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RPM - Q3 2018 RPM International Inc Earnings Call

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OVERVIEW:

RPM reported 3Q18 EPS of \$0.30. Expects FY18 EPS to be \$3.05-3.10.



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PRESENTATION

Operator

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

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

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

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

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

Thank you, Christine, and good morning. Welcome to the RPM International Inc. Investor Call for our fiscal 2018 third quarter ended February 28, 2018. On the call with me today are Rusty Gordon, RPM's Vice President and Chief Financial Officer; and Barry Slifstein, our Vice President of Investor Relations. Today, we'll discuss our third-quarter results, then provide guidance for the balance of fiscal 2018 and answer your questions.

We had a strong quarter with very solid top line sales across all 3 of our segments, which we converted on a consolidated basis into even stronger EBIT gains, despite continuing significant headwinds from higher raw material costs. This improvement in profitability reflects the benefits of our



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focus on operating improvements. During the quarter, we generated record EBIT of \$56.7 million and EPS of \$0.30 per share. Overall, it's a very strong quarter that has continued our momentum and puts us in an excellent position to deliver a record fiscal year.

Our industrial segment was a key driver of our overall success in the quarter with higher sales that we leveraged to the bottom line. Sales increased 9.2% in the quarter, including organic sales growth of 2.2%, growth from acquisitions of 2.8% and a positive impact from foreign currency translation of 4.2%. Strong performance in the quarter included our North American roofing businesses, as well as those businesses providing polymer flooring to commercial and industrial markets worldwide. Disciplined SG&A spending combined with cost reductions drove an EBIT increase over last year of 38.8%, again, despite higher raw material cost.

In the consumer segment, sales increased 6.4% in the quarter driven predominantly by last year's acquisitions of Touch 'N Foam in the U.S. and SPS in Europe. Consumer segment EBIT of \$29.3 million was below last year due to higher raw material costs and delays in effecting price increases, partially offset by better SG&A leverage that allowed us to, nonetheless, outperform our direct peers. Across our businesses, our teams continue to drive innovation and this has translated into continued market share gains in key areas where we compete.

Specialty segment sales increased 6.5% driven by organic sales and acquisitions, despite expected lower sales in our edible coatings business due to the patent expiration last August. Sales were particularly strong in our restoration services business as well as our OEM powdered coatings and pleasure marine coatings businesses. Specialty segment EBIT increased more than 50% for the quarter to \$22.7 million from \$14.9 million a year ago, which included a charge of \$4.2 million associated with the closure of one of our European facilities. The strong EBIT improvement again reflects our focus on cost-savings initiatives, last year's plant closure and a tighter spending control this year.

Corporate/other expenses declined \$6.7 million due to lower pension, compensation and acquisition-related expenses.

We feel well positioned for the remainder of the year and anticipate continued solid operating performance.

Now I'd like to turn the call over to Rusty Gordon for a few more comments on our quarterly results.

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

Thanks, Frank, and good morning. We have posted some slides on our website at www.rpminc.com that better illustrates our solid performance during the quarter, which I want to take a few moments to walk-through. Slides compare our current quarter actual results with last year's results, adjusted for the Synta impairment of \$4.9 million in our consumer segment and the plant closure in Europe of \$4.2 million in our specialty segment.

On the first slide, we illustrate strong sales growth and EBIT improvement of 22.6% in the quarter reflecting the early success of cost-cutting initiatives.

On Slide 2, SG&A improved by 270 basis points, more than offsetting higher raw materials.

On Slide 3, you'll see that our industrial segment combined strong top line growth with even better EBIT leverage. The industrial segment achieved the most success in implementing price increases, and, combined with accelerated sales in Tremco Roofing's liquid applied products and ongoing cost-cutting actions, has increased EBIT year over year by 38.8%.

In the consumer segment, shown on Slide 4, we continue to generate solid overall sales growth and gain market share, but delays in achieving price increases has resulted in year-over-year declines in EBIT in what continues to be a sluggish environment.

On Slide 5, the specialty segment continues to post solid top- and bottom-line results despite facing headwinds, as expected, from a patent expiration last August. Contributing to specialty's continued success are improved profitability from last year's plant closing and cost-cutting initiatives.

I'll turn the call over to Barry to take you through our guidance for the balance of fiscal 2018.



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

Thanks, Rusty, and good morning, everyone. On a consolidated basis, with momentum building in our industrial segment, we expect continued mid- to upper-single-digit top-line sales growth for the fourth quarter driving double-digit EBIT growth, consistent with our communication back in January.

In our industrial segment for the fourth quarter, we expect solid performance from our businesses serving the North American construction market, especially our Tremco Roofing division, where we continued to see strong growth in liquid applied products. We anticipate sales in the industrial segment will grow in the mid- to upper-single digits, including favorable foreign currency translation.

In our consumer segment, we estimate sales growth in the mid-single-digit range in the fourth quarter and continued headwinds in converting top line sales to EBIT. We expect, however, to see some benefits of price increases taking effect in the fourth quarter, which would narrow the year-over-year gross profit gap that we've seen over the past several quarters and drive momentum into fiscal 2019. We also believe that recent changes that prompted our largest competitor to abandon its relationship with the #1 home center will present opportunities for additional market share gains in fiscal 2019.

In our specialty segment, we expect sales growth in the low-single-digit range with continued strength in OEM, Powder Coatings and pleasure marine coatings businesses, partially offset by expected reduced sales in our edible coatings business with the patent expiration last August.

Now to income taxes. As you can see, we're comparing apples-to-oranges in the income tax line due to recent tax legislation and the traditional impact of seasonality on our third quarter, where relatively smaller dollar variances create larger percentage differences.

We reported an income tax benefit of \$5.9 million, representing a negative 17% tax rate. Included in that rate is \$0.01 per share, nonrecurring net tax benefit from tax reform and \$0.08 per share resulting from the lower U.S. statutory tax rate. During our second quarter earnings call in January, we said that we expected an additional \$0.10 per share benefit in the second half of fiscal '18 from the lower U.S. statutory tax rate, which was included in our EPS guidance of \$3.00 to \$3.10 per share.

It's clear to us that most of the financial models included the bulk of the \$0.10 per share lower tax rate benefit in the fourth quarter when, in fact, \$0.08 per share came in the third quarter. For the fourth quarter, we expect our income tax rate to be in the 26% to 27% range. However, this could change as the IRS continues to issue guidance on the new tax law.

We are narrowing our fiscal 2018 earnings guidance upwards to a range of \$3.05 to \$3.10 per diluted share from our previous guidance of \$3.00 to \$3.10 per diluted share, reflecting our expectation of a continuation of solid top-line sales and double-digit EBIT growth.

Back to Frank for a few more comments.

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

As Barry and Rusty referenced, we are in the beginning stages of an operational improvement process that began in fiscal 2017. This process has continued this fiscal year with tighter spending controls that we implemented worldwide. These measures, which have already resulted in SG&A improvements during the third quarter and year-to-date, are not one-off cost-reduction measures.

We took a further step in the implementation of our plan today with the appointment of Tim Kinser as RPM's Vice President of Operations, who will be responsible for supply chain strategies and identifying opportunities to improve manufacturing efficiencies and reduce operating costs. Additionally, we will be realigning businesses and consolidating business systems where appropriate so that they are better positioned for global growth and efficiency.

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One recent example is the combination of our Tremco and tremco illbruck businesses, which will be effective on June 1. This creates a global Tremco brand with sales in excess of \$1 billion, which will now compete worldwide in sealants, adhesives and coating construction markets on a more integrated basis. The new global business will combine the best technologies from Tremco and illbruck and better leverage SG&A manufacturing assets and business systems.

As we look forward to fiscal 2019, we will be in a position, when we report our first-quarter results in October, to further discuss business realignment and operational improvement actions. RPM will execute this process in a manner which allows us to continue to focus on the markets we serve with continued strong revenue growth and improving leverage to the bottom line.

Before we open it up to questions, I want to take a moment to commend our teams for the outstanding results we are reporting today. We recently concluded our growth and strategy meetings, and we're excited by the ambitious plans that we've seen to accelerate growth through operational excellence, innovation and drive. We look forward to building on today's results and carrying our positive forward momentum through the fourth quarter and into fiscal 2019.

We'll now be pleased to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Frank Mitsch of Wells Fargo.

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

A clarification, if I can, on the tax side of things. Guiding \$0.10 for fiscal '18, it turns out you get \$0.08 in fiscal Q3, which is just having a couple of months and then, obviously, fiscal Q4 is your strongest quarter so you would think that, that would have the bulk of the tax savings. So just trying to -- explain to me, if you can, why we're seeing a bigger benefit in fiscal Q3 than we would see in fiscal Q4?

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

Frank, it's Barry. Yes, if you recall, the tax reform became effective December 22, which was in our third quarter. And so adopting the new tax reform, we actually do a cumulative catch up of the new lower tax rate back to June 1, and that's why the bulk of the benefit occurred in the third quarter.

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

All right. So it's a catch up for the previous couple of quarters, and you'll only see the -- so you're seeing 3 quarters of benefit in fiscal Q3 and only 1 quarter benefit in fiscal Q4?

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

Yes, in essence. That's correct.

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

All right. Fantastic. And then a question on the specialty side of things, obviously, very strong quarter for that. Your guidance for top line in fiscal Q4 is lackluster. Is this merely the anniversary-ing of the edible coatings? Or is there something else that's going on as to why specialty is going to show the weakest growth among your 3 divisions?

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

It is the anniversary of the edible coatings business. The patent expired in August, and we had a really strong finish to the year last year. But the underlying performance of the other specialty product companies, as you've seen throughout the year, have more than offset a significant reduction in revenues in that edible coatings business.

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

All right. So that's a -- so there's nothing with the base of the specialty business that we should be concerned about, correct?

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

That's correct.

Operator

Our next question is from Rosemarie Morbelli of Gabelli & Company.

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

Just following up on Frank's question regarding what's going on in specialty. How much did they benefit from the pickup following the hurricane seasons last year? Was that a big part of that growth?

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

Certainly, the restoration products in our Legend Brands business benefited from the hurricane activity. They benefit whenever there's a cold winter, so those results had been particularly strong and they have served to offset some of the reduction in the edible coatings business.

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

Do you feel -- then given your anticipation of a 2% top line growth, which is like low-single-digit translation, do you feel as though you'll have, more or less, all of the pent-up demand following the hurricanes are kind of been addressed at this point?

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

I think that, on a sequential basis, those businesses are continuing to perform very well.



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

Okay. So now looking at the overall quarter, it is really an unusual level for a third quarter. So is this a new level? What would be the normalized results if you excluded the benefit from the hurricane pick up or after the hurricane?

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

I don't know that we would adjust it because of hurricane or anything like that. I think that we benefited from that in the second quarter a little bit as well. I think the right EPS number to look at year over year would be \$0.21. But beyond that, I think these are our -- it's a strong quarter with strong results, but there wasn't anything in particular that I would point to. Some of the benefit of the hurricane activity at Legend was more than offset by what's been a frustratingly difficult and long winter, which seasonally has hurt some of our industrial businesses as well.

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

And I was wondering, lastly, if I may, if you could touch up on the comment Barry made about your competition, and I am assuming he's talking about that Sherwin-Williams and Lowe's agreement, how can it impact RPM? And any specific areas can Home Depot pick up the slack? If you could give us a better feel for what is happening there?

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

Sure. Our largest competitor in the small project paint and wood stains and finishes and other categories in U.S. consumer DIY, literally, walked away from the largest home center in the world. I'm not sure how that fits their strategy, but it fits our strategy fine. And we will have more to report on that when we report our fourth quarter results in July.

Operator

Our next question is from John McNulty of BMO Capital Markets.

Suleyman O. Saleem - *BMO Capital Markets Equity Research - Senior Associate*

This is actually Suley, on for John. In the release you talked about a step up in ad spend and for consumer, just wondering if you could talk about the different parts there as well as the general outlook for consumer for the balance of 2018 and beyond?

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

Sure. I would expect that we would have an increase year over year, notwithstanding the frustrating results in our consumer segment, that we will have an increase year over year in April and May of consumer segment advertising, both in our caulks and sealants category in small project paints and notably in wood stains and finishes.

Operator

And our next question is from Ghansham Panjabi of Baird.

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

This is actually Matt Krueger sitting on for Ghansham. Can you quantify the impact on your business from higher raw materials costs thus far during the fiscal '18 year. And then what are your expectations for raw material cost in the fourth quarter? And how should we think about fiscal '19 compared to fiscal '18 in terms of the raw material landscape?

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

Sure. When you look at our results on a consolidated basis for the quarter and year-to-date, you can see the impact directly in our gross margins, which are lower, and we have worked to more than offset that with the operational improvements and SG&A discipline. We are continuing to see rising raw material costs, particularly in certain categories like epoxies and silicones, so the raw material challenge that is facing our industry is not over. And despite that, we continue to expect a fourth quarter of solid sales growth and EBIT growth in the low teens.

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

Great. And then can you talk a little bit about the industrial segment's organic growth rates moving forward. Why do you think the industrial segment isn't seeing a better pick up in the context of strong PMI and industrial macro numbers? Do you think this could have anything to do with the accelerated pricing initiatives in the segment, and how are those being accepted as well?

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

So first, let me address pricing. Our pricing has been introduced over the last few months, is holding in our industrial segment. There's a likelihood as the calendar year moves on that we will need more, because as I commented a minute ago, raw material challenges are continuing. They're also holding in our specialty segment, and it's been a frustrating and a little bit late in the game in the consumer segment. We commented on that. Industrial is continuing to perform well. We've had both in the third quarter and as we sit here in 2 inches of new snow in Cleveland, we started fourth quarter with some weather challenges that I think are holding back what's otherwise good demand. One of the other challenges that I think everybody is facing are freight issues, that also negatively impacted our consumer segment. And lastly, there are big challenges in the construction markets for contracting and contract workers, particularly in North America. One of the reasons that we're seeing strong results in our polymer flooring business and our Tremco Roofing business is, in many instances, we have our own contracting crews. And so, to a certain extent, I think we are and will continue to perform better in those businesses versus competitors that sell through or to independent contractors. And so those are the challenges we're facing, but the underlying dynamics of our industrial segment are good and we expect them to remain good.

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

That's very helpful. And then if I could just ask one quick follow-up on the question before mine regarding the advertising spending. Can you quantify the overall size of the campaign? And then is that in a direct response to the share shifts that you're seeing in the consumer landscape?

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

I think we could answer both of those in more detail when we report results for the fourth quarter in July.

Operator

Our next question is from Kevin McCarthy of Vertical Research.



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Kevin William McCarthy - Vertical Research Partners, LLC - Partner

Frank, I was wondering if you could elaborate on the Sherwin-Lowe's dynamic as you see it playing out. It sounds to me like you see some potential to gain share in fiscal '19. Can you maybe talk a little bit about the product categories in play for you and the timing of decisions? Just trying to get a feel for whether it's something that could impact early fiscal '19 or later? And how you see the dynamic playing out between Depot and Lowe's, if possible?

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

I think the impact of any of those changes will begin in June. And beyond our comments earlier about seeing our largest competitor in that space abandoned a major account, I think we would hold off on providing any details about market share gains until we report results in July.

Kevin William McCarthy - Vertical Research Partners, LLC - Partner

Okay. Fair enough. And then to follow up, sticking with consumer, I think you made reference to delays in effecting price increases. And just wondering if that delay is a matter of months or whether there's any visibility on better pricing in that channel? Baseball, when there's a delay, sometimes the game resumes and sometimes it gets rained out. Wondering what your outlook is for price there?

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

Yes. Traditionally, we have commented, and I think it's holding true in this environment, in industrial, if there's a lag, it tends to be in the 3- to 4-month range, and in consumer it could be anywhere from 6 to 12 months. And I think that those comments that we've made literally for decades after following the way our businesses operate in a rising raw material environment, continue to be true today.

Kevin William McCarthy - Vertical Research Partners, LLC - Partner

And then, lastly, maybe for Rusty. What is your tax rate for 2019 relative to the range of 26% to 27% that you referenced for the fiscal fourth quarter?

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

Yes. Kevin, we're still working through the new tax law and we'll have to provide guidance on that in July.

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

Related to that, I would just add that given the ups and downs, not only for us but all companies relative to the tax law changes, we think the best way to focus on results is focusing on sales and EBIT, which is certainly what we've been doing. And for a second quarter in a row, have generated stronger leverage and EBIT improvement than our peers, and we would expect to continue that.

Operator

Our next question is from Jason Rodgers of Great Lakes Review.

Jason Andrew Rodgers - Great Lakes Review - VP

Can you give us an idea of the magnitude of the raw material cost increases on a year-over-year basis that you experienced in the quarter? How they compared to last quarter and what you're seeing, so far, in the fourth quarter?



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

Yes. Beyond the impact in our gross margins, I don't know that we would quantify that per se on a -- you can see the impact in Q3 as well as year-to-date, and 100% of that gross margin deterioration is raw material costs. We will start to gain on that, particularly in our industrial and specialty segments as we get into the fourth quarter in the new fiscal year. But as I commented earlier, we are continuing to see additional rounds of raw material price increases in some key raw materials like silicones and epoxies.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And would you give us an update on the oil and gas markets, your performance and outlook there?

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

Sure. The businesses that we have in our industrial segment, which are substantial, that serve oil and gas and heavy industry have stabilized year over year. We haven't seen strong growth, but after 2 years of declining revenues, stabilization is a good thing. And as we get into the new fiscal year, we'll certainly be rounding easier comps in what seems to be a more stable business where there are -- where there is a return to capital spending and investment, which I think will benefit our Carboline businesses, Stonhard and a number of other companies that serve the oil and gas markets.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And then, finally, you talked last quarter about Brazil and results there possibly bottoming out, but you had another negative quarter in Brazil. I wonder if you could discuss the outlook there?

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

Brazil is -- it feels like it's bottoming out for us. Some of the results continue to be foreign exchange related. But again, as we get into fiscal 2019, we'll be rounding easier comparisons. And I do not expect that the -- our Brazilian operations which, by the way, over a 5-year period in local currencies, are up about 50%. So, we continue to see good performance, and as we're speaking now kind of flat results in local currencies. I don't expect that our Brazilian operations will be the negative to sales and earnings in fiscal '19 that they have been for the last 12 or 18 months.

Operator

Our next question is from Vincent Andrews of Morgan Stanley.

Brian M. Scott - *Morgan Stanley, Research Division - Research Associate*

This is Brian, on for Vincent. Just wondering in the industrial segment, if you could maybe bucket out the margin expansion that you saw between pricing ahead of inflation versus some of the cost saves that you've executed over the year?

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

Sure. Again, I think it shows up in the EBIT margin improvement in light of the gross margin challenges that we've been facing. I fully expect us to have positive sales growth and strong leverage to the EBIT line. Some of that's going to come from continued operating improvements and SG&A expense, reductions or discipline. And we are gaining and have gained in terms of dollar terms, some of the raw material price increases we've



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seen. But as I've commented on the call, we're continuing to see more price increases. So that will be a challenge for our entire industry in our new fiscal year and for the balance of calendar of '18, and we expect to continue to be able to leverage strong growth to our bottom line despite the raw material challenges.

Brian M. Scott - *Morgan Stanley, Research Division - Research Associate*

Great. Okay. And then I guess, FX, I think in the third quarter and maybe in the fourth quarter is a little bit better than it would have been at the time you gave back-half guidance. So were there any negative offsets to call out in terms of how you expect sales to develop in the fourth quarter?

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

No. FX is about what we expected and I think where we've communicated and about where it's been for the year. Other than the seasonal impact of a cold winter, and we sure like to see some warm weather particularly in the Midwest and the Northeast, the underlying dynamics of our industrial businesses are pretty strong.

Brian M. Scott - *Morgan Stanley, Research Division - Research Associate*

Great. And then I guess just one more clarification question. Can you just clarify what the share count you're using in the fourth quarter for the guidance is? I saw the dilutive effect, I think, of the converts went away in the third quarter. I'm sort of curious if that's in the guidance of the fourth quarter as well?

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

Yes. I mean, that's included in the guidance. It's going to be in that 136 million range.

Operator

Our next question is from Mike Harrison of Seaport Global Securities.

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

A quick clarification on the guidance. We should be using \$0.29 for the Q3 EPS number. So in other words, we should be looking at something like \$1.20 to \$1.25 for Q4 EPS?

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

Mike, this is Barry. We finished -- the year-to-date through the third quarter at \$1.87 and we're guiding \$3.05 to \$3.10, that implies \$1.18 to \$1.23. And the big difference between that and consensus is the shift in tax from the fourth quarter to the third quarter.

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

All right. Appreciate that. Wanted to ask also about the industrial segment. You talked about integrating Tremco and the tremco illbruck brands together. You also recently did an integration involving the Euclid business. Just wondering how many other businesses that you run on, more or less, a stand-alone basis right now, do you have that could potentially benefit from some integration going forward? Do you have other projects in the hopper?



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

We do have other projects in the hopper. They, in part, in some cases, involve systems integrations that would then allow us to address some G&A efficiencies as well as some manufacturing and operational opportunities, and we'll be in a position to address additional opportunities when we report our first quarter results in October.

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

All right. And then last question for me. You called out the European portion of the industrial business as mixed. Just wondering, kind of what some of the positives and negatives are in Europe and what the outlook in that region for the industrial business looks like?

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

Sure. The U.K. results have actually been pretty strong. Consumer has been a little bit challenged across the European business. And our anticipation for the fourth quarter is, I think, a pick-up in our industrial segment versus what's been some more modest growth. So we've had year-over-year growth in Europe, but it's been substantially more modest than what we've seen in our North American industrial businesses.

Operator

Our next question is from Mike Sison of KeyBanc.

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

In terms of consumer, it looks this is the second quarter in a row of a positive organic growth. The implied guidance for fourth quarter appears to maybe see a little bit of a pick-up. Is demand for DIY getting better or is it more your ability to pick up share and new products?

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

I think, this year, it's been more share because it's been a relatively sluggish environment across the whole lower price range for us and our competitors. And I think on a peer basis, you can see, despite our disappointing results, that they've been better than our peers? Our anticipation is, is that they'll get stronger in this fourth quarter. And in particular, they'll get stronger as we get into fiscal 2019, both for some new products as well as some market share gains and some pick up in the weather would certainly help our consumer business in terms of what drives the spring takeaway.

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

Right. And then any particular brands, in consumer aside -- obviously, Rust-Oleum would do better with some of this competition that you talked about, but any other brands you'd highlight that could maybe pick up some share as you head into '19?

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

Sure. Our DAP, caulks and sealants businesses actually had a pretty solid performance this year, and I think we'll expect to see that continue. It's really been in the small project paint area that's been relatively challenging across the whole industry in almost all channels. And we see that picking up relative to some new products as well as market share gains as we get into the new fiscal year.

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

Okay. And then I didn't hear anything on Euclid, which has been pretty steady, pretty good growth for you guys over the last couple of quarters. Any update there? And what do you think that business can do in '18 heading into '19?

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

That business has been very steady and we continue to see positive results there. One of the challenges in the construction markets, particularly in North America, is the availability of labor. And so there have been -- there's probably pent-up -- we know there's pent-up demand on projects, which is not being met because of some labor shortages. And we can clearly see the difference in that relative to where we have our own contracting activities in Tremco, which is outperforming both their peers and our broader industrial businesses as well as our Stonhard flooring businesses, and I think that will shake out over time. But that's a challenge for everybody, particularly in North America in the construction markets today.

Operator

(Operator Instructions) Our next question is from Arun Viswanathan of RBC.

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

Thanks for the clarification on the guidance, I think I got that wrong. But -- so the adjusted EPS that we should be using for F Q2 and F Q3 are \$0.70 and \$0.30, is that right?

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

We should be at \$1.56 through the end of the second quarter and \$1.87 through the end of the third quarter.

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

There are no adjustments.

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

There are no adjustments.

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

Right. Okay. Great. Appreciate that. Sorry about that. And then in consumer, I guess, are you still seeing the weakness that you've referred to in the past in items below \$50 or \$35? Are you seeing some more strength in the higher ticket items at the big box?

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

It's been relatively challenging across the whole industry through our 9 months, and we expect to see some pick up in that in the fourth quarter. And we expect to be driving pick up of that into our new fiscal year, which what we anticipate to be some more aggressive advertising, some new product introductions and some market share gains.

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

And just a quick question on stains. Do you see any potential that Varathane could see some competitive pressure from Olympic if PPG decides to redeploy that volume?

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

Sure. I mean, we see competitive pressure every day from all of our competitors. The Varathane products, in particular, are focused on interior wood stains and finishes. A year ago or a little more than a year ago, we had a 500 store test at a major home center and that took out about 1/3 of the Minwax category. That was rolled out to all stores. So our most direct competitors in interior wood stains and finishes would no longer be available to the largest home center in the world, and we feel like we have some opportunities there. But we compete every day for every foot of shelf space, and we'll continue to do so.

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

Got it. And then, lastly, on SG&A, you cited some reductions that drove the specialty margins. Where are you in that process? Should we see continued gains there? And is there any similar kinds of initiatives in consumer and industrial?

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

Sure. For a little more than 1 year, 1.5 years, we've been working on our board on some strategies that would reposition RPM to become a \$10 billion or \$15 billion business. The first pieces of activities around that were the operation closures in the Middle East and Europe last year, as well as some year-end cost reduction activities. We have continued to pursue a disciplined approach to SG&A this year. And with the announcement of Tim Kinser as RPM's VP of Operations, we anticipate more opportunities for some plant consolidation, some manufacturing efficiency initiatives as well as some more efficiencies in G&A in particular, particularly in combination with some of our businesses. And we will be in a position to communicate further on that when we report first quarter results in early October.

Operator

Our next question is from Chris Perrella of Bloomberg Intelligence.

Christopher Perrella

A question on the consolidating. Are we going to see extra cash expenses or how could you categorize the cash expenses for the whole organization there? And is there going to be higher capital spending coming as you sort of consolidate or build out the operational footprint?

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

Yes. I think we'll have more to say about that when we talk about additional initiatives in October. In the interim, I think the activities that we have taken over the last year and that we continue to execute on will allow us to take middle- or upper-single-digit growth and leverage it to the bottom line EBIT in the teens. And I think our principal goal as we think about the initiatives we're undertaking is to do so in a manner that both improves our operating profile and our margin profile, while continuing to keep our eye on the ball of serving our customers and serving markets, and we believe we can do that.



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Christopher Perrella

All right. And for the consumer segment, the 70 basis points of organic growth, is that all volume? Are you getting price at all in the consumer business?

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

I think year to date, price in industrial and specialty is around 2%. And year to date, in consumer, it's less than 1%.

Operator

Our next question is from Rosemarie Morbelli of Morbelli & Company.

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

Are you seeing any change in the trend at the independent stores?

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

No.

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

So still declining at a 1% to 2% annually with the volume going into the big box?

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

No. For us, in that channel, it's been relatively flat. But as you've noted, it's been relatively flat across all the channels. There are some exceptions by customer channels, but that's still is an area of strength for us. And again, there may be market share opportunities in certain independent and hardware store co-op customers as we get into the new fiscal year.

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

Okay. And are you -- what do you feel about the inventory situation at the big box? Is it -- have it reached a normalized type of level, excluding the big move that we are anticipating?

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

Sure. Thank you for that question because part of the challenge that we faced, and again it's impacted most of the industry, is some significant inventory adjustments, particularly in the first half of the year at a lot of our largest accounts. And I believe that the inventory levels are stabilized in a couple places. I think it was apparent to us and some of our customers that those moves lowered the inventory to a level that impaired consumer takeaway. And so as we get into the new fiscal year, we don't anticipate that, that would be a factor like it was in fiscal '18.



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

And one last one, if I may. This was -- the \$5.5 million of investment income is kind of larger than what we usually see. Can you give us a little detail on that and what should we expect going forward?

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

Yes. I don't have the detail on that other than from 1 quarter to the next, we would generate low-to mid-single digits of investment income, principally associated with our captive insurance companies. And so that's normalized activity that is not seasonal to our revenues like a lot of our businesses that are weather impacted.

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

So if we just look at an average of \$4 million a quarter, is that a good number to look at going forward?

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

It really jumps around with the market. I would anticipate it would be less in the fourth quarter depending on where the broader market ends up with all its wings, but it's typically a low-single-digit range from 1 quarter to the next.

Operator

I will now turn the call back over to Frank Sullivan for closing remarks.

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

We're very pleased with our results in the quarter and pleased to generate a second strong quarter in a row of good leverage to our bottom line despite the raw material challenges in our markets. We're continuing to aggressively pursue improvements across all our businesses and see opportunities to further enhance efficiencies across our operating base and expense structure in the coming quarters and coming years. We look forward to talking to you about that in our first quarter in October, and also to providing you updates on our performance in the fourth quarter in anticipation of market share gains in a number of areas when we report our results in July.

Thank you for your participation on our call today and for your interest in RPM. Have a great day.

Operator

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



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