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RPM - Q3 2016 RPM International Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 consolidated net sales of $988.6m, net income of $18.6m and EPS of $0.14. Expects FY16 EPS to be $2.50 per share.

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PRESENTATION

Operator

Welcome to RPM International's conference call for the fiscal 2016 third 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 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. (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 & CEO*

Thank you, Ellen. Good morning. Welcome to the RPM investor call for our fiscal 2016 third quarter ended February 29, 2016. On the call with me are Rusty Gordon, RPM's Vice President and Chief Financial Officer and Barry Slifstein, our Vice President of Investor Relations. Today, we will discuss our third-quarter results, including some detail by Barry and comments on the outlook for the balance of our 2016 fiscal year.

We are very pleased with our sales growth, as well as our strong leverage to the EBIT line during our third quarter, which is RPM's seasonally slowest period. We continue to be challenged by the strength of the US dollar relative to our other major currencies and struggling economies in a number of markets we serve.

Over the last several quarters, the negative impact from foreign currency exchange appears to be declining slightly. Nonetheless, compared to the exchange rates in affect last year, foreign currency reduced sales on a consolidated basis by approximately $40 million, or roughly 4.2%, and foreign exchange in total, including transactional FX, reduced EPS in the quarter by $0.04 per share.

Our consumer segment continues to rebound nicely on a sequential basis over the last several quarters with sales up 3.9% for the quarter. Excluding our nail polish business, which is currently in a down cycle in a fashion-oriented cyclical business, sales in our core DIY product lines are up approximately 6% year-over-year. This predominantly organic growth has been driven largely by several product line rollouts resulting from market share gains and new product placements that started to ship later in the quarter when our major customers began stocking for the spring sell-in season.

The industrial segment representing RPM's largest exposure to international markets continues to be a mixed bag. Our US industrial companies serving the commercial construction markets performed well with upper single-digit growth, while businesses having exposure to the global energy sector continue to be challenged with sales down approximately 10%.

In the industrial segment, we see solid local currency organic growth in Latin America while Europe continues to be a mixed bag. At current exchange rates, we expect continued foreign currency headwinds through the first half of fiscal 2017, but expect the negative impact to decline slightly with each passing month.

In the specialty segment, we are pleased with the double-digit growth, excluding the positive impact from the additional month of SPHC versus the prior year. This group of high-margin unique entrepreneurial businesses has been re-energized by the reconsolidation of SPHC and continues to take market share in their respective niche markets delivering strong sales and earnings growth. All in all, we are encouraged by the performance of the majority of our businesses around the world in local currencies.

I'd now like to turn the call over to Barry Slifstein to provide more detail on our quarterly results.

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

Thanks, Frank and good morning, everyone. I will review the results of operations of our fiscal 2016 third quarter, excluding last year's non-cash net tax charge of $83.5 million related to the possible repatriation of overseas earnings to fund the remaining obligations in the SPHC settlement. I will then cover some February 29, 2016 balance sheet and cash flow items before turning the call over to Rusty, who will discuss the outlook for fiscal 2016.

Third-quarter consolidated net sales of $988.6 million increased 4.5% from last year. Organic sales increased 3.9%, acquisition growth added an additional 4.8%, and foreign currency translation reduced sales by 4.2%. Industrial segment sales decreased 3.1% year-over-year to $484.0 million. Organic sales increased 2.6%. Acquisition growth added an additional 0.7% and foreign currency translation reduced sales by 6.4%.

Consumer segment sales increased 3.9% to $339 million. Organic sales increased 4.6%. Excluding the weak nail enamel business, organic sales were up 6%. Acquisition growth added 1.2% and foreign currency translation reduced sales by 1.9%. Specialty segment sales increased 37.5% to $165.6 million from $120.4 million, principally due to the acquisition-related growth from the reconsolidation of SPHC effective January 1, 2015 and the Morrells acquisition in March 2015. Organic sales increased 7.5%. Acquisition growth added 31.5% and foreign currency translation reduced sales by 1.5%.

Our consolidated gross profit increased 8.7% to $413 million from $379.7 million last year. As a percent of net sales, gross profit increased from 40.1% last year to 41.8% this year, representing a 170 basis point improvement. Contributing to the improvement was lower manufacturing costs partially offset by unfavorable transactional foreign currency exchange and unfavorable business and product line mix.

Additionally, last year's gross profit included stepped up inventory costs relating to the SPHC reconsolidation of approximately $5 million. Consolidated SG&A increased 7.1% to $370.9 million from $346.2 million last year. The increase was driven by the reconsolidation of SPHC and the Morrells acquisition, higher advertising, severance and product warranty expenses.

Consolidated earnings before interest and taxes, EBIT, increased 23.1% to $42.1 million from $34.2 million last year, largely driven by better operating leverage on positive sales growth combined with good cost controls.

At the industrial segment, EBIT was down $6.7 million from last year primarily as a result of higher product warranty and severance expenses. Excluding these items, which totaled $6.9 million, industrial segment EBIT would have been slightly higher than last year.

Consumer segment EBIT increased 10.3% to $38.8 million compared to $35.1 million last year due primarily to better operating leverage on positive sales. Specialty segment EBIT increased 128.4% to $21.4 million, principally due to better leverage on strong organic sales. Additionally, EBIT was boosted to a lesser degree by the acquisition of Morrells and the additional month attributed to the SPHC reconsolidation, which occurred on January 1, 2015.

Corporate/other expenses of $20.1 million were higher than last year's figure of $19.1 million due primarily to increased healthcare costs. Interest expense increased from $21.5 million last year to $23.1 million this year. The increase was primarily due to higher average daily borrowings towards quarter end compared to last year and the additional interest associated with the 5.25% $250 million 30-year bond issued last May, partially offset by the early retirement of the $150 million 5.31% UK bond also last May. Investment income of $2.9 million for the quarter was down from last year's $7.7 million due to lower interest income and lower gains on sales of marketable securities.

Income taxes. Our third-quarter income tax rate increased from an as-adjusted effective tax benefit rate of 33.5% last year to an effective tax rate of 11.9% this year. The current quarter 11.9% rate reflects the reversal of contingency reserves and certain other discrete tax benefits necessary to adjust toward our full-year fiscal 2016 effective tax rate that is estimated at 29%. During the prior year's quarter, a tax benefit was recorded due to the reversal of deferred tax asset valuation allowances during a quarter of seasonally low actual income.

Net income of $18.6 million declined 29% from last year's $26.2 million. Last year's adjusted results included a $13 million, or $0.10 per share, tax benefit during the third quarter. Current year EPS of $0.14 per share compares to adjusted EPS last year of $0.20 per share.

Now a quick look at the cash flows and capital structure. Cash provided by operating activities was $223.8 million for the first nine months of fiscal 2016 compared to $24.1 million for the same period last year. The improvement is primarily due to the change in working capital caused by faster collections and lower bonus and pension payments. As of February 29, 2016, total debt was $1.75 billion compared to last year at $1.87 billion. The decrease was principally due to the early retirement of a $150 million UK bond last May utilizing Canadian and European cash.

During the first nine months of fiscal 2016, the company repurchased 800,000 shares of its stock in the open market at an average price of $43.87 per share for a total cost of $35.1 million.

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

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

Thank you, Barry. I would like to briefly cover our updated outlook for the fiscal 2016 year and I will go one segment at a time. First, we will start with the industrial segment. We face a few challenges in this segment, first of all, with the continued slowdown in the global energy sector. Also, we are challenged internationally in certain weak markets such as Brazil, Argentina, parts of the Middle East and Africa and Europe and we are further challenged by the translation of foreign currency results back to US dollars due to the continued strengthening of the US dollar.

In spite of these challenges, there are some positives in this segment, however. First of all, we are growing in the low- to mid-single digits in Europe and Latin America and expect to continue to do so. We are gaining share in these markets with our connections creating value strategy to expand RPM's geographic footprint. We continue to grow in the US with new products such as TUF-STRAND macro-fibers and AlphaGuard roof coatings and we do have a favorable backdrop in the US with a healthy commercial construction market.

So in conclusion, our sales growth in the industrial segment is expected to be fairly flat when translated to US dollars due to the unfavorable impact of translation, but we are seeing growth in local markets and local currencies internationally.

Next, moving to our consumer segment, in the third quarter, we had another sequential improvement in sales growth in our consumer segment compared to earlier quarters this year. We continue to gain shelf space with new product placements. We do have great leading brands in this segment and we are successfully using category management to gain a lot of shelf space this year.

We have solid fundamentals as well in the US DIY market, which is the market where most of this segment's business resides. Some of these fundamentals include good consumer confidence, improving housing values and housing turnover and historically low interest rates. So all these factors make consumers willing to invest in their homes and that's good for RPM's consumer segment. One drag on results is expected to continue in the fourth quarter and that is a declining nail market.

So in conclusion for the consumer segment, we expect a strong spring and sales growth to be in the mid-single-digit range.

Now moving to our specialty segment, our diversified portfolio of entrepreneurial businesses continues to perform well in a variety of different niche markets. For those of you who attended our year-end earnings luncheon at the New York Stock Exchange last summer, you might know Steve Knoop, who heads up this segment. He's the former head of all M&A at RPM and he runs the specialty segment as group president. This segment has made acquisitions recently of Holton Food Products and Morrells, and these businesses continue to meet expectations and facilitate the momentum and growth in the specialty segment.

So in conclusion, for the specialty segment, we expect growth for the remainder of the year in the mid to upper single digit range.

So to wrap up on the consolidated basis, let me give everybody a reminder that last year in the fourth quarter, we reversed out the remaining Synta earnout accrual and we called this out. This reversal in the fourth quarter of fiscal 2015 was worth $9.9 million, or a favorable $0.05 per share impact and that will not repeat this year in the fourth quarter.

Another negative is we expect a continued drag from the strengthening US dollar, but the FX impact will be declining somewhat as we look ahead.

So in conclusion for the full fiscal 2016 year, we are maintaining our EPS guidance at $2.50 a share.

So this concludes our formal remarks and we will be pleased now to answer your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions). Frank Mitsch, Wells Fargo Securities.

Rory Blake - *Wells Fargo Securities - Analyst*

This is actually Rory Blake on for Frank Mitsch. Thanks for taking my question. Just to start off, on the $250 million, the maintaining of the guidance, did you already assume that you would get this charge for the additional warranty and severance in your industrial segment?

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

We did not.

Rory Blake - *Wells Fargo Securities - Analyst*

Okay, so it seems like core trends have actually trended better than you guys have initially anticipated and obviously the US commentary is positive. When you think about the consumer side and the sell-in, this new product penetration, how should we think how that should trend as we get through 2016 into 2017? Is there going to be an acceleration or how do you think the sell-in process will go?

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

I wouldn't call it an acceleration. I think we are continuing to see good benefits from the market dynamics that Rusty referred to in US DIY, in particular. We have some strong market share gains, certain small project paint areas, patch and repair, as well as interior wood stains and finishes. So I would anticipate, unless the underlying economics change, that you will continue to see solid single- digit, middle-single-digit, or a little bit stronger than that out of our consumer segment.

And then the area that could be a positive on the upside is when we finalize all of the filling capacity for the Kirker nail enamel business, they will be annualizing some relatively weak comps and we would expect them in 2017 to again be contributing to positive sales and earnings growth, which should be additive to the results that we are generating now in consumer.

Rory Blake - *Wells Fargo Securities - Analyst*

Thank you so much for your time.

Operator

Ghansham Panjabi, Robert W. Baird

Matt Krueger - *Robert W. Baird - Analyst*

This is actually Matt Krueger sitting in for Ghansham. My first question is, within your consumer business, can you talk about intra-quarter trends, along with how the business has progressed into March, which is traditionally the start of the spring selling season?

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

Sure. As you know, we had a disappointing first quarter and it was a result of a difficult comparison from the prior year, some weakness in the Kirker nail polish enamel business that we've seen throughout the year and also the impact of really lousy summer weather, particularly in small project paint. We came out of that in the second quarter with some decent, albeit low single digit growth and that's accelerated. As Barry commented, excluding the nail enamel product lines, our core growth in consumer is up about 6% in the quarter and we see that trend continuing in the fourth quarter. And early indications in terms of the spring sell-in are very strong. It's a combination of I think good dynamics in the market, as well as beginning to realize some of the market share gains that we talked about.

Matt Krueger - *Robert W. Baird - Analyst*

Great. That's really helpful. And then can you provide some additional details on your recent share gains and product introductions? Which specific markets are you targeting and then what is allowing you to gain so much additional shelf space?

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

So a lot of it is new product introduction and I will tell you, for the most part, in the small project paint categories, regardless of whether it's a concrete substrate or metal substrate or now even in the wood area, Rust-Oleum continues to be the innovator in the retail channels. Certainly we have fast followers at some of our bigger customers and so that continues to benefit us. We have gained some significant market share in interior wood stains at a number of major retailers that are starting to be filled now at the expense of our largest competitor and we also picked up some significant new shelf space with the DAP patch and repair product lines, which again started selling in the spring.

Matt Krueger - *Robert W. Baird - Analyst*

Great. That's it for me. Thanks.

Operator

Vincent Andrews, Morgan Stanley.

Matt Gingrich - *Morgan Stanley - Analyst*

Good morning. This is Matt Gingrich on for Vincent. As it relates to gross margin expansion in the quarter, what were the lower manufacturing costs related to and how did raw material prices change from the second quarter to the third quarter?

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

So if you go back to Rust-Oleum and our comments in the January quarterly call, they are benefiting from what's been a two-year run of really focusing on manufacturing efficiency and they closed a major manufacturing facility in Europe a little more than a year ago and then two smaller plants, one in Illinois and one in California, that were completed this past year. So those are the principal areas in consumer where we've made some real operational efficiency improvements. And then we have had somewhat of a mixed bag, particularly in industrial, with product mix.

Good news, as you can see, in the specialty segment is we've got nice product mix there with some higher-margin businesses and that's leveraging nicely the bottom line. In the industrial sector, it's kind of the reverse. In fact, in the oil and gas sector, it's the one area where pricing is very challenging in an industry that globally is off in certain categories by 30%, or 40% or 50%. We are pleased with the product lines that are down by 10%, but the pricing environment there is very difficult.

And then in the Tremco business, there continues to be a service revenue, which is lower margin, higher growth rate than the product sales, which is higher margin mix. So those were the principal dynamics in terms of the gross margin improvements for the quarter.

Matt Gingrich - *Morgan Stanley - Analyst*

Okay, thanks. And then just to clarify, after the second quarter, in your press release, industrial sales were expected to be flat for the balance of the year, but in today's press release that language was removed. I'm curious why that was the case and just wanted to clarify what's changed regarding your expectations for industrial for the balance of the year.

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

Yes, I expect our industrial to be flat for the balance of the year. The biggest challenge that we face, and we've talked about it, as have other companies, is the FX impact and as we've done throughout the year, we posted on our website a map of the world, which highlights by region actual rates and then provides growth by adjusting FX rates to the prior quarter's levels. And the vast majority of this negative impact on sales and earnings, but in this case your question is sales, is in our industrial segment that I think suffered about 6.5% negative FX impact in the quarter.

So for instance, in Latin America, which is predominantly industrial segment, we are -- in actual rates -- we are down 14% year-over-year in the quarter, but leveling out at prior exchange rates, we were up 15% in local currencies. In Europe, which is probably two-thirds industrial, one-third consumer, in actual rates, we were up 1%. In local currencies, we are up 7%. And so I think we anticipate that continuing to negatively impact our industrial segment in the fourth quarter. So on a core basis, you'll see, we hope, sales up in the low single digit range. There will be a modest impact from prior years' acquisitions and we expect all that to be offset by FX. So we are not changing our outlook for industrial and it'll probably look maybe slightly better than what we saw in the third quarter here more towards flat.

Matt Gingrich - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

Jason Rogers, Great Lakes Review.

Jason Rogers - *Great Lakes Review - Analyst*

Wonder if you could talk more about the warranty and severance charges in the industrial segment in the quarter and if we should expect additional charges in future quarters.

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

Sure. The charges in the quarter were of a one-time nature associated with some corrosion control projects and it was a combination of some warranty issues and quite candidly some customer goodwill decisions and it was relatively unique and it's been resolved. And I say that because, from that perspective, it was a unique set of circumstances that we consider one-time, which is different from the regular warranty expense that we have in our Stonhard flooring, in particular, and our Tremco roofing business where in both of those cases, we are not only supplying the material, but actually doing the application.

Jason Rogers - *Great Lakes Review - Analyst*

And the market share gains that you talked about in consumer, is that due in any part to pricing, or would you say it's mainly through product innovation?

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

It's mainly through product innovation. We have been pursuing a bigger share in interior wood stains and finishes with higher quality products with better color and a number of different characteristics like that. And I think we finally had some -- we've had slow growth in that. This year, we've had some significant breakthrough in terms of some market share gains in some of our bigger customers.

In small project paints, Rust-Oleum continues to be the innovator on different substrates and so again it's really about innovation and bringing new and unique either finishes or new and unique solutions, including time savings, to consumers in partnership with our big customers.

Jason Rogers - *Great Lakes Review - Analyst*

Then looking broadly at the Company, I wonder if you could talk about the pricing environment in North America and overseas, as well as the impact of raw material costs in the quarter and the outlook there. Thank you.

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

Sure. As I mentioned earlier, price is virtually nonexistent in any of our sales results; it's all unit volume growth. I think the exception to that has been in the product lines that serve the oil and gas market and that's just been a very, very challenged market for anybody that's in any services or products that goes into offshore oil or any of those areas. So that's been a challenging pricing environment.

On the raw materials side, we've had a mixed bag of some raw material benefits from some lower raw material costs in certain areas, which have been offset in a number of areas by FX translation, which has been a big problem in a couple of regions. As an example, Canada, the vast majority of what we sell in Canada is produced in the United States and, quite candidly, we are getting killed by FX transactional impact of US-produced products sold in a weaker Canadian dollar environment.

Jason Rogers - *Great Lakes Review - Analyst*

Thank you very much.

Operator

Ivan Marcuse, KeyBanc Capital Markets.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Thanks for taking my questions. Just curious about what you are seeing -- you mentioned US commercial construction continues to be strong. Is there a specific product line that's better than others like admixture, versus roofing, versus waterproofing, or is it pretty much pretty equal across the board?

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

It's generally pretty solid across most of our product lines. The couple of product lines that are growing nicely in terms of double-digit growth would be Euclid fiber products. They continue to be able to sell everything they can make. They are expanding that business more globally from what has been basically a North American start. In our Tremco roofing business, we are going great guns with some proprietary roofing coatings, very sophisticated coatings. They can extend the life of EPM rubber roofs that are coming off 20- or 30-year lifespans and it's kind of fun to see a nice margin, double-digit growth out of roof coatings because that's what started this whole place almost 70 years ago. So it's a little bit back to the future there and that's really booming.

And then our Tremco sealants business broadly is doing quite well in terms of waterproofing, as well as sealants and other waterproofing products that goes into commercial construction.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Great. And then you are seeing I guess continued consolidation specifically in the US architectural market. Do you think these dynamics will allow itself for you to continue to gain share, or how do you see this -- I guess your two big competitors combining, is that an opportunity for you, or I guess -- or to be decided?

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

I think time will tell. I will say if you go back a couple of years ago, you had Akzo sell its architectural coatings business to PPG. You had a Sherwin-Williams swing and miss on Comex and PPG bought that, and now you have the Sherwin-Williams-Valspar transaction and I hope that the food fight of the architectural coatings companies in North America continues vigorously.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Got you. And then last question and I will jump back in the queue, you mentioned Europe is pretty choppy. What's going well there versus what's not?

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

Sure. Consumer is actually going very nicely there, so Rust-Oleum has a good presence and it's going nicely for a couple of reasons. In local currencies, they are seeing growth in the UK, the Benelux countries and a little bit on the continent. And they, as we mentioned earlier in the call, a year ago had closed a major facility in Europe and so the leverage of the return of sales growth is hitting their bottom line nicely.

And in general, we are seeing pretty good business in the construction markets out of illbruck in Germany and some of our other companies. A big slug of what we do in the industrial segment in Europe goes into oil and gas and that business is hurting. And a lot of what we do in the Middle East is either produced in plants in the Middle East where we have two plants, one in Saudi and one in Dubai, but also production that comes out of Europe. And the Middle East, as you will see on our slides, is the only region of the world both in local currencies and year-over-year actual rates which is down. And it's predominately oil and gas.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Got it. Thanks for taking my questions.

Operator

Mike Harrison, Seaport Global Securities.

Mike Harrison - *Seaport Global Securities - Analyst*

We haven't really touched on the specialty segment yet. The SPHC volumes that have been coming in, you had said in the past that those were lower margin and we were seeing a margin drag from those, but this quarter we saw pretty strong margin improvement despite getting another month of SPHC volumes coming in. Can you walk through what's driving the improved margin in specialty and maybe give us a little bit of a sense of what our expectations should look like for fiscal 2017 on the operating margin front?

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

Sure. The specialty segment truly is a collection of unique entrepreneurial businesses, so there is typically less integration there than there are in our other groups or segments. And they have a mix of margins. To the extent that we are involved in OEM coatings businesses like our wood finishes group or powder coatings or some liquid OEM coatings, they tend to be somewhat lower margin in that segment versus specialty food, or specialty colorants or other product categories there. It's the one area where we are in equipment with the Legend Brands business. But in general very well-run businesses and as Rusty alluded to, I think that they had a particularly strong focus on internal investment and internal growth and operating efficiency coming out of the whole SPHC process. And they are continuing to do really well.

So I would expect -- I guess the last thing I would say about that is, that the SPHC businesses that came out of bankruptcy were almost exclusively US businesses. The related affiliates of those businesses overseas were generally not part of that bankruptcy process, so they are also benefiting from being in the region of the world where we and most everybody are seeing the strongest growth. So that is also I think a reason why you are seeing a nice result out of those businesses. We expect that to continue and we also expect to see additional companies added to that specialty segment in the coming years.

Mike Harrison - *Seaport Global Securities - Analyst*

And then I was also hoping you could talk a little bit further about the Kirker business. You kind of refer to that as being in a cyclical downswing. I understand some of the dynamics there, but how is that business performing sequentially? Is there seasonality to take into account there and I guess how much of a benefit could we expect to see once the bottling line is up and running and is that a top-line benefit or margin or both?

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

So the nail polish enamel business is a fashion business and it's a cyclical business in terms of fashion trends and colors and we knew that when we acquired Kirker and hence, we ended up negotiating a transaction which took a couple of years to finalize and ultimately was resolved with these earnout payments, all of which now are behind us. And we had that structure because we and the owners of Kirker knew that it was somewhat of a fashion-related cyclical business, more volatile than typically what other RPM companies are.

And so now we are kind of at a low period. Quarter after quarter over the last five quarters maybe, we've seen significant lower levels of sales and therefore earnings. I think we are going to have a lot easier comparisons next year. There's a number of new products that are coming out, new categories that are kind of revitalizing that. You see new channels opening up with some of the discount drugstore channels and so there's a lot of dynamics that suggest to us that, as we go into 2017, the Kirker businesses are going to be positive contributors to sales and earnings in a way that they were two or three years ago and that they haven't been for any of the last five quarters.

Mike Harrison - *Seaport Global Securities - Analyst*

And then the last question I had was on the wood stains business. You kind of referred to interior wood stains as an area where you are gaining shelf space, but I believe you had a competitor reintroduce their wood stains line at a key big-box retailer. I think that's mostly exterior wood stain. But can you just talk about how much of an impact that's going to have in terms of a revenue headwind for you guys?

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

Sure. Most of our focus in wood stains and finishes has been interior wood stains and finishes with our Varathane brands and you will see significantly more shelf space at a number of our big-box retailers on the interior Varathane wood stains and finishes. And we've been working to bring just better quality products, better, deeper color. The fact that one of the specialty products businesses is an industrial OEM wood finishes business that's got real expertise in the color area has helped a lot and so that's the area where we are picking up market share.

We don't have a particularly big presence in exterior wood stains and finishes. We've got product lines like Wolman. We certainly have a lot of Zinsser primers that have been and continue to be used for exterior wood and we've got a number of other product lines, but that has not been a big category for us yet. And it's not been the area of focus in terms of the market share gains that we are now experiencing.

Mike Harrison - *Seaport Global Securities - Analyst*

Got it. Thank you very much.

Operator

Arun Viswanathan, RBC

Arun Viswanathan - *RBC Capital Markets - Analyst*

So I guess just a question on the cash usage. Looks like you bought back around $67 million in stock year to date, which looks like it's a little bit above normal levels. Is there any change in how you are looking at buybacks versus other uses of cash?

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

No, I think it would be our goal to continue to buy back stock to cover equity program dilution and traditionally not much more. To the extent that we can get a better return by investing in internal growth, new products and acquisitions, we will continue to do that. From time to time over the last decade, we've been a little bit more aggressive and I think we felt pretty good about this year. I think this quarter when you look at a 23% EBIT gain on a 4.5% sales growth and expectations for a strong fourth quarter, I think we continue to feel good about how RPM companies would finish the year and when our stock dropped along with everybody else, we got a little bit more aggressive.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay. Great. And then on the, I guess, the M&A environment, also that looks like it's tracking a little bit lower. Would you think there'd be any greater opportunities now that maybe Sherwin and Valspar are hoarding cash and what areas would you be targeting? Would that be kind of industrial, or US, or continued kind of technology and product line in growth?

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

We commented on this in particular in the January call, but if you look across the last decade, probably 70% plus of the acquisitions that we've done have been product lines that we've integrated into existing businesses. We've completed a few of those, as you know, this year. And so the pipeline for those types of acquisitions continues to be good. They are not material necessarily to sales or earnings for RPM on a consolidated basis, but when you can pick up a $5 million or $10 million product line and expand it through your existing distribution and double sales in a couple of years, the IRRs are pretty nice. So we continue to see opportunities like that. We continue to be the only player that's a really good home for well-run entrepreneurial companies and I would hope that we see more of those in the coming years as well.

And lastly, there's been some speculation as to any divestitures that may be required of the Sherwin-Williams-Valspar transaction. Time will tell. That will be regulatorily driven, but to the extent there are, we would certainly have interest in looking at that as well.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay. Last question is just on energy. You said that there's still some challenges there, down 10% in industrial. I don't know if you've disclosed exactly how much that is and then is there any kind of stabilization or bottoming that you see in those businesses? Thanks.

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

Sure. No, we have not disclosed the specific revenues there. It's below our segment level. It's principally our Carboline business and it's a little bit of a double whammy. It's also Fibergrate and a few other places, but it's a double whammy in the sense that it's a very global business and we sell corrosion control coatings and fireproofing products and other related products into the oil and gas industry in the North Sea out of the UK or Norway, in Africa, in Asia. We are continuing to invest in that business. We are investing in manufacturing capacity in the Viapol Brazilian operation for production of Carboline products. We are also in the beginning stages of investing in coatings manufacturing for those product lines in Malaysia in combination with a Flowcrete business that's already there.

So long term, we are very bullish on that business. I think we are happy to see that the massive and rapid decline in oil prices, which is really unprecedented in my lifetime, has seemed to come to a halt and we've got a base of where oil prices are now and I think over time that business will stabilize and come back. In the interim, it could be off 10% in what's been pretty much of a traumatized industrial sector is pretty good performance by our folks.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Yes. Good to see the consumer turnaround as well. Thanks.

Operator

Rosemarie Morbelli, Gabelli & Company.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Good morning, everyone. I was wondering, Frank, if you could talk about some areas or markets that you may have seen declines sequentially outside of the energy, any trickling into other industries that you are beginning to see?

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

Not really. I think that most of our other businesses are doing relatively well to very well. The impact is FX. The Middle East has been challenged for a lot of reasons. The construction markets there. It's the one area are not good and deteriorating. I think it's an indirect relationship to the oil and gas revenues and their impact on the spending and the government spending there and a lot of major construction products or projects, so that is a challenge. And we certainly are paying a lot of attention to Latin America in general and Brazil in particular. The Viapol team down there is doing a great job. Year-over-year, I think in local currencies, we are up about 7% in the quarter, but down significantly when translated back into reals and the headlines on the economy down there and the situation in general are not good, so we pay attention to that. So those are the two areas of concern for us outside of the broader global oil and gas market.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Thanks. And then I was wondering -- I saw a recent advertisement on ReColor, which also looked as though NeverWet was incorporated in it and you are currently selling this only via television. Can you talk about what is going on there? It is one of your products as I understand; they put it under the Rust-Oleum brand, or is it something else and are you selling it only on television?

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

That's a licensed product by Rust-Oleum and they are working with the original inventor of that on a TV sale, but we are also selling it in the automotive channels.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Is that something that -- you are licensing it now, but I think that you did something for other product lines. Is that something that you would be interested in having and then offering to larger OEMs? And then as long as we are talking about OEM, can you touch on the success of NeverWet on the OEM category?

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

We continue to pursue opportunities with NeverWet on the OEM side. This spring, you will start to see the first NeverWet taglines on umbrella fabrics and certain outdoor furniture OEMs and it's a more robust formula than what would be available to consumers. And so you'll start to see that, so we are having some success there.

On the other products, Rosemarie, I really can't answer that. This whole new is a new category, another licensed idea, so Rust-Oleum is really reaching out to inventors and folks that have some interesting ideas in relationship to coatings products, or other treatments, but don't have the resources, and if we can find some good product technology and partner with inventors to where the strength of our distribution network and the strength of their good ideas benefit both, we will do that.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay. And if I may ask one last question, on the SPHC, I do understand that it is a group of entrepreneur companies, but now that they are back into the fold, is there some potential for margin improvement in terms of looking at supply, raw materials, supply chain and so on? Can you integrate part of some of those entrepreneurial businesses?

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

I would say the integration opportunities there, as I commented earlier, are significantly less than they are and have been in our other groups or segments. But you are continuing to see margin improvement and nice enhancements there. Again, sales on an organic basis I think were up more than 7% in the quarter and I think it'll be really reflected in the fourth quarter because you will have year-over-year true comparisons. While there will be some smaller acquisitions in there, this quarter was the last quarter of any impact of the SPHC reconsolidation. It was essentially one month, and so those businesses are doing well. They are benefiting from reintegrating into the RPM Global Sourcing committee, so that is an area that they are benefiting from and they are pretty good at sharing technology across businesses and I would expect that to drive revenues first, but nicely lever to the bottom line.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay, thank you.

Operator

(Operator Instructions). Christopher Perella, Bloomberg Intelligence.

Christopher Perella - *Bloomberg Intelligence - Analyst*

Thank you for taking my call. I just wanted to follow up on the translational impact on your manufacturing costs. In Canada, Latin America and South Africa, have you seen any pricing to offset the raw material or the transactional FX headwind?

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

Yes, to a certain extent, but not enough to cover the impact, so that's an area that we are focusing on and trying to have some influence on and so in certain -- particularly in certain extreme raw material categories, we have gotten some price, but it hasn't been sufficient to cover the FX impact.

It's particularly true in Canada. It's true for instance with our fluorescent color product lines between the US, Europe and the UK. It's less true -- you mentioned South Africa. Most of what we sell in South Africa is produced in South Africa, so that's really an FX impact. The area that impacts South Africa or Brazil is raw materials because typically you are buying raw materials that are sourced in the US or Europe in dollars or euros, even though you are actually manufacturing in a country like South Africa, or even in some raw material areas in Brazil.

Christopher Perella - *Bloomberg Intelligence - Analyst*

All right, so have you covered I guess the raw materials and you are still trying to -- you are halfway there on the FX? How should I think about it in that respect?

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

It's a tough question to answer because it's so specific to product lines and/or different businesses at a level that we really don't report in terms of specific sales or earnings. But it's Brazil and South Africa in terms of imported raw materials and it's Canada and a little bit of UK in terms of products that are produced outside of those countries and sold into those countries with just dramatically different currencies than they were a year ago.

Christopher Perella - *Bloomberg Intelligence - Analyst*

Okay. And then a follow-up question. How far along are you with the Malaysia expansion?

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

I can tell you that we are continuing -- I'm not answering Malaysia specifically -- but we are continuing with the corrosion control coating and expansion in Brazil, but slowing down a little bit given what's happened in those markets and I think we are making progress in Malaysia. I would bet it will be a year before we are in a position to actually produce products in either of those locations in the corrosion control or fireproofing product areas.

Christopher Perella - *Bloomberg Intelligence - Analyst*

Okay. Thank you very much.

Operator

[Richard O'Reilly], Revere Associates.

Richard O'Reilly - *Revere Associates - Analyst*

Two quick questions. The first is your debt-to- capital ratio, 55%. It's down a little bit year-over-year, but still I think two years ago it was more 47% and historically it was in the 40%s. Do you see ever a time of your debt ratio getting back down to historical levels, let's say in the 40%s, or do you think the acquisitions will just keep it up?

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

Yes, I see our debt-cap ratio improving over time. Historically, based on our acquisition activity over the last 20 plus years, our debt-capital ratio has ranged anywhere from 40% to 65% and I think we've been comfortable in that range. We have always targeted a BBB investment-grade rating and that's still very much in our minds.

The greatest impact on our debt-cap ratio over the last year has not been on the debt side where, through good cash flow, as you see, we've been able to manage the debt down despite growing our business and continuing with the acquisitions. It's been the impact on equity and in particular the CTA from the foreign exchange impact.

So I think there's two things in the future that will allow us to get our debt cap ratio back down in the 40%s. Number one is the fact that, with the exception of the last couple of remaining payments to finalize the trust fund payments, the next decade of cash flows will not have $1 billion of allocation to the asbestos problem. And secondly, certainly over a period of time, you are going to see currencies recover or the dollar in certain currencies balance back out and that will have a positive impact on the equity accounts in our balance sheet. But we would expect to see our debt cap ratio move back down into the 40%s over time.

Richard O'Reilly - *Revere Associates - Analyst*

Okay, good. Second question, it's on the tax rate or the tax credits in the quarter. And I think you said it was a reversal of a reserve that gave you the 12% rate and last year, it was a reversal of a valuation allowance. Is this just the timing of large items that just so happened to fall into the third quarter, or is it because it's the third quarter, the seasonally low quarter, these things just have an unusual big impact?

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

I think the answer to your question is yes to both. Certainly the impact of tax items, particularly with new accounting regulations and stuff like that, they are going to be more periodic and more volatile in terms of how you account for your various tax issues, number one. Number two, the third quarter is a seasonal low period for RPM, so any discrete tax item in the third quarter would have a significantly outsized impact when you are counting pennies per share or percent gains or losses over the prior year.

It's really difficult to compare this year's third quarter versus last year's third quarter because of all the issues associated with the reconsolidation of SPHC last year and a lot of one-time items, the big tax issue last year, some tax discrete items this year and so I think the right way to look at how we are performing is the sales and EBIT line both consolidated and by segment and we are very happy with that.

Lastly, I'd say for the full year, we anticipate having a tax rate of about 29%, perhaps slightly lower.

Richard O'Reilly - *Revere Associates - Analyst*

Okay, good. Okay, thank you, guys.

Operator

We have no further questions at this time. I'd like to turn the call back to Frank Sullivan for closing remarks.

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

Thank you, Ellen. We continue to remain focused on investing in our future even during times of global economic uncertainty and are extremely proud of the great entrepreneurial businesses that make up RPM and how they continue to compete and win in their respective markets. I'd like to thank the more than 13,000 employees around the world for their continued efforts and dedication and to you for joining our call today and for your investment in RPM. We look forward to updating you on the year-end results of our fiscal 2016 in July and providing outlook for our new fiscal year, which starts on June 1. Thank you for your participation on today's call and have a great day.

Operator

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