

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

RPM - Q1 2019 RPM International Inc Earnings Call

EVENT DATE/TIME: OCTOBER 03, 2018 / 2:00PM GMT

OVERVIEW:

Co. reported 1Q19 sales of \$1.46b.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

CORPORATE PARTICIPANTS

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

Kristine Schulze

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

CONFERENCE CALL PARTICIPANTS

David Michael Stratton *Great Lakes Review - Research Analyst*

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

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

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

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

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

Richard O'Reilly

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

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

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

Frank Mitsch *Fermium Research - Analyst*

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

PRESENTATION

Operator

Welcome to the RPM International's conference call for the fiscal 2019 first 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 report 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, President & CEO*

Thank you, Paulette. Good morning, and welcome to the RPM International Inc. investor call for our fiscal 2019 first quarter ended August 31, 2018. On the call with me today are Rusty Gordon, RPM's Vice President and Chief Financial Officer; and Kristine Schulze, our Senior Director of Financial Reporting, who has become involved in our Investor Relations effort.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

Kristine joined RPM in 2000 as a financial analyst and has taken on ever-growing responsibilities in the financial reporting area since. Today, Kristine will discuss our first quarter results in some detail as well as the progress we are making in our cost savings initiative; then Rusty will share our expectations for the remainder of fiscal 2019. And afterwards, we'll take your questions.

Our first quarter sales came in about where we expected, with strong organic growth in consumer and industrial. As anticipated, our specialty segment was facing a very difficult year-over-year comparison in relationship to the strong storm-related results of our Legend Brands restoration equipment business last summer and the impact of the Mantrose-Hauser edible coatings patent expiration, both of which we've been talking about over the past year.

If there's a disappointment in the quarter, it is the continuing difficult raw material cost environment for a fifth consecutive quarterly period. Having said that, as we indicated in our July communications to investors, we believe that this first quarter is the peak of the mismatch between our raw material costs and the ability of our companies to begin getting offsetting price increases. This is true across all of RPM's businesses, but particularly in our consumer business. We anticipate a slowly building improvement between our raw material costs and our pricing and product mix beginning in the second quarter and continuing for the balance of the fiscal year.

Related to our operating improvement initiatives, our 2020 MAP to Growth program, we're making good progress. One indicator of how we feel about our long-term prospects is the action we took last week to redeem our 2.25% \$205 million convertible bond due in December of 2020. Our stock price performance had met the criteria to allow us to redeem these bonds early. We have chosen to do so in a manner that will provide bondholders face value for their bonds in cash with a premium related to the conversion ratio to be paid in shares of RPM stock. The net effect of the terms of this redemption is roughly a 3 million share repurchase on a fully diluted basis without negatively impacting our balance sheet ratios or debt metrics.

Additionally, fiscal year-to-date, we have repurchased approximately 1 million shares of RPM stock. This repurchase, in combination with the convertible bond redemption, will mean that we will have effectively repurchased about 4 million shares of RPM stock.

We also announced this week, a Wednesday, November, 28, 2018, RPM Investor Day to be held in Baltimore, Maryland. At this Investor Day event, we intend to provide details around our forward-looking capital allocation and expectations for significant expense savings, long-term margin improvement and the specific time lines for their achievement. So while the quarter was challenging from an earnings perspective, particularly on a GAAP basis related to our ongoing restructuring activities, we are pleased with the strong revenue growth of our businesses, the outlook for an improving raw material cost price ratio in the coming quarters and the progress we are making on our 2020 MAP to Growth program.

I would now like to turn the call over to Kristine Schulze, RPM's direct -- Senior Director of Financial Reporting.

Kristine Schulze

Thanks, Frank, and good morning, everyone. Today, I will review results of operations for our fiscal 2019 first quarter on an adjusted basis, which will exclude restructuring and other charges totaling \$39.8 million during the quarter.

During the quarter, we achieved record sales of \$1.46 billion, mostly as a result of strong organic growth of 7.8%. Our bottom line, however, was adversely impacted by a combination of items, which included continued raw material headwinds, unfavorable foreign exchange, one-time legal costs and an additional charges related to our 2020 margin acceleration plan.

We continue to make progress in implementing our operating improvement plan during the quarter, which included a reduction of more than 150 positions, mainly in our industrial and specialty segments, and the announced closure of 4 manufacturing facilities. As we faced continued raw material headwinds, we are more aggressively pursuing price increases to protect gross profit margin. In particular, we are experiencing significant increases in the cost of silicone, asphalt, epoxy and acrylic resins, while cans and other packaging continue to rise modestly. While we anticipate that these trends will persist for at least the remainder of calendar 2018, we expect the raw material cost price ratio to improve.

OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

Sales in our industrial segment increased 7.2%, primarily driven by organic growth of 6.7%. Acquisitions added 1.6%, while foreign exchange reduced sales by 1.1%. This segment benefited from a particularly strong performance by our North American waterproofing business as well as our industrial coatings business serving the oil and gas sector, which is enjoying a healthy recovery. Bottom line leverage was masked by the combination of restructuring charges and unfavorable transactional foreign exchange expense resulting from the strengthening of the dollar versus certain international currencies.

Industrial segment restructuring activities included the realignment of our global brands, changes to our leadership structure, the initiation of 2 plant closures and the withdrawal from select international product lines. On an adjusted basis, industrial segment EBIT increased 2.5%. Absent the unfavorable transactional foreign exchange, our adjusted EBIT margin would have increased at a pace more in line with our growth in sales.

In the consumer segment, sales increased a solid 13.6%, primarily from organic growth of 12.4%, which was driven by new accounts and market share gains, particularly in wood stains and automotive finishes. Our expanded relationship with the Home Depot has commenced, which includes a full chain award in the interior and wood stain category. Products began shipping during the current quarter. Acquisitions added 1.7%, while unfavorable foreign exchange offset our sales by 0.5%.

As mentioned during our fiscal 2018 fourth quarter conference call, we anticipated that the fiscal 2019 first quarter would be the high watermark for margin erosion in our consumer segment. In response to continued raw material escalation, we implemented price increases late in the quarter in order to protect our gross profit margins. Adjusted EBIT in the consumer segment declined 27.1%, and nearly half of that was attributable to legal costs, with much of the remainder resulting from stepped up advertising to support our recent market share gains.

Specialty segment sales increased 2.3%, with organic growth contributing 2% and acquisitions, 0.4%. Foreign exchange reduced sales by 0.1%. This segment faced tough year-over-year comparisons related to the extraordinary sales level that our water damage restoration business experienced from last year's Hurricane Harvey. On an adjusted basis, which excludes restructuring-related expenses, specialty segment EBIT declined 7.6%.

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

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

Thanks, Kristine. During the remaining 3 quarters of fiscal 2019, our businesses will continue to aggressively pursue price increases to protect our gross profit margins in response to continued raw material cost escalation. With our final asbestos trust payment behind us, we have freed up capital to allocate to more productive purposes, and we'll talk more about that during our Investor Day on November 28.

As communicated in our year-end earnings release of July 19, 2018, we expect full year fiscal 2019 industrial segment sales to grow in the mid-single-digit range. The segment should benefit from steady construction activity and the ongoing oil and gas market recovery with improving leverage to the bottom line.

In our consumer segment, we expect to benefit from recent market share gains and the stepped up advertising campaign to support new product placements. This should drive sales growth in the mid- to upper single-digit range, which will begin to generate positive earnings growth over the prior year in the second quarter.

In our specialty segment, we lapped the expiration date of our NatureSeal patent as of the end of our fiscal 2019 first quarter and therefore, expect better comparisons for this product line as we go forward. We expect sales growth in the specialty segment to be in the low single-digit range.

I'll now turn the call back over to Frank.

OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Thanks, Rusty. We're focused on the implementation of our operational improvement plan, which is proceeding as scheduled, with cost reduction efforts, including plant closures, the realignment of some of our global brands and changes to our leadership structure. During the remainder of fiscal 2019, we will continue to adjust out charges for our operational improvement initiatives, which will provide some clarity on the performance of our core businesses. We look forward to providing a comprehensive update on our plans at our Investor Day in November 28, which will also be webcast via the RPM website at www.rpminc.com.

We'd now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from John McNulty from BMO Capital Markets.

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

So I guess, a couple of questions. One, I know you've got a lot that you're going to be, I guess, talking about on the 28th of November. But I guess, it looks like you've already made a reasonable number of movements already with the headcount reductions and plant closures. Can you give us a feel for what the run rate in the cost savings might be at this point just so we can kind of think about that going forward?

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

Yes. We have made some good progress in our fourth quarter and over the summer months. But I think at this stage, we would be in a better position at this Investor Day to provide details on the then year-to-date plant activity and cost savings, and then also pretty good detail on what's to come. And so rather than speculate or dribble stuff out on that, I think we'll wait until November 28, at which point we'll have a pretty comprehensive overview of not only what we've done, but where we're headed.

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

Okay. No, fair enough. And then, I guess, with regard to the legal expense, it looks like it was one time. I guess can you help us to understand what that was all about? And again, is it definitively one time?

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

Yes. And so that was a significant part of the underperformance in consumer, certainly along with raw material cost price issues. But we had a \$10 million year-over-year legal expense issue associated with the resolution of a trademark and some IP issues. It is once and done, and it's behind us.

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

Got it. And then, I guess, a question on the consumer business. I mean, the volumes were obviously really strong, and I guess, it seems like there's a lot of things that could have potentially been doing that, whether it's the Home Depot ramp or -- weather, I guess, nicked to the prior quarters, so maybe it unlocked a little bit. I guess, can you help us to think about what a good organic rate is right now, like taking out maybe the noise of an inventory channel fill for Depot and that kind of thing?



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Yes. I think the organic growth rates in the low single digits right now in consumer, excluding the market share gains that we picked up, so it's positive versus the last couple of years. And we also had significant mid- to high-single-digit extraordinary ramp-up expense associated with the new program at Home Depot in terms of increased advertising and some other expense to ramp up into that program.

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

Got it. And then maybe just the last question since it's been a hot topic. On the raw material front, you indicated this is -- you thought this was going to be kind of the worst of the quarters in terms of the spread between raws versus price. I guess, can you give us some clarity as to how much raws were up year-over-year and how much price was up so we can kind of think about the net effect of that?

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

So I think price was up, on average, about 1.5%. And as we go forward, that should get better. And raws have been up probably in the 8% to 10% range. And so we are not catching up yet, but we've seen 2, or in some instances, 3 rounds of raw material price increases. And in some of our businesses, we are on the second price increase range, and it's now happening across all of our businesses.

Operator

Our next question comes from Ghansham Panjabi from Baird.

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

Yes. Maybe just starting off, Frank, with the -- kind of the macro mosaic. I mean, obviously, you have exposure to various geographies, including the emerging markets, Brazil, Asia, China, et cetera. Can you maybe give us a sense as to the underlying demand across those regions? Any impact from tariffs, et cetera? I'm just try to get a sense of the run rate for industrial going forward.

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

So I think our strongest region, and this is fitting with the headlines, is North America and particularly, the U.S. We've had okay growth in Latin America, excluding Brazil. And Europe has been relatively flat. And the balance of the geographies for us are up, but relatively small.

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

Got it. And then just going back to your cost initiative comments. As we kind of think about the operating profit bridge, fiscal year '19 versus '18, what is reasonable for -- certainly from our vantage point in terms of cost savings on a year-over-year basis? And the reason I'm asking is because you have other operating costs such as freight, et cetera, that have started to increase significantly. I'm just curious as to whether your pricing initiatives specific to this year will be enough to offset these other variable costs.

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

So from a macro perspective, both for my time at RPM and the leaders of our businesses, we've been through 2 of these commodity cycles. During the last cycle, from start to finish, we recovered slightly more than we lost. In the prior cycle, we recovered slightly less than we lost. And so there's no reason to believe that, as we get through this cycle, that's 20 deep and 20 long, that we won't recover most of the margin loss at the gross



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

margin level. Those dynamics have not changed. The nature of our products, even in the consumer spaces, while we have -- or particularly in consumer, a difficult time getting price increases as raw materials ramp up. We typically are able to hang on to price as raw materials ramp back down. That is a macro cycle and some comments on our past experience that is aside from the improvements that we expect in the manufacturing and procurement area, the details of which we'll talk more about in November.

Operator

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

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

Frank, I was wondering if you could give us a little more detail on those doubtful accounts? You have an 8 million hit this quarter. Can you talk about your customers and whether you expect additional issues in that particular area?

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

Yes, and I think that's a sharp observation. We had commented about withdrawing from certain product lines, particularly in the developed country. And so over the last decade, we have planted a lot of seeds in different parts of the world. And as part of our operating improvement initiatives, we have challenged our businesses to take a hard look at business operations or particular product lines that don't meet our margin profile expectations and/or have not proven to be the profitable product lines on a regional basis that we had hoped when we made the initial investments. So in a number of instances, places like the Middle East and one area in India, we are discontinuing the sale of certain product lines and in that process, writing off inventory and receivables that would be associated with those product lines. The nature of that is both in terms of size and accounting. They are not excluded in our restructuring charges, but there is noise in our adjusted numbers as we look across our entire organization and make some decisions about where we're going to continue to invest and where we're not.

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

Can you quantify more or less how much in terms of revenues you walked away from?

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

I don't have that number. It would be single tens of millions of dollars. But again, I think we'll have more comprehensive detail when we talk to investors in November about how we're readjusting our portfolio by segment.

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

Okay. And then -- so you mentioned the Middle East and India, but you didn't talk about Brazil, where you have been investing quite a lot in introducing new product lines over the last few years. Can you bring us up-to-date on what is happening in Brazil?

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

No, that's correct. And Brazil has continued to be a very challenging place to do business. The economy continues to struggle. The currency continues to be an issue, and -- but we have a great leadership team down there. They are beating most of their peers on a local currency basis, and we have not discontinued any product lines in the Brazilian market. The other comment I would make while we're having this discussion is we had about a \$5 million or \$6 million transactional exit in the quarter, which was principally associated with a pretty dramatic change in developed -- developing country currencies like Brazil, like Turkey, like South Africa, like Argentina in relationship to our industrial segment.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Okay. And then, if I may, last year, you benefited from Hurricane Harvey. Are you anticipating to benefit from this last hurricane? Or do you have less business in North Carolina as you did in Texas, for example?

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

We'll have some benefit in the month of September and in the second quarter because of the timing of that versus Harvey, which was pretty much a big and sustained benefit across most of the first quarter and into September last year.

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

And then lastly, if I may, kind of a trivial question, but why pick Baltimore for your Investor Day?

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

Our DAP business is there, our single largest shareholder is there, and it's a lot cheaper to bring a lot of people to Baltimore than it is to New York or somewhere else.

Operator

Our next question comes from Vincent Andrews from Morgan Stanley.

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

Just wondering if you'd talk a bit about the media spend in consumer and if you're pleased with the uplift that you're seeing and how we should think about the evolution of that spend, not just through the balance of this fiscal year but into next year. Is it going to likely maintain itself at the current levels? Or do you think you'll be able to dial it back?

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

I think we're up mid- to high-single digits in the quarter year-over-year, and that's going to be a sustained level of higher spending. Some of that's associated with the rollout of the wood stain program. Our first 2 months of that program are exceeding our and our customers' expectations in terms of consumer takeaway. And so we're pretty pleased with the program and think that the support levels that we provided to kick it off are making a difference.

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

Okay. And then last quarter, we also talked a little bit about the continuation of destocking in the consumer, big bucks channel mostly. Has that run its course? Or is that -- are you still sort of lapping that process?

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

I think it will have run its course as we get further into the second quarter and then certainly, for the balance of the year.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Okay. And then just lastly, I'm just curious, as you're doing all this restructuring and planning, is there any thought to changing from your fiscal year to a calendar year to improve the comparability of your results versus your peers?

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

That is not anything that we've discussed at this point.

Operator

Our next question comes from Steve Byrne from Bank of America Merrill Lynch.

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

What categories do you now provide the product and shelf space guidance to Home Depot? And has that now increased to include wood stains?

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

So we provide small project paint, both in spray cans and brush goods in multiple different sizes. We provide products that go on plastic, concrete, certainly metal, and we had provided a much smaller level of interior wood stains and finishes and now are the principal supplier of those products across the entire chain. We also have...

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

The relative...

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

Yes. We also have patch and repair products, caulks, sealants and construction adhesives and a few but growing industrial coatings in their building materials section around concrete sealers and early stages of roofing products.

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

And in your experience with being a category manager, over time, how does that benefit you?

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

It's benefited us significantly in terms of growth, in terms of acceptance of new products and in terms of our ability to really see what's moving the markets across all our customer base. And so it's been a huge benefit for our consumer businesses.

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

Okay. And I assume this wood stain category would be a much larger category than some of these other ones you mentioned.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

I think it's about the same size. We had commented in the fourth quarter that the opportunity initially in the wood stains and finishes on an annualized basis would be in the \$60 million to \$70 million range. I think over time, it will be bigger.

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

Okay, and just one last one. This headcount reduction of 150, it looks like that's roughly a 1% cut. Was that fully driven by the 4 manufacturing facility closures? Or is that more reflective of any change in overall structure? Would you see the portfolio restructuring you're heading into as being potentially a much bigger change in total headcount?

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

So the activities in the first quarter included some G&A position reductions principally. A lot of the plant position reductions are coming, to the extent that we've announced the closures. And we will have, I think, good detail on both the opportunities for consolidating underutilized manufacturing capacity, the impact of some functional reorganizations, both in terms of costs as well as savings, when we present our comprehensive plan in November.

Operator

Our next question comes from Kevin McCarthy from Vertical Research.

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

Frank, how would you characterize your M&A pipeline on the heels of the Nudura deal that you announced 3 weeks ago?

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

Sure. I -- we continue to look at small- to medium-sized acquisitions. We've done a comprehensive review with our board on the returns on our acquisition activity. And with the exception of the Kirker and Synta transaction that we talked a lot about in the past couple of years, we've got a return on those activities that's in the high teens to low 20s. And we would continue to expect to execute on that program. The most recent one is Nudura, which is a patented insulated foam product for building materials and great fit with our Dryvit business. And we're really excited about having the Nudura leadership team and products join RPM.

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

And then, Frank, on a separate topic, you mentioned some transactional currency headwinds in the industrial segment in the first quarter. Do you anticipate any similar currency pressures in that segment or elsewhere based on what you've seen so far in the second quarter?

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

Yes. That's hard to say from one quarter to the next, but we don't anticipate a drop between the dollar and these developing country currencies to the extent we saw over the summer. It was pretty dramatic, and so I wouldn't expect that to happen again. But it's hard to predict, and it could be a couple million dollar gain or a \$3 million or \$4 million loss from one quarter to the next. So it's really the swings quarter-over-quarter around a static number as opposed to a particular hit in 1 quarter.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

And then finally for Rusty, your tax rate came in a little bit lower than we have penciled in any way for the first fiscal quarter. How do you expect your tax rate to trend for the year?

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

Yes. For the year, we should probably be in the mid-20% range.

Operator

Our next question comes from Frank Mitsch from Fermium Research.

Frank Mitsch - *Fermium Research - Analyst*

Pleasure to meet you, Kristine.

Kristine Schulze

Thank you.

Frank Mitsch - *Fermium Research - Analyst*

I'm optimistic that Fermium Research's outlook and future will be as bright as Baker Mayfield's appears to be.

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

Let's hope so to both.

Frank Mitsch - *Fermium Research - Analyst*

Yes, yes. On the consumer side, you guys posted low teens growth in fiscal Q1, and Home Depot was only partly in fiscal Q1 and it's going to be fully in fiscal Q2 and beyond. And so my question is, you maintained the guidance there of mid- to upper-single-digit growth for the consumer segment. Is there -- is that something that we might realistically expect to move higher as your guidance moves higher as we progress through the year and get more quarters under our belt given what you did in Q1?

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

No, I don't think so at this point. I think, as we commented earlier, that across the entire consumer segment, we're looking at low-single-digit organic growth, and that will be accentuated by the pickup of some market share in the wood stains and finishes area. But it's a more solid base of business than we experienced in the past year, and that wasn't unique to us. It was pretty true across the board. And the challenges that we're facing in terms of raw material issues are not unique to us. The mismatch between revenue growth and leverage to the bottom line has been reported by many of our peers that serve kind of the same architectural paint or specialty paint markets. We do see that mismatch in terms of price cost and mix beginning to improve in the second quarter, and it should get better sequentially.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

Frank Mitsch - *Fermium Research - Analyst*

I see. All right. And with respect to the shares outstanding, you mentioned I think that relative to the end of the last fiscal year, you're now down to about 4 million shares. How should we think about the pace of buybacks through the rest of the year?

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

So the net effect of the bond redemption that we talked about, the actual redemption date is November 27. So the effect of what will be roughly a 3 million share repurchase on a fully diluted basis will be effective as of that date. The 1 million shares that we talked about year-to-date have already been completed. And beyond that, I think, again, we intend to provide a comprehensive look to investors about our capital allocation going forward, about the areas and detail and timing of cost reduction and margin improvement initiatives all on November 28.

Operator

Our next question comes from Jeff Zekauskas from JP Morgan.

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

It's Silke Kueck-Valdes. My first question has to do with the restructuring program. I think what you said in the July call is that the \$25 million restructuring that you took in the fourth quarter last year was related to reducing headcount by 150 positions and closing 4 plants, maybe 2 Rust-Oleum plants and then some stuff on the industrial side. And the restructuring that you -- charge of \$20 million that you took this quarter, is that related to additional headcount reductions and additional plant closures?

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

Yes. And the fourth quarter activity was principally related to our consumer segment, and the activity in the first quarter was a mix between industrial and specialty. There's certainly more to come. And again, we'll provide details here in November.

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

Okay. So there's like 150 positions that will come out in the industrial and specialty side and 150 that will come out of the consumer business?

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

There was 150 positions eliminated in the first quarter principally in our specialty segment businesses and industrial segment businesses, and we will report on further activity at our Investor Day.

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

Okay. In terms of the business that you won at Home Depot, the \$60 million or \$70 million wood stains business, like, it looks like the -- if the base business grew low single digits, it looks like that maybe already you booked a big part of that business. I think you already got, like, \$30 million or \$40 million of those sales in your first fiscal quarter.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Yes. I don't have the details on what was sold into the first quarter. Again, we had commented that on an annualized basis, this would be \$60 million, \$70 million. We have worked hard and incurred a lot of upfront expense to meet that load in. The program consumer takeaway is exceeding our and our customer expectations. So I think from that perspective, everybody's happy with it. And we need to get it settled in, in terms of a fully loaded-in program and with a cost basis that's consistent with a consistent program as opposed to the ramp-up.

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

Are the ramp-up costs, like the advertising cost, are those like onetime expenses this quarter? Or do you think you may see that throughout the year?

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

There's a portion of them in the singles of millions of dollars that were one-time expenses. And as we indicated earlier, there's a mid- to higher-single-digit increase in advertising and promotional expense that we would intend to continue throughout the year.

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

And lastly on the industrial side, like, what you've said is that waterproofing and the demand in the oil and gas business was good. How did the Tremco Roofing business and the Stonhard flooring business fare in the quarter? And what's your outlook for those businesses?

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

So in both cases, those businesses are doing quite well. We are continuing to see high-teen to low 20% growth rates in the roofing -- the Tremco Roofing restoration coatings. They've introduced a new product, a new AlphaGuard product recently with a polyurethane modified acrylic proprietary technology that's taking off, and that continues to be a real area of strength for us. And on the Stonhard flooring business, continuing to see solid growth there. I think one of the advantages that Stonhard has versus some of our competitors is their in-house or captive application crews, particularly in an environment where it's difficult to get labor for contracting activities. And the last thing I'd say about Stonhard is, much like our Carboline business or other businesses, most of their activity is driven by industrial spending, and that has continued to be strong, particularly in North America.

Operator

Our next question comes from Mike Harrison from Seaport Global Securities.

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

You've noted several margin headwinds. Obviously, you quantified the legal costs, you talked a little bit about higher advertising spend. Obviously, we're dealing with raws and the transactional FX impact. I'm not sure, if we kind of add that up, if there's a way to really think about how much better the margin could be if we just move past these temporary factors. But any sense as to maybe what the underlying mix and operating leverage would've looked like if we could X out all of those factors?

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

I think the comments that we made in our prepared remarks would indicate that if you X out the FX factors, for instance, in industrial, we would have had EBIT growth equal to or slightly better than our sales growth, the lack of better leverage being the raw material situation. And I think in



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

consumer, you would've come close to flat year-over-year earnings, which is still not very good revenue leverage given the strong revenue growth we had there, excluding the ramp-up costs, higher promotional spend and the one-time legal expense.

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

All right. That's helpful. And then I was wondering if you can talk a little bit about the consumer business. You mentioned automotive finishes within there as a bright spot. How big is that business? And what was driving the strength in automotive finishes?

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

So we continue to pick up market share. It's in the mid-tens of millions of dollars in terms of that business size, and we picked up market share and some of the automotive big-box accounts from our largest competitor in spray paint and small project paint areas there.

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

All right. And then just in terms of the recent acquisitions you've done in consumer, I'm thinking of some of the bigger ones like Touch 'n Foam, SPS, Miracle Sealants, can you give us an update on how those are performing and whether we're seeing an additional contribution to some of the sales growth from those?

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

Sure. The Touch 'n Foam product lines, the cleaning product lines that have been acquired to build a cleaning category, Rust-Oleum, so Miracle Sealants, Whink, a number of products like that. Those are all going exceedingly well. The SPS acquisition in Europe has gone exceedingly poorly. It's in decorative paints, and it's in an environment where, despite rising raw material costs, a lot of the largest architectural paint producers in Europe have been in somewhat of a price war. And so that has not been a particularly good performing acquisition for us or our consumer segment.

Operator

Our next question comes from Mike Sison from KeyBanc.

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

If you add back the \$10 million to consumer, adjusted EBIT is down about 13%, so it's not as bad on a year-over-year basis. Should that decline, significantly lessen, as you get into 2Q, 3Q? And if your pricing actions are gaining traction, is there a point where you might be even year-over-year in adjusted EBIT or maybe even up?

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

Yes. Our expectation is that while we will continue to be fighting raw material cost issues as the year progresses, that you will see positive year-over-year earnings results in the second quarter and sequentially thereafter in each of our segments.

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

Got it. And then industrial's organic growth, you talked about, has been pretty good. Can you maybe -- a quick update on Euclid that's easily one of the bigger businesses in that segment and wanted to see how that was doing.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Sure. Our Euclid North American activity is very strong and doing quite well. The drag on Euclid is the Viapol business in Brazil and the negative impact, both in terms of the economic activity there and further, the FX hit both transactional and translational.

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

Great. And then one follow-up in terms of industrial. EBIT growth was solid in the first quarter. I would imagine, given that pricing is coming through that, that one should continue to strengthen as the year unfolds in terms of EBIT growth.

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

I would think that you'll see improvement there sequentially. And as we commented earlier, you would've had EBIT growth comparable or slightly better than sales growth, except for the transactional FX hit, all of which was related to our exposure to developing countries, all of which is in our industrial segment.

Operator

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

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

Back to raw materials, can you just talk a little bit about what makes you feel like that this is the high watermark, I think you said, for raw material prices? And what makes you think that going forward, things are going to improve?

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

So in general, in our industry, and again, not unique to us, we have been behind the curve on raw material prices in terms of the size of their increases and expectations for how long they would persist. And so related to that, we have been, in different parts of our business, more in consumer, which has been typical of our history, behind the curve in gaining price increases to offset raw material price increases. And in this cycle, we have worked hard to gain and sustain price increases only 3 or 4 months later to find out that we're facing a new round of raw material price increases. So in certain solvent areas, in silicones and acrylics, it's been a challenging raw material environment for our entire industry, and so that is really what explains where we are. The pricing activities began to kick in, in the spring and over the summer, in ways that are more consistent with an understanding across the whole supply chain of the environment that we're in. And I think lastly, while we're seeing some additional price increases, they're not at the magnitude of what they were 12 or 9 months ago. And with the exception of silicones, a lot of the shortages that we were facing have dissipated. And then the last comment that I think is still an interesting factor out there, particularly for us in packaging, is the impact of tariffs.

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

That's helpful. And then, I guess, to follow up on the price increases that you've put into place and your recent market share gains, can you talk a little bit about the competitive environment going forward? You said that typically, there's some stickiness there, where as raw material prices fall, your price increases can stick. How does that dynamic impact where you see your recent market share gains going forward as, hopefully, those prices can stay high, but maybe increase competitive pressures?



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Sure. I think that's the dynamic that we've been through twice before, and there's no reason to believe that, that dynamic doesn't exist today, particularly given the strength of our brands. And that margin improvement on the cycle turn is complementary to some of the manufacturing and procurement initiatives that, we believe, will start to take hold after the 1st of the calendar year.

Operator

We have a follow-up question from Rosemarie Morbelli from Gabelli & Company.

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

Frank, when you talk about share gain, are you mostly referring to the new business at Home Depot? Or are you seeing share gain across all of your product lines or most of them?

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

We're seeing good market share gains in a number of areas. In consumer, it's in wood stains and finishes. It's also in automotive at retail. We're seeing continuing share gains in our industrial segment, in flooring and particularly in waterproofing and roofing restoration coatings. And so those are, I think, the best examples of where we're -- where our growth is outstripping the general market growth.

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

Okay. That is helpful. And then I was just wondering if you could talk about the market in general at the big box. In the past few quarters, it is mostly big projects that have resulted in growth, while the small projects, which is where you play, has been behind the curve, so to speak. Are you seeing any change in that trend? And related to that, have you lost any business at Lowe's that is being replaced by the gain at Home Depot?

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

We have experienced, as you pointed out, across our whole industry relatively weak consumer takeaway in the past fiscal year. We think that there is an improved kind of low-single-digit organic growth in the market, so it's improved from the prior year. Not dramatically, but it's positive as opposed to flat or down. And our volume loss at Lowe's was less than \$20 million.

Operator

(Operator Instructions) We have a follow-up question from John McNulty from BMO Capital Markets.

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

Just one quick follow-up. On the corporate line, when you take out the adjustments that you guys have called out, it looks like it's \$23.4 million or so, which is -- it's the highest level we've seen, I guess, in the last 5 or 6 quarters in that line. And I guess, I'm wondering, given all the cost cuts, why that would be. And if you can kind of explain that one away for us, that would be helpful.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

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

Sure, John. Yes, it was a bit elevated during the quarter. We did have some higher acquisition-related costs and associated legal fees. So I think that number should come down, especially with some of the cost reductions at corporate that were executed in the first quarter.

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

Got it. Is there a run rate that you can point us to in terms of thinking about that for the remaining quarters? I know it's a little bit lumpy, but like just in aggregate?

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

Yes. It should be down, certainly, from the first quarter. I would think in the \$22 million range would've been something I would've expected to be more of a run rate.

Operator

Our next question comes from Richard O'Reilly from Revere Associates.

Richard O'Reilly

Two quick questions. The press release talks about the announced closures of 4 manufacturing facilities. Are those in addition to what you had previously talked about in July?

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

Yes.

Richard O'Reilly

Okay. Can you tell us where they are or what those are?

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

Not in any detail.

Richard O'Reilly

Okay, fine. Second question, the increased advertising expense in consumer, can you describe what that -- where that is going? Is it TV? Is it in-store? Is it in the circulars? Is it rebates? Where is it going?

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

It's a combination of TV and online, and it's across -- the increases are principally in the wood stains and finishes category in a big way and to a lesser extent, but still higher year-over-year in small project paint.



OCTOBER 03, 2018 / 2:00PM, RPM - Q1 2019 RPM International Inc Earnings Call

Operator

We are showing no further questions. I will now turn the call back to Mr. Frank Sullivan for closing remarks.

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

Thank you. Thank you for your participation on our call today. We look forward to seeing as many of you as possible in person at our November 28 Investor Day in Baltimore. The details of that can be found on our website, www.rpminc.com. And we also look forward to welcoming some of you, along with nearly 1,000 of our stockholders, at our Annual Meeting of Stockholders, which is tomorrow afternoon. Thank you for your questions and for your investment in RPM. Have a great day.

Operator

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

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018, Thomson Reuters. All Rights Reserved.

