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RPM - Q3 2017 RPM International Inc Earnings Call

EVENT DATE/TIME: APRIL 06, 2017 / 2:00PM GMT

OVERVIEW:

Co. reported 3Q17 consolidated net sales of $1.02b, net income of $11.9m and EPS of $0.09. Expects FY17 as-adjusted EPS to be $2.62-2.72.

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PRESENTATION

Operator

Welcome to the RPM International's conference call for the Fiscal 2017 third quarter. Today's call is being recorded. This call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com.

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

During this conference call, references may be made to non-GAAP financial measures. To assist you in understanding these non-GAAP terms, RPM has posted reconciliations to the most directly comparable GAAP financial measures on the RPM website. (Operator Instructions) Please note that only financial analysts will be permitted to ask questions.

At this time, I would like to turn the call over to RPM's Chairman and CEO, Mr. Frank Sullivan, for opening remarks. Please go ahead, sir.

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

Thank you, Richard. Good morning, and welcome to the RPM International Inc. investor call for our fiscal 2017 third quarter ended February 28, 2017. 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 third-quarter results and provide comments on the balance of our 2017 fiscal year and answer your questions.

We had a more solid quarter than the GAAP results for our third quarter would indicate. In the third quarter, we continued what I consider to be a cleanup on aisle nine that we started earlier in the year, addressing, changing or closing underperforming business units. Related to this, during the quarter, we incurred a charge for the Restore product line and closure of a European facility, both of which we talked about on our last call, which combined for a total of $9 million of one-time expenses or approximately $0.05 per share.

Year-to-date, we have completed nine acquisitions, with annualized sales of approximately $220 million. Five of these acquisitions were completed in the third quarter, which resulted in an extraordinarily high quarterly transaction cost expense. From one quarter to the next, our transaction costs tend to run somewhere in the neighborhood of $1 million to $2 million range and, typically, about $6 million for a full fiscal year. In this third quarter, we had approximately $6 million of acquisition-related costs, which was approximately $4.5 million higher than the same quarter last year, and particularly impactful during our seasonally low third-quarter period.

This impacted EPS by approximately $0.03 per share. Barry will provide some more details on how these one-time transaction costs and our restructuring costs during the quarter impacted each of our segments. On a consolidated basis, on an apples-to-apples comparison to last year's third quarter $0.14 earnings per share, would be our GAAP results of $0.09 per share plus the $0.08 of these one-time charges, which gives you a sense as to why we feel the third quarter, from an ongoing operating perspective, was stronger than the GAAP results would indicate.

This strength was particularly driven by a rebound in organic sales and leverage to the bottom line in our industrial segment in comparison to a rather weak third-quarter performance a year ago and a pickup in industrial that we expect to see continued in our fourth quarter.

The combination of more solid sales growth in our fourth quarter, the impact of some of our restructuring activities as well as the positive impact on sales and earnings of our recent acquisitions should result in improved fourth-quarter results and a very solid fiscal year 2018. I'd now like to turn the call over to Barry Slifstein to provide you more details on our quarterly results.

Barry M. Slifstein - *RPM International Inc. - VP of IR & Planning*

Thanks, Frank, and good morning, everyone. I'll review the results of operations for our fiscal 2017 third quarter, then cover some February 28, 2017, balance sheet and cash flow items before turning the call over to Rusty, who will discuss the outlook for the balance of fiscal 2017.

Third quarter consolidated net sales of $1.02 billion increased 3.4% from last year. Organic sales decreased 0.1%, acquisition growth added 4.4% and foreign currency translation reduced sales by 0.9%.

Industrial segment sales increased 5.8% quarter-over-quarter to $521.4 million. Organic sales increased 2.5%, acquisition growth added 4.1% and foreign currency translation reduced sales by 0.8%.

Specialty segment sales increased 1.8% to $159.7 million from $156.9 million. Organic sales decreased 0.6%. Acquisition growth added 3.8% and foreign currency translation reduced sales by 1.4%.

Consumer segment sales increased 0.7% to $341.4 million. Organic sales decreased 3.6%, acquisition growth added 5.1% and foreign currency translation reduced sales by 0.8%.

Consolidated gross profit increased 3.8% to $428.6 million from $413 million last year. Contributing to the improvement were lower manufacturing costs and supply chain improvements, partially offset by inventory step-up relating to recent acquisitions.

Consolidated SG&A increased 4.1% to $386.0 million from $370.9 million last year. The increase was largely driven by higher acquisition costs of $4 million and European plant closure of $4.2 million.

Consolidated earnings before interest and taxes, EBIT, decreased 11.9% to $37.1 million from $42.1 million last year, due primarily to the impairment charge, plant closure, acquisition costs and step-up in inventory associated with recent acquisitions.

Partially offsetting these was a strong leverage achieved in the industrial segment. Industrial segment EBIT increased sharply to $14.6 million from $2 million last year due to strong leverage to the bottom line on solid sales growth, favorable transactional currency and higher warranty and severance expense last year.

Consumer segment EBIT decreased 22.9% to $29.9 million from $38.8 million last year. The decline was primarily attributable to poor performance in the Kirker nail enamel business, the impairment charge of $4.9 million and acquisition-related costs of $3.2 million.

Specialty segment EBIT decreased 30.8% to $14.9 million from $21.5 million last year due to the $4.2 million plant closure in Europe and a lack of leverage to the bottom line on low seasonal sales.

Corporate other expenses of $22.3 million compared to $20.1 million last year. The increase is predominantly attributable to higher pension expense.

Income taxes. The effective income tax rate was 25.4% for the three months ended February 28, 2017, compared to an effective income tax rate of 11.9% for the three months ended February 29, 2016. The increase is primarily due to a discrete benefit recorded in the prior year's quarter. The effect of tax rate impact of that discrete benefit was magnified because of the relatively low base of pretax income in the quarter.

Net income of $11.9 million decreased 35.8% from last year's $18.6 million. Current quarter EPS of $0.09 per share compares to EPS last year of $0.14 per share.

And now, a quick look at the cash flows and capital structures. Cash provided by operating activities was $173.5 million this year compared to $223.8 million last year. The decrease was principally attributable to a reduction to both income tax accruals and compensation and benefits accruals.

As of February 28, 2017, total debt was $1.98 billion compared to $1.74 billion last year. In March 2017, RPM issued $450 million in notes to free up available borrowings under the revolving credit facility.

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

Russell L. Gordon - *RPM International Inc. - CFO and VP*

Thank you, Barry. Before addressing our 2017 outlook today, I'd like to step back for a moment to reflect on RPM's progress this year now that we're at the midpoint of our five-year strategic plan. As many of you will remember, there are two components to our strategic plan. First, to grow sales by 8.5% a year, with 3.5% of that growth coming via acquisition. And the second component is to improve our EBIT margins.

In regards to the first component, we have been very successful in executing on this plan in the acquisition area this year. We've done a nice combination of both entrepreneur-run and product line fold-in acquisitions. All of our group presidents have done deals this year, which demonstrates the strength of RPM's broad platform for M&A.

We operate in huge markets, and there's lots of opportunities to grow with acquisitions in the fragmented specialty coating, sealants and other related specialty products areas. And you will notice that this year, our acquisitions fit nicely in our three strategies for growth.

Those are, number one, geographic expansion. As an example, Universal Sealants, which is our fastest growing business from an organic perspective this year, has done acquisitions to extend their business in North America with a couple of deals.

The number two strategy for growth is, product line extensions. And a good example of that was the SPC acquisition that we did last September, which adds to Carboline's platform of steel corrosion-resistant coatings. SPC is a specialist, especially in the pipeline area of that market.

The third strategy for growth, market expansion. A good example of that this year was DAP-acquired, Touch 'N Foam, which expands DAP's presence into the insulation distribution channels. Another good, positive point this year is that we have plenty of liquidity to continue to do deals. We got a good capital market reception for the $450 million of notes, that Barry mentioned, that were issued in March, and this frees up our liquidity to continue to do acquisitions.

In addition to acquisitions, we're also investing in internal growth initiatives this year at RPM. Especially through higher capital expenditures, we're adding capacity in our consumer businesses, which have been gaining market share recently, and also in Latin America, which has been a great area for RPM's growth.

Now turning back to the second component of our long-term strategic plan, that is improving EBIT margins. We've positioned RPM well for future success this year with some of the restructuring activity that Frank mentioned, such as closing down underperforming business units. Now all these positives that I just mentioned didn't help us too much in Q3. For example, we incurred, as Barry and Frank mentioned, some acquisition-related one-time costs, that were $6 million, and we had the $4.2 million charge for closing a European operation. But as we look forward to Q4, we do see some more positives, especially when we expect accretion from this recent flurry of acquisitions that we've accomplished.

So as I look at our outlook for the remainder of this year, I'll address each segment individually. First of all, in our industrial segment, we continue to invest in geographic expansion, both through internal growth initiatives such as the capital expenditures in Latin America that I already mentioned, as well as acquisitions around the world. We've done deals in Canada, Australia and the U.K. so far this year. Also, another positive in industrial for the fourth quarter is we expect continued growth in U.S. commercial construction markets. International has improved for us lately, especially in Europe, where we had low- to mid-single-digit growth in the most recent quarter. And foreign exchange, you might notice, is less of a drag. You might remember, back a year ago in January of '16, when oil was approaching $29 a barrel and commodity prices were low, there were lot of currencies in energy markets such as -- or mining markets, such as Canada, Australia and Africa -- South Africa, that were at very low levels, and some of those currencies have recovered somewhat, especially in Brazil, which I'll get to in a moment.

As we look at the fourth quarter, I think we'll continue to see energy markets still be a drag. Brazil still poses economic challenges to us. But one interesting thing is that the tables have turned upside down in Brazil. Viapol has been defying the odds and growing, but unfortunately, their growth in local currency was down in the mid-single-digit negative range for the most recent quarter, but they were able to grow by 15% in U.S. dollars because the exchange rate has flipped with the real to a favorable position for RPM.

So to sum it up in industrial in the fourth quarter, we're expecting sales growth in the mid-single-digit range.

Now I'll turn to the specialty segment. The sales growth flattened out a bit in the third quarter, but we expect that to improve in the fourth quarter, with sales growth back in the mid- to low-single-digit range.

Turning now to the last of our reportable segments, the consumer segment. We expect to get a benefit from 2 of the larger deals that we've completed this year with SPS, which was acquired by Rust-Oleum Europe and Touch 'N Foam, which was acquired by DAP. In the consumer segment, we do have a favorable economic backdrop with residential markets being favorable and consumer spending looking pretty good in the U.S. The one negative or drag we continue to expect, is the Kirker business. So for the fourth quarter in the consumer segment, we expect sales growth in the mid-single-digit range.

So to wrap this up, I'll talk about our FY '17 full year guidance. You might have noticed this morning in the press release, we are updating the guidance that we last gave on the January earnings call. At that point in time, we said EPS on an adjusted basis for the year would be $2.62 to $2.72. And now as we sit here in April, we are layering in a couple of charges for $0.05 a share, which were not included in that January guidance. That's for the restore impairment charge in the European plant closing. So these 2 items reduce our January guidance in summary by $0.05 a share, so that now we are looking at a full year EPS of $2.57 to $2.67 on an as-adjusted basis.

So with that, we are now happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Mr. Frank Mitsch from Wells Fargo Securities.

Frank J. Mitsch - *Wells Fargo Securities, LLC, Research Division - MD and Senior Chemicals Analyst*

Frank, I really appreciated the commentary on these cleanup on aisle nines. Obviously, RPM had done a phenomenal job of not needing to take various impairment charges, and here we are, two quarters in a row. So with that comment, cleanup on aisle nine, are we done now? And can you just explain a little bit more as to what was going on with the Restore business, as to why that, that triggered that?

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

Sure. Back to the cleanup on aisle nine, fiscal '16 was our seventh year in a row of double-digit earnings growth. We've accomplished a lot over the last couple of years with the reorganization and, basically, dissolution of our Building Solutions Group, and the reconsolidation of SPHC. And this year has been disappointing to us in terms of some lower revenue growth than we planned on as well as the significant deterioration related impairment at Kirker. So we thought it was a good opportunity to look at some smaller underperforming business units and address them in ways that will help both our earnings and our margins as we go into fiscal '18. So as you know, we closed our Flowcrete Middle East business. Took a charge on that. We essentially made the decision at the beginning of the year to product-linize the Synta Restore business into Rust-Oleum. And so in the second quarter, we closed their manufacturing facility in Georgia, and then took a final charge associated with, basically, moving what was a separate business unit into a product line within the Rust-Oleum wooden coatings category. And so that's what happened there. The German closure was an underperforming business unit. And for the most part, we are finished. We'll be looking at some minor items in the fourth quarter, none of which, I think, will rise to the level of a disclosure in terms of being small singles of millions of dollars. But these are all steps that should improve margins and earnings as we go into next year. I would highlight the fact that in this quarter, if you account for or adjust out the $9 million of charges and the extraordinarily high extra $4 million of transaction costs, EBIT on that basis would be $50 million versus $42 million, which is a 19% increase on a modest sales growth. So on an ongoing basis, the underlying RPM businesses are doing pretty well. We are happy to see organic growth pick-up in our industrial segment, which we have not seen up until the third quarter. We would expect that to continue in the fourth quarter. And I guess, the last comment I would make is that the consumer segment results really are a function of weather and customer order patterns that, from one year to the next, flow between February, which is the end of our third quarter, and March, which is the beginning of our fourth quarter. And there's nothing about what's happening in the marketplace with our consumer businesses that doesn't leave us positive relative to their performance in the fourth quarter and in the next fiscal year.

Frank J. Mitsch - *Wells Fargo Securities, LLC, Research Division - MD and Senior Chemicals Analyst*

That is very helpful. And for what it's worth Frank, I think I'm an easier grader than you guys are, because that nickel impairment and closure charge, we stripped out. But appreciate the transparency in terms of you leaving it in. And in terms of transparency, you've done a great job of highlighting what's been going on in Latin America, particularly in your Brazilian operation. And that had been a bright spot, when it was a dark spot for so many other folks, and now, here we're seeing it tick down in local currency terms. Can you expand upon what your expectations are there?

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

Yes. I think currency will start to help us a little bit there instead of hurt us. And while the last few months -- last few quarters have been challenging for our Brazilian business, I think we're actually seeing some flattening out there relative to what was a disappointing couple of quarters after a few years of defying gravity in a difficult environment down there. We've got a really well-run business and we've invested a lot to bring in other RPM product lines. And so, I -- as we look forward, I don't anticipate that business negatively impacting us through a combination of flattening out core growth and maybe some improvement on the currency piece after it killed us for the last couple of years. So I don't think it's going to be a big help to sales growth and earnings growth, but it should not be an impediment to our fourth quarter or our next fiscal year.

Frank J. Mitsch - *Wells Fargo Securities, LLC, Research Division - MD and Senior Chemicals Analyst*

Okay. So flattening out as we look at Q4 as well. And then, obviously, your -- the commentary in the release was very positive on fiscal '18, but you're seeing that flatten out here, and so we're likely not going to be talking about it down in local currency terms. Obviously, the currency is, is helping you, I understand that. But just to get a sense of the health of the business, we're flattening out. Just to be clear -- that's correct?

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

I think that's correct. And that's after a couple of quarters of seeing some deterioration in that business, before which it just continued to go up in local currency, in sales, earnings and unit volume. I think the positive organic growth that we reflected in our third quarter in industrial, is something that we would expect to see in Q4 as well. And beyond that, it really depends on what happens in oil and gas and the underlying economic dynamics. But I think at this stage, the tone is optimistic, more broadly. We'll see what that results in, in terms of actual business.

Operator

Our next question on line comes from Rosemarie Morbelli from Gabelli & Company.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Frank, just following up on Brazil. You talked about lower revenues in local currency. So this is indicative of lack of demand, if I understand properly, for your products in the marketplace. The marketplace seems to be improving, and you have been introducing all the RPM product lines into Brazil. So could you help me understand why we are not seeing the benefit from those new product lines that you are now introducing, which you did not have last year?

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

We had some of them last year, Rosemarie, and I think the big challenge we face in Brazil, quite candidly, is higher comps. We had strong performance in that business in fiscal '16 and in fiscal '15, while much of the Brazilian economy was going the wrong way, and that was a combination of just a well-managed business and investment and introduction of new RPM products. And it's a little surprising to me, but it's our current results that, after a couple of quarters of deteriorating results, we seem to flatten out on what is very challenging comps of a growing business. So I'm optimistic about what we're doing down there. And at this stage of the game, I think if -- what we suffered through Brazil is two or three quarters of deteriorating results, I think that highlights some smart investments and good management down there, because the underlying economic conditions have not been good.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Are you seeing a pickup in this -- in the underlying environment? Other companies seem to be?

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

I think the attitudes in Brazil and the headlines are better than they've been in for a couple of years. But it'll remain to be seen in terms of how that translates into improvement in business. We're continuing to have a positive investment profile in Brazil. We're very bullish across a bunch of our businesses like Carboline and Tremco, Euclid Chemical for that market, along with the Viapol businesses and -- so I think that's positioned. The big picture improvement in the real suggests that the underlying economies are improving.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

All right. That is helpful. And looking at Kirker, in the last quarter, you said that you have seen the bottom of that particular -- of the difficulties. But it -- how was it in the third quarter? Is it continuing at that low level? Or is it actually worsening and whatever you expected did not occur?

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

We -- I think we've bottomed out in terms of our deterioration of Kirker. But it's still comparing to higher sales and earnings last year in the third quarter, and we'll deal with the same thing in the fourth quarter. And then, we would expect in '18 that, that business would no longer be the significant hit to earnings that we've suffered over the last 18 months.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Is that a business that you think belongs to RPM, given its lack of performance in the last couple of years?

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

That is a business that belongs to RPM. That's an accurate statement.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Okay. And then lastly, if I may. 2018 is going to see $220 million of revenues from the recent acquisitions. Could you share with us how much EBITDA they should contribute?

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

Typically, we've not done that, and the $220 million is on an annualized basis. I think we'll get roughly 70% to 80% of that, as you'll see a big quarter's worth of that in our fourth quarter. All of those were pre-fourth quarter transactions. So we'll benefit through the first three quarters of next year, and then they'll be annualized by the time we get to the fourth quarter.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

And then should we assume then, all that margin is similar to corporate or higher?

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

I think that -- again, without really communicating broadly the earnings profile of these businesses, generally assuming on a go-forward basis that our acquisitions would be on a comparable margin profile, to RPM is a safe assumption.

Operator

Our next question on the line comes from Tom Narayan from RBC.

Gautam Narayan - *RBC Capital Markets, LLC, Research Division - Associate*

Just a couple of questions on the consumer segment. I know you guys called out weather and the customer order timing as the real story for what happened in the quarter. Do you notice that SG&A was lower, maybe some of that is because of corporate being lower. But I wonder, was there a difference in promotional activity in this quarter versus Q2? 2Q's organic growth in consumer was really strong. Or was it just these 2 items that you called out, weather and the order timing?

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

No. It's really just those 2 items. And I think we've learned over time, our third quarter is a seasonal low period. And quite candidly, in consumer, it doesn't matter what the weather is in January for 2 reasons: it's not when we really start to have a spring sell-in, and it also tends to be the last fiscal month of most of our big retail customers. And so January is always what January is. Where weather impacts us the most, particularly in consumer, is what happens in February and March. And our spring selling season, given the fact that much of our consumer products are exterior use, it really starts in February, goes into March and into the spring and early summer. And so when we get impacted by weather, it can either drive order flows into February, which gives us a great finish to an otherwise seasonally low month, and that happened last year, or it can drive order flows into March. I believe there was a Home Depot conference call, a week or 2 ago, where they talked about missing a week of sales in the early part of March because of difficult weather and cold weather and snow across the country. So that certainly impacts somebody like us. And it's really not just the weather, they're one and the same. It's what it does to order flows from our big customers. So if we get big order flows, like we had last year at the end of March, we reflect it in our third quarter. And if it gets pushed off into May -- into March -- I'm sorry, into February, like we had last year. This year, I think it's our expectation for a number of reasons, including the fact that we had big orders last February and we didn't this February. So it's just a seasonality. There is nothing in the underlying businesses for some of the market share gains we've talked about or new product introductions that we've talked about that has changed.

Gautam Narayan - *RBC Capital Markets, LLC, Research Division - Associate*

I see, I see. And on the guidance for fiscal fourth quarter, for consumer, you said it's mid-single-digit sales growth, and I know you guys just highlighted the significant M&A, how much of that mid-single-digit growth do you guys -- should we model at coming from M&A, and how much is organic?

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

I think most of that is organic, and then we'll get the benefit, a little bit, on the top line and the bottom line of both the Touch 'N Foam acquisition at DAP and the SPS acquisition at Rust-Oleum and that was an European-based acquisition.

Gautam Narayan - *RBC Capital Markets, LLC, Research Division - Associate*

Okay. And then finally, it's kind of piggybacking after Rosemarie's question on the M&A that you guys have done. We know multiples in the group have kind of come up, and I know you guys do private deals, so maybe not as impacted. But could you comment on what kind of multiples that you guys have being paying for recent deals? Is it kind of in line with historical averages? Or is it being impacted by how the overall group has been trading?

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

We generally have not commented on purchase price or acquisition multiples publicly.

Operator

Our next question on the line comes from Ghansham Panjabi from Robert W. Baird.

Matthew T. Krueger - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

This is actually Matt Krueger, sitting in for Ghansham. Can you provide some added detail on both the strength across the industrial markets and then the broad weakness in specialty? What drove -- what specific factors drove these variations? And then, do you continue -- do you expect these trends to continue moving forward?

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

So I think some of the weakness in specialty just relates to challenging comps year-over-year. And then, we did see some slowdown in certain of the OEM businesses there, powder coatings, some of the Day-Glo color business. And I think we'll see some strengthening there. But in the specialty segment, low single-digit growth is kind of what, I think, Rusty highlighted in his comments, and what we see going into the fourth quarter there. So you'll see positive numbers there, but they'll be very modest. And it's a combination of those factors, a couple of business units underperforming and some challenging comps from the prior year. And then on the industrial side, we're continuing to see good North American activity. We're seeing some first signs of life in some of our -- kind of heavy industry, including oil and gas business. The SPC acquisition, which was pipeline focused by Carboline this past year, has had a bang up year, and that's continuing to generate nice results for sales and earnings. And in general, I think we're just seeing an uptick, modest, but a more solid organic growth numbers than we've seen for probably the last three or four quarters. And we expect to see the same kind of solid low- to mid-single-digit organic growth in industrial in the fourth quarter. Europe's picking up a little bit, and we're not getting hit as hard on a comparable basis by the currencies.

Matthew T. Krueger - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

That's helpful. And then, what impact has inflation across your raw material base had on your various businesses? And can you guide to any impact for the fourth quarter or FY '18?

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

It's been relatively modest, and I don't see that raw material cost will have much of an impact for us in the fourth quarter. I do anticipate that there will be some raw material increases in a number of categories as we go into our new fiscal year. We've seen raw material increases in certain categories like TiO_2, that's not as big a raw material spend for RPM on a consolidated basis as it is for some of our architectural paint competitors, but it certainly impacts certain businesses more than others. So I think we'll be dealing with some modest raw material issues in fiscal '18, and it's something that we're planning on. But the impact for the balance of this fiscal year should be negligible.

Matthew T. Krueger - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

Got it. That's helpful. And then, looking at FY '18, does modest translate to mid-single-digit inflation across the raw material base? High single-digit inflation? Just what kind of range are we looking at?

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

It's really hard to say, because it's category by category. And it's something that -- both in terms of how we manage our businesses that we plan to address on a case-by-case basis as we look at '18. And we'll be in a position to provide, I think, some more meaningful answers to questions like that on fiscal '18 in kind of our normal cycle of talking about and providing some detail on fiscal '18 at our July fourth-quarter earnings releases, which is typically where we would provide guidance for the new fiscal year. And I think we're in a better position to answer questions like that after we get through our planning process.

Operator

Our next question comes Mr. Kevin McCarthy from Vertical Research.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Question on the margin outlook in your industrial segment. You had a really nice comparison, improving it 240 basis points here in the fiscal third quarter you reported. It looks to me as though you have a more difficult comparison in the May quarter, and if my memory is right, you may have had a gain in last year's quarter. So can you talk about your expectations for margins in the fiscal fourth quarter and beyond?

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

Sure. I think the fourth quarter in general is going to be a big mountain to climb if you look by our different segments. We had a huge fourth quarter last year. Consumer, for instance, we had organic growth up 9.9% and a strong leverage in the bottom line. We had pretty good performance in other parts of RPM. So we would expect to see our margins maintained or improved slightly in the fourth quarter. But part of that commentary is really related to the strong fourth quarter we had in a number of areas last year, and the good leverage to the bottom line. I will tell you a combination of expectations of some modest organic growth in '18, the restructuring activities that we've undertaken this year and, particularly, on some of the acquisitions and how they're being integrated, that we expect some margin improvement at the EBIT line across our industrial segment in '18.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Good to hear. Second question relates to consumer. You indicated organic sales were down 3.6%. What was the pricing contribution embedded in that? Was it directionally positive or negative?

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

It was directionally 0.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Very good. Tried to stump you there. Well, I guess related to that Frank, over the past four months, a number of your peers in the coating space have been raising prices across various vertical markets. I know you have a decentralized approach to pricing. Can you comment though, at a high level, in terms of what you're trying to do on the pricing front to combat what sounds like it could be a more challenging raw material environment in fiscal '18?

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

Sure. That's a great question, and -- a couple of things. Number one, we have been in some cases, like this German plant, and in other cases where the costs are more modest, looking at improving our manufacturing overhead. Rust-Oleum's done a phenomenal job over last three years of optimizing their manufacturing. We're still working on that. We've closed a major European plant. They've closed a couple of different plants in the United States. Most recently the Synta plant in the second quarter of this year. Our CapEx is up, as folks have noticed. A lot of that's going towards capital expansion and production improvements. And I think we've done a pretty good job, particularly in consumer, at Rust-Oleum and at DAP. And moving our margins up through mix, we've got a lot of good new products, whether it's the Rock Solid floor coating products, much higher performing, much faster curing than any of the other products in the marketplace, including Rust-Oleum products. They carry higher margins for our retailers or for us, and appropriately so. A lot of new product introduction at DAP. So those are the areas that we're really focused on. As it relates to raw material, it really will be circumstantial, company by company, based on what we face across different raw material categories as we get into fiscal '18.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Okay. Fair enough. And last one, if I may, on the subject of M&A. Rusty, you outlined three different categories of deals: geographic, product line and pipeline. How do you think about potential for synergies, and how does it vary across each of those three categories? Is there a rule of thumb? If you looked at your deals over the last few years in terms of how much you can realize as a percent of sales?

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

Sure. I'll tackle that. Just in terms of acquisitions, when we do a freestanding acquisition, there's very little in the way of synergies. We took over the backing and the administration. We can pick up some benefits of raw material costs, because a lot of times $50 million or $80 million business units aren't buying at the same price levels that RPM is as a whole. And then, hopefully, we'll be able to support accelerated growth in a business like that. In the product lines, which has been at least two out of every three acquisitions we've done for the last couple of years, the real goal is not so much in the cost savings side, although we integrate -- we have completely now integrated the Rock Solid production into Rust-Oleum facilities, it's really on the revenue side. And if we can acquire $10 million businesses with unique technology, and over a couple of year period, drive that revenue to $20 million or $30 million, the accretive benefit to earnings at both Rust-Oleum and at RPM look pretty good. I think there is a lot of excitement at DAP about this Touch 'N Foam acquisition that puts them as a primary manufacturer in the insulating foam category. And there is a couple of categories of customer that Touch 'N Foam had in discount chains and grocery that DAP was not in. And so there is some hope that we can leverage that into some of the new DAP products like the RapidFuse adhesive area. So it's really on the revenue side where we can get a unique technology or a nice tuck-in business. And because they're part of an RPM company, drive the revenue at a higher rate of growth than they otherwise would be able to generate on their own.

Operator

Our next question on the line comes from Mr. Vincent Andrews from Morgan Stanley.

Vincent Stephen Andrews - *Morgan Stanley, Research Division - MD*

You talked about having new products ramping at retail, and you also mentioned the fourth quarter in retail has a difficult comp. So can you just remind us of maybe what the trade load was last year, and what you think the extent of it will be this year, as we think I guess, not just the fourth quarter but, I guess, entering into next year?

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

Yes, I should have the numbers in front of me, and I don't. I think our core organic growth last year in consumer was like 9% or 10% and it levered about a 20% EBIT growth. And that was on top of a record fourth quarter in the year prior. And so our expectation is that year over year, we're going to do better this fourth quarter than we did last year. It will be somewhat modestly better. It's not going to be anywhere close to the big organic growth and leverage to the bottom line we saw last year.

Vincent Stephen Andrews - *Morgan Stanley, Research Division - MD*

I'm sorry, you think you're going to do better this year, but not as well as last year?

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

Yes, I mean, we've been talking about targeting kind of mid-single-digit growth in the consumer business throughout the year. We didn't experience it in the first quarter. We did in the second. We didn't experience it in the third quarter, and we would expect to experience it in Q4. But I think people need to recognize that's on top of a huge fourth quarter last year, which we will beat, but more modestly than certainly what we had last year.

Vincent Stephen Andrews - *Morgan Stanley, Research Division - MD*

Okay, understood. And then just on -- your corporate expense was down a fair amount in the quarter. I assume that's part of the cost-reduction programs that you've been talking about. But is that -- should we be thinking about that type of moderation moving forward? Or was there something unique about this quarter?

Russell L. Gordon - *RPM International Inc. - CFO and VP*

Yes, Vincent, our corporate other expense has moved around a bit during this year. Overall, we're being impacted by higher pension expense this year. But in the third quarter, it actually ticked down a bit, as we adjusted some incentive compensation reserves related to performance as well as a favorable health care experience. So it's kind of jumped up and down, and I think, per quarter, we're averaging about $25 million in corporate other. So that's probably as good a number as any to project as you look to the fourth quarter.

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

As it relates to 2018, some of the activities that we've undertaken this year, some of which are within our control and some of which are related to market elements, like what happens to discount rate. We would expect corporate expense for 2018 to be lower than what it has been in 2017.

Operator

And next question online comes from Silke Kueck from JPMorgan.

Silke Kueck-Valdes - *JP Morgan Chase & Co, Research Division - VP*

If it turns out that infrastructure spending in the U.S. gets going for good, how much of a benefit could accrue to RPM, like over a year, like a two-year period? And how big of a business in general you think infrastructure spending is for you? And do you have any government contracts that you rely on?

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

So we do not have any government contracts we rely on. And it's really hard to forecast whether there'll be a big infrastructure bill, that's been kind of a pie-in-the-sky for Congress for quite a while. The highway bill, I think, is helping us. In general, across businesses and product lines, like Carboline, like Euclid Chemical, like Stonhard, like Tremco. Collectively across RPM, our best guess is about $500 million of our revenues in the U.S. are related to public and private infrastructure.

So certainly, if there's a big pickup in infrastructure, that we will be a beneficiary of that. The timing of that, as you know, very uncertain right now.

Silke Kueck-Valdes - *JP Morgan Chase & Co, Research Division - VP*

Yes, we shall see. Which segment was affected by the German manufacturing plant closure? Was that an illbruck plant that closed down or like -- what did you shut down?

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

It was a business named FEMA, and it was part of our specialty products group.

Silke Kueck-Valdes - *JP Morgan Chase & Co, Research Division - VP*

Okay. How big is your deck coatings business now? Like in rough terms? Is it -- because it's more than Synta, right? There's like deck coatings that you had before you acquired -- like the Synta deck coatings and...

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

Sure. It's a business including, and it's part of the decision to do the restructuring we did. In terms of deck coatings, it's down probably 40% or 50% from its peak of two years ago.

Silke Kueck-Valdes - *JP Morgan Chase & Co, Research Division - VP*

Is that because of competition, or is it just like there's no demand in the market?

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

No. It's a number of issues related to that product category, not just for us, but for our competitors, in terms of wood decks being a very challenging surface relative to prep and performance. And I think a category that boomed for a period of time, and then shrunk mostly related to those issues, not only for us but for our primary competitors.

Silke Kueck-Valdes - *JP Morgan Chase & Co, Research Division - VP*

Okay. And lastly, do you think there will be any -- I mean, I'm sure it's been asked before, but like now that we are like a couple of months later. Will there be any effect in your businesses you think from, from the U.K. exiting Europe? Or that will have no effect at all?

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

No. The organic growth itself hasn't really been impacted in terms of performance, but the pound has crushed us on a relative basis. And it's been a big hit in consumer because the biggest chunk of our overseas business in consumer is U.K.-based. And while they're growing on the continent, and that's growing pretty substantially and aggressively, and the SPS acquisition, which is based in the Netherlands, will advance that, but the pound has crushed us in consumer. And it's hurt us to a lesser extent, but still, in the industrial segment. So it's really been a function of the currency impact, more than the actual business activity. The underlying business activity in local currency has been fine so far.

Operator

Our next question on line comes from Mr. Steve Byrne from Bank of America.

Ian Matthew Bennett - *BofA Merrill Lynch, Research Division - Associate*

This is Ian Bennett on for Steve. I was wondering if you could comment on why some impairment and restructuring charges are included in adjusted EPS and why some are not? And I guess, kind of at the heart of that is, what is an ongoing level of impairment and restructuring charges for RPM as you look at these collection of businesses over a multiyear period? And how does that compare to the level of restructuring and impairment charges that are in adjusted EPS in 2017?

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

Sure. That's a great question, and there is kind of multiple layers to that. First of all, from one year to the next, we probably incur anywhere from, I would say, $3 million or $4 million on the low side to $5 million or $7 million on the high side of year -- over the full-year restructuring adjustments across our businesses, which we never highlight. I think the second issue I would address is, is there is a strong regulatory preference, over the last year or so, to not separate adjusted figures from GAAP results. And so, I think, we along with a lot of our other companies have really published and focused on our GAAP results and then called out those specific items which we think investors should consider in the neighborhood of meaningfully sized one-time items, like impairment charges, which are one time. The last comment I would make is, over the last decade, we've done 100 acquisitions. Over the last, geez, 30 years, we've probably done 180 acquisitions, and we've had three impairment charges. Unfortunately two of them have occurred this year, both with Kirker and Synta. And it's not a normal course of business for us, and there's nothing about our current businesses or the acquisitions that we've completed that would suggest there is any amount of impairment charge that you should factor into the coming years.

Ian Matthew Bennett - *BofA Merrill Lynch, Research Division - Associate*

And just one follow-up. I know that you're not establishing fiscal 2018 guidance at this point. But I was wondering if you could talk about areas that perhaps you're most confident about? And areas that are most uncertain as you look towards progressing against the five-year plan?

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

Sure. I think we feel very good about 2018. I think we've taken this fiscal year which, as I indicated earlier, has been disappointing because the level of growth was somewhat less than we planned on, and certainly the impairment charges, that I just talked about, are unique relative to our history and something that is certainly not a sign of success. We have those behind us. And so I had talked about Kirker, and I'll just regurgitate some of the numbers that I had mentioned. When we acquired that business, I think we announced its revenues were $90 million. It grew pretty dramatically at very good margins for us. And over the last 18 months, that business has been cut in half with a relatively fixed cost structure. It was a very high margin business. When your revenues get cut in half with a relatively fixed cost structure, it's not a very high margin business today. So we've lost a lot of earnings there that otherwise have masked good performance in our consumer segment. And we've also taken this year in addressing some smaller business units where we can improve earnings by $1 million here and $2 million there, along with some expected margin improvement and the benefits of some good tuck-ins, strategic acquisitions that we've completed this year. So I mentioned earlier that fiscal '16 was the end of a string of double-digit earnings growth. We are positioning RPM to get back in fiscal '18 to solid sales growth and double-digit earnings growth and some margin expansion, particularly in our industrial segment. So I feel good about '18. And I feel pretty good about how the market thinks about '18 right now. Beyond that, we'll provide more details in our July conference call.

Operator

Our next question comes from Mr. David Stratton from Great Lakes Review.

David Michael Stratton - *Great Lakes Review - Research Analyst*

You said that oil and gas is seeing signs of life. Could you give a little more color around that? Was it up or down this quarter? And just in general, what you're seeing there?

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

So it was down this quarter, but at a lower rate than what we've seen over the last four or five quarters, six quarters. And so it seems like a combination of, I guess, stable oil and gas prices. It's got some people moving towards -- back to some regular maintenance spending. We're also going to be facing some easier comps, given the difficult environment in that market. And particularly, this SPS acquisition -- I'm sorry, the SPC acquisition, that Carboline made, little -- in the past year so, about a year ago, they're focused on oil pipeline, and that's been -- in maintenance work there. That's been a good market that never really turned down. And I think there's just a generally better attitude from a regulatory perspective and expansion perspective, given the U.S. administration change. And we're seeing that in that product category with solid sales and earnings growth. And so you put all that together and -- nobody's expecting any boom, but it feels like we've kind of hit bottom. With oil prices and gas prices kind of stabilizing, albeit, at a lower level than would drive a big chunk of growth. People getting back to some regular maintenance spending. And I think, generally, optimism around an improved regulatory environment. So I would expect that the, as we look at fiscal '18, that the headwinds we've been facing in that category won't be a problem for us anymore. It'll just be a question of when and how quickly we start to see some solid recovery there.

David Michael Stratton - *Great Lakes Review - Research Analyst*

Got you. And do you care to break out the size of the decline for us?

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

We haven't done it by numbers, but we have talked about quarter-by-quarter. It's been pretty consistently 10% down. And this third quarter, it's been about half of that.

David Michael Stratton - *Great Lakes Review - Research Analyst*

All right. And then, moving on to acquisitions. With the current pace and then also the new notes to free up some credit revolver facility, is there anything in the pipeline, or should we expect this pace to continue? Or just -- we know you're acquisitive, but what do we see over the next couple of quarters?

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

Sure. First of all, I don't -- I think it'll be a long time before we close five deals in one quarter. That was an interesting pileup. As an aside, related to a number of transactions, some of which we've been working on for a few years, some of which popped up in the last six or nine months, all of whom were eager to see their deals close before December 31 of '16 because of their anticipation of higher tax rates with the new administration. And immediately following the election, every one of them said, "We're not closing in '16, we're closing in '17," because their view of tax policy had changed. So that is just an interesting aside. We continue to work with our companies on focusing on great entrepreneurial businesses that would fit in kind of that traditional RPM culture and product lines that we can integrate. And so I would expect us on average to do two or three or four deals a year. Pretty much in the same type and size of what you're seeing. And in some cases, there'll be technologies that we can integrate, and in other cases, there'll be transactions overseas that will serve as a footprint or a base for a particular RPM company to grow. And those are the kinds of things we're focusing on.

Operator

Our next question comes from Mr. Kevin Hocevar from North Coast Research.

Kevin William Hocevar - *Northcoast Research Partners, LLC - VP and Equity Research Analyst*

I think in terms of the DAP, in prior calls you had talked about, it had some capacity issues, and I think you were still running through some higher-margin total DAP capacity this quarter. I was wondering if you could update us on that. Is that fully over at this point? Will there still be any impacts in the fourth quarter? Is that fully behind you at this point?

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

I think it's mostly behind us. We are -- in terms of the capacity issues, we have addressed that, and very successfully. In terms of some of the disappointing results in the third quarter in our consumer segment, at least a couple of million dollars of that at the gross margin level was a function of DAP selling through higher cost toll manufactured product. So while the issue from a manufacturing perspective has been fixed, the impact of higher cost toll product negatively hurt our third quarter, and we should be through almost all of that as we get into the fourth quarter and, most importantly, for fiscal '18.

Kevin William Hocevar - *Northcoast Research Partners, LLC - VP and Equity Research Analyst*

Yes, got you. Okay. And then just a couple of quick hitters. Tax rate's been about 24%, 25%. Is that a good number to use here in the -- for the full year? And then, with interest expense, with the bond issuance, what type of interest expense should we look for going forward?

Russell L. Gordon - *RPM International Inc. - CFO and VP*

Sure. Your first question got broken up a bit. You're asking about the effective tax rate?

Kevin William Hocevar - *Northcoast Research Partners, LLC - VP and Equity Research Analyst*

That's right.

Russell L. Gordon - *RPM International Inc. - CFO and VP*

Yes. The effective tax rate this year has been affected by some large discrete items that play a larger role in our year-to-date results after we get through a seasonally low third quarter. As we go through the fourth quarter, which is a seasonal high for us in terms of earnings, that'll wash out some of the impact of those discretes, and we're still holding the effective tax rate guidance at around roughly 26% for the year. Your second question was about interest expense and what impact the recent capital market issuance would have? Is that right?

Kevin William Hocevar - *Northcoast Research Partners, LLC - VP and Equity Research Analyst*

Right. That's right.

Russell L. Gordon - *RPM International Inc. - CFO and VP*

Yes. We were mostly utilizing short-term debt up until that bond issuance in early March. And we got, I think, we were able to term out some of that short-term debt at nice favorable long-term rates. But there -- those rates are higher than the variable rates that we had. So we would expect, as you normally would, that interest expense goes up to finance brisk acquisition activity.

Operator

And our last question comes from Rosemarie Morbelli from Gabelli & Company.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

I was wondering, Frank, if you could give us some feel as to which areas of improvement do you see in Europe, because Europe improving. But I am guessing that it is not across the board. Can you talk about the different trends?

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

Sure. It is pretty much across Continental Europe. Germany is a huge market for us, and we're finally seeing some modest improvement there. And I think the other aspect of feeling better about what's happening performance-wise in Europe, is just the fact that we're not getting whacked on the currency as hard as we were in the last couple of years.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

And in terms of markets served, any particular area that is doing better than another?

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

No. I mean, we're doing -- we're growing nicely in our consumer segment in Continental Europe more aggressively, both in terms of organic growth and investment, and with this SPS acquisition. We think that would accelerate. And we're just seeing, I think, some modest improvement across most of our business units there in the industrial segment. And as I mentioned, the benefit of not getting a foreign currency problem.

Operator

At this time, I see we have no further questions. I will now turn the call over to Frank Sullivan for closing remarks.

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

Thank you. Thank you for your participation on our call today. As you can tell from our comments, we feel a lot better about the third quarter than our GAAP numbers would suggest. As I highlighted earlier, if you adjust out the one-time charges and the higher-than-usual transaction cost, we'd actually have an EBIT margin or an EBIT growth of plus 19% in the quarter on pretty modest sales. The balance of RPM between consumer and industrial served us well in this quarter, with industrial showing some signs of life, which is -- bodes well for the fourth quarter and, we think, for fiscal '18 as well. We have worked hard this year to position RPM to have a return to double-digit earnings growth and a real solid performance in fiscal '18. And we feel very good about where we are and how the market thinks about that, and look forward to providing you more details on the finish to our fiscal '17 fourth quarter and our outlook for fiscal '18 in July. Thank you for your participation on our call today, and for your investment in RPM. Have a great day.

Operator

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