

FINAL TRANSCRIPT

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VAL - Q4 2010 Valspar Earnings Conference Call

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CORPORATE PARTICIPANTS

Lori Walker

Valspar - SVP & CFO

Bill Mansfield

Valspar - Chairman & CEO

Gary Hendrickson

Valspar - President & COO

CONFERENCE CALL PARTICIPANTS

P.J. Juvekar

Citi - Analyst

James Sheehan

Deutsche Bank - Analyst

Bob Koort

Goldman Sachs - Analyst

Jeff Zekauskas

JPMorgan - Analyst

Mike Sison

Keybanc - Analyst

Steve Schwartz

First Analysis - Analyst

Dmitry Silverstejn

Longbow Research - Analyst

Saul Ludwig

Northcoast Research - Analyst

John McNulty

Credit Suisse - Analyst

Mike Hamilton

RBC - Analyst

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the fourth-quarter conference call. (Operator Instructions). As a reminder, this conference is being recorded.

I would like to now turn the conference over to our host, Ms. Lori Walker. Please go ahead.

Lori Walker - *Valspar - SVP & CFO*

Good morning and welcome to our earnings conference call. Today we will be covering results for the fourth quarter and fiscal year 2010. Bill Mansfield, our Chairman and CEO, and Gary Hendrickson, our President and Chief Operating Officer, are with me on our call this morning.

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Before we begin, I will direct your attention to the press release we issued this morning which contains much of the information that we will be covering in the call. This call is subject to the forward-looking statements language contained in our press release, and our comments may include forward-looking statements as that term is defined by securities law.

This morning I will cover our fourth-quarter and full-year results. Bill will make a few comments, particularly on our outlook for 2011, and then we will respond to your questions.

We were quite pleased with our performance for the quarter. New business contributed significantly to delivering double-digit sales growth in both segments. Leverage from higher volume, pricing and effective control of expenses helped to offset the impact of higher raw material costs.

Fourth-quarter sales totaled \$876.8 million, a 12.9% increase from last year. Adjusted for currency and acquisitions sales were up 11.9%. Fourth-quarter adjusted net income per share increased to \$0.56 in 2010 from \$0.53 in 2009. Fourth-quarter adjusted net income per share in 2010 excludes a \$0.03 per share charge for fees related to the acquisition of Wattyl and a \$0.02 per share charge related to restructuring actions.

Fourth-quarter adjusted net income per share in 2009 excludes a \$0.04 per share charge related to restructuring actions. Net income for the fourth quarter of 2010 was \$51.3 million, and reported earnings per share was \$0.51. Net income for the fourth quarter of 2009 was \$49.9 million, and reported earnings per share were \$0.49. Again, the underlying earnings per share comparison for the fourth quarter is \$0.56 in 2010 and \$0.53 in 2009, a 5.7% quarter-over-quarter increase.

For the full-year 2010, sales totaled \$3,226,700,000, a 12.1% increase. Adjusted earnings per share for the full year increased 26% to \$2.23 in 2010 from \$1.77 in 2009. Adjusted net income per share for 2010 excludes an \$0.08 per share charge related to restructuring actions, a \$0.03 per share charge for fees related to the acquisition of Wattyl, and an \$0.08 per share net gain from the sale of assets to DIC that occurred in the third quarter. Adjusted net income per share for 2009 excludes an \$0.18 per share charge related to restructuring actions and a non-cash charge of \$0.10 per share for Huarun minority interest shares.

Again, the underlying earnings per share comparison is \$2.23 in fiscal 2010 and \$1.77 in fiscal 2009, a 26% year-over-year improvement.

For the fourth quarter, our gross margin, excluding restructuring charges in both years, was 33.3%, down from 36.4% in 2009. Margins were impacted by rising raw material costs, which were partially offset by pricing actions.

As a rate to revenue, fourth-quarter operating expenses were 22.2%, down 190 basis points from 24.1% in the fourth quarter of 2009. This excludes one-time acquisition fees related to Wattyl in 2010 and restructuring costs in both years. The improvement in operating expense as a rate to revenue was due to increased sales. Quarter-over-quarter operating expense dollars, excluding acquisition-related fees, increased \$8.1 million or 4.4%, and it was due primarily to the addition of Wattyl operating expenses and the marketing investment for the launch of our new Valspar brand Signature paint with Hi-DEF Advanced Color System technology.

The tax rate for the fourth quarter was 32.5%, down from 34% in the fourth quarter last year. For the full year, our tax rate fell to 30.4% in 2010 from 32.8% in 2009, due primarily to favorable tax settlements. For fiscal 2011 we expect the effective tax rate to be approximately 32.5% to 33.5%.

Average shares outstanding were down \$1.7 million from last year due to repurchases which were offset by options. During the fourth quarter, we repurchased 1 million shares for approximately \$31 million. Average shares outstanding for the fourth quarter were 100.2 million and are projected to be flat to down slightly for the first quarter of 2011.

Over the course of the full year, we completed the repurchase of 4 million shares under our October 2009 authorization. In October 2010 our board issued a new authorization for the repurchase of an additional 15 million shares.



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Recapping our sales performance for the quarter, our core growth was up 11.9%, driven primarily by improved volume and pricing. Currency was essentially flat and acquisitions added about a 1% for a total increase of 12.9% in the quarter.

Looking at our segment results for the quarter, adjusted for currency and acquisitions, our coatings segment sales increased 14%, driven primarily by volume gains with some pricing. Paint segment sales increased 8.8%, reflecting volume growth in our global consumer and automotive refinish product lines, along with improved mix, which were partially offset by the loss of the Wal-Mart business in the US.

Sales and other increased 11.1%, driven by new business in our resin product line.

I'm now going to move into a discussion of our EBIT margins, and all of the numbers I will be discussing exclude restructuring and one-time acquisition fees. Addressing margins for the quarter by segment, our coatings segment EBIT margin was 14.8%, down from 16.8% in the fourth quarter of 2009, due primarily to higher raw material costs. Our Paint segment EBIT margin was 11.3%, down from 13.2% in 2009, again reflecting raw material cost increases. The EBIT margin for our other category was negative 20% compared with negative 23.5% in the fourth quarter last year. As a reminder, other includes our corporate expenses.

The total company EBIT margin for the quarter was at 11% compared with 12.5% in the fourth quarter of 2009. Looking at margins for the full year, our coatings EBIT margin was 14.1%, up from 12.9% in 2009. The Paint segment EBIT margin for the year was 13.2%, up slightly from 13.1% last year, and the EBIT margin for other was negative 12.9% compared with negative 11.8% in 2009. Total Company EBIT margin for the year was 11.8%, an 80 basis point improvement from fiscal 2009.

Moving to the balance sheet, our net debt at the end of the year was \$771 million, an increase of \$138 million from the end of the third quarter and \$78 million from the end of fiscal 2009. The increase was due primarily to the Wattyl acquisition.

For the fourth quarter, operating cash flow was \$88 million compared with \$182 million in the fourth quarter of 2009. The decline in cash flow was primarily the result of stronger than expected sales in the back half of the quarter, which drove up our year-end receivable balance. Despite this, working capital as a rate to revenue improved to 13.8% from 14.1% last year, and that excludes the Wattyl acquisition.

On a full-year basis, we generated \$135 million in free cash flow, which we define as operating cash flow less CapEx and dividends. We estimate free cash flow of approximately \$150 million in fiscal year 2011. Our net debt to capital was 32.1%. We ended our quarter with \$614 million of reserve liquidity, and that included \$446 million of available committed credit facilities and \$168 million of cash.

Subsequent to our year-end, we increased our main credit facility from \$475 million to \$550 million and extended the facility term from June 30, 2012, to December 31, 2014. Capital spending in the fourth quarter was \$32.5 million, up from \$24.6 million in the fourth quarter of 2009. For the full year, capital spending was \$67.7 million versus \$57.9 million in 2009. Our forecast for 2011 capital spending, including Wattyl, is approximately \$90 million.

Depreciation and amortization for the quarter totaled \$20.1 million, up from \$19.6 million in the fourth quarter of 2009. Depreciation and amortization for the full year totaled \$81.4 million. Our full-year forecast for 2011, including Wattyl, is approximately \$90 million.

As mentioned in our release, we currently expect our fiscal 2011 adjusted net income per share to be in the range of \$2.45 to \$2.65, which includes the additional Wattyl, but exclude nonrecurring acquisition-related charges estimated to be \$0.08 to \$0.10.

With that, I will turn the call over to Bill for his comments.



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Bill Mansfield - Valspar - Chairman & CEO

Thank you, Lori, and good morning, everyone. Thanks for joining the call today. I have a few comments, and then we will open the call up for questions.

Considering the raw material environment, we had a pretty good quarter. We delivered double-digit sales growth in both the Coatings and Paint segments. We also saw double-digit sales increases both in the United States and outside of the US. Overall we were particularly pleased with our generation of new business and our growth in Asia.

2010 was a pretty good year for Valspar. In our Coatings segment, we had four straight quarters of improved year-over-year volumes. Our packaging product line continued to perform well on a global basis with growth in all regions. In our industrial product lines -- general industrial, coil and wood -- our investments in technology resulted in significant new business.

In our Paint segment, our investment in brands continued to make a significant difference, and we believe we are outperforming the market. The launch of our Valspar brand Signature paint with Hi-DEF Advanced Color System technology has been a tremendous success with consumers and our partner, Lowe's. Our business in China delivered strong double-digit growth, and we continued to build a significant global consumer product line with the addition of Wattyl. And I will say more about that acquisition in a minute or two.

During the year our raw material costs accelerated, particularly in the second half where we experienced year-over-year increases in the mid-teens. We are increasing our selling prices in all businesses and geographies. You may recall that there is a lag between raw material cost increases and the impact of our pricing actions. This lag is generally in the six to nine-month range. We did see some benefit from our pricing actions in the fourth quarter with pricing up low single digits, but we still have work to do. We expect this dynamic, the cycle of raw material costs increases and pricing, to remain in play throughout 2011. We will continue to be aggressive with our pricing as necessary, and as I have said on previous calls, we will do what's in the best interests of our customers and our shareholders.

In 2010 the operating leverage from our topline growth, together with improved productivity and controlled expenses, also helped to offset higher raw material costs. For the year we delivered earnings per share of \$2.23, a 26% improvement from \$1.77 in 2009, which was a 13% improvement from 2008. We have been particularly pleased with our ability to deliver double-digit earnings growth through very difficult economic conditions.

Before I turn to the outlook for 2011, let me say a few words about our acquisition of Wattyl, which we completed during the fourth quarter. Wattyl holds the number two position or about 30% of the US dollar \$1.2 billion consumer paint market in Australia and New Zealand. Wattyl is an excellent strategic fit with Valspar. It provides a strong brand portfolio and an excellent geography. It further diversifies Valspar's overall sales mix towards consumer brands. Our Paint segment will now account for more than 40% of total Company revenues. The addition of Wattyl creates a significant business in consumer paint outside the US.

Furthermore, it provides a supply chain and additional brands to support our important partner lows as they enter into the Australian market through a joint venture with the Australian retailer, Woolworths. The joint venture plans to open 150 stores over the next five years.

Now Wattyl goes to market through three main channels -- a network of around 140 company-owned stores, which are geared mostly towards professional contractor type customers; hardware chains and home centers that are targeted to the DIY market; and independent dealers that serve both contractors and DIY consumers. About 60% of Wattyl sales are to the professional market and 40% to the DIY market. We expect Wattyl to be accretive in 2011, and this is included in our guidance. Wattyl is a great strategic fit, has strong leadership and provides an outstanding platform for growth.



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Now looking ahead to 2011, our guidance is for earnings per share in the range of \$2.45 to \$2.65, which once again represents double-digit earnings growth. Our growth will be driven by strong global brands and our differentiated technologies, which allow us to create value with customers, gain share and generate significant new business. We anticipate that raw materials will continue to be our biggest challenge, which has been the case over the last three years, and we've demonstrated over the last three years the operational discipline necessary to address this challenge. We expect to deliver another strong year in 2011.

And with those comments, I will open the call up for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). P.J. Juvekar, Citi.

P.J. Juvekar - Citi - Analyst

During the winter, as demand goes down for paint, are you planning to build paint inventories for the spring season or take any down time?

Bill Mansfield - Valspar - Chairman & CEO

I will let Gary address that question.

Gary Hendrickson - Valspar - President & COO

That is what we normally do. We start to build an inventory for the spring selling season starting at about January or February.

P.J. Juvekar - Citi - Analyst

Okay. And the reason I was asking that question was because the big boxes reduced their inventories last year during the middle of the paint season. So I don't know if they are going to be more careful about how much inventory they build and how much inventory as a result do you plan to build?

Gary Hendrickson - Valspar - President & COO

Yes, I think it will be more or less business as usual next year.

P.J. Juvekar - Citi - Analyst

Okay. The second question I was just wondering, Bill, if you could address, TiO₂, again a similar question, here do producers tend to build inventory during the winter? Do you think they can build enough inventory that you don't see any disruption, or you have enough TiO₂ for your use?

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Gary Hendrickson - Valspar - President & COO

TiO2 will not be limiting to our growth this year. We have worked with our suppliers, and we will be getting what we need for the balance of 2011 for our fiscal 2011 and in the long term as well.

P.J. Juvekar - Citi - Analyst

And TiO2 to being such a big part of the paint can, what kind of price increases -- what do you expect for 2011 in terms of pricing?

Bill Mansfield - Valspar - Chairman & CEO

For us TiO2 is less than 15% of our global raw material buy, and there have been some recent statements in some earnings releases about what people might expect in terms of price increases for 2011, and we don't disagree with what other folks are saying.

Operator

James Sheehan, Deutsche Bank.

James Sheehan - Deutsche Bank - Analyst

So you referred to a six to nine-month lag in recovering raw materials with selling prices. Are we still six to nine months lagging right now, or has that shortened at all since last quarter century since you started to get price in Q4?

Bill Mansfield - Valspar - Chairman & CEO

Well, what I would reference you back to is the comments where we talked about the raw material cost increases really happened in our second half of our fiscal 2010. So I suppose we can split hairs and say it started three months ago or now.

Suffice it to say that most of the raw material cost inflation we experienced in 2010 was in the second half of the year, and we're in the process globally of raising our prices. And so you can figure that that will take us six to nine months to get that in place.

James Sheehan - Deutsche Bank - Analyst

Okay. And then in the all other segment, how should we be looking at that for the first quarter of 2011? I mean I assume it's not going to be as negative as in this quarter. You had some corporate expenses in there. Just how should we be thinking about

Bill Mansfield - Valspar - Chairman & CEO

I will let Lori answer that question.

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Lori Walker - Valspar - SVP & CFO

Typically if you go back and look quarter by quarter, it will still be negative in the first quarter because that is the low point from a seasonality standpoint, and yet corporate expenses run roughly flat throughout the year.

Operator

Bob Koort, Goldman Sachs.

Bob Koort - Goldman Sachs - Analyst

On the Wattyl business, can you just explain a little bit more what is causing the costs over the next year? Is that amortization, or is it something beyond that?

Lori Walker - Valspar - SVP & CFO

Bob, what that is related to is that is related to the step-up of the inventory for fair value accounting.

Bob Koort - Goldman Sachs - Analyst

Okay. Got it.

Lori Walker - Valspar - SVP & CFO

So that really is a non-cash item.

Bob Koort - Goldman Sachs - Analyst

And then there is a lot of folks making a fuss about TiO2. Can you tell us bill, in your product line I assume TiO2 is primarily an architectural issue. So are you also suffering escalation of raw materials on your more industrial-based paints, or is that a little more palatable there?

Bill Mansfield - Valspar - Chairman & CEO

We use more TiO2 in our consumer paint business. But we still use it in our industrial businesses but less. So it is less of an economic impact. And I will reference you back to Gary's prior comments that we are fine from a supply point of view.

Bob Koort - Goldman Sachs - Analyst

And then, I guess, can I assume that it is safe to say, although this TiO2 surge is somewhat new, but you have engineered out as much of that material as you can, or is there still room to re-formulate?

Bill Mansfield - Valspar - Chairman & CEO

Well, I think we are probably no different than any everyone else in the world, and there is a whole range of initiatives that are, I would suspect, underway to address the issue. And I think we still have some opportunities as we move forward.



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Bob Koort - *Goldman Sachs - Analyst*

And then one last quick one. Is there a chance over the next year that share repurchase could outpace option awards?

Bill Mansfield - *Valspar - Chairman & CEO*

Yes, what we have said is we guarantee that we will offset option dilution, and that given the right conditions we would hope to be able to take share count down about 2% a year.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - *JPMorgan - Analyst*

Bill, can you remind me how you buy TiO₂? Do you have a contractual arrangement that lasts for a year, or do you buy it quarterly or monthly? How exactly does that work?

Bill Mansfield - *Valspar - Chairman & CEO*

I appreciate the question, and I appreciate the interest. But our particular sourcing strategy is our sourcing strategy. But if we take a step back and we look generally at the raw material markets for coatings raw materials, what you find is that most companies have a strategy that involves both multiyear contracts, annual contracts and spot buying. And that's not to say any one of those strategies was what we do on titanium dioxide. But I think that you find most companies for their raw materials supply employ a mix of strategies.

Jeff Zekauskas - *JPMorgan - Analyst*

So historically Valspar is pretty entrepreneurial in the way that it builds inventory or holds inventory, and that some years going into the end of the calendar year what you will do is you will cut your inventories dramatically, and then other years you might build them up. So philosophically is this a time to buy raw materials inventory or build raw materials inventory, or is this a time to reduce inventory adjusted for your seasonal demands?

Bill Mansfield - *Valspar - Chairman & CEO*

Alright. I think if you look at the experience the whole industry has had in 2010, we had resin shortages, now were talking about TiO₂. I think any prudent operation looks at it and says, this is probably not the time to take your inventories down to bare-bones levels. That the prudent thing to do is to keep your inventory investment such that you increase your assurance of supply to your customers.

Lori Walker - *Valspar - SVP & CFO*

Jeff, just to add, just to make sure people on the call understand that our balance sheet at the end of the year does include the assets of loans.



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Jeff Zekauskas - JPMorgan - Analyst

Yes. Are acrylics flat or going down or going up? What has been your experience there? I think originally there was an expectation that acrylic prices might come off a little bit.

Bill Mansfield - Valspar - Chairman & CEO

I think probably the spot market has, although I must admit I'm not as close to it as I was six months or so ago, and supply seems to have improved. We still have some concerns, and I think pricing clearly has gone up.

Operator

Mike Sison, KeyBanc.

Mike Sison - Keybanc - Analyst

Great outlook. In terms of 2011 in terms of the volume growth you're looking for in each of the segments that underpin the EPS guidance, can you give us a little bit of color on that?

Bill Mansfield - Valspar - Chairman & CEO

The volume assumptions that underlie the guidance?

Mike Sison - Keybanc - Analyst

Yes.

Bill Mansfield - Valspar - Chairman & CEO

Yes, let me -- you know, I will tell you what, I will give you our overall view in terms of the world. We still see slow growth environment in the US and Western Europe. Latin America is robust. That includes both Brazil and Mexico, and Asia continues to be quite robust. And that is sort of the underlying assumptions as we look at it on a go forward basis. We expect to be able to grow our businesses in line with certainly the underlying GDP growth, then do better than that on the basis of both the strength of the brand and the strength of the technology.

Mike Sison - Keybanc - Analyst

Okay. And then in terms of the squeeze in profitability due to raw materials, does that occur -- obviously does it occur more pointedly in the first and second quarter and then you sort of pick it back up in the third and the fourth when you take a look at your outlook for the year?

Bill Mansfield - Valspar - Chairman & CEO

You know, I tell you what, I kind of look at this like 2009 where we're going to come under some pressure in the first half of the year due to the raw material inflation while we get our pricing in place, and then the second half of the year will be fine. And that is exactly what we told folks was going to happen in 2009, and it is exactly the way it played out for 2009. And we think that's the way 2011 is setting up.

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Mike Sison - Keybank - Analyst

And for the full year, at the end of the year, you will be able to say we pretty much offset everything?

Bill Mansfield - Valspar - Chairman & CEO

Yes, that is correct.

Mike Sison - Keybank - Analyst

Okay. And then last question on the Paint side, it seems to be an area -- architectural demand here in the US seems to be an area that, I guess, is slower than most. You have been a little bit more aggressive in new products in the world of advertising at the beginning of the summer. Can you give us an update on how those are going and the type of growth you can see from the architectural part of your business at the big boxes?

Gary Hendrickson - Valspar - President & COO

So our total paint segment sales were up in the low double digits. North America sales were up high single digits. So while I agree with you that the overall market is fairly weak, clearly we are taking share, and we think there are some reasons for that. One is the DIY segment is a bit stronger than the contractor segment, and we have talked about that a lot. Clearly our investment in brands is paying off, and the Hi-DEF launch was a tremendous success for us and for Lowe's as well.

So, from our point of view, is that even in a weak market like this we threw innovation and threw the right sort of partnership, we can grow through this period of modest growth.

Operator

Steve Schwartz, First Analysis.

Steve Schwartz - First Analysis - Analyst

If we could just talk a little bit about your operating expenses in the quarter, it looks like you had, Lori, maybe \$4.2 million of special charges in there, is that right?

Lori Walker - Valspar - SVP & CFO

It was not quite that much, a little over \$3 million.

Steve Schwartz - First Analysis - Analyst

Okay. And did it fall in SG&A? Because the reason I'm asking it looks like R&D was up quite a bit, and even though you mentioned the \$8.1 million for the product launch and for Watty, that additional \$4 million plus in there is just something I'm wondering if it is going to carry through to 2011?

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Bill Mansfield - Valspar - Chairman & CEO

We are struggling with the \$4.1 million on R&D, Steve. (multiple speakers) Why don't you give us a chance to look at it, and we will call you back after the call.

Steve Schwartz - First Analysis - Analyst

Okay. We can do that later. And then my follow-up question just in regards the share buybacks, you know, the board authorized this huge program of \$15 million, and Bill, I think you mentioned about 2% (multiple speakers) purchases a year. That is 2 million shares. You typically do 4 million. If what you have been authorizing annually for the past couple of years more than covers your expectation, why come out with \$15 million? What kind of message are you trying to send there or is the board trying to send?

Bill Mansfield - Valspar - Chairman & CEO

Well, I think the message is, number one, we generate cash, and so we have options on what we can do with our cash. I will tell you one option is not to keep it in the bank and earn 25 basis points. So we have increased dividends, as you know, for many -- 30-some odd years, and you can pretty much count on us to do that again.

The other options are the make acquisitions, increased EBITDA, increased shareholder value that way or to buy back shares. We have made a couple of deals this past year, 2010. I think, however, people would say that it's been a fairly modest and quiet M&A environment on a go forward basis. If the right deals are not there, we are quite prepared to be aggressive about buying back our shares. On the other hand, if the good strategic acquisitions are there, we will make the deals. That is why there is no time framework on the 15 million share authorization.

Steve Schwartz - First Analysis - Analyst

Okay. But for now, as you know noted, 2% or 2 million shares a year or so?

Bill Mansfield - Valspar - Chairman & CEO

Yes.

Operator

Dmitry Silversteyn, Longbow Research.

Dmitry Silversteyn - Longbow Research - Analyst

A couple of questions. On the joint venture between Lowe's and the Australian big box, is there a timing -- and you talk about 150 stores over several years, but when is that supposed to begin?

Gary Hendrickson - Valspar - President & COO

I think they open their first stores in the next few months, March or April, somewhere around that timeframe.

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Dmitry Silversteyn - Longbow Research - Analyst

Okay. And are these -- so the sales into Lowe's from Wattyl are going to be incremental to what Wattyl is doing currently through its own stores and independents and hardware stores and whatnot. So, if you look at the growth rate of the Australian and New Zealand market, how much of an additive growth would you expect from the opening of the new stores?

Gary Hendrickson - Valspar - President & COO

It is modest -- for the first two to three years, it is modest as those stores are built out, and they start to develop some momentum in Paint. But over the long term, say five to six years, the average store might sell. These are not quite guesses, but they are not precise. It might sell \$1 million in paint at wholesale, and so they are building 150 stores. And we will have -- that is the plan to build 150 stores as we understand it, and we will have the majority of the paint in those stores.

Dmitry Silversteyn - Longbow Research - Analyst

So similar to your position at Lowe's in the United States then?

Gary Hendrickson - Valspar - President & COO

That is what we think.

Dmitry Silversteyn - Longbow Research - Analyst

Okay. So you talked about the raw material expectations where you are basically going to see it sounds like much more pressure in the first half of the year, which also happens to be your seasonally low period and then hopefully you will catch up with pricing and you will get good volume growth and leverage on fixed cost in the second half of the year. So should we expect margins to start improving on a year-over-year basis, if not in the second then certainly by the third quarter? Is that how we should look at that?

Bill Mansfield - Valspar - Chairman & CEO

Yes, second, third quarter, Dmitry, I think that is a reasonable assumption.

Dmitry Silversteyn - Longbow Research - Analyst

Okay. And then the final question, you mentioned a little bit of an impact from the Wal-Mart loss of business. Would you care to quantify that in any way or give us an idea of when that will anniversary in 2011?

Bill Mansfield - Valspar - Chairman & CEO

Well, we will anniversary in 2011, I guess, the fourth quarter. Frankly, for us it is a non-event. It is incorporated into -- you know, the impact is incorporated into our guidance. Our folks already have taken the right steps to offset from a cost structure basis, and other than to provide an explanatory for numbers, I would just as soon move on. That is the past. Let's talk about the future.

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Dmitry Silversteyn - Longbow Research - Analyst

Alright. Well, if you talk about the future, if you look at the McCloskey and some of the other brands that were sold through Wal-Mart over the years and have been discontinued on and off and you look at your brand portfolio given your successes with Wal-Mart -- I'm sorry, with the Valspar brand at Lowe's and Huarun and Watty, has your outlook or strategy for your domestic brands changed at all in the wake of the deals that you have done internationally or the loss of business in Wal-Mart? In other words, are you looking at your brand portfolio differently in the US?

Bill Mansfield - Valspar - Chairman & CEO

No, not at all. McCloskey, you are right. It was sold into wood care brand. Small we sold at Wal-Mart. But our wood care brand is really Cabot, and that was not sold at Wal-Mart. And so no, our brand strategy has not changed at all due to the loss of the Wal-Mart business.

Operator

Saul Ludwig, Northcoast Research.

Saul Ludwig - Northcoast Research - Analyst

In your guidance for next year, looking at the -- I want to focus on the top line. You commented that in the second half of your fourth quarter you saw an acceleration in your topline business. I wonder if you could talk about where you're seeing this pickup in volume that I think things came in a little better than we all thought in terms of your topline in the fourth quarter. That is Part A to my question.

And Part B, in terms of the guidance that you're looking for for earnings, what would be the range of revenues that you might expect from Watty next year, and what would be the range of core growth in the Valspar business, excluding Watty, in fiscal 2011 (multiple speakers) that supported the earnings estimate?

Bill Mansfield - Valspar - Chairman & CEO

Well, that is about a 12-part question there. (multiple speakers) Let me try it this way. With respect to the fourth quarter of this year, we saw more than anticipated strength. Remember, what Lori's comment was was really about our cash flow, and we had given an estimate in the third quarter. And we do not provide topline estimates, as you know, topline revenue guidance. And the revenues were a little stronger than we would have thought for the latter part of the fourth quarter both in the US and in Asia. And consequently we ended up with a higher receivable balance took the cash flow down. But we don't read anything into that other than it is an explanation for why our third-quarter cash flow estimate was a little off. Fourth-quarter cash flow estimate was a little off.

Now, with respect to next year, as I said, we have not been in the practice of providing earnings -- sorry, revenue guidance, only earnings. With respect to Watty and what we think, the Australian market continues reasonably strong. We expect Watty's revenues will grow in line with the market growth, and as Gary pointed out, these stores, the joint venture stores, are just starting to open up, so there will not be any material revenue impact in 2011 from that.

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Saul Ludwig - Northcoast Research - Analyst

What do you think -- you commented in the fourth quarter your pricing component of your revenue growth was low single digits. I assume that means 2% or 3%. What do you think given the pricing initiatives that you have already put in motion, what do you think your price component might be of your revenue growth in 2011?

Bill Mansfield - Valspar - Chairman & CEO

A couple of percent. But you know -- are you talking about now the initiatives that we have already put in place that will come to fruition?

Saul Ludwig - Northcoast Research - Analyst

Right.

Bill Mansfield - Valspar - Chairman & CEO

Because we expect that material costs will continue to increase during the first half of 2011. We probably are going to look at a similar cost scenario in 2011 as we saw in 2010 where you don't have upper single-digit raw material year-over-year raw material increases.

Saul Ludwig - Northcoast Research - Analyst

But don't you need about half of the raw material cost increase in price to sort of neutralize it or a little more? Maybe 60%?

Bill Mansfield - Valspar - Chairman & CEO

Yes, about half would be about right.

Saul Ludwig - Northcoast Research - Analyst

And you think you will be able to get that? So if your raw material costs for instance were up 10% next year, you would expect to have 6% in price?

Bill Mansfield - Valspar - Chairman & CEO

That is correct. We will. That is a little more than 50 over time, but that is correct over time. That is what we demonstrated the last 2 or 3 times through when we have had this situation. That is what I referenced back in the '09 scenario.

Saul Ludwig - Northcoast Research - Analyst

Great. Thank you very much.

Operator

John McNulty, Credit Suisse.

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John McNulty - *Credit Suisse - Analyst*

Just a couple of quick questions. With regard to the Hi-DEF product that you have launched, can you just give us some color as to what types of metrics you put out to figure out if something is going to be successful or not and then how the Hi-DEF platform is actually working relative to those metrics?

Gary Hendrickson - *Valspar - President & COO*

I mean the key metric, John, is how it is selling, and that obviously -- and that metric is POS. Really how that product line was performing or is performing this year versus last year. That is the key one. And on that basis, we could not be more pleased. I mean it is comping almost to triple digits in some weeks and above 50% for the entire time that it has been out.

John McNulty - *Credit Suisse - Analyst*

And what percent of your architectural business right now would be the Hi-DEF platform?

Gary Hendrickson - *Valspar - President & COO*

Of the overall Paint segment?

John McNulty - *Credit Suisse - Analyst*

Yes.

Gary Hendrickson - *Valspar - President & COO*

You know, it is I don't know, 5%, 7% somewhere in that neighborhood.

John McNulty - *Credit Suisse - Analyst*

Okay. With regard to pensions, what is your pension expense for 2011?

Lori Walker - *Valspar - SVP & CFO*

Our pension expense is pretty nonmaterial. It ranges in that \$0.04 to \$0.05. It has been pretty consistent year over year. And in terms of cash that we would need to fund, that, too, is included in our \$150 million in free cash flow guidance.

John McNulty - *Credit Suisse - Analyst*

Okay. Great. And then just the last question, with regard to Huarun and your China platform, can you just give us color as to what you have been seeing in terms of volume trends? If they have shown signs of slowing, accelerating or anything like that from over the last couple of quarters?

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Gary Hendrickson - Valspar - President & COO

The last couple of quarters have been very strong. The whole year was very strong, and we started off -- we are in the second month now of our fiscal year in Asia, and the strength continues. So we are planning performance from that business similar to the performance that we got this year if not better.

Operator

Mike Hamilton, RBC.

Mike Hamilton - RBC - Analyst

Good morning and congratulations, everyone. Just coming back to Watty, as you're getting closer to the situation there, is there anything that you are seeing in cross-marketing beyond what you you're thinking was going in there, ability to pull incremental product, auto, etc.?

Bill Mansfield - Valspar - Chairman & CEO

Yes, I mean I think there will be some modest opportunities for that. We have an auto refinish business in Australia today. Watty also has an auto refinish business, so we think there will be some modest opportunities there to put the Valspar products through Watty distribution potentially.

The other thing that Watty is doing that we were unaware of is that they had a business in China supplying project business. And so we put those two organizations together and might get some benefit from there. And then the big synergies that we counted on and were achieving are the ones that we are experiencing between the industrial business that we have in Australia and Watty, particularly on raw material buys.

Mike Hamilton - RBC - Analyst

Thanks. Bill, it is never a good year unless I give you the opportunity to wax eloquently on Huarun. Can you thumbnail the highlights of the year as you see it?

Bill Mansfield - Valspar - Chairman & CEO

Double-digit -- frankly, 20% topline consistent with what we expected. We continue to penetrate and grow our distribution. We are quite pleased with that. The leadership and our leadership in China and Asia is outstanding in terms of our people, and we expect, as Gary has just said, we expect another great year in Asia in 2011.

Mike Hamilton - RBC - Analyst

And then finally, you highlighted some of the share gains off of technology improvements in wood. Anything in the dynamics that we should be aware of going forward?

Bill Mansfield - Valspar - Chairman & CEO

In terms of our wood coatings business?

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Mike Hamilton - RBC - Analyst

Yes.

Bill Mansfield - Valspar - Chairman & CEO

In the US?

Mike Hamilton - RBC - Analyst

I had assumed you were referring in your prepared comments to Asia, but --

Bill Mansfield - Valspar - Chairman & CEO

Oh, in my prepared -- yes, yes. What our new business -- yes, I guess I'm trying to separate my mind in our wood business -- separate between our new business gains as a result of compliant and environmental and green technology versus the overall condition of the wood coatings market relative to US housing.

The US housing situation has not changed much, so the overall market is still pretty much in the doldrums. We have done well with investments in environmentally friendly technologies, and that is what is driving our results in wood currently.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - JPMorgan - Analyst

Can you remind me how much your sequential price increase was in your Paint business this quarter?

Bill Mansfield - Valspar - Chairman & CEO

Lori is going to get that for you.

Jeff Zekauskas - JPMorgan - Analyst

And then I guess while she is looking, you're working capital is up a lot. And I imagine that a lot of that is from WattyI in that it looks like your inventories and receivables are up maybe each \$100 million year over year. And there is some offset -- there are some offsets on the liability side. Did you have to pay an additional amount for inventory and receivables to WattyI over and above the, I guess, roughly \$150 million that you paid them including debt or \$125 million ex debt?

Bill Mansfield - Valspar - Chairman & CEO

No. No, I think what you are seeing is, number one, you are seeing the impact of WattyI on the balance sheet. Number two, you might recall we talked about the fact that our receivable balances for Valspar ex-WattyI at the end of the year were higher than we expected because the sales were a little better. So that is the explanation.

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Jeff Zekauskas - JPMorgan - Analyst

Well, it is just that in your free cash flow for next year of roughly \$150 million, it does not look like you are giving yourself any working capital benefit next year.

Lori Walker - Valspar - SVP & CFO

Well, the working capital benefit in essence is that we can grow our sales with minimal increase in working capital, minimal to no increase in working capital. So it would improve the working capital rate.

Bill Mansfield - Valspar - Chairman & CEO

Yes, what we tend to focus on, Jeff, is the working capital rate as opposed to the absolute investment dollars. That is certainly for 2011. That is what our focus is going to be.

Lori Walker - Valspar - SVP & CFO

And back to your other question, sequentially in Paint the price mix component improved by low single digits between third and fourth quarter.

Jeff Zekauskas - JPMorgan - Analyst

So just lastly, I always thought that paint -- it was pretty easy to push through paint price increases once you got to the spring, but a little bit difficult in the winter. Is that not correct that it is -- are you going to have to wait a little bit before you really begin to see the effect of your price initiatives? In other words, should you see further margin deterioration in the fourth quarter -- I'm sorry, your first fiscal quarter and maybe into the second before you begin to see a more positive curve?

Bill Mansfield - Valspar - Chairman & CEO

Well, it is kind of a granular question that I'm not real comfortable answering. Other than to tell you this, Jeff, I don't necessarily think that the adage that you can get pricing in the spring and any other time of the year is very hard is true anymore. If we go back and look on a historical basis over the last five years, we in the industry have gotten pricing at varying times. In the summer, in the late winter. So I don't think -- I think it is more about the convergence of need and the positioning of pricing on the shelf that really is driving it.

Operator

That takes care of our question and answer session. Please continue.

Bill Mansfield - Valspar - Chairman & CEO

Well, thanks, everyone. I appreciate your questions today. To summarize, we had another great year in 2010, and we expect to deliver another strong year of double-digit earnings growth in 2011. And that growth will be driven by our strong global brands and differentiated technologies, our expanding global presence, our ability to secure pricing to recover raw materials inflation, and finally, continued operational discipline and productivity improvement. Thanks, again, for joining the call, and we will talk you on our first-quarter conference call in February.



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Operator

That does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference Service. You may now disconnect.

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