



Sherwin-Williams Company (SHW)

Updated April 10th, 2018 by Nick McCullum

Key Metrics

Current Price: \$388	5 Year CAGR Estimate: 9.9%	Quality Percentile: N/A
Fair Value Price: \$390	5 Year Growth Estimate: 9.0%	Momentum Percentile: N/A
% Fair Value: 100%	5 Year Valuation Multiple Estimate: 0.0%	Total Return Percentile: N/A
Dividend Yield: 0.9%	5 Year Price Target \$601	Valuation Percentile: N/A

Overview & Current Events

Sherwin-Williams is the world's second-largest manufacturer of paints and coatings. The company distributes its products through wholesalers as well as retail stores that bear the Sherwin-Williams name. Sherwin-Williams was founded in 1866 and has grown to a market capitalization of \$36 billion and annual sales of approximately \$15 billion. With 39 years of consecutive dividend increases, Sherwin-Williams is a member of the Dividend Aristocrats Index.

In late January, Sherwin-Williams reported (1/25/18) financial results for the quarter and year ending December 31, 2017. Quarterly sales increased by 43.0% while full-year sales increased by 26.4%, driven primarily by the acquisition of Valspar which closed last June. Same-store-sales increased by 6.3% in the year and 8.2% in the quarter, while full year diluted earnings-per-share increased by 55.7%, again due to the Valspar acquisition.

The company also released guidance for fiscal 2018. Sherwin-Williams is expecting to generate adjusted diluted earnings-per-share between \$18.75 to \$19.35 for the twelve-month period ending December 31, 2018. At the midpoint (\$19.05), this represents remarkable growth of 26% over 2017's comparable figure. Sherwin-Williams fourth-quarter earnings release was dramatically influenced by the Valspar acquisition, but other key metrics (including same-store-sales) showed that the company's underlying business continues to fire on all cylinders.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$4.00	\$3.78	\$4.21	\$4.14	\$6.02	\$7.26	\$8.78	\$11.16	\$11.99	\$15.07	\$19.05	\$29.30
DPS	\$1.40	\$1.42	\$1.44	\$1.46	\$1.56	\$2.00	\$2.20	\$2.68	\$3.36	\$3.40	\$3.70	\$7.50

Sherwin-Williams has compounded its adjusted earnings-per-share at a remarkable 15.9% per year since 2008. While this historical growth rate is certainly remarkable, we believe that the company is unlikely to replicate this performance moving forward. Instead, we believe that Sherwin-Williams is capable of delivering 9% annualized earnings growth over full economic cycles. In the near-term, this growth will be attributable to continued strength in the housing and remodeling markets. Longer-term, Sherwin-Williams will continue to benefit from last year's acquisition of Valspar, which gives the company a stronger foothold into many important markets while simultaneously creating meaningful synergy opportunities.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	13.7	14.8	17.0	19.8	21.3	24.3	24.1	24.3	23.2	22.8	20.4	20.5
Avg. Yld.	2.6%	2.5%	2.0%	1.8%	1.2%	1.1%	1.0%	1.0%	1.2%	1.0%	0.9%	1.0%

Using the midpoint of Sherwin-Williams' 2018 financial guidance (\$19.05), the company is trading at a price-to-earnings ratio of 20.4. For context, the company has traded at an average price-to-earnings ratio of 20.5 over the last decade. We believe that the company is trading near its fair value, and valuation changes should not have a meaningful impact on its expected total returns over the medium term.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	79.2%	75.5%	67.3%	71.6%	67.5%	72.3%	90.6%	96.2%	87.7%	34.0%	65.0%	80.0%
Debt/A	63.6%	65.5%	68.9%	71.0%	71.3%	72.2%	82.5%	85.0%	72.2%	81.5%	82.0%	75.0%
Int. Cov.	12.6	17.6	11.1	20.2	23.8	19.3	21.6	26.7	11.7	7.0	6.0	10.0
Payout	35.0%	37.6%	34.2%	35.3%	25.9%	27.5%	25.1%	24.0%	28.0%	22.6%	19.4%	25.6%
Std. Dev.	48.4%	35.2%	21.7%	24.4%	22.7%	21.6%	17.5%	22.8%	23.8%	16.6%	19.0%	19.0%

What stands out about Sherwin-Williams quality metrics is its ratio of gross profits to total assets. While 2017's figure is temporarily depressed as the company did not yet have a full year of earnings contribution from Valspar but its balance sheet had the acquisition's entire debt load, Sherwin-Williams' gross profits have consistently measured above 65% of its total assets over the last decade.

Investors should note that the Valspar acquisition may burden Sherwin-Williams' debt-related metrics in the near future. Through a combination of new debt and Valspar debt assumed at the transaction's close, Sherwin-Williams has added approximately \$10 billion in liabilities to its balance sheet. Moody's downgraded Sherwin-Williams three notches to Baa3 from A3 and S&P downgraded the company to BBB from A. We expect Sherwin-Williams to deleverage its balance sheet over the next several years, which will reduce its debt-to-assets ratio and improve the company's interest coverage.

Qualitatively, Sherwin-Williams' competitive advantage comes from the company's scale and brand. Customers are highly likely to purchase paints and coating from this company because of its familiarity. Sherwin-Williams' "Cover The Earth" logo is instantly recognizable to consumers around the world.

Final Thoughts & Recommendation

The most prominent current event for Sherwin-Williams at the moment is its recently-closed acquisition of Valspar. While this has resulted in a higher leverage ratio (and downgrades from the two major credit rating agencies), it also provides a compelling growth opportunity for the combined company.

Unfortunately, Sherwin-Williams' valuation is only in-line with its long-term historical average. While today's investors could still generate adequate total returns, we recommend waiting on a purchase with the knowledge that lower prices – and better buying opportunities – may present themselves in the future.

Total Return Breakdown by Year

