Clorox Company (CLX)

Updated August 10th, 2018 by Josh Arnold

Key Metrics

Current Price:	$140	**5 Year CAGR Estimate:**	5.0%	**Volatility Percentile:**	20.1%
Fair Value Price:	$122	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	39.7%
% Fair Value:	115%	**5 Year Valuation Multiple Estimate:**	-2.7%	**Valuation Percentile:**	36.1%
Dividend Yield:	2.7%	**5 Year Price Target**	$156	**Total Return Percentile:**	27.7%

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 $18 billion. More than 80% of its $6 billion in annual revenue comes from products that are #1 or #2 in their respective categories.

Clorox reported Q4 earnings on 8/2/18 and results were largely congruent with expectations. The company's recent Nutranext acquisition provided all of the company's 3% sales growth as divestitures, foreign exchange and volume roughly offset each other. Gross margins fell 170bps to 44% as higher commodity and freight costs continue to weigh; our estimate of gross margins for FY2019 remains unchanged. Management's FY2019 guidance is for 3% sales growth and $6.42 in earnings-per-share at the midpoint, which we've adopted as our estimate. Overall, the Q4 report did not change the outlook for Clorox as it is still focusing on cost savings and growth-by-acquisition.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.81	$4.24	$2.07	$4.10	$4.31	$4.26	$4.59	$4.92	$5.33	$6.26	***$6.42***	***$8.20***
DPS	$1.88	$2.05	$2.25	$2.44	$2.63	$2.87	$2.99	$3.11	$3.24	$3.36	***$3.84***	***$4.90***

Earnings-per-share have 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, 2018 was marred by higher commodity and freight costs and those headwinds look set to continue in the coming year, crimping margins.

Earnings-per-share growth this year will be much lower than in FY2018 given that nearly the entirety of last year's gain was from tax reform. Clorox is back to a more normalized rate of growth now and given the headwinds from commodity and freight inflation, our average 5% annual earnings growth estimate will be slightly backloaded. Clorox continues to buy small amounts of growth – like Nutranext – while focusing on cost savings and reducing the float. None of these are significant drivers on their own but combined, should be enough to power mid-single digit earnings growth each year.

Clorox raised its dividend significantly recently as a result of tax reform, but we are expecting more moderate growth moving forward, in line with the company's historical pattern. We see a dividend payout of nearly $5 by 2024.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.5	14.4	31.9	16.7	18.2	20.7	22.3	25.1	24.0	22.3	***21.8***	***19.0***
Avg. Yld.	3.4%	3.4%	3.4%	3.6%	3.4%	3.3%	2.9%	2.5%	2.5%	2.4%	***2.7%***	***3.1%***

Clorox experienced a sizable increase in its valuation in the years since 2012 as its price-to-earnings multiple increased by roughly 50%. However, that revaluation has ended, and the price-to-earnings ratio is returning back to normal levels, which we believe will be more like 19 times earnings, rather than the ratio of 21.8 it trades for today. That's well off from 2016 and 2017 levels but we believe there will be a further 2.7% 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 2.7% today to 3.1% in 2024. Clorox continues to boost its dividend and with a low payout ratio, that should continue.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	43.0%	41.9%	43.5%	42.1%	42.5%	42.1%	43.6%	45.1%	44.7%	44.0%	***43.5%***	***44.0%***
Debt/A	104%	98%	102%	103%	97%	96%	97%	93%	88%	84%	***84%***	***80%***
Int. Cov.	6.0	6.8	5.7	7.5	8.2	9.9	10.6	12.9	13.3	14.0	***15.0***	***16.5***
Payout	48%	47%	106%	58%	58%	65%	64%	61%	59%	54%	***60%***	***60%***
Std. Dev.	20.4%	12.2%	25.5%	10.7%	13.9%	15.0%	15.5%	16.1%	13.8%	15.0%	***14.8%***	***17.4%***

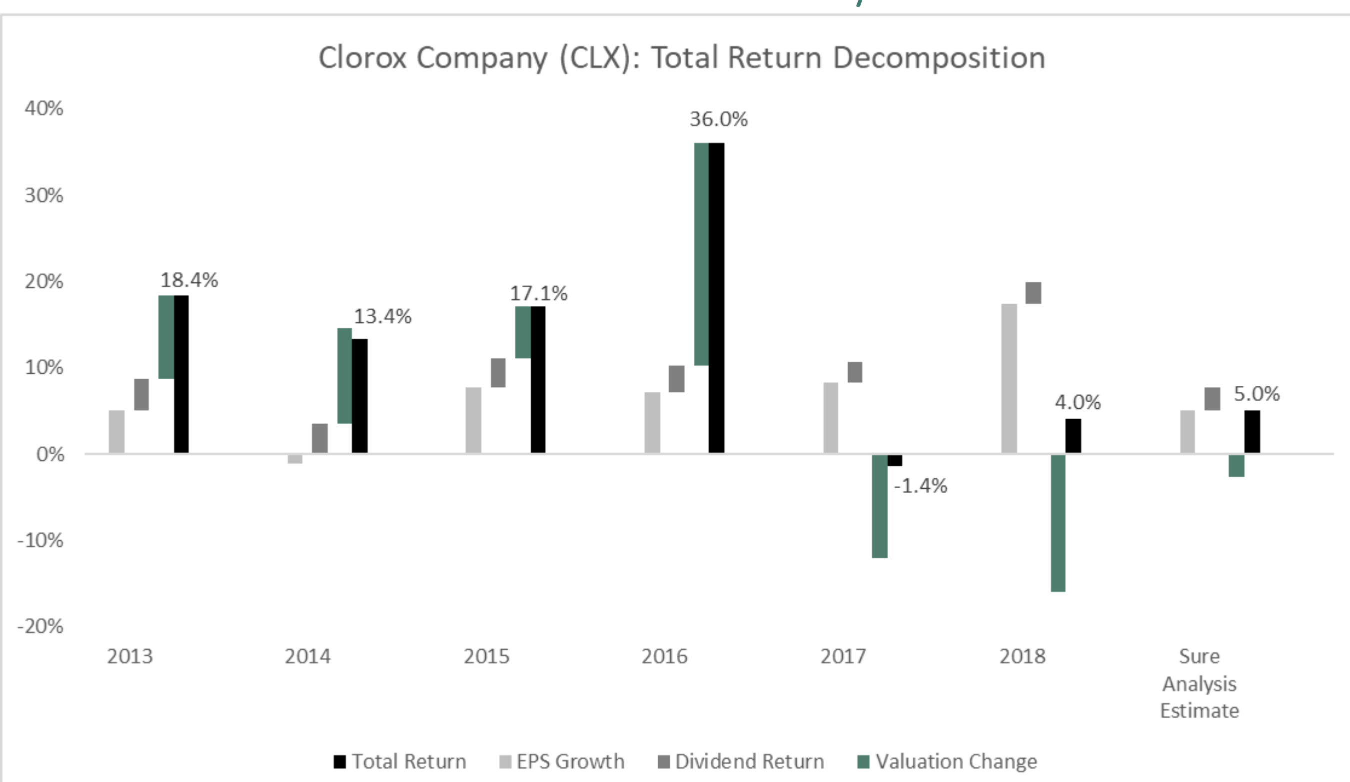
Clorox has improved its leverage and debt coverage in the past few years as it has managed to avoid taking on ever-rising debt totals. The gradual but meaningful improvement has allowed it to improve the safety of its dividend as well. Unless Clorox completes an unusually large acquisition, its debt 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 have not been able to keep up. We are forecasting roughly 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.

Clorox' 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 earnings 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 5.0% annually, comprised of the 2.7% yield, 5% earnings growth and a 2.7% headwind from the valuation. Earnings-per-share 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 overvalued at this point, but it does perform well during recessions and sports a respectable yield. Clorox is acceptable for investors 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 valuation is still too high relative to historical standards. Clorox earns a hold recommendation today given the given its overvaluation and despite its strong yield and decent growth prospects.

Total Return Breakdown by Year



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.