Porter & Co.

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#24

THE BIG SECRET ON WALL STREET

The "Paint-By-Numbers" 15% Compounder

- A Global Leader That Sets Its Own Prices
- Beating the Market with Brand Power

FROM THE DESK OF PORTER STANSBERRY

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A Global Leader That Sets Its Own Prices

Beating the Market with Brand Power

Everyone knows the story of the invention of the telephone... right?

In December 1874, science teacher Elisha Grey – who had already created the first electronic keyboard synthesizer – had a brand-new musical brainstorm.

Before a spellbound audience at the First Presbyterian Church in Highland Park, Illinois, Elisha demonstrated a "Musical Telegraph" that transmitted "familiar melodies through telegraph wire."

But he had an even more exciting idea up his sleeve: a mechanism to send the *human voice* down a wire.

Working in secret – since his patron, a wealthy tycoon, disapproved of such flighty notions – Elisha perfected his "vocal telegraph" over the next two years. On Valentine's Day, 1876, he filed a "caveat," or advance notice of patent, with the U.S. Patent Office.

The rest is history.

Wait, you say – that's not how the story goes...

What about Alexander Graham Bell, whose work with the deaf famously inspired him to experiment with the physics of sound? Don't history books record the words of Bell's first-ever phone call to his assistant:

> "*Mr. Watson, come here; I want to see you"?*

We credit the multitalented Scotsman as the inventor of the telephone. But it's only because Alexander Graham Bell got to the patent office first... just *three hours* before Elisha Grey.

The two men had been separately developing a working telephone for years... Grey in Illinois, Bell in Boston. (Bad blood ran high between them, and some say Bell ripped off parts of Grey's invention.)

And we can't forget the *Italian* inventor of the telephone. Antonio Meucci had filed his own announcement with the patent office back in 1871, though cash flow problems prevented him from beating the other two to the punch.

How three people – working independently – invented the telephone at the same time is a mystery of science. So is why Isaac Newton and Gottfried Leibniz separately discovered calculus in the 1600s. And why, in 1869, Louis Ducos du Hauron and Charles Cros both pioneered the first version of color photography… each presenting their findings independently on the same day.

Maybe there's something to spooky "mass consciousness" theories, like **Indra's net**. But so far, there's no rational explanation for parallel inventions. It just… happens. As the renowned cultural anthropologist Alfred Kroeber once commented,

> *The whole history of inventions is one endless chain of parallel instances."*

In every case, though, history books record the person who "got there first." And often, that means nipping under the wire and filing a patent before a rival.

Take the paint roller, for instance…

The original tool – familiar to home improvement mavens everywhere – was the brainchild of Norman Breakey, a Canadian living in Toronto in 1940. He was tired of painting houses with a brush, so he literally "invented the wheel."

Breakey saw the huge opportunity in his revolutionary new product, but he didn't have the money to commercialize the idea, and had trouble raising money from investors.

And… his biggest mistake… he didn't file a patent.

Richard Croxton Adams, though, *did*.

In the early 1940s, Adams was an engineer at America's leading paint manufacturer. He'd been tasked to come up with a paint brush alternative, since pig bristles – the key part of the paint brush – were rationed during wartime. Adams tinkered away at his basement workbench, and after a while came up with a rudimentary version of Breakey's device – a rotating cylinder covered in a splice of carpeting, attached to a wooden handle.

Backed up by the budget of a major corporation generating $100 million in sales each year, Adams commercialized the product that became known as the "Roller-Koater" in late 1941. Adams' "parallel invention" sold for 89 cents – and crucially, his employer secured the product with a patent.

As the war ended and America enjoyed a post-war baby boom, the Roller-Koater became a staple for millions of households that flocked to the suburbs and consumed record amounts of paint to decorate their new homes. Here's Richard Adams gleefully examining his Roller-Koater product that would change the way America, and the world, applied paint. (Why he's holding a toy penguin is lost to history.)

To this day, Adams' employer – a household brand – is credited with "inventing the paint roller." And Norman Breakey, the original Canadian inventor, died penniless and in obscurity, after failing to capitalize on a brilliant idea that's now become an industry standard.

Smart decisions beget more smart decisions. The company that commercialized the paint roller went on to become one of the longest-running success stories in the history of American business.

The Birth of a 156-Year Old Brand

In 1886, 24-year old grocery store manager Henry Sherwin invested his life savings into Truman Dunham & Co., a local dealer in paint pigments and linseed oil (which in the 1800s was mixed with powder pigments to create liquid paint).

As Henry noted years later, "I had almost no capital. It consisted principally in health, ambition and a few years of such experience as many boys get who must work their own way in the world."

Henry sold the commoditized linseed oil portion of the business to double down on the bigger opportunity he saw in the burgeoning paint market, and brought in a partner, E. P. Williams, to form Sherwin, Williams, & Co. in 1870.

Henry and E.P. were chalk and cheese personalities, but peas and carrots as business partners. Henry was known as "methodical, quiet, soft-spoken and reserved; it was said he could enter a room unnoticed," according to a historical account published by Sherwin-Williams. E.P. was congenial and boisterous, and a natural salesman.

They both shared an ironclad belief in a simple proposition:

> *Think quality, talk quality, sell quality. If you back up the goods, the goods will back you up,"*

as Henry Sherwin once explained.

In an internal communication from the 1890s, the company explained its basic strategy of competing on quality, not price, and charging a premium for premium products:

> *Quality always has a value. The best salesmanship, as well as the best manufacturing and merchandising successes have been built upon quality with a fair price for it. No permanent or satisfactory success is ever made by selling goods for less than they are worth or in pushing a business on a price basis alone. There is no middle road. You must either build a business on quality and get the price for it, or build on price and make the quality to fit it."*

From that baseline of excellence, Sherwin unleashed a major innovation: the first high-quality, ready-made paint in liquid form.

Throughout most of the 1800s, painters had to mix their paint on-site, combining pigments with oil or linseed. When "ready-made" paint was finally introduced in 1867, the quality left much to be desired… the paint often cracked and flaked, leaving consumers dissatisfied.

Sherwin saw an opportunity to succeed where others had failed. He experimented with more than 80 different combinations, and after a few false starts, he realized the fundamental challenge: particle size. The pigment powders available at the time were too large and irregular in size. This meant the pigment particles didn't blend evenly into the binding oil.

The solution would require smaller pigment powders that were uniform in size. But manufacturing equipment of the time couldn't deliver the necessary particle specifications.

That didn't stop Sherwin, though. In the mid-1870s, he hired an engineer to build the first-of-its kind manufacturing facility using "high-quality bearings and water-cooled grinding surfaces that could render pigments fine and uniform enough to remain in suspension in the oil that carried them," according to a historical account published by the company.

In 1876, this facility gave birth to SWP (Sherwin-Williams Paint), backed up by a bold guarantee:

> *This paint, when properly used, will not crack, flake, or chalk off, and will cover more surface, work better, wear longer, and permanently look better than other paints."*

Sherwin-Williams promised to refund consumers in full if the paint failed to live up to its promise. Instead of refunds, though, satisfied customers returned to buy more. Within a few years, SWP became America's best-selling exterior house paint. The innovative Sherwin-Williams manufacturing process behind the paint became the new industry standard, and the original equipment from 1876 remained in operation (with slight modifications) for the next 50 years.

Shown below is a picture of the first can of SWP paint manufactured in 1880. It was opened on the company's 50th anniversary – and was in perfectly usable condition.

The first can of SWP manufactured at the company's Cleveland plant, 1880. The can was first opened on the occasion of the company's 50th anniversary; its contents remained in perfect condition after 36 years.

The Mother of Invention

In 1884, Sherwin-Williams became the first company in the industry to hire a full-time chemist, MIT graduate Percy Neyman. The company then built out a full staff of chemists – and transformed the paint industry from art to science.

By 1900, the Sherwin-Williams laboratories had parlayed their advanced knowledge of paint chemistry into an unmatched array of 600 unique paints, varnishes, colors, stains and enamels. And, it turned out, they created even better products under pressure.

During World War I, the British blockade Germany halted German imports of advanced dye pigments into the U.S., which put a stranglehold on the entire U.S. paint industry. At the time, Germany led the world in advanced chemical engineering, and thus had a virtual monopoly on the supply of these highly-engineered molecules.

Sherwin-Williams set up a new division staffed by leading organic chemists, and set to work to "crack the code" of developing these pigments internally. By 1915, they had developed a suite of synthetic dyes that were at least as good as what the company had been importing from Germany. This not only lowered their costs, but it allowed the company to introduce a new suite of premium paints that left its competitors in the dust. From 1900 to 1919, the company grew sales 15-fold from $2.3 million to $34.2 million.

Then, during World War II, the game changed again. Linseed oil – the primary ingredient in Sherwin-Williams' "ready-made" paint – was rationed. The company had to develop a replacement quickly, in order to keep America's military equipment supplied with critical paint coatings… and later, to keep up with the post-war home improvement boom.

The Sherwin-Williams laboratory rose to the occasion, identifying casein – a water-based milk protein – as a substitute for linseed oil. Enter the first water-based paint in the world, branded as Kem-Tone. (During this time, the Roller-Koater also made its debut.)

Kem-Tone delivered painting performance that surpassed any other competing product on the market. It was a fast-drying, washable paint that dried on almost any surface in under an hour (compared with several days for most oil-based paints at the time). The product came with a label fitting for its revolution in household painting – "the modern miracle wall finish."

Households loved it, retailers struggled to keep it on the shelves, and Kem-Tone quickly became the best-selling paint in the industry's history, selling 10 million gallons within its first three years. The success of Kem-Tone boosted Sherwin-Williams' annual sales to $100 million per year by 1943.

The company invested its profits back into the business, building and purchasing mills and manufacturers across the country.

Predictably, a host of competitors wanted a piece of the pie. In the late 1920s, a flood of companies hawking cheaper paints swamped the market. At the time, the going rate for a gallon of SWP was $4. Competitors offered much cheaper – but lower-quality – options, with prices as low as $2 per gallon.

"Often imitated but never duplicated," Sherwin-Williams' focus on quality paid off. When the Great Depression struck in 1929, it wiped out a substantial portion of the wanna-be's. Sherwin-Williams, though, continued investing and growing its store count through the depths of the Depression, opening 14 stores in 1936 alone. By 1939, it ran 157 stores, up nearly 8-fold from 20 stores in 1917.

This pattern of capitalizing on economic downturns continued over the next century. The company has grown its store count and taken market share during each major industry downturn of the last several decades, including the 1990-1991 recession, the dot-com recession in 2000 - 2002, and through the Great Financial Crisis.

Better than Berkshire Hathaway

Sherwin-Williams has delivered some of the highest, longest-running shareholder returns in the history of American business. Over the last 35 years, the company has compounded investor capital at 15.8% per year – exceeding even Berkshire Hathaway, which has delivered compounded returns of 15.5% over the same period. It achieved this remarkable feat because *it sets the prices*.

As Warren Buffett once explained:

> *The single-most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you have to have a prayer session before raising the price by a tenth of a cent, then you've got a terrible business. I've been in both, and I know the difference."*

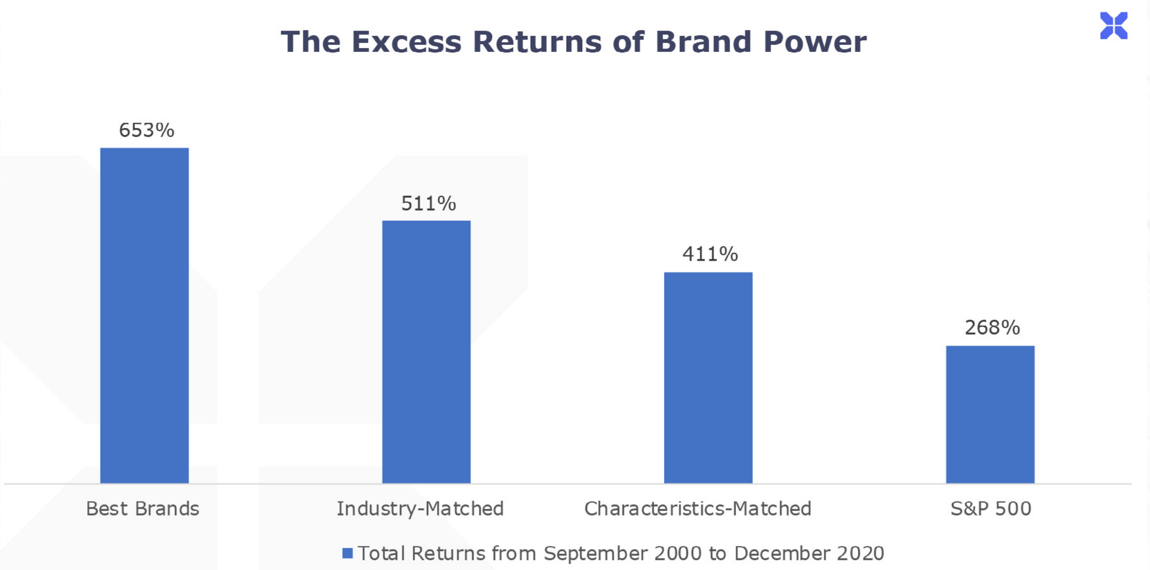
Companies without brand power are forced to compete in commoditized markets (i.e., markets with low value-added products and services that don't command premium prices), attempting to grow profits by selling more volume at ever-thinner margins.

But companies with dominant brands, like Sherwin-Williams, can opt out of the brutal "race to the bottom." Consumers are willing to pay a premium for its uniquely valuable products and services. When a company can control its economic destiny by setting its own prices, it reaps above-average returns on invested capital, and superior shareholder returns over time.

One July 2022 study quantified the advantage created by brand power for publicly traded companies. In the analysis, a hypothetical portfolio invested in the top 100 U.S. brands, ranked by branding research firm Interbrand. This "Best Brands" portfolio was constructed by buying shares in each top branded company in the year after it made Interbrand's top 100 list.

The researchers then compared the Best Brands portfolio against two control groups: an "industry-matched" portfolio of companies that competed in the same industries as the Best Brands, and a "characteristics-matched" portfolio of companies with similar quantitative characteristics as the Best Brands, including metrics like valuation, market capitalization, and profitability.

The table below shows the returns of the Best Brands portfolio versus the two control groups, along with the S&P 500, from September 2000 through December 2020:



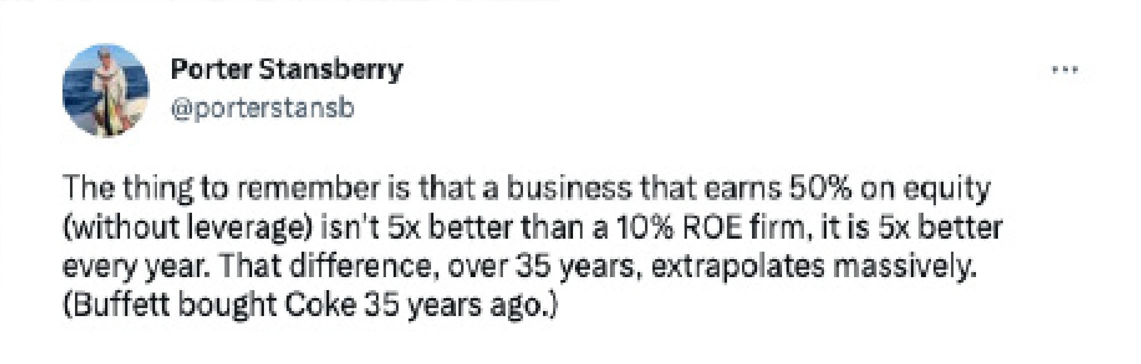
Source: Brand Value and Long-Run Stock Returns (June 26, 2022)

When a dominant brand is *also* capital efficient, the returns can be extraordinary.

World-class companies that earn high profit margins and have minimal capital requirements don't need to reinvest as much as commoditized businesses that can only increase profits with more production. Instead, these companies can grow earnings by raising prices, and then funnel earnings back to investors through share repurchases and dividends.

Growing earnings and a shrinking equity base can generate extremely high returns on equity (ROE) – defined as net income divided by shareholder equity. And high ROE translates into world-beating shareholder returns.

In a recent Twitter post, **Porter explained** the simple math that makes high ROE businesses so much better than the average company:


Porter Stansberry
@porterstansb

The thing to remember is that a business that earns 50% on equity (without leverage) isn't 5x better than a 10% ROE firm, it is 5x better every year. That difference, over 35 years, extrapolates massively. (Buffett bought Coke 35 years ago.)

The company founded by Henry Sherwin and E.P. Williams more than 150 years ago checks all of these boxes: a dominant brand with pricing power, robust profit margins, and high capital efficiency.

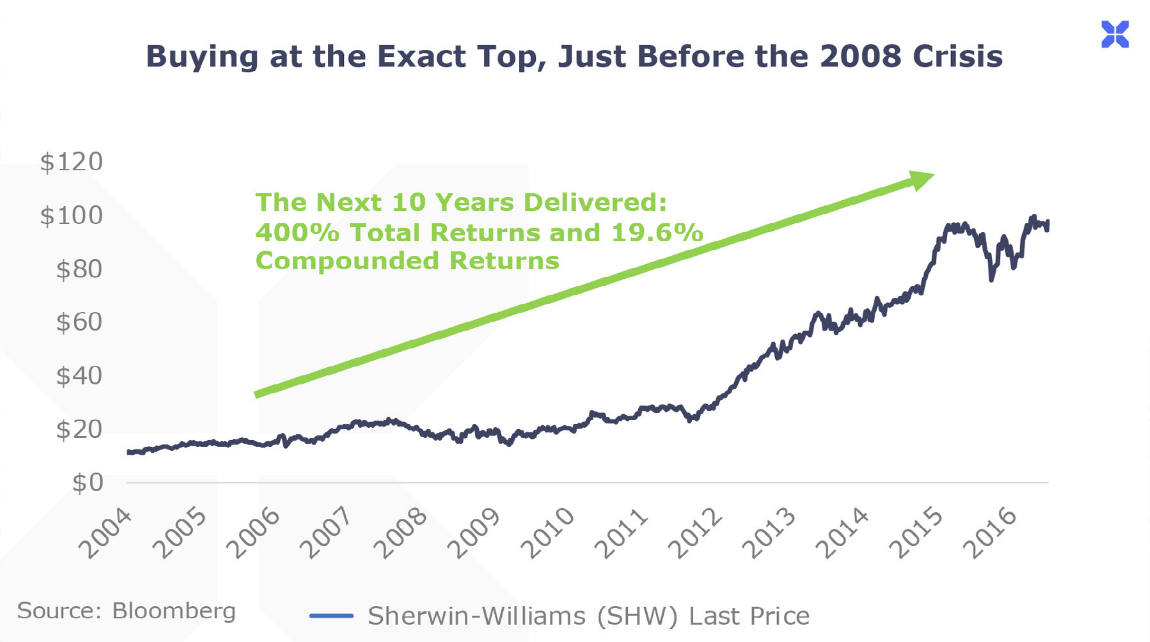
The business's brand power allows it to raise prices with relatively little impact on sales, including a 10% increase in prices last year alone. This pricing power makes the business highly profitable, with 44% gross profit margins (gross profit is calculated as revenue minus the cost of production).

It's also capital efficient, spending less than 2% of revenues on capital expenditures each year. This provides plenty of free cash to return to shareholders, as reflected by 44 consecutive years of dividend increases. In addition, management returns capital to investors with consistent stock repurchases.

Despite being tied to the mercurial fortunes of the residential housing market, Sherwin-Williams' long-term prospects keep improving.

Throughout its 156-year history, the company has used every downturn to acquire weaker competitors and take market share. Growing profits and a shrinking share count have allowed the company to deliver an incredible 62% ROE, and compound shareholder capital at 20% per year, for the last 20 years.

Consider the case of the housing market meltdown in 2008. Investors who bought shares in this company at *precisely* the wrong time – at the exact peak of its share price in July 2007 – still compounded capital at 20% over the next 10 years, enjoying a 400% total return (compared with a 50% return in the S&P 500 over the same period):



Today, we'll make the case for how investors can earn similar returns of 15-20% over the next 10 years, despite the turbulence we see unfolding in the economy and financial markets in coming months.

The Global Leader in Premium Paint

Sherwin-Williams remains the global leader in innovation, with over 2,200 active patents and the largest research and development facility in the industry. It logged $22.1 billion in annual sales last year and $2.1 billion in profits. Its next closest competitor, PPG Industries, generated $17.7 billion in sales and $1.0 billion in profits last year.

The company's portfolio still includes its original flagship SWP brand, which remains the leading paint brand over 140 years after it first became America's best selling household paint in the 1880s. Other key brands in Sherwin-Williams portfolio include Krylon, the top-selling aerosol paint, Dupli-Color, the number one automotive specialty paint, and Thompson's, the leading water-proofing sealant used on wood decks and other exterior surfaces.

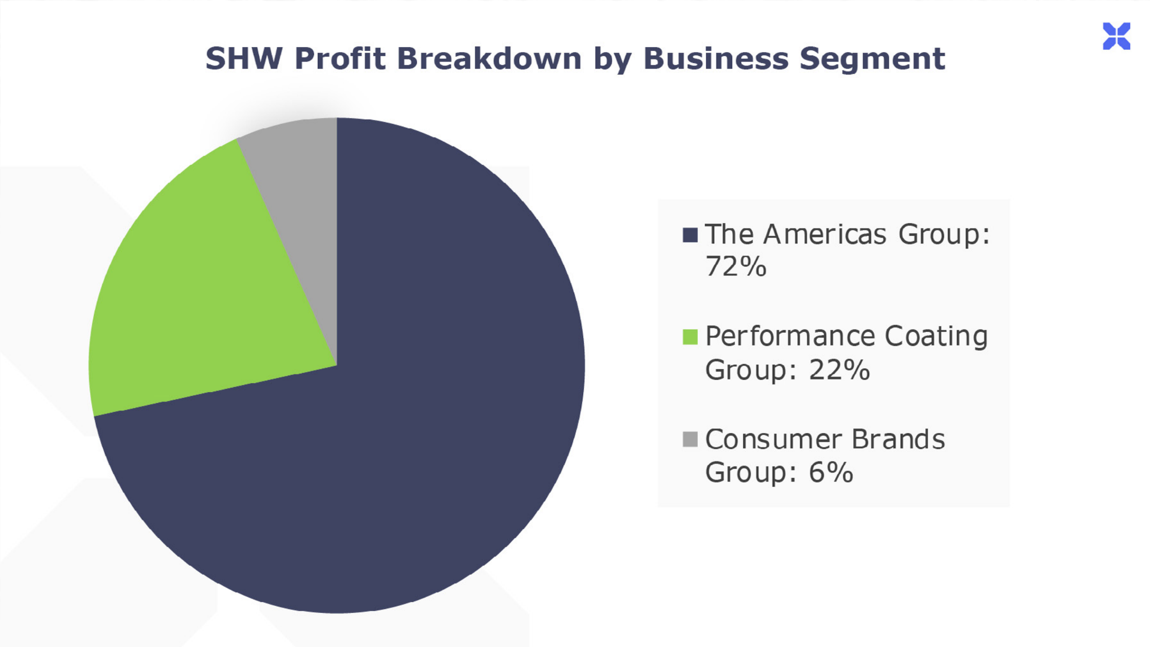
Independent research by industry analytics firms Material Research and Marketvision indicates that Sherwin-Williams is the number one brand preferred by professional painters, the number-one brand preferred by interior designers, and also ranks number one in overall brand awareness.

Customer satisfaction analytics firm J.D. Power consistently ranks Sherwin-Williams as the top choice preferred by consumers, including ranking the company as the number one brand in exterior stains and paint in the 2022 U.S. Paint Satisfaction Study. According to internal Sherwin-Williams customer satisfaction studies, 97% of customers reported that they would buy again and 95% would refer the company's products to a friend.

The company breaks its business down into three segments, starting with the Americas Group (72% of profits). This segment sells Sherwin-Williams branded paint and coatings products *only* at Sherwin-Williams' 4,000 branded store locations in the U.S., Canada and Latin America. This segment is the workhorse of the brand, providing the key driver of both profitability and growth (more on this segment below).

Next is the Performance Coatings Group (22% of profits), which includes protective coatings and finishes for the global automotive, marine, packaging and furniture manufacturing industries.

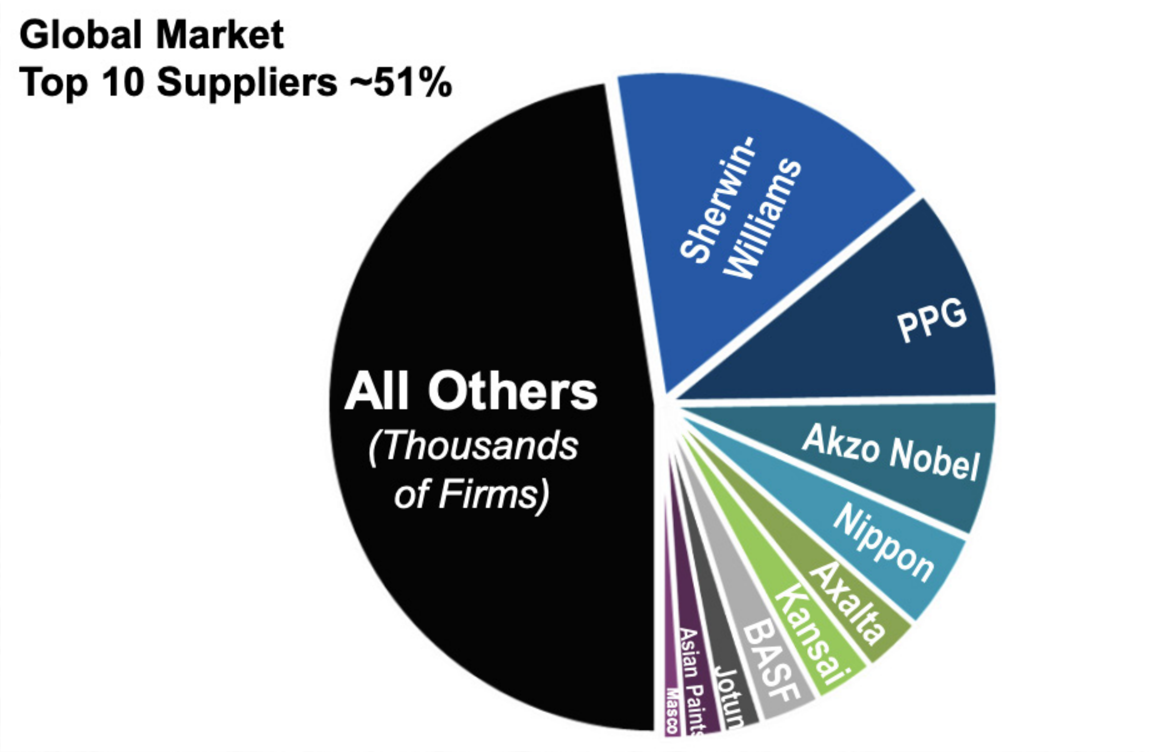
Finally, there's the Consumer Brands Group (6% of profits). For this segment, the company partners with third-party retailers like Lowe's Home Improvement, Walmart, and Ace Hardware to sell non-exclusive brands of paint, coatings and wood finishes.



Since the early days of Sherwin-Williams, the company has cornered the market by developing the highest-quality products available. Now, it's added another weapon to its arsenal: an increasingly powerful scale advantage.

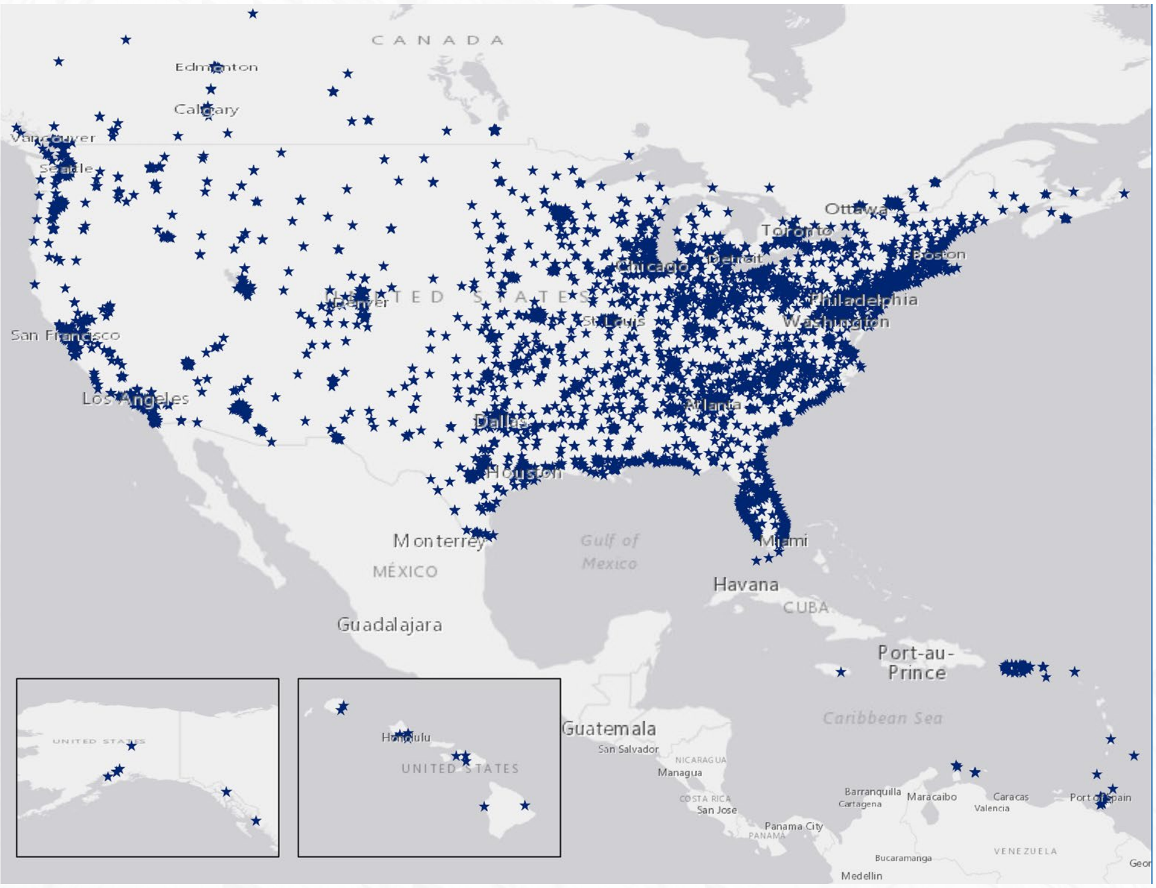
The Biggest Fish in the Pond

With a market capitalization of $58 billion, Sherwin-Williams is more than twice the size of its next closest competitor, PPG Industries (PPG). Sherwin-Williams is also the leader by volume of paint sold, shown below:



This size advantage means that Sherwin-Williams can afford to spend more money than its competitors, building out a vast distribution, logistics and store network. This includes 89 manufacturing plants and 62 distribution facilities spanning the U.S., Europe, Asia and Latin America. It also includes an unmatched retail store footprint, spanning more than 5,000 locations globally, with an emphasis on its core market in the U.S.

Today, roughly 90% of U.S. consumers – including the professional painters, contractors and home-builders who make up roughly 85% of the company's sales – live within a 50-mile radius of a Sherwin-Williams store:



In the business of professional painting, labor makes up around 80% - 90% of the cost of each job. That means time is money, and the paint supplier that can offer the greatest time savings wins by boosting the bottom line of professional painters.

The sheer concentration of Sherwin-Williams stores – instantly recognizable from their "Sherwin-Williams Covers The Earth" logo – means they beat out their key competitor in premium paints, Benjamin Moore, a private company owned by Berkshire Hathaway. Both companies offer a variety of paint and coatings brands with a stellar reputation for quality. But Sherwin-Williams "covers the earth," and Benjamin Moore does not.

In an instructive podcast titled **Benjamin Moore Vs Sherwin-Williams**, the host – a professional paint contractor – explains why he's more likely to buy from Sherwin-Williams:

> *We defer to Sherwin-Williams, and I'll tell ya, the one reason we hear from most of the contractors that prefer Sherwin-Williams is that they just have stores everywhere… There's probably one, two… geez at least seven in our area that I could get to, like now, and that means a lot… If you're 30 miles away and there's no Benjamin Moore store near you, you have to go to Sherwin-Williams - I think that's where they win out, is that there's just so many stores, and the access to it is just so available. So when they (painters) get out to a job and they need a gallon of paint, and the only store close is a Sherwin-Williams, that's where they're going."*

Sherwin-Williams not only has "stores everywhere"… they have great service inside the stores. The company boasts a highly-trained store sales staff of more than 3,000 representatives that handle roughly 18 million orders each year. Every store manager is required to complete a 4-year training program, effectively earning a bachelor's degree in paint, before they can manage a Sherwin-Williams location.

Sherwin-Williams also elevates its staff from employees to company stakeholders by awarding shares in the company as a form of compensation. Today, Sherwin-Williams has one of the highest participation rates in share-based compensation in corporate America. As of the latest data from 2016, 17% of the company's employees were shareholders, who together owned over $4 billion of the company's stock.

Because Sherwin-Williams pays well and invests in employees' career growth, these employees stick around. The average turnover (i.e., the number of employees who quit/get fired) for any given retail store is 20 - 25% per year. Sherwin-Williams turnover is just 5 - 7% per year, and more than 7,000 employees have a tenure of more than 20 years… meaning professional painters can develop long-term relationships with their local store staff. (Our podcast host explains how he's used the same Sherwin-Williams sales representative for the last 9 years.)

The bottom line: Sherwin-Williams makes it easy for painters to get quality paints. As a result, 23 of the 25 top U.S. homebuilders use Sherwin-Williams products almost exclusively. And this unmatched customer loyalty and brand power is how Sherwin-Williams translates paint into profits for shareholders.

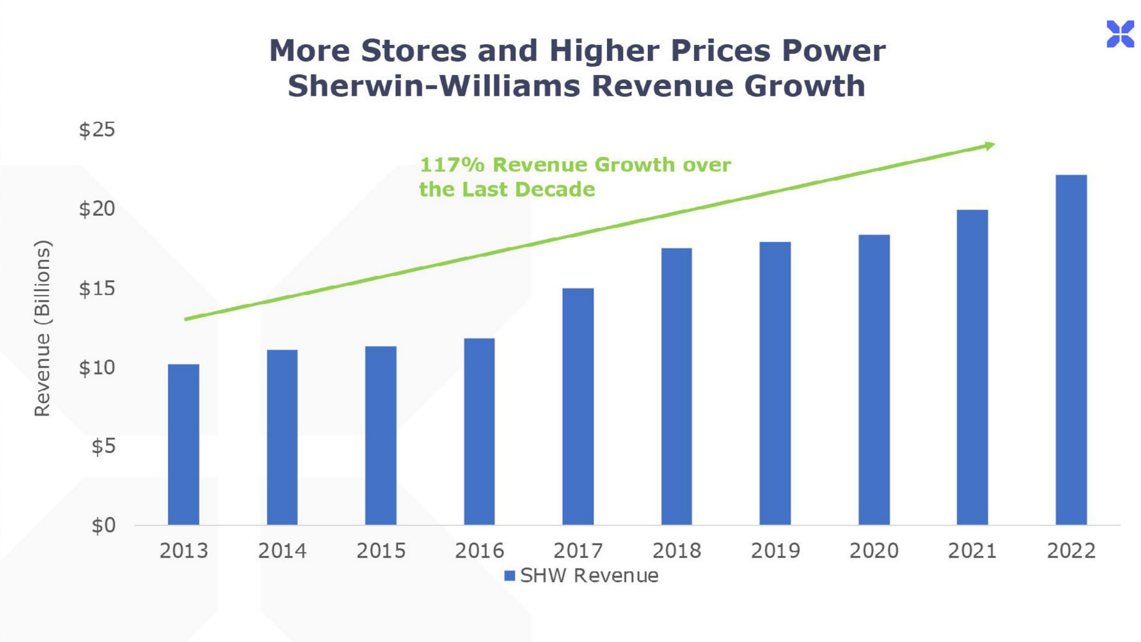
The Wonderful Compounding Machine of Sherwin-Williams

The global paint and coatings market grows at the rate of global GDP over time, averaging roughly 2-3% growth per year. Sherwin-Williams outpaces the broader industry with a two-pronged growth strategy. First, it builds 80-100 new stores a year. And second, it aggressively buys smaller rivals and converts them to Sherwin-Williams locations. Over the last decade, the company has made 14 acquisitions, including five acquisitions in 2022 for a total of $1.03 billion.

Sherwin-Williams expands its store count like clockwork every year, even during sharp recessions like the 2008-2009 industry downturn. The company has increased its store count by 17% over the last decade, allowing Sherwin-Williams to continuously take market share and grow its sales at twice the rate of the overall market:

Meanwhile, the company continues to reap the benefits of pricing power, with consistent price increases across its portfolio of brands over time. This includes 2022, when inflation hit 40-year highs, and the company raised prices in its Americas Group by 10%.

This combination of aggressive store count growth and pricing power has boosted the company's revenues by an average of 9% each year over the last decade, driving total revenue higher by 117% over the period:

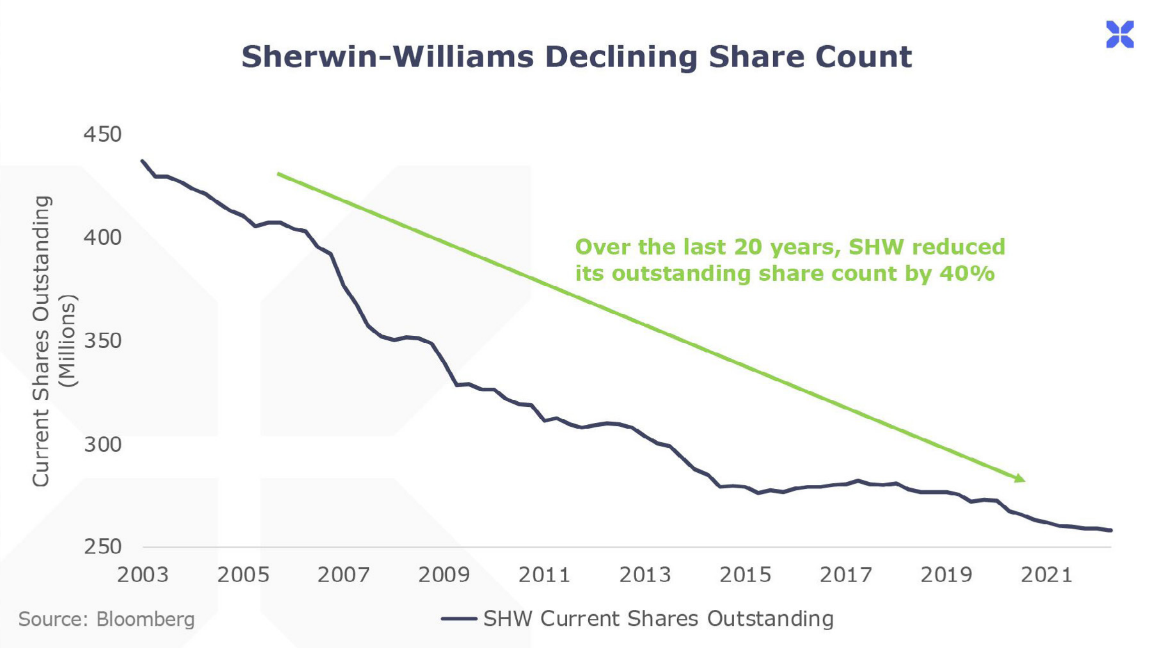


But unlike many businesses that are forced to make a trade-off between growth and profitability, Sherwin-Williams has become more profitable over time. That's largely thanks to its robust distribution network, which makes it easy to transport heavy cans of paint from factory to store.

In the U.S. alone, Sherwin-Williams has over 60 manufacturing plants and distribution centers, and controls its distribution with a company-owned fleet of over 3,160 trucks that ship 2.3 million orders each year. Less money in the hands of third-party shippers means bigger profit margins for Sherwin-Williams.

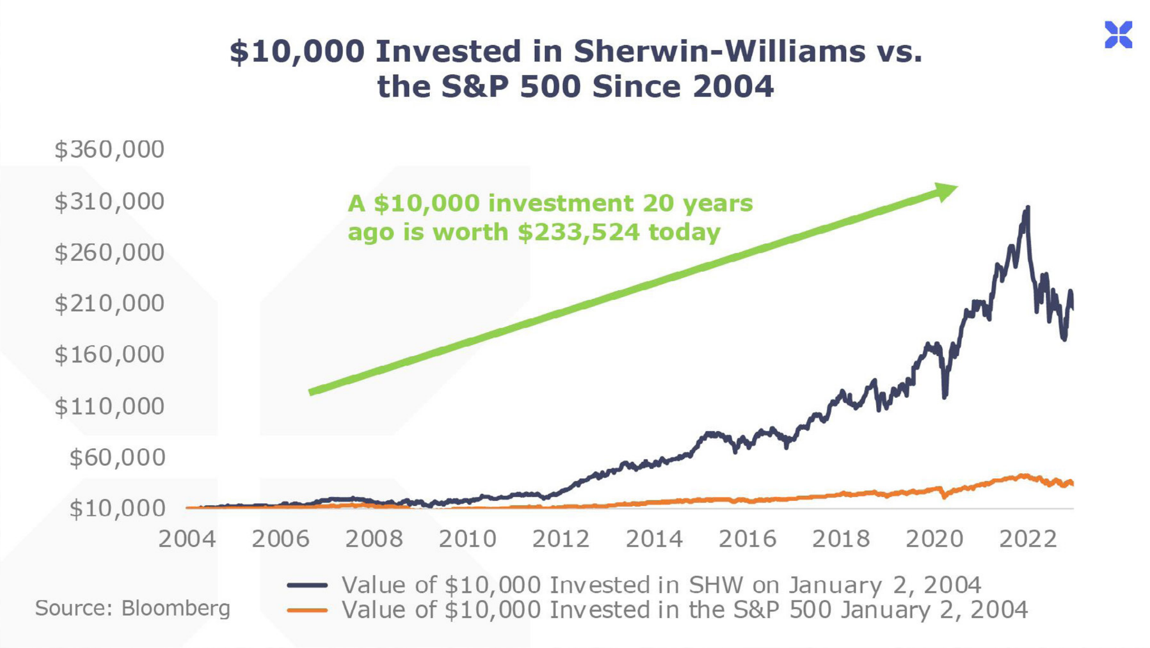
That's how net income has outpaced revenue growth over the last decade, growing by 167% from $770 million in 2013 to $2.1 billion last year, compared with 117% revenue growth over the same period. The company's ability to increase profits faster than sales is a result of its expanding profit margins (i.e., net income divided by revenue), which expanded from 7.4% in 2013 to 9.1% last year. This compares with PPG, its closest competitor, which earns net profit margins of just 5.8%.

The company returns a substantial portion of earnings back to investors, including raising its dividend each year for the last 44 years, and reducing its share count by 40% over the last 20 years, from 437 million shares to 258 million shares today:



The combination of growing sales, growing profitability, and a shrinking share count has allowed Sherwin-Williams earnings per share to grow more than 10-fold over the last 20 years, from $0.75 in 2003 to $7.85 per share last year.

That's how a quiet little paint company has handily outperformed the broader stock market, compounding at 19% per year for the last 20 years compared with 9% in the S&P 500. A $10,000 investment in Sherwin-Williams would have grown to $233,524 compared with the same investment in the S&P 500, which would have grown to $34,638 over the same period.



The future is bright for Sherwin-Williams. The company now enjoys a self-reinforcing virtuous cycle: a leading portfolio of brands and unmatched scale allows it to capture more of the market, growing sales and increasing profitability. This growing profit stream drives further expansion… reinforcing its advantage over competitors with greater store count concentration, allowing it to take more market share… and so on. (This is the quintessential "inevitable" business, and we're confident it will continue dominating its market for decades to come.)

Management expects the company to continue growing at twice the rate of the overall market. As usual, the company plans to open 80 - 100 new stores this year, with a long-term goal of adding over 1,500 stores to reach a total global store count of 6,700 over the next decade.

But more immediately, the company faces the prospect of a sharp upcoming recession, which will pressure industries across the board, including paint and coatings demand.

And that's good news for investors who want to acquire a world-class wealth compounder at a bargain-basement price…

Playing the Long Game

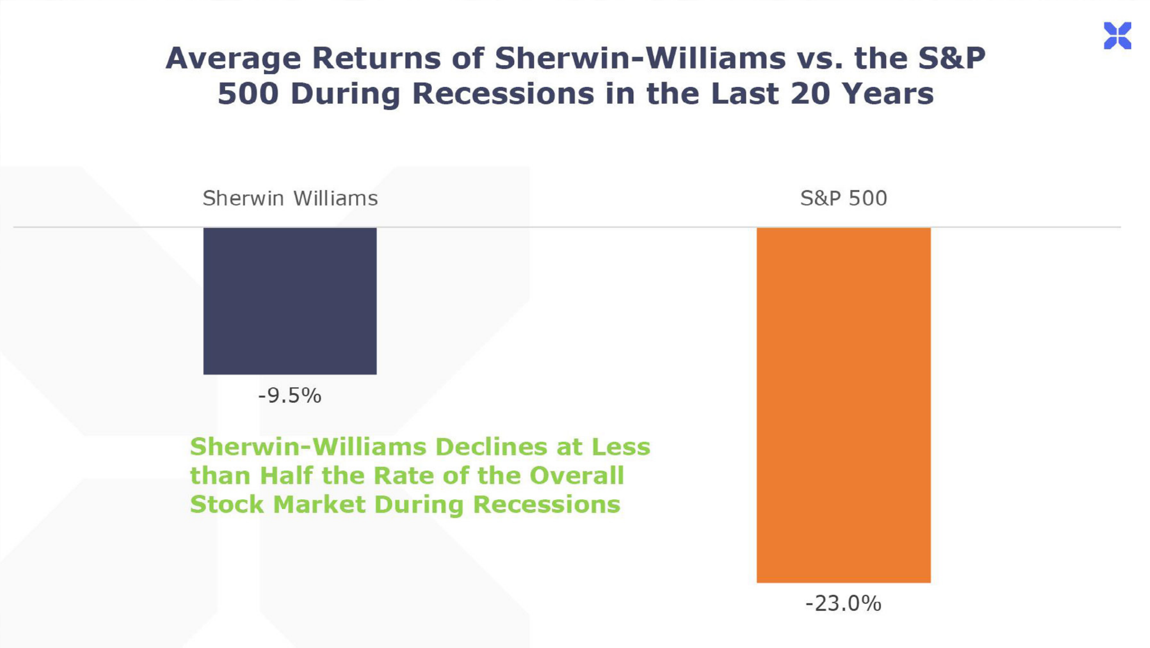
The last two industry downturns, in 2001 - 2002 and 2007 - 2009, provide a blueprint for how Sherwin-Williams handles economic slowdowns and rebounds.

In the wake of the dot-com recession, Sherwin-Williams' earnings declined and bottomed out at $128 million in 2002. The company continued investing and growing its store count, and during the subsequent bull market through 2007, earnings rebounded more than 5-fold to reach $631 million.

Sherwin-Williams also suffered from the devastating housing bust in the mid-2000s, when new housing starts plunged by a record 90% from 2.5 million per year to just 250,000 in 2008. Here again, the company continued investing in new product development, growing its store count, and snapping up rival businesses through every year of the downturn.

By 2012, Sherwin-Williams' earnings had recovered above the prior high set in 2007, registering $631 million that year. By 2017, earnings had grown to $1.7 billion, up nearly three-fold from the prior peak in 2007.

Meanwhile, through each downturn, Sherwin-Williams continued generating positive earnings and cash flows, and returning those cash flows to shareholders through repurchases and dividends. That's how Sherwin-Williams also outperforms the broader market during recessions and bear markets, with average declines less than half that of the S&P 500 during downturns:



With this history in mind, we expect this 156-year-old company to continue creating long-term value for the business during the upcoming downturn... just as it always has.

During the Sherwin-Williams Q4 earnings call in January, management acknowledged that the current weakness in the housing market will inevitably spill into their business. But they outlined an aggressive plan to add more stores during the downturn, even as competitors back down by closing down locations:

> *We're not just reporting things are tough... that's not who we are. We expect it's going to be tough, and we're going to come out fighting and swinging aggressively... We're a 156-year-old company. We're investing in this accordingly. We're not trying to win a week or a month or a quarter. We're investing long term... We have competitors that are backing off because of some of the pressure in some of these segments. And we're going to go -- we're going to be aggressive. I'll just leave it there."*

Management further explained...

> *There's so much change in the market. ... our incremental store count, we've been aggressively adding stores. Our competition, I would say, has been aggressively closing down stores... and we expect our competitors, as they pull back, we're going to take advantage of those opportunities as well as the new products. You mentioned a couple of those, the services, the new stores, we're going to be very aggressive during these times. And we expect as we go through this, to grow share. And as we come out of it, that coil spring is going to pop."*

With this playbook in mind, here's how we see the business unfolding over the next decade, and how shares of Sherwin-Williams could continue delivering world-class returns for investors.

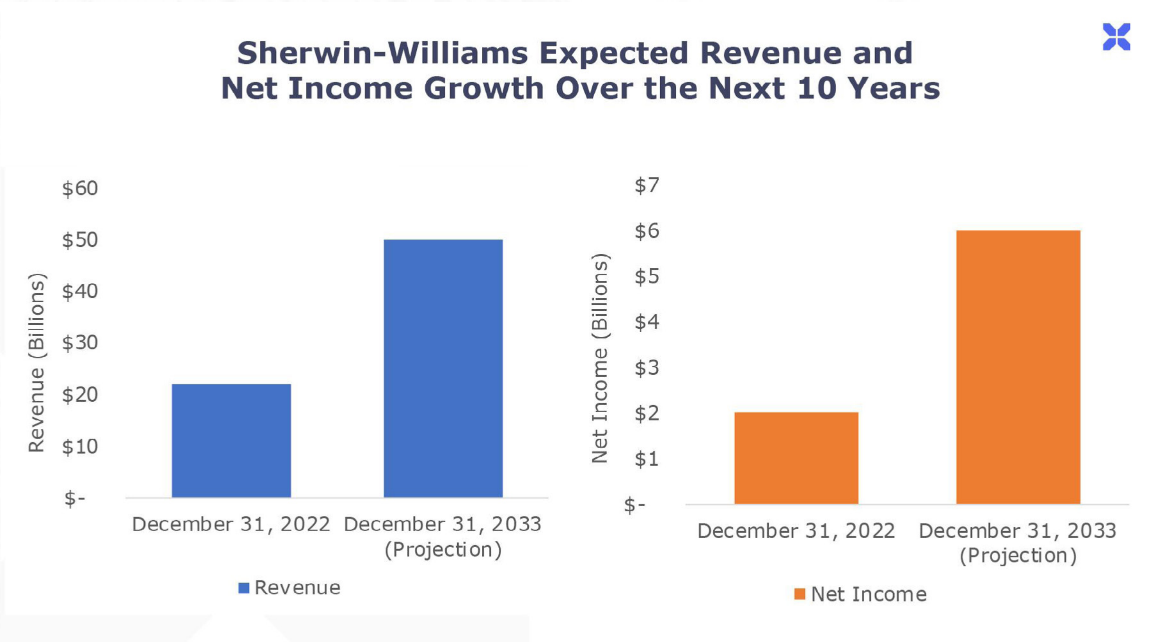
How to Earn 15 - 20% Compounded Returns in Sherwin-Williams

Last year, Sherwin-Williams earned $2.02 billion on revenues of $22.1 billion. We expect the company's profitability could fall as the broader economy weakens, and the housing market in particular comes under further pressure. This process will likely unfold throughout the course of 2023, and could continue well into 2024.

The recovery back to new highs could take several years, just as it did from 2008 - 2012. But over the next 10 years, the investments the company is making today will bear significant fruit.

Porter & Co.

Over the next decade, we expect the company will increase revenues from $22 billion today to $50 billion by 2033, and during the same time period, net income will rise from $2.1 billion today to $6 billion.



Meanwhile, we expect the company will continue its 44-year track record of growing its dividend, assuming roughly 8% annual dividend growth over the next ten years (compared with 11% average growth through the last downturn and subsequent expansion, from 2007 - 2016). The company will also continue using its excess free cash flow to buy back shares. Based on Sherwin-Williams' history of consistent share repurchases, which reduced its share count by 40% over the last 20 years, we expect the company will reduce the outstanding share count by 20% over the next decade, from 258 million currently to 207 million by 2033.

Finally, let's consider valuation. Sherwin-William shares have historically traded at a premium valuation of between 20 - 30x earnings, which we can expect going forward. Today, the company trades at roughly 26x trailing earnings. We assume shares trade right in line with its current and historical multiple of 25x at the end of the 10-year period.

Adding it all up, this puts our projected 10-year share price at $724 per share, with the following assumptions summarized in the table below:

A 10-Year Roadmap for Sherwin-Williams					
	Net Income ($M)	Shares Outstanding (M)	Earnings per Share	Earnings Multiple	Share Price
10-Year Projection	$6000	207	$28.94	25	$723.54

Based on this outlook, and including the future dividends, the total return investors can expect over the next 10 years is 239%, or 9% compounded returns, based on a current share price of $224 per share:

10-Year Projected Returns from Buying SHW at $224	
Buy Price	$224
Future Share Price	$723.54
Dividends	$35.06
Total Return	238.66%
Compounded Return	9.09%

While this return will likely beat the broader stock market over the same period, we think investors can do quite a bit better with a little patience.

Assuming the economy continues to deteriorate, which will likewise cause a shortterm decline in Sherwin-Williams' operating results, we believe investors will get the chance to buy shares at the more attractive price of $150 per share in the months ahead.

This would reflect a 19x multiple on the $7.88 in earnings per share the company earned in 2022, which we believe is a likely outcome in a bear market. Buying at $150 per share, and keeping the same 10-year assumptions listed above, will boost the 10-year total return to 400%, or 15% compounded returns:

10-Year Projected Returns from Buying SHW at $150	
Buy Price	$150
Future Share Price	$723.54
Dividends	$35.06
Total Return	405.73%
Compounded Return	15.03%

A 15% compounded return is a market-beating result. For perspective, over the last 10 years, the S&P 500 has compounded at 11.6% (versus Sherwin-Williams' 16.5% compounded growth over the same period).

However, there's a chance investors can do even better...

During the previous two major bear markets following the late 1990s dot-com bubble and the mid-2000s housing bubble, Sherwin-Williams shares troughed at around 12x earnings. If we see a similar trajectory during this recession, the price could drop to just under $100 per share.

If this opportunity presents itself, and the 10-year projections laid out above hold true, investors could lock in the opportunity to earn 20% compounded returns over the next 10-year period, or a total return of 659%:

10-Year Projected Returns from Buying SHW at $100	
Buy Price	$100
Future Share Price	$723.54
Dividends	$35.06
Total Return	658.60%
Compounded Return	20.74%

With a 156-year legacy of superior quality, a portfolio of best-selling products in its market today, and an unmatched sales and distribution network, the business enjoys an entrenched competitive advantage that would be virtually impossible for a competitor to disrupt. Instead, Sherwin-Williams continues to press its advantage and take market share from its smaller rivals.

This is the quintessential "inevitable" business, and we're confident it will continue dominating its market for decades to come. And for patient investors who buy at the right price, the shares will soon present an opportunity to compound capital at world-class rates of 15 - 20% per year for the long term.

Today, we're putting Sherwin-Williams on the watch list to buy at or below $150 per share.

Action to Take: Buy Sherwin-Williams (SHW) under $150 per share.

New to the Porter & Co. Portfolio? Start With Our Top 3 "Best Buys" Today

The goal of Porter & Co. is to bring you world-class investment research, focused on "inevitable" businesses that you can buy and hold forever. This is the surest and safest path to building permanent wealth.

While we don't believe in timing the market, we do keep a constant eye out for bargains. In each edition of *The Big Secret*, we highlight three current portfolio picks that are at an attractive buy point. In addition to today's recommendation, we suggest you start with these:

1. Dirty energy is never going away… Instead, it will just take safer, cleaner forms, like nuclear energy. **BWX Technologies (BWXT)** is A Matter of National Security, and a bargain at 16x enterprise value (i.e., the combined value of equity and debt) to operating income. BWXT has been a leading manufacturer of nuclear reactors and components since the birth of the nuclear power industry over 100 years ago. BWXT is responsible for powering the Navy's submarines and aircraft carriers as well as all the mechanical equipment in the engine room. The company's recession-proof business with the U.S. government is based on long-term contracts that provide a high degree of cash flow stability and predictability. It's also pioneering a revolutionary "bring-your-own-energy" concept for the commercial sector: small modular nuclear reactors (SMRs). These portable reactors could rip up the playbook of energy as we know it today, making nuclear energy a safe, cheap and sustainable global energy source.
2. **Viper Energy Partners (VNOM)** is an oil and gas royalty company – the best business in the energy sector, and the Secret Behind T. Boone's Fortune. Unlike oil and gas producers, VNOM never spends a dime searching for oil or drilling holes deep into the earth. It simply owns the land upon which other companies drill, and collects a percentage of the cash flow. That makes it one of most capital efficient businesses you'll find anywhere, with 80% free cash flow margins. VNOM funnels its profits directly to shareholders, instead of back into the ground. Last year, VNOM paid out $2.44 in dividends, or roughly 8% of its current share price. The recent correction in energy prices has provided a compelling entry point in this stock, with a current valuation of just 15x earnings.
3. **Qurate Retail 3/15/2031 8% Cumulative Preferred Stock (QRTEP)** is The Best Risk-to-Reward Opportunity We Have Ever Seen. The company is managed by the greatest CEO of all time, John Malone. This unique preferred share class offers an incredible 25.1% yield, with an extra margin of safety over owning the common shares. And there's also 214% of additional upside if these shares are redeemed at par value ($100). As we explain in the writeup, the business suffered a temporary hiccup in 2022 due to supply

chain disruptions, but we make the case for a successful turnaround effort. Best of all, you get to invest alongside America's best CEO – John Malone and his business partner Greg Maffei, who own about 8% of these shares. With a 25.1% yield and 214% of further upside from price gains, this is our top pick in today's market.

The Big Secret on Wall Street PORTFOLIO

ENERGY & COMMODITIES	Ticker	Description	Purchase Date	Cost Basis	Closing Price	Yield	Income Received	Total Return	Status	Risk Rating (1 - 5)
EQT CORPORATION	EQT	U.S. Gas-Focused E&P	06-03-2022	$47.99	$32.78	1.25%	$0.45	-30.76%	Buy	4
TELLURIAN INC.	TELL	U.S. LNG Exporter	06-17-2022	$3.53	$1.68	0.00%	$0.00	-52.41%	Buy	5
VIPER ENERGY	VNOM	Oil and Gas Royalty	09-02-2022	$30.58	$30.52	6.42%	$0.98	3.01%	Buy	3
BWX TECHNOLOGIES, INC.	BWXT	Nuclear Power Equipment	12-23-2022	$58.24	$64.62	1.36%	$0.00	10.95%	Buy	3
BLACK STONE MINERALS	BSM	Oil and Gas Royalty	02-17-2023	$15.90	$16.35	11.74%	$0.00	2.83%	Buy	2
AMERIGO RESOURCES	ARREF	Base Metals	03-31-2023	$1.21	$1.36	5.88%	$0.00	12.40%	Buy Under $1.35	4
BATTLESHIP STOCKS										
ALTRIA	MO	Tobacco Maker	07-15-2022	$42.24	$44.98	8.36%	$1.88	10.94%	Buy	1
PHILIP MORRIS	PM	Tobacco Maker	07-15-2022	$90.18	$99.77	5.21%	$2.54	13.45%	Buy	1
CREDIT ACCEPTANCE CORP	CACC	Consumer Finance	07-29-2022	$575.91	$477.47	0.00%	$0.00	-17.09%	Buy	3
NOVO NORDISK	NVO	Pharmaceuticals	10-28-2022	$106.67	$167.33	2.09%	$1.19	57.98%	Hold	2
WINMARK CORPORATION	WINA	Specialty Apparel Stores	09-16-2022	$218.96	$326.12	0.86%	$4.40	50.95%	Buy	1
ACTIVISION BLIZZARD	ATVI	Video Games	03-03-2023	$77.71	$85.52	3.27%	$0.00	10.05%	Buy Under $82	2
DOMINO'S PIZZAS INC	DPZ	Restaurants	02-27-2023	$300.00	$333.19	1.32%	$0.00	11.06%	Buy Under $300	3
INCOME & DISTRESSED DEBT										
MICROSTRATEGY INC	CUSIP: 594972AC5	2025 Convertible Bond	10-14-2022	$758.00	$1,020.00	0.64%	$3.25	34.99%	Buy Under $800	4
ICAHN ENTERPRISES	IEP	Specialty Investments	12-09-2022	$50.39	$52.33	15.29%	$0.00	3.85%	Buy	3
QURATE RETAIL, INC.	QRTEP	8% Cumulative Preferred Stock	01-20-2023	$40.64	$31.80	25.16%	$2.00	-16.83%	Buy Under $50	3
ANNALY CAPITAL MANAGEMENT	NLY	Real Estate Investment Trust	02-03-2023	$23.75	$19.36	18.18%	$0.00	-18.48%	Buy Under $24	2
SABA CAPITAL & INCOME OPPORTUNITIES FUND	BRW	High Yield Bond Fund	03-17-2023	$8.07	$8.11	13.17%	$0.00	0.50%	Buy Under $9	3
OAKTREE SPECIALTY LENDING CORP	OCSL	Specialty Investments	03-31-2023	$18.57	$19.04	11.55%	$0.00	2.53%	Buy Under $22	2
BETTER THAN THE MARKET										
CAMBRIA SHAREHOLDER YIELD	SYLD	Yield Focused ETF	01-06-2023	$61.22	$59.08	2.62%	$0.00	-3.50%	Buy	2
WATCHLIST										
NVR, INC.	NVR	Homebuilder	NA	-	$5,580.10	0.00%	-		Buy Under $3,500	
FREEPORT-MCMORAN	FCX	Base Metals	NA	-	$43.25	1.39%	-		Waiting For Recession	
SOUTHERN COPPER CORP	SCCO	Base Metals	NA	-	$80.53	3.73%	-		Waiting For Recession	
SHERWIN-WILLIAMS	SHW	Specialty Chemicals	NA	-	$227.59	4.25%	-		Buy Under $150	

Disclaimer: this hypothetical portfolio should not be considered investment advice or a recommendation to buy/sell any financial instrument. For informational purposes only. Investors should perform their own due diligence before buying or selling any financial instrument. No express or implied guarantee of accuracy or applicability to real-world trading. Risk Ratings are based on a security's fundamentals and business model rather than its current valuation.

On Thursday, April 13, **Novo Nordisk (NVO)** came out with an upside preannouncement for the first quarter and higher 2023 guidance. Revenue and operating profit jumped 25% and 28% in the first quarter, respectively. The company's brighter outlook is primarily due to strength in its weight-loss drug Wegovy, bolstered by bullish press and additional manufacturing capacity. For 2023, the company now sees revenue +24 - 30% (vs. the prior +13 - 19%) with operating profit +28 - 34% (vs. the prior +13 - 19%).

Shares of Novo Nordisk continue to rally, up 21% since our last portfolio update where we detailed the powerful tailwinds behind Novo's miracle weight-loss drug, Wegovy. Shares of Novo Nordisk have gained 58% since our initial recommendation, and we expect continued strong demand for the company's diabetes and obesity drugs for many years to come.

Tellurian Rallies on Potential $1 Billion Sale-Leaseback Deal

On Friday, April 6, **Tellurian (TELL)** shares rose 20% following the announcement that Tellurian signed a letter of intent with a New York-based institutional investor regarding the sale and leaseback of 800 acres of land.

Tellurian will receive $1 billion for the sale of 800 million acres of land in Lake Charles, Louisiana where the company is building its flagship Driftwood LNG terminal. Tellurian will lease the property back from the investor for 40 years. If the deal goes through, the capital would support Tellurian's plans to bring its Driftwood facility online by 2027. However, the contract is contingent on Tellurian securing additional financing for phase 1 of the Driftwood construction, and will terminate on July 14 if Tellurian is unsuccessful in raising this capital.

Our original Tellurian thesis, dating back to last summer, depends on the company securing financing for the Driftwood project. Specifically, the company needs to raise $13 billion to complete phase 1 of Driftwood, which the company expects will come from $5 billion in equity and $8 billion in debt.

If Tellurian can secure financing in the coming months, the company expects production from phase 1 of the Driftwood LNG terminal will come online in 2027, with the final phase reaching completion in 2029. The fully completed facility would produce 3.8 billion cubic feet per day (Bcf/d) of LNG, making it one of America's largest export facilities, and boosting U.S. LNG production by more than 30% from current levels. It would also satisfy 10% of LNG demand in Japan (the world's top LNG importer).

Construction is already underway at the Driftwood project, with construction crews working on-site to lay the groundwork for phase 1 of the terminal. The next step is securing a financing partner for phase 1, which would unlock $1 billion in additional financing from the recently proposed sale-leaseback transaction.

Since our last Tellurian update, the company has continued to negotiate with Indian and Japanese companies as well as oil majors for an equity investment in Driftwood. These potential equity partners in Driftwood could secure a long-term supply of low-cost U.S. LNG for years to come. Given current analyst expectations of a global supply shortage of LNG that will last through the next decade, many LNG buyers around the world have an incentive to lock in a low-cost source of LNG by investing in a project like Tellurian's Driftwood.

The news of the sale leaseback is another step in the right direction towards advancing Driftwood to the next phase of construction. Tellurian's Chairman, Charif Souki, recently commented on the deal:

> *This $1 billion financing that we will close at the same time as the rest of the financing, is a major step forward. We will be talking to our banks in NY next week and given what is happening in the market, we are highly confident we can get $7 billion from the banks."*

While Souki remains upbeat about securing financing, the company has so far struggled to obtain a third-party investment into Driftwood. A failure to obtain financing remains the single biggest risk in this story, but also the key catalyst that could unlock substantial upside if a deal gets struck.

Tellurian shares are highly speculative. For now, we plan on holding the position in our model portfolio as we continue monitoring the Driftwood situation.

Microstrategy Bond Benefits from BTC Eclipsing $30,000

Bitcoin has surged back above $30,000 – up 80% so far this year. The rally in the digital currency has been fueled by a declining U.S. dollar, creating investor demand for alternative stores of value. The U.S. dollar is down 14% from its prior peak last October, which has also boosted gold prices up towards new record highs at $2,060 per ounce.

The gains in Bitcoin have boosted the price of **Microstrategy's 2025 Convertible Bond** (the Bitcoin bond), which we recommended on October 14 of last year. The bonds have rallied 35% from our original recommendation price of $758 to $1,020 as of Thursday's close.

Recall from our MSTR issue "**What Will Happen as Central Banks Run Out of Credit**", Microstrategy is betting big on Bitcoin. When we published the original recommendation, Microstrategy held 129,699 Bitcoin on its balance sheet. Since then, the company has continued acquiring more Bitcoin, including purchasing 3,204 Bitcoin in the fourth quarter at an average price of $17,616. As of April 4, the company owns 140,000 Bitcoin at an average cost basis of $29,803 per coin, worth $4.25 billion at Bitcoin's current price of $30,350.

The company also capitalized on an opportunity to reduce its debt load at a discount, when California-based Silvergate Bank collapsed on March 8. Silvergate was a crypto-friendly bank involved with the FTX crypto exchange. The collapse of FTX last November, amplified by stricter crypto regulations, ultimately caused a "**crypto bank run**" on Silvergate. This forced the bank to wind down and liquidate its assets, in many cases at discounted prices.

Silvergate had previously extended a $205 million loan to a Microstrategy subsidiary. As a result of the financial distress from the Silvergate bank collapse, the two companies agreed to extinguish the loan for $161 million, or a 21% discount, on March 24.

Microstrategy's savvy move to repurchase this loan at a substantial discount is a strategic win for the company, freeing up its balance sheet to potentially acquire more Bitcoin in the future.

The Bitcoin protocol ensures that only 21 million coins will ever be created, providing the ultimate sound money and store of value. Our long-term bull case for Bitcoin remains the same as the view we shared on October 14:

> *The bottom line: in a world where overly-indebted governments around the globe issue endless new supply of fiat currency to inflate away their obligations, more and more of those currency units will flow into alternative stores of value, like Bitcoin. And if the global investment community begins diversifying even a small portion of their wealth away from traditional investments into Bitcoin, there's simply not enough supply to meet demand at today's prices."*

We recommend you continue to hold Microstrategy's 2025 Convertible Bond. The price will track the price of Bitcoin, which will continue to be volatile, but we see much higher upside in the years ahead. The Bitcoin bond is one of the safest options to get exposure to this unique asset.

Porter Stansbury

Porter & Co.

Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team – all of whom are real humans, and many of whom have Twitter accounts – you can get acquainted with us **here**. You can reach me (Porter) personally via:

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