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RPM - Q2 2018 RPM International Inc Earnings Call

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OVERVIEW:

Co. reported 2Q18 consolidated net sales of $1.32b and net income of $95.5m or $0.70 per share. Expects 2018 EPS guidance, excluding one-time adjustment to be $3.00-3.10.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome to the RPM International's Conference Call for the Fiscal 2018 Second Quarter. Today's call is being recorded. This call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com.

Comments made on this call may be forward-looking statements based on current expectations that involve certain 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 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 & CEO*

Thank you, Jason.

Good morning, and welcome to the RPM International Inc. Investor Call for our Fiscal 2018 Second Quarter Ended November 30, 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 second quarter results, then provide detailed guidance for the balance of fiscal 2018 and, of course, answer your questions.

We were pleased with our performance during the second quarter. Our strategically balanced business model is alive and well and we continue to see the benefit of last year's product line acquisitions and cost reduction actions on improved leverage, which more than offset higher raw material costs that have negatively impacted gross margins across most all of our businesses. Earnings per share of $0.70 improved 34.6% from last year's adjusted results of $0.52 per share and increased 17.3%, excluding a $0.09 per share benefit based on a lower tax rate recognized in the quarter relative to last year's tax rate.

Sales in our industrial segment increased 11% in the quarter driven by strong organic growth of 5.4% and acquisition growth of 3.3%. We saw solid organic growth in our North American roofing businesses and those businesses providing polymer flooring to commercial and industrial markets. We also saw a slight rebound in our companies serving the oil and gas sector with positive organic sales growth for the first time in 3 years.

We continue to see mixed results in Europe and continued poor performance in Latin America, particularly Brazil. EBIT results for the industrial segment reflect the combination of higher raw material costs, unfavorable foreign -- transactional foreign exchange and continued disappointing results in struggling Latin America, partially offset by price increases and better SG&A leverage from fiscal 2017 expense initiatives.

Sales in the consumer segment increased 11.1% in the quarter driven by last year's acquisition of Touch 'n Foam in the U.S. and SPS in Europe as well as a return to solid organic growth of 3%. Consumer segment EBIT declined due to higher raw material costs, unfavorable manufacturing overhead absorption and product mix.

Sales in the specialty segment increased 7.4% driven by recent acquisitions and a solid organic growth of 2.8% after overcoming a 3% loss of sales associated with the fiscal 2017 closure of an unprofitable European business and further reduced by the impact of the recent patent expiration in our edible coatings business.

Sales were particularly robust in our restoration services business due to the severe hurricane season and strong growth in our powder coatings and wood finishes business. We saw strong EBIT leverage in specialty as we were able to more than offset higher raw material costs and the negative impact of the recent patent expiration with good cost control.

We also recognized $11.1 million of cost savings in our corporate/other segment with lower pension and health care, acquisition and other professional fee reductions.

Lastly, the strong results in our second quarter could have been better in relationship to the 2 weeks at the beginning of the quarter that were impacted by the devastating hurricanes, particularly in strong markets like Florida, Texas as well as in Puerto Rico.

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

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

Thanks, Frank, and good morning, everyone.

I will review the results of operations for our fiscal 2018 second quarter compared to last year's second quarter adjusted results, then cover some November 30, 2017 balance sheet and cash flow items before turning the call over to Rusty, who will provide more detail on our guidance for the balance of the fiscal year.

Last year's second quarter adjusted results exclude the impact from the impairment charge and Middle East business closure.

Second quarter's consolidated net sales of $1.32 billion increased 10.5% from last year. Organic sales increased 4.2%, acquisition growth added 4.7% and foreign currency translation increased sales by 1.6%.

Industrial segment sales increased 11% quarter-over-quarter to $702.9 million. Organic sales increased 5.4%, acquisition growth added 3.3% and foreign currency translation increased sales by 2.3%.

Consumer segment sales increased 11.1% to $415.4 million. Organic sales increased 3%, acquisition growth added 7.3% and foreign currency translation increased sales by 0.8%.

Specialty segment sales increased 7.4% to $197.1 million from $183.6 million last year. Organic sales increased 2.8%, acquisition growth added 3.8% and foreign currency translation increased sales by 0.8%.

Consolidated gross profit increased 5.5% to $551 million from $522.2 million last year. As a percent of net sales, gross profit declined 200 basis points due to higher raw material costs and unfavorable manufacturing absorption and product mix.

Consolidated SG&A increased 2.9% to $419.6 million from $407.7 million last year. The increase was largely due to added SG&A from acquisition. As a percent of net sales, SG&A declined 230 basis points to 31.9% from 34.2%, reflecting last year's cost reduction actions and lower expenses in the corporate/other segment.

Consolidated earnings before interest and taxes. EBIT increased 15.4% to $131.8 million from $114.2 million last year on higher organic sales and last year's product line acquisitions and cost reduction actions, partly offset by lower gross profit margins principally due to higher raw material costs.

Industrial segment EBIT increased 8.9% to $70.2 million from $64.5 million last year due to higher sales and last year's cost reductions, which more than offset higher raw material costs, unfavorable transactional foreign currency exchange and continued disappointing results in Latin America, especially Brazil.

Consumer segment EBIT declined 5.3% to $45.2 million from $47.7 million last year, principally due to higher raw material costs, unfavorable manufacturing absorption and unfavorable product mix, partially offset by better SG&A leverage.

Specialty segment increased 10.8% to $34.4 million from $31 million last year due to solid organic and acquisition-related sales growth, especially in our restoration service businesses, combined with better SG&A leverage due to cost-cutting actions. This was partially offset by higher raw material costs and the unfavorable impact from a recent patent expiration.

Corporate/other expense of $18 million declined from $29 million last year. The decrease is predominantly attributable to lower pension expense, health care costs, outside professional service fees and acquisition-related expenses.

Income taxes. The effective income tax expense rate was 12.2% for the 3 months ended November 30, 2017 compared to an effective income tax rate of 24% for the 3 months ended November 30, 2016. The lower rate was due to favorable tax benefits recognized as a result of legal entity restructurings that were completed during the second quarter.

Net income of $95.5 million increased 35.3% from last year's $70.5 million. Current quarter EPS of $0.70 per share compares to EPS last year of $0.52 per share, representing a 34.6% increase.

Now, a quick look at the cash flows and capital structure. Cash provided by operating activities was $115.2 million this year compared to $158.7 million last year. The decrease was principally attributable to an increase in accounts receivables resulting from substantially higher sales, the timing of receivable collections this year versus last year and the timing of payments to suppliers.

Total debt. As of November 30, 2017, total debt 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 to the 524(g) trust in December 2016 of $102.5 million and the prefunding of the December 2017 524(g) trust payment of $119.1 million and the 2018 pension plan contribution of $52.8 million. Included in total debt for this year is $253.7 million of short-term debt reflecting the upcoming maturity in February 2018 of our 6.5% $250 million bond.

In December 2017, the company issued $300 million of 4.25% 30-year notes due 2048, the net proceeds of which will be used to retire the $250 million of 6.5% bonds due this February, therefore -- thereby lowering RPM's overall interest rate.

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

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

Thank you, Barry.

And I'd like to provide some color on our fiscal 2018 guidance, which we are raising today. I'm happy to report record results for RPM today. RPM's model, as Frank mentioned, is built on strategic balance, which is working well. So to be more specific, when we talk about strategic balance, that is the balance between acquisition and organic growth as well as the strategic balance in our business portfolio between consumer, industrial and specialty businesses.

Originally, our fiscal 2018 guidance was built upon our accomplishments last year in brisk acquisition activity and cost reduction actions. Through 6 months, I'm pleased to say that we have realized the benefits of these activities from last year and, operationally, we have performed in line with our expectations. I'm especially pleased to say that our bottom line has exceeded our expectations as our tax team has realized more discrete benefits through 6 months than we originally anticipated.

As we look ahead to the back half of the year, some themes. First of all, raw materials will continue to be a challenge for us, but there is a couple of drags we talked about a lot over the last 3 years that are appearing to turn the corner. First of all, our industrial segment sales to energy markets have turned the corner in the most recent quarter reported. Secondly, we're expecting the translation impact of foreign exchange to be positive. That's the impact from translating the sales and earnings of our foreign subsidiaries into U.S. dollar results.

So in general, we see more positives than negatives, which is why we are raising our guidance today. We share optimism in the U.S. economy with the new tax law. In U.S. construction, we see an uptick being led by regions impacted by the recent hurricanes and we're also looking ahead to overall improvement in the global economy. We're optimistic in regards to the opportunities from the new tax law to further invest in our great businesses and brands and we'll talk a bit about that more later.

So I'll start by talking about our industrial segment, which had the strongest organic growth of our 3 segments in the second quarter, led by roofing. Our construction activity has picked up in some of the hurricane-impacted regions. We expect that to continue in the second half. As I mentioned, our industrial coatings business especially has been impacted by the downturn in energy markets and we expect that to turn the corner.

Also, our industrial segment is the most global of our 3 segments with 50% of its business outside of the U.S. and we expect to see the most favorable impact of global economic improvement here, which will be compounded by the strengthening of the euro, the pound and the Canadian dollar that we've seen lately and I'd say that should help us in terms of our translational foreign exchange impact.

In terms of some of the challenges, we are lapping the anniversary of several of our fiscal '17 acquisitions. Last year, you might remember the bulk of these were done by January and you'll hear this theme again as we discuss the other 2 segments. Another challenge for us is Brazil. The macroeconomy is challenging to us, but the comps do get easier as we progress into the back half of the year.

And one additional note on industrial. As we mentioned before on our October earnings call, we continue to pursue additional cost savings in this segment to improve the operating leverage. So for the balance of this year, we expect the industrial segment's sales to grow in the upper single-digit range.

Moving now to consumer. Frank and Barry already spoke to some of the margin challenges in this segment. Another near-term challenge will be the favorable acquisition impact that we've seen this year is going to end this month in January as we lap the anniversary of the SPS and Touch 'n Foam acquisitions. In terms of -- looking beyond the near-term challenges, however, we do see a positive future for home improvement spending. And as a result, we plan to invest in stepped-up advertising and promotional activity during the upcoming spring. So in summary, we expect our consumer segment sales to grow in the low to mid-single-digit range, but we do expect the back half earnings to be flat to last year as a result of some of these stepped-up investments in brand advertising and promotional activity.

Moving to the specialty segment. We did report nice results in the second quarter with good leverage, but their performance has been even better than the numbers indicate. For example, their organic growth of 2.8% in the quarter was the lowest of our 3 segments, but it actually would have been the highest if sales are factored out of the prior year from a European business that we closed last winter. And another note on specialty is that they are generating this good performance in spite of the drag on sales from a U.S. patent that expired prior to the second quarter. And as we mentioned, this impacts our edible coatings business.

So as we already discussed, the negative impacts on sales have been offset so far this year by great sales in our restoration service business as well as a couple of businesses selling into OEM markets. So in summary, we expect our specialty segment sales to grow in the low single-digit range as the acquisition impact from FY '17 is reduced as we move forward in the back half of this year.

So I'll conclude with some overall comments. As we mentioned, our operations are performing in line with the expectations when we issued our original guidance in July. Sales are a bit better. Raw materials are a bit more challenging, but overall were in line with expectations. And we expect this to continue in the back half.

One area we mentioned we are better than we anticipated is taxes. Our year-to-date effective tax rate of 19.6% is better than we expected. Barry already mentioned the discrete benefits which we recognized. So even if there was no tax reform in the U.S., our fiscal 2018 effective tax rate would turn out to be better than we originally expected.

Now, as we move forward with the new tax law enacted in December, we're going to see a reduction in our federal statutory rate from 35% to 21%, which is effective for the last 5 months of RPM's fiscal year, and that blends to a rate of 29.2% for RPM in fiscal '18. We expect this to give us a $0.10 per share benefit to EPS and allows us to increase our full year EPS guidance now to a range of $3 to $3.10 per share.

And let me make an important note here. This excludes a onetime adjustment that we expect to record in the third quarter that will result from the new tax law that has been enacted. And this onetime adjustment stems from a couple of factors. First of all, based on the new tax law, we're going to remeasure our deferred tax assets and liabilities. That's one impact. The second impact is that there will be a transition tax on our deferred foreign earnings. So we still have to refine our estimates for these 2 different impacts. We don't have a number, but we will be recording a one-time adjustment in the third quarter and that is not built into this guidance range of $3 to $3.10 per share.

Now, with that, we look forward to answering your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Frank Mitsch from Wells Fargo Securities.

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

I think your tax team did a great job, excluding the tax reform. Maybe that tax team should help out the Browns, just a thought. Look, Frank, you talked a lot about better growth, organic growth sequentially, an improvement over the fiscal first quarter, looking at upper single digits in industrial. And actually, I think Rusty was talking about, if you exclude some of the shutdown, specialty would have been better as well. I'm trying to get a handle on how much of this is hurricane-related in terms of getting a better second half -- fiscal second half growth relative to other initiatives that you have underway.

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

Sure. So, in general, I think our industrial businesses have demonstrated some good growth after 3 tough years, particularly in the heavy industry area, as Rusty said. We're seeing the first positive, very modest, but first positive organic growth in product categories that serve oil and gas for instance. We're seeing the first year after 3 years of not having FX hurt us. And quite candidly, industrial activity is picking up pretty broadly. Geographically, this will give you a good sense of it since most of our consumer is in North America. There is a slug of it in Europe. But across the region or across the world, we were up 10% in U.S.; up 12% in Europe; on a small base, up 11% in Asia; up 18% in Canada. The only places where we were down were in the Middle East with a lot of turmoil. And while we were modestly positive in Latin America, it was all currency-related. If anything, our specialty -- or I'm sorry, our consumer businesses and our industrial businesses could have been better in the second quarter. We got, like everybody, hit pretty hard at the start of the quarter with the impact of the hurricanes, particularly in consumer where you had almost 2 weeks of 1,000-plus retail outlets shut down in major markets like Texas and Florida and, to a lesser extent, Puerto Rico, so that hurt us. We expect the positive trends that were showing in industrial to continue in the second half. I think specialty is managing through the challenges that we've talked about very well. And consumer, I think, will continue to be challenged in the second half just like they have in the first. I would remind folks, and we've talked about this in prior quarters, we're continuing to hold or gain share in the first half of the calendar year. A number of our direct competitors were down organically in the 10% to 11% range. In the most recent quarter, where we were up 3%, as far as we can tell, competitors are down anywhere from 1% to 3%. And we are going to end up with a year, quite candidly, that's disappointing in consumer. To address that for our 2019 fiscal year, we are planning to kick in some aggressive promotion and advertising programs in the spring and that's part of the revised guidance that we provided.

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

All right. That's very helpful. And one of the factors you mentioned was the manufacturing absorption issue in consumer. What exactly is that? How sustainable is that? What should we be thinking there?

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

Well, we've been through a 7-year run in consumer. That's been -- in our core consumer business, all the Rust-Oleum product lines and DAP product lines have really done great. We've added capacity and, as we have demonstrated throughout the year, we've had a slow-down with a flat to moderately negative organic growth. And so we've had some absorption issues there along with some significant major customer inventory cutbacks. At a couple of our major customers, you're looking at inventory levels that are down anywhere from low to mid-teens, while our sales are only down either flat or down modestly. So even there, the takeaway has been better than what our sales have been in because of inventory adjustments. The last comment I would make, which is a little bit off this, for our entire industry, and it's certainly impacted us, the raw material situation has been broader, bigger and more persistent than anybody anticipated in the middle of the year.

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

And to that end, now that you brought it up, I mean, how are -- how is your pricing relative to that? I know the -- I know there was an expectation 3 months ago that obviously you'd face some margin pressures due to higher raws for this -- for the fiscal second quarter, but then that would abate in the second half. Are you suggesting that those raw pressures are going to continue to persist into the fiscal second half of your year?

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

Yes. We are seeing, as I said, pretty broad and consistent raw material price increases in some categories, in some regions like silicones in Europe, MMA resins, different odds and ends. We have seen some shortages in allocation. And so I think, again, it's been a more bigger challenge for our whole industry than anybody anticipated in the spring or early summer and we are managing our way through that as aggressively as we can.

Operator

Next, we have Rosemarie Morbelli from Gabelli & Company.

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

Frank, I was wondering if -- when we look at your change in guidance, it is $0.15 above previous guidance, $0.10 of which is going to come from the benefit from the new tax law, if I understood properly, and then $0.05 from operations. So when we look at that $0.05, assuming I am correct, is that mostly from the hurricane benefits that you are going to see offsetting the hit in the second quarter?

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

No. Most of our change in guidance is tax-related. I think we're -- if you go back to the beginning of the year, we are comfortable, on a consolidated basis, with being in the original guidance that we provided. The tax benefits that we did not anticipate but realized in the second quarter are one reason that we increased our guidance. And then, the second reason is an anticipation with a May 31 fiscal year-end of 5 months of benefit of the -- a new tax reform that we would add an additional $0.10 for fiscal '18. So that's what gets you to the $3 to $3.10. I think to add just a little bit to the comments I made earlier, I think we're comfortable with our guidance and we'll certainly do well this year despite the raw material issues. It's likely that we will outperform our expectations in industrial and underperform our expectations at the beginning of the year in consumer.

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

So when you look at the second quarter and look at it versus the full year, are you looking at EPS of $0.61, which excludes the tax benefit in the second quarter, which is how we are going to look at it mostly...

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

Yes.

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

Or are you looking at the $0.70?

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

No. We're looking at this -- I mean, I think the right way on an apples-to-apples basis for the quarter is to look at revenue growth, it was up 10% with a solid almost 5% organic growth, and EBIT growth that was up 15%. So despite big raw material issues, we were able to leverage that growth to our bottom line -- the EBIT line and then, in adjusted EPS, which is equalized for the -- for last year's tax rate of plus 17% or $0.61. So I think if you want to eliminate the impact plus or minus of the tax issue, compare our year this year to the same tax rate last year's quarter and you come up with a $0.61 quarter, which is plus 17%. That's how we think about it in terms of the operating performance.

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

Okay. And looking at shellac, how large is that particular business? And the fact that the patent expires, I mean, does it mean just more competition on pricing or are there other issues?

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

No. Our MBZ business had a -- we didn't release the size of the product line, but they had a -- they were the inventors of NatureSeal, which was the product that allowed apples to be coated with NatureSeal on a water wash and not brown and that went off-patent this summer. The management team there was able to negotiate with all of their major customers new contracts and so we did not lose any market share. But they were very aggressive in recognizing the patent expiration, wanting to continue to keep that customer base. So we slashed our prices pretty aggressively. So you've got significantly lower volume and a lower gross profit margin on what is still a very healthy business in kind of a unique specialty products company that's involved in specialty food coatings and additives.

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

Okay. And then, going back to my question on the hurricane benefit, what do you think it is going to be in the second half of this year?

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

It's hard to say. I think it depends when the winter breaks, for starters. We haven't had a very harsh winter for the last couple of years and this year's winter season seems to be getting off to a pretty robust chill and so that's likely to impact business. But I think in our Tremco Roofing business, construction businesses, on the consumer side, probably more DAP caulks and sealants and patch and repair. We would expect to have some benefits in the spring and early summer as people do more patch and repair and/or renovation continues.

Operator

Next, we have from Vincent Andrews from Morgan Stanley.

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

I just want to clarify the previous question on the EPS guidance in the $0.61 versus $0.70. When you talk about now doing the -- your new guidance, does that assume that you did $0.61 in the second quarter or $0.70?

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

$0.70.

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

$0.70. Okay.

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

It's going to be $0.70 in this quarter, but in terms of doing apples-to-apples, I think $0.61 is the right number to look at.

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

Understood. Okay. And then, I just wanted to ask about the investment spending in consumer and maybe for a little more detail because it sounds like you are gaining share, but you're just not delighted with the overall volume performance. So is this spend designed to try to grow the category or is it designed to try to grow share or both? And then, I guess, my follow-up to that would just be -- you talked about EBIT in consumer being flat in the back half of the year as a result of this. So is that because there's going to be higher raw material inflation or you're just not expecting to get an immediate return on this spend?

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

Well, it's been a -- we won't get an immediate return on the spend, but it's been a challenging year for consumer across the board, not just us, but a lot of our peers. And so we have gotten new placements in a number of major customers in wood stains and finishes. We continue to be the lead provider of small project paints. We continue to grow in the concrete and garage floor coatings category, both in terms of share and increasing the market. But I think that with a very disappointing year, this spring, we intend to increase our promotional spending and our advertising spending in light of what's going to continue to be in the second half, I think, challenging results, modest growth and challenges with raw materials. And that's also in our guidance. And really, it's a goal to move some of our new product categories and pick up the whole market. It's interesting when you look at some of our major customers, you can slice and dice their categories in different ways. One interesting way is, at a major home center, items that are $35 or higher are up in the high-teens, and items that are lower than that are in the single digits. And so there's been a -- seemingly, a spend on bigger renovation in different odds and ends and less on the decorating and small project paint, for instance. And so to ensure that we have a return to strong sales in earnings growth in fiscal '19, we're going to spend the dollars that we think are appropriate in the right places this spring.

Operator

Next we have Ghansham Panjabi from Robert W. Baird.

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

First off, can you give us a better sense as to what drove the strength for polymer flooring? Any particular end markets that are growing faster that you can call out?

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

No. I think that whether it's in polymer flooring or roofing, and those are 2 interesting categories, this also applies to our Dryvit business. We've got good opportunities and good growth. And interestingly, one of the challenges that's inhibiting better growth is the availability of contractors. And so that's been, for a number of reasons, immigration issues and a pick-up in construction activity with not a concurring pick-up or return to that market of real qualified contractors. So that's one area where in roofing and polymer flooring, particularly in our Stonhard business where we actually do the application, and our Tremco roofing business where we do the application, and then to a lesser extent, in Dryvit, because of some shortages in some of the contracting there, that's been an impediment to us. But broadly speaking, we're doing well in North America and in Europe. And then the developing world is so modest, it's almost not worth talking about in those categories.

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

Okay. And then on the specialty segment, how much was restoration up year-over-year during the second quarter? And would margins in that segment have been down year-over-year in specialty, were it not for the strength in restoration, given the patent expiration impact you called out?

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

Yes. I don't know that we've ever disclosed the particular product categories in restoration within our specialty segment. I could tell you that the revenues and earnings in that area are both up double digits. And were they flat? You might very well see more modest-to-flat results in our specialty segment as a result of the patent expiration in the MBZ business. And so I think that the leaders of those businesses are managing those businesses really well. They particularly managed the patent expiration well. And I think those businesses, given their special nature, are managing the raw material gross margin situation better than most. And to a certain extent, we'll take luck when we get it. In this case, the strong restoration activity has showed up when it was needed in relationship to offsetting some of the declines in earnings in the edible coatings area.

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

Okay. And just one final one, I know there's some nuances on the tax line specific to '18, at least your fiscal year. So can you give us a better sense as to what the tax rate would be -- would look like for RPM post the U.S. tax law changes FY '19 and beyond?

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

Yes. I'll give you just a rough cut of it. And then we'll have a better sense, like everybody, as the year unfolds and everybody starts to better understand the nuances of what's a somewhat complicated bill. But I think Barry referenced that we'll have 5 months of the new tax law. So if you just look at statutory rates, the statutory rate for our U.S. business was 35%. And with the 21% statutory rate on a blended basis, we'd be at 29.2%. These are just statutory rates. And then obviously in our next fiscal year, we'd be at 21%. There's some gives and takes. There were manufacturing credits in the old tax law that are gone. There's some different odds and ends. We estimate that for fiscal '18, the 5 months impact of the new tax law will add $0.10 per share roughly, give or take $0.01, for this fiscal year. And my best guess is that in '19, we would pick up another $0.10 per share as a result of having a year in which the tax law is fully applicable.

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

And would that drop down the cash almost equally?

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

Yes. I think the -- again, this is very rough, and we'll refine this. But my guess is in the coming year or so, past '18 into '19, the impact of the tax reform for RPM will be an increase in after-tax cash flow somewhere in the neighborhood of $30 million to $40 million.

Operator

Next, we have Arun Viswanathan from RBC Capital Markets.

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

Great. Yes, so I just want -- sorry to belabor this point, but on the tax issue, so it looks like you are recognizing the $0.09 benefit in F Q2. And then there's another $0.10 benefit from the impact from lower rates for the rest of the year. So that's $0.19, and your midpoint is up $0.15. So I mean, is it incorrect to think that the actual fundamental performance is down $0.04? Or is that what you're trying to interpret as well with the guidance?

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

No. What -- I guess what I'll comment on is just a repeat of what we've said. Here are the factors: Number one, we are on target on a consolidated basis despite what's been a broader, persistent and bigger raw material issue hitting us in our own industry, factor number one. As we look into the future, our industrial businesses are performing well despite those challenges, and we continue to see that happen. And if anything, they'll outperform our original expectations for the year. Our specialty businesses are managing well and on plan, given the challenges that we've communicated. Our consumer business is underperforming. We expect that to persist. And in light of looking to the strength of our businesses, their market share, their products, we plan on some increases above what we originally anticipated in promotional and advertising spending this spring. And so those are all the factors that weigh in on the operating side, along with the tax issues that you've highlighted for our revised outlook up to $3 to $3.10.

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

So when you look -- when you think about the EBIT or even top line performance for each segment, do you feel more encouraged by that post this quarter? Or about the same?

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

I think we feel good about where industrial is and where it's going. I think we're really pleased with how well the leaders of our specialty segment businesses have managed this year, given the challenges we knew we'd face. And I think we're disappointed in our consumer performance year-to-date. We see that persisting and we intend to take actions to make sure that '19 is a return to really solid performance and growth in the top and bottom line in our consumer segment.

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

Okay. That's helpful. And then just on corporate, that was also a little bit below us. Is that due to some of your focused efforts on lowering SG&A? Or how do you think about corporate for -- expense for the rest of the year?

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

I think it'll be consistent with where we've been. We -- last year, as Barry and Rusty had alluded to, took a number of actions in our corporate expense area and also across our operations, including probably a 240-person RIF in the fourth quarter, shut down some small operations and addressed some corporate area expense, and all of that is helping us leverage sales to the bottom line. That should continue for the balance of the year.

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

And then just lastly on M&A, could you just update us on what you're expecting to complete the rest of the year or if there's any particular areas where you're finding more opportunity, and if there's any improvement on that post this tax reform?

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

Sure. Our M&A activities remain what they have been. We're continuing to focus on kind of small- to medium-sized product lines that we can integrate and/or family businesses that will join RPM as a freestanding entrepreneurial business. Really don't have much more to add to that other than announcing deals when they happen. The M&A environment remains the same. I think the only impact in that area of the tax reform is some limitation on the deductibility of interest expense. That's not an -- will not be an issue we do anticipate for RPM. But perhaps it'll be an issue for some of the highly levered private equity or LBO activity, which has been a competitor to RPM in kind of the midrange. And we can only hope, but that's kind of the state of play in the M&A market right now.

Operator

And next, we have Kevin McCarthy from Vertical Research Partners.

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

Frank, in the consumer segment, you referenced organic sales growth of 3% in the quarter. How would you disaggregate that between volume contribution and price contribution?

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

Yes. It's mostly all volume, and it's mostly in caulks, sealants, patch and repair product categories. We're continuing to have relatively flat results in the small project paint area. And again, I'd point out that through the year, from what we can see of our major U.S. competitors, we're continuing to outperform relative to what's been a very punky market in that space for most of calendar '17.

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

As a follow-up, was price positive at all? And given your comments on raw materials, how would you characterize the prospects for an acceleration and price realization over the next several quarters?

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

So given 40 different business units and hundreds of different product lines, the impact to price across our RPM businesses varies widely. And I would say that price is probably 25% or 30% of our organic growth and on a consolidated basis. And I would expect that to continue for the balance of the year, but it's very different in different business units, product lines and segments of RPM, and that's about all the detail we'd provide on that.

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

Okay. And then I guess a broad question. Last question on the SG&A and cost reductions. You've done a nice job there. It sounds like you're going to be ramping some spend in consumer. But can you give us a sense for what inning of the game we're in? Perhaps it's a never-ending game in some respects, but how much prospective cost-reduction opportunity is there still?

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

Yes. On the one hand, it's a never-ending game in relationship to what our cost structure looks like relative to revenue, and particularly, revenue growth. I don't know that we have any significant expense reduction initiatives planned now per se other than how we manage our spending base at each business unit. We continue to look at opportunities to realign RPM businesses, particularly as we think about how we're best positioned to get to a -- to be a $10 billion business. And there'll be some opportunities there that when it's appropriate, we'll talk about.

Operator

And next, we have Jason Rodgers from Great Lakes Review.

Jason Andrew Rodgers - *Great Lakes Review - VP*

Just a follow-up on the raw material cost increases. Could you quantify the magnitude of those increases you saw on a year-over-year basis in the quarter as well as the success that you're having, implementing price increases to offset that?

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

A little bit. In certain categories, we're seeing raw material prices that went up 8% or 10% in the late spring, early summer, and some of those are going up again. In certain categories that I commented on, silicones and, particularly in Europe, are one. You're seeing not only significant price increases about some availability issues. And so it really is across the board. We're seeing raws that are petroleum-based go up modestly, resins going up more aggressively, and then certain categories, like the ones I mentioned, that are -- been going up with 2 or 3 price increases. We have attempted, in a number of our businesses, to institute price increases at the beginning of the year. We have new price increases, some of which have gone in place in January. But it's really a mixed bag between product line price increases. In some cases, it might be as much as 8% or 10% in other product categories where we have really not gotten much in the way of price yet.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And then I wonder if you could provide an update on Kirker and how the changes you've made there are progressing to improve results.

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

So Kirker, as those who have followed us know, is a smaller business than it was a few years ago and relatively modest in size. And it had virtually no impact on RPM. And I'm happy to say that in the quarter, their sales and earnings were better than they were last year.

Jason Andrew Rodgers - *Great Lakes Review - VP*

All right. And then finally, I wondered if you care to mention any developments or milestones you're seeing in some of your major new products, like TUF-STRAND, AlphaGuard or NewBrick?

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

Certainly. So the TUF-STRAND continues to move nicely, a little bit seasonal in North America in terms of concrete pours that don't happen so much in cold weather like we're seeing now. But we are looking at and continuing to execute on capacity expansion now more outside of the United States. NewBrick, which is a Dryvit product, is just getting going. The early signs in that are pretty exciting. And we're looking at ramping up production in the East Coast and possibly -- and the new tax bill might help us with this in terms of media expensing, adding some West Coast manufacturing that would come later in calendar '18.

Our RockSolid product line, Rust-Oleum, is doing extraordinarily well. It's a high-performing product that outperforms all of our peers in Rust-Oleum's -- some of Rust-Oleum's older lower-price versions of concrete coatings and garage floor coatings. And as our numbers show, we're continuing to maintain and, in some cases, pick up share versus peers that have had the same or more challenges in the small project paint area. I guess the last comment I would make is that we picked up a significant wood stain and finishes placement. We should start to see the benefits of that in the spring. And then our AlphaGuard product line, which is a proprietary resinous base coating for roofs, continues to grow at double digits with Tremco, and we're looking to add capacity there in the spring.

Operator

Next, we have Mike Harrison from Seaport Global Securities.

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

Frank, I was wondering if you could address the manufacturing absorption issues that you noted in the consumer business. It just seems a little bit odd that the volume won't be up year-on-year, but we're having some of these absorption issues.

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

So the volume in our spray paint small project paint areas for the year is not up. After a extraordinary 7-year run, both there and in caulks and sealants, patch and repair products in the last 1.5 years, we added some significant capacity. We'll look to continue to add capacity where it's appropriate and also optimize some of our manufacturing. But it's really the first year after a great run of 7 years of good, strong organic growth where, in the first half of the year, we actually experienced negative growth, minus 1%-or-so, and relatively flat in some of these areas. And it's a very seasonal business. And so when times were booming, we would be manufacturing product anywhere and everywhere we could. It's where our inventory build is the biggest because of the seasonality of the business. We have more capacity than we need in the late fall and in the winter months. And we tend to have less capacity than we need in the peak season, so we have to build inventory into that. I think we're correcting that, both in terms of capacity as well as manufacturing processes. But in those categories, we are dealing with absorption issues, at the same time we're dealing with raw material issues, and that's been one of the negative impacts in our consumer segment results.

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

Okay. That makes sense now. And then looking at the caulks and sealants uptick that you've seen, is that -- are we starting to see any benefit from kind of hurricane-related rebuild? Or should I think of that as being related more to kind of an easier comp? If I recall correctly, you were capacity-constrained in the prior year.

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

That's correct. And so I think that we're hopeful that we'll see some benefit from that in the construction products areas and again, in the consumer side, more on the DAP caulks and sealants, patch and repair products in the spring. And some of the devastation there was such that the real rebuild in -- and construction activity isn't going to happen until the spring or the summer. I think the easier comps will be in industrial and consumer next year in the second quarter because we lost probably 10 days of the negative impact in some major markets like Florida and Texas.

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

Got it. And then can you just comment at all on what you've experienced in the line review processes as you've gone through your year-end? Any potential gains in shelf space in some of these small project paints and wood stains and other areas? Particularly, there's been some consolidation in the industry.

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

Sure. We've continued to maintain our market share across our consumer businesses. The area where we picked up some share at some of our major accounts is with our Varathane wood stains and finishes line. And then other areas that have been driving what growth we've been getting is in kind of new or unique product categories, like the RockSolid concrete and garage floor coating businesses. And share or market presence isn't the issue. It's just been modest or punky consumer takeaway exacerbated by big inventory issues in some of our major customers. And so that should -- once those are mostly behind us, as we get into fiscal '19, we'd certainly be seeing easier comps in relationship to our activities and interest in being more aggressive in promoting and advertising and not annualizing the inventory issues that we faced with a couple of major customers this year.

Operator

And next, we have Michael Sison from KeyBanc Capital Markets.

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

Your industrial segment is doing pretty well. But in terms of the growth outlook for sales, do you think EBIT growth in the second half will be in line with that upper single-digit growth, a little bit better, a little bit worse because of raw materials?

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

I would expect, with one caveat, which is look out the window almost anywhere in America and you can see snow, I would expect for the third and fourth quarter that we'll generate high single-digit revenue growth, certainly in the third quarter. The fourth quarter should be maybe a little moderate because we'll have annualized most of the acquisition activity from last year. And that growth, despite raw material issues, on a consolidated basis, should generate mid- to upper-teen income growth.

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

Great. And then just as a quick follow-up with raw material, what's the actual squeeze this year? And if you get some pricing, could that be maybe a positive for you in '19 as you catch up with the raw materials?

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

Yes. I think we, and our whole industry, are working to catch up. Typically, we're a -- maybe a 3- or 4-month lag in our industrial and specialty businesses and as much as a year lag in our consumer businesses, but the challenges that we've been facing is multi -- or multiple price increases in certain categories that have hit 3 or 4 months after the last one. And so we're playing catch-up. Our whole industry is playing catch-up. And I would expect that to settle down some time this spring. But I think our whole industry, no matter who you talk to last spring, kind of expected things to settle down at the end of the summer, and that has not happened yet.

Operator

And next, we have Steve Byrne from Bank of America.

Ben Gottesdiener

This is Ben Gottesdiener, on for Steve. Just a quick follow-up on some of your prior raw material commentary. Do you have a line of sight as to when of -- when some of these raw material shortages will be alleviated?

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

I don't have a good answer to that question as we sit here. I don't know that there's shortages in any of the petrochemical type products. I think the area that's been the biggest challenge is in silicones in terms of a broader category, and then some unique raw materials that go into some of our M&A areas where RPM companies, both in terms of waterproofing products and flooring products, are global leaders. And so we've seen some easing in those shortages. It's hard to know in the silicone area how much of it is capacity and how much of it is organized. But in any event, that's the best I can tell you at this point sitting here, but we'll look into that.

Operator

And next, we have Silke Kueck from JPMorgan.

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

With retailers lowering inventories in the mid-teens range, that's presumably something that affected like last calendar year volumes. Can you tell what ordering patterns look like currently as like the retail channels get ready to stock up for the spring season?

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

The answer to that is, yes, we can. The inventory issue hit us late spring and throughout the summer. And they're issues that we had to manage through. And in some cases, they were good inventory management practices to a new level at major customers. In other areas, you could go into major customers and literally, for weeks, be out of stock in basic colors like black and white. Most of that's behind us. We do have insight into consumer takeaway on a pretty regular basis and what we think that would do for us. That's really not going to be a factor for us until the spring. Again, this is a seasonal business, particularly in the small project paint area and the outdoor painting area and roofing and other things. And inventory builds typically don't start until kind of the February time frame.

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

Okay. And secondly, do you have any insights as to how the big-box retailers are reacting to the consolidation among the U.S. paint companies?

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

We're not really in the architectural paint business. And so I do think it's interesting to see how that shakes out. And beyond that, I really don't have much of a comment. We continue to be the leader in almost all of the small project paint categories, regardless of whether it's for metal or for elements of wood, for concrete, patch and repair and caulks and sealants. We're getting more into the adhesives area. One of the product categories I failed to mention for Rust-Oleum was a partnership with Tremco and their first entree in a major way with a major big-box customer into the building materials aisles with 5-gallon pails of roof coatings. And so that's a new and exciting area for us. We've been working on that for probably a couple of years, and you'll see that take off this spring as well. So that's a whole new product category and a whole new aisle and area of home centers that we hope to better penetrate in the future.

Operator

And our final question comes from Rosemarie Morbelli.

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

Frank, I was just wondering, or Rusty, if you could give us an update on what you are doing with the -- where you are on the 524(g). You have been prepaying. Where do we stand? How much more is there to go? And when do you have a choice between putting either cash or stock into that fund?

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

Our final payment on that is due in December of '18, so 11 months from now. And there is a possibility relative to our understanding of the new tax legislation that, that could be accelerated to being paid before May 31. But we'll have a better feel for that when we talk to investors on our April conference call.

Operator

And we have no further questions at this time.

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

Thank you to all for your participation in our investor call today. We're pleased with our second quarter results, particularly in light with a lot of the major challenges that we knew we were facing at the beginning of the year, exacerbated by the ongoing raw material issues. We remain excited about our ability to deliver solid sales and leverage that to mid-teens or better earnings growth for the balance of the year, and for positioning RPM for another year of strong growth in our fiscal 2019. And we look forward to communicating to all of you throughout the year and again, on our investor call for the third quarter in April. Thank you all, and happy New Year.

Operator

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