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RPM - Q1 2016 RPM International Inc Earnings Call

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# **OVERVIEW:**

Co. reported 1Q16 consolidated net sales of \$1.24b and net income of \$99.8m or \$0.74 per diluted share. Expects FY16 consolidated sales growth to be 7-8% and EPS to be \$2.50.



#### CORPORATE PARTICIPANTS

Frank Sullivan RPM International Inc. - Chairman & CEO

Barry Slifstein RPM International Inc. - VP of IR

Rusty Gordon RPM International Inc. - VP & CFO

#### CONFERENCE CALL PARTICIPANTS

John McNulty Credit Suisse - Analyst

Matt Gingrich Morgan Stanley - Analyst

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Patrick Zellner Piper Jaffray - Analyst

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David Stratton Great Lakes Review - Analyst

Kevin Hocevar Northcoast Research - Analyst

Arun Viswanathan RBC Capital Markets - Analyst

# **PRESENTATION**

## Operator

Welcome to RPM International's conference call for the FY16 first quarter. 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 report 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.

(Operator Instructions)

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 & CEO

Thanks, Hilda. Good morning. Welcome to the RPM investor call for our FY16 first quarter ended August 31, 2015. On the call with me today are Rusty Gordon, RPM's Vice President and Chief Financial Officer, and Barry Slifstein, our Vice President of Investor Relations. On today's call, we'll discuss our first-quarter results, including some detail by Barry Slifstein, and including more information on RPM's third reportable segment, called specialty, and the comments and outlook for the balance of our FY16.



During our first quarter, we continued to be challenged by the strength of the US dollar relative to other major currencies, principally the euro, Canadian dollar, British pound, Brazilian real, and South African rand, as well as sluggish global economy outside of the US. Translational foreign currency reduced sales on a consolidated basis by approximately \$83 million, or roughly 6.9%, and foreign exchange in total reduced EPS in the quarter by \$0.08 year over year.

The consumer segment was severely impacted by an unseasonably rainy late spring and summer, which extended into mid-July in many regions. We believe the shortfall in sales during the first quarter will be picked up in the remaining quarters of the fiscal year. And we're pleased that the economic fundamentals that drive our consumer segment remain strong, and we're seeing that halfway through our second quarter with strong performance from our consumer businesses.

The industrial segment's results were mixed during the quarter. Our US-based industrial companies performed well, with mid-single-digit growth, driven by continued growth in businesses serving the US commercial construction markets, offset in part by those product lines with exposure to the energy sector.

Internationally we're very pleased to see positive quarter-over-quarter growth in every region of the world, in local currencies. Our industrial segment businesses in Europe were down 12.9% when translated back into US dollars, but up 3.3% year over year in euros. Brazil continues to do very well, driven by a great management team, and sales through Viapol of other RPM product lines. Sales in Brazil translated in to US dollars in the quarter were down 20.8%, but up in local currencies by 15.6% in a very challenged economy; truly extraordinary performance. We anticipate that the first half of our FY16 will experience the most significant impact of the strong US dollar, especially in the industrial segment, which has our most international exposure.

In the specialty segment, most of the growth over the last year comes from the acquisition-like impact of reconsolidating the SPHC businesses, comprised mostly of US-based businesses. Excluding acquisitions, the dominant share of business in this segment is fairly balanced between the US and Europe, with reported sales down 11%, but relatively flat year over year in constant dollars.

All in all, we are encouraged by the performance to our FY16 plan in most of our international businesses across Europe and Latin America. Even though the results don't translate well into the US dollars, they're performing well in local currencies in each market. And we expect better results in consumer over the remaining quarters of the fiscal year. In short, our Q1 performance is circumstantial and not directional, as we are performing well in every region of the world in our industrial businesses, and we are seeing a return to strong sales and earnings growth across all of our consumer businesses.

I would now like to turn the call over to Barry Slifstein to provide more detail on our first-quarter results.

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

Thanks, Frank, and good morning, everyone. Thank you for joining us on today's call.

As disclosed in the Company's annual report on Form 10-K for the year ended May 31, 2015, during July 2015, RPM's Board of Directors approved the realignment of certain businesses and management structure to recognize how the company allocates resources and analyzes the operating performance of its operating segments. During August 2015, RPM made the determination to combine the former RPM2 industrial operating segment and the former SPHC operating segment into a single operating segment called the Specialty Products Group. These businesses are characterized by having leading positions in niche markets that typically do not compete with RPM's traditional peers, and operate in a multitude of industries including, but not limited to, fluorescent pigments, fire and water damage restoration equipment, specialty OEM coatings, and edible coatings for food and pharmaceutical uses. These changes have resulted in the creation of a third reportable segment referred to as the specialty segment.

Now I will review the results of operations for our FY16 first quarter, then cover some of August 31, 2015 balance sheet and cash flow items. I'll then turn the call over to Rusty, who will discuss the outlook for FY16.



First-quarter consolidated net sales of \$1.24 billion increased 3.2% from last year. Organic sales increased 0.2%, acquisition growth added an additional 9.9%, and foreign currency translation reduced sales by 6.9%.

Industrial segment sales decreased 4.5% year over year to \$663.3 million. Organic growth increased 3.7%, acquisition growth added an additional 0.6%, and foreign currency translation reduced sales by 8.8%.

Consumer segment sales decreased 8% to \$395.6 million, principally due to sales deferred into future quarters resulting from unfavorable weather conditions during the first half of the quarter, as well as timing of promotional orders in the prior year. Organic sales declined 5.4%, acquisition growth added 0.4%, and foreign currency translation reduced sales by 3%.

Specialty segment sales increased 130.7% to \$183.6 million from \$79.6 million, principally due to the reconsolidation of SPHC effective January 1, 2015, and the Morrells acquisition by SPHC in March 2015. Organic sales increased 0.6%; acquisition growth, SPHC and Morrells added 141.7%; and foreign currency translation reduced sales by 11.6%.

Our consolidated gross profit increased 4.8% to \$533 million from \$508.4 million last year. As a percent of net sales, gross profit increased from 42.2% last year to 42.9% this year, representing a 70-basis-point improvement. Contributing to the improvement was lower manufacturing costs, partially offset by unfavorable transactional foreign currency exchange.

Consolidated SG&A increased 7.6% to \$372.9 million from \$346.5 million last year. Nearly all of the increase was due to the reconsolidation of SPHC and higher transactional foreign exchange expense.

Consolidated earnings before interest and taxes, EBIT, decreased 1.9% to \$160.6 million from \$163.7 million last year, largely driven by unfavorable translational and transactional foreign currency exchange and poor weather during the first half of the quarter, which hampered consumer segment sales.

At the industrial segment, EBIT decreased 4.4% to \$84.3 million, largely attributable to the significant impact from both translational and transactional foreign currency exchange, with roughly 50% of industrial segment sales outside the US.

Consumer segment EBIT decreased 13.8% to \$66.1 million compared to \$76.7 million last year, due primarily to poor weather conditions through the first half of the quarter, resulting in deferred shipments into future quarters.

Specialty segment EBIT increased 64.7% to \$28 million, principally due to the reconsolidation of SPHC. The reduction in EBIT margin reflects the overall lower margin contribution from SPHC compared to the core RPM2 industrial companies.

Corporate other expenses of \$17.7 million were fairly flat to last year's amount of \$18.1 million.

Interest expense increased from \$19.4 million last year to \$22.5 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 security facilities, part of which was ultimately replaced with a 30-year bond issued in May 2015.

Investment income of \$4.1 million for the quarter was slightly higher than last year's \$3.8 million.

Income taxes: our first-quarter income tax rate of 29.4% was essentially flat to last year. Net income increased 0.7% to \$99.8 million from \$99.1 million last year. Diluted EPS of \$0.74 per share was 1.4% above last year's EPS of \$0.73 per share. The combination of translational and transactional foreign exchange reduced EPS by \$0.08 per share during the guarter.

And now a quick look at cash flows and balance sheet: cash provided by operating activities was \$6.6 million for the quarter versus a use of cash of \$125.2 million for the same period last year. The improvement is mainly due to the change in working capital caused by faster collections and



the timing of disbursements. Depreciation and amortization expense was \$27.9 million compared to \$23.3 million last year, driven predominantly by the reconsolidation of SPHC, and the resulting higher depreciation and amortization expenses.

CapEx of \$12 million this year was flat to last year. Our accounts receivable DSO was 64 days this year compared to 67 days last year. Days of inventory increased to 91 days this year compared to 81 days last year, principally due to reduced sales in the consumer segment as a result of poor weather conditions during the quarter.

Finally, a few comments on our capital structure and overall liquidity: As of August 31, 2015, total debt was \$1.73 billion compared to last year at \$1.48 billion. The increase was principally due to the \$450 million trust payment made in December 2014 using funds from our revolving credit facility, part of which was replaced with the 30-year bond issuance in May 2015 with an interest rate of 5.25%. During the fourth quarter of FY15, the company retired \$150 million notes originally set to mature in November 2015, principally with Canadian and European cash.

On May 26, 2015, S&P published a ratings upgrade on RPM from BBB-minus to BBB. Our net-debt-to-capital ratio was 54.7% at August 31, 2015, compared to 46.6% last year. Our long-term liquidity at August 31, 2015, was \$882 million, with \$169 million in cash and \$713 million available through our bank revolver and AR securitization facilities. During the quarter, the company repurchased 300,000 shares of its stock in the open market at an average price of \$42.67 per share for a total cost of \$12.8 million.

With that, I'll turn the call over to Rusty.

#### Rusty Gordon - RPM International Inc. - VP & CFO

Thank you, Barry. I would like to briefly cover our updated full-year outlook for FY16. Even though our consumer segment was off to a very slow start, largely driven by unfavorable weather conditions, we expect the shortfall to be mostly recouped over the next three quarters of this fiscal year. In addition, we believe that the economic fundamentals that drive this segment's sales continue to be positive. Therefore, consumer segment sales for the balance of this fiscal year are expected to grow by 5% to 7% compared to the same period in the prior year.

In the industrial segment, in local currencies, we expect growth in Latin America to continue in the upper single-digit range, and in Europe to continue in the low- to mid-single-digit range. In the US, we also expect solid mid-single-digit growth, especially for those businesses serving the commercial construction markets, partially offset by the impact of the slowdown in the energy sector. The industrial segment represents RPM's largest international exposure, and we expect a large portion of strong organic growth, in local currency, will continue to be offset by the negative impact of foreign currency translation. As a result, sales for the full fiscal year in the industrial segment will show slightly positive growth after being translated in to US dollars.

In the specialty segment, most of the year-over-year growth will be attributable to two factors. Number one, the reconsolidation of SPHC, with SPHC included in the full-year FY16 results, compared to only the last five months of FY15. And number two, the acquisition of Morrells this past March. The core specialty segment, excluding SPHC and Morrells, is expected to generate low single-digit growth in local currencies, all of which is expected to be offset by foreign currency translation. Of course, in addition to the core specialty growth -- or core specialty business over the remainder of the year, RPM in the specialty segment will benefit from the additional months of SPHC results, since it was reconsolidated on January 1, 2015, and the Morrells acquisition, which was added in March of 2015.

When tied together on a consolidated basis, we expect to grow RPM sales by 7% to 8% for the remainder of this fiscal year. As mentioned at year end, both translational and transactional foreign exchange will have a negative impact on results for the full year, but will be particularly unfavorable during the first half. Based on these factors, and assuming no further currency devaluation in the euro, Canadian dollar, and Brazilian real, we are reducing our full-year EPS guidance to \$2.50 per share.

This concludes our prepared remarks, and we are now pleased 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 questions. A couple of questions. First one. On the margins, this is the first time we've actually seen margin weakness so far in actually a number of quarters for you, certainly for the seasonally strong ones as well. I guess I'm wondering, given that it seemed like raw materials should be starting to really — the benefit of them should really be flowing through, what are the dynamics behind that? Is it just some of the weather-related issues and the volume impact around that? Or I guess how much of it would be tied to some of the FX-related issues on the transaction side? If you can kind of quantify or bucket some of those, some of the hits, that would be helpful.

## Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure, John, I'll address that by segment. I think the biggest challenge in the consumer segment was lack of leverage. And we still have strong EBIT margins there, as you can see in the results. Lack of leverage certainly negatively impacted EBIT margins and gross margins there. We would expect to see that change in each of the succeeding quarters.

In the specialty segment, the biggest issue from a margin perspective, because we're seeing good margin performance at the individual businesses, is the combination of the SPHC businesses, which have more of the traditional RPM margin profile, with the core RPM2 industrial businesses that were formerly reported as part of our industrial segment, which are really those unique special businesses like fluorescent color, food additives and coatings, different product lines like that, that have significantly higher margins than traditional RPM. So what you're seeing a quarter-over-quarter deterioration in margins, that's 100% mix. And those businesses are actually doing pretty well.

And then lastly is in industrial. And the biggest challenge there in terms of margins is FX, particularly as it relates to transactional impact on material cost and gross margins.

#### John McNulty - Credit Suisse - Analyst

Okay, great. That's very helpful. And then a question on the full-year guidance. So your sales numbers came down a reasonable amount in the quarter and the guidance obviously; it's impacted there as well. And yet you're really only pulling down the numbers about \$0.05, which means you've either got to see significant margin improvement as we go through the rest of the year or there's other things that may be at work maybe below the line. Can you help us to understand why the sales cut is as big as it is and it's not really impacting the bottom line all that much?

# Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure. I'll answer that in really two ways. Number one, in consumer we talked about revenue growth for the balance of the year in the 5% to 7% range. Halfway through our second quarter, we're at the top end of that guidance and are doing quite well. Secondly, across all of our consumer product lines and businesses, this spring had a number of line reviews, and we were the beneficiary in almost every instance. A little bit of which will hit this fall and a lot of which will begin to roll out in new programs and major customers in February and March. So we remain very bullish about that business segment. And contrary to the first-quarter performance, that business segment is doing great.



As it relates to, I think, the rest of our businesses, it's really a function of solid growth. So we filed with our earnings release our investor presentation. It's also available on our website. If you look at slides 6 and 7, I think you'll also see why, despite disappointing pennies per share results in the quarter, we're pretty bullish. And we tend to be on plan across most of our businesses. Those two slides highlight -- the first one highlights our consolidated growth of 3% sales growth in the quarter, and highlights by region what that growth looks like translated into US dollars. So for instance, in Europe we're down 6% translated in US dollars and in Latin and South America we're down 14%.

When you look at those in local currencies and constant dollars, we're actually up 10% across Europe on a consolidated basis and we're up 15% in Latin and South America. In fact, we're up double-digit sales in every region of the world except North America, which is up 9%. Even that has been mitigated, North America, by the strength of the dollar versus the Canadian. On a core basis our industrial businesses are on our operating plan and competing and winning in their markets. And we think that will be more reflective of our results, to your question, in the second half of the year assuming there isn't some additional leg of dramatic increase in the dollar versus the currencies that we talked about versus what's already happened in the last year.

John McNulty - Credit Suisse - Analyst

Great. Thanks very much for the color.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Thank you.

#### Operator

We have a question from Vincent Andrews from Morgan Stanley.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Good morning.

# Matt Gingrich - Morgan Stanley - Analyst

Hey, morning. This is Matt Gingrichfor Vincent. I was hoping to clarify the drivers underlying the performance of consumer in the quarter. Specifically your guidance was initiated on July 27, but then you attributed the weakness to poor weather in June and July. I was wondering if there's any other factors that contributed to a result that was different than what you originally expected in the guidance range?

# Frank Sullivan - RPM International Inc. - Chairman & CEO

There's really two issues, and I think Barry commented on them both. One was poor weather. We had a strong sell-in season in the spring, and then sat through the wettest, rainiest, coldest June and early part of July that anybody's seen in a long time. So consumer takeaway was very poor, particularly for small project paints that are used in exterior applications, whether it's on decks, exterior metal, things like that.

The second was a major sell-in program with a significant customer in last year's first quarter that was not repeated this year. Those are the two factors that drove the lower results in our consumer segment.



# Matt Gingrich - Morgan Stanley - Analyst

Okay. And then in the past you've outlined an expectation for improvement to SG&A as a percentage of sales for your industrial segment, along the magnitude of a couple hundred basis points. And I'm just wondering how the introduction of the Specialty segment impacts that outlook going forward?

#### Frank Sullivan - RPM International Inc. - Chairman & CEO

So that is a great question and something we look forward to reporting on in the coming years. When you look at our three segments, you'll see consumer segment with EBIT margins in the 16% range. We continue to be focused on new product introductions, driving sales, being a great partner to our core North American customers.

In our specialty segment, which is now a third reportable segment, you'll see EBIT margins, with the combination of the businesses that make that up, in the 15% range. And we think there's a little room over the next few years in SG&A to improve that. It really highlights the impact in our now third industrial segment, which has EBIT margins in the first quarter of 12.7%, and our highest investment in SG&A. And it also isolates the area where we have, I think, the biggest opportunity to bring SG&A down over the next couple of years and improve the EBIT margins in our industrial segment as you see it reported in this first quarter.

# Matt Gingrich - Morgan Stanley - Analyst

Would you see a similar improvement across specialty as well or just -- (multiple speakers)

Frank Sullivan - RPM International Inc. - Chairman & CEO

I think to a lesser extent it's true in pecialty and it's less true in consumer.

Matt Gingrich - Morgan Stanley - Analyst

Thanks, guys.

#### Operator

We have a question from Rosemarie Morbelli from Gabelli and Company.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Good morning, Rosemarie.

Rosemarie Morbelli - Gabelli & Co. - Analyst

Good morning. Can you hear me?

Frank Sullivan - RPM International Inc. - Chairman & CEO

Yes.



# Rosemarie Morbelli - Gabelli & Co. - Analyst

Okay. Could you give us a feel for the amount of business you do on the energy side and how much of a hit it had? What would have been the results excluding energy?

# Rusty Gordon - RPM International Inc. - VP & CFO

I think on a consolidated basis it's in the \$200 million range across a number of different product lines: corrosion control coatings, some FRP products that had gone into fracking, tank lining products, pipelining coatings. And so that is under significant pressure. I think Barry commented that on his prepared remarks. So that is an area that's troubled. I think it's down, and I don't see it coming back for a period of time. But again, I think you have to put that in perspective. On an annualized basis it's probably \$200-plus million, maybe a little bit more, of revenues on RPM's total revenue base in the \$4.6 billion range.

## Rosemarie Morbelli - Gabelli & Co. - Analyst

How much was it down versus last year, Frank, and what was the impact on the EBIT line? Can you share?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

I can tell you that from a revenue perspective we were certainly off double digits. We have not and don't provide margin or profit information by product line.

# Rosemarie Morbelli - Gabelli & Co. - Analyst

And so now looking at a brighter part of the business, can you talk about what is happening in Brazil? You're consolidating a couple of acquisitions. Are there any additional acquisition in that particular business, or is it just moving into the region, some of the product lines that you were not previously selling?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

It's both. As I mentioned, despite the headlines in Brazil, it seems to be a country in recession and there are a number of challenges there. On a core real basis, our businesses were up 15% in Latin America, and I think closer to 20% in Brazil. And we did the acquisition of Betumat, which was a waterproofing and roofing products company, in the middle of June last year. So we had a little bit of acquisition impact in the quarter, but it won't have much, if any, impact for the year.

The balance is good management, good growth in the core Viapol product lines. And as we've communicated over the last year or so, 1.5 years, we have invested in concrete admixture capacity. We have invested in waterproofing capacity. We have invested in polymer flooring capacity. So Viapol is becoming a Brazilian entity by which we will be selling not only Viapol product lines but Euclid product lines, Flowcrete flooring product lines. We're in the beginning stages of investing in corrosion control coatings for the Brazilian market in Petrobras that will be sold under the Carboline brands.

That investment is having a positive payoff in terms of some of the admixture in flooring revenues. And I would expect continue to have a positive payoff as we bring new other RPM product lines online and start selling them. We are at the beginning phases of doing the same thing in Malaysia around a Flowcrete plant where we're investing in Euclid chemical products as well as Tremco sealant products for production in Malaysia, which will replace what currently is a long supply chain, not very cost competitive production of those products from North America.



# Rosemarie Morbelli - Gabelli & Co. - Analyst

That is very helpful. Thank you. And I was just wondering quickly, if I look at last year's reported numbers, EPS was \$0.76, now \$0.73. And I thought that SPHC was accretive by \$0.05 last year. Is that differential kind of a first-quarter dilution from SPHC, or what else could it be?

#### Frank Sullivan - RPM International Inc. - Chairman & CEO

I'll let Rusty or Barry talk about the quarter, but SPHC was reconsolidated into RPM as of January 1, 2015. So they had zero impact on the first quarter last year.

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

Hi, Rosemarie, it's Barry. Our reported results were \$0.73 last year. And during the call we called out some SPHC-related expenses, SEC investigation expenses and a couple other minor expenses that some folks on the outside chose to make some adjustments. But our reported results were \$0.73.

#### Rosemarie Morbelli - Gabelli & Co. - Analyst

Okay, thanks. I appreciate the help.

#### Operator

The next question comes from Patrick Zellner from Piper Jaffray.

## Frank Sullivan - RPM International Inc. - Chairman & CEO

Good morning.

# Patrick Zellner - Piper Jaffray - Analyst

Good morning, and thanks for taking my question. First question, could you break down the end market pockets where the industrial segment is seeing strength? Is it admixtures for US nonresidential construction, roofing, or flooring? Is there any way you can break that down a bit?

# Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure. In the industrial segment, which is now one of three, our construction-related products are doing quite well. It's concrete admixtures, it's waterproofing, it's sealants, and those are doing well in North America, principally the US, not so much in Canada. But those product lines are doing quite well in Latin America and South America, and they're also doing quite well on a euro basis in Europe. In local currency our construction-related product lines are experiencing nice solid growth in European marketplace.

We're also seeing strong growth percentage-wise when you look at our investor deck in Asia Pacific and Middle East and Africa, but they're on very small basis. So I think the percentage improvements are impressive, but it's relatively small basis.

Then we're seeing good growth in a lot of our other industrial maintenance coatings categories, with the exception of those that serve the various aspects of oil and gas. Lastly, our roofing business, which for those that have owned RPM for a long time, had some challenges a few years ago, is in great shape and they are growing their top line and bottom line very impressively in double-digit ranges.



# Patrick Zellner - Piper Jaffray - Analyst

Great. Thank you. That's helpful. My next question is on AlphaGuard. Is the first quarter cadence reflecting the goal of doubling sales in 2016?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

So AlphaGuard is a new formula roof coating that we had commented on, I believe, at year end. It's part of our Tremco roofing business. That business had significant growth last year and that significant growth is continuing.

In fact, if you look at our investor deck, I think it's in there. We talk about connections creating value, and slide 14 really talks about an interesting connection between Legend Brands, which is a specialty segment business, and Tremco Roofing. And our Legends Brands business, which is in equipment for dehumidification, has produced a patented roof cleaning system. It uses water, all of which is recaptured. It takes a traditional roof cleaning, which is two guys and a bucket and a lot of detergent and a lot of wasted water, and it improves the speed by about two-thirds, recaptures all the water, and that in combination with the AlphaGuard is leading to significant sales in terms of cleaning and recoating a number of old, mostly single-ply roofs, that are coming off warranty.

Patrick Zellner - Piper Jaffray - Analyst

Great. Thank you.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Thank you.

## Operator

We have a question from Christopher Perrella from Bloomberg Intelligence.

# Christopher Perrella - Bloomberg Intelligence - Analyst

Good morning. Thank you for all the color on the overseas performance. Just a question, though, on consumer. With your expectations of deferred sales out of the first quarter, how do you see that layering in over the next three quarters? Is that coming mostly in the spring, or are you going to get some of those sales in the second quarter here?

# Frank Sullivan - RPM International Inc. - Chairman & CEO

We have not provided specific quarterly guidance for probably a decade now. So I don't know that we would do that, other than say that our expectation for consumer growth over the remaining nine months of the fiscal year is in the 5% to 7% range. And as I commented earlier, we are at least halfway through the second quarter performing at the top end of that range. And I would expect us to deliver consistently there.

The odd one for us is the third quarter because it's a seasonal low. And, so depending on whether we have big sales in February or March, you can see, again, big percentage gains but on a relatively small base. But we will make up, we think, most, if not all, of the lost revenues in the first quarter. Some of it will continue to be weather-related relative to winter weather and what that does to our third quarter.



Christopher Perrella - Bloomberg Intelligence - Analyst

All right. Thank you. And then on the inventory build in the first quarter here up \$52 million, what is driving that?

Frank Sullivan - RPM International Inc. - Chairman & CEO

That again, as Barry commented on, I think the acceleration of receivables collection and the inventory build that's a little bit out of line is entirely related to the shortfall in revenues in our consumer segment. We had planned for and worked with our major customers on a big selling season, had a lot of good programs and saw consumer takeaway fall pretty significantly in a number of our product categories in June and July. And when that happens, you end up with collecting receivables and more inventory than you want. That's being corrected as we speak by strong takeaway.

#### Christopher Perrella - Bloomberg Intelligence - Analyst

All right. And then with the launch, the new product launches or the new commercial programs in the spring coming up, when does -- seasonally, when do you build ahead of that? Does that come in the third quarter or do you actually --?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

It starts to come in the third quarter. And again as I mentioned, it can be sometimes weather-related in terms of major customers and their perception of cold, long winters. But typically it starts in February, which is the last month of our third quarter. And builds in to typically a strong fourth quarter for us, which is March, April, and May. And that's what we experienced this last year just to see a weather-related slowdown in consumer takeaway, which is now corrected.

Christopher Perrella - Bloomberg Intelligence - Analyst

All right. Thank you very much.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Thank you.

# Operator

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

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

Good morning, guys.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Good morning.



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

Hey, just given all the market concern related to industrial facing end markets in general, Frank, can you just give us a sense as to how your businesses in that segment performed during the first quarter on a monthly basis for you? Was there any meaningful deviation in the year-over-year growth rates in any particular month during the quarter?

#### Frank Sullivan - RPM International Inc. - Chairman & CEO

No. I think the two headlines there are strong results in most of our product lines, except those that serve the oil and gas area, which again is a not inconsequential couple hundred million dollars. And very strong performance, particularly in international regions of the world offset by very difficult FX translation gains. But the underlying performance on a local currency basis across our industrial businesses almost everywhere in the world was pretty solid.

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

And then on that international comment, and just your results in general, you seem to be much more optimistic than the rest of your peer group which are noticeably more cautious on most of those regions that you're out-performing on. How should we think about why RPM is different? And also historically do your industrial businesses sort of come in -- are the early cycle businesses coincident or somewhat later cycle?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

It depends. Some of them are industrial capital spending driven, such as oil and gas, tech industry for flooring, things like that. A lot of it is also construction market, whether it's light construction, multi-residential construction, hospitality, those types of things.

I think the things that are driving our performance globally are a fewfold. Number one, something that we initiated some years ago and we hope to do more of is what we call across RPM Connections Creating Value. I think you're seeing it in its most concrete form in Brazil where, for the first time, we had a business base that's being leveraged across multiple RPM products. We do that within our groups, and in some cases by segment to a lesser extent. But in this case Viapol is serving as an exceptional base for business growth for multiple RPM product lines, and that's expanding.

We're starting to do the same thing in Asia, which has been the one region of the world that's been frustrating for us in terms of our lack of success in acquisition growth. So you're going to see more leveraging of existing facilities with other RPM products and the related manufacturing capabilities.

Lastly, Europe is a little circumstantial. We're coming off very difficult period of time and we're just facing easier comps.

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

Then just switching to consumer, on the commentary on the acceleration and growth rate that's expected through the fiscal year, are there any new products in particular that you think will drive that growth rate for 2016?

#### Frank Sullivan - RPM International Inc. - Chairman & CEO

I think the things that will drive our performance in the second half in particular are related to some of the market share gains we expect at a number of major customers. We've got some pick-ups at major customers that will be shipping in February and March in small project paints, in wood stains and finishes. We have launched a new program at some of our major home centers called Spray Smart, which is a patented spray application for line striping and utility work.



Rock Solid is a new flooring product line that's more high performing than the existing ones. That's being launched chain-wide at a number of our major retailers. But at this stage of the year, the impact of that will mostly occur in the last four or five months of the year. So there's a lot of programs that are committed to and in place that give us comfort relative to our expectations of solid growth in consumer and our hope that maybe we'll pick up some of the shortfall in the first quarter.

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

One final one for me on the raw materials side. I'm sorry if I missed this, but are you assuming any sort of incremental benefit as we progress through your fiscal year on that? Actually, what's occurring in raw materials as it relates to your specific cost-of-goods basket? Thanks so much.

#### Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure. Raw materials are a little bit of a mixed bag. We're seeing some improvement in a number of categories. And on the flip side, we're seeing some significant increases as a result of transactional FX, where we produce products in the US and sell them in Canada or in Europe, or in some developed regions of the world, where raw materials are purchased from euro or US sources in dollars or euros and are sold in local currencies such as real or South African rand. It's a mixed bag for us.

We had on a consolidated basis I think about 70 basis points of improvement across RPM. I'd expect us to have more improvement in the coming quarters through better leverage on higher growth, particularly in consumer, when we start demonstrating better growth there, which we're doing, as well as some operating efficiency in relationship to continuing strong sales.

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

Perfect. Thanks so much.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Thank you.

# Operator

We have a question from Frank Mitsch from Wells Fargo Securities.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Good morning.

# Rory Blake - Wells Fargo Securities - Analyst

Hi, this is actually Rory Blake sitting in for Frank Mitsch. Thanks for taking my question. Apologies if you addressed this, but most have been answered by this point. Have you guys had any updated stance on the M&A environment, what you're seeing and how aggressive you guys may be over the next few quarters?



# Frank Sullivan - RPM International Inc. - Chairman & CEO

I can tell you that -- I guess two things on M&A. Our pipeline of small and medium-sized transactions continues to be pretty good. There are a couple larger transactions in our space, one of which was publicly announced the other day. And at those price levels we'd rather buy RPM stock than overpay for slow growing businesses. And I think we demonstrated that in the quarter.

Rory Blake - Wells Fargo Securities - Analyst

All right. Thank you. I appreciate it.

#### Operator

We have a question from David Stratton from Great Lakes Review.

# David Stratton - Great Lakes Review - Analyst

Hi. Thanks for taking my call. I don't know if you touched on this yet, but in the previous quarter you referenced a 7% -- I'm sorry, a \$0.07 impact to EPS due to FX. Since you're already at \$0.08, is there any revision that you'd like to touch on?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

I think that's in part one of the reasons why we reduced guidance. I think there's a belief that we can make up some, if not most, of the shortfall in consumer over the balance of the year. But we got whacked pretty good in foreign currency. It was not necessarily the euro, which is essentially where we thought it would be, but the Brazilian real and the South African rand, for a period of time the Canadian dollar, the Australian dollar. There's a lot of off currencies that still drive, let's say \$100 million worth of revenue here and there that dropped dramatically.

I think we're comfortable with the balance of the year, given where currency rates are today. If the dollar's got another 15% rise versus all the other currencies in the world, we'll be in the same boat as everybody else, and we'll communicate that at the time.

# David Stratton - Great Lakes Review - Analyst

All right. Thank you. Also I think a couple quarters ago you mentioned your first shipments of NeverWet OEM. I was just curious how that went and how those products are being received? Thanks.

#### Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure. We have our first shipments of NeverWet OEM, and they're related to outdoor fabrics. And they're going very well. We continue to struggle with some opportunities in the Chinese market relative to registration, some requirements of which are, show us your formula and we'll register your products, to be blunt about it. We're a little bit stymied there and we're continuing to work on that. But our first orders are out and they're with an outdoor fabric company, and it's growing and it's going well.

David Stratton - Great Lakes Review - Analyst

Thank you.



Frank Sullivan - RPM International Inc. - Chairman & CEO

Thank you.

## Operator

We have a question from Kevin Hocevar from Northcoast Research.

## Kevin Hocevar - Northcoast Research - Analyst

Good morning, everybody. You mentioned the expectation of the deferred spending in the consumer segment, kind of that being picked up in the balance of the year. How much of the 5% to 7% sales growth is dependent upon kind of those projects that were delayed being picked up in the balance of the year?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

It's hard to say, again because the seasonal nature of a lot of our products. So I think we would anticipate some strong performance and maybe some stronger performance than we originally planned in the second quarter. And we have reasons to feel confident about the spring selling season relative to some new commitments we have at major customers.

Third quarter, who knows? That's a function, in part, of weather. It is a seasonal low. But I think in general we're pretty comfortable, at least for the periods in which we tend to have good consumer takeaway, including the second quarter that we're in now.

# Kevin Hocevar - Northcoast Research - Analyst

Okay, great. And then maybe there's no update on Kirker or Synta so far in the call, and that's probably a good thing. Wondering how those businesses are doing compared to how it was performing last year?

# Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure, some of the year-over-year challenges in the first quarter relative to load-ins that weren't repeated relate to Synta. That business is not stabilized relative to some of the challenges last year.

The Kirker business is going well. We had a disappointing year last year after two booming years, and the business is growing well. And we would expect to see the benefit of their investment in some of their packaging capability that we've been working on for the last year show up in our results in the second half of the year.

Kevin Hocevar - Northcoast Research - Analyst

Okay, great. Thank you very much.

Frank Sullivan - RPM International Inc. - Chairman & CEO

Thank you.



#### Operator

We have a question from Arun Viswanathan from RBC Capital Markets.

# Arun Viswanathan - RBC Capital Markets - Analyst

Good morning. Thanks for taking my question. You guys talked a lot about mid single digit growth in North America and strong growth overseas. Maybe you can just help me understand the pricing environment as well as it relates to costs coming down in several markets. How are you able to raise prices in Brazil, if that's part of the plan? And then similarly in North America, have you seen any increased competition, especially in the Consumer segment?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure. In North American consumer there's little or no price, with a possible exception on certain product lines up into Canada, and that relates to price increases in other places. We, and other people in our industry and a lot of industries, are trying to figure out a pricing element of what do you do with US-based raw material and raw material costs that are sold in a foreign currency at established price where you've got a real significant hit on your gross margin because of that transactional FX mismatch. So there's actually some price increase in those circumstances.

Then in places like various markets in Latin America, you're looking at mid-single-digit to low-double-digit inflation. I would guess that on par, I mentioned and you can see on our investor deck, that on a consolidated basis by region South and Latin America is up 15%. As best we can tell across all our business, average price down there benefits about 5% or 6%.

#### Arun Viswanathan - RBC Capital Markets - Analyst

Okay, great. That's helpful. So just to be clear then, when you say no pricing in North America consumer, are you implying that you're at least holding onto price even in a declining raw material environment?

## Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure. In most product categories, we're holding onto price. That's also true in Europe. There's little or no inflation across any of our US businesses and no pricing action. Same is true in Europe, with the exception of how we're trying to deal with the transactional FX problem. Latin America has got some inflation and we're getting price.

# Arun Viswanathan - RBC Capital Markets - Analyst

And then just if I may, you sounded a little bit more optimistic on commercial construction. Outside of any new initiatives, maybe you can just talk about the market environment and how it's potentially more favorable than residential? Thanks.

# Frank Sullivan - RPM International Inc. - Chairman & CEO

Sure. We're seeing a good sell-through on major projects, whether it's C-1 construction chemicals. There's certain regions in the world, and even certain regions in the US, where concrete has got some waiting times to it. Different product lines like our patented macro- and microfibers are doing -- we're selling everything we can make. So the construction markets, multifamily housing, hospitality, universities, it's all going well.

Tremco Roofing is not involved in new construction but we have had new leadership there and this year they are hitting pretty much on all cylinders. They've got some new products. They're marrying it up with some Legend Brands cleaning technology, and they're fortunately back to being



focused on the marketplace. And they're competing and winning. So that's, I think, a good assessment of what we're seeing in the marketplace from a construction-related market.

Arun Viswanathan - RBC Capital Markets - Analyst

Great. Thank you.

#### Operator

We have no further questions at this time. Do you have any final remarks?

#### Frank Sullivan - RPM International Inc. - Chairman & CEO

Thank you. Thank you for your participation on our call today. In a world of decelerating global growth and an unusually strong US dollar, we're extremely proud of the strong performance generated around the globe by the entrepreneurial businesses that make up RPM. We'd like to thank our more than 12,000 employees around the world for their continued efforts in growing their businesses, and very much want to thank our shareholders for your support. And we look forward to reporting growing sales and growing earnings beyond this first quarter.

And I'd just like to re-emphasize that what we've experienced is circumstantial, and hopefully you got a sense directionally that we're bullish about the rest of the year. Thank you for your participation on our call today, and have a great day.

#### Operator

Thank you. Ladies and gentlemen, this concludes today's conference. We thank you for participating. You may now disconnect.

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