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RPM - Q4 2016 RPM International Inc Earnings Call

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OVERVIEW:

Co. reported FY16 consolidated net sales of $4.81b, net income of $354.7m and EPS of $2.63. 4Q16 consolidated net sales were $1.43b, net income was $152.9m and EPS was $1.13. Expects FY17 diluted EPS to be $2.68-2.78.

CORPORATE PARTICIPANTS

Frank Sullivan *RPM International Inc - Chairman & CEO*

Rusty Gordon *RPM International Inc - VP & CFO*

CONFERENCE CALL PARTICIPANTS

Frank Mitsch *Wells Fargo Securities - Analyst*

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

Matt Gingrich *Morgan Stanley - Analyst*

Ivan Marcuse *KeyBanc Capital Markets - Analyst*

Silka Kueck *JPMorgan - Analyst*

Arun Viswanathan *RBC Capital Markets - Analyst*

Kevin Hocevar *Northcoast Research - Analyst*

David Stratton *Great Lakes Review - Analyst*

Richard O'Reilly *Revere Associates - Analyst*

PRESENTATION

Operator

Welcome to RPM International's conference call for the FY16 fourth quarter and year end.

Today's call is being recorded.

This call is also being webcast and can be accessed live or replayed on the RPM website at www.RPMInc.com. Comments made on this call may include forward-looking statements based on current expectations that involve risks and uncertainties which could cause actual results to be materially different. For more information on these risks and uncertainties, please review RPM's reports filed with the SEC.

During this conference call, references may be made to non-GAAP financial measures. To assist you in understanding these non-GAAP terms, RPM has posted reconciliations to the most directly comparable GAAP financial measures on the RPM website.

(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*

Thank you, Ellen, and good morning. Welcome to the RPM investor call for our FY16 fourth quarter and year ended May 31, 2016.

We're hosting today's call from RPM's offices in Medina, Ohio, as the combination of the Republican National Convention in Cleveland, which changed the timing of our year-end Board meetings and earnings release, and remodeling at the New York Stock Exchange in their meeting rooms, made it logistically easier to stay here this year. It is our intent to host an analyst luncheon next year in New York when we release 2017 results.

On the call with me is Rusty Gordon, RPM's Vice President and Chief Financial Officer. Barry Slifstein, our Vice President of Investor Relations, could not be with us today, due to a family illness. Today we will discuss our fourth-quarter and full-year results, including some detail by Rusty, and comments on the outlook for our FY17, and then answer your questions.

We're very pleased with our sales growth, as well as our strong leverage to the EBIT line, during our fourth quarter. The negative impact related to the strong dollar is still evident in our results, but diminishing as a percent as each quarter goes by. In Q1, currency translation reduced sales by 6.9%, in Q2 by 6.3%, in Q3 by 4.2%, and in the fourth quarter just ended, by 2%. Overall, foreign exchange in total, excluding transactional FX, reduced earnings per share by about $0.05 per share in the quarter.

Although the negative impact from currency is expected to be less severe in FY17 than in the prior two years, Britain's exit vote from the EU has worsened things a bit since our fiscal year ended. We continue to be challenged by weaker economies around the world, especially in our industrial segment, which has roughly 50% of its sales outside the US, with sales in the energy and heavy manufacturing industries affected the most.

Consumer segment sales continued their upward momentum on a sequential basis, with our fourth-quarter revenues up 9.9% over last year's fourth quarter in the consumer segment. This predominantly organic growth has been driven largely by several product rollouts resulting from market share gains and new product placements earlier this fiscal year. Sales in our nail polish business were up slightly from last year, a trend we believe will continue in FY17.

Continued strength in the US housing market and strong consumer takeaway at our major retail customers has contributed to robust organic sales in the consumer segment. During last year's fourth quarter, we benefited from a one-time $9.9 million earn-out accrual reversal. During this year's fourth quarter, we recorded a legal settlement charge of $9.3 million related to a deck coating product. Excluding both of these non-operating items, consumer segment EBIT increased 18.2% quarter over quarter.

The industrial segment, representing RPM's largest exposure to international markets, continues to be a mixed bag of performance, with most regions outside of the US generating declining quarter-over-quarter results when translated back to US dollars. Our US-based industrial companies serving the commercial construction markets performed well, with mid-single-digit growth, while our businesses having exposure to the global energy sector continued to be down by approximately 10% in revenues.

Latin America, especially Brazil, continues to exceed our expectations in the dynamics in their economy, with sales in the low double-digit range in local currencies. In Europe, most companies are delivering low- to mid-single-digit growth, a nice improvement over a more choppy environment there earlier in FY16. During the fourth quarter, we completed the acquisition of the 51% of Carboline Dalian Paint Production Company in China that we did not previously own, representing our first complete acquisition in China. Related to this, we recorded a one-time gain of $8 million as a result of the revaluation of the company's original 49% ownership. Excluding this one-time gain, we were very pleased with EBIT growth in the Industrial segment of approximately 7% on flat or slightly down revenues.

In the specialty segment, sales were up 5.1% compared to the prior year, driven by several smaller acquisitions during the year. Specialty also had significant leverage to EBIT, up 20% for the quarter. All in all, we are encouraged by the performance of the majority of our businesses around the world in local currencies, despite weakness in global energy and heavy manufacturing.

I would now like to turn the call over to Rusty Gordon to provide more detail on our fourth-quarter results.

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

Thanks, Frank. I will review the results of operations for our FY16 fourth quarter and full year using FY15 adjusted figures, then cover some May 31, 2016 balance sheet and cash flow items, before turning the call over to Frank, who will discuss the outlook for FY17. Before we get started, as a reminder, in FY15 third quarter, we adjusted out an $83.5 million non-cash net charge for a tax accrual, as previously disclosed.

In our fourth quarter, consolidated net sales of $1.43 billion increased 3.9% from last year. Organic sales increased 4.6%, acquisition growth added an additional 1.3%, and foreign currency translation reduced sales by 2%. In the industrial segment, sales decreased 0.7% quarter over quarter to $686.6 million. Organic sales increased 1.6%, acquisition growth added an additional 0.5%, and foreign currency translation reduced sales by 2.8%.

In the consumer segment, sales increased 9.9% to $543.8 million. Organic sales increased 9.9%, acquisition growth added 1.4%, and foreign currency translation reduced sales by 1.4%. In the specialty segment, sales increased 5.1% to $196.2 million from $186.7 million in the prior year. Organic sales increased 1.7%, acquisition growth added 4.2%, and foreign currency translation reduced sales by 0.8%.

Our consolidated gross profit increased 8% to $647.2 million from $599.3 million last year. As a percent of net sales, gross profit increased from 43.6% last year to 45.4% this year, representing 180 basis points of improvement. Contributing to the margin increase were lower manufacturing costs and supply chain improvements, partially offset by unfavorable transactional foreign currency exchange and unfavorable business and product line mix.

Consolidated SGA increased 7.4% to $424.6 million from $395.4 million last year. The increase was driven by the prior-year benefit of an earn-out reversal, current-year acquisitions and higher professional fees. Other income includes the $8 million gain on acquisition of the 51% of Carboline's Dalian China business that it did not previously own, and the $9.3 million legal settlement charge. Consolidated earnings before interest and taxes, or EBIT, increased 7.9% to $220.4 million, from $204.3 million last year. Excluding last year's earn-out reversal, this year's legal settlement charge and the Dalian acquisition gain, consolidated EBIT increased 14.1%.

In the industrial segment, EBIT increased 15.4% to $107.9 million. Excluding the Carboline Dalian acquisition gain, Industrial segment EBIT increased approximately 7%. In the consumer segment, EBIT decreased 2.6% to $98 million. Excluding the prior-year earn-out reversal and the current-year legal settlement charge, consumer segment EBIT increased by 18.2%.

The specialty segment EBIT increased 20.1% to $32.7 million, principally due to better leverage on our core business, and a favorable contribution from several smaller acquisitions during the year. Corporate other expenses of $18.2 million were slightly higher than last year's figure of $17.1 million, driven largely by higher professional fees, as well as higher healthcare costs.

Interest expense decreased from $27.3 million last year to $23.6 million this year. The decrease was primarily due to the $4 million of higher interest expense last year relating to the early retirement in May 2015 of the $150 million notes originally set to mature in November of 2015. Investment income of $2.3 million for the quarter was in line with last year's figure of $2 million.

In regards to income taxes, our fourth-quarter income tax rate decreased from an effective rate of 28.2% last year to 22.8% this year. The decrease in the quarterly income tax rate is due primarily to FY16 fourth-quarter valuation allowance reversals, the benefit associated with the non-taxable gain from the Carboline joint venture re-measurement, a deferred tax benefit from state tax rate changes, and the comparative differences in levels of actual versus forecasted income. Net income of $152.9 million increased 19.5% from last year's $128 million. Current quarter EPS of $1.13 per share compares to EPS last year of $0.94 a share, an increase of 20.2%.

And now here are some full-year measures. Consolidated net sales increased 4.8% to $4.81 billion, from $4.59 billion in the prior year. Organic sales increased 2.8%, acquisition growth added an additional 6.7%, and foreign currency translation reduced sales by 4.7%. Currency translation reduced sales by $215 million for the year. Net income of $354.7 million increased 9.8% from last year's $323 million. Current-year EPS of $2.63 per share compares to an adjusted EPS last year of $2.38 per share.

And now a quick look at the cash flows and capital structure. Cash provided by operating activities was a record $474.7 million for FY16, compared to $330.4 million last year. The improvement is primarily due to higher net income this year versus last year, and overall better working capital management. As of May 31, 2016, total debt was $1.65 billion, which was slightly below last year.

Finally, during FY16, 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. There were no share buybacks during the fourth quarter.

With that, I will turn the call back over to Frank.

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

Thank you, Rusty.

I'd like to briefly cover our full-year FY17 outlook. In general, RPM remains in a growth mode, with capital spending planned to increase from $117 million in FY16 to $130 million in FY17, mostly supporting international organic expansion. We're also undertaking some activities in 2017 to drive greater operating efficiency, with an eye towards achieving our publicly communicated FY18 goal of a consolidated EBIT margin greater or equal to 12.5%.

Specifically, in the consumer segment, market share gains and new product placements from earlier this fiscal year drove incremental sales during most of FY16, a trend we expect to continue in FY17. We believe that improved shelf presence and continued innovation against a backdrop of favorable US economic fundamentals will position the consumer segment for another solid year. Therefore, consumer segment sales growth for FY17 is expected to be in the mid-single-digit range.

In the industrial segment, we expect solid growth for those businesses serving the US commercial construction markets to be somewhat offset by the continued slowdown in certain geographies and the global energy sector. We continue to invest in international expansion with a long-term approach, especially in our admixtures, polymer flooring and construction chemical businesses.

In relationship to foreign exchange, there is good news and bad news. I will start with the good news. At current exchange rates, we anticipate that the negative impact from currency translation related to the euro, Canadian dollar, Brazilian real and South African rand, will dissipate over the first half of FY17, and hopefully, will have no impact in the second half of the year.

The bad news -- the British pound, on the other hand, will create additional currency headwinds from both a transactional and translational perspective, starting in this first quarter. We expect growth in Latin America and Europe to be in the low- to mid-single-digit range. Therefore, sales for the industrial segment in FY17 are expected to be in the low-single-digit range.

In the specialty segment, we expect these predominantly US-based niche businesses to continue to gain share, benefiting from a full year of recent acquisitions, growing in total in the mid-single-digit range during FY17.

From a diluted earnings-per-share perspective, there were certain one-time items in FY16 that will not repeat in FY17, including the Kirker earn-out reversal in the second quarter of $0.08 per share, the Dalian, China joint venture acquisition gain of $0.06 per share in the fourth quarter, which was offset by a $0.05 per share loss on the legal settlement charge in the fourth quarter. Excluding these three items from the full FY16 diluted earnings per share of $2.63, an apples-to-apples starting point for FY17 would be a FY16 earnings per share pace of $2.54.

We expect our core businesses to leverage 4% to 6% consolidated sales growth into 10% to 12% core earnings growth. However, in FY17, we anticipate an approximately $0.06 per share unfavorable currency translation, driven largely by the devaluation of the British pound against the US dollar since our fiscal year-end and a $0.05 per share in higher-benefits costs, mostly due to the continued decline in the US discount rate and its impact on our pension plan expense. As a result of these factors, our earnings guidance for FY17 is a range of $2.68 to $2.78 per diluted share.

As we discussed last year, FY16 was going to be characterized as the year of investing in growth initiatives, even during a period of global uncertainty. During FY16, capital expenditures were $117 million, or roughly 40% higher than in FY15 (sic - "FY15"), and included additional capacity for both our AlphaGuard liquid-applied roofing product and our Tuf-Strand macro-fibers.

During the year, we combined our Euclid Chemical business, with sales predominantly in the Americas, with our Flowcrete polymer flooring business, which has sales across Europe, Africa, the Middle East and Asia -- into what we now call the Euclid Group. These businesses complement each other, both from a technology and geographic footprint perspective.

Our goal over the next three to five years will be to introduce local production of Euclid products at Flowcrete facilities, and vice versa, in strategic geographies around the world, and begin to sell products like Tuf-Strand outside of the Americas. One of the strategic locations is in Malaysia, where we currently have a small Flowcrete manufacturing facility, but intend to build it out to support a number of industrial product lines, including Euclid Chemical, Tremco and Carboline, similar to the current structure of what we are doing with Viapol in Brazil.

During FY17, we will be investing in expanding capacity at DAP, and expanding paint production at Rust-Oleum. So while markets and global economies remain choppy and unpredictable, we will continue to be focused on growth at RPM. We will now be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Frank Mitsch, Wells Fargo Securities.

Frank Mitsch - *Wells Fargo Securities - Analyst*

Nice end to the fiscal year.

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

Thank you.

Frank Mitsch - *Wells Fargo Securities - Analyst*

I think you mentioned during the prepared remarks that Kirker was a bit better in 2016 versus 2015. Can you tell us how it ended the year in Q4? And how confident are you in the projection of 2017, seeing that highly profitable business continue to grow?

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

Sure. Kirker was not better in 2016 than in 2015.

Frank Mitsch - *Wells Fargo Securities - Analyst*

Okay.

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

We have seen probably, prior to this quarter, six quarters sequentially of declining sales and earnings. In the fourth quarter, Synta had its first positive year-over-year results in about a year and a half, and we expect to see that trend continue in FY17.

Frank Mitsch - *Wells Fargo Securities - Analyst*

Okay, all right, that's helpful.

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

I'm sorry, I meant Kirker. Since it is in the same boat, since I mentioned it, as you know, Rust-Oleum wood deck product line, where we have had some challenges for the last few years. And we would expect to see contributions to sales and earnings in 2017 of that product line as well. Those were the two businesses that have posed the biggest challenges to us over the last 18 months.

Frank Mitsch - *Wells Fargo Securities - Analyst*

Yes, so that is why I was asking about it. So it looks like that has turned, so headwinds are now reversing into tailwinds. And you talked about the potential of a dividend increase. Can you talk about use of cash, how your M&A pipeline looks, and what can be our expectations there?

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

Sure. First of all, this was our best cash-generation year ever, and I think a combination of a focus on improvement in working capital, strong income, we did get another year of some tax benefit from the SPHC payments, so we are very focused on cash flow. You are seeing cash that was previously dedicated over a decade, in significant amounts annually, $80 million, $90 million associated with the past asbestos liability, now being reinvested more aggressively into growth. On a capital spending perspective, we are going to continue to see that trend improve, both in the capacity issues at a number of our businesses, and a more organic growth strategy particularly focused on the Asian markets.

Our M&A pipeline is good. We completed, I believe, six acquisitions in FY16, three of which were businesses where the management is going to stay and run that as part of RPM. The other three of which were product lines that we completely integrated. We are hopeful that we will have a similar result in 2017. And particularly on the product lines that we can integrate, while they are relatively small, the IRRs and the contributions to earnings are both high in terms of IRR, and come pretty quickly. So that program is in good shape.

Our board considers dividend action every year at its October board meeting. I'm highly certain that we will have our 43rd year of a dividend increase, but at this stage, would not get in front of our board in terms of what our activity would be there.

Frank Mitsch - *Wells Fargo Securities - Analyst*

Terrific. Thank you.

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

Thank you, Frank.

Operator

Ghansham Panjabi, Robert W Baird.

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

Hey, apart from maybe the first quarter, you have tough comps in consumer fall in a very strong FY16. How should we think about the various drivers for that business, Frank, in 2017? And also, how much of the 4% to 6% growth in consumer is from acquisition?

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

Very little of the growth will be from acquisitions, as we think of it now. We had some product line acquisitions last year. The beauty of product-line acquisitions in our consumer segment is, is that our very strong distribution, and our real strong salesforces can accelerate some of that growth.

And so while there won't be a big contribution necessarily in terms of how we count acquisition activity, our ability to expand that growth of product lines in the future, which will be counted as core growth, certainly will be important, and you will see more of that. In general, I think FY17, relative to very strong comps, will be what we called out, a mid-single-digit growth, as we continue to serve a pretty solid marketplace and hang on to the new product introductions and gains that we achieved in 2016.

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

Okay. And then some further color on the legal settlements, the deck coatings. What does that specifically refer to? Is it a warranty item? Or whatever else you can share with that, on that topic.

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

Yes, I mentioned on an earlier question, Synta, and I think it is no surprise -- typically, we would not identify specifics around product lines or smaller companies like we have with Synta, and also with Kirker. But in both cases, we had acquisition structures that had potential earn-outs, and we've had those earn-out reversals.

So in the case of Cinta, we had an earn-out reversal a year ago, indicating that the business was not performing up to the projection that we had in the acquisition model. So we structured it in a manner that give us some flexibility. And there were some real issues with our product lines that were resolved this year related to surface prep and a couple of other items. All of those have been corrected.

And a product line that grew very strongly in its first year because of the strong Rust-Oleum sales, marketing and distribution -- declined significantly. We had that year-over-year last year earn-out reversal gain, and this year, the warranty settlement. And we would expect those deck coating product lines to be not big, but solid contributors again to sales and earnings growth, as opposed to the significant contributors to declines in sales, earnings and in this case, a product warranty expense that puts that issue behind us.

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

Okay. And then just one final one on your comment on Brexit. How are volumes tracking in Europe thus far in the quarter? I know it's very early, but I was just looking for incremental color there. Thanks so much.

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

Sure. On Brexit, literally, our fiscal year ended, and as we planned for the new fiscal year and how to communicate it, the Brexit vote occurred. And the immediate impact was a significant decline in the pound at dollar ratio. So in relationship to our pretty strong presence in the UK and revenues in pounds, literally starting the year, unless the pound changes for better or for worse, we will lose somewhere in the neighborhood of $0.05 or $0.06 per share on our pound-based business, relative to that pretty dramatic change that occurred. So we communicated that here.

I would say that in the fiscal year, we lost over $200 million in revenues and more than $0.20 a share due to FX transactional and translational impacts. And as you'll recall, this time last year, our forecasted FX would negatively impact us by $0.07. So I think that further highlights the strength of the underlying business contributions that our businesses created and generated throughout the year.

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

Thanks so much.

Operator

Vincent Andrews, Morgan Stanley.

Matt Gingrich - *Morgan Stanley - Analyst*

This is Matt Gingrich on for Vincent. I was wondering if you could comment on the delta between sell-in and sell-through trends in the quarter?

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

I do not have specifics on that data, so I would be speculating. I think that in general, consumer takeaway has been pretty solid, and that has been building throughout the year. It was not true in the first quarter of last year. And it's pretty solid. It has returned to kind of normal levels. So traditionally, our consumer businesses in normal times would grow at mid-single-digits, and that is what we expect this year.

Matt Gingrich - *Morgan Stanley - Analyst*

And then in regards to industrial, has the oil-related weakness gotten sequentially worse, or should we expect some incremental easing as you lap the year-over-year comps?

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

It has gotten sequentially worse, and we're presuming it is going to stay that way for all of FY17. We actually had probably better performance than we anticipated in the first quarter or first four or five months of FY16. And as we approach this first quarter, it's very weak.

What you had was the hang-on of projects that were halfway completed, and they were going to get finished. But the new project pipeline, if you will, into oil and gas exploration and fracking, has dried up. And that will be a negative impact for those of our businesses that serve the oil and gas markets throughout 2017.

Matt Gingrich - *Morgan Stanley - Analyst*

Great. Thanks, guys.

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

Thank you.

Operator

Ivan Marcuse, KeyBanc Capital.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Looking at the industrial side within the US, the Euclid Chemical business and Tremco waterproofing. I imagine a lot of that -- it was above average growth in the US. I was just curious if -- you know, what kind of growth rates have you seen in those businesses in the fourth quarter, and would serve your expectation looking out to 2017?

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

So we're seeing, in construction-related products, particularly in North America, high-single-digit growth, and it is leveraging to the bottom line very nicely. We think that will mitigate a little bit in FY17, but it still should be very solid growth. Some of that has been driven by economic activity, and I think a lot of that has been driven by expansion of new product. And so whether it is the AlphaGuard roofing product or the Tuf-Strand macrofibers, in both cases, part of our challenge is, we're having capacity catch up with demand, and that is still an issue for us.

One of the things we plan for continued investment, for instance, in FY17, is an investment in Brazil to the able to produce the Tuf-Strand fibers in the Brazilian market. This year, we were exporting them from the US., and there's challenges both from a cost perspective and a transactional FX perspective there. But our goal was to get the product in the market, create some acceptance and demand, and now we're going to move production, in the new fiscal year, down to Brazil. That is just one example of where we're headed with some of these product lines.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Got you. And staying in the industrial side, how big in terms of sales is the UK? And is it all industrial, or is there a little bit in consumer?

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

I would take a -- I'm not sure I know that number. It's hundreds of millions of dollars, and it is split between industrial and consumer probably 50/50. But I don't have the specifics on that.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Okay. And then moving over to consumer real quick, your consumer sales, at least for the fourth quarter, were significantly above where some of your other public competitors have reported in that DIY market. How much is the market? Was it all market share gains for you in terms of there? Because the market looked like it grew maybe 1% to 2%. So is the delta to your 10%, is that pretty much market gains? And what product did you really see a big boost from? And was there any load-ins in the fourth quarter to think about?

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

Yes, it's a great question. So some of it is market share gains, and some of it is -- so should not be indicative of a rate that we can sustain in 2017. Again, that is why we have outlined mid-single-digit growth, and that is where it will be. But we have picked up market share significantly in interior wood stains with our Varathane product line, versus their largest competitor, in a number of major retailers.

We have picked up a share with a number of DAP products, including a new carded adhesive product. We're going to be adding to capacity for both DAP and Rust-Oleum in paint production in the new fiscal year. So that would give you sense that we've got pretty good demand there. We also had a very orderly transition from the president of DAP, who did a phenomenal job for us for 20 years, to a new president who has brought in a different approach to sales and marketing at DAP. And that is going extraordinarily well.

So we've got a lot of good momentum, both in terms of our approach to the market, and in particular, new product introductions. So while it translates to better sales, and I suppose market share gains, it is not just replacing a competitor with a like product by an RPM company, but typically new products in new categories for us. So we are pretty excited about that.

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

Great. And then the last two real quick questions, probably for Rusty. What are you expecting in total for the corporate expense line for the year 2017? And how to think about the tax rate? Thanks.

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

Yes, sure, Ivan. In terms of the tax rate -- I will take that first -- we were at 26% or so in FY16. Same in FY15, if you look at our adjusted numbers. So we would expect it to be in the same range in FY17. And then, as far as the corporate expense goes, in FY16 we averaged a little over $18 million a quarter. And that's going to go up because of higher pension expense.

And our healthcare experience was pretty good in 2016. I'm not sure we can expect that to continue. So for that reason, I would expect our corporate expense to be in the $20 million, $21 million range each quarter. Does that answer your question?

Ivan Marcuse - *KeyBanc Capital Markets - Analyst*

It does. Thank you very much.

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

Sure.

Operator

Silka Kueck, JPMorgan.

Silka Kueck - *JPMorgan - Analyst*

I was wondering if you can talk about how big the European business is for the consumer side? And what just did well on the consumer side in Europe?

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

In general, our European business is just over $900 million. It was, a few years ago, over $1 billion. And while we continue to advance in local currencies and have good growth in units, the translational impact of the rising dollar has reduced that. And it pretty much mirrors RPM's mix between consumer and industrial. I would say it is roughly about a third, maybe a little bit less, consumer; and two thirds, probably a little bit more, industrial.

So it is probably a little more industrial and a little less consumer than what RPM is on a consolidated basis. The consumer products tend to be split between the UK market, which is their biggest sector by far, and then a presence in the Benelux and in France. We're looking to expand into the continent more aggressively. But the consumer piece is most predominantly UK, and that is the area that is negatively impacting us, versus translational and transactional impacts, with the drop of the British pound.

And we continue to do fairly well in the quarter. We were up 5% in Europe in actual rates, and 6% in local currencies. And as Rusty commented on, the euro has been relatively stable. It has been pretty much the British pound that has caused us challenges this year.

Silka Kueck - *JPMorgan - Analyst*

Okay. So it sounds like, in both cases, UK is maybe half of the European sales, something like that?

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

No, I don't think that is correct. I think, again, if you think of -- these are rough numbers -- but if you think a consumer of about 30% in Europe, out of that $900 million to $1 billion of total revenues. In industrial, 70%. And then better than half the consumer piece is in the UK. Whereas the industrial piece is split pretty evenly across all of Europe -- UK, Germany, France, southern Europe and a little bit in eastern Europe.

Silka Kueck - *JPMorgan - Analyst*

Okay, I understand. Thank you for clarifying that. I also had a question on the specialty side. The incremental margins for the specialty businesses seem really high -- which is nice to see. The sales were up $10 million. The profits were up $5 million. What is behind that? And are those sustainable margins, or are those were particularly good for some reason?

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

I think the margins are sustainable. Those businesses are called specialty for a reason, and the reason is, they typically do not fit in terms of product categories or markets or customers that fall into our consumer segment businesses, our industrial segment businesses. But they also tend to be higher-margin niche businesses. So the growth rates tend to be a little bit more challenging, but the margins are nice. And so when you get growth, it leverages to the bottom line.

It is also where -- in the lower-margin piece of specialty is where we have our OEM coatings -- so powder coatings, wood coatings. We had an excellent acquisition in the wood finishes area of Morrells last year, and that contributed nicely to the EBIT growth. Very typical family-owned company that joined RPM, a management team that stayed that was really chomping at the bit to get more capital to grow, and they had a really good first year as part of our Wood Finishes Group in RPM. That contributed to the EBIT growth as well.

Silka Kueck - *JPMorgan - Analyst*

Okay, thank you. And lastly, I was wondering if you could tell us what the tax benefit was from the SPHC payments in 2016, and what you expect for maybe 2017?

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

Yes, we were able to, on the tax front, to collect a big tax refund on an NOL carryback in FY16. And we will continue to get deductions on future trust payments. As we look forward, we have another trust payment due in December of this calendar year.

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

Year over year, though, I think, Silka, we had a similar tax benefit last year in FY15. So you look at the cash from operations year-over-year improvement of about $130 million, and that was income and operational more than the SPHC tax shield, because we had it in the prior year as well.

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

That's correct, yes.

Silka Kueck - *JPMorgan - Analyst*

Where exactly does it show up on your cash flow statement? Is it just -- it's just like a change to your deferred income, your deferred tax line?

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

Yes, first of all, if you go to the deferred taxes line on the cash flow statement, you can see in the prior year, we had a big $97 million change. And then in the current year, in FY16, that amount would show up -- looking for it now. Or -- I apologize -- I can follow up offline. I was just -- only if you had it readily available, but that is okay.

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

Yes, I think the deferred tax line last year, the big item was related to the non-cash charge we took. We will find out and clarify exactly where that is. But as you know, the SPHC payments are tax-deductible, and so we have gotten the benefit of that -- if you want to call it a benefit. And we have three more of those payments at much smaller rates in the coming years.

Silka Kueck - *JPMorgan - Analyst*

Okay, thank you very much.

Operator

(Operator Instructions)

Arun Viswanathan, RBC Capital Markets.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Good quarter. I wanted to understand just some of the puts and the takes in the guidance. Would you characterize -- would you say that there's a little bit more conservatism built in on the industrial side than the consumer side going forward? And is that mainly due to markets and the international exposure, or is it of a comp nature?

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

I think there's really no conservatism in terms of our outlook. And on the industrial side, we will be staring at difficult comps, particularly in oil and gas and heavy manufacturing, in the early part of 2017. As I mentioned, with our Carboline product lines and other Carbolines that serve the oil and gas markets, we were still benefiting from work on projects that were committed to and in process even as oil dropped. And that has dried up. So that is going to be a very difficult market for us globally, and anybody that serves that market with any products.

And heavy industry, which is a big driver of a lot of our industrial coatings, fireproofing, flooring products, in terms of maintenance and expansion is in what seems like it's third of a pretty significant recession, and we don't see that changing. So the industrial markets that we serve will be challenging. We continue to focus on investing for growth, and we also continue to look for ways to improve our SG&A spend, so what growth we have will be nicely leveraged to our bottom line.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay, that's helpful. And then on the M&A side, maybe you can discuss the environment a little bit? I guess, has there been any change in either multiples or what you are seeing post the situation with Sherwin and Valspar, now that they are supporting cash for their merger in anticipation of closing that in the next year?

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

Yes, we have not seen much change. There are still a robust pipeline of M&A opportunities in the small- to medium-sized market. Valuations are consistent with what they have been historically. And the Valspar SW merger has certainly significant valuation to it, and I think that impacts large transactions and public company valuations.

But we've got a nice pipeline. Just like in 2016, I would expect in 2017, that we would be able to complete a handful of small- to medium-sized deals. And particularly on the product lines, where we can leverage growth pretty quickly. It is fun to have a $10 million or $20 million or $50 million product line that can add pennies per share to the whole total, and we keep looking for those.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay, thanks.

Operator

Kevin Hocevar, Northcoast Research.

Kevin Hocevar - *Northcoast Research - Analyst*

Wondering if you can talk about -- a few of your competitors called out destocking at a large retail customer. So wondering if you saw any of that during the quarter, or maybe after the quarter ended? Or did you not see that at all?

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

I think we have seen a little focus on working capital performance or inventory at some of our major customers here as we get into the new fiscal year. So we did not see it, obviously, in the fourth quarter. We had good unit volume there. So we're seeing a little bit of it as we start the new fiscal year. I think on a full-year basis, it does not concern us, because there's pretty solid consumer takeaway in our categories.

Kevin Hocevar - *Northcoast Research - Analyst*

Got you, okay. And then from a big picture, I know you talked about earlier how Europe had done to the first two months of the quarter. Wondering if you could give a big picture how business overall is doing, with us being two months into the current quarter? If you are seeing trends -- how you guided them, mid-single-digit growth in specialty and consumer, and lower in industrial? Or if you are seeing any larger variations, I guess, from there, as we start this year?

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

Sure. We're off to a solid start to the fiscal year. There is some of the items that you mentioned that I think are just temporary, relative to the consumer segment in Q1. It will be a challenging quarter for industrial, because we had pretty solid business, particularly in areas like oil and gas, a year ago in the first quarter, that just are not going to be repeated. So it will be -- it is a rough economy. It has not changed any from the last year.

We're focused on growth, investing, gaining share and introducing new products. And particularly on the new product piece, I think that is what is driving a lot of our growth. But the dynamics in heavy industry, oil and gas, and regional economies really hasn't changed. So we would expect another year of putting our head down, expanding some of the successful new product ranges that we have had, and continuing to fight and gain market share.

Kevin Hocevar - *Northcoast Research - Analyst*

Okay. And then wondering if -- you talked about, after you adjust the base this year, growing sales mid-single-digits and leveraging that 10% to 12% in terms of earnings. And I noticed your gross margins were really great, saw great expansion here this quarter. So wondering if that leverage to earnings is going to come from the volume growth in leveraging SG&A, or you also see gross margin expansion for XYZ reason? Wondering where that leverage is going to come from to earnings in 2017?

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

Sure. I think, related to the comments I just made, we had good gross margin performance in the quarter. We don't see a lot of expansion there for the balance of the year, in general, across our businesses. We continue to look for opportunities, both through leveraging higher sales, and also some opportunities for driving efficiency across some of our operations and across some manufacturing, a few opportunities for that continue in Europe. So the real focus on growth that we have is working. And in this environment -- and I think our fourth quarter proves it -- if you can drive growth, you can leverage it very nicely to the bottom line.

And so that is why we are so intent on keeping a growth footing. It's working, even in places that is as challenged as Brazil. And I think that's the real fight in our markets, which is how and who can generate growth. Because the dynamics otherwise are pretty good for being able to leverage that to your bottom line.

But it is a struggle out there, and that is not new. It has been that way for at least the last year and a half, and we're going to keep fighting and figuring out how to grow the businesses. So you've got to really look at our revenue growth. If we were at the bottom end of our range on the sales side, we will be at the bottom end of our range on the earnings side. If we are at the upper end of our range on the sales side, we will be at or better than the upper end of our range on the earnings side.

So I really do think this year, for everybody in our industry, it's going to be one of who is growing and who is able to get the growth. Because the dynamics for leveraging into the bottom line remain pretty good.

Kevin Hocevar - *Northcoast Research - Analyst*

Okay. And then just last question. Curious what you saw out of raw materials in the quarter. Is that still a good guide for you guys? Being on FIFO accounting, do you expect if it is a good guide, a to carry forward into the 2017?

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

Sure. I think that the FIFO accounting is one of the reasons our gross margin improvement showed up perhaps a few quarters later than some of our industry peers. Today, raw materials are relatively stable. There are a couple of raw materials -- TiO_2, which, we are not as big a buyer of as some of the more pure paint players. Those suppliers are trying to put through price increases. So you are seeing some, I guess, stability in raw materials, is how I would characterize the environment as we finish the year and as we think about 2017.

Kevin Hocevar - *Northcoast Research - Analyst*

Okay, great. Thank you very much.

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

Excellent. Thank you.

Operator

David Stratton, Great Lakes Review.

David Stratton - *Great Lakes Review - Analyst*

A lot of the topics have been talked about already. But I was wondering about -- in your product lines you've touted throughout the year -- specifically AlphaGuard, RoofTec, Tuf-Strand, NeverWet -- how did those perform? Are they meeting expectations going into FY17? And are there any new products that might be added to the list, that have some great prospects?

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

Sure. Thanks for the call. The product lines -- historically, we have had a chance to talk a lot about consumer product lines. And both Rust-Oleum and DAP have been very innovative. But this past year was really a story of sales gains from new product introduction and innovation in our Industrial segment. We continue to be able to sell all of the macrofibers we can make. And as I commented earlier, we're looking to expand capacity now outside of the US.

The AlphaGuard is a proprietary -- a modified urethane coating system. Very exciting for our Tremco roofing business. With that product range and our ability to clean roofs through the RoofTec business, we were able to get the re-coating of Ford Field. We're looking at some similar large-sized, large-scale projects there. And that's a product range that, so far, is pretty much being produced and sold in North America. So there's opportunities for us to expand production, and therefore, capabilities and sales ability outside of the US. So those are good, and we continue to focus on those.

I think the other real story -- and this is why it's an issue of market share gains -- with few exceptions, we don't have market shares globally that should be impacted hugely by GDP growth. Obviously GDP growth impacts all businesses, but our ability to expand Euclid Chemical on the back of existing Flowcrete plants in the Middle East, in India, in Malaysia, is pretty exciting.

So it is not necessarily new products and construction chemicals that are growing those areas internationally. It is the fact that we're starting to manufacture those locally, and can be much more competitive in terms of both price and service. So those are, broadly speaking, I think the areas where we are trying to drive growth in our industrial segment, in what is otherwise a choppy market.

David Stratton - *Great Lakes Review - Analyst*

All right. And then the most recent acquisition, very small, having to do with expansion joints and things like that. Is that in any way related to the recent -- I guess it's almost a year old now, though -- infrastructure build? And how is that playing out and affecting your business? Are you able to see any direct correlations there?

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

It is too soon to say about an acquisition that is not a month old. But our USL business and their product lines for expansion joints for bridges and roadway works in the UK, is very successful business, somewhat cyclical to government spending. And the business that we just acquired in North Carolina is very akin to that. So there's opportunities to share know-how and technology between what we're doing in the UK and parts of the Middle East, and what the API/MAI business, which is headquartered in North Carolina, can do in the US. A lot of growth opportunities there, and so we're very excited about it in general.

I don't know that the highway bill is impacting us in any big way. I can tell you to the extent that it is driving protective coatings in the corrosion control and protected coatings industry, marginalize is very challenged. Because the players in that market also serve marine and oil and gas. And people are very aggressively bidding on big projects like that, because of what little growth there is globally in some of the heavier industry and oil and gas markets.

The other acquisition we did, I think since year-end, is the Duram acquisition, which is a small manufacturer in Australia for Tremco. Again, very exciting for us, even though it is a small deal. Tremco has been exporting high single-millions of business in the Australia market, and this will allow us to produce those products locally, which will significantly add to price, margin and service.

David Stratton - *Great Lakes Review - Analyst*

All right, thank you very much.

Operator

Richard O'Reilly, Revere Associates.

Richard O'Reilly - *Revere Associates - Analyst*

Two quick questions. The first, I want to follow up on your comments about the energy sales. I thought you said sales were -- oil and gas sales were down about 10% in FY16. Was that correct?

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

That is correct, and we will see that or worse in FY17.

Richard O'Reilly - *Revere Associates - Analyst*

Yes, that is my follow-up question. It sounds like a significant drop-off from that level in 2017 then?

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

I think that is correct. So as you think about our Industrial segment throughout the year, we will have more difficult comps in the first quarter and in the first half of the year, and then they will be, I think, equalized. Because we have really been experiencing the trial of those market challenges in the last half of 2016.

Richard O'Reilly - *Revere Associates - Analyst*

Okay, fine. Second question is, the legal settlement in the consumer business related to the deck coatings -- can you go into that? It sounds like it is a consumer class action. Can you go into a little bit about that? Because you have been pushing a new product in the last couple of years for deck coatings.

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

That is correct, and that is what it is. It was negotiated to resolve those issues. In fact, with the Restore product line, when it was first introduced, I think the timing of the introduction in the fall was difficult, relative to freeze-thaw cycles. It is an acrylic product, so if you put on in the day and you've got freezing temperatures at night, you're going to have problems. It was surface preparation-dependent.

And we have addressed all of those issues. We have re-launched the product line. There's a series of different products there. And we're very comfortable with where the product is in its performance, and so we're in good shape there going forward. But it was a painful year in that product range, relative to a significant decline in sales, that impact on earnings, and then resolving what up until then had been warranty payments, with a class settlement.

Richard O'Reilly - *Revere Associates - Analyst*

Okay. So it was a consumer class, okay. I guess I should file my claim soon then. Okay, thanks a lot. Bye-bye.

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

Thank you.

Operator

We have no further questions at this time, so I would like to turn the call back over to Frank Sullivan for closing remarks.

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

We are proud of our great entrepreneurial businesses that continue to compete and win in their respective markets, and continue to execute on finding growth throughout the world in these challenging markets. I would like to thank the more than 13,000 employees around the world for their continued efforts and dedication to RPM, and for delivering another record year of sales and earnings. And thank all of our investors for their investment in RPM, and for you for joining us on today's call. We look forward to updating you on our progress throughout FY17, for what we expect to be another year of record results. Thank you and have a great day.

Operator

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