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RPM - Q2 2017 RPM International Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 consolidated net sales of \$1.19b, adjusted net income of \$70.5m, and adjusted EPS of \$0.52. Expects FY17 as-adjusted EPS to be \$2.62-2.72.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome to RPM International's conference call for the FY17 second 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 and CEO*

Thank you, Hilda. Good morning and welcome to the RPM International Inc. investor call for our FY17 second quarter ended November 30, 2016. On the call with me today are Rusty Gordon, RPM's Vice President and Chief Financial Officer; and Barry Slifstein, our Vice President of Investor Relations. Today we'll discuss our second-quarter results, provide comments on the outlook for the balance of our FY17, and answer your questions.



During the FY17, we experienced a number of negative trends related to our Kirker fingernail enamel business. During the fiscal second quarter, overall market declines and a loss of market share resulted in a downward revision of our long-term forecast for the business.

After a thorough analysis, we determined that an impairment charge of approximately \$188 million was appropriate, and took this charge for the quarter. In addition we incurred a \$12.3 million charge related to the decision to close the Flowcrete polymer flooring business in the Middle East. Aside from these items, in general, our sales are holding up well in light of economic conditions and in comparison to our peers.

In our consumer segment businesses, excluding the significantly underperforming Kirker fingernail polish business, our core growth was up 6.4% for the quarter, that's organic growth. As indicated earlier this year, capacity constraints and related manufacturing costs at our DAP business negatively impacted what otherwise should have been good leverage to the bottom line in our consumer segment.

Our specialty products businesses are continuing their strong performance, with sales growth up 5.7% in the second quarter. While our industrial segment increased modestly, we continue to see mid-single-digit growth in our businesses serving the US construction chemical markets and in the quarter, and 6% growth in local currencies in Europe.

We are undertaking some cost-cutting measures, including the closure of a couple of underperforming business units. One of the key performance measures that we have used at RPM for more than a decade is CANE, capital adjusted net earnings.

We're taking steps through cost cutting this year and where necessary, starting with the Flowcrete Middle East business unit, the closure of CANE-negative businesses. We anticipate an additional closure of a European business unit in the third quarter of a similar size and impact as the Flowcrete Middle East business. The combination of these closures and expense cuts will significantly improve our cost structure and earnings for our FY18.

In the third quarter, we announced four acquisitions in conjunction with four different RPM operating companies. On an annualized basis, these acquisitions will add approximately \$160 million in revenues. While transaction costs will negatively impact our third quarter, these acquisitions will be accretive to earnings in our 2017 fourth quarter and in our FY18.

While sales for the FY17 will reach record levels, it is clear that as a result of restructuring costs, M&A transaction costs, and the Kirker impairment charge, FY17 earnings will be below the prior year. Our continuing sales growth momentum, complemented by the 2017 expense reduction actions and the so-far-completed 2017 M&A transactions, position RPM for strong FY18 performance to record levels of sales and earnings.

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

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

Thanks, Frank, and good morning, everyone. I will review the results of operations for our FY17 second quarter, then cover some November 30, 2016 balance sheet and cash flow items, before turning the call over to Rusty, who will discuss the outlook for the balance of FY17.

Second-quarter consolidated net sales of \$1.19 billion increased 3% from last year. Organic sales increased 3.8%, acquisition growth added 1.7%, and foreign currency translation reduced sales by 2.5%.

Industrial segment sales increased 1.6% quarter over quarter to \$633.4 million. Organic sales increased 2.2%, acquisition growth added 2.2%, and foreign currency translation reduced sales by 2.8%.

Consumer segment sales increased 4.1% to \$373.8 million. Organic sales increased 5.8%, acquisition growth added 0.6%, and foreign currency translation reduced sales by 2.3%.

Specialty segment sales increased 5.7% to \$183.6 million from \$173.6 million. Organic sales increased 5.2%, acquisition growth added 2.5%, and foreign currency translation reduced sales by 2%.

Consolidated gross profit increased 5.6% to \$521.7 million from \$493.9 million last year. As a percentage of net sales, gross profit increased from 42.7% last year to 43.8% this year, representing a 110-basis-point improvement. Contributing to the improvement was lower manufacturing costs and supply chain improvements.

Consolidated SG&A increased 19% to \$419.5 million from \$352.6 million last year. The increase was largely driven by the Flowcrete exit charge of roughly \$12 million in this year and the Kirker earn-out reversal of \$14.5 million last year that lowered SG&A. Also contributing to the increase were higher employee costs, specifically pension, healthcare, and compensation; acquisition costs relating to the recently announced acquisitions; outside professional fees; and increased investments in advertising and promotional activities in the consumer segment.

The following comments on earnings are adjusted amounts and exclude the current-quarter Kirker impairment charge, the Flowcrete exit charge, and last year's Kirker earn-out reversal. Consolidated earnings before interest and taxes, EBIT, adjusted EBIT decreased 10.2% to \$114.2 million from \$127.1 million last year due to higher overall SG&A expenses.

Industrial segment EBIT was down 1.7% to \$64.5 million from \$65.6 million last year due to unfavorable mix. Consumer segment EBIT decreased 6.2% to \$47.7 million from \$50.9 million last year. The decline was primarily attributable to higher investments in advertising and promotional activities, and poor conversion of sales to EBIT in our caulks and sealants division. Excluding Kirker's results from both years, consumer segment EBIT improved slightly year over year.

Specialty segment EBIT increased 10.6% to \$31 million from \$28.1 million last year. Corporate other expenses of \$29 million compared to \$17.4 million last year. The increase is predominantly attributable to \$6.9 million in higher employee benefits, pension, and healthcare; \$2.6 million in higher professional fees; and \$1.5 million in higher acquisition expenses.

Net income, adjusted net income of \$70.5 million decreased 4.9% from last year's \$74.2 million. Current quarter adjusted EPS of \$0.52 per share compares to adjusted EPS last year of \$0.55 per share.

Now a quick look at the cash flows and capital structure. Cash provided by operating activities was \$158.7 million this year compared to \$167.1 million last year. The reduction was principally attributable to higher payouts of compensation and benefits. As of November 30, 2016, total debt was \$1.64 billion, which was slightly below last year's debt level of \$1.66 billion. With that, I'll turn the call over to Rusty.

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

Thank you, Barry. I'd like to cover our FY17 outlook. Clearly, the second quarter was a tough quarter, but as Barry and Frank mentioned, we have made some recent accomplishments that will make the future better for RPM.

First of all, we're investing in our brands with advertising support, plant capacity expansion. This should allow RPM's good organic revenue growth to continue in the future.

Number two, as you can tell recently, we've had a flurry of deal activity. I'm pleased to say that all six of RPM's group presidents have done acquisitions so far this year, and the most recent deals are nice fold-in product line acquisitions that should help us on the bottom line.

Number three, we are addressing our expense base. We are closing unprofitable businesses or facilities such as Flowcrete Middle East, as well as the European facility in the third quarter that Frank mentioned earlier.

However, in spite of all these positives, this won't help us much in Q3 of this year. In the third quarter, the big problem is that the bar is high when we compare to the prior year. Last year in the third quarter of FY16, our EBIT was up 23% versus the prior year. We had a mild winter last year that seems unlikely to repeat this year.

Also, as Frank mentioned, the recent deals, while they're very good for our future, will actually hurt our Q3 earnings per share. For example, we'll incur higher professional fees associated with these acquisitions. We'll also incur inventory step-up charges on the first turn of inventory for these acquisitions. Also, as you can see in our press release, we're expecting a \$0.05 per share approximate charge in Europe for restructuring.

On the other hand, when we get to the fourth quarter this year, we are anticipating a strong quarter. Spring is our seasonal peak for RPM sales, and we're going to enter this fourth quarter with the capacity issues resolved, especially at DAP. And we are expecting accretion from our recently announced acquisitions.

So what does this mean for the second half of FY17 and our year in total? Well, I'll address that question individually for each segment. First in the consumer segment, we're continuing to build market share and our consumer takeaway is very good. We have very favorable POS data coming in.

Also in consumer, we've done two nice acquisitions, first SPS in Europe, which will allow Rust-Oleum to leverage SPS's manufacturing and distribution base, in continental Europe where Rust-Oleum is really picking up a lot of home center accounts with their consumer product line. Touch 'N Foam as well, we expect a meaningful contribution starting in the fourth quarter.

It's a nice fit for DAP. It strengthens DAP and a lot of channels outside their core hardware base, such as insulation, distribution channels, industrial channels, construction supply channels. So that will be a positive for DAP.

On the negative side, Kirker we're expecting to fall well short of our original expectations this year. So to sum it up for consumer, we're maintaining our sales guidance with growth in the mid-single-digit range in the second half of FY17.

Now, moving to the industrial segment, we expect continued growth in our businesses serving the US construction markets. There's been an uptick recently in business optimism, and we expect that to result in more investment spending.

Moving to the UK and local currency, we were encouraged in the second quarter by the sequential improvement we saw in their sales growth versus the first quarter. But on the negative side, the foreign exchange headwinds have increased, especially with the recent strengthening of the US dollar versus the pound, and also the euro recently. And as many of you know, foreign exchange rates are a big issue for our industrial segment and half of their business is outside the United States.

The energy sector we have not seen any uptick there. Despite the recent normalization of oil prices, maintenance spending continues to be down. So to sum it up for industrial, we're maintaining our sales guidance in the low single-digit range for the second half of FY17. And that guidance includes recent acquisitions.

Moving to the specialty segment, we continue to have a nice balance of organic and acquisition growth. That will be enhanced by the acquisition we announced yesterday of Prochem by our Legend Brands Company. Legend Brands is building a leadership position in the restoration and professional cleaning markets, and Prochem will certainly take us a long way towards that goal. So in summary for specialty, we're maintaining our expectations for sales growth in the mid-single-digit range in the second half.

So to wrap it up, we are updating our guidance today. Our original guidance that we gave in July was for EPS of \$2.68 to \$2.78 a share. Now that included unfavorable FX translation year over year of \$0.06 a share, as well as additional pension expense of \$0.05 a share. Now we're updating it due to, first of all, the further strengthening of the US dollar, especially against the pound and the euro. And what we thought would be \$0.06 of unfavorable FX translation will now be \$0.10.

Second thing that's changed is we've updated our pension estimates from actuaries. Our pension expense was originally expected to be \$0.05 a share, and now with the updated estimates, we expect it to be \$0.07. So, as you can see in the press release, these two items have reduced our original guidance down from \$2.68 to \$2.78 a share, down to \$2.62 to \$2.72 on an as-adjusted basis.



So while we're excited about the recent flurry of acquisitions, they'll only be nominally accretive to our second half. We'll see accretion in the fourth quarter, as Frank mentioned, which will be largely offset by an earnings reduction in the third quarter. So now, we'll be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Frank Mitsch from Wells Fargo is online with a question. Please go ahead.

Frank Mitsch - Wells Fargo Securities, LLC - Analyst

Hi, good morning, gentlemen. Interestingly, you're lowering your full-year guidance by \$0.06, which obviously, you just explained was due the FX and pension. Yet, Kirker is coming in much lower than you originally expected.

I have a few questions regarding Kirker. A, if you could break out that \$188 million adjustment, seems like a large number. What all goes into that?

B, what are your expectations now for that business? Is it a candidate for disposal? Where does it fit on the CANE access?

And C, how -- given that it's coming in less than expected, how are you making it up, given that you're keeping your guidance essentially flat?

Frank Sullivan - RPM International Inc. - Chairman and CEO

Sure, so as we had communicated when we acquired Kirker, we expected in the first full year that revenues would be about \$100 million. We also communicated that Kirker had a margin profile that was higher than RPM's average, and their cost structure is relatively fixed. And so, when you have a business that has a fixed cost structure and a very solid revenue base of \$100 million and makes a lot of money, and when that revenue base is cut by more than half, and you've got a fixed cost structure, it makes a lot less money.

We have written off a substantial portion of the goodwill and intangibles on that business. The deterioration in that business really accelerated recently, and it was as a result of about a 15% to 20% decline in the overall market. And some actions that were taken at Kirker in relationship to that, and in relationship to their customer base and supply chain, which did not work out. So they lost further market share and some key customers.

We've made some changes at the sales and marketing leadership there. And I think their results have relatively bottomed out in terms of where sales and earnings are as we get through this fiscal year.

I think the strong thing, and I'll answer this big picture, is when you look at the underlying strength of RPM, first in consumer. As I mentioned in my comments, our core consumer businesses of caulks and sealants, patch and repair products, small project paint, primers, the DAP and Zinsser and Rust-Oleum brands, we were up more than 6% on an organic basis in comparison to the recent results of our peers. We're real happy with that. We continue to see the benefits of market share gains there.

And the challenge that we communicated earlier on DAP was around what was a pretty extraordinary growth last year that has continued this year that caused some capacity constraints. And so we had [toll] manufacturing issues, some SG&A issues, all of which have been resolved. And so you'll see better leverage to the bottom line out of our core consumer business that will make up for the shortfall of Kirker in the second half of the year.



Frank Mitsch - Wells Fargo Securities, LLC - Analyst

That's very helpful. And just coming back to Kirker, you've got two things going on there it seems. A, you've lost market share in the polish business, and B, obviously the industry is shifting against you.

What gives you the confidence that business has actually bottomed and that you might -- and the second part where the market is shifting away from polish will not continue? What gives you the confidence that we have, in fact, bottomed here?

Frank Sullivan - RPM International Inc. - Chairman and CEO

I think we've seen some orders from some customers that had been lost that are returning in modest ways. And we have been working on some substantial new relationships that are still developing and will be positive for the future, but are developing a little bit more slowly than we had anticipated when the year started.

Frank Mitsch - Wells Fargo Securities, LLC - Analyst

Alright, that's helpful. And then lastly, you guys also referenced a higher consumer spend in advertising weighing on results. When -- any chance you can give us an order of magnitude and when you think that flips, and you see the fruits of those spending?

Frank Sullivan - RPM International Inc. - Chairman and CEO

Well, I think we're seeing the fruits of those spending now when you look at our organic growth, particularly versus the recent revenue growth. It's in some cases flat, and other cases down at our peer companies. We are working hard, and quite candidly, I think we've got the right balance, as we sit here, between supporting revenue growth across many RPM companies, not just consumer, while at the same time, appropriately tackling costs.

You'll see better leverage in the fourth quarter out of consumer, principally because we've addressed some capacity issues there that have been a drag on what otherwise has been very solid results. And we're continuing to have a forward investment mentality in our specialty businesses and many, not all, but many of our industrial businesses.

So, throughout a challenging year, we've been working to get the balance between supporting and driving sales growth, which is working and tackling costs, which we think will bode very well for the coming fiscal year.

Frank Mitsch - Wells Fargo Securities, LLC - Analyst

That's helpful. Thank you.

Operator

Thank you. The next question comes from Steve Byrne from Bank of America Merrill Lynch.

Frank Sullivan - RPM International Inc. - Chairman and CEO

Morning.

Ian Bennett - BofA Merrill Lynch - Analyst

Good morning. Hi, this is Ian Bennett on here for Steve. Just to follow up on some of the items that were called out, with the increased SG&A spending, particularly in consumer, can you talk about what that marketing is going towards and what type of sales growth we could expect from some of that spend?

Frank Sullivan - RPM International Inc. - Chairman and CEO

Again, in the quarter, when you look at our peers who reported flat or down results in their comparable divisions versus our consumer segment or our organic growth, excluding Kirker, was up [6.4%] (corrected by company after the call). That's pretty good volume relative to what people are seeing in our market. We are picking up share in some wood stains and finishes category, and small project paint in a major discount retailer, and just the introduction of new products, so it's been a pretty solid story.

Our DAP business experienced double-digit organic growth last year. We have been somewhat inhibited by capacity issues in the first half, and we have addressed those in a manner that will eliminate that capacity constraint in the second half. That both hampered revenue growth to a certain extent, but more importantly, caused us to utilize some toll manufacturing and incur some other expenses that, as of the middle part of the third quarter, will be behind us.

Ian Bennett - BofA Merrill Lynch - Analyst

Okay. So it sounds like that level of SG&A spend is a relatively good proxy for moving forward.

Frank Sullivan - RPM International Inc. - Chairman and CEO

I think that's correct, but you'll see better leverage in the bottom line starting in the fourth quarter. The challenges for our third quarter are a function of the items that Rusty mentioned and the fact that it's a seasonal low quarter for us. So \$0.01 per share, one way or another, has big percentage gains to it, but it's not very material in relationship to the full year.

Ian Bennett - BofA Merrill Lynch - Analyst

Excellent. And then just one more, if I may, on corporate expense. Can you talk about what the major drivers are of corporate expense being up first half of the year compared to last year and expectations for the balance of the year?

Frank Sullivan - RPM International Inc. - Chairman and CEO

Sure. The three biggest drivers there are higher pension expense, healthcare costs, and professional fees. We are -- I would step back from that and talk more broadly about the underlying strength of all of RPM in relationship to that. In the last three to five years, we have overcome almost \$100 million in earnings hits from three primary areas.

Number one is foreign exchange, not unique to us. But in the last two-and-a-half years, we've lost about \$400 million in revenues and somewhere between \$40 million and \$50 million in earnings, strictly as a result of FX translation or transaction impact.

Pension cost, which goes specifically to your question, over the last five years in our P&L has gone from \$26 million in 2012 to what will be \$52 million this year. With an increase in the discount rate in our new fiscal year, we'll see pension expense start to drop for the first time; that's not been true this year.

And then lastly, professional fees and services have risen in relationship to a number of items that we talked about in the past, and we're hopeful that those will be dropping in a material amount as we go into the new fiscal year. The last element of that earnings hit was the earnings drop that we talked about already on Kirker.

If you think about RPM as a whole and the impact of those three items, I think it really highlights the strength of our businesses and why we feel pretty good about where we're headed and feel pretty good about the investments we're making and the revenue growth that's driving and the expense cuts that I think will start to benefit our fourth quarter, as well as our new fiscal year that starts June 1.

Ian Bennett - *BofA Merrill Lynch - Analyst*

Thank you very much.

Operator

Thank you. Our next question comes from Rosemarie Morbelli from Gabelli & Company.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Thank you. Good morning, everyone. I was wondering if you could talk about those trends in Europe. In euros, you showed quite a strong growth at 6.8%, I think. Could you talk about what is particularly strong there, and then can you give us a little more detail in terms of the restructuring? Is there a particular business line that you are consolidating, for example, or is it across the board?

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

No, the restructuring we referenced in our comments and will be referenced similarly in our 10-Q is in relationship to an industrial segment factory and business unit that will be closed. Beyond that, we can't comment. We'll provide more details in the third quarter. We expect that to negatively impact the quarter by about \$0.05.

Relative to our underlying performance, we've seen okay performance in our industrial sector. Again, it's been mixed, but very strong performance in the UK across all our businesses, and particularly strong performance by Rust-Oleum as they expand their European presence in the UK and on the continent. Now with a pretty nice acquisition, approximately \$60 million in revenues; some manufacturing we can leverage; and a better, more efficient manufacturing base on the continent where most of Rust-Oleum's current manufacturing is in the UK.

So they've got really strong momentum and they're doing really well. Unfortunately, when translated back to dollars, with what the pound has done and what the euro has done, those results aren't reflected in our US dollar functional currency as well as they are in local currencies.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

And staying with that for a second, in terms of the restructuring and the closing of Flowcrete in the Middle East, what kind of savings are you anticipating from those actions?

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

We have not disclosed that at this point in time. And I think as we move in to providing guidance for our FY18 and we complete some of the additional cost-cutting programs that we plan, we'll be in a better position to talk about our expectations for the new fiscal year and, in general, what that means for our earnings.



Rosemarie Morbelli - *Gabelli & Co. - Analyst*

And then lastly, if I may, while you don't give quarterly estimates, looking at the third quarter, given it's small size, given the cost of the acquisitions, could you actually report a loss on an adjusted basis in the third quarter?

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

We don't provide quarterly guidance, as you've commented, and I can tell you last year we had a \$0.14 per share. We anticipate a \$0.05 hit on restructuring in Europe, and we anticipate some transaction costs related to the acquisitions that we've announced and completed in the third quarter.

And then operationally, I think we anticipate some less operational performance just in relationship to what seems like a pretty tough winter relative to a very mild winter. Beyond that, I don't know that we would comment.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay, thank you. That is helpful.

Operator

Thank you. Our next question comes from Ghansham Panjabi from Robert W Baird.

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

Good morning.

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

Hi guys, good morning. Happy new year. Going back to the guidance for FY17, it looks like you need to generate roughly \$1.38 or so in the back half to hit the midpoint of your range. Last year, it was roughly around \$1.27, not to mention some of these headwinds you talked about, Frank, FX and pension et cetera.

Can you just give us a bridge on the plus side, and how much accretion do you expect from acquisitions for the back half in total, understanding that there's some variability between 3Q and 4Q?

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

Sure, beyond the comments that Rusty made, I don't know that we would provide any finer points, other than on an annualized basis, the deals that we announced this quarter will provide about \$160 million in revenues. Year to date, we've done about \$200 million of acquisitions. In every instance, they're the kind of small- and medium-size product lines that we can add value to immediately.

And so beyond commenting that they will hurt earnings in the third quarter as we pile up transaction costs and inventory step up, they will be accretive to earnings in the fourth quarter in a manner that we think in the back half of the year should be neutral. And so, I -- beyond the comments that we've made and the guidance that we provided, I think your math is correct. But that's all the detail we provide.



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

Okay, and just in terms of the raw material aspect, is there any change for your revised 2017 guidance related to maybe high raw material costs relative to your previous forecast?

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

Not at this point.

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

Okay. Then just one final one. In terms of the consumer strength that you're seeing, which is exceptional relative to the peer group, were you, first off, surprised with the strength during the quarter? And if so, which categories really outperformed? And also, did your supply constraints on the DAP side, did that cost you from a sales perspective for the quarter?

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

First of all, it didn't surprise us. As you may recall, we anticipated 5% to 6% growth in consumer when we talked about the fiscal year in July. What actually surprised us was the relatively lower growth than we expected in the first quarter. So we're back to the forecast and the budgeting that our consumer businesses had for the year.

The DAP supply constraints were an issue in the first quarter, and so I think they cost us some sales. That is not true in the second quarter in terms of revenues, but it's certainly true in terms of bottom line because of toll manufacturing costs and other costs.

All of those capacity issues are behind us. We will bleed out some higher toll manufactured inventory in the third quarter, and beyond that, you should expect to see the type of leverage that we've generated in the past. And I think that financial analysts and our investors would expect, based upon what sales growth we can generate in the second half of the year in consumer. We'll have certainly better leverage than we did in the first half.

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

Thanks so much, Frank.

Operator

Thank you. Our next question comes from Vincent Andrews from Morgan Stanley.

Matt Gingrich - *Morgan Stanley - Analyst*

Good morning. This is Matt Gingrich on for Vincent. I'm curious if you could clarify which end markets in industrial drove the unfavorable mix.

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

Mostly in our roofing and in our Latin America Viapol business. Roofing was a function of service revenues versus materials, and Viapol was a function of retail mix versus commercial industrial sales. And in both cases, it was a negative mix issue with the gross margin and not a raw material issue.



Matt Gingrich - *Morgan Stanley - Analyst*

And then, did the challenging advancement in oil and gas and heavy machinery weaken sequentially from the first quarter to the second quarter? And if it's flattened out, should we expect the beginnings of easier comps to provide reliefs in the coming quarters?

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

No, in those categories, we have been consistently down about 10% quarter by quarter and month by month and our guidance expects that the balance of this fiscal year will be the same. While we will be seeing easier comps next year, the nature of a lot of our products in oil and gas and how oil and gas projects are put on the map, I suspect it will be a good 12 months before we start to see pickups in relationship to greater activity and offshore oil platforms and oil and gas. The element that is maintenance-related would certainly pick up sooner.

Matt Gingrich - *Morgan Stanley - Analyst*

Thanks, guys.

Operator

Thank you. Our next question comes from Kevin McCarthy from Vertical Research Partners.

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

Good morning, Kevin.

Kevin McCarthy - *Vertical Research Partners - Analyst*

Good morning, gentlemen. With regard to your portfolio review, as per your CANE metric, what percent of your sales are running negative at this point? And how would you characterize the opportunity for earnings improvement as you sort through the portfolio and address those business?

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

Fortunately, it's a very small percent. We -- CANE is essentially an EBA metric that we use for performance measurement and compensation. There are only a couple of those businesses. And I think we came to the conclusion that there was little likelihood in the near term that they would end up being cost of capital, or CANE positive, so they're being closed.

There are smaller operations, which we typically don't talk about because they would be too modest. Our goal is to call out items that are \$10 million or greater in terms of unique expense or unique income. Beyond that, we just do our job.

So earlier this year, for example, we took a \$1.5 million hit on a small closure of a plant in the southeast. And so we're going to look in smaller places where we might do this. The other area of expense improvement is just a number of areas of expense reductions across RPM, which we will enact -- are in the middle of enacting and will continue to enact for the balance of the fiscal year.



Kevin McCarthy - *Vertical Research Partners - Analyst*

That's helpful. Switching gears, the presidential election has obviously transpired since your last earnings call. I was curious on two subjects, what you're hearing with regard to infrastructure, perhaps from your customer base. And then second, as it relates to future tax regime, have you thought at all at this early stage about border adjustment and what that might mean for RPM given your trade balances?

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

Sure. The issue on taxes is really not an issue for us. We would be affected equally as everyone else. The nature of our products are such that we typically are manufacturing in the country in which we sell and distribute. There are some exceptions across the UK and Europe, and so that wouldn't be affected.

And then, the biggest cross-border transactions at RPM, as of any meeting, which has hurt us relative to my earlier comments on foreign exchange, translation, and transaction, is between the US and Canada. Beyond that, it's not really an issue.

And then let me let Barry Slifstein address the infrastructure question.

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

Kevin, we have about \$500 million worth of sales in the US that has exposure to infrastructure. Now, a lot of the highway bridgework might be below our margin profiles, so we'll be selective. But any way you slice it, infrastructure spending is going to help RPM.

Kevin McCarthy - *Vertical Research Partners - Analyst*

Okay. Thank you for that. Then a final quick one, if I may, what is the magnitude of inventory step-up impact that you anticipate in the fiscal third quarter?

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

We don't have that number, but we will highlight the transaction cost and inventory step up when we report the third quarter if that would be helpful.

Kevin McCarthy - *Vertical Research Partners - Analyst*

Fair enough. Thank you very much.

Operator

Our next question comes from Mike Harrison from Seaport Global Securities.

Mike Harrison - *Seaport Global Securities - Analyst*

Hi, good morning.

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

Good morning.

Mike Harrison - *Seaport Global Securities - Analyst*

Was wondering if we could go back to the Kirker business and just talk a little bit about -- you mentioned that there were some actions that you took that seemed to have turned off some customers. And I was wondering if that was the addition of the bottling line and this idea that you could go from selling barrels to taking out the middleman and selling bottles, and somehow that process didn't go over with the customers.

Are we still moving forward with adding the bottling line and transitioning the business to more of a direct-to-the-warehouse type of process? Or are we going back to selling it in drums?

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

We have the capabilities today, which are expanded from three or four years ago, to supply our customers anywhere from bulk drums into supporting direct packaging for them, if that's what they would choose to do.

Mike Harrison - *Seaport Global Securities - Analyst*

But it wasn't that transition or that additional capability that was the issue that drove away some customers. It sounds like that's what you're saying. Can you talk about what happened to send those customers away?

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

I think we had some decision-making at a leadership level of sales and marketing that did not work out, and we have made appropriate leadership changes in relationship to their sales and marketing.

Mike Harrison - *Seaport Global Securities - Analyst*

All right. Understood. And then, was also hoping, just in terms of the corporate expense number, what can we expect in terms of that exact number for the remainder of the year? I know you said there were some professional fees. Those probably go ahead with the acquisitions you've done. But are we back toward a low to mid \$20-million-per-quarter level as we look at the second half of the year and into 2018?

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

Mike, it's Rusty here. In terms of the corporate other expense, what we saw in the second quarter isn't too different from probably what we'll see in the third and the fourth quarter. I would expect those expenses to range between \$28 million and \$30 million, probably on the higher side in the third quarter due to the acquisition-related professional fees. So that's what I could tell you.

Mike Harrison - *Seaport Global Securities - Analyst*

Great. Then the last question I had is can you give us an update on your efforts to expand the industrial business in Asia? Is that something that we're gaining some traction with now or is that more of FY18 or even FY19 benefit?



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

I think it's more of a FY18 benefit, but it is a program that we are continuing to pursue. And we are investing in what was a Flowcrete plant in Malaysia to expand capacity for other RPM product lines. And we are looking at opportunities to either add, initiate, or acquire productive assets in other parts of Asia. And I think the benefit of that will start to show up in the middle part of 2018.

Mike Harrison - *Seaport Global Securities - Analyst*

Alright, thanks very much.

Operator

Thank you. Our next question comes from Arun Viswanathan from RBC Capital Markets.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Good morning. Thank you. I just had a question. You guys, as you noted, had stronger than peer performance in the consumer segment. I just wanted to get your thoughts on the DIY channel in general and what you're seeing at your home center customers. Many of your peers have noted a pretty strong destocking and slowdown. Have you seen that as well? And if not, what would you attribute your strength to, specifically with your product lines?

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

First of all, I think I'd attribute the strength in our product lines to what's just been good consumer takeaway, good small contractor activity that purchases from our core customer base and new product gains across pretty much all of our core consumer product brands.

I do think every year, you see inventory adjustments and destocking, which typically hit our third quarter, as a lot of our major retail customers approach their year end. I think we've already hinted that we would anticipate across all of RPM, perhaps some operational slowdown year over year, just in light of a tough winter versus the winter we had last year. Those are all circumstantial though.

In terms of our core business, consumer takeaway in our categories is good to the extent that contractors and are doing like contracting work and purchase our products through our customer base. That's continuing to be pretty strong. And the market share gains that we have picked up, I think will benefit us in our stronger spring and summer selling season.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay, thanks. And do you expect a large amount of new customer load-ins or at least new product load-ins at your customers in FQ4 this year again?

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

No, not beyond what's driving our results now, and we would expect it would carry into the spring selling season.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay. Then I had one more on Kirker. It looks like, if I heard it correctly, you said you were up 6.5% ex-Kirker, but then organic was up 5.8% without it -- or with it. If I did that quick math, it sounded like Kirker was a \$2 million to \$3 million revenue drag on the quarter. Is that accurate or was it greater than that?

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

Beyond the comments that we've made, we typically don't provide revenues or earnings by individual operating unit. Given the negative impact of Kirker and the impairment charge, I think we felt it was appropriate to provide some more details than we normally would have so that investors can understand what's going on in light of a significant impairment charge. But beyond that, I wouldn't provide any more detail other than what we have.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay, thanks. And last one, if I may, is just on your non-US businesses, are you seeing any improvement or stabilization in Brazil and Europe?

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

Latin America as a whole, we were up in local currencies. I think Brazil, which our Brazilian operation key market share grew remarkably, despite all those challenge. This quarter was the first down quarter in Brazil, pretty much ever since we've owned that business. That remains to be a -- remains a challenging market.

The rest of Latin America is doing well for us, and we'll see what a new government and what feels like a flattening out of some of the economic challenges in Brazil brings in the coming quarters and years. Thank you.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Thank you.

Operator

Our next question comes from Christopher Perrella from Bloomberg Intelligence.

Christopher Perrella - *Bloomberg Intelligence - Analyst*

Thank you for taking the call. A question with the Flowcrete expansion going on in Malaysia, does the closure of the Middle East business, how does that read to your expansion plans over in Southeast Asia? And how does the Flowcrete closure relate back to the energy sector in the Middle East?

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

The Flowcrete closure in the Middle East is pretty unique. Again, we look at our business in a number of ways and this was a CANE-negative business not earning its cost to capital. It was specific to some major projects in certain countries around certain sporting events, and that activity is down. It's not been as profitable for us as we had thought, and the prospects of improving that were not high.

And so when you look at what we're doing with Flowcrete and Euclid and creating a global construction chemical business, whether it's in the United States, Latin America, India, or Asia, our investment footing is forward and we're doing quite well. But at the same time, we're looking at areas that have been a drain on resources and this was one of them.

Aside from that, we still have a very good base of business in manufacturing in Saudi Arabia and Dubai that supports Stonhard; our USL business; and most importantly, Carboline. And those businesses are continuing and continuing to do fine. But where we have discrete units, particularly in our entrepreneurial culture, that are underperforming and the likelihood for their improvement is not on the horizon, we're going to be more aggressive in shutting them down.

Christopher Perrella - *Bloomberg Intelligence - Analyst*

All right. Could you just touch on your wood stains and coatings business in the US, and what product lines you have and maybe what areas you would be interested in expanding in?

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

Sure, it's -- that business has been doing quite well. We are a leader in touchup and repair products for wood stains and finishes, whether at furniture retailers, basically in the furniture supply chain: furniture retailers, distributors, touchup and repair shops, and manufacturers.

We also have a very strong line of wood stains and finishes and top coats that are mostly sold through distribution. And then we do some OEM direct, mostly to the furniture manufacturing that is still located in the US, which obviously is smaller than it used to be. Very profitable and nicely growing business for us and we would look for opportunities to continue to grow there.

Christopher Perrella - *Bloomberg Intelligence - Analyst*

Thank you very much.

Operator

Thank you. Our next question comes from Kevin Hocevar from Northcoast Research.

Kevin Hocevar - *Northcoast Research - Analyst*

Hi, good morning, everybody. Wondering if you could comment, so organic sales growth was 3.8% for the quarter. I wondered if you could comment on volume, and well, particularly price in there. Did price move at all? I know on the industrial side, industrial coatings, some of your peers there have seen some pressure on price. So just curious if that's pretty much a volume number or if there's any movement in price in there as well.

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

With very rare exceptions, and the rare exceptions are around FX issues, for instance, in Canada or a few other places, it's all volume.

Kevin Hocevar - *Northcoast Research - Analyst*

Got you. Okay. And then, you noted that the acquisitions you've made should be pretty fairly neutral in the back half of the year to earnings. What about when we think of 2018, what type of benefits might you get from the recent slew of acquisitions you've made?



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

We would expect them to, obviously, add, on an annualized basis, \$200 million of sales. We won't get all of that, obviously, because these acquisitions have occurred at various stages in our first and second quarter, and now in our third quarter, and all of them should be accretive to earnings.

It's the bread and butter of RPM. I think we sometimes get accused of focusing on small- and medium-sized deals. When you do five or six deals across five or six different business units in a relatively low cost-to-capital environment and we can add value immediately, they certainly will add pennies per share to the whole total.

Kevin Hocevar - *Northcoast Research - Analyst*

Got you. Okay. Maybe you've already answered this with some of your comments and answers to questions. But when I look at the consumer segment guidance for the back half of the year for mid-single-digit type growth, it looks like SPS and Touch 'N Foam both had about \$60 million in annual sales. So when I think of -- and applying seasonality to that, it looks like that adds the mid-single digits alone to sales.

And so I was curious, I don't know if that implies that organic growth -- because you grew sales organically 6% here in consumer in the second quarter. So wondering if, for any reason, we expect organic growth to slow down. I know FX will be a little bit of a bigger headwind, it sounds like.

I don't know if Kirker, maybe, I'm not sure if you felt the full impacts of some of the recent business losses in the second quarter. Maybe that you start seeing more of that in the third and beyond. And I know that there's some tougher comp in here in the third quarter.

But just wondering if you could comment on that. What are the moving pieces there that you're adding these acquisitions which seem to get you to that mid-single-digit number alone? What are the other moving pieces that get you to the -- keeps you at that mid-single-digit growth rate, as opposed to something higher?

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

Sure. As you mentioned and Rusty commented on, Kirker will not be helpful to the second half. Otherwise, the dynamics are the same and we feel really good about them. I think the variable there is the third quarter and third-quarter weather and those types of factors. But the dynamics that have been driving the organic growth in the second quarter remain, and we would expect that to be true in general.

But the third quarter, as we've commented on earlier, weather-related issues could certainly impact some of our industrial business and some of our consumer business in terms of takeaway and activity. But the underlying dynamics have not changed and they're very positive.

Kevin Hocevar - *Northcoast Research - Analyst*

Got you, okay. Thank you very much.

Operator

Our question comes from Rosemarie Morbelli from Gabelli & Company.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Thank you for taking my follow-up. I was wondering, you gave us \$160 million of revenue contribution from the last four acquisitions. Could you share with us the EBITDA contribution?

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

Typically, Rosemarie, we've not done that, and it's not our practice that we would start.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Even if you put them in the aggregate? Bunch them all together.

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

No, what I think we have typically done and we will do again this year is when we talk about our 2018 results, we'll certainly talk about our expectations for growth, how much of that would be organic versus acquisition. And then, I think provide some general guidance as to what between our segments and our organic and acquisition growth will be driving our earnings. But specifically, we've not done that and for all kinds of reasons competitively, we would not start.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay. And then another quick one, which you may not give an answer to either, but what is the size of the professional fees that you have experienced and how much of that will go away in 2018?

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

We've certainly experienced high single-digit professional fees. And I'm hopeful that a significant amount of that will go away in 2018, but time will tell.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay, thank you very much.

Operator

Thank you. We have no further questions. I would like to turn the call over to Mr. Frank Sullivan for final remarks.

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

Thank you for your participation in our call this morning. As we had commented earlier, we feel we have the right balance of supporting and driving sales growth in a challenging environment, while appropriately tackling cost and expense reductions, all of which bode well for the fourth quarter of this fiscal year and for the fiscal year which starts June 1.

I'd like to thank the 13,000 RPM employees around the world who are continuing to compete and win in their markets. And we greatly appreciate your participation and your questions, and most importantly, your investment in RPM. Thank you, happy new year, and have a great day.

Operator

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



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