Clorox Company (CLX)

Updated April 6th, 2018 by Josh Arnold

Key Metrics

Current Price:	$130	**5 Year CAGR Estimate:**	5.8%	**Quality Percentile:**	N/A
Fair Value Price:	$117	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	N/A
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.1%	**Total Return Percentile:**	N/A
Dividend Yield:	2.9%	**5 Year Price Target**	$149	**Valuation Percentile:**	N/A

Overview & Current Events

Clorox is a manufacturer and marketer of consumer and professional products spanning a wide array of categories from charcoal to cleaning supplies to salad dressing. The company was founded in 1913 and has a market cap of $17B. More than 80% of its $6B in annual revenue comes from products that are #1 or #2 in their respective categories.

The company's recent Q2 report was mixed as volume growth continued but has decelerated from high levels of growth in 2017. In addition, gross margin weakness is persisting after peaking in 2016, due to higher transportation and input costs. Clorox provided favorable guidance for 2018 but it is largely due to tax reform and not growth in operating earnings. Management has reiterated its commitment to fixing the margin problem but progress has been slow.

Growth on a Per-Share Basis

Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2023**
EPS	$3.24	$3.81	$4.24	$2.07	$4.10	$4.31	$4.26	$4.59	$4.92	$5.33	***$6.15***	***$7.85***
DPS	$1.66	$1.88	$2.05	$2.25	$2.44	$2.63	$2.87	$2.99	$3.11	$3.24	***$3.84***	***$5.10***

EPS has grown very steadily throughout the past decade as Clorox continues to grow both organically as well as through acquisitions. In recent years, Clorox has been focused on cost savings and efficiencies that have afforded it more robust earnings growth via margin expansion. However, this year doesn't look quite as rosy as the company is facing two significant headwinds in terms of further margin growth: transportation and input costs.

EPS growth this year is going to be strong but that is due almost entirely to tax reform, which the company believes is worth 70 to 75 cents in EPS for 2018. Stripping out that gain means core EPS growth will be moderate at best this year as Clorox works through its margin issues. The good news is that SG&A costs continue to leverage down and Clorox also spends ~8% of its revenue on advertising, which is fertile ground for further cost savings should that be necessary. Low single digit sales growth and flat to slightly higher margins should afford Clorox our five-year estimate of 5% EPS growth.

There is also the matter of the 14% dividend increase that was announced in February, an uncharacteristically large increase that was due to tax reform improving earnings and free cash flow. We expect dividend growth to settle back into the mid-single digit range where it has been for the past decade as this most recent increase was a one-time event.

Valuation Analysis

Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Now**	**2023**
Avg. P/E	18.5	14.5	14.4	31.9	16.7	18.2	20.7	22.3	25.1	24.0	***21.1***	***19.0***
Avg. Yld.	2.8%	3.4%	3.4%	3.4%	3.6%	3.4%	3.3%	2.9%	2.5%	2.5%	***2.9%***	***3.4%***

Clorox experienced a sizable increase in its valuation in the years since 2012 as its PE increased by roughly 50%. This enormous revaluation of the company led to a powerful rally in the stock that wasn't driven by earnings growth. That revaluation has ended and the PE is returning back to normal levels, which we believe will be more like 19 times earnings over the long term, rather than the 21.1 it trades for today. That's well off from 2016 and 2017 levels but we believe there will be a further 2.1 percentage point annual headwind to total returns going forward.

As a result of the valuation falling but continuing dividend growth, we believe the yield of the stock will rise from 2.9% today to 3.4% in 2023. Clorox continues to boost its dividend and with a low payout ratio, that should continue.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	41.2%	43.0%	41.9%	43.5%	42.1%	42.5%	42.1%	43.6%	45.1%	44.7%	***44.0%***	***44.0%***
Debt/A	108%	104%	98%	102%	103%	97%	96%	97%	93%	88%	***84%***	***80%***
Int. Cov.	5.5	6.0	6.8	5.7	7.5	8.2	9.9	10.6	12.9	13.3	***14.0***	***16.0***
Payout	49%	48%	47%	106%	58%	58%	65%	64%	61%	59%	***62%***	***65%***
Std. Dev.	30.7%	20.4%	12.2%	25.5%	10.7%	13.9%	15.0%	15.5%	16.1%	13.8%	***14.8%***	***17.4***

Clorox has improved its leverage and debt coverage in the past few years as it has managed to avoid taking on ever-rising debt totals. The gradual but meaningful improvement has allowed it to improve the safety of its dividend as well. Unless Clorox completes an unusually large acquisition, its debt should continue to fall over time. However, gross margins are struggling due to rising input and transportation costs and the company's cost saving measures haven't been able to keep up. We are forecasting flat gross margins over the next five years as Clorox tries to increase efficiency while fighting off pricing pressures, higher input costs and freight inflation.

The company's competitive advantages include its broad array of products as well as the fact that it largely makes staples that people buy irrespective of economic conditions. This affords Clorox strong recession resistance as it actually increased its EPS markedly during and after the Great Recession. Clorox is a pure-play defensive stock in that regard.

Final Thoughts & Recommendation

Overall, we are expecting five-year total returns of 5.8% annually, comprised of the 2.9% yield, 5% EPS growth and a 2.1% headwind from the valuation. EPS growth is the most at risk due to the margin situation but the bar is fairly low and Clorox has produced enough sales growth to do most of the work. The stock looks a bit overvalued at this point but it does perform very well during recessions and it sports a very respectable yield. It is thus acceptable for investors that are seeking a nice current yield but have a very long time horizon for the stock to work out its valuation issue. Clorox is not, however, suitable for value investors as its PE is still too high relative to historical standards.

Total Return Breakdown by Year