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RPM - Q4 2018 RPM International Inc Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to RPM International's conference call for the fiscal 2018 fourth quarter and year end. Today's call is being recorded. This call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com.

Comments made on this call may include forward-looking statements based on 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, President & COO*

Thank you, Brandon. Welcome to the RPM International Inc. investor call for our fiscal 2018 fourth quarter ended May 31, 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 will discuss our fourth-quarter results, provide an update on our cost saving and operating improvement initiatives as well as some detail on our fiscal 2019 year, after which we'll answer your questions.

I'd now like to turn the call over to Barry Slifstein to walk you through the quarter and some of our operating improvement actions. Barry?

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

Thanks, Frank, and good morning, everyone. During the quarter, we adjusted out restructuring and other charges totaling $24.6 million to reduce expenses and position RPM for long-term growth, as well as inventory-related charges of $37.7 million, mostly in the consumer segment, tied to a strategic shift in direction. It was a difficult quarter for RPM as winter-like conditions persisted for almost two-thirds of the quarter. The raw material environment remained challenging with significant cost increases in silicones and epoxies and moderate increases in TiO2, acetone and MDI over the past year, with the expectation that this trend will continue.

During the fourth quarter, in the consumer segment, we closed two manufacturing facilities and eliminated approximately 150 positions. In the industrial segment, we closed an unprofitable business in China and a polymer flooring facility in North America, which will now be serviced from another location. In addition, we reorganized our global legal function by reducing headcount at our operating companies and consolidating functions at our corporate headquarters.

Sales in our industrial segment increased 10.8%, driven mostly by organic growth of 6.2%, with FX contributing 2.9% and acquisitions 1.7%. Industrial sales continue to be driven by solid results in most of our international markets, with sales in Europe up in the solid mid-single-digit range. In the energy sector, sales were up, a trend we expect to continue in fiscal '19, while we're still struggling in Brazil. The lag of price increase implementation versus raw material inflation continued at a similar pace as in the prior quarter and adversely affected our leverage to the bottom line, with EBIT up 8.1% on an as-adjusted basis.

In the consumer segment, sales declined 3.0% in the quarter, driven predominantly by a decline in organic sales of 5.4%, partially offset by favorable FX of 1.2% and acquisition growth of 1.2%. Small project spray paint in the U.S. suffered with the undercurrent of market share jostling during the fiscal year, making it difficult to achieve price increases in our coatings categories to offset rising raw material costs, which further contributed to lower-than-expected sales.

We did achieve solid sales growth in caulks and sealants and in some consumer international markets, like Canada and South Africa. The lack of operating leverage, combined with higher raw material costs, resulted in the decline of EBIT of 30% on an as-adjusted basis.

Operationally, our consumer segment struggled the most during the quarter for several reasons. The spring selling season of March through May is the busiest season of the year for our customers as consumers are anxious to get outdoor projects completed for summer. In March, there were four northeasters on the East Coast and snow continued in the Midwest into May, significantly muting fourth-quarter sales. Retailers reacted to the unfavorable weather trends by reducing inventory, which compounded the already sluggish consumer takeaway environment over the past several quarters, further exacerbating the problem. The decision by a large competitor to stop shipping any and all products to the largest home center in the world essentially ended a price-driven market share battle and accelerated Rust-Oleum's market share gains in the interior wood stain category to immediate full-chain award at the Home Depot, which began shipping in June.

Despite disappointing results during the past fiscal year, RPM's consumer segment continues to win the ground war and take market share from the competition. Over the last 20 years, Rust-Oleum's small project paint business has grown to become the clear industry leader in both innovation and market share. Rust-Oleum's recent gains in the interior wood stain and finish product lines position us to quickly become the market share leader in this category as well. We believe that the combination of recent market share gains and easier prior-year sales comparisons should set the stage for a rebound year in consumer during fiscal 2019.

Specialty segment sales increased 1.5% due to positive FX of 1.5% and acquisition growth of 0.6%, which were partially offset by a decline in organic sales of 0.6%. The decline in organic sales was largely driven by the negative impact from a patent expiration last August, partially offset by strong sales in OEM powder coatings and wood finishes, resulting in a decline in EBIT of 0.9% on an as-adjusted basis.

In corporate/other expenses, they increased $3.6 million due to higher insurance expense and outside services.

I'll now turn the call over to Rusty for some details on fiscal 2019.

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

Thanks, Barry. During fiscal 2019, we expect the challenging raw material environment to continue, which will maintain pressure on gross profit margins. All of our businesses are aggressively pursuing price increases, including now in our consumer segment businesses.

The industrial segment should benefit from steady construction activity and a mostly stable international backdrop outside of Brazil. Additionally, our industrial coatings business should benefit from the ongoing oil and gas market recovery. We expect industrial segment sales in fiscal 2019 to grow in the mid-single-digit range.

In our consumer segment, we enter fiscal 2019 with a leaner and more simplified organizational structure, along with improved product line focus. With recent market share gains, a stepped-up advertising campaign to support new product placements and the recent purchase of Miracle Sealants, consumer is poised for growth. We expect consumer segment sales in fiscal 2019 to grow in the mid- to upper-single-digit range.

In our specialty segment, we will annualize last year's patent expiration at the end of our fiscal 2019 first quarter. We also see extremely difficult year-over-year comparisons for our Legend Brands restoration business, which experienced a sales boost due to three hurricanes last fall. Therefore, we expect sales growth in the specialty segment in fiscal 2019 to be in the low-single-digit range.

Although top-line sales will continue to be solid, the first quarter is expected to be the most difficult in terms of bottom-line leverage for several reasons. In consumer, there will be a higher first-quarter promotional advertising and load-in spend to support recent market share gains. Furthermore, the gap between current price increases and raw material inflation is at its peak, with our consumer businesses finally realizing some of their price increases now. In our specialty segment, the first quarter of fiscal 2019 is the last quarter of negative comparison relating to the NatureSeal patent expiration last August.

During fiscal 2019, we intend to adjust out charges relating to our operational improvement initiatives to provide better clarity on the performance of our core businesses. We have committed to announcing a comprehensive update to our 2020 MAP to Growth prior to the end of November and have elected not to provide EPS guidance as we navigate through this transitional period.

I'll now turn the call back to Frank.

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

Thank you, Rusty. Before we go into Q&A, I'd like to address our operating improvement initiatives. We began addressing opportunities to reduce our cost structure with our board over a year ago. Activity related to that is in part reflected in the 150 basis points of improvement in SG&A as a percent of sales we achieved in fiscal 2018 over our fiscal 2017 results. We were in the early phases of this initiative when a now major shareholder, Elliott Management, contacted us because they believe that RPM stock was undervalued, particularly in relationship to opportunities to improve our operating performance and margin profile. We agree.

The expense reduction and plant consolidation activities we announced in our consumer segment in the fiscal 2018 fourth quarter, mostly at Rust-Oleum, were already part of our operating improvement plan. These actions will generate $25 million of savings on an annualized basis, and $23 million of which will be realized in fiscal 2019. We are executing additional cost reduction and production optimization activities in our fiscal '19 first and second quarters that, on an annualized basis, will result in a similar magnitude of savings once they are completed. After these activities, I believe we will have completed three innings of a nine-inning process that will play out over the next two-and-a-half years, which will include additional SG&A efficiencies, further production optimization and a related organizational realignment that is already in process.

Over the next three to four months, we will be both executing on our operating improvement plan initiatives and finalizing the details of our 2020 MAP to Growth program with our board's operating improvement committee and the work of the consulting firm, AlixPartners, who has already been engaged with the RPM businesses for the last month.

On a quarter-by-quarter basis, we will provide you with the details of our results and separate out our restructuring and reorganizational expenses and related charges to give you a sense of the performance of our ongoing businesses. Before the end of calendar 2018, we will set a date for an investor day, which will include corporate leaders and operating leaders of our four realigned groups who will address growth initiatives, operating improvement and operating improvement initiatives in detail and provide a complete outline of our 2020 MAP to Growth program. This will include margin improvement and operating efficiency goals and our goals around capital allocation, balanced between growth and returning capital to shareholders.

It would be misleading to say that the last six months has been easy. It hasn't been. Having said that, the leadership changes and organizational realignment and already completed operating improvement activities are absolutely the right thing to create a better and more valuable RPM. Our engagement with Elliott Management has encouraged us to think bigger than we otherwise might have. We are up to the challenge and excited about the opportunities we see for significant improvement in the coming years.

We'll now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And from BMO Capital Markets, we have John McNulty.

John Patrick McNulty - *BMO Capital Markets Equity Research - Analyst*

So I guess a couple of things. On the raw material front, obviously, the headwinds were pretty severe. I guess, can you give us -- it sounds like on the consumer side, you finally kind of opened up the gates or the market is, I guess, more constructive in terms of being able to pass that through. I guess, can you walk us through on the timing on when you think you can catch up on both the industrial and the consumer segments if raws kind of level off here?

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

Sure. I don't know exactly when we can catch up. I know we're finally instituting, over the summer months, raw material -- I'm sorry, price increases in a number of our consumer product lines. We have had price increases in our specialty and industrial businesses over the last six to nine months, enough to cover the raw material cost increases but obviously not enough to cover our full margin. And so we're continuing in that vein. As you heard from Rusty, we believe that our first quarter that ends August 31 will be the peak of the mismatch between raw material price increases and our ability to recover pricing.

John Patrick McNulty - *BMO Capital Markets Equity Research - Analyst*

Got it. And then I guess maybe a little bit of granularity. Again, the raw materials make things a little bit muddy, but it did look like you had some decent cost cuts or efficiency improvements in the quarter. Is there a way to kind of break out how much raw material pressure you faced in the quarter and/or how we should think about the cost cut benefits that you saw in the quarter as well? Because it does seem like this is something you've been working on for a while.

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

Sure. As you know, we had about $15 million of expense reduction in last year's fourth quarter. And we had in the spring of last year two plant closures, which were really the beginning of the activities that we're continuing. And so that benefited us. I think the full couple hundred basis points of gross margin deterioration in the quarter are all related to the mismatch between raw material costs and pricing; as well as in our specialty segment, some mix issues, which, as Rusty outlined, between the Mantrose-Hauser patent expiration and a few other items, will be corrected after the first quarter.

John Patrick McNulty - *BMO Capital Markets Equity Research - Analyst*

Got it. And then maybe just one last question. I think there's a lot of focus on the margin benefit that you can get from some of the cost cutting initiatives. But I guess, with some of the moves that you're starting to take, it looks like there may be some working capital and efficiencies or benefits as well. I guess, can you give us some color as to how we should be thinking about that as we look forward and maybe where the cash or freed up capital would be put to work?

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

John, I could tell you generally that we are undertaking initiatives to address working capital improvement. With the last asbestos payment in May of this year, that call on our capital will now be behind us and with the operating margin improvement, all of which should improve on our existing cash flow generation. But in terms of details, I think that we'll be in a better position when we announce the specific date of our investor day sometime this fall to address cash flow and detail working capital goals, margin improvement and discuss return of capital opportunities.

Operator

From Wells Fargo, we have Frank Mitsch on the line.

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

Frank, you mentioned that you've completed, I guess, three innings of the nine-inning process here in terms of the productivity program. Elliott Management has suggested that you'd be able -- that RPM would be able to achieve 650 bps of margin improvement off of fiscal 2017. When we get to that ninth inning, what do you think that margin improvement will shake out at?

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

I'd be hesitant to address that specifically. I think the numbers that we had kicked around over the last year internally and in some investor conference was around 300 basis points. I don't know if we can do better than that or not. What I know is that we are in the process of addressing opportunities, from manufacturing to procurement to consolidation of production, and taking a look both organizationally in terms of expense reduction. And we will be in a much better position on our investor day this fall to provide specific guidance in terms of where our goals are and the time frame in which we expect to achieve them.

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

All right. Great. So I guess we're going to have to -- if I were to follow up and ask you of that 300 bps that you have been talking about, the pace of improvement, I guess -- so I guess you suggested over the next two-and-a-half years, I guess by -- so by the end of calendar 2020 is what you're targeting. In terms of the pace of that progression, is it more front-end loaded? Is it mid-loaded? Is it back-end loaded? Is this something that I need to wait for the Investor Day?

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

We took out -- we improved, on an annualized basis, with the actions we did in our consumer segment and consolidating some functional areas like legal, about $25 million of annualized costs in the fourth quarter. I think that we see a similar amount of savings with the actions that we already have planned over the next two quarters, so the quarter in which we are currently operating and our second quarter. And there will be more opportunities. But to quantify anything beyond that, I think we'll have to wait until we get through some of the assessments that we're doing and then provide a more comprehensive program to our investors in the fall.

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

Got you, got you. And then I guess just lastly, the changes that you've made at Rust-Oleum in terms of the headcount reduction and a couple of manufacturing facilities and so forth, how should we think about the order of magnitude improvement coming into consumer from the actions that have already been taken?

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

Sure. I think that on the year, across almost all of our business segments, we'll generate solid sales and solid adjusted earnings growth. It will be muted particularly in consumer in the first quarter for the reasons that Rusty articulated relative to where we are in the price/cost situation and some significant spend relative to some new programs that Rust-Oleum has. But in general, I think that when people look back at 2018, particularly in relationship to the competitive environment that we're in, our industrial segment is performing very well and that is accelerating. Our specialty segment is performing well. And 2018, in hindsight for our consumer segment, will be remembered as a poor-performance year, but a very important and very successful strategic year, and that's going to start to play out in 2019.

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

All right. Great. Well, for what it's worth, your first -- your fiscal first quarter should start out a little bit better in the interior stains business since I did refinish my floors and we used a lot of your products. So you're off to a good start there.

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

Thank you, Frank. We appreciate it.

Operator

From Bank of America, we have Stephen Byrne.

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

Just want to drill in a little bit more on that -- those changes at -- in Rust-Oleum. Would you characterize those as self-help opportunities driven by management within Rust-Oleum? Or was this driven by some top-down initiative that you could share resources between businesses to enable those headcount reductions?

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

So the activities that we undertook last spring and that we undertook this May are all activities that were planned for and executed by the leadership at Rust-Oleum. We have a new president of Rust-Oleum starting in March of this year. And he took a look at this business, took a look at some of the market share gains and new categories that they are entering and realigned their businesses internally and really focused their sales and marketing efforts in specific areas, along the lines that Rusty Gordon commented on. On a go-forward basis, I would expect that we will have more opportunities to share resources across all of our consumer businesses and a lot of our strategic realignment, not only in consumer but as we move from six groups to four groups, with an ultimate goal, when we get to the end of this 2020 MAP to Growth, to actually be reporting in four segments, to be able to share resources in kind of four centers of excellence. One example would be between Rust-Oleum and DAP. DAP has been on a really good growth trajectory the last couple of years, but 95% of their business is still NAFTA-based. Rust-Oleum has a substantial base of business in the U.K., Europe and here and there and other places like Australia and South Africa. And we will be leveraging those RPM investments and assets that are the base for Rust-Oleum's international business to start promoting the DAP product lines in caulks and sealants, patch and repair products, and adhesives. So, there are opportunities for us to share resources on a more deliberate basis, and our realignment is targeted at a number of things, including that.

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

And just to follow up on that, Frank, are those folks that you have at headquarters that are going to drive that geographic expansion between businesses? Or is that something that you're going to be looking to the consulting firm to drill into -- in one of the areas that they focus on?

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

No, I think that the operating improvement initiatives that will consolidate activities will either be at the corporate headquarters or at one of these four group levels around IT, G&A, a different approach to the RPM asset base in terms of production. But from a sales and marketing and product development and innovation perspective, we will still remain very entrepreneurial. And to the extent that we have a more consolidated approach to those, it will be at these four group levels, not at a corporate level. One of our strengths is that we continue to be innovative and responsive to the market. And you don't support that by having market-based decisions around sales and marketing in a corporate headquarters, in our opinion.

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

And, Frank, just one other area that I was curious to hear your views about in terms of a potential area of cost cutting, and that would be on product distribution. Did the businesses have responsibility for shipment to their customers? Or is that something that has some sense of control? And do you outsource any of that distribution function?

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

We will be taking a hard look at logistics, distribution and procurement and manufacturing as we realign from six groups to four.

Operator

From Great Lakes Review, we have Jason Rodgers.

Jason Andrew Rodgers - *Great Lakes Review - VP*

I just wanted to clarify a statement that was made about the savings that are planned. You talked about the $25 million in annualized savings, and then you talked about additional actions in the first half of fiscal '19. Are those additional actions expected to realize savings of a similar to $23 million to $25 million? Or is that not the case?

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

They will generate approximately $25 million of annualized savings, but the benefits in the future quarters are things that we'll have a better feel for and we'll communicate as we work through those. So we'll have an update when we report our first-quarter results as to what was accomplished in the first quarter, what the expense or charges were to accomplish that and then what the associated savings would be on an annualized basis and for the balance of 2019.

Jason Andrew Rodgers - *Great Lakes Review - VP*

So -- just so I get it straight, is the total approximately $50 million, from what you've announced so far? Or are you still talking about everything in the $25 million?

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

What we have announced so far that has been executed has been principally in our consumer segment and around certain corporate functions. And it is a $25 million annualized savings, $23 million of which will benefit our fiscal 2019.

Jason Andrew Rodgers - *Great Lakes Review - VP*

Okay. And then you talked about the first quarter being difficult in consumer due to the price/cost situation. But are you seeing any pent-up demand in that segment so far in the first quarter after the lousy weather that you had?

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

We should have solid revenue growth in our consumer segment in the fourth -- in the first quarter as a result of better POS across our entire customer base and, in particular, the market share gains in wood stains and finishes that we picked up.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And just one additional clarification. The growth in the energy sector, the upper-single-digit growth, is that just for Europe? And if so, what was the growth company-wide in that sector for the quarter?

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

No, it's across the board in North America and pretty much globally. And so, to the extent that our performance coatings group and certain parts of our other industrial segment companies serve energy. And energy is pipelines, oil and gas, offshore oil platforms, refineries, windmill blades. All of those markets pretty much globally are starting to show positive trends in terms of a pickup in maintenance spending and activity, also in terms of mining and other activities. So heavy industry that was in a recession from kind of the '15, '16, '17 time frame is now spending, and that seems to be solid and steady and improving. And the same is true in construction activity.

Jason Andrew Rodgers - *Great Lakes Review - VP*

And then finally, I know you're not giving guidance, but any thoughts on CapEx and the tax rate for fiscal '19?

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

Sure. I think all in, CapEx will probably be around $140 million. And again, we'll provide updates quarter by quarter. Our core CapEx is something slighter than that, but some of the restructuring activities will drive additional CapEx, so I think that's a good number. And our tax rate will probably be in the 25-ish range on a global basis.

Operator

From Morgan Stanley, we have Vincent Andrews.

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

Just wanted to dig in a little bit on the consumer and on the weather and the customer activity. And I guess my question is just, how do you sort of piece apart how much the impact was from weather versus the destocking that took place? And what's your level of confidence that you're not sort of stepping down to a new level of inventory at the customer?

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

So I think in relationship to your last comment, we have stepped down to a new level of inventory at our customers. It started at most of our major customers last summer and has continued throughout the year, and unfortunately, because of the weather issues that Barry mentioned, was an issue. They are at that level and that should not be an issue for us in fiscal 2019. If anything, in certain kind of high-volume colors or categories, we're seeing some replenishment because of some out-of-stock situations relative to some of those inventory adjustments at major customers. The weather circumstance and the spring was what it was and it certainly impacted our business to the extent that a lot of it is driven by outdoor projects and spring and summer projects. And so that was disappointing. But those issues are behind us as are the issues around what was a pretty significant price battle with our major competitor over the last year. And I think that's behind us as well.

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

Okay. And just as a follow-up, maybe at the high level, from a capital allocation perspective, I think we all traditionally think of RPM as looking to go out and do the bolt-on acquisitions and so forth, and we don't generally think of you guys as buying stock back or those types of things. But it seems like there's a discussion of moving more in that direction. And maybe I'm wrong, but Frank, you sound like you're receptive to that. So, I'm just curious, in your mind or the board's mind philosophically, is it just that you noticed there's great runway of opportunity ahead of you and you think your stock is cheap? You could have made these arguments over the years before when you were a big share repurchaser, so what is it that maybe is going to tip the balance more towards repurchases from a capital allocation perspective?

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

Sure. I think we'll provide some more details at what we -- when we announce the investor day this fall. But big picture, I can tell you that we have acquired stock occasionally in the past. But over the last 14 or 15 years, we paid out $1.4 billion pretax of our cash flow and capital on the asbestos liability situation. $800 million of that went out the door in the last three-and-a-half years. And so with that behind us and the ability to be sharper on working capital and improve our margins, not only should our cash generation improve but our capital allocation will now have, what has been a significant piece particularly over the last three years, be freed up to take a look at either growth investments or return of capital. So, I think we will have more resources in relationship to that, and we'll be working with our board in the coming months to develop the right balance between continuing our growth, which is paramount, and returning capital to our shareholders, both through a continually growing dividend and opportunities with more, and we think, growing after-tax cash.

Operator

From JPMorgan, we have Jeff Zekauskas.

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

It's Silke Kueck for Jeff. How much will the interior wood coatings business add in annual sales in fiscal '19? Maybe it's something like $80 million or $90 million, roughly.

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

No, we believe it's around $60 million.

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

$60 million. Okay. And the inventory write-down of like $38 million that you took in the consumer business, like which -- like in the footnote it says reflects some obsolete product, like which product did you exit? Or what is it that you wrote down? Like what's obsolete?

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

I think there are a number of items. One example would be NeverWet, where we had first-generation product that was still good product and moving slowly because we have a single component that is the primary driver and focus there, and a number of other kind of smaller and unique SKUs in different categories. And with the realignment of the businesses, where Rust-Oleum took their industrial business and consumer business group and realigned both in the U.S. and Canada into one holistic group and a refocus of their sales and marketing on primary categories. There was a decision with limited resources, limited time as to where to really focus those efforts. And it was that kind of realignment and decision-making process that led to some of the charges, the headcount reductions as well as the decision to write off certain product lines of inventory.

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

Okay. That's helpful. Of the $25 million in restructuring costs that you took this quarter, has all of the money spent already? Or will this all happen like in the first quarter or throughout next fiscal year?

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

Most of it was incurred in the fourth quarter. You'll note that we said that the annual savings will be $25 million, only $23 million of which will be realized in fiscal '19. So, there is some follow-on activity related to some planned activity that will stretch into the first three or four months of this fiscal year. And as I indicated earlier, on a quarter-by-quarter basis, to the extent that we have other activities, we'll provide the details, the associated costs and what we expect the savings to be.

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

But what you did in the fourth quarter is you accrued for those expenses but you haven't paid it out yet, right? So, like the cash outflow is still to come?

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

No. The lion's share of the charges in the fourth quarter were incurred and paid in the fourth quarter, with the exception of singles of millions of dollars associated with the completion of the announced planned activity. So the vast majority of the expense and the associated cash was incurred and spent in Q4.

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

And then lastly, over the past five years, like maybe acquisitions have averaged something like 4% or so in terms of the benefit to sales growth. And following your business review, do you think that your acquisition strategy will continue the same way? Or will it change? Do you think we will acquire less? Like how do you think about that?

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

I think we'll have a more comprehensive review and ability to communicate on that at our investor day in the fall. In the interim, when we bump into $20 million and $50 million opportunities that are good strategic fits at the right price, we will complete them.

Operator

From RBC, we have Arun Viswanathan.

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

Just got a couple of questions here. So, I guess first off, you guys have discussed that 300 basis point potential improvement in margins in the past and maybe a couple hundred from SG&A and 100 from gross. Is that still kind of the split that we could potentially expect? And then secondarily, there's also been some discussion in the past that your businesses are quite different than other businesses that we analyze in coatings and building products and sometimes take a higher specification level, which leads to SG&A kind of being structurally higher. I mean, is that -- has that changed? Or should we kind of expect that while you can improve SG&A, there's always going to be a slightly higher level for RPM?

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

So I think in certain of our categories, we will have a higher spend, particularly where we are the unique supply and apply model, for instance, in our Stonhard flooring business, in our Tremco roofing business, both of which are experiencing very solid growth. And certainly, we'll have a higher spend in what we call industrial coatings, which is really maintenance coatings as opposed to what other people refer to as industrial coatings, which are really large volume OEM, which we're not in. But that doesn't mitigate the opportunities at all that we have in improving our conversion costs and optimizing our manufacturing footprint and consolidating a number of functions and SG&A, whether it's at the corporate level or in these four groups. And again, what we're talking about internally is four centers of excellence. So, there's plenty of opportunity to both improve margins with a number of levers, they're not just all expense reductions. And at the same time, continue to be, at the sales, marketing and product development and service level, that entrepreneurial company that is more nimble and more focused on unique delivery of niche products.

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

And then what do you think the gross margin opportunity is? Are there opportunities for better procurement? Or has some of the recent raw material inflation kind of lessen that opportunity as well?

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

I think there's opportunities for better procurement as we organize better around that. And so, to your earlier question, there's some areas where our decentralized structure in sales and marketing product development is a clear competitive advantage, and we prove that every day. There's other areas where our decentralized structure has not been very efficient, and procurement is one of those.

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

Great. And then on consumer, you noted a pretty sharp drop-off, and a lot of it was weather and price competition and so on. Looking out longer term, I guess, do you have confidence that, that business can kind of return to prior operating levels? Or has there been a structural shift within the industry that's related to a shift towards do-it-for-me or low unemployment driving weaker results in DIY? I mean, are there any structural trends that have kind of changed that business to a lower level? Or do you think that business can kind of recover to where it was in the past?

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

No. I will repeat what I said in my prepared remarks. The prior consumer segment and particularly Rust-Oleum, 2018 will be remembered as a year of poor performance but a very important and successful strategic year. The only structural shift that I would comment on, and there are some, is that our single largest competitor in that category has decided not to sell any of its products to the largest home center in the world. That is a structural shift.

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

And the last question I had was just on capital allocation. You noted that you spent quite a bit of money on asbestos liability payments for the last several years. And then if we look at working capital, it looks like there's a decent opportunity that you have as well in front of you. So if I look at those two things, I mean, you're talking north of $100 million per year for asbestos probably and a reduction of a couple points of working capital to sales, I mean, that's a pretty -- it could be a substantial amount that could be adding to free cash. Is that the right kind of way to look at it, right, as far as in sizing opportunity? And then as far as priorities, again, you have mentioned the potential larger acquisitions now in the past, given that you've moved on from asbestos, but are you shifting that strategy now to be a little bit more internally focused? And would that imply that you're finding buybacks a little bit more attractive?

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

Sure. I think, generally, your question is directionally correct. Specifically, we'll be in a better position to provide details after we get some more work done in the next couple of months.

Operator

From Vertical Research Partners, we have Kevin McCarthy.

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

Frank, you mentioned in your prepared remarks that you had embarked on some of the restructuring initiatives about a year ago. You now have a new relationship with Elliott as a large shareholder. AlixPartners, you're one month in, and you've got a couple of new board members. You also mentioned you're thinking bigger now in that context. So, I was wondering if you could just help us understand, given all those new relationships, what sort of ideas and capabilities do you have now at your disposal that RPM might not have been able to accomplish on its own? Just trying to distinguish between wheels that were already in motion and then new approaches here.

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

Sure. I am -- this is probably not the best answer to your question, but I think we're in the process of reviewing a lot of stuff and that we'll be in a better position to answer that question at our investor day this fall. But we have opportunities both for production, capacity consolidation, but also production optimization. We have opportunities in the procurement area. We have opportunities to consolidate G&A, either at corporate or in the four-group/segment that we're going to. And so, there's a number of areas that we are kicking the tires on and hope to have more specifics when we have our investor day in the fall. I do think that the $25 million of savings that we executed on in the fourth quarter and a comparable amount that's already in the pipeline gives you some sense of the activities that we have ongoing, and those will continue. And to the extent that they can be accentuated by the review that we're undergoing with our board. And we've never used an outside consulting firm in this way. And the first month of their activity has actually been very positive. So, we'll see what comes in.

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

And as a follow-up, you mentioned moving from six groups to four. I think RPM has always been perceived as a company that's highly decentralized. As you transition and consolidate the number of groups, will that remain the case? Or would you expect to emerge from this process as a significantly more centralized company than you were in the past?

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

I believe from a sales, marketing, customer service and product development perspective, we will remain the most decentralized company in our space. And that has been a competitive advantage, both in terms of market share gains and organic growth. But as I said earlier, there's elements of our decentralized structure, particularly as the world has evolved in terms of systems that has not been very efficient, and that provides a lot of opportunity for improvement, which will both -- you'll see in our margin profile improving and our cash generation improving.

Operator

From Northcoast Research, we have Kevin Hocevar.

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

There's obviously a lot of moving parts to this year with -- for fiscal '19 with all the cost savings and price/cost and market share gains. And I can appreciate that you're not giving any specific EPS guidance at this point, but wonder if you can help us with EBIT margin to some degree, if you can point us in the right direction, either for the company as a whole or by the segments, what type of -- what EBIT margins could look like this year when we sum all that up?

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

Yes. I don't know that we would provide any particular guidance now. We'll be in a better position having executed on some additional expense reduction and consolidation to provide a better outlook both for the balance of 2019 and for the years beyond that this fall.

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

Got you. Okay. And as we look at the sales guidance that you have provided, obviously, there's a lot of raw material pressure that's been happening and continues to happen. And it sounds like some of the pricing initiatives are starting to gain some traction. So, wondering how much of price is factored into that guidance this year.

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

Again, it's hard to say at this point. I would tell you, as of the fourth quarter on a consolidated basis, it was probably about 1%. And I would expect it to be something greater than that in fiscal '19. But I think we're in a period of time where we will report more detail quarter by quarter things as they happen, as opposed to in a year in which it will be almost impossible to predict, for instance, GAAP results, because of different charges and the timing of those charges. So that's the approach that we would take for the year.

Operator

From Baird, we have Ghansham Panjabi.

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

This is actually Matt Krueger sitting in for Ghansham. Given that the price/cost gap is currently at its widest, how should we expect the recovery to progress over the next several quarters, i.e. how is pricing going to be layered in? Are there any major step function changes? And how do you think this will differ across the segments?

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

I think the peak for us, particularly in consumer, in recognizing that RPM is on a FIFO inventory accounting method is really the first quarter, we started getting hit hard with raw material prices as they flowed through our P&L after August 31. So that's one factor. The benefit of price increases that we've been able to institute over the last six to nine months and now finally, in consumer, over the summer months, will also have benefits. And so we will be annualizing some easier comps after our first quarter. The other thing that's been significant in our specialty segment is the Mantrose-Hauser NatureSeal patent expiration, which was at the end of August last year. So, after the first quarter, we'll also be annualizing what was a significant hit. That management team did a great job of working with its customers. We didn't lose any market share, but we had to reduce price significantly in relationship to the patent expiration. And 100% of that price reduction flowed right through our bottom line. And so we will be annualizing that after the first quarter as well.

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

That's very helpful. And then understanding that the operational improvement program is in the early stages and things like that, what do you view the likelihood that the operational improvement plans involve any sort of portfolio pruning across any of the businesses?

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

Again, we're taking a look at pretty much everything we have. And to the extent that there are any opportunities there, we would expect to address those in the fall.

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

Okay. Okay, that's helpful. And then last question for me. Are there any other opportunities for business wins given your competitor's exit from one of the major big box players? And if there are, what type of pricing concessions or pricing competition do you expect when bidding on this business?

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

Sure. We don't take any of our business or any of our customers for granted. And we have to win our business every day, and that will not change. But I really think it's the innovation and the focus in that space that has helped us win over the long term. And we're just better at it, and that's not bragging, it's where we live. We live every day in spray paint and small project paint. Rust-Oleum just came out with a new delivery product, a spray can called Turbo. It's on fire, very excited. And so, whether it's packaging, whether it's product, whether it's taking a two-component product and making it into one component, we tend to be the innovator there, and it's because it's where we live. We don't live in being a paint store operator or in other areas that some of our competitors do. And so, we would expect that, that innovation will help us to continue to both grow and also improve our margin profile.

Operator

We will now turn it back to Frank Sullivan for closing remarks.

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

Thank you very much for your participation in our call today. We look forward to updating you on our fiscal first-quarter results and additional items of our operating improvement activities when we release results in the first week of October. And at that time, we would also expect to have scheduled an investor day that will include not only corporate leaders but the operating leaders of our businesses. And we remain very excited about the sales and earnings results we will generate in fiscal '19 on an adjusted basis and the activities that we are undertaking that will serve RPM shareholders well in the coming years. Thank you and have a great day.

Operator

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