Sherwin-Williams Company (SHW)

Updated July 24th, 2018 by Nick McCullum

Key Metrics

Current Price:	$421	**5 Year CAGR Estimate:**	8.5%	**Volatility Percentile:**	42.3%
Fair Value Price:	$394	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	72.1%
% Fair Value:	107%	**5 Year Valuation Multiple Estimate:**	-1.3%	**Valuation Percentile:**	49.1%
Dividend Yield:	0.8%	**5 Year Price Target**	$606	**Total Return Percentile:**	54.2%

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 $39 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 July, Sherwin-Williams reported (7/24/18) financial results for the second quarter of fiscal 2018. The company generated 27.8% growth in consolidated sales, with the Valspar acquisition contributing 21.0% of this growth. Importantly, Sherwin-Williams generated robust same store sales growth of 6.8% in the quarter in United States and Canada locations. Moving down the income statement, diluted earnings-per-share of $4.25 increased by 26.5% over the same period a year ago, which includes $1.23 per share in charges for acquisition-related costs and $0.25 per share related to environmental provisions. For comparison, $3.36 in similar charges were recorded in the same quarter of fiscal 2017. Excluding these one-time accounting items, Sherwin-Williams generated adjusted diluted earnings-per-share of $5.73, which increased by 26.8% over last year's comparable figure.

Sherwin-Williams' second-quarter financial performance was very strong and gave the company the ability to raise its fiscal 2018 financial guidance. The company now expects to generate adjusted earnings-per-share between $19.05 and $19.35 in the twelve-month reporting period. For context, the midpoint of this guidance band ($19.20) implies 27.4% growth over last year's comparable figure. We have updated our 2018 earnings estimate to reflect the midpoint of Sherwin-Williams' newly-revised financial guidance.

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	***$19.20***	***$29.54***
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. As we have seen in the company's most recent earnings release, recent performance has been even stronger. 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, 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	***21.9***	***20.5***
Avg. Yld.	2.6%	2.5%	2.0%	1.8%	1.2%	1.1%	1.0%	1.0%	1.2%	1.0%	***0.8%***	***1.0%***

Sherwin-Williams' price-to-earnings ratio has increased since the time of our last quarterly research due to a rising stock price that was partially offset by improved 2018 financial guidance. The company's current earnings multiple is 21.9, slightly above its long-term average of 20.5. If the company's valuation were to mean revert over a period of 5 years, this would introduce a 1.3% headwind to its annualized returns during this time period.

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.

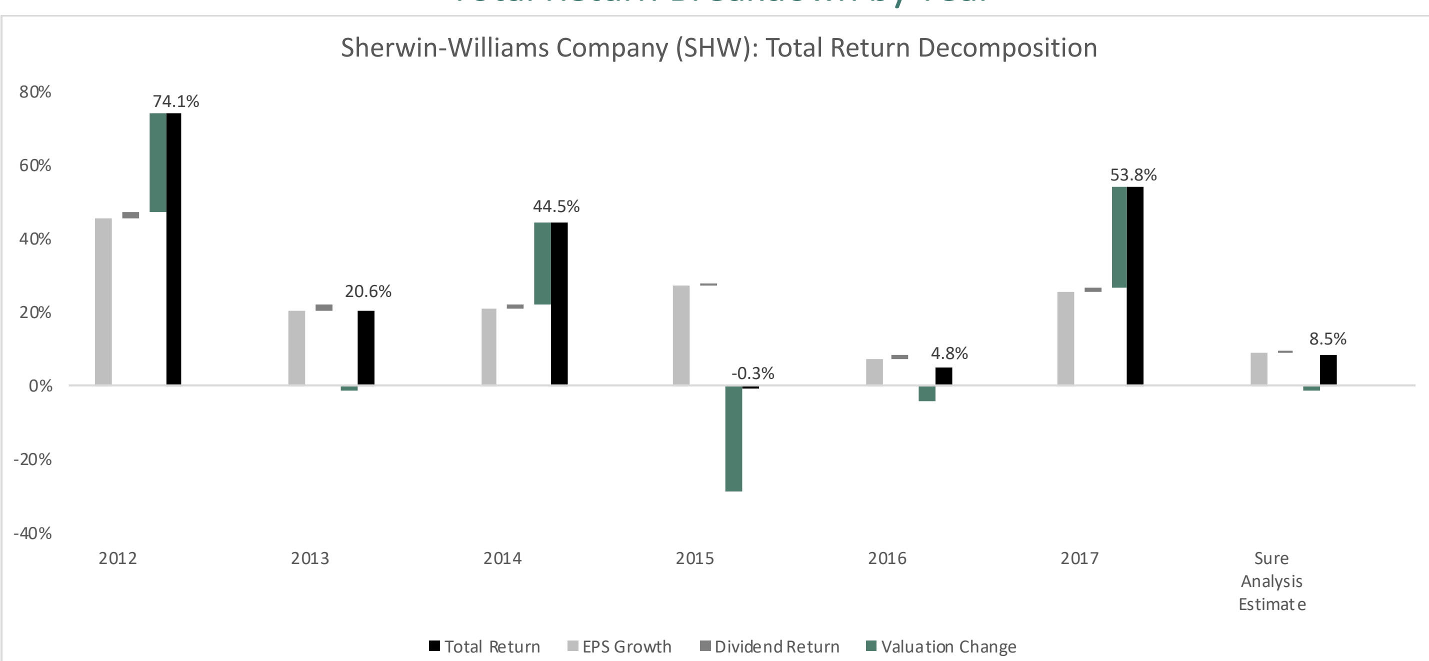
Investors should note that the Valspar acquisition may burden Sherwin-Williams' debt-related metrics in the near future. Through a combination of new debt and Valspar's debt assumed at the transaction's close, Sherwin-Williams has added approximately $10 billion in liabilities to its balance sheet. Moody's downgraded Sherwin-Williams three notches to Baa3 from A3 and S&P downgraded the company to BBB from A. We expect disciplined deleveraging moving forward.

Final Thoughts & Recommendation

Not much has changed with respect to Sherwin-Williams since the time of our last quarterly research report. The most prominent current event for Sherwin-Williams continues to be 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.

Meanwhile, Sherwin-Williams' current price-to-earnings ratio is elevated from its normal level. We suspect that this will cause slight valuation contraction if mean reversion were to occur. While today's investors may achieve reasonable high single-digit total returns, our recommendation continues to be for investors to wait for lower prices – and better buying opportunities – that may present themselves in the future.

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.