



# Ecolab Inc. (ECL)

Updated July 23<sup>rd</sup>, 2018 by Nick McCullum

## Key Metrics

|                                |                                                  |                                       |
|--------------------------------|--------------------------------------------------|---------------------------------------|
| <b>Current Price:</b> \$140    | <b>5 Year CAGR Estimate:</b> 5.2%                | <b>Volatility Percentile:</b> 3.4%    |
| <b>Fair Value Price:</b> \$108 | <b>5 Year Growth Estimate:</b> 9.0%              | <b>Momentum Percentile:</b> 48.5%     |
| <b>% Fair Value:</b> 130%      | <b>5 Year Valuation Multiple Estimate:</b> -5.0% | <b>Valuation Percentile:</b> 17.3%    |
| <b>Dividend Yield:</b> 1.2%    | <b>5 Year Price Target:</b> \$165                | <b>Total Return Percentile:</b> 27.2% |

## 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 early May, Ecolab reported (5/1/18) financial results for the first quarter of fiscal 2018. In the quarter, revenue increased by 10% while acquisition-adjusted fixed-currency sales grew by 6%. This strong sales growth was driven by solid, broad-based growth in each of Ecolab's operating segments. Moving down the income statement, reported diluted earnings-per-share of \$0.84 declined by 2% while adjusted diluted earnings-per-share rose by 14%. Ecolab's first quarter earnings release was well-received by the markets and shares rose modestly following its announcement.

Ecolab also updated its 2018 financial guidance with the release of its second-quarter earnings report. The company now expects to generate adjusted diluted earnings-per-share between \$5.30 and \$5.50, which represents 13% to 18% growth. This robust performance is expected to be driven by improving volume and pricing growth in all operating segments, partially offset by higher delivered products cost. Ecolab's prior forecast was for earnings-per-share between \$5.25 and \$5.45. We have updated our 2018 earnings estimate accordingly.

## 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>\$5.40</b> | <b>\$8.31</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 \$5.40 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>25.9</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> |

Thanks to a slightly lower stock price and improved guidance for 2018 earnings-per-share, Ecolab's price-to-earnings ratio has declined slightly since the time of our last quarterly research report. Using the midpoint of 2018's financial guidance, Ecolab is trading at a price-to-earnings ratio of 25.9. Although the company's average price-to-earnings ratio

*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*

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 5.0% 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         |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------|
| <b>GP/A</b>      | 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> |
| <b>Debt/A</b>    | 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> |
| <b>Int. Cov.</b> | 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>   |
| <b>Payout</b>    | 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> |
| <b>Std. Dev.</b> | 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 deteriorated 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.

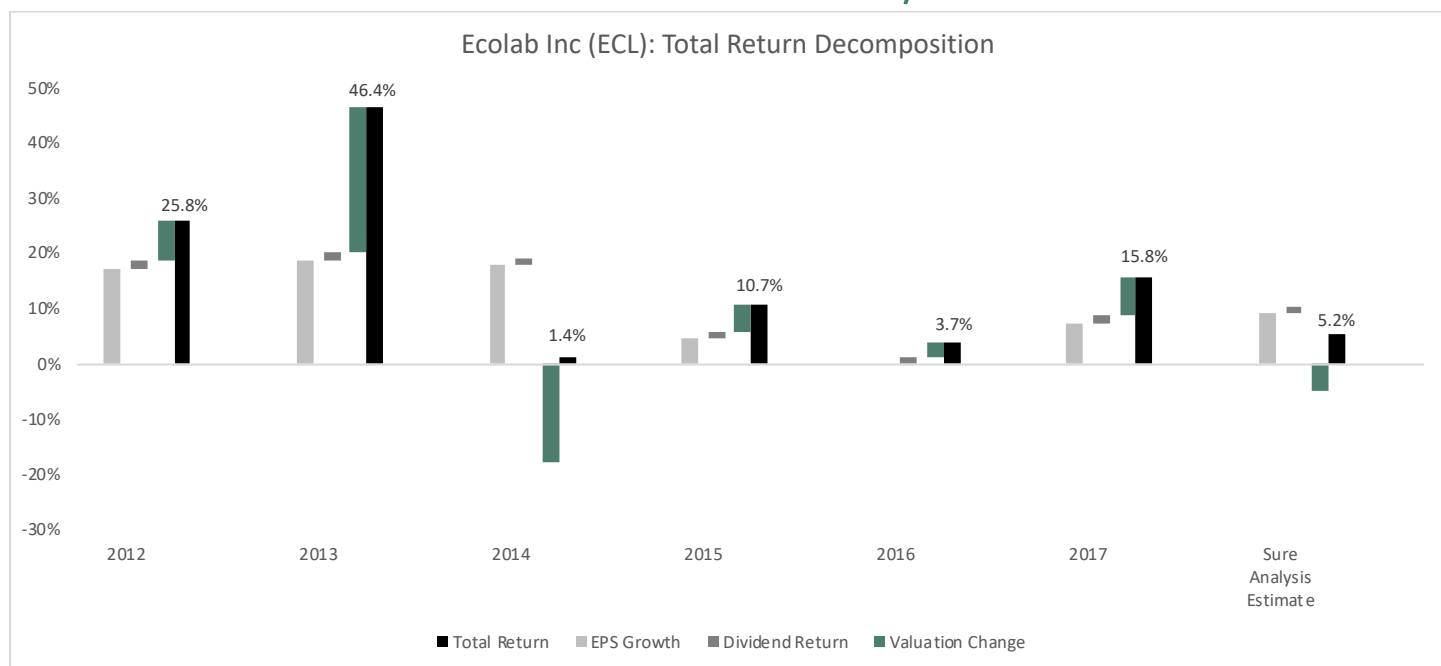
This belief is largely due to the company's various competitive advantages. Ecolab's most compelling competitive strength is its scale, which allows it to aggressively invest in marketing, advertising, and research and development. Ecolab spends more than \$1 billion on research and development each 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 continues to fire on all cylinders. Indeed, the company's financial performance in the most recent quarter was very strong, which resulted in an increase to its full-year financial guidance.

Despite these positives, our recommendation on Ecolab remains unchanged from our last quarterly update. The company's valuation is almost harder to stomach than the cleaning products that it manufactures. While there's a lot to like here outside of valuation, Ecolab fails to earn a buy recommendation from Sure Dividend at its current price.

## Total Return Breakdown by Year



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