

SHERWIN WILLIAMS:

SHORT IDEA



Idea Background

- This provides a good pair against ARHS and is also a nice way of shorting the housing market more indirectly than just homebuilders as it is further down the supply chain. It is a mainly margin squeeze story.
- Adds cyclical to the short side of the portfolio.

Industry Top-Down: Furniture Stores and Retailers

- This is not a stock with especially bad-looking quants. FY1 measures are all below average but FY2 and FY3 are above average. P/E is to stay high all the way to 2024. The **change in estimates** though, places this stock in last place. I believe both **valuation and estimates are too demanding** given the fundamental headwinds this company is facing.

Ticker	Company Name	Market Cap												Percent Change in FY1 EPS Estimates (Prev 60 Days)	Percent Change in FY2 EPS Estimates (Prev 60 Days)	
			Revenue Growth FY1	Revenue Growth FY2	EPS FY0 - Previous Financial Year	EPS FY1 - Current Financial Year	EPS FY2 - Next Financial Year	EPS FY3	EG F1	EG F2	EG F3	PE FY1	PE FY2			PE FY3
CE	Celanese Corp	11.78 B	12.31%	-1.58%	18.12	18.12	15.93	16.84	0.01%	-12.08%	5.71%	6.00	6.82	6.45	1.88	-4.47
WLK	Westlake Corp	12.31 B	38.75%	-8.64%	15.58	22.07	15.89	16.24	41.67%	-27.99%	2.17%	4.36	6.06	5.93	1.62	-8.93
LYB	LyondellBasell Industries NV	26.70 B	19.01%	-7.11%	18.19	16.72	15.06	14.61	-8.08%	-9.92%	-2.98%	4.90	5.44	5.60	0.26	-6.66
NDSN	Nordson Corp	12.94 B	8.42%	4.38%	7.74	9.32	9.95	10.86	20.47%	6.76%	9.05%	24.26	22.72	20.84	0.10	0.06
EMN	Eastman Chemical Co	11.10 B	3.08%	-0.11%	8.85	9.72	10.26	11.30	9.77%	5.62%	10.14%	9.31	8.81	8.00	-0.94	-2.15
DOW	Dow Inc	35.88 B	7.93%	-5.14%	8.98	7.94	6.68	7.11	-11.53%	-15.97%	6.53%	6.29	7.48	7.02	-1.01	-8.46
PPG	PPG Industries Inc	29.27 B	8.05%	4.43%	6.77	6.70	8.24	9.14	-1.10%	23.00%	11.01%	18.60	15.12	13.62	-4.50	-4.43
SHW	Sherwin-Williams Co	60.22 B	10.00%	5.51%	8.15	8.63	10.43	11.83	5.90%	20.79%	13.51%	26.92	22.29	19.63	-8.42	-5.82
AVG	Industry Average	25.03 B	13.44%	-1.03%	11.55	12.40	11.55	12.24	7.14%	-1.22%	6.89%	12.58	11.84	10.89	-1.38	-5.11

Biggest negative change in estimates

Company Overview

Description: The Sherwin-Williams Company develops, manufactures, distributes, and sells paints, coatings, and related products to professional, industrial, commercial, and retail customers.

The Sherwin-Williams Company NYSE

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SHW **230.86** USD **-12.11** **(-4.98%)** **230.86** USD **0.00** **(+0.00%)** **Tue Oct 25th 2022 (During-Market)** **Materials** **Chemicals** **\$ 59.50e** **23.9x** **869,092** **-2.71%** **-22.91%**
Last Updated • Tue Sep 13 4:00PM EDT After Market • Tue Sep 13 7:00PM EDT Next Earnings Date Sector Industry Market Cap Forward P/E Volume Total Return (3M) Total Return (1Y)

Snapshot Chart



Key Data

Dividend Yield	1.04%	Avg Volume (10D)	1.36M
Beta (5Y Monthly)	1.05	Volatility (1Y)	31.91
Shares Outstanding	257.75M	Short Interest %	0.73%
Industry	Chemicals		
Competitors	PPG DD AXTA CE ECL		

Performance Returns

	1M	3M	YTD	1Y
Price	-8.25%	-2.94%	-34.44%	-23.57%
Total	-8.03%	-2.71%	-33.98%	-22.91%

Valuation

	LTM	NTM
P/E	34.7x	23.9x
EV/Sales	3.5x	3.1x
EV/EBITDA	19.6x	18.4x
Price/Book	26.7x	

Capital Structure

Market Cap	\$59.50B
Total Debt	\$12.51B
Cash & Inv.	\$312.60M
Enterprise Value	\$71.70B

Analyst Estimates

	FY 2022	FY 2023	FY 2024
Sales	\$21.97B	\$23.22B	\$24.05B
YoY Chg	10.13%	5.69%	3.58%
EPS	8.64	10.44	11.81
YoY Chg	6.00%	20.82%	13.10%

News

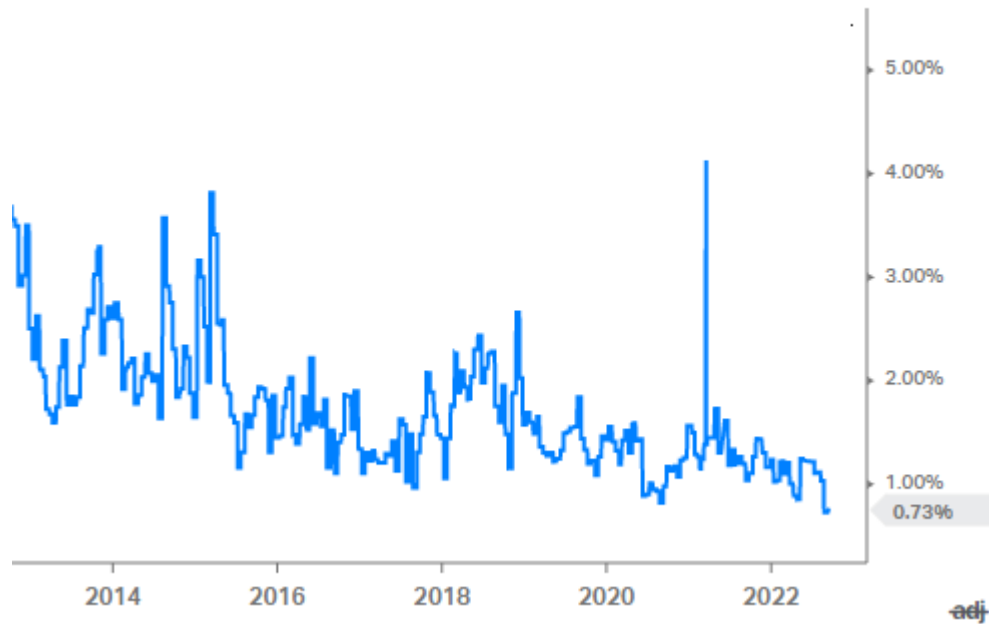
- Evercore ISI Adjusts Price Target for Sherwin-Williams to \$260 From \$285, Maintains Outperform Rating MT Newswires • Sep 12 '22
- Sherwin-Williams: After A 30%+ Retreat, Future Returns Look Much Brighter Seeking Alpha • Sep 08 '22
- Sherwin-Williams Amends Credit Agreement MT Newswires • Sep 08 '22
- Evercore ISI Raises Sherwin-Williams Company's Price Target to \$285 From \$270, Maintains Outperform Rating MT Newswires • Sep 08 '22
- Should You Invest in the Materials Select Sector SPDR ETF (XLB)? Zacks • Sep 06 '22

Company Overview

Shareholders: SHW has very low short interest and no anomalies in institutional holdings (employee ownership plan 8%)

Short Interest %

[Open Graph](#)



Shareholders

Name	Equities	%
Sherwin-Williams ESOP	20,639,085	7.93%
The Vanguard Group, Inc.	19,781,172	7.60%
SSgA Funds Management, Inc.	10,747,763	4.13%
T. Rowe Price Associates, Inc. (Investment Management)	10,250,997	3.94%
Massachusetts Financial Services Co.	8,898,426	3.42%
Osprey Partners Investment Management LLC	7,025,151	2.70%
Fidelity Management & Research Co. LLC	5,626,326	2.16%
BlackRock Fund Advisors	5,126,087	1.97%
Newfleet Asset Management LLC	5,053,893	1.94%
Scout Capital Management LLC	4,791,000	1.84%

Quantitative Analysis - Operational leverage

- Forecasted Eps growth is almost half the Revenue growth, indicating **negative operational leverage** and **margin erosion**.

Earnings Matrix - Reported & Estimates									
					Sales	EBITDA	EBIT	EPS	EPS GAAP
	FY 2021	FY 2022		FY 2023					FY 2024
1Q Mar	\$ 4.66B	\$ 5.00B		\$ 5.39B					\$ 5.62B
2Q Jun	\$ 5.38B	\$ 5.87B		\$ 6.30B					\$ 6.59B
3Q Sep	\$ 5.15B	\$ 5.83B		\$ 6.16B					\$ 6.33B
4Q Dec	\$ 4.76B	\$ 5.29B		\$ 5.52B					\$ 5.83B
Year	\$ 19.94B	\$ 21.97B		\$ 23.22B					\$ 24.05B
Growth	5.77%	10.13%		5.69%					3.58%

Earnings Matrix - Reported & Estimates									
					Sales	EBITDA	EBIT	EPS	EPS GAAP
	FY 2021	FY 2022		FY 2023					FY 2024
1Q Mar	2.06	1.61		2.00					2.30
2Q Jun	2.65	2.41		3.03					3.50
3Q Sep	2.09	2.60		3.05					3.55
4Q Dec	1.34	2.01		2.32					2.59
Year	8.15	8.64		10.44					11.81
Growth	-18.76%	6.00%		20.82%					13.10%

Quantitative Analysis - Revenue Mix

- Sherwin Williams operates in **three segments**:
 - 1. The Americas Group:** offers architectural paints and coatings, and protective and marine products, as well as OEM product finishes and related products for architectural and industrial paint contractors, and do-it-yourself homeowners.
 - 2. Performance Coatings group:** develops and sells industrial coatings for wood finishing and general industrial applications, automotive refinish products, protective and marine coatings, coil coatings, packaging coatings, and performance-based resins and colorants.
 - 3. Consumer Brands Group:** supplies a portfolio of branded and private-label architectural paints, stains, varnishes, industrial products, wood finishes products, wood preservatives, applicators, corrosion inhibitors, aerosols, caulks, and adhesives to retailers and distributors.

\$19.9 billion

2021 Revenues

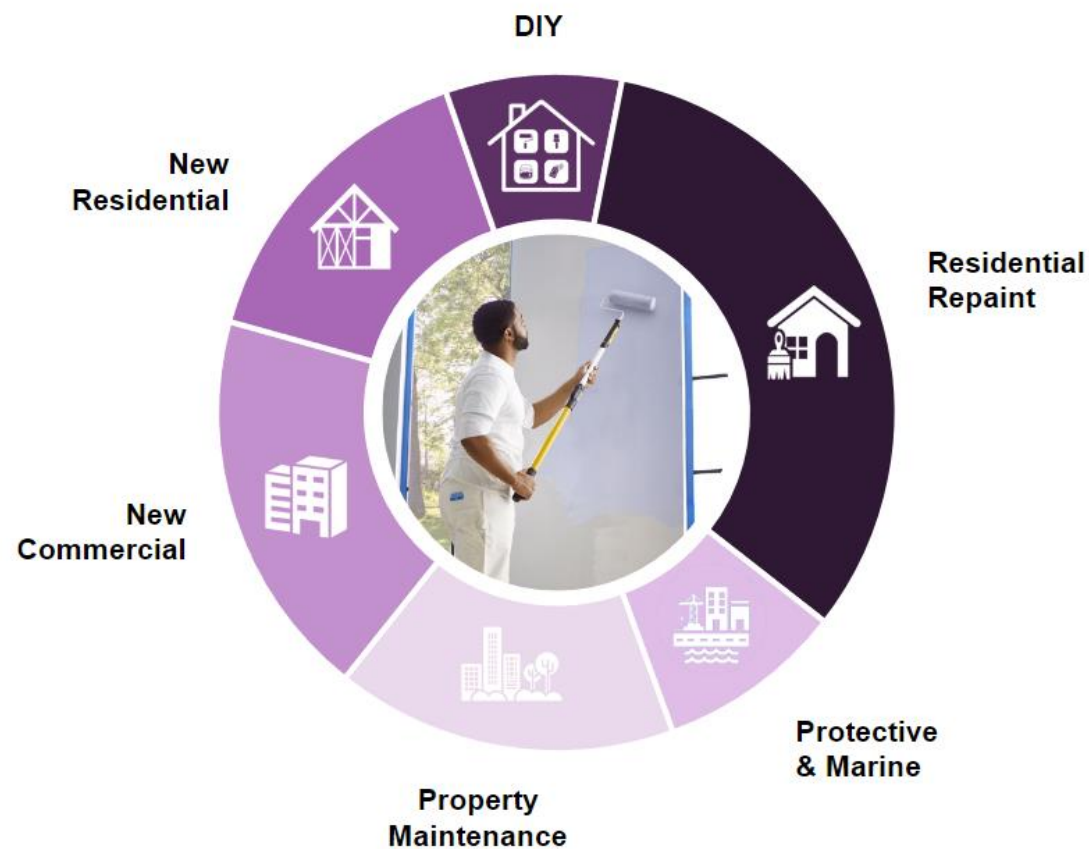


FY21 Sales

Quantitative Analysis - Americas Group

- The Americas Group is quite diversified in its end markets, with Residential Repaint being the most important of them:
- Last Quarter:
 - Sales increased 8.1% including low-double-digit pricing; same store sales increased 6.4%
 - Growth in all pro customer segments, led by Property Maintenance and New Residential
 - Residential Repaint up high-single digits versus a very strong double-digit comparison
 - Announced 10% price increase effective September 6, 2022 → “And that’s really is what’s driving this additional 10% price increase September 6, which we do believe will have a similar effectiveness to previous price increases.” – So, none?
 - Segment profit decreased to \$700.4 million, and segment margin decreased to 21.0% - declines driven by lower DIY and Protective & Marine sales volumes and higher raw material costs
 - Reported Segment Margin YoY down to 8.6% from 16.8% , -820 bps.
 - **In conclusion, even after low double-digit price increases sales have only increased high single digits due to lower margin and volumes.**

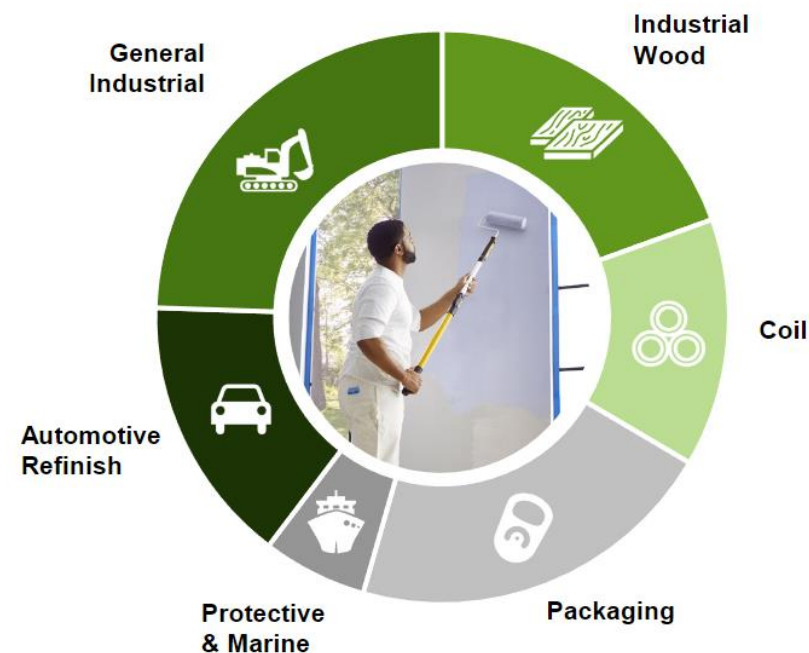
2021 Sales



Quantitative Analysis - Performance Coatings group

- Performance Coatings group is also quite diversified in its end markets, and has been the best performing segment
- Last Quarter:
 - Sales increased 15.2% including mid-teens pricing and -3.7% FX
 - Strong double-digit growth in North America and Latin America; mid-single-digit growth in Europe and high-single-digit decline in Asia
 - Coil and Packaging highest year-over-year increases and double-digit growth in nearly every region
 - General Industrial and Auto Refinish double-digit growth in North America and Latin America; declines in Europe and Asia
 - Industrial Wood strong in North America, soft in Europe and Asia
 - Adjusted segment profit increased to \$247.1 million, and adjusted segment margin increased to 13.8% - increases driven by strong top-line growth and good cost control
 - Reported Segment Margin to 11.0% from 9.3% , +170 bps
 - Incremental price increases to mitigate raw material inflation
 - **In conclusion, sales are barely higher than the price increases, hinting at volume weakness even in this segment.**

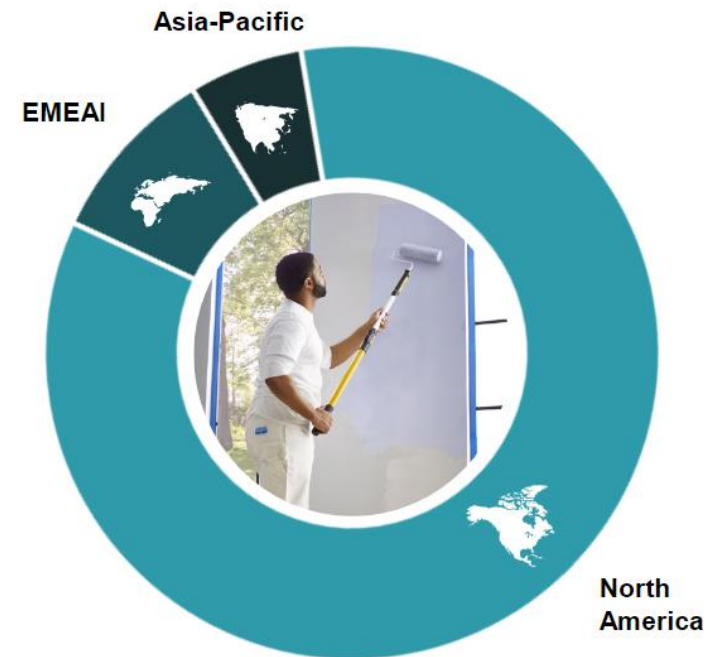
2021 Sales



Quantitative Analysis - Consumer Brands Group

- Consumer Brands Group is a smaller segment but also the worse performing one.
- Last Quarter:
 - Sales increased 0.9% - high-single-digit price realization nearly fully offset by weak DIY sales volume, tight supply of alkyd resins significantly impacting non-paint categories (aerosols and stains) in June, soft international sales and slight FX headwinds
 - China down by a very high double-digit percentage due to COVID lockdowns; Europe also down high double-digits due to the slowing macroeconomic environment
 - Adjusted segment profit decreased to \$82.6 million and adjusted segment margin decreased to 11.2% - declines driven by lower sales volume, supply chain inefficiencies and higher raw material costs
 - Reported Segment Margin to 8.6% from 16.8%, -820 bps
 - Incremental price increases to mitigate raw material and other cost inflation

2021 Sales



Qualitative analysis – Last Quarter and Estimates, KPI's

- Q2 Non-GAAP EPS of \$2.41 **missed by \$0.33**.
- Revenue of \$5.87B (+9.1% Y/Y) **missed by \$140M**.
- Lowered FY22 diluted net income per share guidance to a range of **adjusted EPS of \$8.50-\$8.80**, including acquisition-related amortization expense of \$0.85 per share, from prior guidance of **\$9.25-\$9.65**
- Full-year **revenues rising by high-single to low-double digit percentage**, compared with its prior outlook for a 10% Y/Y increase, or ~\$21.8B consensus.
- In conclusion, they see revenue growth unchanged via price increases offsetting lower demand, but lower margins/profits.

Breakdown of \$0.80/share FY22 Adjusted Earnings Guidance Midpoint Reduction

Impact	Softer Demand	Admin Segment	Higher Input Costs, <i>net of pricing</i>
	<ul style="list-style-type: none"> ▪ North America DIY ▪ Europe ▪ China 	<ul style="list-style-type: none"> ▪ Higher interest expense ▪ Acquisition related costs 	<ul style="list-style-type: none"> ▪ Raw materials ▪ Freight ▪ Transportation ▪ Incremental costs to serve
\$\$\$	~\$0.50/share	~\$0.20/share	~\$0.10/share
Recent Actions	<ul style="list-style-type: none"> ▪ 10% price increase in The Americas Group effective September 6th ▪ Price increases in other businesses ▪ Continued focus on capturing demand and share gains ▪ Managing general and administrative expenses tightly across all businesses – continue to invest in long-term growth ▪ Execute simplification and platform projects ▪ Execute integration of acquisitions ▪ Ongoing portfolio review of programs, brands, and businesses 		

Catalysts

- Earnings Call Oct 25th. → further margin erosion, price increases not offsetting lower volumes/demand, housing market offers incremental risk.
- Inflation and supply chain further eroding margins .
 - *“Notably, certain specialty resins crucial to several of our industrial coating products were in short supply. With the tightness in the supply chain, we continue to have inefficiencies in our operations but have chosen to continue serving our customers, albeit at higher costs.”*
 - *“The slowing demand we cited at our Investor Day did not improve over the remainder of the month, so we experienced tight supply in certain resins, particularly alkyd resins, that significantly impacted our North American nonpaint sales”*
- LEN, KBH earnings Sept 21st.
- PPG industries (competitor, same industry) earnings Oct 20th.
- Incremental risk coming from China covid policy, deep recession in Europe.
 - *“Internationally, demand deteriorated faster than anticipated in Europe, and we saw no real recovery in China following the lifting of COVID lockdowns, both of which meaningfully impacted Consumer Brands and Performance Coatings Group sales.”*
- FX headwinds

Price target

- Stock is trading at \$230 per share. I expect them to decrease EPS FY2022 guidance/estimates to at least 8 EPS, and trade at a P/E 2022 of 23.

Earnings Matrix - Reported & Estimates					Sales	EBITDA	EBIT	EPS	EPS GAAP
	FY 2021	FY 2022	FY 2023	FY 2024					
1Q Mar	2.06	1.61	2.00	2.30					
2Q Jun	2.65	2.41	3.03	3.50					
3Q Sep	2.09	2.60	3.05	3.55					
4Q Dec	1.34	2.01	2.32	2.59					
Year	8.15	8.64	10.44	11.81					
Growth	-18.76%	6.00%	20.82%	13.10%					

↓ P/E (EST FY1)	P/E (EST FY2)	P/E (EST FY3)
26.7x	22.1x	19.6x

- Price target is \$185

Gatekeeping

- The stock has held on and regained the losses of the last earnings report but started breaking down again after Jackson Hole and the inflation numbers. There seems to be a resistance level at 220. Head and Shoulders?



Trade Structure

The timing lends itself to a Calendar Spread where we sell 4 of the 220 October puts and buy 6 of the 230 November puts that encompass the earnings catalyst.

Leg	Position	Expiration	Days	Strike	Type	Initial Price	Initial CF	Price	Value	P/L
1	6	nov yyyy	28.00	230	Put	11.00	-6,600	45.08	27,049	20,449
2	-4	oct yyyy	0.00	220	Put	4.00	1,600	35.00	-14,000	-12,400
							-5,000		13,049	8,049

1.6:1 Risk-Reward if it goes to 185 before October expiry

Leg	Position	Expiration	Days	Strike	Type	Initial Price	Initial CF	Price	Value	P/L
1	6	nov yyyy	0.00	230	Put	11.00	-6,600	45.00	27,000	20,400

-1600 credit

+1600 credit

4.4:1 Risk-Reward if we collect the credit and it goes to 185 before November expiry