

Ecolab, Inc. (NASDAQ: ECL)

Recommend to Buy 5% | PT: \$206.26

October 2, 2023



CIMG Investment Research

ECL is the *Cleanest* Choice

Ecolab is a global conglomerate that operates in 40+ industries, with their main end markets consisting of healthcare, water and energy, food and beverage, and hospitality. With nearly 3M customers located in 170 countries, Ecolab's value proposition is to serve customers with end-to-end products and services in every region of the world. ECL's stock plunged ~30% in January 2023 due to the impact of excessive inflation on the profit margin of the company, which ECL combatted through price increases on the customer. As inflation subsides with aggressive federal policy, ECL has ample opportunity to expand margins as well as attract and retain new customers through their leadership position in the industry.

Investment Thesis

ECL's Extensive Portfolio Makes them the Premier Partner for Water, Hygiene, and Sustainability Needs: For decades, Ecolab expanded their portfolio through acquisitions, exposing them to new end-markets and becoming a one-stop-shop for their customers. From growth in pest control to markets to water and life science markets, ECL has tapped into a larger TAM opportunity of ~\$152B, of which they already have 10%. \$83B of this opportunity consists of unsold customers which Ecolab is positioned to capture through the convenience of having a singular, global supplier help meet their sanitation and sustainability needs. Ecolab's talented sales force begins with leasing, or in some cases selling, products and machines accompanied by an ongoing stream of consumables essential to operations. Ecolab is then able to cross sell proprietary service offerings such as data analytics and efficiency software for their clients to further their goals. Given their superior portfolio, Ecolab is equipped to capitalize off multiple macro tailwinds within the industry they operate in such as a larger global population, freshwater scarcity, and higher demand for food production processing. Additionally, a tailwind that Ecolab is currently capitalizing upon is the emphasis on ESG, in which Ecolab has become a trusted partner for multiple companies aiming to improve their sustainability initiatives with end-to-end products and services.

ECL Retains their Customers While Growing with Them; Circle the Customer, Circle the Globe: Ecolab's approach is guided by 4 critical components; customer focus, taking bets, an unmatched innovation pipeline, and their service and expertise training for their customers. A key component in all this is their unique competitive strategy- "Circle the Customer, Circle the Globe," which drives Ecolab to provide customers with the most comprehensive and sustainable solutions needed, to address both internal and external, complex problems and support clean, safe and healthy businesses. Additionally, it paves the road for future growth, business investments and success. Ecolab's "Circle the Customer, Circle the Globe" strategy is the key driver of the company's current and future penetration of the \$55 billion opportunity awaiting within their pre-existing customer contracts. As a result of their end-to-end offerings, Ecolab is both able to expand with their customers, and able to prove their value and vitality for customer success. With a revenue mix of 90% consumables, Ecolab can consider majority of their revenue recurring, as customers become dependent on the endless solutions they provide. Additionally, Ecolab's Exponential Return on Investment (eROI) >25% helps them drive strong pricing and volume as they take further share across ever-expanding end markets. As demonstrated by countless success stories, Ecolab provides their customers real value in a variety of aspects. From productivity, to sustainability, and capital saved, Ecolab's customers can clearly recognize their significance.

Healthcare Committee

Audrey Stoettner – Committee Head
aestoettner@crimson.ua.edu

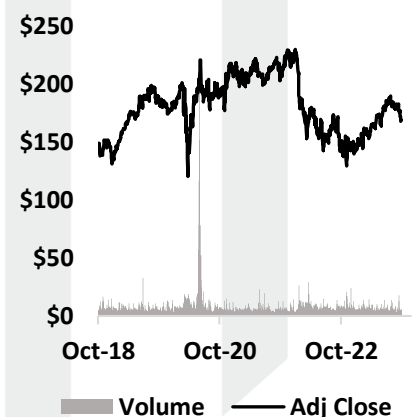
Grant Darling – Analyst
gedarling@crimson.ua.edu

Madeline Fischer – Analyst
mafischer1@crimson.ua.edu

Joleigh Underwood – Analyst
jkunderwood@crimson.ua.edu

Brooke Peterson – Analyst
bepeterson1@crimson.ua.edu

Figure 1: ECL 5-Year Stock Chart



Price	\$166.90
PT	\$206.26
Dividend Yield	1.24%
Upside	23.6%
52-Week Range	\$131.04-\$180.79
Mkt Cap	\$48.28B
LTM P/E	41.22x
LTM Prices/Sales	3.28x
LTM EV/EBITDA	21.18x
TTM Revenue	\$14.76Bb

ECL Has Ample Runway for Margin Expansion through Pricing Power: Given the pandemic, cost inflation, and supply chain constraints, Ecolab has faced a challenging environment since 2019. Down from their “high-water mark” adjusted operating margin of 16% in 2019, margins bottomed out at 7% in the first quarter of 2022, and have resurged to approximately 12% in the latest quarter. From cost normalization alone, Ecolab should have no problem recouping its 2019 EBIT margins but retains additional upside through their strong pricing power and innovation pipeline. Because of the incredible value ECL provides to its customers, defined as “Total Value Delivered” by management, it can pass inflation through with little to no impact on volume. Following 40% supply-side inflation in 2022, Ecolab has increased prices by 11.5% Y/Y for the past four quarters, while volume only fell 25 bps over the same period. As costs normalize following aggressive monetary policy to cool inflation, margins will naturally expand following a year’s worth of rapid price increases and LSD price hikes going forward. In addition to Ecolab’s strong pricing power, management plans to additionally expand operating margin through cutting SG&A costs, shifting the proportion of revenue portfolio to higher margin segments, and growing volume through new products set to roll out this year. It is our view that the market is pricing Ecolab with compressed margins in mind, while we have confidence that 16%+ operating margins are well within reach and a more accurate long-term profile for a market winner with value-based pricing power.

Valuation

We arrived at a price target of \$206.26 using a discounted 2 year forward multiple on 2025 EBITDA. We first modeled out revenue for each of the four segments using a volume and pricing build. We believe that both volume and pricing will have a 1% incremental growth rate as compared to historical rates of 2.5% and 1.5%, respectively. For volume, we are confident in greater innovation, enterprise selling, and faster growing end markets. For pricing, we believe this is where Ecolab takes advantage of its total value added to customers and drives up prices with little to no resistance. On the margin side, we believe that management can approach its pre-pandemic 44% gross profit margin by 2025. This is mostly driven by what we expect to be a decrease in product delivery costs as well as lower raw material input costs. Likewise, Ecolab’s ability to upcharge its products as well as their expansion into higher margin industries will capture a fair share of this margin. We are projecting modest SG&A productivity improvement over the coming years which will result in an additional 100-200bps of operating margin expansion. We believe a 20x EBITDA multiple is fair due to Ecolab’s dominant competitive position in a fragmented but growing industry, additional inflows of capital from ESG funds and an increasing global need for Ecolab’s resources specifically as water scarcity increases. We believe 2025 will be an inflection year; as such, our 20x multiple on 2025 EBITDA suggests 23.6% upside for Ecolab stock.

Company Overview

Ecolab, Inc., headquartered in St. Paul, Minnesota, is a globally recognized leader in water, hygiene, and energy technologies, providing tailored solutions to businesses and organizations across the globe. With deep industry expertise and a commitment to sustainability, Ecolab enables clients to conserve resources, maintain clean and safe environments, and enhance operational efficiency. Operating through its core business segments of water, hygiene, and energy, the company serves diverse industries, including manufacturing, food and beverage, healthcare, and more. Ecolab reports their revenue through 4 main segments, comprising a total of \$14.2B for FY2022. Their Global Industrial segment makes up 48% of FY22 revenue and provides water treatment and cleaning solutions to large industrial customers within manufacturing, food processing, and power generation industries. The Institutional and Specialty segment comprises 31% of FY22 revenue and provides cleaning services to foodservice, hospitality, lodging, government, education, and retail industries. The Healthcare and Life Science industry makes up 11% of FY22 revenue and provides specialized cleaning and sanitizing products to the healthcare, personal care, and pharmaceutical industries. Their Other segment makes up the remaining 10% of revenue and offers services for pest elimination, textile care, semiconductor manufacturing, catalyst manufacturing, and chemicals and aerospace component manufacturing. Ecolab’s extensive global presence, continuous innovation, and focus on regulatory compliance creates enduring customer partnerships. Moreover, Ecolab is dedicated to environmental and social responsibility, striving to make a positive impact on communities and the planet.

Industry Overview

Ecolab’s product and services portfolio is so extensive that it operates in multiple industries, many of which they have obtained leadership positions. Ecolab has 15% of a \$14B market in the food and beverage industry, 11% in the \$43B institutional and specialty market, 9% in the \$39B industrial water market, 7% in the 15B pest control market, and 5% in the \$11B life sciences market. These markets are extremely fragmented due to competition from regional players around the world. However, none of the regional players possess the global scale and portfolio offerings that ECL has obtained for nearly 10 decades. The industries served through Ecolab’s offerings are highly regulated to ensure safety and sustainability, in fact, regulatory restrictions have increased ~300% over the past 50 years. Customers of ECL and other compliance providers reap the benefits of sustainability compliance through cost savings since failure to do so would amount in extreme impairment charges. As global concerns related to water scarcity, pollution, hygiene, energy consumption, and sustainability continue to grow, Ecolab’s expertise and solutions have become increasingly vital for its customers across a wide range of sectors, making it a key player in addressing some of the world’s most pressing challenges.