

The Sherwin-Williams Co.

NYSE:SHW

Analyst: Patrick Donovan

Sector: Materials

BUY

Price Target: \$310.83

Key Statistics as of 3/19/2016

Market Price:	\$288.69
Industry:	Chemicals
Market Cap:	\$26.62B
52-Week Range:	\$218.27-294.35
Beta:	0.84

Thesis Points:

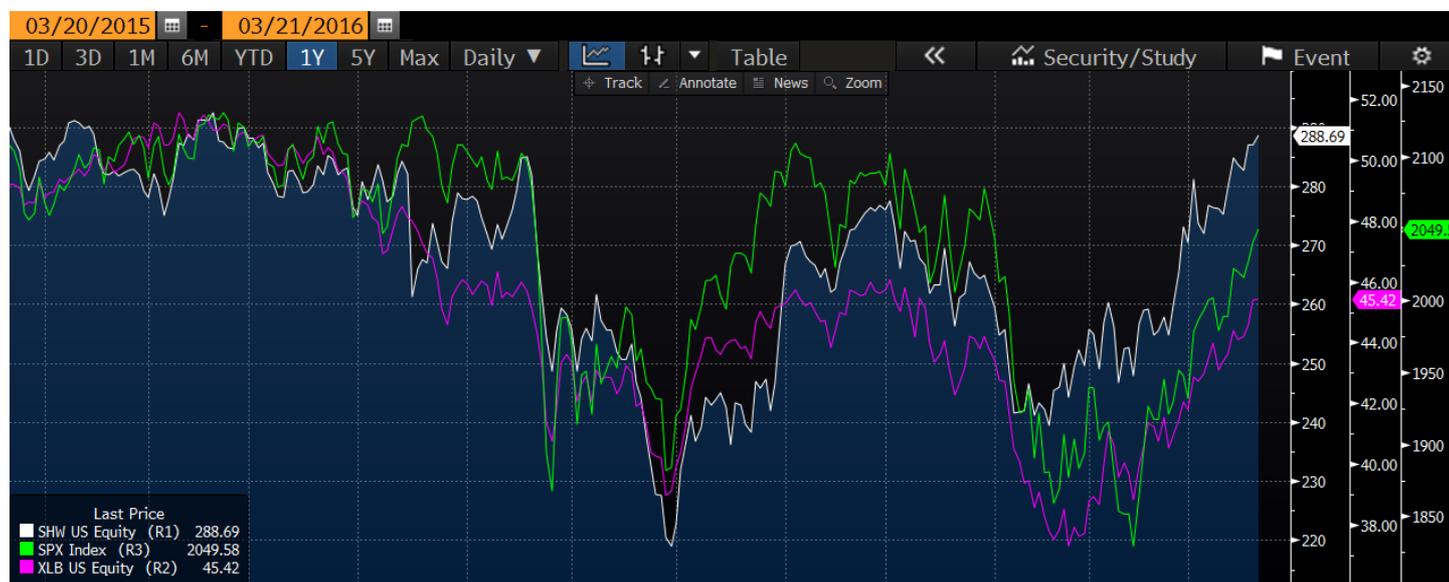
- Increases in housing starts and existing home sales are driving sales of coatings higher.
- Decreases in the price of inputs have significantly improved the company's operating margins.
- Already leading the industry in market share, acquisitions have positioned SHW to capture more of both the consumer and contractor market in the coming year.

Company Description:

Sherwin-Williams is an American company listed on the New York Stock Exchange. Known primarily for providing homeowners and contractors with the highest-quality paint products on the market, Sherwin has a reputation for delivering coatings that outperform competitors in every way. The company not only provides services and products to contractors and do-it-yourself consumers, but also to a variety of businesses who use their products as original equipment manufacturer coatings. The company is headquartered in Cleveland, Ohio where it was founded 150 years ago in 1866. Sherwin-Williams produces premium coatings products and has the largest market share of paint sales in the United States.

Closing Price Graph

Displayed below is Sherwin-Williams share price over the past year. In green is the S&P 500, and in purple is the SPDR materials sector index. The graph, along with data, shows that Sherwin-Williams typically follows the markets, however in the last quarter has been able to outperform competitors very well.



Thesis

Sherwin-Williams is already the leader in the United States in terms of paint sales, and looks to grow market share even further in 2016. The company has enjoyed a decrease in the cost of inputs thanks to many of the key components in coatings being derived from petrochemicals. The cost of inputs for the industry tends to lag behind changes in the price of oil. While the rebound may have already begun for the price per barrel, SHW should see a lower cost of materials for the remainder of the year, barring any unusual jumps in the price of oil. Thanks to this decrease in cost of goods sold, and an improvement in sales for three of the four business segments under the Sherwin-Williams brand, margins have improved greatly in 2015 and according to the company's financial statements and earnings calls, management is working hard to continue these improvements in 2016. Another key component of the company's improvements is continued acquisitions. Over the past five years the firm has acquired several small market share competitors in order to move into new markets, especially the southern and south-eastern United States. By purchasing competition rather than simply opening a new Sherwin-Williams location, it has made accessing new customers much easier and more effective. In the professional paint contracting business the majority of cost is in labor. Contractors are willing to pay a premium for SHW products because they beat competition in many aspects such as coverage, durability, cure time, and ease of application. These benefits combined with entry into new markets are driving sales of Sherwin-Williams paints up consistently. Another important element of the business that is estimated to grow in 2016 is housing starts and sales. Contractors have grown to trust the product, and now as the housing market continues to grow and rebound from the bubble in 2008, SHW has positioned itself to take advantage of growth in both starts and existing home sales.

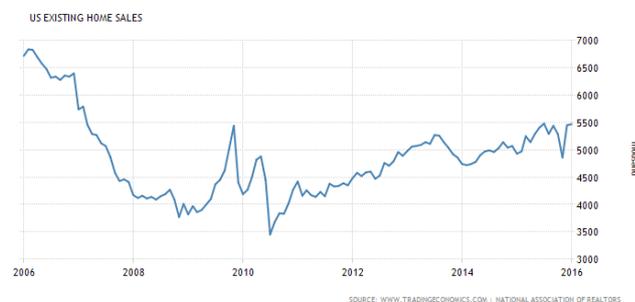
Industry Outlook

The two primary markets for Sherwin-Williams are painting contractors and private consumers. There are several positive changes in the market occurring over the course of the 2015 and 2016 fiscal years that will affect the firm. One of the most impactful will be the

growth of housing starts in the coming year. Since 2008-09 the industry has been slowly but surely recovering but has yet to return to the peak level. Industry analysts and data from the U.S. census bureau point towards continued growth in starts and a convergence toward the peak level of 2008 within the next 3 years.



Since 2011 housing starts have doubled and the decrease in cost of many construction inputs has further pushed the rate at which starts are growing. Sherwin-Williams is positioned perfectly to take advantage of the situation as they have grown market share last year in both consumer and contractor sales. The key here, contractor sales, have grown for SHW from 40% of total sales to 60% in the last decade. As more contractors continue to build new homes, they will look toward the industry leader in coatings to help them finish their projects. The other end of the spectrum for customers is the consumer market. Consumers tend to purchase more paint products when existing home sales are increasing, this is because paint is seen as an inexpensive means of improving home value. As shown below, existing home sales are up this year and forecasted to continue growing in the next year, meaning more growth in sales for the consumer and contractor markets.



Segment Analysis

The Sherwin-Williams company splits operations into four primary segments; paint stores, global finishes,

consumer group, and the Latin American coatings group. Paint stores are the largest segment by a significant margin, representing 63.6% of total revenue in 2015. In the most recent earnings call on January 28th 2016, the firm announced several improvements in efficiencies for the paint stores group. Citing specifically the reduction costs of inputs and processes and a sharp increase in customer demand. Paint stores service many of the professional painters who account for the majority of sales. As mentioned previously, acquisitions have increased the contractor market and these improvements in both cost and sales have helped improve the profit margin of the paint stores group by 19.9% in the 2015 fiscal year. Although other segments for Sherwin are less critical to the overall health of the company it is important to highlight some of the changes occurring in these operations as well. The consumer group saw sales rise 11.1% last year, mostly attributed to the introduction of HGTV home by Sherwin-Williams in Lowes stores. Once again, thanks to improvements in efficiency, specifically volume-driven operating efficiencies, profit margin for this segment improved 19.6% in 2015. For Sherwin's 2015 operations the only segment which saw a drop in profit was the global finishes group. Unfortunately, unfavorable changes in the currency markets due to an increase in the value of the U.S. dollar drove down revenues in this segment while sales improved.

Management

In January of 2016 Sherwin-Williams announced that John Morikis would replace Christopher Connor as CEO. Morikis had been the head of the paint stores division from 1999 to 2006, when he was promoted to COO. Connor will remain on the board most likely for the first two quarters of 2016 in order to facilitate a smooth transition for Morikis. His reputation has allowed the company to maintain spectacular ratings among industry analysts. In the past five years management has spent more than half of operating cash on repurchases and nearly 20% on dividends. The management team does a great job of improving shareholder value, and have a reputation for increasing market share at the same time.

Porters Five Forces

The valuation model created by Dr. Girard allows for an analysis of Porter's five forces. Scaled from 0-100 the results of this test can help give insight into how a firm is positioned amongst its peers. In terms of bargaining power of suppliers, customers and the intensity of existing rivalry, Sherwin-Williams falls right in the middle with scores of 50 for each category. The threat of substitutes for SHW falls around 67 points. This indicates that there is a high likelihood that customers are aware of, and have easy access to competitor's products. It is important to note, however that this score also indicates that customers are more likely to remain with Sherwin-Williams than try another product. It should come as no surprise that there are many other manufactures of paint, however Sherwin-Williams is the industry leader and has a more significant reputation of outstanding service. The final category of the five is threat of new competition, where SHW scores 75. This indicates a relatively low chance of new competition springing up and impacting SHW's business.

Financials

During the 2015 fiscal year management at Sherwin-Williams focused on improving efficiencies and growing market share with gusto. Based on the results from the annual report and the first earnings call from 2016 I was able to use the Proforma valuation model created by Dr. Girard to estimate the value of the company today and then proceed in forecasting the value in one years' time. Non-Adjusted revenue growth has been higher than the industry throughout the history of operations at Sherwin, however looking into the future I estimate that revenue growth will converge closer to the industry average of 5.4% per year. Operating costs will decrease slightly from current levels to 78%, just above the industry average due to the nature of SHW business. The company has had fairly consistent dividend yield and thus I estimated the future yields to be 1.5% of revenues. Based on all of my inputs the fair value today matches up exactly with how the market values Sherwin-Williams. With that in mind, the one year target price for SHW is \$310.83 and I am recommending a buy.

The Sherwin-Williams Company (SHW)

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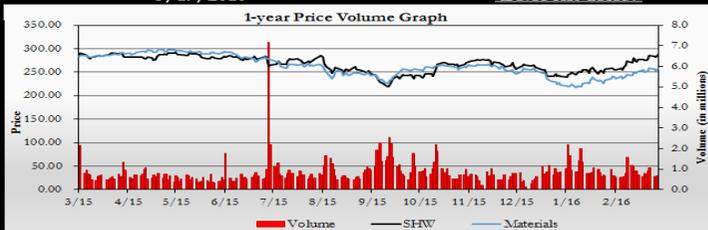
NEUTRAL

Analysis by Patrick Donovan
3/19/2016

Current Price: \$288.69
Divident Yield: 0.9%

Intrinsic Value: \$283.63
Target Price: \$310.83

Target 1 year Return: 8.59%
Probability of Price Increase: 80.67%



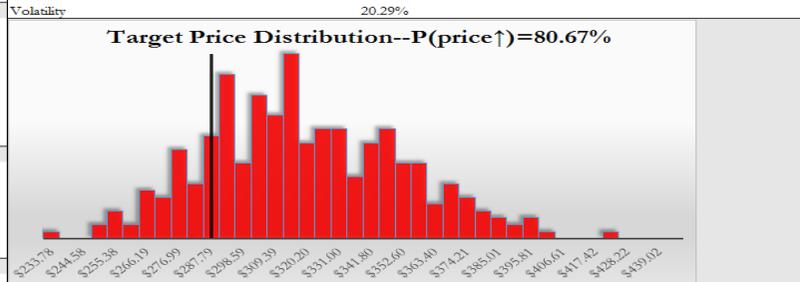
Description
The Sherwin-Williams Company develops, manufactures, distributes, and sells paints, coatings, and related products to professional, industrial, commercial, and retail customers primarily in North and South America, the Caribbean, Europe, and Asia.

General Information
Sector: Materials
Industry: Chemicals
Last Guidance: November 3, 2015
Next earnings date: April 17, 2016
Estimated Country Risk Premium: 7.27%
Effective Tax rate: 32%
Effective Operating Tax rate: 32%

Market Data	
Market Capitalization	\$26,618.03
Daily volume (mil)	0.91
Shares outstanding (mil)	92.20
Diluted shares outstanding (mil)	94.02
% shares held by institutions	55%
% shares held by investments Managers	64%
% shares held by hedge funds	6%
% shares held by insiders	1.08%
Short interest	1.45%
Days to cover short interest	1.56
52 week high	\$294.35
52-week low	\$218.27
Levered Beta	0.84
Volatility	20.29%

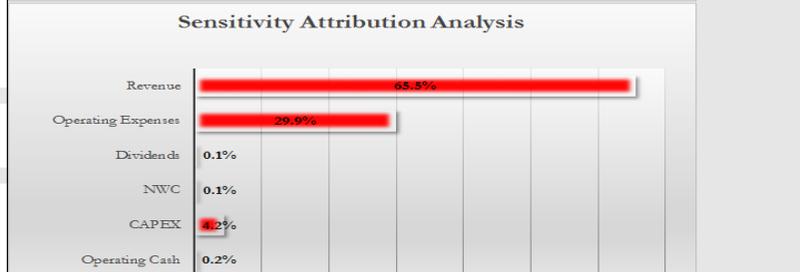
Past Earning Surprises	
Quarter ending	Revenue
12/31/2014	-1.38%
3/31/2015	-1.79%
6/30/2015	-4.03%
9/30/2015	-2.75%
12/31/2015	0.47%
Mean	-1.89%
Standard error	0.7%

EBITDA	
12/31/2014	46.34%
3/31/2015	-6.02%
6/30/2015	-2.98%
9/30/2015	5.50%
12/31/2015	14.65%
Mean	11.50%
Standard error	9.4%



Management	
Connor, Christopher	Executive Chairman
Mozikis, John	Chief Executive Officer, Pre
Hennessy, Sean	Chief Financial Officer and
Davisson, Robert	President of the Americas Gr
Knight, Timothy	Senior Vice President of Cor
Conway, Mike	Director of Corporate Commu

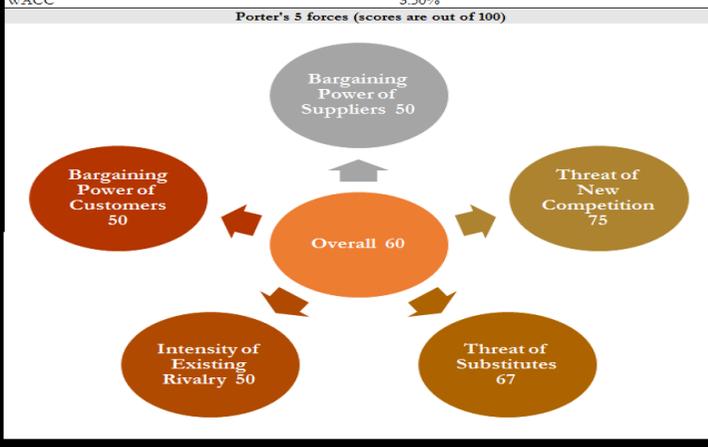
Peers	
PPG Industries, Inc.	
The Valpar Corporation	
Axalta Coating Systems Ltd.	
Ecolab Inc.	
Monsanto Company	
Celanese Corporation	
RPM International Inc.	
Albemarle Corporation	



Profitability	
ROIC	34.0%
NOPAT Margin	13%
Revenue/Invested Capital	2.56
ROE	36.5%
Adjusted net margin	13%
Revenue/Adjusted Book Value	2.90

Invested Funds	
Total Cash/Total Capital	4.0%
Estimated Operating Cash/Total Capital	4.0%
Non-cash working Capital/Total Capital	6.9%
Invested Capital/Total Capital	96.9%

Valuation	
Period	Revenue growth
Base Year	1.9%
12/31/2016	2.8%
12/31/2017	5.1%
12/31/2018	4.7%
12/31/2019	5.9%
12/31/2020	4.9%
12/31/2021	4.3%
12/31/2022	4.5%
12/31/2023	4.8%
12/31/2024	5.0%
12/31/2025	5.0%
Continuing Period	5.0%



Capital Structure	
Total Debt/Common Equity (LTM)	0.16
Cost of Existing Debt	3.50%
Estimated Cost of new Borrowing	2.41%
CGFS Risk Rating	3.50%
Unlevered Beta (LTM)	3.28%
WACC	3.50%

Net Claims	
Period	Invested Capital
Base Year	\$3,621.51
12/31/2016	\$3,401.93
12/31/2017	\$4,481.16
12/31/2018	\$4,909.68
12/31/2019	\$4,435.27
12/31/2020	\$4,996.50
12/31/2021	\$5,980.90
12/31/2022	\$6,282.55
12/31/2023	\$6,627.63
12/31/2024	\$7,016.49
12/31/2025	\$7,411.65
Continuing Period	