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RPM - Q4 2015 RPM International Inc Earnings Call

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OVERVIEW:

Co. reported 4Q15 consolidated net sales of \$1.37b and net income of \$128m or \$0.94 per diluted share. Expects FY16 adjusted EPS to be \$2.55.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome to RPM International's conference call for the FY15 fourth quarter and year end. Today's call is being recorded. This call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com.

Comments made on this call may include forward-looking statements based on current expectations that involve risks and uncertainties which could cause actual results to be materially different. For more information on these risks and uncertainties, please review RPM's reports filed with the SEC.

During this conference call, references may be made to non-GAAP financial measures. To assist you in understanding these non-GAAP terms, RPM has posted reconciliations to the most directly comparable GAAP financial measures on the RPM website. Following today's presentation, there will be a question and answer session.

(Operator Instructions)

Please note that only financial analysts will be permitted to ask questions. At this time, I would like to turn the call over to RPM's Chairman and CEO, Mr. Frank Sullivan, for opening remarks. Please go ahead, sir.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Thank you, Hilde. Good morning and welcome to the RPM International Inc. investor call for our fourth quarter ended May 31, 2015. On the call with me this morning are Rusty Gordon, RPM's vice president and chief financial officer; and Barry Slifstein, our vice president - investor relations.



On today's call, we will discuss our fourth-quarter and full-year results including some detail provided by Barry and then comments on the outlook for our 2016 fiscal year from Rusty. Results of the reconstituted Specialty Products Holding Corporation were included in the entire fourth quarter and the last five months of the 2015 fiscal year. We delivered solid results in our fiscal fourth quarter with sales up 7.5% and EBITDA up 18.7%, driving earnings per share of \$0.94, up 17.5% over the prior year. There are many moving parts to say the least, including the negative impact of foreign currency, the benefit of the Synta earnout reversal and contributions during the quarter from SPHC. We are pleased to put closure to the 15-year Bondex asbestos issue and reconstitute a group of well-run companies in niche specialty markets that generated significant earnings and cash flow, while looking forward to reigniting investment in their future growth over the coming years.

As for the foreign currency rates during quarter, the headwinds worsened from the previous two quarters. To give you some perspective on rates, the average exchange rate for the euro during last year's fourth quarter was EUR1.38 to the US dollar. During this year's fourth quarter, the average exchange rate from the euro to the dollar was approximately EUR1.09, representing a decline of 21% in our largest geography outside the U.S. Our second largest geography is Canada, where we experienced an 11% decline quarter over quarter from a foreign exchange perspective. Other major currencies for RPM were the British pound, the Brazilian real and South African rand, all of which experienced noticeable devaluations against the dollar quarter over quarter. For the fourth quarter, translational foreign exchange reduced sales by nearly \$80 million or 6.2% and negatively impacted EPS by \$0.08 for the full year. Despite the economic and related foreign exchange challenges, the RPM companies delivered record results in our fourth quarter and on an adjusted basis for our full 2015 fiscal year.

I'd now like to turn the call over to Barry Slifstein to provide more detail on our fourth-quarter and full-year results.

Barry Slifstein - RPM International Inc. - VP of IR

Thanks, Frank and good morning, everyone. Thank you for joining us on today's call. I will review the results of operations for our fiscal 2015 fourth quarter, then cover some May 31, 2015 balance sheet and cash flow items. I will then turn the call over to Rusty who will discuss the outlook for fiscal 2016.

Fourth-quarter consolidated net sales of \$1.37 billion increased 7.5% from last year. Organic sales increased 3.4%, acquisition growth added an additional 10.3%, and foreign currency translation reduced sales by 6.2%. Industrial segment sales increased 14.2% year over year to \$878.5 million. Organic growth increased 6.4%, acquisition growth, mostly SPHC, added an additional 16.3%, and foreign currency translation reduced sales by 8.5%. Consumer segment sales decreased 2.5% to \$494.7 million, principally due to declines year over year from Kirker and Synta. Organic sales declined 1.3%. Acquisition growth added 1.3%, and foreign currency translation reduced sales by 2.5%. Our consolidated gross profit increased 6.9% to \$599.3 million from \$560.7 million last year. As a percent of net sales, gross profit decreased from 43.9% last year to 43.6% this year. Negatively impacting gross profit was transactional foreign exchange, unfavorable product mix, and approximately \$2 million in stepped-up inventory costs at SPHC.

Consolidated SG&A increased 1.5% to \$395.4 million from \$389.4 million last year, and as a percent of net sales, decreased to 28.8% from 30.5% last year. Nearly all of the increase was due to consolidating the SPHC businesses during the fourth quarter. Also included in SG&A was an additional \$6 million of severance-related cost reduction initiatives in Europe and U.S. consumer. Partially offsetting higher expenses was the Synta earnout reversal of \$9.9 million. Consolidated earnings before interest and taxes, EBIT, increased 18.7% to \$204.3 million from \$172.1 million last year, largely driven by incremental sales and earnings of SPHC, strong performance from those businesses serving the commercial construction markets in the U.S., and the Synta earnout reversal. At the industrial segment, EBIT increased 21.6% to \$120.7 million. Consumer segment EBIT increased 17.1% to \$100.6 million compared to \$86.0 million last year, including the Synta earnout reversal of \$9.9 million. Corporate/other expenses of \$17.1 million were above last year's amount of \$13.1 million, primarily due to higher insurance and benefits expenses.

Interest expense increased from \$19.7 million last year to \$27.3 million this year, primarily due to higher interest due to the \$450 million payment to the 524(g) trust in December 2014, which was funded from the revolving credit and accounts receivable securitization facilities. In addition, approximately \$4 million of interest expense was incurred in conjunction with the early retirement in May 2015 of the \$150 million notes originally set to mature in November 2015. A more normalized run rate for interest expense going forward should approximate \$23 million. Investment income of \$2 million for the quarter was essentially flat to last year. Our fourth-quarter income taxes increased from an effective tax rate of 26.4% last year to 28.2% this year. The change in the quarterly income tax rate is due primarily to fiscal 2014 fourth-quarter valuation allowance reversals

and the comparative differences in levels of actual versus forecasted income and changes in the jurisdictional mix of earnings. Net income increased 17.7% to \$128 million from \$108.8 million last year. Diluted EPS of \$0.94 per share was \$0.14 per share or 17.5% above last year's EPS of \$0.80 per share. SPHC was accretive to EPS by \$0.06 per share in the quarter.

Now a quick look at the cash flows and balance sheet. Cash provided by operating activities was \$330.4 million for the 12 months ended May 31, 2015 versus \$278.1 million for the same period last year. Last year's amount included the GSA payments, approximately \$45 million after tax. This year's amount reflects the benefit of lower federal estimated payments resulting from the establishment of the 524(g) trust by SPHC, partially offset by higher working capital needs to fund higher sales, legal and professional fees and higher pension, incentive compensation and bonus payments. Depreciation and amortization expense was \$99.2 million compared to \$90.1 million last year, driven predominantly by the reconsolidation of SPHC and the resulting higher depreciation and amortization expenses. CapEx of \$85.4 million this year compared to \$93.8 million last year. Our accounts receivable DSO was 60 days this year compared to 59 days last year. Days of inventory increased to 78 days this year compared to 77 days last year.

Finally, a few comments on our capital structure and overall liquidity. As of May 31, 2015, total debt was \$1.66 billion compared to last year's at \$1.35 billion. The increase was principally due to the \$450 million trust payments made in December 2014 using funds from our revolving credit facility. During the fourth quarter, the company retired \$150 million notes originally set to mature in November 2015, principally with Canadian and European cash. Also during the fourth quarter, the company issued \$250 million 30-year notes with an interest rate of 5.25%, the proceeds of which were primarily used to reduce revolver debt. On a sequential basis the company reduced its total long-term debt by approximately \$212 million from February 28, 2015 to May 31, 2015. On May 26, 2015, S&P published a ratings upgrade on RPM from BBB minus to BBB. Our net debt to capital ratio was 53.4% at May 31, 2015 compared to 42.4% last year, representing a nearly 400 basis point improvement on a sequential basis from the third quarter. Our long-term liquidity at May 31, 2015 was \$964 million with \$175 million in cash and \$789 million available through our bank revolver and AR securitization facilities.

With that, I will turn the call over to Rusty.

Rusty Gordon - RPM International Inc. - VP and CFO

Thank you, Barry. I would like to briefly cover our full-year FY16 outlook. Similar to FY15, FY16 had several moving parts as well. Before covering some of those items, I would like to first discuss the fundamentals of our various businesses and geographies relative to FY15.

First, in our consumer segment, we expect a return to top- and bottom-line growth in Synta and Kirker, both of which were significant drags on sales and earnings in FY15. Synta has a broad range of new product offerings and placements, and Kirker will increase sales from newly implemented bottling capabilities. New product innovation and market share gains should continue to drive incremental sales. Although the general economics impacting our core consumer segment are all indicating favorably, the continuation of poor weather into the summer season has gotten us off to a slower-than-expected start. As a result, consumer segment sales are expected to increase 4% to 5% for the year.

In the industrial segment, in local currencies, we expect good growth in North and South America, especially in our construction businesses. We expect continued positive momentum from our other U.S.-based businesses, such as those serving the U.S. commercial construction markets as well as SPHC companies. Speaking again in local currencies, we anticipate that our European businesses will turn the corner at some point during FY16 and resume growth. Offsetting these favorable trends will be a couple of unfavorable items. First, we have seen a decline in top-line sales in our businesses serving the energy sector as overall activity is trending down with a lower cost of oil, and we expect this trend to continue during FY16. Second, with about half of the industrial segment sales outside the U.S., the strengthening dollar will have a significant negative impact from a transactional and translational FX perspective, particularly in the first half of the fiscal year. Based on these factors, assuming no further currency devaluation in the euro and along with an anticipated benefit from the SPHC companies, we expect industrial segment sales to increase 8% to 10%.

Now to some of the moving parts. FY15 adjusted EPS of \$2.38 benefited from approximately \$0.15 per share in earnout reversals relating to Kirker and Synta. We also incurred \$0.07 per share for higher legal and professional services during the year and cost-cutting initiatives during the fourth quarter. Taking these items into account, the FY15 adjusted EPS base for purposes of understanding FY16 is \$2.30 per share. With \$2.30 per share

as a starting point for FY16, I should note that SPHC contributed \$0.05 per share in FY15, leaving our core EPS at \$2.25. We anticipate that RPM core businesses, excluding SPHC, will grow from a base of \$2.25 per share to \$2.52 per share, representing a 12% improvement. Additionally, we expect SPHC to contribute \$0.20 per share on a full-year basis. That gets us to a pro forma \$2.72 per share, representing an 18% improvement over last year and is a better apples-to-apples comparison to FY15 before two additional items.

The first item takes into account the negative impact of translational foreign exchange. By simply taking actual FY15 results and applying the spot rates from this past May 31, 2015, our expected FY16 results will be reduced by \$0.07 per share. The second item relates to the anticipated change in tax rates from FY15 to FY16. During the third quarter of FY15, RPM benefited from a reversal of certain tax valuation allowances, which drove our effective tax rate for the year down to 26.2%. In FY16, we estimate our core effective tax rate at 29%, the increase of which will reduce EPS by \$0.10 per share, all of which will be recognized during the FY16 third quarter compared to the prior year. Therefore, our EPS guidance for FY16 is \$2.55 per share, which includes an incremental contribution for SPHC of \$0.15 per share and a \$0.27 per share or 12% incremental contribution from our core businesses reduced by these negative tax and foreign exchange impacts. For a summary of all of these moving parts, please see the investor presentation on our website.

In order to assist you in modeling the quarterly splits for our 2016 guidance, I will mention some important considerations. Number one, the \$0.07 impact expected from unfavorable foreign exchange translation in FY16 will be heavily weighted in the first half of the fiscal year. Number two, starting with the first quarter of FY16, we expect our results will be negatively impacted by rainy weather in the U.S., which will probably be a larger drag on our consumer segment. Number three, you should keep in mind the following unusual items that impacted certain quarters during FY15. First, during the second quarter last year, we reversed \$17 million for the Kirker earnout accruals. Secondly, in our adjusted results for the third quarter last year, our income tax line represented income, not expense, of nearly \$7 million. Third, as we just described for our fourth quarter, we reversed \$9.9 million for the Synta earnout accrual.

This concludes our prepared remarks. We are now happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

We have a question from John McNulty from Credit Suisse.

John McNulty - Credit Suisse - Analyst

Good morning, thanks for taking my question and also thanks for the bridge on 2016 - definitely helpful in thinking about the puts and takes. A few questions. The first is with a bunch of moving parts, can you walk us through how we should be thinking about the cash generation in 2016 based on your guidance first, what you saw in 2015?

Rusty Gordon - RPM International Inc. - VP and CFO

Sure, John. We're going to be investing in capital spending more heavily in 2016, so that will, in the short-term, negatively impact our cash flow. We're also picking up the excellent cash flow from our SPHC businesses, which will be a plus. And additionally we will get further tax benefits on the NOL carryback from the initial settlement payments. So, those will be some of the pieces that move around as we look ahead to FY16.



John McNulty - *Credit Suisse - Analyst*

Okay, great. And then with regard to the margins, looks like even backing out some of the maybe one-time things like the reversal of the Kirker payments, margins looked like they were pretty solid in both businesses. I guess can you walk us through if that's largely the result of some of the raw material benefits you're seeing or if there's something else there and how to think about that progressing forward?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

I think the areas that have contributed to the margin improvement have principally been in SG&A. We took some costs out of our industrial segment over the last year, and throughout this year, we took some costs out of both industrial and consumer and have tried to keep a lid on SG&A spending for the year. We have seen in certain areas some raw material benefits, but as was mentioned in the prior comments, a lot of that was offset by transactional FX where we either purchased raw materials in dollars in foreign operations or where we actually have a inter-company transfer of finished goods from a dollar-based manufacturing base into either Canadian or European end-use markets.

John McNulty - *Credit Suisse - Analyst*

Okay, fair enough, and just last question. With regard to the weather impact that you saw in the quarter, is there any way to articulate what the actual hit may have been? I know it's going to be a little bit fuzzy, but whether it's getting data from your point of sale side at your customers or what have you that maybe you can give us a little bit of color as to how to think about that?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

So I think towards the end of the quarter, and we're experiencing it in the beginning of this first quarter, where we're seeing relatively flat to slightly down year-over-year comps and it's basically consumer take away. And as far as we can tell, I think others in our industry have commented on it, it's weather related. So a lot of that is deferred.

We had good results starting in the spring, and we've just seen a lot of deferred spending in maintenance and repair. And I think we will see a perk up here towards the end of the summer and into our second quarter, but those are the elements that have really impacted consumer. Not so much our industrial business.

John McNulty - *Credit Suisse - Analyst*

Great, thanks very much for the color.

Operator

We have a question from Frank Mitsch from Wells Fargo.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

Good morning gentlemen. Just to follow-up on that last question, what are your thoughts about making it up in fiscal second quarter, fiscal third quarter, the weather impact on consumer?



Frank Sullivan - *RPM International Inc. - Chairman and CEO*

I think as you think about this year with some of the detail that Rusty provided in his prepared comments, you will see stronger underlying performance in our second quarter and our fourth quarter on a net basis. A lot of that has to do with both the slow starting consumer to the first quarter as well as the tax impact on our third quarter.

So, I think we will see pretty good results in the second and fourth quarter. The second quarter will still have some negative hit on the year-over-year foreign exchange impact, and if rates stay roughly where they are, most of that FX hit will have been a hit in the first half of the year.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

All right, understood, and on the Synta reversal, obviously I think you would prefer to pay out all of the earnout and then some, but it looks like you went to Plan B here. Where does that business stand now and what are your expectations in FY16?

It sounded as if -- I think you were talking about Synta and Kirker looking at better top lines in 2016. Can you just expand upon that please?

Rusty Gordon - *RPM International Inc. - VP and CFO*

Sure. Any earnout associated with the Synta transaction is now finished, and it's been a very challenging -- both Kirker and Synta had extraordinary growth in FY14. And there were a number of dynamics in their underlying markets as well as just comparing explosive expansion years.

For Synta, we have a number of new product placements and expect a nice recovery both in the top- and bottom-line for those product lines. You will see a lot of that in the spring and early summer of next year, a little bit of that this fall.

At Kirker, we've been talking about building out capacity in the bottling area, and we've had expansion in Europe and through the acquisition of some assets, as well as some internal investment in assets, have finally accomplished what we want there. So you're going to see a nice recovery in both Synta, but also in Kirker throughout fiscal '16.

And both of those are good product lines in terms of sales and on a leverage basis how it leverages their bottom line. And actually both of those are predominantly U.S., and so their contributions to sales and earnings will not be impacted by FX nearly to the extent of the rest of RPM.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

All right, terrific, that's helpful. And lastly as I think about the 8% to 10% growth in industrial, what percent of that would you say is M&A versus -- or volume end price?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

So when you think about -- I will give you both consumer and industrial on a standard rate basis. We're looking at core growth of about 5%, and then the impact of predominantly SPHC of about 10%, and then that gets cut back again in the first half of the year by FX.

So, including what we anticipate the negative impact of foreign currency translation, that's what drives that 8% to 10%. But on a core basis, pretty solid core growth, 10% contribution of SPHC throughout the year.

We're looking at a 4% to 5% core growth in consumer, as well. And I think you get a sense of what we've done in terms of really focusing on SG&A and what we hope to be a better mix this year when, again, you look at core growth of 5% driving core earnings growth of 12%. So it's pretty nice leverage before you take into account the hit from foreign exchange.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

Terrific, thanks so much.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Thank you.

Operator

We have a question from Ghansham Panjabi from Robert W. Baird.

Ghansham Panjabi - *Robert W. Baird & Company, Inc. - Analyst*

Hi guys, good morning. Can you give us more detail -- I'm sorry if I missed this -- in terms of the various end markets for industrial, U.S. commercial construction, and also maybe a sense as to what you're seeing in Europe specific to commercial construction there? Thanks.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Sure, as it relates to commercial construction, we're continuing to see a good growth in the core U.S. markets, and that's across sealant product lines, across roofing and waterproofing, concrete admixtures. We're seeing good growth in terms of market share gains in a number of new product areas, a new proprietary roofing system in our Tremco roofing business that is really seeing explosive growth, continued expansion both organically and also based on capital expansion in some of the Euclid Tuf-Strand fiber business.

I think we're picking up market share in Latin America. Our Brazilian business continues to show year-over-year growth in local currency, despite some of the economic challenges you can read in the headlines about what's happening in Brazil.

About the only area in our industrial business that's really, from a market perspective, going to be hampered throughout the year, are product lines, corrosion control coatings, fire proofing products that serve the petrochemical and oil production, exploration, fracking markets. Those revenues could be down 20% to 30% year over year. So it's probably a couple hundred million bucks of revenues that will be negatively affected market wise.

Lastly we're starting to see in local currencies some flattening out in our European operations. And given the difficult challenges they had in fiscal '15, you should see is some easier comps as those businesses pick up. But again I will remind you that most of the headwinds we're seeing are either euro related or Canadian dollar related, and we will experience most of that over the first half of this new fiscal year assuming rates stay where they are.

Ghansham Panjabi - *Robert W. Baird & Company, Inc. - Analyst*

Great, that's helpful. And maybe a question for Rusty, on the 5% core sales growth and the bridge to the 12% core EPS growth that you called out both in your slide deck and your comments. What are the major drivers there?

Rusty Gordon - *RPM International Inc. - VP and CFO*

The major drivers for the EPS growth of 12%? Well, a lot of it is derived from the more robust volume increases in our industrial segment. Of course, FX is a drag, but we are getting nice volume gains and leverage to the bottom line from our construction businesses throughout the Americas. On the consumer side, we're going to have more modest growth, but it's really industrial that's driving the core growth for RPM in fiscal '16.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

So also, Ghansham, I might add to that. Throughout the year, we took about \$10.5 million or \$11 million of severance and restructuring charges, about \$6.5 million of that was in the fourth quarter. So we've continued to sharpen up our SG&A, particularly in the industrial segment. And with rising revenues, you're going to see the benefits in fiscal '16, and hopefully beyond, of some of our actions in the SG&A area. I also think we will have better product mix. Certainly Synta and Kirker are two examples of product lines that have a more favorable margin mix. And to the extent we see a nice recovery there, that will positively impact our margins as well.

Ghansham Panjabi - *Robert W. Baird & Company, Inc. - Analyst*

Thanks so much, guys.

Operator

We have a question from Vincent Andrews from Morgan Stanley.

Vincent Andrews - *Morgan Stanley - Analyst*

Thanks and good morning, everyone. Could you just give a sense in the quarter how the revenue line was put together in both segments in terms of volume, price and mix?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Sure, when you look at the quarter -- I want to look at something here real quick. We had flat, slightly down results in consumer, and then you had a contribution -- Barry, do you have the SPHC contribution or the acquisition contribution in the quarter?

Barry Slifstein - *RPM International Inc. - VP of IR*

In the quarter for the industrial segment, acquisition growth accounted for 16.3%, the bulk of which was SPHC. Pricing in this environment is fairly neutral, and organic growth is largely offset by foreign currency.

Vincent Andrews - *Morgan Stanley - Analyst*

Okay and same thing in consumer or obviously ex-SPHC?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

In consumer, there's really no SPHC. We had organic sales down about 1%, and then FX further reduced consumer segment results by 2.5%.



Vincent Andrews - Morgan Stanley - Analyst

Oh, what about the mix impact? You referenced mix as a reason why GPM got hurt.

Barry Slifstein - RPM International Inc. - VP of IR

Again, we had poor performance throughout the year including obviously in the fourth quarter. That was the basis for the reversal on the Synta acquisition earnout. So if you look at Synta product lines, Kirker product lines to a certain extent, Carboline product lines in industrial, which are negatively impacted by what's happening in the whole oil and gas area, it tends to be higher margin areas.

So that's really what drove the mix, and we would hope to see some of that margin improvement in fiscal '16 as Kirker and Synta recover in consumer. And I think a margin improvement in industrial will be more relative to SG&A control and some expense cuts as opposed to real benefits from mix.

Vincent Andrews - Morgan Stanley - Analyst

Okay, and just lastly, was price flat in consumer as well, and how should we be thinking about GPM in fiscal '16?

Frank Sullivan - RPM International Inc. - Chairman and CEO

We would expect to see gross margins improve a little bit. We are benefiting from some raw material reductions. That's offset by some of the foreign exchange transactional impacts, and then the balance of it is mix.

Vincent Andrews - Morgan Stanley - Analyst

Okay, thanks very much.

Operator

We have a question from Jeff Zekauskas from JPMorgan.

Frank Sullivan - RPM International Inc. - Chairman and CEO

Good morning, Silke.

Silke Kueck - JPMorgan - Analyst

Good morning how are you?

Frank Sullivan - RPM International Inc. - Chairman and CEO

Good.

Silke Kueck - JPMorgan - Analyst

How large is the -- I have a couple of questions I will start with the easy ones. How large is the energy business for you?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Well I think that the revenues that we would have that would be impacted by energy are probably around \$200 million. And it's principally Fibergrate product lines, Carboline product lines that relate to corrosion control coatings, fire proofing coatings, also some of our product lines that are involved in transportation, railcar, stuff like that. But whether it's from fracking, which has been an area that we've had some good success, or the maintenance and repair, which can't be deferred for very long, but is certainly being deferred now, major refineries, offshore oil, those types of things, we're seeing significant top-line reductions and obviously the impact on our bottom line in those areas. And that is reflected in our 2016 guidance.

Silke Kueck - *JPMorgan - Analyst*

Secondly, I was wondering whether the weather effect that you're seeing and I guess in June, will that have an impact on the roofing business in the industrial side, or it shouldn't have?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

It will have a little bit of an impact on the roofing business, but I think after a couple years of challenges in our Tremco roofing business, some of which were self-inflicted, we have had a really nice turnaround. They contributed nicely to the fourth quarter, and we expect both their core business, and then as a result of some new coatings products and technology that they introduced, that we will see a really strong performance in 2016. That's also part of the mix story there. Our Tremco roofing business had slightly higher margins than RPM averages.

Just as one example in the new products category is our AlphaGuard product line, which is a polyurethane-related roof coating with some proprietary technology. We sold about \$5 million of that product in fiscal 14, about \$20 million of that product in 2015 and hope to double those product sales or more in 2016. And really nice recovery there, good leadership, very engaged sales force, and not only core but new products are being real successful there. So that's a nice story.

Silke Kueck - *JPMorgan - Analyst*

On the industrial business, does your outlook include the acquisitions that you already made? Maybe there's like \$45 million worth in sales from the acquisition that you already made. Are those included in the sales growth forecast for 2016?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

That's correct. And I commented earlier, Silke, that we're really looking at, on a standard currency basis, about 15% growth in our industrial segment. That's about 5% core growth and about 10% from acquisitions, most of which is the reconsolidation of SPHC, but not all of it. It's some of the smaller acquisitions you're referencing, and that gets knocked back by currency to the 8% to 10% range that we had provided for the industrial segment for 2016.

Silke Kueck - *JPMorgan - Analyst*

Oh, I understand, so the 8% to 10% is all-in then, okay.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

That's correct. That includes both core growth, impact of acquisition growth for the year, as well as the negative impact we expect of FX.

Silke Kueck - *JPMorgan - Analyst*

And then I have like two questions that have to do with understanding the charges. So on slide 29, the core growth on the apples-to-apples basis would lead to earnings per share in 2016 of like \$2.72. And then there's a \$0.10 headwind from taxes and \$0.07 headwind from foreign currency, and that's how you get to the earnings guidance of \$2.55?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

That's correct, and I will tell you one thing that's not on this slide is, if you start with the 2015 adjusted EPS of \$2.38, within fiscal '15, had foreign exchange rates stayed steady from the beginning of the year to the end of the year, we would have added \$0.08. So, we lost \$0.08 per share in FY15 without which we'd have reported \$2.46 as opposed to \$2.38. So there's an \$0.08 headwind in 2015.

Just spot rates today, versus where our average rates were that drove our 2015 results, will dictate another \$0.07 loss, principally in the first half of FY16. But, that's how you get down to there. Plus, we're assuming a more normal tax rate of 29% for the year, So, that drives the other \$0.10 hit. But when you look on a core basis, we should have good leverage in our core businesses, nice contributions from acquisitions. And so it's a -- there's nothing modest about 12% core earnings growth given the economics in Europe and some of the challenges that our businesses are more than overcoming in Latin America, particularly Brazil.

Silke Kueck - *JPMorgan - Analyst*

Yes, and then my last question is -- and it's also just to understand where the charges fit. So this quarter, there was a \$10 million benefit from the reversal of the accrual. So presumably it's a benefit on the consumer side and probably a benefit that sits on the gross margin line; is that correct?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

It flows throughout the P&L in terms of Synta results, but the actual earnout reversal would not -- would be in SG&A, not in gross margin. If you strip that out, I think on revenues that were down about 1%, we had a consumer segment that grew year over year at 5%.

Silke Kueck - *JPMorgan - Analyst*

Oh, okay, and the \$6.5 million severance expense, that presumably mostly affects the industrial business and it's also an SG&A item?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

That's correct.

Silke Kueck - *JPMorgan - Analyst*

And then there's a \$2 million headwind that was an inventory step-up that -- I presume that sits in cost of goods sold and that's related to the industrial business, that's the SPHC issue?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

That's correct.

Silke Kueck - JPMorgan - Analyst

Okay, and there's like a \$4 million headwind from paying down a piece of your debt early.

Frank Sullivan - RPM International Inc. - Chairman and CEO

And the interest expense is overstated. We had a favorable early redemption of bonds that were due in December, so we had to accelerate a certain amount of interest expense and related fee accruals. But I think Barry commented, \$23 million is more of an ongoing quarterly rate for interest expense.

Silke Kueck - JPMorgan - Analyst

That's helpful. I will get back into queue. Thanks very much.

Frank Sullivan - RPM International Inc. - Chairman and CEO

Thank you.

Operator

(Operator Instructions)

Our next question comes from Mike Ritzenthaler from Piper Jaffrey.

Mike Ritzenthaler - Piper Jaffray & Company - Analyst

Hi yes, good morning. A couple of questions just to clarify some earlier points, the first are on taxes. Does the higher expected tax rate in fiscal '16, that already incorporates the potential benefit or refund from SPHC NOLs?

Frank Sullivan - RPM International Inc. - Chairman and CEO

That's correct, but in reality, and I am not a tax expert, but the NOL affects our cash taxes, but really doesn't have an impact on reported book taxes. So you aren't going to see it that way.

It took awhile for our tax folks to explain that to me, and so it's really disjointed. We will get a nice tax benefit from those NOLs in the next year or two, but you won't see that on our book reported effective tax rate.

Mike Ritzenthaler - Piper Jaffray & Company - Analyst

Okay yes, that makes sense. And then I guess if taxes are expected to be a \$0.10 headwind in 2016 and FX is expected to be a \$0.07 headwind, it doesn't look or appear that raw materials provide much of a tail wind. And I'm just wondering is that, are lower raw material costs already included elsewhere or what's the right way to embed lower raws into our models as we think about 2016?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

So I think part of the raw material benefit you would see in a -- as we build this up in core growth of 5%, which is leverage to a core earnings growth of about 12%. And it just depends on the business. And in some places we're -- in the energy sector, we're not getting much benefit there because the reduction in revenues.

And we are particularly getting hit the other way with transactional FX as we produce most of our products in U.S. For instance, it gets sold in Canada, and some inter-company transactions from the U.S. to Europe. And we're benefiting from lower raw materials, but it is getting eaten up in a few places.

Mike Ritzenthaler - *Piper Jaffray & Company - Analyst*

That makes sense, and then I guess last question for me is the visibility in consumer into the potential growth within that business from the NeverWet OEM application, something that's come up on a couple previous calls. Just wondering if there's an update there and just if you could comment on the visibility that you have there, that would be helpful, thank you.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Sure. In consumer, it's actually an interesting communication conundrum, because we have some commitments on new product placements in deck coating areas for the upcoming 12 months, a little bit this fall, a lot in the spring of next year. We should be gaining market share in a number of areas related to small project paints, whether it's in some spray paint product areas or in wood stains and finishes, as well as new products like NeverWet, which continues to be good.

We shipped our first NeverWet OEM products, relatively modest, and continue to work with OEMs on approval. A lot of those approvals are in China, related to OEM products that are produced in China and exported back to the U.S.

And so I'd say that we are experiencing a relatively -- at least for us -- poor start to the year which seems to be weather related, which is in contrast to new product placements and our expectations for some nice growth in that segment. So, you will see much better growth as the year progresses and certainly in the back half of the year as it relates to the new product commitments that we're talking about. And unfortunately, we're experiencing relatively flat results in our first quarter.

Mike Ritzenthaler - *Piper Jaffray & Company - Analyst*

Yes, thank you Frank.

Operator

The next question comes from Rosemarie Morbelli from Gabelli & Company.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Good morning, everyone. Obviously a lot of my questions have been answered, but I was wondering, Frank, you said that CapEx will -- or maybe Barry said -- CapEx will increase substantially in 2016. Can you give us a feel for the amount that you're expecting, and is it all related to SPHC or is it going in some other areas?



Frank Sullivan - *RPM International Inc. - Chairman and CEO*

So CapEx is going to go up in a manner that is probably surprising to some, and it's an area that we're really excited about. Our plan for CapEx in 2016 is \$120 million. That's up from what's been an \$85 million to \$90 million range over the last couple of years, and it's driven by a number of things.

First from a macro perspective, we look back over the last decade and we have deployed about \$3.5 billion worth of capital. \$575 million of that has gone -- on an after-tax basis, has gone into this whole asbestos mess.

With that resolution, I think we're very excited and have been working with our Board and our operating leaders about our footing going forward. And so you will see us spending CapEx for internal investment, particularly for international markets, more aggressively.

The big things that are driving that, we are expanding the Tremco Roofing AlphaGuard coatings capacity at the product line, and I mentioned it's continuing to grow very nicely. We're continuing to add capacity outside of North America now for the Euclid Tuf-Strand products. We are in the final stages of the bottling capacity for Kirker. We're expanding in Latin America.

We have a Colombian operation that was acquired 20 years ago at about \$1 million, and they will do over \$25 million today. So we're building a whole new greenfield plant there that serves Central America.

And then I guess the last thing I'd commented on is we're continuing to spend money in Viapol. By the end of this year, we should be in a position to have Viapol as a base of business for RPM in Brazil, not only for the Viapol product lines we talked about, but for Euclid admixtures, Flowcrete flooring, Tremco sealants and Carboline corrosion control coatings.

And lastly we're in the beginning stages of utilizing that Viapol build-out model around a Flowcrete plant in Malaysia where we have early commitments to add Euclid chemicals, concrete repair and admixture capacity in the next 12 months, as well as Tremco sealants and Carboline coatings. So we're real excited. This isn't really an increase in our capital deployment so much as it is a very welcome ability to deploy all of the capital we generate either to a more aggressive growth approach internally or to, when appropriate, returning more capital to shareholders.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

So that is very helpful, Frank, thanks. So if we look at it this way, then in the future the next FX issue when this one goes away, does that mean that then you will end up with mostly translation-type of hit as opposed to transaction as you seem to be adding capacity in other regions as opposed to selling, exporting from the U.S.?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

It really depends on what foreign exchange rates do, but we've got a huge opportunity to grow in different parts of the world. What we're doing in Malaysia is really, along with a couple other things, an opportunity to start being more forward investing in the Asia Pacific region which is wide open for RPM companies.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

And if none of those particular projects are going to benefit the top line in 2016, are those mostly 2017 type of impact?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

You will see the benefits of those in 2017, 2018 and beyond. That's correct.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Thank you, and if we look at whether Congress, if Congress passes the infrastructure project, what benefit can we expect for you guys in 2016?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

It certainly will help us to the extent that a major highway bill is passed. We have a number of corrosion control product lines for infrastructure, waterproofing product lines for infrastructure. And so that certainly will be a nice benefit, and it hopefully -- if it happens -- will serve to offset some of the challenges in those same businesses around oil and gas.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

And you don't have any of that in your projections; correct?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Just the core stuff we would do year to year maintenance wise.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

And then lastly, SPHC, could you give us a feel for the type of cash flow generation?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

They are good businesses with, as we had talked about earlier, about \$400 million in annualized sales. That is growing. And very nice cash flow benefits from those businesses, aside from the tax NOLs associated with the tax deductibility of the payments. So they are a real nice addition to RPM. Margins typically are at or slightly better than our average, and cash flow relative to the working capital investment is somewhat better than the RPM averages.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Thank you.

Operator

Our next question comes from Christopher Perrella from Bloomberg Intelligence.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Good morning.



Christopher Perrella - *Bloomberg Intelligence - Analyst*

Hi, thank you. Could you give a bit more color on your Brazilian operations? Is Viapol keeping pace; are share gains there keeping pace with the currency drop? And also, are you currently selling Tremco and other products through Viapol? And when this capacity expansion comes online, will that then reduce your local manufacturing costs?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

The answer to most of those questions is yes. In the quarter, we saw double-digit revenue growth from Viapol split evenly between core growth and the Betumat acquisition they did a few years ago, actually just a year ago, and defies the headlines of what you see down in Brazil. So, we're real happy with the results of that business and the strong leadership we have down there.

We should start to see the benefits in the second half of the year of some of the Euclid product line production down there, as well as some of the polymer flooring product lines down there. I don't think we're going to see much benefit on the top line from the Tremco sealant or Carboline coatings until 2017. Those capital expansions will be happening in 2016.

And then the other element of it is making sure that you have the right timing and match of how you're expanding your sales and tech service capabilities at the same time. So, it's a very well run business in a very interesting economy and country. And we have, I think, created a model that we can use in other parts of the world where we take that and really make it the platform for any and all RPM companies for the Brazilian marketplace. And as I indicated earlier, part of the big increase in CapEx is starting the same thing in Asia around an existing plant in Malaysia.

Christopher Perrella - *Bloomberg Intelligence - Analyst*

Okay, and then a quick one on Kirker. Are you done with the potential earnout adjustments on that? I think you mentioned in your prepared remarks Synta is done at this point?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

We have one more earnout of approximately \$17 million, which was the same number that was reversed in FY17. So, it will be the last year. And we're pretty hopeful -- with the completion of the capital spending, for having Kirker getting into the filling capacity, and just a rebound in their core market -- that their results will be such that they will have earned that earnout. And that will be good news for RPM shareholders, as well as former Kirker shareholders as well. But that's the last remaining earnout that would possibly be addressed in FY16.

Christopher Perrella - *Bloomberg Intelligence - Analyst*

Okay, thank you very much.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Last comment I will make on that is if we reverse the earnout, obviously we will call it out as a specific single item.

Christopher Perrella - *Bloomberg Intelligence - Analyst*

Great.



Operator

Our next question comes from Ivan Marcuse from KeyBanc Capital.

Ivan Marcuse - KeyBanc Capital Markets - Analyst

Hi, just a quick question. If your SG&A as a percent of sales has been moving in a pretty positive direction for the past couple of years, do you have a goal or expectation of where you think you could get SG&A as a percent of sales or thoughts around that?

Frank Sullivan - RPM International Inc. - Chairman and CEO

Sure, I appreciate the question, because it's been a very deliberate effort. And I think we've done a lot on the SG&A side in our consumer segment and not too sure how much more there is there.

But I can tell you on the industrial segment, there is a couple hundred basis points that we can get at over the next three or four years. And that's an area -- as we've gone equally with both of these businesses, or business segments, in the last year. In the fourth quarter and in the coming year, you will see continued efforts, particularly in our industrial segment, both through leveraging higher revenues, but also through being sharp on expenses in terms of where we choose to invest, and where appropriate, taking some cutbacks or severance actions.

And so that's where it should come. We continued to show margin improvement. Over the next two to three years, I would expect us to show another 100 basis points or so on a consolidated basis, and more of that would come from industrial than consumer.

Ivan Marcuse - KeyBanc Capital Markets - Analyst

Have the initiatives on SG&A line changed your -- the way you view acquisitions as a result? So typically you used to buy them and let them run. Is there a little bit of a focus on top of letting them run costs can we take out or leverage existing costs?

Frank Sullivan - RPM International Inc. - Chairman and CEO

No, I think our acquisition activities will continue as they have. We've gotten pretty good at identifying medium-sized businesses that we can bring into RPM, particularly the RPM2 or our SPHC type of businesses. And then we've gotten relatively good at actually acquiring product lines and fully integrating those.

One of the areas that we will spend more time talking about is EBITDA, in terms of showing margin improvement, for two reasons. Number one, when we reconsolidated the SPHC businesses, we had to go through, and again, I'm not a CPA, but go through a type of a purchase price accounting, if you will. That's not the right way to typify it. But we revalued all of the intangibles on businesses that we had previously acquired and already had intangibles on them and really stepped those up. So that's driving somewhere in the neighborhood of \$8 million a year, Barry, \$8 million to \$10 million?

Barry Slifstein - RPM International Inc. - VP of IR

About that.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Somewhere in the neighborhood of \$8 million to \$10 million a year of higher amortization. It's non-cash amortization and purely additive to cash flow. And you will see, as we start spending more to build out our capital base, some higher levels of depreciation. Most of that would hit the gross margin line.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

With that, Rusty, what's your expectation for -- you may have said this and I apologize if I missed it -- depreciation amortization for 2016?

Rusty Gordon - *RPM International Inc. - VP and CFO*

It will go up because we will have a full year of the stepped up assets at SPHC, both from an amortization standpoint and depreciation of stepped-up plant property and equipment standpoint.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Great, so how much will it be up?

Barry Slifstein - *RPM International Inc. - VP of IR*

Ivan, it will be about \$100 million, maybe a couple million more than that in fiscal '16, the combined depreciation and amortization.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Great, thanks for taking my questions.

Rusty Gordon - *RPM International Inc. - VP and CFO*

Thank you.

Operator

We have a follow-up question from Jeff Zekauskas from JPMorgan.

Silke Kueck - *JPMorgan - Analyst*

Do you plan to repatriate any cash this year?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

No, we do not.

Silke Kueck - *JPMorgan - Analyst*

You do not?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

No, we do not.

Silke Kueck - *JPMorgan - Analyst*

Okay, that was my follow-up question, thanks very much.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Thank you.

Operator

We have a question from Robert [Ritzis] from [Brodart] Capital.

Robert Ritzis - *Brodart Capital - Analyst*

Yes, just two quick questions. I probably missed it. Have you seen any improvement in your business in Latin America especially Brazil? And then I just have one other quick question.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Sure. We had commented earlier about fourth-quarter performance of our Viapol business, which broadly now is really euphemism for RPM's presence in Brazil. And we were up double digits. It was about half organic growth and half acquisition related from product lines we completed. And that is on a standard rate basis.

So, the RPM companies across the globe and particularly in Brazil are competing and winning in the marketplace. You're seeing those real results and local currencies get knocked back by translational impact. So, on a year-over-year basis in the fourth quarter, I think we were flat to slightly down in our Brazilian results when translated back into U.S. dollars even though we were up double digits.

Robert Ritzis - *Brodart Capital - Analyst*

And just on top of that, do you see business getting better in Brazil, staying -- not counting the acquisition but the organic business getting better or still tough sledding or what?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

I will give you a mixed answer. I think for RPM we see it getting better because we're investing into it and we're expanding market share and product ranges that we didn't produce in Brazil.



So for instance, our Tremco Sealants business, Euclid Chemical business, we have a presence down there, but most of it is imported. So, to the extent that we can start manufacturing locally, we will have the ability to produce at lower costs, provide better service. So, I think we're still going to be growing.

The headlines for Brazil aren't good. That's obvious and well known. And both our forward investment attitude down there and really strong leadership is leading to continuing sales and earnings growth on a local currency basis.

Robert Ritzis - *Brodart Capital - Analyst*

And the second, not related to Brazil, is, if you looked at the housing business, which you are obviously heavily related to, are you getting from builders or your customers more optimistic signs? Obviously the weather, people have commented was lousy the last 90 days, but are you getting a sense of optimism from your customers that building's going to pick up, et cetera, or that's just because the weather was so bad you feel more optimistic?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

I think we feel more optimistic about our consumer product areas for the balance of the year, but we have clearly been impacted by just a dismal end of spring, start to summer in many parts of the U.S. And our consumer segment is predominantly a North American (U.S., Canada) type business versus our industrial segment, which is more 50/50 U.S. versus rest of the world.

Robert Ritzis - *Brodart Capital - Analyst*

But do you have any signs, concrete signs that business is going to pick up other than hopefully the weather gets better?

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Absolutely. Again, we commented earlier. We got a number of market share gains in some small project paint areas, some new commitments more at the end of our fiscal year so in the spring of next year and deck coating areas.

And so we've got a number of new product areas and some market share gains that should benefit our consumer businesses nicely for the balance of the year. And I think the underlying dynamics of housing turnover, new home construction, all of which will support solid growth. Nothing spectacular, but the underlying dynamics are not bad.

Robert Ritzis - *Brodart Capital - Analyst*

Thanks very much for your help.

Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Thank you.

Operator

We have no further questions at this time. I would like to turn the call back over to Mr. Sullivan for final remarks.



Frank Sullivan - *RPM International Inc. - Chairman and CEO*

Fiscal 2015 marked the end of RPM's five-year plan to hit \$5 billion in annual sales. Although we finished the year at approximately \$4.6 billion, the shortfall was much narrower than meets the eye. In our five-year plan, we contemplated the resolution of SPHC in less than four years, providing for at least one full fiscal year of their \$400 million plus annual revenues.

And secondly, as we had noted on this call, our current-year sales were reduced by \$154 million due to unfavorable foreign exchange related to the strong dollar. Had both of those been adjusted for, revenues would have been in excess of \$5 billion. We actually hit 92% of the revenue growth goals that we communicated publicly five years ago and 97% of the income goals that we had communicated to our Board internally.

Over that five-year period, including the 10.7% adjusted net income growth for the fiscal year just ended, we had five straight years of solid double-digit earnings growth. We are very excited about a forward investing posture that will drive another long-term strategic plan of positive sales and earnings growth for RPM and our shareholders in the coming years.

With that, we thank you for your presence on our investor call today. We look forward to welcoming a number of you to our luncheon at the New York Stock Exchange this afternoon and to commenting to all of you as we progress through 2016. Thank you and have a great day.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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