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Ecolab Inc. (ECL) CEO Doug Baker on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-29-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $1.71 beats by $0.00 | Revenue of $3.82B (1.89% Y/Y) misses by $-72.3M

Earning Call Audio

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Ecolab Inc. (NYSE:ECL) Q3 2019 Earnings Conference Call October 29, 2019 1:00 PM ET

Company Participants

Mike Monahan - SVP, External Relations

Doug Baker - Chairman and CEO

Dan Schmechel - CFO

Conference Call Participants

John McNulty - BMO capital Markets

Vincent Andrews - Morgan Stanley

Manav Patnaik - Barclays

Gary Bisbee - Bank of America Merrill Lynch

David Begleiter - Deutsche Bank

John Roberts - UBS

Dan Rizzo - Jefferies

Christopher Parkinson - Credit Suisse

Rosemarie Morbelli - G. Research

Mike Harrison - Seaport Global Securities

Eric Petrie - Citigroup

Andrew Wittmann - Robert W Baird

Operator

Greetings, and welcome to the Ecolab's Third Quarter 2019 Earnings Release Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce Mike Monahan, Senior Vice President, External Relations. Mr. Monahan, you may now begin.

Mike Monahan

Thank you. Hello everyone and welcome to Ecolab's third quarter conference call. With me today is Doug Baker, Ecolab's Chairman and CEO; and Dan Schmechel, our CFO. A discussion of our results, along with our earnings release and the slides referencing the quarter's results and our outlook are available on Ecolab's website at ecolab.com/investor.

Please take a moment to read the cautionary statements in these materials, stating that this teleconference and the associated supplemental materials include estimates of future performance. These are forward-looking statements, and actual results could differ materially from those projected. Factors that could cause actual results to differ are discussed under Risk Factors section in our most recent Form 10-K and in our posted materials. We also refer you to the supplemental diluted earnings per share information in the release.

Starting with a brief overview of the results, pricing, new business gains and product innovation led the third quarter sales, and along with productivity improvements and cost efficiency actions yielded the third quarter's 12% adjusted diluted earnings per share increase.

Moving on to some highlights from the quarter and as discussed in our press release, acquisition adjusted FX currency sales increased 2% as the institutional and Other segments shows steady sales gains and more than offset a modest decline in energy and moderately softer industrial markets.

Adjusted fixed currency operating income margins increased to 140 basis points, consuming their steady improvement. Income growth was led by double digit gains in the Industrial and Energy segments. Adjusted earnings per share increased 12% to a $1.71, representing another quarter of double digit adjusted EPS growth. Currency translation was an unfavorable $0.03 per share in the quarter. Progress continues on the spin-off of our upstream energy business, we continue to expect a spin-off to be completed by mid-2020.

Looking ahead, we will begin rebuilding our sales momentum in the fourth quarter as the moderated delivered product costs environment has enabled us to re prioritize new business development as our sales team's primary objective. As always, we will drive our new business wins by focusing on our innovative products, sales and service expertise, and our value proposition of best results and the lowest total operating costs for customers. We will also continue driving productivity and cost efficiencies.

Our digital investments are developing well and we look for them to add new actionable insights for customers to improve their operations, increase our sales force effectiveness, and enhance our market differentiation. We narrowed our forecast with the full year 2019. We now look for adjusted diluted earnings per share to rise 10% to 12% to the $5.80 to $5.90 range, as price and volume gains and cost efficiency benefits more than offset the impact of moderated delivered product cost increases and business investments.

Currency translation deteriorated $0.02 and is now expected to be an unfavorable $0.13 per share in 2019. Fourth quarter adjusted earnings per share are expected to be in the $1.64 to $1.74 range of 6% to 13%. In summary, we expect good fourth quarter earnings momentum in 2019 to more than offset moderated delivered product costs and unfavorable currencies exchange, and along with cost efficiency actions yield 10% to 12% adjusted earnings per share growth. As we continue to make right investments in key areas of differentiation including product innovation and digital investments, we expect to develop superior growth this year and for the future.

And now, here's Doug Baker with some comments.

Doug Baker

Thanks Mike. So, I'll this offer my take on the quarter. There's a lot to likes in this quarter and there are some areas that we're addressing. The good news is as we leave the third quarter moving into the fourth quarter, we're in a very good position in this year successfully, while I'd say importantly building momentum as we head into 2020. So, the positive in Q3 will certainly 12% adjusted EPF growth.

We have very strong cash flow with a Q3 conversion rate of over 100% as we reduce inventories pulled our supply chain SAP roll out in North America, year-to-date cash flow is up 29%. We also continued our strong pricing helping drive the 140 basis points OI margin improvement Mike reference.

Our team is executed really well across the board. They continued to drive the business performance improvements. They're also managing in North American SAP rollout, which has moved from supply chain into the commercial arena and they're also managing a spin of upstream all this they're doing while improving the business.

So, we also talked that we've shifted our sales team priority focus, as raw materials stabilized and some market has softened. We've moved our field team focus from what I call pricing and growth to growth and pricing, meaning growth is primary. That's the only thing we asked him to do, but you always have to have something as number one priority and right now we believe it's smart to have growth as the number one priority.

So, this shift moves this team back to what I would call their natural state, and we're seeing strong results in all of our leading indicators. Net business is accelerating. It was virtually flat year-on-year in Q1, up 10% in Q2, was up over 40% in Q3. We really need roughly 15% year-on-year to continue the growth trajectory that we'd like to see.

At the same time while we're accelerating our net new business, the team has continued to deliver on pricing which excluding upstream in Q3 was up 3%; and very importantly, our customer retention has improved throughout the year as well, so our pricing efforts are not leading to declining retention trends.

Finally, I feel very good about our priorities, our plan and the execution. So, we got on cost early, we remain on cost, we've got a great job securing the needed pricing as we've discussed, we've also shifted successfully to driving new business; and as I mentioned are starting to see those results while continuing to secure pricing. We're also driving the critical investment for sustained advantage like digital, like SAP, like people development and like the upstream spin.

So now, let me turn it back to Mike, who will open up the Q&A session.

Mike Monahan

That concludes our formal remarks. Operator, would you please begin the question-and-answer period.

Question-and-Answer Session

Operator

Yes, thank you. We will now be conducting a question-and-answer session. [Operator instructions] And our first question comes from the line of John McNulty with BMO capital Markets.

John McNulty

With regard to the reprioritization around new business development versus pricing kind of moving the volumes sort of front of I guess of the queue. I guess, how quickly can you get that shift to start really working on the volumes? And I guess also, how should we be thinking about what this means for price mix as we look to 2020 as well?

Doug Baker

Yes, it's a little different by business. I would say in industrial, there's usually a couple quarter lag between securing significant new business and when you start seeing it show up in the P&L. Institutional, that lag can be a bit shorter call it a quarter and a half. So, there's always a takes a little time for what I would call accelerating new business trends to show up in the growth trend and make a difference.

We would expect to have one I think historically good pricing. Next year, we're going to enter the year with very good carry in momentum. We will continue to price in this environment. It's just going to be and we just -- I mean, honestly, it's about as simple as it sounds. We were late getting on pricing. Sales teams hate doing pricing. It's a contentious discussion with customers who are they who they're trying to be like us.

And so, this is always a hard thing to get sales teams excited and motivated around and you've got to make a call. We rang the bell little over a year ago on pricing. They started making very material difference as a consequence of that, and we now know given the situation where they can raw markets is broadly economically, it's smart to get on volume. So, I think what you'll see is an increasing volume trend going throughout the year, but we'll take a few quarters for you to see material change.

John McNulty

And then maybe just a quick question on the Industrial segment and the overall growth actually looked relatively robust considering some of the macro back drop. I guess can you speak to the condition of the end markets that you're seeing and, and what that means in terms of some shared gain that it looks like you may have been picking up?

Doug Baker

Yes, I think our industrial business I would agree, I think it's fared pretty well. I mean, it shows up for instance water looking like it went from an eight to five we really probably think it went down two points and this is several factors. I mean, certainly some markets are softening but it's not stopping across the board in the industrial areas. There is a number of places where it's still quite strong and we see those areas.

So the F&B business, chemical plants, commercial buildings, life sciences is example those markets are really an impacted whereas steel, auto and paper which I think there is a lot of noise around and we would also say we see some of that softening there as well.

But with that said, I think we view this market. I mean if this is a conditions wherein we think ultimately our new business efforts will overcome a lot of that song thing maybe not 100% of it, but we can still grow it a very good clip in that business and obviously if it gets dramatically worse then we'll have to update our forecast, but that's not what we see right now.

Operator

The next question is coming from the line of Vincent Andrews with Morgan Stanley. Please proceed with your question.

Vincent Andrews

Maybe, if you could just help us unpack the volume performance as we strip out energy and then the low margin businesses you exited, if you can just kind of walk us through the segments and where you were happier where you think there's more work to be done?

Doug Baker

We would -- I don't I've ever had a quarter where I thought I was happy with our volume growth. And this would include it, meaning we have aggressive targets that we go chase. But if you unpack it your take away, paper was down this year and in the Energy segment, we probably lost a point in total. So without those, we will be up a point, but that's not where we need to be, which is really why sort of this shift in emphasis.

We have very good trends in pricing and other things. We know we're going to have good carry-in. We've got to get moving on adding even more share. I would point out against every one of our major competitors, we track wins and losses we've gained share against all of them, but you've got to go on a really major share gain strategy when you have softening markets.

Vincent Andrews

If I could, just as a follow-up to that into the pricing pivot, are there specific new business initiatives that you're putting in place, is it product-specific or is it digital new technology, ERP system driven? Or is it just basic blocking and tackling?

Doug Baker

Well, we all use innovation as one of the primary, if you will, means to the end i.e. we bring additional benefit to customers, new and our existing and that's absolutely critical to equipping the sales team to have good success in new business. So certainly, the new digital efforts that we've had are starting to bear fruit. We're seeing it in a number of accounts, in QSR where we really led in the Institutional side, we're seeing it in food retail as well and water was one of the early adopters and we've seen very strong efforts around there as well.

But with that said, there has been clear new target established for the last four months of the year, what we're trying to achieve, what kind of momentum we're trying to drive. I think the sales teams love these initiatives, they're all over it it's clearly tracked, clearly monitored it's led by Christophe Beck, our COO and that initiative will also, we're quite confident, help us gain volume momentum as well as pricing momentum.

Operator

Next question is coming from the line of Gary Bisbee with Bank of America Merrill Lynch. Please proceed with your questions. Mr. Bisbee, your line is open for questions. Moving on, our next question will be coming from the line of Manav Patnaik with Barclays.

Manav Patnaik

My first question is just also just to follow up quickly on the pricing shift. What changed between I guess today and the prior quarter, is it just any backdrop that the -- weakness in the Industrial side or was it just -- may be just a little bit more color on why the decision was made today?

Doug Baker

Well, it wasn't really made today. It was obviously made several months ago. And as we start moving this shift, I mean you got to -- it takes little time to enact it. This is like a natural occurrence for us. Sooner or later, our natural bent is growth then pricing, and so what I would call, it was a call to get back to natural state versus sort of a -- abnormal state where it's pricing over growth.

And as we look at the situation we saw a rise, if you will, stabilizing in terms of market, in fact, we had a little daylight in Q3 year-on-year i.e. raws were slightly cheaper this year than they were a year ago in total when we net everything out And so that condition certainly, you know, what's we had forecast, we started to see that, in fact, it was true. And it takes a little time for these shifts to start bearing fruit.

So you got to be a little bit ahead of the curve not behind it. There is no doubt that all the pricing actions that are in flight are going to be completed by the sales team. We continue to monitor that I'd point out that we had still strong new business growth, even when pricing was in front. So we'll continue to have good pricing effort even when growth is in front.

Manav Patnaik

And then just your comments on the net new business, the acceleration from 0 to 10 to 40, I guess in the fourth quarter or broadly just some thoughts on how we should interpret that into growth next year because I think you said all you need is really 15%. So that 40% sounds a stand-out there?

Doug Baker

Yes. And it's not a relatively small number right in terms of the whole P&L. So, I mean if I wanted to give you a very simplistic example if you've got a business in a $100 million and it loses 5% a year in attrition. Then if you want to grow at 7% you're going to need to add 12% new business. Somehow let's pretend it only comes from net new gains in corporate accounts, we have some businesses like that. Kay, would be like that really the only sell corporate accounts, well as you go through this, you start doing the math that 12%, it's got to continue to grow each year, roughly a 15% rate, if you want to continue to grow at 7%.

And so that's how we look at this and so we measure this very closely, we like to be more around the 20% rate, so that we have some wiggle room if you will, in our numbers and those are the types of things that we look at because they're good forward indicators for us. But as I mentioned, I think John had asked the question. It doesn't, it's not like an immediate show-up.

So if we land, a new contract, we will count it as new business that day, it may take us three to four months to fully install and to realize that volume, but at the same time we are counting losses, the day it's announced, even though it may take four to six months for that loss to fully see itself into our P&L, and we think that's important. And so really this whole number is really a measure of our of our large wins and losses, principally in corporate accounts.

Operator

The next question comes from the line of Gary Bisbee with Bank of America Merrill Lynch.

Gary Bisbee

Okay. Let's see if this works this time, I guess, Doug, one more cut at the revenue. There is a number of areas where the comps were actually quite a bit tougher. F&B, paper being too. You talked about timing at Life Sciences. We know you walked away from some low-margin business that at Institutional recently, like how much of the sequential deceleration is sort of those factors that can normalize relative to actual change in the underlying trajectory like, because of weaker macro conditions or other items?

Doug Baker

Yes, I think in Industrial, I mean I think when you normalize you get like this, I mean, if we were going to just to kind of top size this thing, it's a there's like a 2 point apparent deceleration. I mean we are still going to grow on our higher base. We would call it 1 point market and 1 point is sort of gear shift from pricing to new business. And that's why we know we get on this new business, we're already starting to see the results, we know we will end up, if you will, gaining back some of that sales momentum.

Now we aren't going to be able to cover any market condition. Nobody's ever expected us to nor will we promise that we can, but if the conditions remain more or less like they are today. We think this is still a relatively good market for us to continue to perform in the fashion that we're performing.

Gary Bisbee

And then a quick follow-up just on pricing, you said you expect to enter 2020 still having pretty solid pricing, but obviously, the comps get more difficult as we move out because you start lapping the bigger price increases you've gotten. What's reasonable to think about over the next year? I mean is it sort of like the 1% or so that's been the long-term average or 1% to 2% or anyway to help us.

Doug Baker

Yes, I would say, it's not going to be at the current rate, which really when you strip out as I mentioned, Upstream averages up, right, it's a little over 2.5%. It's about the rate that we expect in the fourth quarter and it is going to slow through the year, but we will be significantly above our normalized 1% calling almost terminal rate that we have. So I think we're in a position next year where we don't forecast inflation really in our raw material base to still have benefit from pricing.

Operator

The next question comes from the line of David Begleiter with Deutsche Bank. Please proceed with your questions.

David Begleiter

Thank you. Doug, can you discuss the competitive dynamics in U.S. institutional and any concern that -- may be more aggressive view on the new business development might elicit some price response from your large competitor?

Doug Baker

Yes, David, I haven't, we haven't seen huge change in their behavior really anywhere, I would say, as we look at our wins and losses against our main Institutional F&B competitor, it's 4 times more wins than losses. And so our advantage, I think in technology and feet on the street and ability honestly to deliver great value I think continues to show up.

So I mean, I'm just -- the numbers that we have, we don't see it. If we look at retention kind of ex the large margin walk away situation, we have very good retention, and so we're not seeing it. We're not getting nickels and dimes with small, medium accounts. Our retention has actually improved in Industrial throughout the year, which is terrific given the very strong pricing performance that they've had. So that's what we know.

David Begleiter

Very good. And just on buybacks, Doug, you bought back no stock in the quarter, is that due to more active M&A pipeline and how is M&A pipeline today?

Doug Baker

Yes, we've got a large pipeline I've mentioned this and we're obviously going after a number of what I'd call middle to smaller deals. I think we also have larger folks that we'd be interested in, but there you got to be pretty, pretty price disciplined. Typically they're longer -- they're companies with the history and your ability to improve them is X, but not X times three, and so we need to make sure that we're going to get a return for our shareholders over any reasonable period of time.

I would say I never really want a recession, but I mean if there is an upside and there is a recession coming, I just can't tell you what year it's going to be, it will be a better M&A environment.

Operator

Next question is from the line of John Roberts with UBS. Please proceed with your question.

John Roberts

Doug, thanks. In the Institutional SBU, for the business that was exited, was that business that Ecolab never should have been in, or was it business that you've got in and then the customers eroded in that business? And then if you can characterize for us the businesses that you are exiting?

Doug Baker

Yes. No, we were in that business a long time, the value equation we had was favorable. The offers that were put on the table for the customers were dramatic decreases on what I would characterize as lower margin business for us before we ever would consider meeting those deals. And so while it was good, it was going to be upside down if we met those like bids. And so, we chose not to do that. We of course continue to try to secure the business at a much different price than was being offered and the customers made a choice. This has happened. I mean, this isn't the first time, I wish it would be the last. And as I mentioned before, we've been through -- we went through a wave of this in F&B for a number of years, I would say we secured almost all of that business back. I can't really think of one that we have and I'm sure there is one. We've had in Institutional over years. It kind of moves by region. And in many cases, we've re-secured that business as well. So we've got to maintain price discipline. Going -- selling customers for a cash loss just doesn't make any sense to us. And I -- we do not believe our cost advantage or we have this monster cost disadvantage, I think we just understand the cost of doing the business quite well.

John Roberts

And then post-spin, will you put the downstream energy business into the Industrial segment? And are the margins about the same as the overall industrial segment currently?

Doug Baker

Yes, downstream will end up in the Industrial segment. In fact, their margins are higher.

Operator

The next question comes from the line of Laurence Alexander with Jefferies. Please proceed with your questions.

Dan Rizzo

Hi guys, this is Dan Rizzo on for Laurence. How are you? So with the pricing and the shift to growth for next year, is there a certain threshold with external factors that would kind of make you shift your policy again. I mean would be a spike in oil or I mean how do you think about it if things were to change in terms of the input cost environment?

Doug Baker

Yes, well absolutely, I mean you can draw a scenario where it would be smart to re-prioritize again, input pricing had a growth. We aren't anticipating that environment obviously but should it happen, we could pivot quickly there.

Operator

Next question is coming from the line of Christopher Parkinson with Credit Suisse. Please proceed with your question.

Christopher Parkinson

Your results in F&B continue to do pretty well on enterprise selling across water pest elimination among a few other substrates. Can you just give us an intermediate to long-term update on where these initiatives stand? Where they could go in 2021? And just are there any other glaring enterprise selling opportunities within Industrial comparable to F&B? Thank you.

Doug Baker

Well, yes, I would probably characterize it as -- why don't I say within water just because it's really water and F&B partnering very successfully. And honestly, there are a lot of legs left in that partnership. There is many customers where we may have small penetration of the combined concept, but not full enterprise and there are others where we haven't penetrated yet at all. So I would say I think the team has done a great job. But there is still plenty of room left to go even there. With that said, if you look at the water match up with

Institutional, particularly in the hotel segment and with healthcare and the hospital for acute care segment, there is a significant upside. With water and life sciences is, pharma continues to make sure that they create really sterile boundaries even external to they're building et cetera. So there are a number of initiatives and opportunities as we go forward. The data that we're getting and the new capabilities to digital just enhance our capability to what I would say it, marry these solutions to create outsized impact for customers.

Christopher Parkinson

Got it. You've also -- lot more with products and service programs in healthcare over the last 12 months to 18 months, including some stuff internationally. Can you just quickly walk us through the two to three key growth drivers for our 2020 in both the U.S. and abroad just given the strategy evolution? Thank you.

Doug Baker

Yes, look, I would say, number one, continue driving the program, selling initiatives that are already underway. They continue to have success. We know long-term that's one of the smartest strategies and the team continues to work to pull what I would call some commoditized segments and wrap them with digital capability to create additional programs moving forward. The other, as we discussed at the Investor Conference that we had is OEM Solutions. A lot of this is marrying our capability and other med-tech device companies' capabilities and creating joint solutions that really gives both sides an advantage and these can be quite sticky as well. Those would be two big initiatives that we continue to push. We continue on Anios to push internationally and geographic moves outward using their technology where we don't want to build, if you will, a ground-up Ecolab healthcare business and we continue to build out countries like Australia, China et cetera with more traditional Ecolab full service approach.

Operator

Our next question comes from the line of Rosemarie Morbelli with G. Research. Please proceed with your question.

Rosemarie Morbelli

Doug, looking at downstream energy, you mentioned the timing of new business start-up and timing of also maintenance. Could you give us an estimate of the impact on the downstream growth? And then, is that a business that you can catch up in the fourth quarter or do you have to wait until the spring of next year because of weather?

Doug Baker

Yes, no, I mean the downstream business will we think be much better in the fourth quarter, because of the timing issues that we discussed. So mid-single-digits type performance. I would say, downstream is not that much different than some of the other businesses. They have been clearly all over pricing as well and have done a very good job securing pricing. It's helped them drive significant enhancement in margin, because they had to rebuild margins as well as a result of raw material price inflation. And so, they are also in a shift to make sure that they get on and have growth and pricing but growth first, as they start driving share gains and they've got plenty of opportunities to do that.

Rosemarie Morbelli

And then quickly if you could touch on how much business overall you may have lost because of your pricing strategy? And then if you could update us on the transaction, the Holchem transaction in the UK, where do you stand?

Doug Baker

Well, the Holchem, I mean I think it has been announced, we have a disagreement with the anti-trust authorities. Unfortunately, the power in this disagreement is asymmetrical. Just the same, we plan to challenge it through the legal channels that are available to us. But clearly, it's not a positive. And so, we just have to let that and move through the courts. In terms of -- customers we lost because of pricing. I mean aside from the conversation we've just had around those two customers in Institutional, which is now well over a year old story in terms of when we got the news, we don’t know -- I don't know of -- I'm sure there is a few but not material and the best evidence is the evidence I cited earlier, which is what we call our retention, which we measure very carefully by business. Our retention corporately is better and it's improved throughout the year in Industrial. So we don't really see the pricing has had an adverse effect on our customer base.

Operator

Our next question is from the line of Mike Harrison with Seaport Global Securities. Please proceed with your question.

Mike Harrison

Was wondering about the water business, you mentioned some softening in autos and steel. Can you talk a little bit about how those markets were trending during the third quarter and into Q4 were they worsening? And I guess kind of the heart of my question is that autos have been weak for some time. So is it that they're shut down activity that happened in Q3? And I guess why didn't -- why haven't autos looked weaker earlier in the year, because they've been under some pressure for some time?

Doug Baker

Yes autos I think as you know well publicized scenario. So I don't think we see a situation where that turns around by any means in Q4. I mean you might have GM. It was a specific customer because strike on and strike off. But aside from that I mean autos weakened throughout the quarter and we would expect them to remain weak in Q4 as we go through.

In terms of steel, we got more of mixed message as it goes. I mean we secured new business in that area. But overall, I mean the steel business as a consequence, in part because of autos and other Industrial is down. But we don't look at that one as hopeless as that business continues to grow. We would expect it to grow in the fourth quarter.

Mike Harrison

And then a question on the F&B business, just looking for an update on the protein market. You mentioned that, that market grew moderately during the quarter, but was wondering specifically if you can comment on what you're seeing related to African swine fever and the impact that that's had on protein markets?

Doug Baker

Yes, I don't think that's going to have a material impact on us, given most of our exposure in protein would be beef and chicken. So we've seen the protein business continues to grow. It's low single-digits. We would expect more of the same.

Operator

The next question is from the line of PJ Juvekar with Citi. Please proceed with your question.

Eric Petrie

Good afternoon, this is Eric Petrie on for PJ. Doug, your volume and mix was flat in the quarter, how do you think that compares versus underlying industry trends?

Doug Baker

Well, as we mentioned earlier that's heavily influenced by Energy, right, which was off considerably and also paper. I think even those declines were very much in line with industry trend. You might even argue we held sort of our gain share in those markets. And then on the balance, I think now I mean how many -- I've got a lot of industries to walk through, but I would say, I think if you look in total, I think we're -- if you look at our net wins and net losses what we think is actually going on in the markets, I would say we feel we are gaining share, but not at the rate that we want to or need to in the market environment we're in right now.

Eric Petrie

In healthcare, your team has been innovative with product launches including digital dashboards, predictive analytics, and core temperature fluid management. Do you think that's enough to get the top-line growth higher?

Doug Baker

Well, we're bouncing around the low to mid-single digits, right now. I think it's going to take us a while to move out of that range. So I think those things are going to enable us to do it. But as we talked in the Investor Conference, I mean we need to continue if you will, evolving the portfolio much more to grow. Some of that we do by taking things that have been commoditized and putting them in the growth category. And some, it's just over time, the stuff in the growth category grows faster than the stuff not and we start seeing a natural shift as we go.

Operator

Your next question comes from the line of Andrew Wittmann with Robert W Baird. Please proceed with your questions.

Andrew Wittmann

Yes, there's been a lot of questions on kind of the top-line, I wanted to dig in a little bit more into the margin profile. I mean if you look over the course of the year, the SG&A margin has been falling each quarter sequentially around here from like 29%, 27%, this quarter about 25% and you're guiding 25% SG&A in the fourth quarter. I guess as we look at that 25% in the quarter and then guidance for the fourth quarter, is there anything unusual in that, that makes that unusually low or anything or is that kind of the way to be thinking about it as we head into 2020?

Doug Baker

Yes, there is no big news in there that would say makes it look artificially low. I mean certainly, we work on productivity routinely. We still believe there is productivity in front of us as we leverage more effectively new tools, i.e., we need to equip our teams with capabilities to enable them to manage more business successfully. And we are working on those tools all the time, they are always in flight. And so we do not believe by any means that we're at the end of like our productivity journey, but we've got to do it in a way that makes sense i.e can people adopt the new technology, does it work, does it truly enable us to continue to serve customers the right way? And I think we've done a good job doing that as evidenced by both retention, which is good and continued decline in SG&A ratio.

Andrew Wittmann

Great, thanks for that. I guess my follow-up question would be, I guess similar on the gross margin side. Obviously, there's a lot of factors that have -- that go into this. In the last couple of quarters, you're starting to see some gross margin leverage from the pricing, which is great to see. I was just wondering what the bigger puts and takes are Doug that you're looking at on the gross margin side? Obviously raw materials has been the story for many, many years now. Are there other factors that come out of your cost efficiency initiatives that you've got in place, which I think were largely SG&A based, but are there other puts and takes besides the raw material complex that could factor into your gross margin performance as you head into 2020?

Doug Baker

Yes, no, I think there is a number. I mean, one, we got on a lot of formulation work and what I would call is optimizing where we make what in particularly the Energy business, they were impacted by the SAP roll-out that we had. That was really more on what I would call legacy Ecolab plants primarily. So as a consequence they were liberated, they weren't frozen. And so you see even there in tough volume situation good gross profit and very good leverage that is both SG&A and a lot of the work in the plants et cetera. That opportunity exists across the board and the supply chain SAP work is largely done. We got a few plants left to do, but it's really not material, and now those plants are leveraging the new tool, understanding and having more clarity about what's happening in terms of all the way through freight, but making -- we do a batch process should we be rethinking formulation structure and the rest. And so a lot of this work is still in front of us and I would say greatly enhanced and enabled by the work we just did with SAP. There is also clearly work to be done on SG&A. And so this is why we still believe, delivering double-digit EPS is really the right path and the way to think about it going forward, because we can grow and we can also grow while obtaining leverage, not just through volume but through efficiency work both in plants and in SG&A.

Operator

Thank you. We've reached the end of our question-and-answer session. I will turn the floor back to Mike Monahan for closing comments.

Mike Monahan

Thank you. That wraps up our third quarter conference call. This conference call and the associated discussion slides will be available for replay on our website. Thank you for your time and participation and our best wishes for the rest of the day.

Operator

Ladies and gentlemen, thank you for your participation. This does conclude today's teleconference. And you may now disconnect your lines at this time and have a wonderful day.