

The “Next Big Thing” Just Might Be Hiding in Plain Sight

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Question: What is going to be the most dramatic change to our society over the next 10 years and which company is going to benefit from this “next big thing?”

It is believed that if an investor can answer correctly with an investment, he stands to make an enormous amount of money. Many investing strategies focus on the search for the “next big thing” — the company or asset that is not only going to disrupt an industry’s status quo, but leave an improved and streamlined business model in its wake. These are “story stocks,” companies whose share price is based on the narrative of their expected future potential, rather than their current earnings or assets.

The key to capitalizing on this investment strategy is to be early, before the company’s full potential is recognized and begins its parabolic growth, and to be right. Investors need to extrapolate what the company’s true disruptive power will be by forecasting the total addressable market, the company’s revenue growth rate, and potential market share. Of course, this assumes that these metrics are not only accurate and sustainable, but will continue to grow at a predictable and brisk pace. However, the main challenge when investing in the “next big thing,” is to invest in a company at the exact time when the company’s survival is the most uncertain.

There are numerous variables and unknowns that need to be considered for a company to not only be sustainable but profitable: Is the industry growing and are margins healthy? Are the barriers to entry significant enough to keep “outsiders” at bay? Do industry members act rationally? Just as important is the company’s management team which plays a significant role in its success: Does management have a laser-like focus on execution? Are they able to pivot from setbacks and react to direct attacks on its business model? Of course, during this time, a healthy portion of luck also contributes to the company’s fortunes.

One of the most disruptive company in recent history began by operating in the retail space, eventually migrating to a brick and mortar presence. By providing outstanding customer service, quick home delivery, and low prices, this company became the go-to shopping experience. As you probably have guessed, I am talking about Sears – Not the Sears of today, but the Sears of the 1930’s. Amazon did not write the book on disruption, it just borrowed a few chapters used by Sears over 80 years ago.

Founded in 1906, Sears began as a mail order, catalog company and transitioned into a brick and mortar retailer in 1925. By 1929, Sears had grown to over 300 stores nationwide and marketed itself as the everything store, selling clothing, footwear, bedding, furniture, jewelry, beauty products, appliances, toys, housewares, tools, auto supplies, and gardening equipment. The key to Sears’ success hinged on upscale store design and fanatical customer service (I know, hard to believe), leveraging its operational efficiency and logistics, including home delivery, and its ability to get below market prices from manufactures and wholesalers.

Starting in the 1930s, Sears expanded beyond its retail footprint by adding Allstate Insurance to its products. Change the dates and swap out Whole Foods for Allstate, and we could easily be talking about Amazon. I am not suggesting that Amazon is going to end up like Sears, but I do not think that Sears ever imagined it would end up like Sears.

Maybe a better approach to investing in the “next big thing” is to invert the question: What is not going to change over the next ten years and which company will benefit?

Even though uncertainty has not been completely eliminated, this is a much easier question to answer. One of the companies that quickly comes to mind is Sherwin Williams (SHW), the leading global manufacturer of architecture paints and industrial & special purpose coatings. Sherwin Williams began its operations one year after the end of the United States Civil War. Except for ongoing technology upgrades, supply chain improvements and cost reductions, the company continues to operate in much the same manner as it has for the past 100 plus years. The biggest change to the company’s operation has been a much improved logistics operation which is responsible for its global procurement and distribution.

Disrupting Sherwin Williams or the paint and coatings industry would not be easy. It would require a massive amount of upfront capital to build out a national manufacturing and distribution network, and even doing so would not guarantee sales or profits. Paint and coatings represent a very small portion of the overall cost to build/remodel a house, manufacture a car, or protect industrial machinery, and that is why trusted brands truly matter. It takes years to build a brand’s reputation and in Sherwin Williams case, it has been working on its brand’s image for over 150 years. Leveraging that reputation and infrastructure is a competitive edge the company maintains and why it is the leader of its industry.

With the news media’s insatiable appetite for reporting on the “next big thing,” it is easy to see how investors can easily be preoccupied and overlook a high caliber, hidden in plain sight company like Sherwin Williams. Some of the best long-term investments are often cloaked because they do not fit within a particular investing “style.” They trade at too high a multiple to be considered a value stock, and their revenue growth rates have long since returned from the stratosphere to more mundane but sustainable level.

Sherwin Williams is an “anti-story” stock, operating in an unexciting, overlooked segment of our economy that attract little to no attention. But what investors also tend to overlook is the significant amount of cash a company like Sherwin Williams can continuously generate over a long period of time – Cash that can be reinvested back into the company, used for acquisitions, pay out dividends, reduce debt, or repurchase common shares. Add to that a management team that is focused on reducing costs, and you have a recipe for long-term success. Even though Sherwin Williams has received little to no fanfare the stock has returned 680% over the past 10 years, surpassing Apple’s 603% return of over the same period of time.

Although some treat it as a competition, investing is not an Olympic sport. An investor does not get extra points for his willingness to buy shares of a highly volatile “story stock.” For those addicted to the adrenaline rush and the need to react to every news item and price change, the lure of “the next big thing” is just to great too ignore. But for the long-term investor, the “next big thing” might just be hidden in plain sight.