

## Welltower (HCN) Cancel SELL Initiation of EQ Coverage

Current EQ Rating*	Previous EQ Rating
3-	na

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 are canceling our SELL recommendation on WELL as the new structure has already shown many of the risks we had highlighted.** Essentially this is a very high fixed-cost business that needs very high occupancy to make money, but residents churn over a 30-36 month cycle requiring it to bring in significant numbers of new residents all the time. COVID halted new move-ins and accelerated move-outs. Its moves to become an operator inflated the REIT stats by omitting several ongoing costs and still viewing the company as a triple-net lease landlord. And now the CEO has left. Liquidity was enhanced by issuing new debt and selling properties and should be adequate with small near-term maturities.

**We are initiating earnings quality coverage of WELL with a rating of 3- (Minor Concern)**

What concerns us most is the WELL has changed its operating model considerably over time, but still does not update its key reports stats to reflect it has higher cash outflows under the new operating model. Funds from Operations are overstated in our view. There remain several areas of risk for further impairments in our opinion too.

### **What Is Getting Worse:**

- As an operator of senior housing more than a passive triple-net landlord these days, WELL should adjust its FFO calculation to account for capital spending on existing properties. This lowers pre-COVID FFO/share from \$3.70-\$3.90 to about \$3.00.
- Falling occupancies should pressure FFO for a longer time as operating leverage unwinds too. This can cause more impairments.
- WELL adds back losses from non-consolidated entities in its FFO calculation. However, it consistently is a net drag on cash flow of about \$50 million, or another 12-cents in FFO.
- Write-offs and impairments continue to hit the property book as WELL restructures additional properties from triple-net to JV's where it shares the costs and profits of operating the facilities.

### **What Is Getting Better:**

- The 30% dividend cut improves the coverage considerably.
- The company boosted liquidity by issuing debt, selling properties, and paying down near-term maturities. It should be able to ride-out COVID. Its net debt figure is still 5.7x EBITDA.
- WELL's real estate lending book may have been through the worst of its Genesis story. It has collected, written off, or reserved for 55% of the loan at this point.

### **What to Keep Watching:**

- WELL has become more focused on buying/building properties and selling them too. Gains from selling facilities are half of pre-COVID income.
- This creates a circular issue – if sold property is not replaced, then future FFO declines. If it is replaced – WELL has a history of seeing purchases exceed sales in dollar terms and it funds that shortfall by issuing more stock.

- The share count is up 20% since 2015 and ROI generally ranges between only 7.5%-8.5% using EBITDA less maintenance spending – which gives them credit for the gains achieved on property sales.
- Non-consolidated entities historically carried more debt and consistently lose money – WELL may have to invest more in this area on existing deals.

## Senior Housing Has More Expenses than Triple-Net Leasing – WELL Does not Adjust for This in Stats

Originally, Welltower was overwhelmingly a straight landlord under triple-net lease arrangements. That means it owned the real estate and another company operated the business and paid rent to WELL. It also means that the operating company covered taxes, maintenance/upkeep, capital upgrades, and insurance. This effectively makes the rent payment smaller.

Over the last 5 years, Welltower moved away from the triple-net structure and into being the owner/operator of properties. This is the Senior Housing unit. On the surface, WELL can collect more money on the top-line than with triple-net leases. However, it also has more operating expenses to pay such as running the business, property taxes, insurance, and capital spending to repair and upgrade the property. In its reported REIT stats, Welltower does not adjust for this change in business model – it simply touts that it has become more profitable via Funds from Operations – which is Net Income + Depreciation/Amortization + Impairments +/- Gains/Losses – non-consolidated entity income:

	2019	2018	2017	2016	2015	2014	2013
Reported FFO	\$3.91	\$3.71	\$3.16	\$4.39	\$4.03	\$3.82	\$3.32
CapX existing units	\$0.81	\$0.71	\$0.68	\$0.61	\$0.54	\$0.43	\$0.49
Adjusted FFO	\$3.10	\$3.00	\$2.48	\$3.78	\$3.49	\$3.39	\$2.83
Dividends/Share	\$3.48	\$3.48	\$3.48	\$3.44	\$3.30	\$3.18	\$3.06

We think this is important because on the FFO figures WELL reports, it has enjoyed solid dividend coverage for a REIT. But, subtracting out the recurring capital spending for properties where the company is the operator and a third-party tenant is paying the maintenance and capital improvement – suddenly WELL has not covered its dividend since 2016.

COVID made this worse and it gave the company an excuse to cut the dividend from 87-cents/quarter to 61-cents. The cuts may not be finished:

	2Q20	2Q19	1Q20	1Q19
Reported FFO	\$0.80	\$0.96	\$0.86	\$1.17
CapX existing units	\$0.10	\$0.17	\$0.17	\$0.14
Adjusted FFO	\$0.70	\$0.79	\$0.69	\$1.03
Dividends/Share	\$0.61	\$0.87	\$0.87	\$0.87

- WELL is claiming – “normalized” 2Q’20 FFO is 86-cents based on COVID-related expenses

Here are the items we think investors should focus on:

- With COVID, WELL slashed its maintenance Cap-Ex in 2Q20. That will need to rise going forward in our opinion. That could squeeze real FFO more going forward.
- The change to owning and operating the properties has not led to income growth. FFO adds back impairments and gains/losses. FFO/share has been falling since 2016.
- FFO also adds back the impacts the unconsolidated entities and noncontrolling interests – we will discuss these below – but they have been consuming cash also.
- WELL has shed more operating income from Triple-Net than it gained from Senior Housing. Operating income in Triple-Net fell from \$1.2 billion in 2015 to \$450 million in 2019. Seniors Housing rose from \$700 million to just over \$1 billion for the same period.
- The operating results are likely to get worse before they get better and lower FFO more due to falling occupancy rates. At the same time, most costs to run the facilities are largely fixed.
- The Net Debt to EBITDA is 5.7x (\$12.76b / \$2.25b). The highest EBITDA has ever been is \$2.33 billion. That level of debt may pressure the dividend even though near-term maturities are not heavy.
- Earnings are lower than FFO too - \$3.05 in 2019 EPS vs. \$3.91 in FFO and 2Q20 EPS was 38-cents vs. 80-cents in FFO. We think there could be more impairments

to push down EPS and the dividend requirements of 90% payout are driven by EPS not FFO.

## More Impairments Seem Likely in Several Areas Due to Low Occupancy

In looking at WELL, it invests in Senior Housing in a number of ways. In nearly every case, the operating economics include heavy fixed costs and profits require a high occupancy rate. It really gets down to the fact that the whole facility has to be cleaned and maintained whether 8 people live there or 80. The same is true with cooking meals and having medically trained staff on-site. Utilities, insurance, and vehicles all add costs.

Senior Housing has been an area in real estate that has been overbuilt. People have waited longer to move-in. Because they wait longer, they may have more health issues and require more care which also adds more to costs. On the 2Q'20 conference call, the CFO confirmed this again, saying, “move-in pick-ups are really going to your most needs-based resident.”

Plus, the older properties have to compete even more on price and can pressure the prices others can charge. We have discussed in the past how several times players in this industry have said the only way they can get a meaningful price hike is to get it from new residents as the current residents simply are not there long enough for 1%-2% annual price increases to make a difference. On top of that, residents turn over quickly. The typical resident lives in Senior Housing about 30-36 months. So, all these properties need to add new residents that replace one-third of their current occupants every year just to post flat results.

From what we have seen, break-even for a senior living property is occupancy in the high 70%-low 80% range. Companies in the past with occupancies of about 85% have seen profits falling as their cost inflation cannot be absorbed at 85% occupancy. Also, there have been acquisitions done with figures below that occupancy where the buyer essentially said, “we are confident we can turn it around and we are buying the real estate below replacement cost.”

The first problem we see is occupancies were not very high coming into COVID and they have dropped off since then. The decline has been in place since 2016:

Occupancies	2Q20	1Q20	2019	2018	2017	2016	2015
WELL Sr Housing	82.9%	86.9%	86.9%	87.5%	85.8%	86.5%	87.2%
WELL Triple Net	85.6%	86.1%	84.3%	84.9%	86.5%	88.7%	91.0%
Brookdale	77.8%	83.0%	83.9%	84.3%	85.0%	86.0%	86.9%
Healthpeak	79.8%	85.7%	83.0%	85.0%	87.0%	88.0%	87.0%
Ventas	82.2%	86.6%	86.6%	87.0%	88.3%	90.3%	91.2%

Take some of this with a grain of salt as companies like WELL actively traded properties and moved more into JVs during this time and to other non-consolidated entities where they own under 50% and may be out of the metrics. (In fact – they just completed another sale of senior housing into a JV they own). They would have kept some of the better-performing ones and focused on culling weaker performers. But the long term trend has fallen off. Also, these are often the one month snapshot for occupancy rates. WELL provided another snapshot of recent month-by-month occupancies for senior housing:

Occupancies	20-Jul	20-Jun	20-May	20-Apr	20-Mar	20-Feb
WELL Sr Housing	79.4%	80.1%	81.0%	82.8%	85.0%	85.8%

Falling occupancy and COVID have multiple negative implications for cash flows to test for impairments as well as simply the cash flows that make up FFO:

- COVID means higher mortality rates of current residents – so they need a higher replacement rate
- COVID means people are more afraid to move in and there may be higher health quality requirements to move in.
- COVID boosts training, cleaning, new repairs/upgrades to facilities, and perhaps other medical operating costs
- Falling occupancies have normally led to lower rents for new residents
- Falling occupancies simply reduce operating leverage – and thus lower cash flow and operating income and several of these players are at the problem stage now
- High debt levels mean the equity values for these investments will suffer the most if income levels drop

## Welltower Has a Sizeable History with Impairments and Restructuring

The bullish case for WELL used to center on master-lease arrangements with Triple-Net operators. The Aging of America story would boost demand, allow the operators to raise prices and occupancy, and if there were problems with any facilities – the operator couldn’t just toss it out of the portfolio due to the master-lease. Despite all this – WELL managed to see many types of problems:

	2Q20	1Q20	2019	2018	2017	2016	2015
Impairments	\$77.0	\$60.1	\$28.1	\$115.6	\$124.5	\$37.2	\$2.2
Loan Losses	\$1.4	\$7.1	\$18.7	\$0.0	\$63.0	\$10.2	\$0.0
Other Exp.	\$19.4	\$6.3	\$52.6	\$112.9	\$177.8	\$12.0	\$46.2

- 2Q20 – Entered a contract to sell six Senior Housing properties and the price triggered a \$56.4 million impairment. Another sale of property caused an \$18.8 million impairment.
- 1Q20 – Wrote off \$32.3 million in rent as it amended a lease. It also wrote off \$27.8 million to reflect properties carried at a level above Fair Market Value.
- 2019 – Wrote off \$18.7 million in real estate loans receivable deemed uncollectible.
- 2018 – \$81.1 million to terminate a Triple-Net relationship and restructure it as Senior Housing in a JV – appeared in other expenses.
- 2018 - \$79.6 million to terminate another Triple-Net relationship and restructure the deal as Senior Housing.
- 2017 - \$88.3 million in other expenses to terminate a Triple-Net relationship and restructure deal.
- 2017 - \$96.9 million impairment taken against 21 properties.
- 2017 - \$63.0 million of first mortgage notes of Genesis written off.
- 2016 – like 2017, found value impaired for 22 properties and wrote off \$20.2 million plus a \$6.9 million of Genesis first mortgage notes written off.

- 2015 - \$35.6 million charge in other expenses as Genesis value above Fair Market Value.

Some things to keep in mind: 1-cent in FFO is currently about \$4.2 million and they are adding back impairments in calculating FFO. Adjusted for the maintenance spending, we see pre-COVID FFO at about \$3.00 per share. WELL is routinely getting about 20-cents of \$3.00 by adding back all these recurring “one-time” items. They are not adjusting for the charges taken in “other expenses” so in 2017 for example – it added back the \$96.9 million impairment of properties but not the \$88.3 million to terminate and restructure a Triple-Net lease in other expenses.

**Further, Triple-Net lease operators have no incentive to convert a solid operating property to a Senior Housing structure and split the profits/losses with WELL.** In the case say of an occupancy of 90%-95%, that operator loves having a low fixed lease payment to WELL and keeping all the profits for themselves. If they are losing money, having WELL sign on to cut rent expense, fund some of the losses and capital improvements in return for potentially higher profits if occupancy rises sounds like a reasonable deal to pursue. **The key is these are more troubled properties in the first place and WELL is assuming more risk making these conversions and recognizing impairments in the process.**

As WELL has pulled more troubled properties out of Triple-Net and moved them to Senior Housing where they share in operating expenses, profits and losses – the growth in Triple-Net same-store operating income has improved while same-store operating income in Senior Housing has declined:

SS NOI Growth	1H20	2019	2018	2017	2016
Sr. Housing	-16.1%	-0.2%	-1.0%	1.4%	1.2%
Triple-Net	1.7%	1.5%	1.5%	1.6%	-5.2%

Two of the bigger companies where WELL has become more involved via joint ventures and converting troubled Triple-Net leases into Senior Housing partnerships are Sunrise and Revera. These are 23% and 11% of Senior Housing operating income. WELL owns 34% of Sunrise. They appear to be doing even worse than the same-store portfolio has a whole:



SS NOI Growth	2Q20	2Q19	2Q18	2Q17
Sunrise	-39.4%	-4.1%	6.5%	10.0%
Sunrise units	127	123	124	116
Revera	-32.4%	-6.5%	1.3%	0.0%
Revera units	94	98	98	98
Full Sr. Housing	-24.7%	-1.7%	0.0%	-2.6%

- If we adjust for the growth of Sunrise units helping drive higher NOI – we estimate the **10.0% in 2Q17 growth becomes -1.3% dividing** NOI by 116 units compared to NOI divided by 104 units in 2Q16. **The 6.5% growth in 2Q18 become 0%** under the same adjustment.

## Unconsolidated Entities Pose Risks Too

A great deal of WELL's Senior Housing is operated in JVs where the company owns more than 50% of the deal and/or is considered the Primary Beneficiary. There are also investments that are not consolidated. This is where ownership is 10%-50% and WELL is not the Primary Beneficiary. 72% of these entities represent Senior Housing as well. We see several points of concern with these entities:

- WELL does not make money with these deals. It is carrying these assets on the books for \$786.9 million. Nearly every year, the cash outflow to unconsolidated entities exceeds the cashflow in from those entities:

N/C Entities	2Q20	1Q20	2019	2018	2017	2016	2015
Income from N/C	\$1.3	-\$3.7	\$42.4	-\$0.6	-\$83.1	-\$10.4	-\$21.5
Cash to N/C	-\$88.6	-\$137.1	-\$279.6	-\$136.9	-\$114.4	-\$101.4	-\$160.3
Cash from N/C	<u>\$5.2</u>	<u>\$3.6</u>	<u>\$216.2</u>	<u>\$90.9</u>	<u>\$70.3</u>	<u>\$119.7</u>	<u>\$130.9</u>
Impact on FCF	-\$83.4	-\$133.5	-\$63.4	-\$46.0	-\$44.1	\$18.3	-\$29.4

- The \$42.4 million in income for 2019 includes a one-time gain of \$38.7 million

- WELL still expects to fund another \$212.3 million to these entities as of 6/20.
- The income (loss) from non-consolidated entities is adjusted out of FFO because it is non-cash. However, these investments are routinely a net cash drain. **As we showed above, FFO after paying for Capital Spending at existing properties is about \$3.00 per share pre-COVID. A \$50 million cash flow drain is 12-cents per share that WELL has to cover before the dividend.**

- WELL stopped disclosing the balance sheet information for these investments in 2017. We know total liabilities to equity was 2.7x and 2.75x in 2017 and 2016. For June 2020 and December 2019 – WELL’s balance sheet was just under 1.0x total liabilities to equity. Assuming the non-consolidated entities still have similar balance sheets – there is much more leverage at work here for entities that as a whole are losing money.
- WELL could face the risk have having to invest larger sums into these investments if other partners bow-out if more cash is needed. It has already boosted its exposure. Its share of investments in this area were under \$500 million 2016-18 (\$483 million in 2018). It is now \$787 million.
- WELL may invest more in these deals than they are worth. Their accounting treatment if their investment exceeds Fair Value – the excess will be amortized against WELL’s share of income from these entities. We did not find enough information or discussion to determine if this has occurred or if it is material.

## Real Estate Loans and Allowances May See Less Fireworks

Welltower ran into one huge loan that became a disaster for it related to Genesis Healthcare. In 2015, WELL had \$820 million of real estate loans. In 2016, it had to restructure the \$317 million Genesis loan into four different ones. At that time, it took a \$6.9 million reserve. Prior to that, its loan loss allowance was zero. These were mortgage loans.

Loan Book	2Q20	1Q20	2019	2018	2017	2016	2015
R/E Loans	\$228.7	\$223.7	\$312.8	\$398.7	\$495.9	\$622.6	\$819.5
Loss reserve	\$3.9	\$2.5	\$42.4	\$68.4	\$68.4	\$6.6	\$0.0
Allowance %	1.7%	1.1%	13.5%	17.1%	13.8%	1.1%	0.0%
Non R/E Loans	\$452.0	\$451.3	\$362.9	\$282.4	\$0.0	\$0.0	\$0.0
Loss reserve	\$78.1	\$78.1	\$26.0	\$0.0	\$0.0	\$0.0	\$0.0
Allowance %	17.3%	17.3%	7.2%	0.0%	0.0%	0.0%	0.0%
Total Loans	\$680.7	\$675.0	\$675.7	\$681.1	\$495.9	\$622.6	\$819.5
Bad Debt Exp.	\$0.0	\$6.9	\$18.7	\$0.0	\$63.0	\$6.9	\$0.0

- In 2017, Genesis deteriorated further and the allowance rose by \$63.0 million.

- In 2018, it collected \$85.3 million on the loan.
- In 2019, an extra reserve of \$18.7 million was taken and written off. It moved one of the four loans to non R/E Loans as the collateral was sold.
- In 1Q20, another Genesis loan was moved to non R/E Loans of \$86.4 million along with \$42.4 million of loss reserve

Overall the loan book is getting smaller. We would argue that the remaining non R/E Loan book could be viewed as more questionable as it lacks a mortgage. That area is not all the Genesis stuff. Genesis moved it from \$282 to \$452 million.

## Is Welltower Becoming More of a Deal Maker than an Operator?

Two other things jumped out at us in recent years: First, the bulk of income is coming from gains on real estate sales. Second, the share count has grown rapidly.

The company is repeatedly selling assets into its own JVs and booking gains. Other times it is booking gains selling the JVs to other parties. Some of these properties are being purchased and others constructed. We can argue that they have taken impairments and charges against some of these properties before booking the gain. **However, in dealing with the FFO figure – WELL ignores impairments and it ignores the gains. So, there is no impact on FFO.** However, the cash outflow to make purchases continually exceeds the cash inflow from the actual sales. They are in turn funding part of that shortfall by issuing more shares of stock:

R/E Trading	2Q20	1Q20	2019	2018	2017	2016	2015
Cost of R/E Sold	\$1,021.0	\$528.4	\$1,900.9	\$1,125.1	\$1,011.2	\$1,852.4	\$543.6
Gain realized	\$155.9	\$262.8	\$748.0	\$415.6	\$344.3	\$364.0	\$280.4
Net Proceeds from R/E	\$1,196.7	\$801.4	\$2,650.7	\$1,541.9	\$1,378.0	\$2,350.1	\$824.0
Net Income	\$159.2	\$329.4	\$1,330.4	\$829.8	\$540.6	\$1,082.1	\$888.5
Gain % of Income	98%	80%	56%	50%	64%	34%	32%
Cash Received on Sale	\$1,196.7	\$801.4	\$2,650.7	\$1,541.9	\$1,378.0	\$2,350.1	\$824.0
Cash Spent on R/E	\$0.0	-\$390.8	-\$3,959.7	-\$3,560.4	-\$805.3	-\$2,145.4	-\$3,364.9
Construction	-\$73.3	-\$48.8	-\$323.5	-\$160.7	-\$232.7	-\$403.1	-\$244.6
Net Cash Change	\$1,123.4	\$361.8	-\$1,632.5	-\$2,179.2	\$340.0	-\$198.4	-\$2,785.5

Cash from Eq. Sale	\$4.3	\$591.0	\$1,056.1	\$789.6	\$622.0	\$534.2	\$1,755.7
Diluted Shares O/S	419.1	412.1	403.8	375.3	369.0	360.2	349.2

We are looking at this more from a cash flow situation. The only time this isn't a large cash drain is in years when WELL doesn't buy much Real Estate like in 2017 and 2020. The problem then becomes, it is selling off future income in the form of rental revenue and not replacing it. That would reduce FFO and the cash to pay the dividend and the capital spending to maintain the current Senior Housing.

However, if they replace what they sell, then they spend the cash proceeds and then some. The share count is up 20% over this time. Even through the dividend when flat for several years before the recent cut, the total outlay was still increasing. Dividend outlay rose 16% from 2015-2019. Also, their cost of equity capital at \$55 per share was 6.3% before the dividend cut. Now it's 4.4%. It's not as though their ROI is that great overall. If we use straight EBITDA – less maintenance spending as a proxy for income, it will give WELL credit for all the gains they have achieved on asset sales, which exceed the impairments. It will also recognize that there is an operating business here that earns rental income and will deduct the non-consolidated losses:

ROI	12 mths 6/20	2019	2018	2017	2016	2015
EBITDA	\$2,996	\$2,916	\$2,315	\$1,967	\$2,486	\$2,213
Maint. Cap EX	<u>\$327</u>	<u>\$329</u>	<u>\$266</u>	<u>\$250</u>	<u>\$219</u>	<u>\$188</u>
Cash flow Proxy	\$2,669	\$2,587	\$2,049	\$1,717	\$2,266	\$2,026
Equity	\$16,048	\$15,540	\$14,632	\$14,423	\$14,806	\$14,591
Debt	\$14,436	\$14,915	\$13,227	\$11,732	\$12,358	\$12,877
less Cash	\$1,679	\$285	\$215	\$244	\$419	\$361
Capital	\$28,805	\$30,170	\$27,644	\$25,911	\$26,745	\$27,107
ROI	9.3%	8.6%	7.4%	6.6%	8.5%	7.5%

We think under the best light – giving WELL full credit for the gains on asset sales – this is a 7.5%-8.5% ROI business. And the difference is often the size of the gain they take as that is such a large part of income. In 2017, the gain was only \$344 million and ROI was 6.6%. In 2019, the gain was \$748 million, and ROI was 8.6%. 130 bp of the improvement was due to the \$404 million larger gain.

For the trailing 12 months ended 6/30, WELL was helped by selling assets and not replacing them. That grew the cash balance and cut the capital figure by \$1.4 billion – that added 50bp. The gain for the trailing 12 months was also \$1.0 billion. Every \$100 million of that added 35bp to ROI. The problem going forward as we noted above – if they sell assets and don't replace them it should make future operating income lower and future gains lower too. That would push ROI down.

## 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

*Behind the Numbers, LLC is an independent research firm structured to provide analytical research to the financial community. Behind the Numbers, LLC is not rendering investment advice based on investment portfolios and is not registered as an investment adviser in any jurisdiction. All research is based on fundamental analysis using publicly available information including SEC filed documents, company presentations, annual reports, earnings call transcripts, as well as those of competitors, customers, and suppliers. Other information sources include mass market and industry news resources. These sources are believed to be reliable, but no representation is made that they are accurate or complete, or that errors, if discovered, will be corrected. Behind the Numbers, LLC does not use company sources beyond what they have publicly written or discussed in presentations or media interviews. Behind the Numbers does not use or subscribe to expert networks. All employees are aware of this policy and adhere to it.*

*The authors of this report have not audited the financial statements of the companies discussed and do not represent that they are serving as independent public accountants with respect to them. They have not audited the statements and therefore do not express an opinion on them. Other CPAs, unaffiliated with Mr. Middleswart, may or may not have audited the financial statements. The authors also have not conducted a thorough "review" of the financial statements as defined by standards established by the AICPA.*

*This report is not intended, and shall not constitute, and nothing contained herein shall be construed as, an offer to sell or a solicitation of an offer to buy any securities referred to in this report, or a "BUY" or "SELL" recommendation. Rather, this research is intended to identify issues that investors should be aware of for them to assess their own opinion of positive or negative potential.*

*Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them may have a position in, and from time-to-time purchase or sell any of the securities mentioned in this report. Initial positions will not be taken by any of the aforementioned parties until after the report is distributed to clients, unless otherwise disclosed. It is possible that a position could be held by Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them for stocks that are mentioned in an update, or a BTN Thursday Thoughts.*

