



# Ecolab Inc. (ECL)

Updated April 12<sup>th</sup>, 2018 by Nick McCullum

## Key Metrics

<b>Current Price:</b> \$141	<b>5 Year CAGR Estimate:</b> 4.8%	<b>Quality Percentile:</b> N/A
<b>Fair Value Price:</b> \$107	<b>5 Year Growth Estimate:</b> 9.0%	<b>Momentum Percentile:</b> N/A
<b>% Fair Value:</b> 132%	<b>5 Year Valuation Multiple Estimate:</b> -5.4%	<b>Total Return Percentile:</b> N/A
<b>Dividend Yield:</b> 1.2%	<b>5 Year Price Target</b> \$165	<b>Valuation Percentile:</b> N/A

## Overview & Current Events

Ecolab Inc. is a manufacturer and distributor of household cleaning products. The company operates in three major business segments: Global Industrial, Global Institutional, and Global Energy, each of roughly equal size. Ecolab was founded in 1923 and has grown to a market capitalization of \$41 billion and annual revenues of nearly \$14 billion. With 32 years of consecutive dividend increases, Ecolab qualifies to be a member of the Dividend Aristocrats Index.

In late February, Ecolab reported (2/20/18) financial results for the fourth quarter of fiscal 2017. Sales increased by 9%, or 6% excluding acquisitions and foreign exchanges. Strong sales growth was driven by accelerating momentum in each of the company's business segments. On the bottom line, Ecolab's adjusted earnings-per-share increased by 11% over the prior year's quarter.

Ecolab also published financial guidance for fiscal 2018. The company expects to deliver adjusted diluted earnings-per-share in the range of \$5.25 to \$5.45, which represents 12% to 16% growth over 2017's figure. This robust guidance is based on improving volume and pricing growth in all segments, partially offset by higher delivered products cost. The company is also anticipating a \$0.10 per share earnings benefit from the U.S. Tax Cuts and Jobs Act. All said, Ecolab's earnings release was well-received by the markets and its share price rose following the announcement.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$1.86	\$1.99	\$2.23	\$2.54	\$2.98	\$3.54	\$4.18	\$4.37	\$4.37	\$4.69	<b>\$5.35</b>	<b>\$8.23</b>
<b>DPS</b>	\$0.52	\$0.56	\$0.62	\$0.73	\$0.83	\$0.97	\$1.16	\$1.34	\$1.42	\$1.52	<b>\$1.67</b>	<b>\$2.70</b>

Ecolab has compounded its adjusted earnings-per-share at a rate of 10.8% per year since 2008. Looking ahead, we believe that a long-term annualized growth rate of 9% is feasible for this high-quality dividend stock. The company is guiding for \$5.35 of earnings-per-share in fiscal 2018. Applying a 9% growth rate to this figure allows us to compute a 2023 earnings-per-share estimate of \$8.23.

Ecolab's growth will largely come from bolt-on acquisitions. The company has historically implemented a strategy of acquiring smaller household products companies and scaling their products through its impressive supply chain. As an example, Ecolab acquired Cascade Water Services in January for an undisclosed sum. Cascade generated 2017 sales of \$35 million and is in the business of selling water treatment programs. We believe additional tuck-in acquisitions are highly likely for Ecolab moving forward.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	23.4	19.9	21.1	20.4	21.8	25.4	26.0	25.9	26.3	27.5	<b>26.4</b>	<b>20.0</b>
<b>Avg. Yld.</b>	1.2%	1.4%	1.3%	1.4%	1.3%	1.1%	1.1%	1.2%	1.2%	1.2%	<b>1.2%</b>	<b>1.5%</b>

Using the midpoint of 2018's financial guidance, Ecolab is trading at a price-to-earnings ratio of 26.4. Although the company's average price-to-earnings ratio over the last decade has been 23.8, we believe that a fair value for Ecolab is closer to 20 times earnings. If the company's valuation reverts to a price-to-earnings ratio of 20 over the next 5 years, this will introduce a 5.4% headwind to the company's annualized returns during this time period.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	63.0%	58.2%	63.1%	18.3%	31.0%	31.0%	34.0%	33.9%	34.1%	32.2%	<b>33.0%</b>	<b>35.0%</b>
Debt/A	67.0%	60.1%	56.3%	68.8%	65.4%	62.6%	62.3%	62.9%	62.4%	61.8%	<b>62.0%</b>	<b>63.0%</b>
Int. Cov.	11.7	11.2	13.8	10.3	4.7	6.0	7.7	6.5	7.3	8.0	<b>9.0</b>	<b>9.0</b>
Payout	28.0%	28.1%	27.8%	28.7%	27.9%	27.4%	27.8%	30.5%	32.5%	32.4%	<b>31.2%</b>	<b>32.8%</b>
Std. Dev.	46.0%	25.6%	20.3%	26.5%	17.1%	16.7%	16.7%	19.3%	19.6%	10.6%	<b>18.0%</b>	<b>18.0%</b>

Ecolab's gross profits as a percent of its total assets has declined from its remarkably high figures reported a decade ago. In addition, the company's interest coverage has worsened and its payout ratio has increased (although it still remains quite conservative). Still, we believe that Ecolab is a very high-quality business and should perform better during recessions than many of its peers in the large capitalization equity universe.

This belief is largely due to the company's various competitive advantages. Ecolab's most compelling competitive strength is its scale, which allows it to aggressively invest in marketing, advertising, and research and development. Ecolab spends more than \$1 billion on research and development each year, which has allowed it to create an intellectual property portfolio that contains more than 7,700 patents. As mentioned earlier, Ecolab's size also allows it to acquire smaller companies through bolt-on acquisitions. All said, the company's size, scale, and research focus lead us to believe that many years of dividend growth are yet to come for this high-quality Dividend Aristocrat.

### Final Thoughts & Recommendation

Ecolab's recent financial performance has been very strong, and its multi-decade streak of consecutive dividend increases shows that it is willing and able to prioritize its profit distributions to shareholders.

Unfortunately, Ecolab is trading at a valuation multiple that we simply are not comfortable with. It is likely that valuation contraction will have a significant negative impact on the company's total returns during the medium term. Accordingly, we suggest that investors look for more affordable investment opportunities within the consumer staples space.

### Total Return Breakdown by Year

