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RPM.N - Q4 2022 RPM International Inc Earnings Call

EVENT DATE/TIME: JULY 25, 2022 / 2:00PM GMT

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## PRESENTATION

### Operator

Welcome to the RPM International's Conference Call for the Fiscal 2022 Fourth Quarter and Year-End. Today's call is being recorded. This call is also being webcast and can be accessed live or replayed on the RPM website at [www.rpminc.com](http://www.rpminc.com).

Comments made on this call may include forward-looking statements based on current expectations and involve risks and uncertainties, which could cause actual results to be materially different. For information on these risks and uncertainties, please review the 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 direct comparable GAAP financial measures on the RPM website. (Operator Instructions)

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.

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

Thank you, Michelle. Good morning, and welcome to the RPM International Inc. investor call for our fiscal 2022 fourth quarter and year-end. Joining me on today's call are Rusty Gordon, RPM's Vice President and Chief Financial Officer; and Mike Laroche, Vice President, Controller and Chief Accounting Officer.

I'll share a broad commentary on our consolidated performance for the quarter and the year. Then Mike will provide details on our financial results, and Rusty will conclude our prepared remarks with our outlook for the first quarter of fiscal 2023. Please note that our comments will be on an as-adjusted basis and all comparisons are to the fourth quarter of fiscal 2021, unless otherwise indicated. We provided a supplemental slide

presentation to support our comments on this call. It can be accessed in the Presentations and Webcast section of the RPM website at [www.rpminc.com](http://www.rpminc.com). After our remarks, we'll be pleased to take your questions.

We generated record fourth quarter performance, which reflected accelerating momentum across RPM throughout fiscal 2022. As we progress through the year, our nimble businesses responded quickly to address ever-changing supply chain constraints, inflationary challenges and foreign exchange headwinds. I'd like to share a few examples across RPM.

In response to the scarcity of some raw materials, we purchased a manufacturing facility in Texas last September. The dedicated team quickly ramped up production of alkyd resins, which were in very short supply, due to a supplier explosion at one of our primary suppliers in the industry. In addition, our R&D professionals have been working around the clock to reformulate literally thousands of products to qualify different materials, all while maintaining high performance.

Another example is our disaster restoration equipment business, which was hampered by the semiconductor chip shortage. It found alternative supply and reconfigured its products to accommodate these challenges and deliver for its customers.

As you can see on Slide 3, this chart reflects the quarter-by-quarter actions that we took to steadily generate momentum across our businesses throughout the year. Also having an impact were the investments we've been making to accelerate growth in the fastest-growing areas of our business, particularly our high-performance building construction and coating systems. Our associates' efforts along with solid construction and industrial maintenance activity as well as a rebound in energy markets culminated in the fourth quarter that produced consolidated record sales and record adjusted EBITs.

On the next slide, you'll note driven by pricing adjustments and operational efficiencies, we achieved record results in all 4 segments in sales and record EBIT in three of our segments. The lone outlier was our Consumer Group, which began to narrow the year-over-year gap in adjusted EBIT results as price increases started to catch up with inflation and access to raw materials improved.

Better materials availability was largely due to the production facility we acquired last fall. We also benefited from \$17 million in incremental savings during the quarter from our ongoing operating improvement program efforts.

On that subject, driving operating efficiency remains a top priority at RPM, and our teams have made significant progress in developing the follow-up plan to our highly successful NAFTA Growth Operating Improvement program, which concluded at the end of fiscal '21. We're calling the new program, MAP 2025, and we will share details about it with you at an Investor Day to be scheduled in October around the time of our first quarter earnings release in Annual Meeting of Shareholders. We are confident that MAP 2025 will contribute to the momentum we are building for a successful fiscal 2023 and beyond. I'll now turn the call over to Mike Laroche to discuss our consolidated and segment financial results in more detail.

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

Thanks, Frank, and good morning, everyone. For the fourth quarter, we generated record consolidated net sales of \$1.98 billion, an increase of 13.7% compared to the \$1.74 billion reported in the same quarter of fiscal 2021. Organic sales growth of 15% or \$261.9 billion -- \$261.9 million. Acquisitions contributed 0.9% to sales or \$16.3 million, while foreign currency exchange was a headwind that decreased sales by 2.2% or \$38.6 million. Adjusted diluted earnings per share were a record \$1.42, which was an increase of 10.9% compared to the \$1.28 reported in the year-ago quarter.

Our consolidated adjusted EBIT was up 11.7% to a record \$263.7 million compared to \$236.2 million reported in the fiscal 2021 fourth quarter. Our Construction Products Group generated fourth quarter record net sales of \$745.9 million, up 18.5% compared to the fiscal 2021 fourth quarter. Organic sales growth was 19.9% and acquisitions contributed 1.6%. Foreign currency translation headwinds reduced sales by 3%.

Despite comparisons to a strong prior year when sales and earnings were at record levels, CPG continued to generate high growth propelled by its differentiated service model as well as its unique building envelope and restoration solutions.

The segment's business is producing the strongest sales growth were those providing roofing systems, insulated concrete forms as well as admixtures and repair products for concrete.

Results in international markets were mixed with Europe being challenged by macroeconomic headwinds, while Latin America experienced significant double-digit sales gains.

CPG fiscal 2022 fourth quarter adjusted EBIT increased 10.9% to a record \$122.4 million. This segment was able to offset significant raw material inflationary pressure with selling price increases and operational improvements. Our Performance Coatings Group fiscal 2022 fourth quarter net sales were a record \$329.4 million, an increase of 16.3% over the year-ago period. Organic sales increased 17.4% and acquisitions contributed 1.8%, which were partially offset by a foreign currency translation headwind of 2.9%.

PCG's business is providing flooring systems, protective coatings and FRP grading, all generated double-digit sales growth. A rebound in international markets as well as ongoing success in the company's vertical end markets, including energy, technology and food and beverage helped drive PCG's results. In addition, improved sales management systems and price increases were major factors in the segment's excellent top line results.

Adjusted EBIT increased 37.3% to a record \$42.6 million in the fourth quarter of fiscal 2022, driven by volume growth, selling price increases, revenue growth leveraging, good product mix and operational improvements.

The Specialty Products Group reported record net sales of \$225.8 million for the fourth quarter of fiscal 2022, an increase of 11.4% compared to the fiscal 2021 fourth quarter. Organic sales increased 12.2% and acquisitions added 0.5%, which were offset by unfavorable foreign currency translation of 1.3%.

The majority of SPG's businesses experienced double-digit sales growth. Leading the way were its OEM coatings companies as well as its food coatings and additives business, which has improved performance under new management. Its disaster restoration equipment business continued to rebound as it cleared backlogs caused by semiconductor chip shortages and grew sales in the teens despite a difficult comparison to a strong prior year that had high demand for its products driven by winter storm yearly.

SPG's adjusted EBIT was a record \$44.2 million in the fiscal 2022 fourth quarter, an increase of 21.8% compared to adjusted EBIT of \$36.3 million in last year's quarter. The segment's increase in adjusted EBIT was bolstered by the favorable impact of higher sales, which were leveraged to the bottom line due to selling price increases that began catching up with prior cost inflation.

Our Consumer Group achieved record net sales of \$682.8 million for the fourth quarter of fiscal 2022, an increase of 8.6% compared to the fourth quarter of fiscal 2021. Organic sales increased 10% which was partially offset by unfavorable foreign currency translation of 1.4%.

The Consumer Group's top line growth was driven by improved supply of key alkyd resins produced by the manufacturing plant we acquired last September as well as price increases and high growth in product lines with professional remodelers including caulks and sealants. While North American markets grew, European markets remained challenged due to macroeconomic headwinds in the region.

Fiscal 2022 fourth quarter adjusted EBIT was \$80.3 million, an increase -- a decrease of 14.2% compared to adjusted EBIT of \$93.6 million reported for the prior year period. Adjusted EBIT was impacted by continued raw material cost inflation and higher costs from ongoing shipping challenges and industry labor shortages. In response, the Consumer Group has been instituting price increases to catch up with inflation, building resilience in its supply chain and investing in capacity and process improvements to better respond to customer demand.

To wrap up, I have a few comments on capital allocation. Our significant liquidity enables us to fund internal growth initiatives, make acquisitions and reward our investors with cash dividend payments and repurchases of our shares. Since our last earnings release in April, we repurchased \$50 million of our common stock. This is in addition to earlier share repurchases and early redemption of our convertible notes in November 2018 with roughly \$200 million of cash. Combined, this puts us at \$658 million towards our \$1 billion repurchase goal that was established at the onset of our MAP to Growth program in 2018.

Now I'll turn the call over to Rusty to discuss our outlook.

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

Thanks, Mike. Looking ahead to the first quarter of fiscal 2023, we will continue to focus on navigating a number of challenges. The strengthening U.S. dollar is expected to be a headwind impacting the translation of our international results. We expect significant cost increases to continue for certain raw materials, labor and packaging. We also anticipate continued higher costs from unreliable bulk transportation, which creates production inefficiencies, although they should have less of an impact moving forward as well as fuel surcharges which are being driven by high energy prices that have been exacerbated by the conflict in Ukraine. These cost pressures are expected to disproportionately affect our consumer segment.

Despite these challenges, the proactive measures we took over the course of fiscal 2022, enabled RPM to accelerate momentum in the business and it is expected to carry over into fiscal 2023. We expect to continue implementing price increases as needed and continue improving operational efficiencies in order to minimize cost pressures and restore margins closer to historical levels.

While there is a recessionary undercurrent in the economy, we anticipate that demand for our products and services will remain strong particularly those that improve energy efficiency and extend the useful life of our customers' assets through protection and restoration. In addition, we are making strategic investments in organic growth initiatives focused on market opportunities and industry trends including the future funding for infrastructure and onshoring of industries responsible for pharmaceutical, food, technology and energy security.

Based on these factors, we expect to generate fiscal 2023 first quarter consolidated sales growth in the mid-teens over last year's record first quarter sales. For each of our 4 segments, we anticipate sales growth in the teens. It is likely that the consumer group will generate the highest growth of the 4 segments due to: number one, selling price increases that should allow it to catch up with inflation; number two, improved alkyd resin supply; and number three, investments made in new capacity, sales inventory and operational planning, and continuous improvement initiatives.

Fiscal 2023 first quarter consolidated adjusted EBITDA is anticipated to increase 20% to 25% versus the same period last year.

Lastly, I'd like to announce that we have hired Matt Schlarb, as our Senior Director of Investor Relations. He previously held Investor Relations positions with Watery.com, Mettler Toledo and Fairmount Santrol. We're pleased to have him join RPM and look forward to having him raise our Investor Relations function to a new level. Matt will be joining us on our equity analyst calls this week and you'll be working more closely with them as we near the announcement of our first quarter results and the investor event that will provide details on our MAP 2025 initiative.

This concludes our prepared remarks, and we will now be pleased to take your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from John Roberts from Credit Suisse.

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**John Ezekiel E. Roberts** - *Crédit Suisse AG, Research Division - Research Analyst*

Does the alkyd resin capacity get you to the integration that you want? Or would you like to have even further integration, if possible? It's always a trade-off between having capital deployed versus having your margins higher.

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

Sure. I think the Corsicana plan is relatively unique. We have another kind of backward-integrated business as well with our Stonhard Group. And I believe we have the backward integration that we desire at this point in time. We do plan to spend probably close to \$100 million over the next 3 years at Corsicana to backward integrate into a few other categories as well as use that site for expansion of our new Dura product line. But we do not plan any additional significant investments in backward integration at this time other than internal investments on that site.

**John Ezekiel E. Roberts** - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And then you noted the recessionary undertones to the economy. Which markets do you think are most at risk here for RPM?

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

For us, we're doing quite well in North America. Latin America is relatively strong compared to last year. The areas that we see the biggest challenges shouldn't be a surprise. It's principally Europe. And it's a function of some of the inflation hitting Europe later, slowing growth and most of which I would attribute to the Russian war on Ukraine and its impact, both on current economic activity and anticipated challenges in the energy markets in Europe, specifically.

**Operator**

The next question comes from Mike Harrison, Seaport Research Partners.

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

Was wondering if you can talk a little bit about the construction business. And I guess specifically, can you break down how much of that organic growth -- 20% organic growth was pricing and how much was volume? And I guess as you're looking forward, how much macro impact would you expect to see in that construction business, if we slip into a recession? What do you feel like trends around infrastructure spend and some of the onshoring or reshoring that you referenced might be enough to keep that underlying growth looking pretty solid?

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

Sure. So we, in general, feel really good about the dynamics, particularly North America for our Construction Products Group and our Performance Coatings Group. In both cases, unit volume growth was in the mid- to high single digits. And it could have been better, particularly in our Construction Products Group, but we continue to face shortages that impact projects.

Some of those shortages are related to intermediate chemicals that we purchase, and others of those shortages related to fasteners or insulation board or be involved in but slow down projects. So that organic growth could have been better in the quarter, and we continue to face some of those challenges.

I will tell you that the literally hundreds of billions of dollars that came from the American rescue plan in February '21 and the \$1.9 trillion infrastructure, real hard core infrastructure, both of which bodes well for the dynamics in the markets that our Construction Products Group and Performance Coatings Group serve. And again, those are principally driven in the United States.

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

And maybe a question for Rusty. Obviously, we're in a pretty unusual situation as it relates to working capital, leading you guys to be free cash flow negative for Q4 as well as for all of fiscal '22. Can you give us some initial thoughts on working capital and CapEx for fiscal '23? I think we're all just trying to get a better sense of what the free cash flow might look like for this coming year.

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

Sure. Yes. We had a rough year for cash flow in fiscal '22. When you combine decreasing margins and inflation, that's usually a bad sign for cash flow. And as a result of unreliable supply, we had to build up inventory where we could because supply was so unreliable as was transportation.

As a result of that, our inventories need to get into balance better in fiscal '23, our finished goods as well as raw materials. We have cases where we don't have enough finished goods even though inventory did increase to really supply and service our customers like we'd like. So that's getting better as a number of the force majeure have expired over the year. We still face a few supply challenges, but not nearly as bad as last year.

So now that as we said in our guidance, we're going to be back expanding margins again, EBIT margins. We would anticipate a much better year for cash flow. As it relates to capital expenditures, we are looking to play offense and invest more in our businesses. We have a lot of high-growth areas, including high-performance buildings. That's been a real growth area for us.

And as a result, we're going to push up our capital spending as probably closer to the \$300 million range in fiscal '23. Acquisitions, on the other hand, have continued to be at high multiples. And as you know about RPM, we're very disciplined and don't pay those crazy multiples. So we would anticipate acquisition activity to continue to be lower than historically we've been at. So hopefully, that answers your questions.

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**Operator**

The next question comes from John McNulty of BMO Capital Markets.

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

So I guess maybe the first one, high level, can you give us some color as to how to think about price versus volume in the quarter? And overall, if there are any segments that kind of stood out as the leaders or the laggards and how that may change as we kind of push into the first half of fiscal '23 for you?

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

Sure. So I provided the unit volume by group, mid- to high single digits in Construction Products and in Performance Coatings. Unit volume was relatively flat across the different businesses in our Specialty Products segment, and we were down high single digits in Consumer for the quarter.

I will tell you, high level, from our perspective, it was a great quarter. We delivered the guidance that we provided. In the fourth quarter, we are ahead of cost price mix in three of our 4 segments. In Q1, we should be ahead of the cost price/mix dynamics in all four of our segments, meaning you will see higher EBIT growth than earnings -- than sales growth and you will see EBIT margins improving in three of our 4 segments, those EBIT margins will be at or near all-time records. And in Consumer, we've got a lot of catch-up to do, but you'll see a significant EBIT margin improvement. So we feel really good about the quarter that just ended. And that momentum that you can see in Slide 3, as we build momentum, principally around the cost price/mix dynamic that impacted our industry we'll continue to build in Q1, and we think even better in Q2.

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

Got it. No, that's helpful color. And then I guess maybe to that, back of the envelope, when I kind of look at 1Q, it looks like you're kind of assuming year-over-year, the margins improved by, whatever, 50 to 100 basis points for the corporate level. I guess how should we think about how that progresses through the year? I mean is that kind of a decent run rate? Do you continue to catch up with either more pricing or the raw materials maybe even giving away a little bit? I guess, how are you thinking about the potential for margin improvement throughout the year?

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

Sure. The largest improvement you'll see in our consumer group, it's a function of finally catching up on cost price/mix and also the operating efficiency initiatives that we're undertaking there in relationship to a very challenged fiscal '22. So you'll see significant improvement there and continued improvement with reasonable leverage to the bottom line in our other 3 segments.

Rusty indicated that in Q1, we see earnings growth in the 20% to 25% range. Q2 should be better than that. And boy, we are hesitant to go beyond any further comments because depending on what week it is and what headline you read, we're either heading for more inflation or a recession and what's happening in Europe relative to energy markets. So it's difficult to predict 3 to 5 months, let alone anything beyond that. But the next 2 months will be rock solid in terms of sales growth, earnings growth and EBIT improvement in every one of our segments.

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**Operator**

The next question comes from Vincent Andrews of Morgan Stanley.

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

Wondering if you can talk a little bit more about the EU, in particular, obviously, there's a lot of volatility in the energy markets and a lot of anxiety over what could happen from a supply perspective of natural gas and electricity? Could you talk about your exposure and what mitigation plans you have in place? And sort of what -- if there was a disruption, what that would mean not just for your European business, but would there be any sort of collateral consequences good, better and different in other geographies?

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

Sure. So the European business on a consolidated basis is about \$1 billion. I think it's highly likely that when we finish '23, it could be less than that. Demand is certainly weaker than North America. And with the foreign exchange translation and the strength of the dollar, that will further lessen or negatively impact translated results back into U.S. dollars.

It's really a slower demand, flat Europe, I think because of the challenges that they're facing economically and significantly higher energy cost than what we're seeing in the U.S. Again, part of it is the oil and gas dynamics globally. And part of it is what's happening with Russia and the impact on natural gas. Natural gas is the primary feedstock to all of our big European Russian chemical suppliers in terms of energy. And in some cases in our facilities, some of our construction product facilities, it's a primary driver of energy as well.

So that's something we'll be paying attention to. And those are the dynamics. And back to not being able to look out very far, you can certainly paint a geopolitical economic picture where things get better nicely if things move in a positive, more peaceful direction. And if things persist and the threat of Russian turning off natural gas to Germany in particular, but Western Europe happens, then you're going to have a very quick and negative dynamic shift, I think, in all manufacturing in Europe.



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

And just as a follow-up, in PCG, you mentioned sort of the sales management systems. And I guess 2 questions about that. One would be just sort of how much runway is left in that improvement process? And is there anything that you can take from your learnings in that segment and applies to your other segments? Or is this just a question of PCG catching up with where everybody else is?

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

A couple of things. Number one, PCG is benefiting, particularly in our Carbolite unit from higher spending in the oil and gas markets and energy markets. And certainly, that's cyclical, and it's not a cyclical upturn. As I indicated earlier, the huge chunks of money, particularly in the United States, in the infrastructure bill and the American Rescue Recovery Act are serving our Performance Coatings business pretty well.

And the dynamics of some of the pricing benefits and commercial excellence that we've experience in our Performance Coatings. We are certainly shareable across other parts of RPM. The fact of the matter is, is that we are utilizing data on a more consolidated, more detailed basis in all of our businesses. In some cases, it might be RPM catching up to what others are doing, but it's benefiting RPM in a lot of places. And it -- those practices are particularly shareable because of commonalities and sales forces and approaches to the market and compensation structures between our Performance Coatings Group and our Construction Products Group.

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**Operator**

The next question comes from Josh Spector, UBS.

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

Just to follow up for the earlier question around construction and specifically margins in the quarter. I think typically, you have relatively similar margins fourth quarter, first quarter and construction margins have been generally outperform over the past couple of years. So curious maybe you can give us some more comments about what drove the lower margins in construction and where you see those heading over the next year?

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

Sure. There's 2 elements that I would call out that drove the Construction Products Group challenges. One is they are the owner of our Corsicana plant even though the primary beneficiary today is our Consumer group relative to alkyd resin productions. So there's a \$8 million or \$10 million negative hit for the year or through 9 months that we owned it in our Construction group from that, that should get better as we further utilize that plan.

The second area is silicones. Silicones have been the primary largest year-over-year, up hundreds, a couple of hundred percent in terms of costs and our Construction Products Group. Silicone polymers are up 211% versus last year in the fourth quarter. And our Construction Products Group is the largest purchaser of silicone or silicone-related products for a lot of their sealants. The other area where we buy silicones is in our DAP business. And so those are the primary drivers of it.

Excluding those and to a certain extent, that's a silly statement because those are -- that's the world we work in, but those two factors were what impeded the construction products from otherwise generating record EBIT. And as you'll note, through the MAP to Growth program, their EBIT results -- their consolidated EBIT figures are up almost 500 basis points. And we anticipate that continuing to expand on a sustainable basis in the next couple of years.

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

That's helpful. And just another follow-up just on construction, but related with Europe. Are you able to quantify what you're seeing volumes in that segment in Europe relative to the rest of the world?

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

Well, it's flat to slightly down, and it's true across all of our businesses. And in the Construction Products Group, in particular, we have a really nice manufacturing facility in Poland, and Poland has been very challenged. We have Ukrainian workforce who have left to fight. We have Polish associates who are hosting Ukrainian families in their homes. And so there's a lot of challenging things going on there, and that's particularly unique to our Construction Products Group that's got a significant manufacturing base of Poland. Other than that, it's pretty weak demand and concerns about energy costs across Europe, U.K. and across all of our segments.

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**Operator**

The next question comes from Kevin McCarthy of Vertical.

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

Bottom of Slide 3, you referenced product reformulations. And in your prepared remarks, I think you used the word thousands of products. I imagine that was quite an undertaking. Can you help us frame it in terms of what percentage of your sales would have been reformulated and whether that had any material cost impact, either positive or negative as you executed through that process?

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

Sure. I don't have a good number. We can work on that. But I can tell you across our businesses we've reformulated over fiscal '22, literally thousands of products. So you had to reformulate them, recertify them due to the quality control checks. And it's literally in the face of initially some primary raw material shortages. Those are tough to reformulate around. But it was a lot of the smaller more modest intermediate chemicals that we were unable to get.

One of the larger categories would be in seed oils, and that's a challenge coming out of Russia and Ukraine. And so our Construction Products Group, in particular, has reformulated a lot of coatings into more bio-based seed oils and very favorable performance and very favorable environmental footprint. In a few places, we've had to reformulate back into more solvent-based resins just as an example. And so you've got to go through the reformulation process, the recertification process with your customers or with codes and then make sure you're doing the QC checks such that this reformulation isn't impacting performance.

And the -- and this is not unique to RPM in our industry. The real -- there's lots of heroes, I think, frontline workers during the COVID period. And certainly, in the last year, our folks in our labs have worked over time to address this issue. And that's -- we can get a better sense of that for you. That's in light of what across the board in terms of materials keeping quarter-over-quarter, it's up about 35% in terms of material inflation in the quarter last year versus this quarter. But it was really an intermediate chemical raw material availability that drove most of the reformulation.

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

Okay. And then just to follow up on that latter comment, how do you expect that 35% inflation level to trend in the first quarter? And then related to that, you commented on silicones and oil. So are there other sort of problem children in the family? And then also, are you starting to see relief anywhere among the raw material basket at this point?

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

So the biggest challenges for us in the fourth quarter year-over-year were areas like metal packaging, particularly impacting consumer, up 50%. Alkyd resins quarter-over-quarter, year-over-year are up 115%. I mentioned silicone up over 200%.

Other costs, some of these intermediate chemicals that were not big buyers of that are critical and MDI is up 72%. You've got freight costs and fuel costs and surcharges. So it's been, again, not unique to us, incredibly challenging.

Our budgeting anticipates additional inflation over fiscal '23 of about 15%. And that's what we've anticipated. Most of the pricing action that we've needed to cover that would have occurred in fiscal '22 and/or is occurring. There's additional price increases in a number of RPM companies occurring in the first quarter of '23. And then we'll stay tuned to both availability issues and inflation issues. And it's hard to really judge.

We are seeing underlying primary base chemicals that we don't purchase directly but impact our purchases, flat or declining. You're certainly seeing oil prices move in the right direction. That has not made its way into the things we buy yet. And the volatility is such, it's really hard to tell other than we're in a period of time where the core underlying chemicals and oil prices are certainly moving in the right direction.

**Operator**

The next question comes from Frank Mitsch of Fermium Research.

**Frank Joseph Mitsch** - *Fermium Research, LLC - President*

I appreciate the product shoutout in one of your early answers highlighting rock solid. Well done and well played.

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

I was trying to give you a headline.

**Frank Joseph Mitsch** - *Fermium Research, LLC - President*

It's under consideration. You mentioned 3 of the 4 segments should see all-time record margins or near all-time record margins. Is that -- was that a 1Q comment? Or was that a '23 comment? Or how should we think about that comment you made?

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

So I would tell you that our Performance Coatings Group is at all-time record EBIT margins and that should continue to move in the right direction. Our Construction Products Group just missed, and it just missed is -- if you adjust out for the Corsicana plan impact, we're about equal to record margins of last year's fourth quarter. The big bogey there I mentioned before is silicone. We're a big buyer of silicones and they have been a real challenge for us.

And then our Specialty Products Group had a record EBIT percent in the fourth quarter as well. And we expect them to build upon that and get back to record EBIT margins for coming quarters.

So in Q1, you should see year-over-year EBIT margin improvement in every one of our segments, including Consumer. I think the Consumer results that we should be posting in the next couple of quarters will look impressive. But you have to keep in mind that's in light of some pretty weak comparisons.

But we're pretty excited. We thought we had a really good fourth quarter. And as I said earlier, we met the guidance that we provided. And to be able to be where we are, relative to the challenges we're facing and I think our industry broadly in terms of the cost price/mix dynamic. We're ahead of the curve in three places, and we'll be ahead of the curve in all four in the first quarter.

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**Frank Joseph Mitsch** - *Fermium Research, LLC - President*

Very helpful. And if I could just follow up on the inventory question earlier. Obviously, you've had to increase your inventories given the supply chain issues. And I'm curious, when do you expect that to normalize? And how do you see your customers because you'd assume that your customers are also seeing some of the same issues in that they may be building more inventory. How should we think about the inventories throughout the chain?

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

Sure. I think as everybody knows the inventories and working capital have been a challenge for business in general. Thankfully, we're not in fast fashion, but you've got a lot of fashion retailers that have a lot of what people don't want and very little of what they do. And so that's a dynamic that's playing out in certain industries.

In our case, we kind of suspended our working capital goals, which will be, in some detail, talked about in our MAP 2025 program that we'll talk in some highlight about in our annual report that goes out in mid-August and then details in October. But this year was challenging. So we were doing our best to accumulate raw materials. In certain areas, we're accumulating as much raw material as we could get, but not producing as we're waiting for the valve or a particular intermediate chemicals so that we could start production again.

And so we have a higher level on a relative basis of days of raw material inventory than we've ever had. And then in certain other places, the other that's strange is, and again, not unique to RPM, we would have the largest chunk of something, we would have relatively little of, which is WIP. And so you can have products like in our Legend Brands business or in some in our Construction Products Group or Consumer Group that are partially finished. And in the case of Legend Brands, literally waiting for a chip or batches that are partially completed, but waiting for a key element.

And so with inventory is something we have little of anywhere and something that we and other people probably had a lot more of than they ever realized relative to the dynamics of raw material availability. And we expect that to improve significantly in '23. I don't believe we'll get back to record cash flows, but we will get back to the positive. This is the first year in my history that we had negative cash flows in the fourth quarter and for the year. And we'll get back to generating a few hundred million dollars of free cash flow and then some in fiscal '23.

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**Operator**

The next question comes from [Jeff Futasis] of JPMorgan.

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**Unidentified Analyst**

You guys have FIFO inventory and costs have been rising. Your FIFO costs -- are your FIFO costs and your LIFO costs about to caught up? Or is there still a meaningful gap? And because of that gap, maybe raw materials will peak in the second quarter of next year? Is that fair as a base case?

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

Yes. Jeff, this is Rusty here. As far as FIFO goes, you're correct in that we're going to continue to see increases go through the P&L from the last 3 months. On average, we hold about 90 days of inventory. So the latest quarter's purchase order inflation that we're seeing on actual POs will come through 90 days later in the first quarter.

I would say our fourth quarter too was penalized somewhat again because of FIFO by some of the Omicron disruption in the winter time. So you might remember, December, January, a lot of people out work -- out sick at our suppliers, freight carriers and in our facilities, too. So we had a lot of production inefficiencies around New Year that hit us in the fourth quarter.

So on the good news front, that should be flowed through, and we should have better efficiency coming through our cost of sales from that standpoint in Q1.

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**Unidentified Analyst**

Okay. Got that. In fiscal -- for my follow-up, in fiscal '22, were your consolidated volumes down low single digits?

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

For consolidated fiscal '22, our volume was pretty flat for the year up a tad, but yes, it was not down. It was up very marginally.

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**Operator**

The next question comes from Steve Byrne of Bank of America.

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

So Frank, you mentioned your raws for alkyd resins have effectively doubled. Is it fair to say that one of the key drivers of that are the vegetable oil materials that go into those resins, which just surged during your fiscal first quarter but have really pulled back. Are you looking for that Corsicana plant margins to meaningfully improve in this fiscal first quarter or maybe in the fiscal second? Is that a fair expectation?

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

Yes. Steve, this is Rusty here. As far as alkyd resins go, you are correct. A lot of the plant-based oils have been rising since the Russian invasion of Ukraine. And alkyd resins have gone up more so because of the explosion a year ago that took out 30% of North America alkyd resin production capacity. So they continue to go up here as we speak in the first quarter.

So buying alkyd resins externally is going to continue to be more expensive every day. And you are correct. We are ramping up our Corsicana, Texas plant and getting more of our alkyd supply in-house, and that progress is continuing. So we continue to make more different varieties of alkyd resins and should continue to get more of our alkyd resins sourcing done in-house.

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

And then Rusty, this plant was acquired by Tremco, right? And not -- why isn't the Tremco plant, not an RPM plant when you indicated consumer businesses getting resins from this plant? So I guess I'm not sure who drive sourcing at a plant that was acquired by Tremco and maybe you could comment even a little more broadly. How do you incentivize that cost fertilization between brand and businesses for production and sales?

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

Sure. Steve, this is Frank. So we don't have any RPM plants. RPM International Inc. doesn't own plants. Our plants are owned and operated by our four segments or their operating company businesses. That's where we have the expertise. And I think we have a very strong manufacturing operations team in our Construction Products Group.

And our expectations for the Corsicana plant, were broader than just alkyd resins. They had -- they were not producing out the resins when we acquired them. And so well, that is the primary driver of our focus and investment with them in fiscal '22, we expect to expand it in other areas. And we're also going to use that site as a significant expansion site for Nudura, which is also a Construction Products Group.

Lastly, I'd say that the cooperation and communication across our businesses post-MAP to Growth in a center-led approach across many functions, but particularly in manufacturing and operations, makes it possible and it's working and I say possible because 10 years ago, it really wasn't and it's working exceptionally well to be sharing manufacturing assets. And so that is definitely a shared manufacturing asset.

The Consumer Group is the biggest beneficiary of that in fiscal '22 and will be, I think, for most of '23. But it's an asset that's shared across multiple RPM businesses, and it's got to report somewhere, and it's not RPM because we don't have the manufacturing expertise in our shop.

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### Operator

The next question comes from Arun Viswanathan of RBC Capital Markets.

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

So yes, I just wanted to get back to the inventory issue, I guess. I was just curious, within your Consumer Group, how would you characterize inventory levels at the big box? Obviously, we've heard elevated levels in other areas of the retail channel, but is that also what you'd say for your big box partners?

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

Fill rates in consumer across multiple categories are still below where they need to be. And so you're looking at an industry, both in terms of customers and suppliers that operate with fill rates in the high 90s and today they're probably in the 70s, and that's true across multiple product categories. So there are still dynamics of core inventory fill that need to be fixed and will be fixed as we, in our case, as we roll into fiscal '23. And so the inventory situation in consumer is not where it should be and that has been true for the last 2 years.

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

Okay. And if I could just ask in that group, is it possible that you actually see maybe some outsized performance or increased demand in the small project category, if we do go into a more material recession? Have you seen that in prior cycles?

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

We have -- in prior recessions, we've actually seen an uptick in our Consumer DIY business. And we could certainly see that. We will have completed what's a multiyear \$70 million expansion of capacity in our Consumer business by the end of the summer. And so as we work through the supply constraints, work through raw material availability issues and all these freight issues, we will find ourselves in a very good position, cost-wise, capacity-wise and hopefully, cost price/mix as we work into the year relative to consumers. So we're in pretty good shape there. And in all past recessions, that's been somewhat countercyclical aspect of RPM.

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

So on the next MAP program, I guess, would the focus be a little bit more on capital allocation and cash flow? I know SG&A was really an initial focus for the initial MAP to Growth program. But does this one switch a little bit more to capital allocation?

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

Sure. And so we'll get into the details, as Rusty indicated in October. But I do think in most areas, we have addressed SG&A in meaningful ways. And so the new MAP program will be benefiting from improved cash flow, a particular focus on working capital and a particular focus on gross margin improvement along with some revenue growth expectations.

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**Operator**

Our next question comes from Mike Sison of Wells Fargo.

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**Michael Joseph Sison** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Analyst*

Just one quick one. Your outlook for the Q1 adjusted EBIT growth of 20%, 25%, it sounds like 2Q could even be better. How much of that growth will simply come from pricing, maybe catching up with raw materials and then the sort of volume growth and maybe some cost savings and such?

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

I don't see our underlying unit dynamics changing, pretty good strength in North America, some growth in Latin America. Asia is relatively small for us. So it won't drive the larger shift very much and concern about demand and weakness in Europe. And so as I commented earlier by segment, I would expect us to see mid- to high single-digit unit growth in Construction Products Group and Performance Coatings Group qualified by any raw material availability challenges, which might pop up again, both for our products and/or components that are on projects -- construction projects that were a part of that might hold things up.

I think you're going to see some improved unit volume growth in our Specialty Products Group, which has been relatively flat for most of fiscal '22. And I would expect that most of our profitability improvement in consumer in the next couple of quarters will be a combination of price finally catching up with costs and some of the operating efficiency efforts that we've been pursuing for the last year with unit volume relatively flat, although again, we'll see quarter-by-quarter.

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**Michael Joseph Sison** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Analyst*

Right. So maybe the way to think about it is if you get that volume growth in mid-single digits, that probably levers up to about half the growth of the other half could be the price raws?

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

Again, it's really a segment-by-segment story. That's why I went through that, Michael. And we'll provide detail on how it plays out when we report first quarter results. But I think the first quarter results between unit and price will be comparable to what we delivered in Q4.

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**Operator**

Our last question comes from Ghansham Panjabi of Baird.

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**Matthew T. Krueger** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

This is actually Matt Krueger sitting in for Ghansham. So first off, versus your pre-COVID baseline, can you talk about where we're at across each of your businesses from a volume or demand perspective, however you want to portray that?

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

Sure. So in our Specialty Products Group, we are meaningfully improved from pre-COVID in terms of sales growth, both obviously price but also units. And we've affected a lot of efficiency. We are slightly below the high-teens EBIT margin record that they had. I believe their EBIT margin record is north of 17%. And so we would expect to get back there hopefully, in fiscal '23.

In our Construction Products Group, except for the silicone issue and the Corsicana plant, we would be at all-time EBIT margins and we expect to build upon that in fiscal '23.

Our Performance Coatings Group generated record EBIT margins throughout '22 and we'll continue to build on that.

It's really our Consumer Group that is the most dynamic. As you recall, our fiscal '21 was huge. We had organic growth in some quarters as high as 30%, particularly in the summer and the fall of calendar '20 as the world was dealing with the state home orders and it really drove a higher level of DIY activity than anybody had ever seen before. And then some operating inefficiencies and supply chain challenges that hit our Consumer group worse than our other segments.

And so we are ahead of our pre-COVID in terms of revenue, in terms of unit volume. Meaningfully ahead, obviously, in price. But we lost significant profitability and margin in fiscal '22 versus the peak of fiscal '21. As I said earlier, we would expect to regain a lot of that in fiscal '23 but certainly not all of it.

So we will talk in more detail about our Map to Growth goals, including by segment, and it will take us a couple of years to regain the record level of profitability that we had pre-COVID in our Consumer Group.

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**Matthew T. Krueger** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

And then just to round things out, I guess, we talked quite a bit about raw material challenges and supply chain constraints. But I wanted to switch over to interest rates. So how do you expect higher interest rates to impact demand across your various business units? And have you seen any impact from higher rates across any of your end markets already, whether it be because of housing affordability or other reasons?

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

I'll address that in two ways. Number one, from an RPM perspective, our balance sheet is about 70% fixed rate at an average fixed rate of about 3.5% and its maturity is over -- average maturity is over 10 years. So we're in really good shape relative to rising interest rate environment, specifically on our balance sheet and our P&L.

As it relates to the broader markets, we read all the headlines, but we're not seeing any impact in the United States yet. There's a funny dynamics, for instance, in new home construction. There is still a shortage relative to demand in housing. And yet you've got rents going up. You've got mortgage rates going up. So seeing how all those dynamics play out over time will be interesting in the near term, particularly in our DAP business, which has a significantly larger chunk of its business that goes in pros and into new home construction.

The pro business that we have is solid. It's high single digit in terms of unit volume and outperforming DIY meaningfully. The Construction Products Group, our Nudura business goes into light commercial and residential. It is component problems that are slowing down the completion of some



of the housing and light commercial activities, not demand. So as we sit here today, the dynamics in our business do not reflect some of the recessionary headlines that you're reading about.

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**Operator**

Thank you. There are no further questions at this time. Please continue.

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

This year is one of milestones across RPM. RPM is now in its 75th year in business. When my grandfather founded Republic Powdered Metals in 1947, he had 1 product, the heavy-duty aluminum roof coating called illumination. First year sales were \$90,000. To be in business for 7.5 decades and generate \$6.7 billion of revenue this fiscal year is quite a feat considering our humble beginnings.

Our Carboline business, a leading manufacturer of industrial corrosion control and fireproofing coatings also is celebrating its 75th anniversary this year. Topping both is our Stonhard business, a producer of high-performance flooring system, which is celebrating its 100th anniversary in calendar 2022.

Achieving these milestones is especially impressive when you consider the average life span of an S&P 500 company is 15 years according to a Harvard business review article from 2018. The credit for this longevity belongs to our more than 16,000 associates worldwide and the hard work they put in every day to drive our growth and success, which was particularly challenging in the fiscal 2022 year just ended.

Thank you for all you do to move the business forward and to build a better world. Our people, combined with positive market trends, innovative products and a strong balance sheet gives us confidence that we have a bright future ahead of us.

I would also like to thank our shareholders for their continued investment in RPM. We remain focused on generating long-term value for you. We look forward to updating you on our fiscal 2023 first quarter results and to providing the details of our MAP 2025 program in October. Thank you, and have a great day.

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**Operator**

Ladies and gentlemen, this concludes your conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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