THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

RPM - Q4 2017 RPM International Inc Earnings Call

EVENT DATE/TIME: JULY 24, 2017 / 2:00PM GMT

OVERVIEW:

RPM reported 4Q17 consolidated net sales of $1.49b, adjusted net income of $138.3m and adjusted EPS of $1.02. Co. expects FY18 EPS to be $2.85-2.95 and 1Q18 EPS to be $0.83-0.85.

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Arun Shankar Viswanathan *RBC Capital Markets, LLC, Research Division - Analyst*

Christopher Perrella

Frank Joseph Mitsch *Wells Fargo Securities, LLC, Research Division - MD & Senior Chemicals Analyst*

Ghansham Panjabi *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Jason Andrew Rodgers *Great Lakes Review - VP*

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

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

Michael Joseph Harrison *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

Michael Joseph Sison *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

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

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

Steve Byrne *BofA Merrill Lynch, Research Division - Director of Equity Research*

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

PRESENTATION

Operator

Welcome to RPM International's Conference Call for the Fiscal 2017 Fourth Quarter and Year-End. Today's call is being recorded. This call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com. Comments made on this call may include forward-looking statements based on the 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, 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, Vanessa. Good morning, and welcome to the RPM International Inc. investor call for our fiscal 2017 fourth quarter and year ended May 31, 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 will discuss our fourth quarter and full year results and then provide some detailed guidance for our new fiscal 2018, after which we'll take your questions.

In the fourth quarter, we took additional actions to reduce our cost base and position RPM for double-digit earnings growth in fiscal 2018. We generated steady organic growth given the challenging economic environment, which, especially in our industrial segment businesses, appears to be accelerating. Adjusted EBIT increased 1.7% despite a sharp rise in raw material cost, compounded by shortages and availability in a few key product line areas. A significantly higher tax rate in this year's fourth quarter compared to last year further reduced adjusted EPS by $0.12 per share, which otherwise would have been flat year-over-year.

Sales in our industrial segment increased 5% in the fourth quarter, driven predominantly by current-year acquisitions and strong organic growth in the U.S. at our high-performance polymer flooring business and our roofing businesses. Consistent with the results reported in our fiscal third quarter, our businesses in the oil and gas sector were down in the mid-single-digit range versus double-digit range we experienced over the last 2 fiscal years. Industrial sales in Europe increased in the low single-digit range in local currency, which is consistent with the more positive outlook we've seen over the last few quarters.

Sales in the consumer segment increased 3.9% in the quarter, driven predominantly by the recent acquisition of Touch 'n Foam in the U.S. by our DAP subsidiary and SPS in Europe by Rust-Oleum. Organic sales were down 1% principally due to underperformance at Kirker, which we now believe has stabilized at a lower base for fiscal 2018. Very difficult comparisons to last year, when we experienced a 9.9% increase in organic growth in our consumer segment, also made it a difficult year, along with weather challenges in the early part of the quarter.

Sales in the specialty segment increased 5.4%, driven by recent acquisitions and solid organic growth of 3.6%. We saw stronger results in our specialty cleaning products, building restoration and wood preservatives businesses during the quarter.

All in all, while we are disappointed in our quarterly results, we're pleased that our organic growth continues to outperform our peers and seems to be accelerating as we enter the new fiscal year.

I'd now like to turn the call over to Barry Slifstein to provide you with more detail on our fourth quarter results.

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

Thanks, Frank, and good morning, everyone. I will review the results of operations for our fiscal 2017 fourth quarter and full year on an adjusted basis, then cover some May 31, 2017 balance sheet and cash flow items before turning the call over to Rusty, who will provide more detail on our guidance for fiscal 2018.

During the fourth quarter, we adjusted out $15 million in company-wide severance charges. Fourth quarter consolidated net sales of $1.49 billion increased 4.6% from last year. Organic sales increased 1.2%, acquisition growth added 4.8%, and foreign currency translation reduced sales by 1.4%.

Industrial segment sales increased 5% quarter-over-quarter to $733.5 million. Organic sales increased 2.2%, acquisition growth added 4.3%, and foreign currency translation reduced sales by 1.5%.

Specialty segment sales increased 5.4% to $194 million from $184.2 million. Organic sales increased 3.6%, acquisition growth added 3.3%, and foreign currency translation reduced sales by 1.5%.

Consumer segment sales increased 3.9% to $565.3 million. Organic sales decreased 1%, acquisition growth added 5.9%, and foreign currency translation reduced sales by 1%.

Consolidated gross profit increased 2.5% to $663.4 million from $647.2 million last year. As a percent of net sales, gross profit declined 100 basis points due principally to higher raw material cost and an unfavorable shift in mix towards service install sales.

Consolidated SG&A increased 3.4% to $438.9 million from $424.6 million last year. The increase was largely driven by higher warranty, pension and bad debt expenses; an increase in the earn-out accrual relating to the success of our Citadel acquisition; and additional SG&A on fiscal 2017 acquisitions.

Consolidated earnings before interest and taxes, EBIT, increased 1.7% to $224.1 million from $220.4 million last year on higher sales, which was partially offset by lower gross profit margins due to higher raw material cost.

Industrial segment EBIT decreased 7.9% to $101.1 million from $109.7 million last year. Included in last year's industrial results was an $8 million gain on the purchase of the remaining 51% of Dalian China. Excluding this gain, industrial EBIT in the quarter was essentially flat to last year.

Consumer segment EBIT increased 6.1% to $103.9 million from $98 million last year. Included in last year's consumer result was $9.3 million in a legal settlement relating to the Restore product line. Excluding the legal settlement, consumer segment EBIT declined 3.1% from last year, driven predominantly by the poor performance at Kirker.

Specialty segment EBIT increased 10.2% to $34 million from $30.9 million last year due to SG&A spending controls, partially offset by higher raw material cost.

Corporate other expense of $14.9 million compared to $18.2 million last year. The decrease is predominantly attributable to lower incentives, outside professional service fees and insurance expense.

Income taxes. Our fourth quarter income tax rate increased from an effective tax rate of 22.8% last year to 30.7% this year. The increase in the quarterly income tax rate is principally due to an unfavorable fiscal 2017 fourth quarter adjustment to the estimated benefit from the domestic manufacturing deduction combined with nonrecurring fiscal 2016 fourth quarter tax benefits related to valuation allowance reversals, the benefit associated with the nontaxable gain from the purchase of the remaining 51% of Dalian China, and the deferred tax benefit from state tax rate changes.

Net income of $138.3 million decreased 9.6% from last year's $152.9 million. Current quarter EPS of $1.02 per share compared to EPS last year of $1.13 per share. A significantly higher tax rate this year compared to last year accounted for the difference.

And now a quick look at the cash flows and capital structure. Cash provided by operating activities was $386.1 million this year compared to $474.7 million last year. The decrease was principally attributable to an increase in inventory and the pre-funding of the fiscal 2018 pension plan contribution included in other accrued liabilities.

Total debt as of May 31, 2017 was $2.1 billion compared to $1.6 billion last year. The increase is largely attributable to cash used for fiscal 2017 acquisitions of $254.2 million, the payment of the 524(g) trust in December 2016 of $102.5 million, the pre-funding of the December 2017 524(g) trust payment of $119.1 million, and the pre-funding of the fiscal 2018 pension plan contribution of $52.8 million. Included in total debt for this year is $253.6 million of short-term debt, reflecting the upcoming maturity in February 2018 of our 6.5% $250 million bond.

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

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

Thanks, Barry. I'll provide some color now on our fiscal 2018 guidance. 2017 was a difficult year for RPM, but we accomplished a lot to improve both our top line and bottom line in fiscal 2018. On the top line, we did a number of acquisitions, which fit well with existing RPM businesses. And for the bottom line, we closed unprofitable operations and also embarked on a severance program in the fourth quarter, which eliminated 230 positions. We ended the year with adjusted EPS of $2.47 this year, but that result included some nonrecurring expense items that we called out in our third quarter conference call in April, 3 items in particular: number one, the impairment charge on the Restore product line; number two, a European facility closing; and number three, we experienced very high one-time acquisition costs. All 3 of those items added up to $0.08 a share of nonrecurring expenses. So to develop the FY '18 outlook, it is first necessary to add back $0.08 of nonrecurring items to our adjusted EPS of $2.47 a share.

Now in FY '18, we expect incremental earnings from the following items. First of all, we expect a $0.10 per share net benefit of cost-reduction initiatives undertaken during the past year. Secondly, we expect $0.10 a share from acquisitions that were completed during the FY '17 year. And then number three, we expect to get $0.10 or $0.20 a share from our core organic growth estimated at 3%. So in summary, if you take our adjusted EPS in fiscal '17 of $2.47, add back the $0.08 for nonrecurring items, the $0.10 for cost reduction, $0.10 for acquisitions and the range of $0.10 to $0.20 for organic growth, you end up in fiscal '18 with our outlook of $2.85 to $2.95 per share.

Now I'll address some specifics for each segment. First, our industrial segment. We expect steady growth in the U.S., and we expect this to benefit our companies participating in commercial construction market. Also, we think that the oil and gas markets will bottom out during the year, and we can start to get positive comparisons in our industrial coatings business. And then also, we expect Europe to contribute positively to growth, both on the top line and on the bottom line. So in summary, we expect our industrial sales to grow in the low- to mid-single digits.

Next, I'll move to specialty. We expect our growth in fiscal '18 to be driven by our fluorescent pigments business, also our wood preservatives and treatment business. We have -- expect to lose revenue due to a U.S. patent expiration that affects our edible coatings business, and we believe this will negatively impact EBIT by roughly $10 million. So in summary, we expect our specialty segment sales to grow in the low single digits.

Moving next to consumer. We expect organic sales growth in consumer in the low- to mid-single-digit range. As we have favorable market conditions, we continue to pick up new listings and new accounts, both in the United States and Europe. Our DAP capacity issues have been resolved, and now we can manage the recent uptick in growth that we've experienced there. Kirker, as many of you know, has masked our consumer segment performance over the last 3 years. And we believe this has stabilized now under new management, and we're positioned to rebuild and move this business forward. In addition to our internal growth initiatives, we also expect a meaningful boost from acquisitions for DAP purchasing Touch 'n Foam and Rust-Oleum purchasing SPS. So in summary, we expect our consumer segment to grow sales in the mid-single-digit range in fiscal '18.

Now as we move throughout fiscal '18, please keep in mind there will be some variability in our year-over-year comparisons each quarter. The main thing will be the tax rate, and I'll come back to this later. But we expect our tax rate in fiscal '18 to be in line with fiscal '17, but the quarters during the fiscal '17 year ranged between a 23.6% tax rate in the first quarter all the way up to a 30.7% tax rate in our fourth quarter. So I'll come back to this. Let's focus on the first quarter for a moment. There's a couple of things to keep in mind. We have headwinds and we have tough comparisons. I'll start with the tough comparisons. If you turn back to the first quarter of fiscal '17, nearly all our groups were on plan at that time, and the results weakened thereafter. As an example, in Brazil, our business there grew nicely in the first quarter of fiscal '17 while that country was hosting the Olympics, but our business there declined in subsequent quarters. Another aspect of tough comparisons, like I mentioned, the first quarter of last year, we had a very favorable 23.6% tax rate, and we expect that to be up in the first quarter of fiscal '18 and probably cost us $0.03 a share in the year-over-year comparisons.

Now I'll move to a couple of headwinds. First of all, material costs. As Barry and Frank mentioned, they were higher in the recently ended fourth quarter of fiscal '17. We expect those to continue to be elevated in the first quarter of fiscal '18. Secondly, we do expect some headwinds from a foreign exchange perspective on both the translational and transactional FX front. So as a result, our EPS estimate for Q1 of fiscal '18 is for $0.83 to $0.85 per share.

Now looking past the first quarter to the balance of the FY '18 year. On the positive side, we do see raw material availability improving and our announced price increases taking hold. We expect the foreign exchange headwinds to move to neutral or even positive territory as we move throughout the year. This will be a nice change after a consistently negative impact of FX for the last 3 years.

And let me offer, before I close, a couple of more specific items on quarters. In the third quarter of fiscal '17, as I mentioned earlier, there were $0.08 a share of nonrecurring, nonoperating items that we called out in our April conference call. You should add those back to fiscal '17 for a base for modeling fiscal '18. Also, in the fourth quarter of fiscal '17, as we discussed, we have a 30.7% tax rate, and we would expect in the fourth quarter of '18 to pick up $0.05 a share as we move to a more normalized tax rate.

With that, we will now be pleased to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we have our first question from Frank Mitsch with Wells Fargo Securities.

Frank Joseph Mitsch - *Wells Fargo Securities, LLC, Research Division - MD & Senior Chemicals Analyst*

Frank, you don't often see companies hit the top line or post a pretty good top line, and then, obviously, the bottom line was negatively impacted. You've made a good case regarding the tax rate being somewhat elevated here in Q4, but obviously, a lot of discussion regarding costs. And I really want to get a little better handle on the raw material side of things. The release mentioned the shortages, and I think you guys said that as well in your prepared remarks. What specifically are we looking at? And the pricing actions that you are undertaking, when will that be enough to equal or more than offset the increase in the raw materials?

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

Let me address the fourth quarter. 100% of our underperformance in the fourth quarter in terms of our results and our internal budget was at the gross margin line and principally driven by higher raw material cost and the shortages that we mentioned. There had been shortages in items like MDI/MMA resins, which are a critical resin for a number of our specialty flooring products, particularly in Europe, and then tightness in a number of other markets. It's certainly an interesting time from that perspective. When I was first out of school, I was in the banking business and wrote loan agreements and remember force majeure clauses, which essentially meant act of war or act of God. Apparently, in 2017, they mean unplanned maintenance shutdowns for some of our suppliers. That's not unique to us. And so that is the principle cause of our underperformance in the fourth quarter. We are committed to executing better in '18, and you'll see that. We're also committed to communicating better, and I mentioned that without providing quarterly guidance. I think we communicated poorly this year around the third quarter items that Rusty called out that we identified but did not adjust out of our numbers. To the extent that there's an item that's big enough to identify, we will adjust it out of our numbers accordingly. And we did not look forward and appreciate the $0.12 year-over-year hit that was coming from a tax perspective. So that was, as much as anything, poor communications. As we look to the first quarter, June was a little bit punky. July is booming. I think you'll see us continue the organic growth numbers that we showed in the fourth quarter, plus some price. That will be reflected a little bit in the first quarter and better as we get into the rest of the year. So it's highly likely that, versus the guidance that Rusty provided, we would have a first quarter with sales that are equal to or slightly higher than our bottom line performance for the raw material reasons we mentioned, as well as a $0.03 adjustment backwards on the lower tax rate year-over-year.

Frank Joseph Mitsch - *Wells Fargo Securities, LLC, Research Division - MD & Senior Chemicals Analyst*

Yes, yes. Okay, that's helpful. So pricing actions a little bit coming through in Q1 and more so thereafter?

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

That's correct. We are initiating price increases in a number of product categories, some of which have taken hold, some of which will take hold in the coming months. It's a function depending on market category of what's the lag between announcing price increases and when they take effect, and we will see how that works. But all in all, I think we're pleased with the continued organic growth numbers that our businesses are putting up, particularly on a relative basis to our other public company peers.

Frank Joseph Mitsch - *Wells Fargo Securities, LLC, Research Division - MD & Senior Chemicals Analyst*

All right, great. And then lastly, on the severance and the cost cuts, you're expecting a $0.10 improvement in fiscal '18 versus '17 from that action. Is that equally spread out throughout the year? Is that how we should think about that $0.10?

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

Yes, and that's a net figure. Obviously, with 14,000 employees around the globe, we've got some increases in G&A, and so that $0.10 is a net figure that will hit our bottom line. The actual positive benefit of the RIFs and the factory shutdowns were greater than that. So that's meant to be net of ongoing operations.

Operator

And our next question comes from Rosemarie Morbelli with Gabelli & Company.

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

Frank, I was wondering, you said that you are seeing a better July and that June was funky, which I assume you mean volatile. But I also assume that this is company-wide. Could you give us a better feel as to what you are seeing on the consumer side?

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

So the consumer performance for us, I think, is stronger than the numbers would indicate. Keep in mind, in the fourth quarter last year, our consumer segment generated 9.9% organic growth. When you look this year, ex Kirker, we were actually slightly positive year-over-year in the fourth quarter in consumer. I think that's the benefit of some of the market share gains that we had talked about a year ago and picked up. And I think versus some of our more directly comparable public peers and some of their segments that, in some cases, are customer- and geography- and product-wise almost identical to RPM's consumer segment to be flat year-over-year in a period of time in which there were weather -- a difficult rain and cold weather issues at the start of the spring versus peers that are down in the 10% range is actually a good indication of the benefit of the market share stuff that we picked up a year ago and the fact that when consumers are going in the stores, they're choosing RPM brands. We see that continuing into the first quarter. And I think we feel pretty good about where our consumer businesses are, particularly without the distraction in the new fiscal year of some of the DAP capacity issues that we had in fiscal '17.

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

Do you see any change in the way the Lowe's and the Home Depot operate vis-a-vis your product lines? They are kind of working on their inventories on the paint side. What about on your categories?

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

So I think broadly speaking, in home centers and kind of across retail, there has been some efforts to pare back inventories. It's been broadly across paint, not just in our categories, and so that affected us and others. But I think most of that's behind us, and I would not comment specifically about any particular customers.

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

Sure, I understand. And if you -- if we look at Kirker, I understand there is a new management in place. Could you share with us the new size of Kirker in terms of revenues? And are they losing money at the EBIT level? Or what are they doing at this particular stage? And what kind of incremental improvement do you anticipate next year?

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

So traditionally, we have not provided revenue or financial information on individual subsidiary companies. I think in the past couple of years, we felt compelled to do so on Kirker because of its significant deterioration. So I'll remind you of what we've said in the past. Revenues peaked 2.5 years ago to $100 million. It was a very profitable business with a slightly higher gross profit margin than the RPM average and a lower SG&A spend. Revenues are, after a 2.5-year dive, less than 50% of what they were, and the business is modestly, with a capital M, profitable. We have new leadership there, and the business seems to be stabilized. And I don't anticipate that Kirker will be anything we talk about in fiscal 2018. The significant loss in revenues and significant loss in earnings for that business unit masked what otherwise have been continuing industry-leading performance of our other core consumer product lines. And so I'm looking forward to a year in which our investors can look at our consumer segment performance and know that it's principally our core small project paint, patch repair, caulks and sealants, primer and all the specialty businesses where we have the leading brands. And we would expect Kirker to be a modest contributor to sales/earnings growth but nothing material.

Operator

And our next question comes from Ghansham Panjabi with Robert W. Baird.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I guess if you could provide some more color on what drove the strength in polymer flooring, and I also -- you also called out roofing within industrial as well. Just give us a sense as to what's driving that.

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

So we had a change in leadership at our Tremco business about 3.5 years ago. You may recall we had a liability issue there, changed management, and there's been a real concerted effort to improve that business. And so we are seeing that take hold this year. I would say it's a combination of decent spending in the construction markets, whether it's reroofing, which is about 90% of what Tremco does; the industrial sealant business, which is driven by both heavy commercial and light commercial construction. And so it's a combination of decent dynamics in the underlying markets and outright improvement in the roofing business versus some challenges that they had 3 years ago. Leadership matters everywhere, and that's made a difference for Tremco. In the polymer flooring area, again, it's a lot of industrial capital spending. RPM probably has a revenue base in polymer flooring that's 3x or 4x greater than any one of our competitors globally between Flowcrete, Stonhard, aspects of Euclid Chemical and RPM Belgium business. And those businesses would have actually been higher, except for a significant MMA area, particularly in Europe, where, literally, we have a backlog where we normally wouldn't have of kind of mid-single digits and growing for orders we have that we can't fill because of MMA shortages. That is now improving. And so some of the shortages that we saw in the fourth quarter are improving. As you might guess, they're improving with higher raw material prices. And we are getting in front of that with our own price increases.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, that's helpful. And then in Europe, do you sense any sort of sustained improvement? Or do you think this is just a function of, perhaps, easier comparisons from a year ago? And then also, Frank, could you just touch on your other geographies from a macro perspective?

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

Sure. The improvement in Europe seems sustained. It's not anything that's roaring, but it's a steady improvement across most of the big economies in which we do business, from U.K. to France and Germany. And so we would expect that to be a benefit. As Rusty commented as well, we, along with most of our peers that have an industrial presence in most of industrial America, have been clobbered for 3 straight years, transactionally and translationally, from a rising dollar. That's now reversed. And so after the first quarter, if FX rates just stay where they are, they will not hurt us, and most currencies will actually get a benefit, a slight benefit going forward in terms of the euro and the pound and a few other currencies. So that has been a headwind that will reverse, which will be nice. And I think that dynamic in terms of currencies is evidence as well that what we're seeing in Europe seems to be pretty sustained. Geographically, I think the area that's hurting us the most now is Brazil. We have a great management team in Brazil with the Viapol business. They had kind of defied logic in terms of their strong performance through the Olympics in construction markets. A lot of their products are kind of at the end of big project cycles, so they were completing projects that had been started a few years earlier. We had also added capacity for a number of product areas, sealants, Carboline corrosion control coatings, but the continuing recession and political turmoil in Brazil has really caught up with our business. And so we're seeing significant downturns, 10%-plus in terms of business deterioration, and we see that continuing probably for the balance of fiscal '18. That's the only region that's meaningfully down. The flip side to that, as Rusty highlighted, is we're annualizing some easier comps and starting to see some more steady spending in the oil and gas sector and the energy sector, which is also a big market for our industrial coatings businesses.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And then just one final one maybe for Rusty. In terms of the EPS bridge, fiscal year '18 versus '17, how should we think about the price-cost differential year-over-year?

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

Yes. In terms of price-cost, like Frank mentioned, we would expect our price increases to take hold through the first and second quarters and give us some relief on the margin. But we don't think that will play out, really, until we get into the second quarter of this year.

Operator

Our next question comes from Vincent Andrews with Morgan Stanley.

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

You mentioned this patent cliff on your edible coatings costing you $10 million of EBIT this year. I guess I'm just curious. Are there any other issues, similar issues with patents and expiration that we should be aware of?

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

No.

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

Okay. And then in terms of the oil and gas market bottoming out, I mean, I understand what you just said on the softer comps, but the underlying market still looks a bit volatile. So what gives you the confidence that, that's actually going to happen this year?

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

I think we're starting to see a return from -- or to some basic maintenance spending that had been deferred and, I believe, in the oil markets that we're kind of settling into a base. So it's a combination over the last few years of both the steep decline in oil prices but also the volatility. And obviously, rig counts went down, capital investment went down and maintenance went down. Maintenance can be deferred for only so long. We're actually seeing some pretty significant pickup, which is benefiting our revenues now and pipeline activity. And that's a core product for our Carboline business and also the principal products of a SPC business that we acquired a year ago in Canada, whose products are exclusively for a pipeline business, mostly oil and gas. So we're seeing spending there, and we would anticipate that, that picks up at a modest but steady basis, which beats 2.5 years of watching your revenues decline 10%. And in the fourth quarter, we saw that. It was really the first quarter where the decline was kind of a mid-single digit. So we're seeing some improvement there.

Operator

And our next question comes from Steve Byrne with Bank of America.

Steve Byrne - *BofA Merrill Lynch, Research Division - Director of Equity Research*

What's the split in your sales within the consumer segment between what you would estimate as a do-it-yourself purchaser versus a contractor?

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

So the vast majority of our Rust-Oleum product lines, small project paints, spray paint, concrete products, are sold to DIY-ers. I would take a rough guess at maybe 80-20. Whereas the DAP business is probably a little closer to 50-50 between consumer DIY and either homebuilders or light maintenance or small contractors. DAP's not in the heavy commercial market that our Tremco Sealants business are in. But to a certain extent, homebuilding would impact DAP and the DAP product lines in ways that it would not, for instance, with Rust-Oleum.

Steve Byrne - *BofA Merrill Lynch, Research Division - Director of Equity Research*

And do you see opportunities to strengthen that exposure with the contractor? It would seem you have high brand equity in a lot of these products. You don't require any custom blending or colorants or so forth. Why couldn't that be direct-to-sale to a contractor, either Internet-based or through some other channel than just the big boxes?

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

Well, we sell, through our Tremco Sealants business, a lot of -- and in Euclid Chemical operations, sealants and concrete repair products and a lot of coatings for concrete and construction markets through an industrial distribution base, and you'll see some of that growing in online sales. But on the DIY space, I think the DIY space that so far has really not been negatively impacted by online sales, I think it has to do with, in part, cost-weight ratio relative to shipping costs, has to do with flammability of certain products, has to do with the fact that when people go into any one of our retail customers are typically doing projects, so they're buying different odds and ends. It's something that we pay a lot of attention to. But I would highlight again a comment I had made earlier. Our consumer businesses are doing well. They're well positioned. They're in almost every retail outlet. We are recognized as the innovator. And when you compare our year-over-year results with a number of our competitors, we are outperforming significantly.

Operator

And our next question comes from Kevin McCarthy with Vertical Research Partners.

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

Frank, would you comment on what you're seeing in the M&A pipeline today and specifically whether you see any meaningful potential for a larger deal given the backdrop of industry consolidation? Or should we expect bolt-ons, a la the Key Resin deal last week?

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

Sure. The type of M&A that we've been comfortable in commenting on is the just traditional RPM bread-and-butter, where we are a really good home for entrepreneurial companies, family businesses or whether we've -- where we've gotten to be very good at acquiring businesses or product lines and completely integrating them. Key Resin is a great example. We just announced it last week. We do a lot in polymer flooring, and so someone might say, "Well, gee, why are you buying another flooring business?" A key product area for industrial and commercial flooring is terrazzo, and it's not an area that any of our businesses have much of a presence or a strength in, and Key Resin is a leader in the U.S. in the terrazzo flooring market. So we're very excited about that. Jeff Cain is the big part of the founding family, and he's going stay and run that business for us as part of the Euclid Group. So that's something we're very excited about. You will see more of those kind of acquisitions. '17 was probably a larger year in M&A than typical. We did 9 deals. And I think on an annualized basis, they would move about $220 million, $240 million in sales, somewhere in that range. I don't know that we would do 9 deals a year, but I think this year, I'd anticipate a handful of deals maybe in the same size, and it's really where we are focused.

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

Same dollar amount, you mean, Frank, or same size per deal...?

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

I would say, again, transactions are opportunistic. A lot of them are companies that we followed for years. Every once in a while, an opportunity pops up through a bank auction or some other process that we're not aware of. So we could get some sizable, but we'll get a couple deals done this year just based on what's in the pipeline. But to be able to say it would be to do $50 million or $100 million or $200-plus million is really hard to say at this point in time, other than we are continuing to focus on the kind of transactions going forward that we completed in 2017.

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

Understood. That's helpful. And second question, if I may. Did the shortages that you referenced in MDI and MMA have a measurable impact on your volumes? And I guess on the pricing side, were your pricing contributions on average positive in each of your segments year-over-year? Or did they run negative?

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

There was virtually no pricing to speak of in '17 and virtually no pricing in the fourth quarter. So to a certain extent, I think we and a lot of folks in our industry got caught short in the fourth quarter. Everybody's working to make up for that in terms of price increases where it's appropriate. And I don't know that the volume was not inconsequential in our industrial segment relative to MMA and MDI and a few other things. With higher prices, amazingly, the shortages are improving, and so it won't be a headwind to revenues going forward. But as Rusty highlighted, we do anticipate a hit to our gross profit margin year-over-year in the first quarter.

Operator

And our next question comes from Arun Viswanathan with RBC Capital Markets.

Arun Shankar Viswanathan - *RBC Capital Markets, LLC, Research Division - Analyst*

So I just want to ask about a couple dynamics we've been seeing. Are you guys noticing a noticeable shift from contractor to DIY or away from DIY and more towards the pro? It seems like some competitors in adjacent industries are seeing that. I just wanted to get your thoughts on that.

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

Sure. In our product categories, that is not necessarily the case. I think that more relates to the dynamics in tint base architectural paint, which is really not a space that we play in. We have some gallon good products that are specialty niche areas. To a certain extent, our Zinsser primer business is a very solid business. They're doing quite well. And so we don't see it there. I think it has more to do with the dynamics in the architectural paint market and how that's playing out relative to some industry consolidation and challenges of company-owned stores versus other retail outlets for architectural paint.

Arun Shankar Viswanathan - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay, great. And then on the raw side, understanding that there was a little bit of pressure from availability. I would have thought that you guys would have seen less pressure just given that none of your raws make up more than 5%. So do you think that going forward, I know your price increases, but just from an inflationary standpoint, that you won't see as much inflation in your raw bucket?

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

We anticipate that some of the price spikes that we've seen will be mitigated or at least stop rising here as we get towards the end of the summer. I think there are some indications that, that is true, particularly with some of the availability. But broadly speaking, there were efforts across a number of resin categories, acrylic resins, epoxy resins, some of the shortages we referenced. So broadly speaking, there were efforts, some more successful than others, to raise prices across most of our industry's raw material base. We are certainly not as big a buyer of certain raw materials like TiO2 for reasons I just mentioned relative to our not having a presence in the architectural paint market, to say the house paint market, if you will. And so that hasn't hurt us as much and will not be a challenge for us like it would be for folks in that business.

Arun Shankar Viswanathan - *RBC Capital Markets, LLC, Research Division - Analyst*

And then just a question on the guidance and how it relates to some of the challenges in '17. The $2.85 to $2.95, maybe you can just characterize a couple factors that would get you to the upper end of that or the lower end, if that's a fair statement. And then also on Kirker, I understand that management has been changed. But what kind of gives you the confidence that, that business has stabilized at a new level? I thought that there were some structural issues that may continue. But yes, maybe just give me some thoughts there.

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

On Kirker, I think we found a base of business that we won't lose, and we're growing from there. On the other areas, I think it really -- the 2 factors that we have to manage in fiscal '18 to be at the upper end of our range are growth, which, if what we're experiencing as we speak is any indication and we end up adding some price to that, will not be the issue, and the other issue will be raw material costs. And our current understanding or view of the market is that we and the folks in our industry have some catching up to do on price that's happening and that the raw material base will not continue to increase as we get into the fall. And I think that's every indication that we see. If those prove to be true, then our ability to be at the upper end of our range will come out. If we wake up like, unfortunately, we have for too many years in a row now, with growth mitigating as we get towards the end of the year and GDP being back in the 1% or 1.5% range and continuing challenges on the raw material front, then we'll be at the lower end of that range. I think we're very confident in the range we provided. And there's some dynamics out there that suggest to us this will be a positive year, but I think the performance over the next 3 or 4 months will be very telling for how we and our whole industry perform for the rest of the year.

Operator

And our next question comes from Silke Kueck with JPMorgan.

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

Is the acrylic and epoxy shortage an issue specifically in Europe? Or is that also something that touches North America?

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

So it's mostly Europe. The raw material issues that we have seen both in terms of first increases and as well as the first shortages were European-based and principally impacting our industrial segment businesses.

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

And as best as you can tell, it looks like it's something that may persist for like another quarter and then things will get looser again.

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

We're already seeing some availability in MMA and a couple other areas that were tight to the point of building backlogs in a couple of companies where we normally wouldn't build a backlog because we had order flow that we couldn't meet. That persisted for about 30 or 45 days and seems to be clearing up.

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

Okay, that's helpful. And secondly, is there a positive cash flow item that you expect in fiscal '18 from funding and pre-funding the asbestos trust, like I said, like a positive tax component?

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

Sure. We're a May 31 fiscal year, so that is also our tax year. And to the extent that we could prefund our pension obligation before May 31 as opposed to spread it out on a quarterly basis throughout the year and the decision to accelerate our December '17 SPHC trust payment was also a tax-driven event. So if there's any tax reform out of this Congress whose effective date is before May 31, '18, we will be happy to have made these decisions. If there's not, it essentially serves as an acceleration of payments that otherwise would have been made over the coming 12 months.

Operator

And our next question comes from Mike Harrison with Seaport Global Securities.

Michael Joseph Harrison - *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

Frank, I was wondering if you could talk a little bit more about the weather impact that you saw this quarter. Roughly how much of a drag was weather on organic sales growth in consumer? And did you see any impact in the industrial business this quarter?

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

We saw a lousy start to our quarter in March because of wet, cold weather. It was a relatively mild winter right up until March. And for better or for worse, I'm not the only industry CEO crying the weather blues, but it negatively impacted our quarter. So we got off to a very difficult start and a slow start year-over-year, and as the quarter progressed, we continued to do better. And so when you look at our quarterly results, and obviously, we don't publish and nobody publishes monthly results, but our April was better than our March, and our May was much better than our April. And June was a little bit punky weather-wise as well. But we are seeing pretty robust growth right now for the month of July. So again, I think that was more just temporary weather-related. Demand seems to be pretty good across most of our businesses right now.

Michael Joseph Harrison - *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

And was there any impact in the industrial business?

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

Not that I could tell per se. There was a little bit of an impact in March in our Tremco Roofing business. I think we made up most of that. There was a negative impact in our Dryvit business, which is a water-based, entirely exterior-use product. And so that didn't perform as well in the fourth quarter as we'd like. But there's nothing about either of those businesses that suggested that wasn't just temporary. They're both doing very well.

Michael Joseph Harrison - *Seaport Global Securities LLC, Research Division - MD & Senior Chemicals Analyst*

All right. And then in terms of the cost actions that you've taken, I was wondering if you could give a little bit more detail on that. And in particular, you said that the $0.10 number was a net number. Where are some of the incremental growth spending initiatives taking place?

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

Sure. We looked across our businesses mid-year, when it became apparent to us that we were going to underperform to our business plan and after the impairment charge on Kirker, and really challenged our businesses to look to where there might be some areas of underperformance that we could either improve or close. So we identified a plant in Germany and identified a plant in Middle East, both of which were closed, and basically both of which were underperforming business units that were liquidated. And we also challenged our businesses in the second half of the year to look across their business units and take a hard look at headcount reductions. And as a result of that, we affected a 230-person rip pretty evenly across RPM business segments. It was not even across our business units. Those that are doing well were not impacted, and those that had had a disappointing year took some hard decisions there. The net nature of it is when you got -- the simple way to think about it is when you've got a 14,000-person global business and you've got a cost and benefit base that would rise even under some constraints in modest terms of about 2%, that offsets some of the expense cuts and headcount reduction benefits that we got year-over-year. So rather than give people a number in the tens of millions of dollars that would be misleading, we thought the best way to do it would be to provide a net number that people should think of as incrementally positive from these actions for the new fiscal year.

Operator

And our next question comes from Jason Rodgers with Great Lakes Review.

Jason Andrew Rodgers - *Great Lakes Review - VP*

I apologize if I missed it, but did you give a CapEx estimate for fiscal '18?

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

No, I think it will be relatively flat year-over-year, somewhere in the $130 million range.

Jason Andrew Rodgers - *Great Lakes Review - VP*

Okay. And would you provide, perhaps, more detail on what changes you're looking for new management to make at Kirker to improve results going forward?

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

Better management of our customer base and a better focus on customer service and, I think, recommitting to their place in the supply chain.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And then finally, any update on some of your significant products such as AlphaGuard, RoofTec, TUF-STRAND? Any milestones or new developments there?

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

Sure. We are selling all the TUF-STRAND fiber we can make, and we're starting to sell it more internationally. AlphaGuard for Tremco Roofing continues to grow at double digits. Dryvit introduced in the spring a new patented product called NewBrick, and it is a brick kind of facade surrounded a piece of installation. And they're very excited about the potential for that product in commercial and light commercial markets. It opens up a Dryvit product to bricklayers as an entirely new contractor base to sell that product. And so we are doing a number of things from a manufacturing perspective to get at that in terms of volume and efficiency and continuing to try and get it specified. So that will be an interesting product. It's relatively new. The potential is pretty exciting, but we need to get out there more with it and get market acceptance. The Rust-Oleum RockSolid product for garage floors is booming. It is related to an acquisition we bought with some unique technology that actually improves upon our and all of our competitors' products in terms of performance and a 12-hour cure time as opposed to cure times that were 24 hours-plus with old technology and competitor technology. So that's going quite well also.

Operator

And our next question comes from Mike Sison with KeyBanc.

Michael Joseph Sison - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Just wanted to get a better feel for the squeeze in raw material sensitivity. You said organic growth should provide $0.20 in EPS incrementally, and I assume that's covering the raw material headwinds. In the event that the environment, for whatever reason, is more difficult, does that -- what type of headwind is it, just like a $0.05, maybe $0.10?

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

Sure. Well, we said that organic growth would be $0.10 to $0.20, and I think the variability there is really how well we manage raw material cost versus our ability to get price. And then our expectation, I think it's pretty generally believed that things will stabilize towards the end of the summer or fall. But I think you'll see a first quarter that -- the fourth quarter was disappointing to us on a growth basis. We're still getting at it. I think you'll see a first quarter then, on a growth basis, looks even better. And in a stable raw material environment, we put a lot of it on our bottom line. And as we've indicated with the guidance that Rusty provided for the first quarter, our ability to leverage that in the first quarter will be muted. If we can manage that better and we can get some raw material relief or some combination of raw material price relief, then I think there's an opportunity for us to outperform in the back half of the year.

Michael Joseph Sison - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Got it. And then a quick follow-up, and I apologize if I missed this. But I thought that Euclid's been a pretty good performer, generating pretty good organic sales growth. Any thoughts there on how that's doing as we head into '18?

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

Sure. So our Euclid Group is continuing to grow well in the U.S. and North America, expanding globally, and all of that's the good news. The bad news is within the Euclid Group is the Viapol Brazilian business, which is killing us month by month. We're down about 10%, and we see that continuing for the balance of the year.

Operator

And our next question comes from Kevin Hocevar with Northcoast Research.

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

You called out $5.5 million of transactional FX headwinds in the industrial segment. Could you remind me what currencies are causing that? And I think you called out that it was continuing to be a headwind here in the first quarter. I wonder if you could give us a sense, is it a similar magnitude? Is it getting any better? What's happening there?

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

So it is getting better. And the currencies that impact us the most, particularly on the transactional side, is the relationship between the U.S. dollar and the Canadian dollar. We produce a ton of products in the U.S. that are sold in Canada. The ratio, which sometimes helps and sometimes hurts, between the U.K. pound and euro, where we have a lot of cross-border transactions with the big manufacturing base in the U.K. but also in Europe, so depending on which way those products go. Day-Glo, which is the world leader in fluorescent pigments, our manufacturing bases are in the U.S. and Europe and the U.K. And there's a lot of different technology products that are produced exclusively for global distribution in one place or another. So there's the -- so those are the principal areas, along with some just intercompany items that drive transactional FX issues. On the translational side, it's been the euro, the Canadian dollar, the U.K. pound and then in odds and ends, to a lesser extent, the Brazilian real. As we sit here today, all of those have improved in relationship to translational. And if currency rates stayed the same today for the rest of our fiscal year, after the first quarter, you will see either no impact or a positive impact on transactional -- on translational impact of FX, which is the first time that that's happened in 3 years. We lost -- this is a year ago, I don't know of the date, but we've lost $400 million to $500 million in revenues and probably $50 million or $60 million in operating earnings due to FX translational and transactional impact over the last 3 years.

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

Got you, okay. And how big of a headwind was the DAP disruption in fiscal '17? And I don't know if this was -- I thought the non-repeated DAP disruption will be a tailwind in fiscal '18. But I don't know if that was necessarily specifically called out or not. So correct me if I'm wrong, but shouldn't that then be a tailwind in fiscal '18?

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

Yes, it should. And it negatively impacted us in terms of our ability to supply customers. We actually lost a little share temporarily. Fortunately, we've gotten almost all of that back, and we have cleaned up the manufacturing pinch points. And so it should be a tailwind for us as we go into fiscal '18. And DAP will be a great example of kind of the macro issue for RPM, which it will be a combination of growth but also raw material cost issues that we'll be managing for the year in terms of how much of that growth we can put on our bottom line.

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

Okay. And just a quick one. What do you expect corporate expense to look like in 2018?

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

Yes. For the 2018 year, we'd expect it to be fairly flat. We expect pension expense to go down, but we do expect increases in health care, and there may be some other small increases in professional services and bonus as we restore the bonus after a poor performance in FY '17.

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

Yes, we have a pretty levered compensation program for corporate executives and our operating leadership team. And our underperformance in '17 will show up in our proxy. And so there will be a category back to the net savings of an anticipation of better compensation relative to variable comp in '18 to the extent we hit our internal numbers.

Operator

And our next question comes from Christopher Perrella with Bloomberg Intelligence.

Christopher Perrella

Could you give a breakout? What portion of the consumer sales goes to the retail channel as opposed to industrial distributors? I'm just trying to size your big-box exposure.

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

Sure. On an annualized basis, our consumer segment's about $1.6 billion. And we probably do $100 million or so in MRO distribution, the balance of it's across -- we're in virtually every North American retail outlet that you would like to be in, with one major exception.

Christopher Perrella

All right. And then what -- could you give color behind the rise in accounts receivables, the rise in the doubtful account allowance and the inventory on the balance sheet?

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

Sure. Yes, in terms of the doubtful accounts, we did have, as we mentioned in our second quarter conference call, some bad debt reserves that we put up as part of the decision to close Flowcrete Middle East. And there were also some other bad debt reserves taken in certain emerging markets during the year. On the inventory front, the growth in inventories was really in the consumer segment. And that was involved with trying to maintain customer service at very high levels in spite of some capacity challenges that we had, especially early in the year. We mentioned DAP as one example.

Christopher Perrella

So with the challenges in DAP reversed, will you be working that down and maybe see release of working capital in '18?

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

Yes. And you're also likely to see allowance for doubtful accounts and reserves for bad debt expense lower in '18 versus '17 as well.

Operator

We have no further questions at this time. I would now turn the call back over to Mr. Sullivan for closing remarks.

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

Thank you for your participation on our investor call today. With a strong acquisition program, particularly in 2017, and the cost actions we've taken in this past fiscal year, we're excited about returning RPM to solid double-digit earnings growth in 2018 and think we have rebuilt the momentum to continue that for a number of years to come. I'd like to thank the more than 14,000 employees around the world for their continued efforts and dedication to RPM. In this challenging growth environment, we are continuing to compete and win in the markets that we serve. And thank you for your interest in and investment in RPM. We look forward to talking to you in October, when we talk about the first quarter of our new 2018 fiscal year. Have a great day.

Operator

And thank you, ladies and gentlemen. This concludes today's conference. We thank you for participating. You may now disconnect.