

November 7, 2012

## INVESTMENT LETTER

### Ecolab, Inc. (NYSE: ECL): Is This the Only Cockroach?

It was 10:00 A.M. on a Friday morning in Tulsa. The manager of the upscale restaurant, known especially for its prime rib and steaks, was preparing for lunch, conversing with the waiters and the waitresses, the busboys and the hostesses, making sure that everyone was ready to work when the doors would open at 10:30 A.M.

The manager looked around, made sure that the lights had been adjusted to the proper strength, that the music had been turned on (he had no latitude in selecting the music nor in controlling its strength or volume, but he was required by the corporate office to have music playing at all times and he frequently wondered what kind of judgment and taste dictated the selection and the volume of the music), that all the tables had been set properly, with the forks and knives on the required napkin, and with each set of silverware facing the right direction and in the right place. The silverware was sturdy and the napkin was a cloth napkin and not the cheap paper variety: the manager's restaurant was an upscale restaurant with a cuisine and ambience respected locally and nationally.

He breathed a sigh of relief, knowing that he and his team were ready for the daily luncheon challenge, at least as far as the dining room was concerned. The dining room, the manager knew, was the subject of first appraisal by his customers, and first impressions were hard to erase.

Then, because of his training, because of his attention to detail, he corrected himself. The first contact that the restaurant patron experienced was actually not with the dining room but with the two sets of doors that led into the dining room. He quickly turned and approached these doors, making sure that they were clean. He was satisfied: the glass doors had been thoroughly Windexed.

Before I go on, I want to make a preemptive apology. Clients tell me that they often read my letters after work and before dinner. But please, if you have started this letter, put it down before I get into the visceral, unappetizing arena of the

business of cleanliness in restaurants and hospitals. Instead, read this letter at a time when you are not thinking about or consuming food, or when you are not worried about hospital bacteria.

My intent, of course, is not to upset you with this letter but to show you how [Ecolab, Inc. \(NYSE: ECL\)](#) does its business and makes money. This requires descriptions of activities which may be unpleasant, descriptions which may be unappetizing, but descriptions which may sharpen understanding of what [Ecolab](#) does.

We are back at the restaurant. Now it was time for the manager to check the kitchen, to see if everything and everyone was ready. He pushed open the kitchen doors. The prep people were busy, chopping vegetables and meat into the required uniform portions, each weighing the same amount. The stoves were ready. He smiled at the chefs.

As he did so, he recalled what Warren Buffett had said about the restaurant business, after someone had asked him how he viewed his position in [McDonald's Corp. \(NYSE: MCD\)](#). He had answered by saying that had he known before he invested in [McDonald's](#) how difficult the restaurant business was, referring to the endless details that had to be conquered in order to be successful, he might not have invested in [McDonald's](#).

The manager made his way back to his office just outside the kitchen area. He was wondering how busy today's lunch rush would be, estimating the number of employees he would have to have on hand during the lunch hour rush and at what time he could cut some of them when, as he looked down on the spotless floor, a cockroach, realizing that it had been spotted, picked up its pace and fled into the corner created by two walls, finding a tiny crevice for escape.

The sighting upset the manager but he quickly settled down, realizing that in all probability there was nothing to worry about. His restaurant was

### Cockroaches wrote the textbook on survival

Cockroaches are probably the world's oldest survivors. Maybe you cannot break down their lineage on [Ancestry.com](#) (NASDAQ: ACOM), but it is important to know that species "very similar to present-day cockroaches have been found in deposits dating back to the Carboniferous period. This means that cockroaches are an astonishing four hundred million years old." (*Iowa State Daily.com*, October 8, 2012.)

Once cockroaches enter an establishment, they can spread rapidly. A cockroach egg will hatch within roughly fourteen to fifty days depending on the species and will reach adulthood within anywhere from thirty days to one year. A single female cockroach can produce more than three hundred eggs over its lifespan. Depending on the species of the cockroach, within a two-year span there can be thousands of these horrible pests where there were none before. (*Iowa State Daily.com*, October 8, 2012.)

Cockroaches make a game of eating what is conventionally considered edible as well as what most of us think of as inedible. They are adaptable and they are tough. They believe in a flexible diet, they multiply faster than rabbits, and they are clever in avoidance of anyone or anything that wants to kill them. They fear no one—except perhaps [Ecolab](#).

known for its cleanliness and consistently received high rankings from the health department. Most importantly, he had [Ecolab](#) on his side.

Before he had come to the highly acclaimed national chain he had worked at a local restaurant whose owner did not have the acumen to employ [Ecolab](#). At that restaurant, the spotting of a cockroach raised more than an academic question of whether there were more ready to surface. But at the restaurant that he now managed, he knew that the cockroach that he had spotted represented no threat, that even with the most thorough and sophisticated continuous pest eradication programs, the kind for which [Ecolab](#) was known, occasionally one would see a pest, but that the pest he had just encountered would not be around for long.

The manager knew how critical [Ecolab's](#) work was. Restaurant patrons will tolerate only one experience with a cockroach or any other pest. One encounter and the patron will likely never come back. But the manager was not worried. He knew that [Ecolab](#) was armed with products and experience so that it could eradicate whatever enemy decided to take up camp in his restaurant.

[Ecolab](#) often sells all the products needed to clean a restaurant, from the front door to the back door, especially the kitchen. [Ecolab](#) can sell twenty-five different product categories to a restaurant. These

include the detergents and computer-controlled dispensing systems that hook up to the dishwasher as well as all the other products needed to clean and sanitize a restaurant—surface sanitizers, hand-cleaning products, degreasers, delimers, floor cleaners, glass cleaners, and other products.

[Ecolab](#) not only sells these cleaning products, but also trains the restaurant staff on how to use them. Critical to [Ecolab's](#) success is development of a partnership with clients, partnership that means provision of supplies, but also training. The service specialists audit results on a monthly basis. They make sure that the dishes are clean. They make sure the dishwasher is operating correctly. They capture all this information on a tablet computer and share it with the restaurant's manager. If the restaurant is part of a chain, they download the information to a central repository so that the chain's headquarters can see what is going on in all their units (*Source: [www.sellingpower.com](http://www.sellingpower.com)*).

The key to [Ecolab's](#) service, the manager remembered, is guaranteed pest elimination, not merely control. When [Ecolab](#) first contracts with a restaurant, the service specialist, who has received extensive training in pest biology and behavior as well as [Ecolab's](#) proprietary protocols, performs an initial service or a "clean out."

To read the full Investment Letter, please email us at [contact@ferimc.com](mailto:contact@ferimc.com) or call (918) 743-5959. You could also fill out your contact information at <http://www.ferimc.com/contact.html>, we will contact you as soon as possible.