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EDITED TRANSCRIPT

RPM.N - Q3 2022 RPM International Inc Earnings Call

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OVERVIEW:

RPM reported 3Q22 consolidated net sales of $1.43b and adjusted diluted EPS of $0.38. Expects 4Q22 consolidated sales to increase in low-teens.

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CORPORATE PARTICIPANTS

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

Michael J. Laroche *RPM International Inc. - VP, Controller & CAO*

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

CONFERENCE CALL PARTICIPANTS

Arun Viswanathan *RBC Capital Markets, Research Division - Senior Equity Analyst*

Frank Mitsch *Fermium Research, LLC - President*

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

John McNulty *BMO Capital Markets Equity Research - Analyst*

Joshua Spector *UBS Investment Bank, Research Division - Equity Research Associate - Chemicals*

Kevin McCarthy *Vertical Research Partners, LLC - Partner*

Michael Harrison *Seaport Research Partners - MD & Senior Chemicals Analyst*

Richard Garchitorena *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

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

Stephen Byrne *BofA Securities, Research Division - MD in Americas Equity Research & Research Analyst*

Steven Haynes *Morgan Stanley, Research Division - Research Associate*

PRESENTATION

Operator

Welcome to RPM International's conference call for the fiscal 2022 third quarter. Today's call is being recorded. This call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com.

Comments made on this call may include forward-looking statements based on current expectations that involve risks and uncertainties, which could cause actual results to differ materially. 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) At this time, I would now 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*

Good morning. Welcome to the RPM International Inc. Investor Call for our fiscal 2022 third quarter. Joining me on today's call is Rusty Gordon, RPM's vice president and chief financial officer; and Mike Laroche, our vice president, controller and chief accounting officer. I'll share a broad commentary on our consolidated performance for the quarter. Mike will provide details on our financial results, and Rusty will conclude with our formal remarks and our outlook for the fourth quarter of fiscal '22, after which we'll take your questions.

Please note that our comments will be on an as-adjusted basis and all comparisons are to the third quarter of fiscal 2021, unless otherwise indicated. We've provided a supplemental slide presentation to support our comments on this call. It can be accessed in the Presentations & Webcast section of the RPM website at www.rpminc.com.

For the third quarter of our fiscal 2022, RPM generated record consolidated EBIT and sales, despite a difficult comparison to the prior year. These results were driven by our associates worldwide who persevered despite an extremely challenging operating environment, including ongoing raw material and labor shortages, Omicron-related disruptions that were particularly acute in the third quarter, as well as material, wage and freight cost inflation.

Our consolidated adjusted EBIT growth was driven by three of our four segments: Construction Products, Performance Coatings and Specialty Products, which leveraged selling price adjustments and operational improvements to the bottom line. Our Consumer Group is the outlier. Mike will discuss this in more detail when he presents our segment results.

With our primary raw material costs up more than 40%, on average, versus a year ago, our Consumer Group will need to catch up with significant selling price increases, which will be instituted at the end of this month. We have been fast to respond to supply chain challenges by quickly scaling up in-house resin production at a manufacturing facility we acquired in September. Additionally, due to our on-going investments in the fastest-growing areas of our business, our high-performance building construction and coating systems have generated accelerated growth.

Construction and industrial maintenance activity is robust, and energy markets have recovered while consumer takeaway remains strong. Due to three years of extraordinary work by our associates to implement our MAP to Growth operating improvement program, we have made structural improvements to RPM while maintaining our entrepreneurial culture, which is the core strength of RPM. As a result, our Performance Coatings Group and Construction Products Group are operating not only at record sales and EBIT but at record margins in the third quarter.

Our Specialty Products Group is trending towards this same performance with record results in sales and EBIT and improving margin performance. And we are making good progress in our Consumer business. In short, we are playing offense almost everywhere, investing in accelerating organic growth, significant increases in capital expansion, particularly in the areas of Nudura ICF, roof restoration coatings and a number of our consumer product areas, all of which are building positive momentum as we go into the fourth quarter and we roll into fiscal 2023. I'd now like to turn the call over to Mike Laroche to discuss our financial results in more detail.

Michael J. Laroche - *RPM International Inc. - VP, Controller & CAO*

Thanks, Frank, and good morning, everyone. During the third quarter, we generated consolidated net sales of $1.43 billion, an increase of 13% compared to the $1.27 billion reported during the same quarter of fiscal 2021. Organic sales growth was 13.4%, or $170.1 million. Acquisitions contributed 1.4% to sales, or $17.8 million, while foreign exchange was a headwind that decreased sales by 1.8%, or $23.4 million.

Adjusted diluted earnings per share were $0.38, which was unchanged compared to the year-ago quarter. Our consolidated adjusted EBIT was up 0.8% to a record $80.6 million compared to the $79.9 million recorded in the fiscal 2021 third quarter. On a "double-stack" basis, comparing fiscal Q3 '22 to pre-pandemic Q3 of FY '20, sales, EBIT, adjusted EBIT, net income, diluted EPS and adjusted diluted EPS all achieved double- or triple-digit growth.

Similar to the first and second quarters of fiscal '22, our third-quarter performance reflects the benefits of our balanced business portfolio, where softness in one segment is generally offset by strength in the others. During the third quarter of fiscal 2022, three of our four operating segments -- Construction Products Group, Performance Coatings Group and Specialty Products Group -- generated strong double-digit sales growth. Combined sales in these three segments increased 19%, while sales in the Consumer segment were up modestly. Again, after removing Consumer, the remainder of RPM produced exceptional adjusted EBIT growth of 97%.

Our Consumer Group continued to be disproportionately impacted by inflation, as well as by Omicron-related labor and supply chain disruption, particularly during December and January. This instability in supply caused inefficiencies and continued to negatively impact conversion costs, resulting in a decline in adjusted EBIT at our Consumer Group for the fourth consecutive quarter. Later in the call, we'll discuss the actions we're taking to address these challenges affecting this segment.

Our Construction Products Group generated third-quarter record net sales of $482 million, up 21.7% compared to the fiscal 2021 third quarter. Organic sales growth was 23.2% and acquisitions contributed 2.2%. Foreign currency translation headwinds reduced sales by 3.7%. CPG record revenue growth was largely due to the segment's ongoing success in promoting its differentiated restoration solutions, which offer particular advantages versus new construction given the current raw material and labor shortages. These same challenges have continued to help speed the adoption of the segment's innovative building envelope products.

CPG's fastest-growing businesses are those providing roofing systems, insulated concrete forms, commercial sealants, as well as concrete admixtures and repair products. The segment's international operations generated strong top-line growth in local currencies, which was muted by the strengthening U.S. dollar. CPG fiscal 2022 third-quarter adjusted EBIT increased 89.7% to a record $35.1 million. Despite a difficult prior-year comparison, CPG was able to dramatically increase adjusted EBIT and EBIT margin to third-quarter records due to improved product mix, volume growth, and operational improvements. All of these factors, combined with selling price increases, helped to offset higher raw material inflation.

Our Performance Coatings Group's fiscal 2022 third-quarter net sales were a record $270.9 million, an increase of 19.6% over the year-ago period. Organic sales increased 17.8% and acquisitions contributed 3.4%, which were partially offset by foreign currency translation headwind of 1.6%. PCG continued its momentum with all of its North American businesses generating double-digit organic sales growth. PCG's businesses serving emerging markets generated explosive growth, and its European companies continued their steady rebound. Driving its strong top-line were increased industrial maintenance spending, recovery in energy markets and price increases.

PCG's best performing businesses were those providing polymer flooring systems, corrosion control coatings and raised flooring systems. Adjusted EBIT increased 89.9% to a record $26.8 million during the third quarter of fiscal 2022. Adjusted EBIT increased as a result of volume growth, operational improvements, and a more favorable product mix. Additionally, adjusted EBIT margin was a third-quarter record.

Specialty Products Group reported record net sales of $189.4 million during the third quarter of fiscal 2022, an increase of 11.9% compared to the fiscal 2021 third quarter. Organic sales increased 11.9% and acquisitions added 0.8%, which were offset by unfavorable foreign currency translation of 0.8%. SPG generated record sales as a result of strong performance at nearly all of its businesses, with the highest growth coming from those serving OEM and food additive markets.

In addition, this segment's sales of disaster restoration equipment rebounded after securing the supply of semiconductor chips and reconfiguring its products to accommodate them. This is an example of how our businesses quickly adjust to challenges, demonstrating a key advantage to RPM's entrepreneurial culture. This business did face a tough comparison to the prior-year period when demand for its restoration equipment was inflated because of winter storm Uri.

Adjusted EBIT was a record $26.6 million in fiscal 2022 third quarter, an increase of 5.4% compared to adjusted EBIT of $25.3 million in the last year's quarter. This record adjusted EBIT was largely due to operational improvements.

Our Consumer Group achieved record net sales of $491.6 million during the third quarter of fiscal 2022, an increase of 2.9% compared to the third quarter of fiscal 2021. Organic sales increased 3.6%, which was partially offset by unfavorable foreign currency translation of 0.7%. As we anticipated, the segment grew revenue, in part, due to its ability to mitigate the severe alkyd resin shortages it had experienced by leveraging the new Texas manufacturing facility we acquired in September.

During the third quarter, sales and productivity were challenged by unreliable shipping and supply resulting from labor shortages caused by the Omicron variant, particularly in December and January. Speaking of challenges, the Consumer Group also faced a difficult comparison to the prior-year period when sales increased 19.8% and adjusted EBIT increased 48.6% due to elevated demand for its home improvement products during the pandemic's first phase.

Fiscal 2022 third-quarter adjusted EBIT was $17.2 million, a decrease of 63.9% compared to adjusted EBIT of $47.8 million reported during the prior-year period. Due to the nature of its products and the markets it serves, inflation has been more impactful on the Consumer Group than RPM's other segments, and raw material inflation, in particular, has had the most significant impact on EBIT. Partially offsetting these factors were price increases and operational improvements, as the Consumer Group is currently investing in capacity and process improvements to meet customer demand, as well as build resilience in its supply chain. The Consumer Group is continuing to implement price increases to catch up with the inflation this segment has experienced over the last four quarters.

Lastly, I'd like to note that we have significant liquidity, which enables us to fund internal growth initiatives, make acquisitions, reward our investors with cash dividend payments and repurchase our shares. Helping to keep our liquidity strong is a $300 million bond offering we completed in January. Also, during the third quarter, we repurchased $15 million of our common stock. Now I'll turn the call over to Rusty to discuss our outlook.

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

Thanks, Mike. For the fiscal 2022 fourth quarter, our operations and those of our suppliers are expected to be impacted by ongoing supply chain challenges and raw material shortages, which will exert pressure on revenues and productivity. The strengthening U.S. dollar will also unfavorably impact the translation of our results in international markets. In addition, the war in Ukraine is creating some supply and inflationary pressures, which Frank will address in a little bit. While it's too soon to tell, rising interest rates may slow business and consumer spending in the coming months.

Despite these challenges, we expect to generate fiscal 2022 fourth-quarter consolidated sales growth in the low teens versus a difficult comparison to last year's fourth-quarter sales, which grew 19.6%. On a segment basis, we anticipate sales growth in the low teens in all four of our operating groups as a result of strategic investments we are making to capitalize on market opportunities and industry trends.

We anticipate that consolidated adjusted EBIT for the fourth quarter of fiscal 2022 will increase in the low teens versus the same period last year, when adjusted EBIT was up 10.6%. We expect that earnings will continue to be affected by raw material, freight and wage inflation, as well as by the impact on sales volumes from operational disruptions caused by raw material shortages.

Our Consumer Group will be disproportionately impacted by these issues. Its EBIT margins have eroded all three quarters of this fiscal year due to inflationary pressures, which have a greater impact on the Consumer Group than RPM's other segments. We continue to work to neutralize these factors by improving operational efficiencies, employing additional price increases to catch up with inflation and adding manufacturing capacity to improve resiliency.

This concludes our prepared comments. We are now pleased to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Frank Mitsch from Fermium Research.

Frank Mitsch - *Fermium Research, LLC - President*

You mentioned that raws in some of your primary materials were up 40%-plus in the third quarter. That was significantly up from what it was in the second quarter. Can you talk about where you see that trending? What is of most particular concern for you in terms of raw material availability?

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

Sure. I can give you some examples, I think, Frank. First of all, we were starting to see some flattening out of raw material prices in certain resins and other categories, oil-related items until the onset of the Russian war on Ukraine. And that flattening out has changed, and things are once again, for geopolitical reasons, now looking like they might be heading up. So, it's anybody's guess as to where we'll be in the fourth quarter.

I can give you some specifics just to put things in context. For instance, in Consumer, aerosol cans year-over-year are up 66%. Alkyd resins are up 113%. Acrylic latex is up 41%. Monomers are up 86%. More appropriately to our industrial product lines, epoxy resins year-over-year are up 72%. MDI's up 106%. And so, it's a litany of sad, higher increases in critical raw materials.

We had seen a significant improvement in availability. Most of the force -- not all, but most of the force majeures that have been announced over the last 12 to 15 months had been rescinded. But once again, we're anticipating some challenges in certain resins, particularly some bio-based resins that we source in Europe and from India, as a result of the disruptions from the Ukraine war.

Frank Mitsch - *Fermium Research, LLC - President*

Got you, got you. So, you did mention a couple of times in the call that you are implementing price increases. You continue to implement price increases. How do we think about when -- given what we know today, in terms of when RPM will be able to have pricing cover the impact of raws? And I guess part of that question is also, if you're looking at sales in the fiscal fourth quarter up low teens, how are you looking at that in terms of price versus volume versus FX?

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

Sure. On average, in the quarter, price was up 12.5%. And so, you can see when you look at the organic growth, we had tremendous organic growth in our Construction Products Group and our Performance Coatings Group. A modest mix of -- would appear flat in the Specialty Products Group, but it was a mix of some organic growth in certain units and others not. And when you do the math, you'll see that we had actually unit declines in the quarter in Consumer. That was as much a result of the manufacturing and operating disruptions, raw material challenges as demand remains pretty solid there. As we think about the fourth quarter, as Rusty indicated, we've got really good momentum going into Q4. We would expect to continue to operate at record levels of sales, EBIT and EBIT margins in our Construction Products Group, Performance Coatings Group, and at this point, we believe, in our Specialty Products Group.

And so, on a consolidated basis, I think we have a shot at having record results. It really depends on where we finish the quarter in Consumer. As we sit here today in Q4, price will add about 12.5% in terms of revenues. But as Rusty indicated, we are going out with another round of price increases across a number of product lines in RPM, where appropriate, but in particular, in our Consumer Group at the end of this month in relationship to both being impacted the most directly by raw material costs and packaging costs, being small project-driven in paints and patch repair and epoxy sealants.

We have a disproportionate packaging impact there as well. And so, we will report results in July. I would anticipate that we will be somewhat higher in the fourth quarter than the 12.5% based on our current pricing situation across RPM today.

Operator

Your next question comes from the line of John McNulty from BMO Capital Markets.

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

Great job in a really tough environment. I guess I wanted to dig into maybe two areas. The first one would just be on the alkyd situation. I know it's been a really tough overhang for you guys for the last, call it, three quarters or so. It sounds like you've got some of that remedied with the Texas facility up and running. I guess, how should we think about how that takes some of the pressure off the Consumer business? It seems like there's a lot of other moving parts. But I guess, how much does that flip the switch where things get noticeably better for you?

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

Sure. Since the fall, we have added internal capacity with the addition of the Corsicana, Texas plant, and the team there's ability to ramp up successfully in producing alkyd resins, which they had not done before. That was part of the reason for the acquisition. There was another supplier during that time frame that withdrew supply from the marketplace. So, it remains a challenging environment, let's say. And the alkyd situation is a particularly critical raw material for our Consumer Group.

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

Got it. So, you've got your asset running, but it sounds like somebody else actually took more capacity out. So maybe it's helped but not as much as it otherwise could have. Is that right?

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

That's correct.

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

Got it, okay. And then on the Construction business, the volumes are really -- they're seeming like they're kind of really humming at this point. I guess, can you speak to how you see that playing out throughout the rest of this year? And because you have kind of a contractor approach where you've got your own labor force, like I guess, I assume it gives you better visibility around that business. So, I guess, how far out in terms of line of sight do you have around the business trends that you're seeing there?

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

So I would tell you that the line of sight anywhere isn't very good relative to all the dynamics in the marketplace. As we roll into Q1, I would expect us to have record results in sales, earnings and margins everywhere. That includes Consumer, based on the actions that we're taking, and also rounding, finally, some easier comps after the extraordinary kind of stay-at-home-driven boom in DIY products that we're rounding now.

I think the organic growth that we're seeing in our Construction Products Group for the foreseeable few quarters, as far as we can tell, will remain in the mid- to high-single digits on an organic growth basis. You can add about 12% in terms of sale price impact to that. So again, without getting too far over our ski tips just because it's difficult to predict the future in this environment, the momentum going into the next couple of quarters is really strong, and it doesn't seem like there's anything that will interrupt that at this point.

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

Got it.

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

Yes. I would add one more thing to that, John. We're -- whether it's in our Nudura ICF or roof restoration coatings, as we sit here today, we could be selling more, but we are out of capacity in a few of these product areas. And we have a significant capacity expansion program in Nudura- the first elements of which will go into effect at the end of the fourth quarter and through the summer. And we have a significant capital expansion in our roof restoration coatings, which should roll out throughout the balance of this calendar year.

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

Got it. Can you -- actually, just as a follow-up to that, can you help us to understand how much capacity that might unlock?

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

I can tell you, in roof restoration coatings, probably another $50 million or $100 million. And in Nudura, we hope to realize another $40 million or $50 million of capacity by the end of this calendar year and as much as another $100 million of capacity by the end of the summer of '23.

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

Wow, okay. So pretty notable. Okay, thanks very much for the color. Really helpful.

Operator

Your next question comes from the line of Ghansham Panjabi from Baird.

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

Just given that Europe is a pretty significant end market for RPM, can you just comment on current operating conditions post the war? And also, anything that you may be seeing in China at this point, just given the lockdowns, et cetera?

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

Sure. Our business -- first of all, I'll tackle Asia. Our business in Asia is relatively modest compared to some of our peers. We're not seeing much of an impact, mostly because we don't have a big slug of business there, and the business that we do have is driven by our industrial product lines. And so, at this point, it's relatively stable. We're not seeing much negative impact.

As it relates to Europe, Europe was recovering more slowly than North America for sure. And that recovery seems to be okay today, although we certainly -- we have not seen any meaningful disruption to our business activities as of yet, although we're certainly heightened to that. As it relates to the Ukraine situation, we were very quick and early to discontinue any and all business activities in Russia. We don't have any manufacturing business there. The business we do have is relatively modest so it's about $5 million or $6 million on an annualized basis.

And we both felt it was the right thing to do and certainly wanted to respond to concerns that a significant number of our workforce in European manufacturing and distribution of Ukrainian descent. And so that's the impact on Russia and the Russian war on Ukraine. But in general, we're heightened of kind of anticipating impacts, but we haven't seen it yet.

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

Okay, that's very helpful. And just in terms of the energy end markets, I mean, obviously, you've seen a major step function higher with energy prices, et cetera. Just remind us how big energy is as an end market for RPM and what you're seeing in that end market from a recovery standpoint, yes, post Covid.

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

Sure. Our energy exposure is mostly in our Performance Coatings Group, and mostly in Carboline. So, the Performance Coatings Group, let's say, is about $1.1 billion, and Carboline and Stonhard are, by far and away, the two largest business units there. I would guess, directly and indirectly, and now you're talking broadly, oil and gas and refinery and pipelines and things like that, probably $300 million or so of exposure to oil and gas markets broadly.

Again, as you can see, we got high teens organic growth, high-single-digit unit volume. And there's somewhat higher growth in that business than average in those businesses or product lines that are exposed to energy markets, and we see that continuing. So, there's a little bit of a double-edged sword in that it is driving a significant increase in capital spending and business for us in our industrial segments. It's also driving a significant increase in our raw material costs as well.

Operator

Your next question comes from the line of Steve Byrne from Bank of America.

Stephen Byrne - *BofA Securities, Research Division - MD in Americas Equity Research & Research Analyst*

You have this intermediary between you and your end customer in your Consumer segment. And I just was curious, what is the process that you go through to get price in the Consumer segment? Is that -- is there a delay? Is that a negotiation? Does that represent a bigger challenge for you than in your other segments?

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

Yes. There is typically a delay, and yes, it is a negotiation, particularly across our large customers. We've announced three price increases over the last 12 months. And the timing of those being instituted across large customers, it varies a little bit, not a lot. And we are both disproportionately being impacted by raw material costs, both direct chemical raw material costs as well as packaging costs in our Consumer business, and as our numbers reflect, somewhat behind the curve in terms of addressing cost/price mix, which is necessitating a fourth price increase that will be announced at the end of this month.

Stephen Byrne - *BofA Securities, Research Division - MD in Americas Equity Research & Research Analyst*

And Frank, you mentioned labor shortages in this segment. Is that your -- is that RPM employee labor shortages? Is that your customer or distribution channel? And is that improving at this point?

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

It was really in two areas. The biggest area, our largest plants are our Consumer plants, and we had, in a number of Rust-Oleum plants, both our largest DC, which is in Wisconsin, and our largest manufacturing facility, which is in Wisconsin, a meaningful impact of Omicron in terms of either people that were out infected and/or people that were quarantined because of exposure. And so, it had a disproportionate impact on our Consumer business, particularly Rust-Oleum.

We also saw it in our Consumer business with the traditionally just-in-time freight delivery of raws into our plants and then distribution where some of our customers pick up, and in some cases, we handle freight. And there was a disproportionate impact over that period of time, we believe, because of Omicron on freight availability and truckers, and so that impacted the segment as well.

Stephen Byrne - *BofA Securities, Research Division - MD in Americas Equity Research & Research Analyst*

In the last month of this next quarter, are you seeing things improve for you?

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

Yes, we are. In that category, we're seeing things improve, and so the flow through our plants is significantly better. That will help profitability and margins as we go into the fourth quarter. So, the Omicron spike, both across RPM, we track -- we've been tracking quarantine and infections in Covid literally from March of 2020 every week. The Omicron spike was shockingly quick, high, and then dissipated pretty quickly.

And so, we're back to a much more normal pace in terms of not having that same disruption at the end of February and in March. And we're hopeful that the worst of Covid is behind us. It seems like if Covid isn't done with America, America is done with Covid.

Operator

Your next question comes from the line of Vincent Andrews from Morgan Stanley.

Steven Haynes - *Morgan Stanley, Research Division - Research Associate*

This is Steve Haynes on for Vincent. I just want to ask a question on cash flow. Operating cash has been about $500 million year-on-year through the first nine months, and it's mostly on working capital. So, could you just talk a little bit on how you're thinking about operating cash generation for the full year and if you're expecting kind of a big release of working capital in the fourth quarter?

Michael J. Laroche - *RPM International Inc. - VP, Controller & CAO*

Sure. You're absolutely right. Our operating cash flows were negatively impacted by working capital, largely driven by supply chain issues we've been discussing and inflation, quite honestly. We expect that inflation is going to continue, and we're going to continue to purchase opportunistically where we can to help lock in availability and price. So, you may see some unusual relationships in working capital as it relates to cash flows for the next few quarters.

Steven Haynes - *Morgan Stanley, Research Division - Research Associate*

Okay. And then maybe just a quick follow-up on the conversion cost. Is there a way you can maybe size like, I guess, the cumulative impact throughout the full year so far, and just so we can get a like an idea of like what the upside is when ultimately, that begins to reverse?

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

Sure. If you look at our EBIT margin, in general, quarter-by-quarter and, in particular, for instance, this quarter where we're suffering the worst in Consumer, the vast majority of that EBIT margin decline is a gross margin decline, though we don't disclose gross margins by segment. And of that, I would tell you about two-thirds are maybe a little bit more are material-related and about one-third is operating efficiency and throughput in the plants.

And so, we fully expect in all of our businesses, as we get back to normal, the workforce disruptions are mitigated or eliminated and put behind us and we have normal flow-through in our plants to where we were just a couple of years ago, that, that one-third impact on our margins would be recovered. The balance is literally a cost/price mix dynamic, which we are managing better in our industrial businesses than we have in our consumer businesses year-to-date.

Operator

Your next question comes from the line of Kevin McCarthy from Vertical Research.

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

With regard to your Performance Coatings segment, you said in your prepared remarks that you're seeing explosive growth in emerging markets. That word explosive got my attention. So, I was wondering if you could kind of talk through where you're seeing the strongest growth. And what exactly is driving that? Is it to do with maybe some of the acquisition activity that you've done or more organic in nature? Curious if you can offer any color there.

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

Sure. It's more organic in nature, and we've taken a broader RPM platform approach to some of the developing markets. And so, there's a really good, both cooperation between our Performance Coatings Group and our Construction Products Group, the two groups of RPM that have the greatest international exposure and the greatest developing world exposure, and a real focus on driving organic growth and investing.

So, we're seeing significant growth in India, significant growth in Africa, in the Middle East, in Latin America. And I would tell you, some of it is recovery from Covid, for instance, in Latin America. Some of it is a result of a more intense focus on a more RPM platform basis and putting these regions under leaders who are responsible for a broader swath -- proven leaders who are responsible for a broader swath of RPM businesses and products, and it's working. The last thing I would note is it's explosive on a relatively small base, but if we keep growing that base, it'll keep getting bigger and become a more meaningful part of our business.

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

Great. And then my second question was much broader in nature. If I look at slide 11 of your deck, your sales forecast for the fourth quarter is extremely uniform across all of your segments. They're all expected to grow at a low teens pace. And so, I was wondering if you can talk about 2023. Perhaps it's early to get specific on guidance there. But sitting here today, how would you expect those trends to diverge moving forward? Do you have in your mind a segment that you would expect to grow materially faster than the others or slower at the other end of the spectrum?

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

So I think two comments on that, Kevin. One is, I think the furthest out we can really see is a quarter or two. So as I mentioned earlier, as we sit here today, I would expect every one of our segments, including Consumer, to be generating solid sales and earnings growth in Q1. And the momentum that we are seeing in our Performance Coatings Group and Construction Products Group will continue.

The Specialty Products Group should be back to record margins, not just higher sales and earnings. And we'll see solid recovery in Consumer, both on the top line and bottom line in part because the actions we're taking are taking hold, in part because of disruptions of Covid are being put behind us, and in part because we'll be rounding some easier comps in Consumer.

So, you ought to see record results in Q1 for RPM on a consolidated business in each of our segments. I think this outlook really is a continuation of what we're experiencing in our three more industrial segments and an expectation that we're finally going to see positive results out of Consumer.

Longer term, again, unless the dynamics change, we would expect to have a solid fiscal '23, and we'll provide pretty good details on that in July. And we also hope to be able to provide some longer-term perspective on where we're going with a MAP to Growth 2.0, something that many of you know we've been working on for a while. But our willingness to get out there and make longer-term commitments has been disrupted by Covid and supply chain challenges that were working their way into something more normal and stable until the Russian war on Ukraine. And so, I think that's the caveat here. We're not seeing much of an impact on our European business yet. But time will tell in the coming months as to what impact there might be and to what extent.

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

Excellent. We'll look forward to the updates.

Operator

Your next question comes from the line of Arun Viswanathan from RBC Capital Markets.

Arun Viswanathan - *RBC Capital Markets, Research Division - Senior Equity Analyst*

Hope you're well. Yes, so I guess I just wanted to understand the low teens guidance. I think you mentioned 12.5% price. So, is that to imply kind of low-single-digit unit volume growth or maybe a little bit better and offset by a little bit of FX pressure? How should we think about kind of your volume versus price dynamics?

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

Sure. I think particularly in Performance Coatings and Construction Products, we're expecting a mid- to upper-unit volume growth and the continuation of what's been about a 12%, 12.5%, on average, price increase. So, you could see results on an organic basis in the mid- to high-teens. That's going to be knocked down a little bit by the strengthening U.S. dollar, which will take a couple of points off our results.

So, I think in overall mix, it's certainly possible that we'll continue mid-teen performance in some of the industrial businesses and would expect to see kind of a low teens kind of 10%, 12%-ish in Consumer. And so that's where we are. It will be a mix of both. But I think we feel pretty comfortable with this guidance. And as I said, I think we'll be, in the fourth quarter, at record EBIT on a consolidated basis and hopefully, record EBIT margins. It just depends on how quickly the actions we're taking in Consumer affect a stronger recovery there.

Arun Viswanathan - *RBC Capital Markets, Research Division - Senior Equity Analyst*

Okay. And I guess I also wanted to just follow up on a comment you made earlier as far as potentially some of the cost pressures that you've been feeling over the last couple of years have been plateauing or flattening out. And then there was a little bit of a spike, I guess, with the Russia-Ukraine invasion. And has that moderated now? It does appear that some of the energy and price impacts have started to moderate as well. Would you say that that's the case? And do you see that this is kind of a longer-term impact or is it just kind of transitory?

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

It's hard to say right now. Again, we were seeing some underlying positive trends in things like ethylene, propylene and even some of our direct purchase raw materials. And all of that reversed with the Russian war in Ukraine. And really, who knows? And I'm not trying to be cagey here. If this thing is resolved, which I think the world is praying for relatively quickly, then I do think we could see some stability.

If this thing expands and has greater impact on oil and gas prices as well as some of the organic resins that are impacting that we purchase principally from India, but they've spiked up for reasons that I don't -- some people do, I don't directly understand other than they've spiked up because of the impact of the Russian war. It's hard to know how this will expand and what impact that will have on raws. And so, we are paying attention to both its impact on our European business, which so far, thankfully, has not been much, and its impact on raw material costs, which at least in the near term have reversed an otherwise positive trend.

Arun Viswanathan - *RBC Capital Markets, Research Division - Senior Equity Analyst*

Great. And then lastly, if I could just ask about the M&A strategy. I know that there was a greater focus on MAP to Growth over the last couple of years. But are you finding yourselves getting back into the inorganic market as well? How would you characterize the environment there? And if there's any focus, what areas are you focusing on and how are you seeing valuations?

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

Sure. So, the pipeline of the typical RPM, small- to medium-sized product lines is pretty good. And we would expect to be able to just generally complete, let's say, $100 million or $200 million on an annualized basis of product line or business acquisitions. That's been our bread and butter.

Large transactions have been in extraordinary prices. And I think that you're going to see some mitigation and valuations as interest rates rise, and inflation is seen as something that is other than temporal, and we would welcome that. And so that's kind of where we are. We wouldn't expect to be an aggressive player at these historic high valuations, which seem to be persisting now in the face of significant raw material costs.

I can tell you Rusty, Matt Ratajczak, Mike Laroche, Rusty's team did a 10-year bond at the end of January and were able to capture a 2.95% coupon. And if we turned around and do that bond today, it would cost us 4.25% or more. And so, I don't know how well the rise in interest rates and its impact on incremental cost of capital is being reflected in the markets yet, but eventually, it will be.

Operator

Your next question comes from the line of Josh Spector from UBS.

Joshua Spector - *UBS Investment Bank, Research Division - Equity Research Associate - Chemicals*

Just a clarification, first off, just on the raws inflation, make sure I heard it right. When you talked about the 40% increase, was that total company or Consumer? And I guess when you think about that in terms of total variable cost inflation in COGS, what would that number look like?

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

So I'm not sure I can answer the last part of your question, but yes, the 40% is total company. And that's materials and packaging. It does not incorporate freight or labor, which are also well above, although certainly not to the same extent. And Consumer is somewhat higher, in particular, in relationship to its exposure on things like acrylic resins, which again, year-over-year are up 113% -- or alkyd resin's 113%. Aerosol cans are up 66%, so that's really specific to Rust-Oleum.

And so, they have some higher outliers in relationship to their -- the small packaging nature of our consumer businesses and the disproportionate impact of acrylic resins on Consumer versus the rest of our businesses.

Joshua Spector - *UBS Investment Bank, Research Division - Equity Research Associate - Chemicals*

Okay, that's helpful. And just a specific question on Europe and specifically the Performance segment. An epoxy producer earlier shut down some capacity in the region. And part of that decision was related with lower demand. That seems a bit counter in terms of what you guys are seeing in terms of that segment. So curious if you have any thoughts or comments around that.

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

Sure. So first of all, epoxy resin costs for us are up 70% year-over-year, so that's not been a good thing. We have been able to pass on price. There was a reference earlier to our ability to provide supply and apply, which is benefiting us both in a lot of our roofing businesses as well as the Stonhard flooring business, and so that's been an advantage for us. Epoxy resins and some of the intermediate chemicals in the epoxies had some availability challenges earlier in the year. As we sit here today, we're in pretty good shape.

Operator

Your next question comes from the line of Silke Kueck from JPMorgan.

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

Last quarter, you said that you had a $200 million headwind from lost sales due to the raw material shortages and maybe $100 million of that was in the Consumer segment. Can you tell how much it was in this quarter, how much it was on Consumer? And what would you think you might experience in the fourth quarter, and how do you think about '23?

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

Sure. I don't think we had much in the way of discernible lost revenue in Q3, and it had as much to do with the seasonal nature of our business, where, as you know, our third quarter is meaningfully lower than our other three quarters. And so, we haven't seen as much of an impact that we can point to. It is possible that it would be an impact in Q4 equal to what we saw in Q1 and Q2 just because Q4 is a significantly large quarter for us as we build into a construction season and we build into a consumer DIY season, particularly for exterior-use products. But the short answer is it did not have a noticeable or a measurable impact in Q3 like it did in the prior quarters.

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

And for the fourth quarter, if I understood it right, you think maybe it's like order of magnitude like in the $200 million range, something like that?

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

I would think it would be half of that, and it would be predominantly in Consumer, unless there are raw material disruptions as a result of the Russian war on Ukraine that we don't anticipate sitting here today. But we don't have the raw material disruptions in our industrial businesses that we had for the first half of the year. I mean, for the first half of the year, we had enough significant raw material disruptions, either of direct raw materials or ingredients that went into the chemical raw materials we purchased, that we had to shut production in numerous places. That is not occurring as we sit here today.

And on the consumer side, the disruptions that we had, both from a raw material availability perspective and just the normal throughput is improving again as we sit here today. So, if we have an impact in Q4, I would bet it would be closer to $100 million across the whole business, but we'll give you the details of that in July.

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

And my second question is just on the -- on resins, what percentage of your cost of goods sold baskets are epoxy resins, alkyd resins, acrylic resins? Like if you add it all together, is it like one-third of your material costs? Is it bigger than that? And what percentage can you make in-house now? Or maybe like what percentage can you make next year, given the manufacturing capabilities you acquired?

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

Sure, yes. In terms of resins, there's not one resin that's even 5% of RPM's total raw material basket. You mentioned some of the bigger ones we do buy, acrylic resins, alkyd resins, epoxy resins. They are meaningful to different product lines. In terms of in-house production, we are supplementing, as we've talked about, in alkyd resins. That's a nice facility in Texas to absorb shocks in supply like we've had over the last 12 months. But we continue to do business with a number of suppliers of alkyd resins and expect to continue that in the future.

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

Our expectation would be that the in-house production on alkyd resins would be somewhere in the 20% or 25% range. As I said, we were moving in the right direction and then another long-term supplier withdrew their capacity from the market in the last couple of months as well, which was unexpected and something we're adjusting to.

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

Okay, that's helpful. In terms of your savings program, are there any measurable savings from the last bit of like the MAP program that you saw in the quarter? Or was all of that used up by -- because some of it is obviously the procurement of raw materials. So, were there any measurable savings you can quantify that you've gotten from the MAP program like incremental year-over-year?

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

As best we can calculate, in the quarter, roughly about $15 million.

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

$15 million?

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

Yes. And I'll tell you that the ability of the Construction Products Group and Performance Coatings Group to recover in this environment to record levels of EBIT and EBIT margin has got as much to do with the efficiencies from our MAP operating improvement program as they do from a cost/price mix [standpoint]. So, it's been hugely -- the timing was lucky. It's been hugely beneficial for us as we faced the disruptions over the last year.

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

Okay. And my last question is on the Consumer business. So, PPG expanded its relationship with Home Depot in primers and sealers and [crafting] paint and stains. And when you look at your market share at Home Depot or generally your big-box retail business, do you think your share is like flat or up or down? Can you tell?

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

I don't think we have lost any market share, and there's no area where we can point to. The biggest challenge for us and for most people in the consumer markets as well as some of the basic architectural paint business is supply. And so, we prided ourselves on fill rates of 98%, 99%. It's where we operated for a long time. And as a result of both the Covid disruption and supply chain challenges, fill rates have been significantly lower. And that's been a challenge for us, for others in our industry and, quite candidly, when you go to one of the big retailers, for people in a lot of places.

So, the challenge is supply relative to raw material availability and costs and Covid-related disruptions much more so than market share challenges at this point. And we are expanding capacity in our consumer businesses to make sure as we put these disruptions behind us, that we can get back to those high fill rates and maintain market share and grow.

Operator

Your next question comes from the line of Mike Sison from Wells Fargo.

Richard Garchitorena - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

This is actually Richard on for Mike. So, first question, you did mention that the Russian invasion had a meaningful impact on the supply chain, obviously. Is that comment based on just the higher derivative price for oil and products? Or is there specific products which may not be available in terms of supply chain, such as ClO2 or other ones?

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

Yes. We have not seen availability issues directly, but we saw a pretty quick reversal in what seemed like stabilizing prices in some basic commodity chemicals, some trends that were moving in the right direction that would suggest that maybe our raws would be stabilizing or perhaps, over time, going down and that reversed very quickly. And so, it's, obviously, oil -- directly, oil and solvents and things like that, but it impacted all of our resins.

And then as I mentioned earlier, some of the bio-based resins, soy-based resins, soybeans, stuff like that, there are some availability challenges there, and whether those become big problems or get corrected here in the coming weeks and months, time will tell.

Richard Garchitorena - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Okay. And then just a follow-up on the EBIT guidance, low teens across the board, I mean, basically, can you give us some color in terms of where you see the most growth on the EBIT side? And obviously, for Consumer, do you expect sequential improvement as part of that?

(technical difficulty)

Operator

This is the operator. I apologize, but there will be a slight delay in today's conference. Please hold and the conference will resume shortly. Thank you for your patience.

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

We appear to have a disconnect, and I believe we're back live on the conference call. Yes, so operator, if there are any additional questions, we would be happy to take them.

Operator

Your next question comes from the line of Mike Harrison from Seaport Research.

Michael Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

Maybe just to, I guess, close the loop out on the last question that was asked. I didn't hear the response, but do you see particular segments with that low teens EBIT guidance for next quarter, particular segments exceeding that? And then I think my question would be if the Consumer business, do you expect EBIT there to be up on a year-over-year basis?

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

So I would tell you that our Construction Products Group, Performance Coatings Group have an opportunity to outperform that low teens between price and unit volume. It will be somewhat mitigated by FX, given the strength of the dollar. But we see good momentum there continuing in both. They are generating record results on top of really strong results a year ago in Q4.

Our Consumer business will be moving in the right direction. And we're seeing that. We're taking actions to move it there, so you'll see a sequential quarter-by-quarter improvement. I would expect positive unit volume growth modestly there, and we've suffered some negative unit volume growth in the last couple of quarters, so you'll see good progress there. And you'll see improvement sequentially in our margins. I don't think we get back to a positive EBIT and stronger margins in year-over-year in Consumer until the first quarter of our new fiscal year, which starts on June 1.

Michael Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

Great. And then in terms of the Consumer business, you mentioned that your fill rates, I think last quarter, you said fill rates were in the 50% to 70% range. You said they continue to be still a little bit low. But I think we're trying to get a sense of how much seasonal demand you're going to be able to meet and kind of where those inventory levels are as we head into the spring season.

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

So our -- without getting into specifics, because it's different by product line and different by customer, but our fill rates are improving meaningfully week-by-week. And a lot of that has to do -- the fill rate challenges we had in Q3 were related, as we talked about earlier, with the Omicron impact, particularly in our Rust-Oleum manufacturing facility and DC. They're separate but very large facilities in Wisconsin and the availability of raw materials and packaging.

There were also freight disruptions over the last two quarters that impacted fill rates as well. All of that is improving, and we're not going to be back to the levels that we want to be in Q4, but we're going to be meaningfully better than we've been in the last couple of quarters. And I think that will be part of the sequential improvement that we expect to experience in our Consumer Group.

Michael Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

All right. And then last question for me is you mentioned in the press release that inflation and higher interest rates could be impacting consumer demand. Have you seen any evidence of that yet or is that just kind of what Econ 101 tells you?

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

No. My comment was really an impact on M&A valuations. It's hard. We compare the consumer demand, both sequentially and year-over-year, but we're also looking back to some of the pre-Covid periods. And so, it's somewhat of a challenge to get a good gauge on where the appropriate consumer demand is relative to the literally 30% or 35% unit volume increases we saw for about three quarters in a row during the Covid period because of the stay-at-home orders.

And so, consumer takeaway is solid, and we think that's continuing and will continue into the summer. I think we and our large customers believe that through Covid, we expanded the base of confident DIYers, so we've got a larger base of regular consumers that we're excited about. Our problem has been supply. It's been raw material supply and a related product supply that's reflected in fill rates that are -- that have been below where they need to be.

Operator

There are no further questions at this time. I would now like to turn the call over to Mr. Frank Sullivan for closing remarks.

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

Thank you very much for your participation on our conference call this morning. We are looking forward to continuing to build momentum and positive growth into our fourth quarter of fiscal '22 and to a really strong start to our new fiscal year. We look forward to providing you details of our fourth-quarter results in July when those are released as well as an outlook both for fiscal '23 and some longer-term goals that we've been working on for quite some time.

I am grateful to the RPM associates who have generated a return to record sales and record earnings despite all the challenges that we faced. And we appreciate everybody's investment in RPM. Thank you, and have a great day.

Operator

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