Payable	$55.732	$32.925	$26.086	$34.561	$29.558	$20.475	$14.485
Non-GAAP COGS	$49.491	$45.221	$40.313	$35.785	$33.526	$30.861	$27.637
DPOs	102.5	65.5	59.5	88.9	80.2	59.7	48.2
Accrued Exp. & Other Cur. Liabilities	$53.184	$40.888	$38.085	$33.841	$33.483	$24.022	$20.217
Days of Sales	20.6	17.3	18.1	18.1	20.0	15.7	14.8

**Non-GAAP COGS removes stock compensation and amortization of intangibles.*

Free cash flow is already a huge negative figure of -$100 million for the last twelve months and it includes the $169 million of employee pay from stock options. We also see above that accounts payable DPOs skyrocketed in 2Q22. The YOY increase in payables added about $26 million to cash flow in the quarter. A YOY increase in accrued expenses added another $20 million. Free cash flow is also being helped by rising deferred revenue that increased by $78 million in the last year. Deferred Revenues more than offset receivable growth of $46 million yet FCF was still a huge negative number.

- Headline Free Cash Flow is also overstated as it ignores the cash cost of NET's acquisitions. Cash spent on acquisitions was $92.5 million in the last year vs. the already negative $100 million in free cash flow.

- NET just reported a 0% non-GAAP operating margin for 2Q22. To reach that figure, it added back $57.5 million in stock compensation which was 24.5% of sales. It also added back $6.2 million in amortization of acquired intangibles and acquisition costs of just under 3% more of sales. NET's goal is a 20% non-GAAP operating margin, which we think means it will need to exclude about 47% of GAAP costs. Does that mean employees are going to accept 40% or more of their pay in stock?

- The bulk of the cost-cutting is expected to come from non-GAAP Sales and Marketing which is supposed to decline 1500bp as a percentage of sales from 42% of sales to 27%-29%. It was 44% in 2Q22. The key here is NET needs the cash cost to decline by 1500bp, not the total cost that includes stock compensation. **Total cost with stock compensation and amortization of intangibles was 50% in 2Q22. Compared to the non-GAAP 44%, there is a hefty amount of cash expenses in selling costs.** Here is the discussion on Sales and Marketing from the 10-K:

> *"Sales and marketing expenses* ***consist primarily of employee-related costs, including salaries, benefits, and stock-based compensation expense, sales commissions*** *that are recognized as expenses over the period of benefit, marketing programs,* ***certificate authority services costs for free customers****, travel-related expenses,* ***bandwidth and co-location costs for free customers****, and allocated overhead costs. Sales commissions earned by our sales force and the associated payroll taxes that are direct and incremental to the acquisition of channel partner and direct customer contracts are deferred and amortized over an estimated period of benefit of three years for the initial acquisition of a contract and over the contractual term of the renewals for renewal contracts****. We plan to continue to invest in sales and marketing to grow our customer base and increase our brand awareness, including marketing efforts to continue to drive our pay-as-you-go business model. As a result, we expect our sales and marketing expenses to increase in absolute dollars for the foreseeable future. However, we expect our sales and marketing expenses to decrease as a percentage of our revenue over the long term****, although our sales and marketing expenses may fluctuate as a percentage of our revenue from period to period due to the timing and extent of these expenses."*

- Looking further at Sales and Marketing, NET has millions of free customers who do not pay it at all. It may be that only 5%-10% of the customers do pay them. NET is operating a network and paying fees for bandwidth and co-location for the other 90%-95% too. We doubt the companies NET is paying are going to accept shares as payment, so that area should remain a cash cost. The same could be said about advertising payments.

	2021	2020	2019
Advertising	$36.2	$25.0	$18.8
% of Revenue	5.5%	5.8%	6.6%

Advertising payments are falling as a percentage of sales, but the absolute dollar figure seems likely to keep rising. This is a cash cost too related to finding more free users.

- Sales commissions are still rising. That makes sense as NET is still growing revenues and is touting new client sign-ups. They capitalize initial commissions and amortize them over 3 years. Renewals are capitalized and amortized over the length of the renewal. With rising commissions, the amount going into expense is going to keep rising for years to come:

	2Q 22	1Q 22	4Q 21	3Q 21	2Q 21	1Q 21	4Q 20
Deferred Acq. Costs	$15.0	$15.6	$17.3	$12.8	$14.5	$10.9	$11.7
Amortized Acq. Costs	$10.6	$9.7	$8.6	$7.8	$6.9	$6.1	$5.2
Build up of Future Expense	$4.4	$6.0	$8.7	$5.0	$7.6	$4.8	6.5

As renewals become a larger part of the business, the amount of deferred acquisition costs should more closely align with the amount being expensed. Until that time, the amount of new commissions being capitalized should be lumpy from quarter to quarter, but the rising total of unexpensed commissions should keep pushing up the amortization figure.

- We believe NET can leverage marketing costs. The problem we see is all the costs should continue to rise – bandwidth, advertising, commissions, co-location… At the same time, NET is guiding to impressive y/y revenue growth, but the rate is slowing: 41% for 4Q20, 45% for 3Q20, 54% for 2Q20, and 54% for 1Q20. At the same time, non-GAAP Sales and Marketing is still growing at a fast clip: by 42% in 1Q22 and 52% in 2Q22. So if we assume NET can grow sales at 40% for a while and Sales costs only rise at 30% for a while, it can start adding 200-300bp to non-GAAP margins per year – it will just take 6-10 years of 40% growth to hit their target. Otherwise, NET needs to convert more pay to stock compensation to speed up this process. That seems unlikely too. The problem we see is too many of these cost items represent cash spending now and with the stock down 70% from its highs, it may not be an appealing currency.

What Was Strong?

- Revenue growth continues to grow sequentially and y/y. This was driven by a retention rate of over 100% again. Retention measures clients that paid for both this period and last year. It measures in dollar terms, so NET is retaining clients and getting them to spend more:

	2Q22	1Q22	4Q21	3Q21	2Q21	1Q21	4Q20
Sales Growth (seq)	11.1%	10.0%	12.4%	13.1%	10.4%	9.7%	38.0%
Retention	126%	127%	125%	124%	124%	123%	119%

- Deferred Revenue grew faster than sales, allowing the DSO figure to grow too. That should make it easier to hit revenue guidance. NET beat revenue guidance by $7 million in 2Q22:

	2Q22	1Q22	4Q21	3Q21	2Q21	1Q21	4Q20
Sales Growth	11.1%	10.0%	12.4%	13.1%	10.4%	9.7%	38.0%
Deferred Rev Growth	18.5%	13.2%	24.9%	14.7%	18.3%	25.9%	13.4%
Sales	$234.5	$212.2	$193.6	$172.3	$152.4	$138.1	$125.9
Def. Revenue	$162.7	$137.2	$121.2	$97.0	$84.6	$71.5	$56.8
Days of Sales	63.1	58.2	57.6	51.8	50.5	46.6	41.5

Dentsply Sirona Inc. (XRAY)
Earnings Quality Update

We are maintaining our earnings quality rating of XRAY at 2- (Weak).

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

Summary

XRAY gave preliminary 2Q22 results of sales coming in at $1.005 billion or greater and adjusted EPS of $0.60 or greater. It held its lowered full-year outlook of organic sales growth of 2-3%, adjusted margin of 17%, and adjusted EPS of $2.35-$2.55. It did indicate a greater headwind from FX than it had in May.

No information regarding the completion of the audit, new information on it, and neither the 1Q22 10-Q or 2Q22 10-Qs are available. We understand that since the Chief Accounting Officer left on August 4, 2022, it is unlikely new people in control will sign off on SEC documents until they fully understand the situation and work with the SEC to resolve it.

We see a few other areas for concern from the preliminary results of 2Q22:

- XRAY noted that 2Q22 benefited from deferring some costs that will be recognized in 3Q and 4Q, so margins for the second half are already facing headwinds beyond FX. It also noted that 2Q growth was helped by taking pricing. Yet, it didn't even recover lost sales from 1Q.

- The adjustments from GAAP to non-GAAP EPS widened to 34 cents. In the prior five quarters, adjustments were 19-29 cents. In the period when it was 29 cents (4Q21) there were higher losses in equity investments.

- The largest part of non-GAAP adjustments is adding back amortization of acquired intangibles. That has been fairly stable as well at $55-$56 million the prior five quarters. Guidance in the 10-K was it would fall from $222 million in 2021 to $214 million in 2022. Yet, guidance for 2Q22 is this will be 18 cents of adjusted EPS. That looks low to us – being approximately $39 million after taxes. At an 18%-21% tax rate, this would be about

$48-$49 million vs. $55 million. So we expect XRAY to report that it took an impairment for acquired technology or customer relationships.

- Restructuring is forecast to be 13 cents of adjusted EPS for 2Q22. That should be about a $35 million hit pretax. That is far out-of-line with recent periods too where it has been $0-$8 million. This may be where an impairment occurs.

- Marking investments to Fair Market Value is forecast to be 4 cents of adjusted EPS, which sounds like a $10-$11 million hit. That has been a $2-$4 million item for most recent periods. That could be an FX-related hit. It could also be an impairment to the value of an equity investment.

- 1Q22 results where XRAY pre-announced problems and the departure of the CEO and CFO were hit by too much CAD/CAM inventory in the dealer networks. XRAY said dealers were carrying $50 million in excess inventory and that was the key reason US organic sales were down 13.5%. Yet, this contradicts the supply chain shortage story. How did they overstock dealers with tech equipment if they couldn't complete machines? Also, if that stock was worked down in the channel, why are sales only $1.005 million vs. 1Q22 sales of $965 million? The reduced guidance for 2022 is $4.1-$4.2 billion in sales. They will need a strong back-half of the year to hit that figure. Organic growth was -1.4% in 1Q22 and 2Q sales growth will be -6% before adjusting out FX to determine organic growth. Forecasts call for 2%-3% organic growth for 2022.

- It's also worth watching R&D here. XRAY's goal is to spend 4% of sales and it complained about the lower sales figure in 1Q for lowering margins because costs like R&D saw reverse leveraging on margins. We've pointed out that XRAY was underspending in this area for some time. It is difficult to say $45 million in 1Q22 was a big headwind. Based on initial sales guidance of $4.3-$4.4 billion for 2022, XRAY should have budgeted $43-$44 million per quarter:

	1Q22	**4Q21***	**3Q21**	**2Q21**	**1Q21**	**4Q20**	**3Q20**	**2Q20**
R&D Spending	$45	$59	$35	$40	$40	$44	$27	$18

**Don't forget 4Q21 saw XRAY reclassify costs expensed earlier in the year as SG&A into R&D to meet the 4% of sales promise. R&D was really $49 million in 4Q21.*

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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