Sherwin-Williams (SHW) Earnings Report: Q1 2016 Conference Call Transcript

The following Sherwin-Williams conference call took place on April 21, 2016, 11:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Bob Wells; Sherwin-Williams Co ; SVP, Corporate Communications
- John Morikis; Sherwin-Williams Co ; President & CEO
- Sean Hennessy; Sherwin-Williams Co ; CFO

Other Participants

- Ghansham Panjabi; Robert W. Baird & Company, Inc.; Analyst
- Chris Parkinson; Credit Suisse; Analyst
- Bob Koort; Goldman Sachs; Analyst
- Duffy Fischer; Barclays Capital; Analyst
- Vincent Andrews; Morgan Stanley; Analyst
- Don Carson; Susquehanna Financial Group / SIG; Analyst
- Arun Viswanathan; RBC Capital Markets; Analyst
- PJ Juvekar; Citigroup; Analyst
- Mike Harrison; Seaport Global Securities; Analyst
- Nils Wallin; CLSA Americas, LLC; Analyst
- Dmitry Silversteyn; Longbow Research; Analyst
- Chuck Cerankosky; Northcoast Research; Analyst
- Ivan Marcuse; KeyBanc Capital Markets; Analyst
- Rosemarie Morbelli; Gabelli & Company; Analyst
- Scott Rednor; Zelman & Associates; Analyst
- Jay McCanless; Sterne Agee; Analyst
- Greg Melich; Evercore ISI; Analyst
- John Roberts; UBS; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Thank you for joining the Sherwin-Williams Company's review of first-quarter results for 2016.

With us on today's call are John Morikis, President and CEO; Sean Hennessy, CFO; Allen Mistysyn, Senior Vice President, Corporate Controller; and Bob Wells, Senior Vice President, Corporate Communications.

(Operator Instructions)

An archived replay of this webcast will be available at Sherwin.com beginning approximately 2 hours after this conference call concludes and will be available until Thursday, May 12 at 5 PM Eastern time.

This conference call will include certain forward-looking statements as defined under US federal securities laws with respect to sales, earnings and other matters. Any forward-looking statements speak only as of the date on which that statement is made. The company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

A full declaration regarding forward-looking statements is provided in the company's earnings release transmitted earlier this morning.

(Operator Instructions)

I will now turn the call over to Bob Wells.

Bob Wells (SVP, Corporate Communications):

Thanks, Operator. Good morning, everyone. Thanks for joining us.

In the interest of time, we've provided some balance sheet items and other select financial information on our website, Sherwin.com, under Investor Relations April 21 press release.

I'll begin by highlighting overall company performance for the first quarter 2016, compared to the first quarter 2015, then comment on each reportable segment.

Consolidated net sales increased 5.1% to a record $2.57 billion, driven primarily by higher paint sales volume in our Paint Stores Group and consumer group. Unfavorable currency translation decreased consolidated net sales 2.8% in the quarter.

Consolidated gross profit dollars increased $129.3 million in the quarter to $1.26 billion. Our consolidated gross margin increased 280 basis points in the quarter to 49% of sales, from 46.2% in the first quarter last year.

Most of the gross margin improvement in the quarter resulted from the positive mix effect of Paint Stores Group, our highest gross margin segment, outpacing the growth of the other segments, coupled with increased operating leverage from higher production and distribution volume.

Selling, general and administrative expenses increased $73.2 million over the first quarter last year to $1 billion. As a percent of sales, SG&A increased to 38.9% in the first quarter this year from 37.9% last year. Roughly half of this increase was from acquisition-related costs.

Interest expense increased $13.3 million compared to the first quarter last year to $25.7 million. This increase resulted from the shift to long-term debt from short-term that occurred midyear 2015 and acquisition-related interest expense.

Consolidated profit before taxes in the quarter increased $23.1 million to $216.4 million, due primarily to improved operating results from our Paint Stores Group. Unfavorable currency translation reduced profit before tax in the quarter by $9.4 million, or 4.9% compared to the first quarter last year.

Our effective tax rate was flat at 32% compared to the first quarter of 2015. For the full year 2016, we expect our effective tax rate will remain in the low 30% range. Consolidated net income increased $15.7 million to $147.1 million. Net income as a percent of sales was 5.7%, compared to 5.4% in the first quarter last year. Finally, diluted net income per common share for the quarter increased 13.8% to $1.57 per share from $1.38 per share in 2015.

Looking at our results by operating segment, sales for our Paint Stores Group in the first quarter 2016 increased 10.5% to $1.62 billion from $1.46 billion last year. Comparable store sales, that is sales by stores opened more than 12 calendar months, increased 9.4%.

All of the Paint Stores Group sales increase was due to higher organic paint and equipment sales across all end markets. Price mix had a negligible impact on sales in the quarter.

Regionally, in the first quarter, our Eastern division led all divisions, followed by Southeastern division, Midwestern division, Southwestern division and Canada. Sales in volumes were positive in every division. Segment profit for the group increased to $77 million, or 43.6%, to $253.5 million in the quarter as higher paint and equipment sales volumes were partially offset by higher SG&A spending. Segment operating margin increased to 15.7% of sales from 12.1% in the first quarter last year.

For our Latin America Coatings Group, first quarter net sales, stated in US dollars, decreased 24.7% to $125.2 million due to unfavorable currency translation and negative volumes that were partially offset by selling price increases. Currency translation rate changes decreased sales in US dollars by 22.2% in the quarter.

Segment profit in US dollars decreased to a loss of $900,000 in the quarter from a profit of $9.5 million last year. Segment profit was negatively impacted by higher raw material costs and unfavorable currency translation partially offset by selling price increases. Currency translation decreased Latin America segment profit $6.2 million in the quarter. As a percent of net sales, segment operating profit was a loss of 70 basis points in the quarter compared to a profit of 5.7% in the first quarter of 2015.

Turning to the Consumer Group, first quarter sales increased 7.5% to $378.1 million. As a reminder, in March we annualized the start of the initial shipments of the HGTV Home by Sherwin-Williams paint program to Lowe's stores, which was completed by May 1 of last year. Segment profit for the Consumer Group increased $8.6 million to $64 million in the quarter from $55.4 million in the first quarter last year. The profit improvement in the quarter was due primarily to improved operating efficiencies and higher sales volumes. Segment profit, as a percent of external sales, increased to 16.9% from 15.8% in the same period last year.

For our Global Finishes Group, sales in US dollars decreased 3.3% to $454.2 million in the quarter as unfavorable currency translation was partially offset by positive price mix. Unfavorable currency translation decreased net sales for the segment 4.7% in the quarter.

First quarter segment profit, stated in US dollars, increased $9.7 million, or 24.9%, to $48.6 million, due primarily to decreasing raw material cost and good cost control, partially offset by unfavorable currency translation, which decreased segment profit $3 million in the quarter. As a percent of sales, segment profit increased to 10.7% from 8.3% in the same period last year.

That concludes my recap of our results for the quarter, so I will now turn the call over to John Morikis, who will make some general comments and highlight our expectations for second-quarter and full-year. John?

John Morikis (President & CEO):

Thank you, Bob, and good morning, everyone. Thank you for joining us.

First quarter 2016 was a good quarter for Sherwin-Williams , from both a revenue and profit perspective. Architectural paint volume growth in North America was the strongest we've seen in the past 10 years or longer.

Industrial coatings demand also picked up some momentum in North America and Europe. Even with a 2.8% drag from unfavorable currency translation in the quarter and continued soft market conditions in Latin America, our consolidated sales growth exceeded 5% for the first time since third quarter 2014.

To get a clearer picture of our profitability, you need to back out the acquisition-related costs we recorded in the quarter. Acquisition costs, diluted net income per common share increased 31% on sales growth of just over 5%.

As a percent of sales, gross profit expanded 280 basis points year-over-year. Operating profit improved

300 basis points, and profit before tax improved 190 basis points. Our incremental margin on consolidated profit before tax was 48.6%. SG&A was the only line on the P&L that went the wrong way as a percent of sales. The results of higher SG&A spending by our Paint Stores Group and the acquisition-related expenses.

Both our domestic operating segments delivered strong results in the quarter. Paint Stores Group recorded double-digit revenue growth in four of the five customer segments we track, led by residential repaint, new residential and DIY.

Comparable store sales growth of 9.4% was the strongest comp performance we've seen in a few years. Our optimism is fueled further by our professional contractor customers reporting very healthy order book trends that extend well into the year.

During the quarter, Paint Stores Group opened 20 new stores and closed seven redundant stores. Our plan still calls for full-year store openings in the range of 90 to 100 net new locations. Today, our total store count in the US, Canada and Caribbean stands at 4,099 compared to 4,010 a year ago.

Consumer Groups' 7.5% sales increase and 110 basis point improvement in segment profit margin in the quarter primarily reflected strong results from our national account customers. Sales to commercial, industrial and MRO customers also showed good progress in the quarter. Strong sales growth and volume driven productivity gains by our global supply chain organization resulted in a very healthy 32% profit margin on incremental sales from our Consumer Group in the quarter.

Unfavorable currency translation continued to weigh on sales and profit performance in our Global Finishes Group and our Latin America Coatings Group. Global Finishes Group did report positive volumes and positive sales in local currencies, driven primarily by improving market conditions in North America and Europe. They also managed expenses very well resulting in an impressive 240 basis point expansion and segment operating margin.

Sales volumes in most Latin American countries continued to decline, with Mexico standing out as the notable exception. The impact of currency devaluation once again was worse than anticipated in the quarter.

Our net working capital increased in the quarter due to the strong upward inflection of our business in the first quarter evaluated over the trailing 12 months of sales. This increase in working capital resulted in a net operating cash use of approximately $80 million in the quarter, compared to a use of about $55 million in the first quarter last year.

Our capital expenditure in the quarter totaled $52 million. Depreciation was $42.9 million and amortization was $5.8 million. In 2016, we anticipate capital expenditures of approximately $240 million, depreciation of $170 million to $180 million and amortization of about $30 million. Capital spending will run higher than normal in 2016 as we complete some facility renovation projects.

During the quarter, we made no open market purchases of our common stock or treasury. On March 31, we had remaining board authorization to acquire 11.65 million shares.

As we indicated on our call announcing the Valspar acquisition, we intend to build cash on our balance sheet over the course of the year to reduce total borrowings required to close the deal. This, along with the cash required to service the debt after the close, will significantly curtail our share repurchases for the foreseeable future.

Yesterday, our Board of Directors approved a quarterly dividend of $0.84 per share, up 25% from $0.67 last year.

As I mentioned at the beginning of my remarks, North American architectural paint demand is strong, driven by a steadily increasing level of residential construction and remodeling activity. As we move into the prime painting season, we're also encouraged by growing signs of a more robust non-residential recovery and improving demand for many industrial products.

This growth will continue to be offset, to some degree, by challenging conditions in Latin America and currency headwinds, particularly in the first half of the year. Our outlook for second-quarter 2015 is for consolidated net sales to increase low to mid-single digits percent compared to last year's second quarter.

With sales at that level we expect diluted net income per common share for the second quarter to be in the range of $3.95 to $4.15 per share, a 9.5% increase at the mid-point compared to last year's record $3.70 per share.

For the full year 2016, we expect consolidated net sales to increase over 2015 by a low single-digit percentage. With annual sales at that level, we are raising our expectation for full-year diluted net income per common share to be in the range of $12.50 to $12.70 per share compared to $11.16 per share earned in 2015.

Again, I'd like to thank you for joining us this morning and now we'll be happy to take your questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Ghansham Panjabi, Robert W. Baird.

Ghansham Panjabi (Analyst - Robert W. Baird & Company, Inc.):

Hi, guys. Good morning.

John Morikis (President & CEO):

Good morning, Ghansham.

Ghansham Panjabi (Analyst - Robert W. Baird & Company, Inc.):

In recent quarters, you called out some of the non-architectural end markets within PSG as being challenged. Just curious how these markets performed during the first quarter. Just trying to understand why there was such a meaningful acceleration in Q1 sales trends in the Paint Stores Group segment.

John Morikis (President & CEO):

So, we have spoken about the commercial side, that we feel pretty good about that Ghansham. The area that we have spoken of having some pressure would be the protective and Marine business, particularly in the protective side here if you breakdown the areas that are impacted by the oil and gas, that's probably had the most significant impact. We have seen other areas that we've increased our focus on started to pay greater dividend, and we're excited about the results we are experiencing as a result of the actions we are taking.

Ghansham Panjabi (Analyst - Robert W. Baird & Company, Inc.):

Okay. Then in terms of full-year sales guidance, why not raise that higher given your big first quarter and also strong sales guidance for the second quarter, particularly with FX easing as the year progresses? Are you expecting any sort of moderation during the year in PSG?

Sean Hennessy (CFO):

No. I think what we expect is the Paint Stores Group will continue to lead the sales gains for us. I think second quarter is going to be in the same situation we will see the Paint Stores Group. I think the first quarter, many years we don't even change the guidance after the first quarter, because it is the smallest quarter. We did raise the EPS. I think we will review it at the end of the second quarter.

I think this year, if you remember, I think Consumer had a very nice first quarter, finalized the load-in, anniversing the load-in of the HGTV program. And I think we've got that sort of a headwind a little bit in the second quarter, typically about the second quarter. But make no mistake about it, I think the Paint Stores Group is, as John said in his comments, the Paint Stores Group will lead us in the sales gains each and every quarter.

John Morikis (President & CEO):

I would say the customer base that we enjoy relationships with inside that store's organization are feeling pretty bullish about the outlook this year.

Ghansham Panjabi (Analyst - Robert W. Baird & Company, Inc.):

Perfect. Thanks so much, guys.

Bob Wells (SVP, Corporate Communications):

Thank you, Ghansham.

Operator:

Chris Parkinson.

Chris Parkinson (Analyst - Credit Suisse):

Thank you. Obviously it appears the spring season is already off to a solid start on reconstruction R&R, but can you also comment on the competitive environment in the big boxes, and also any preliminary expectation for Infinity?

John Morikis (President & CEO):

The big box environment is always competitive. We expect our role there is to continue to add value to all of the customers that we serve, and our job is to make sure we are aligned with their goals and driving customers into their stores.

Regarding Infinity, it's our practice to let our customers speak to what their expectations are. We have very high hopes. It's a really terrific, quality product in that can, and our expectation would be that it's going to be very strong, but we don't want to get ahead of our customers.

Chris Parkinson (Analyst - Credit Suisse):

Perfect. Thank you. And a quick follow-up. Obviously, it's still early, but do you have any new color on the Valspar approval timeline now that the process has begun? Any reminder there would be appreciated. Thank you.

John Morikis (President & CEO):

We've begun the review process. When we announced the acquisition, we committed to provide you with updates and if we have material news. We really have no material news to update right now. I think it's only fair to say that our thoughts are when there is a material update that we will provide that, but giving it day-by-day or play-by-play would be a bit much. Our thoughts are to keep you up to speed with material actions

Chris Parkinson (Analyst - Credit Suisse):

That's appreciated. Thank you, very much.

Bob Wells (SVP, Corporate Communications):

Thank you Chris.

Operator:

Bob Koort

Bob Koort (Analyst - Goldman Sachs):

Thanks, very much. I was wondering if you could talk a little bit about the gross margin. You mentioned incrementals as they flow through the P&L statement, but the gross margin, in particular, is pretty fantastic. What should we expect as you go through the rest of the year there?

Sean Hennessy (CFO):

Bob, this is Sean. I probably should have said that last time I answered, but this is Sean. And when you take a look at how our gross margin was last year, and if you look at the second, third and fourth quarter, how strong it was. If you think about the way the raw materials were moving last year, we felt that at the beginning of the year was really where we were going to have to make most of our improvement in the gross profit of sales in the improvement.

Last year, we were at 46% in the first quarter, we jump all the way to 48.8% and then we go to 49% and then over 50% the last three quarters. We feel good about where our gross margin is. We think the raw goodness will continue to shrink, and we are going to hit a line somewhere later in this year where we expect it will be negligible.

We felt that we had to have this kind of an improvement in the first quarter to have improvement throughout the year, and we feel good about where we are with the gross profit.

Bob Koort (Analyst - Goldman Sachs):

And then, maybe related to that, last year you talked about in some of the contractor bids there was a little pressure, but you have articulated today some building momentum in those markets, as well. Can you characterize how the pricing dynamic is in the professional painter market at the moment?

John Morikis (President & CEO):

I'd say it's very similar to what we've always expressed and experienced. We have spoken about those larger projects that typically go to bid and are a little bit more aggressive in pricing, but outside of that, I'd say it's always a competitive market, and it continues to be. We continue to try to differentiate ourselves, not only with the quality of the product, but with the services we provide.

We expect that our competition will be out there, and we have to earn every gallon that we sell.

Bob Koort (Analyst - Goldman Sachs):

Thanks, John.

Bob Wells (SVP, Corporate Communications):

Thank you, Bob.

Operator:

Duffy Fischer, Barclays.

Duffy Fischer (Analyst - Barclays Capital):

Good morning, fellows.

Bob Wells (SVP, Corporate Communications):

Good morning, Duffy.

Duffy Fischer (Analyst - Barclays Capital):

Question around raw materials. Could you split them out a little bit? Talk about the organic and inorganic side. Obviously with oil moving higher, has there been a material change in how you're thinking about raw materials throughout the rest of the year?

Sean Hennessy (CFO):

You know on the petroleum-based side, we primarily price off of propylene and chemical grade propylene has averaged around $0.30 a pound for a while now. Barring no major outages in propylene or monomer production, we anticipate a relatively flat polymer pricing market over the balance of the year, probably.

On the titanium dioxide side of the equation, we said on our year-end call that we saw prices kind of flattening, but we didn't see a lot of pressure in supply/demand balance. Those fundamentals have pretty much played out as we expected.

There is obviously a December price increase announcement that we think may be gaining some traction among smaller customers. Another price increase announcement has been stacked on top of that.

We do believe that it's going to take tight market conditions, or tighter market conditions, for those price increases to gain significant traction, but I think it's safe to assume that we're not going to see further declines in TiO2.

Duffy Fischer (Analyst - Barclays Capital):

Great. Thanks. And then just on the back of that, if, let's say oil moves a little higher, and you get a little pressure on raw materials. Philosophically, as we get into next year, would you guys be able to go out with price increases if raw materials were moving higher?

John Morikis (President & CEO):

You know, Duffy, our practice has always been to talk to our customers first, so if we do that, we will talk to you about it after we've shared that with our customers. I think the band, that gross margin chart we often talk to, that demonstrates our ability to operate in that band, is where I would point you.

In areas, or times, where we've had significant pressure, we've been out with price increases, and I think it also demonstrates the discipline we have when there haven't been raw material increases for us not to go out with price increases.

Our first effort is to mitigate or drive more efficiency and drive down the cost any way we can to avoid having to put price increases in, but if we find ourselves in that situation we have also demonstrated our ability to put those effective price increases into the market.

Duffy Fischer (Analyst - Barclays Capital):

Great. Thanks, fellows

Bob Wells (SVP, Corporate Communications):

Thank you Duffy.

Operator:

Vincent Andrews.

Vincent Andrews (Analyst - Morgan Stanley):

Thanks, very much. Good morning, everyone. Just a question on weather. If you look at the last four quarters, particularly the first three, we had some challenges, and then Q4 last year it was helpful. This quarter, this first quarter, seemed to be, the feedback we got was somewhat mixed. Against all that sequential roller coastering, where do you think things are now? Do you think the quarter and the performance in the Paint Stores Group is really reflective of state-of-the-art instant demand, or do you think we're still making up lost gallons from last year, or is there any risk we pulled some forward from later this year?

John Morikis (President & CEO):

I think demand in our stores clearly improved from fourth-quarter to first-quarter. How much, if any, of that was due to the mild weather in the first quarter is really very difficult to determine.

I would say this, that we are very encouraged about the comments we are getting from our customers. They are very bullish about the paint season, as I mentioned in my comments. The discussions we're having with them, they are feeling very good about the market. And that keeps us very excited and focused on growing with them, so it's hard to say how much, if any, but most importantly, their outlook for the year is very positive.

Vincent Andrews (Analyst - Morgan Stanley):

And just as a follow-up, the guidance you gave at Q4 presumably included some share repurchases. Is that correct, and if so, could you quantify how much you think you took out in the new guidance?

Sean Hennessy (CFO):

I will just tell you that at the beginning of the year we did have share repurchase.

I'll go back to some of the comments John made in his comments. Our plan has changed. Our plan is to accumulate cash. In prior years, we always utilized that cash. Our plan was to utilize 100% of the cash, and if you think about what we're trying to do with the acquisition and acquire and accumulate cash for that closing of the Valspar deal, it implies very little cash is going to be used towards buybacks. Versus you probably were looking that we were looking at spending another $700 million, $800 million, $900 million on stock.

It probably was significant. You can pick what you think the average purchase price would have been for the year.

Vincent Andrews (Analyst - Morgan Stanley):

Okay. We will do that. Thanks, very much. I appreciate it.

Operator:

Don Carson, Susquehanna Financial.

Don Carson (Analyst - Susquehanna Financial Group / SIG):

Yes, thank you. John, just want to go back to your views on the architectural paint market. Last year, we had subpar growth, about 2%, 2.5%. As you look at what your customers are telling you, what kind of gallonage growth do you see for the rest of this year?

And given that outlook, I'm wondering why you only have low to mid single-digit sales growth expectations for Q2. I know you are running some tougher Consumer Group comps, but it would seem especially with the weather snap back in Q2 that PSG should have a very strong performance.

Sean Hennessy (CFO):

This is Sean, and I'll let John talk about the market in total. I go back to some of the comments I made earlier about the guidance. I think when you look at the second quarter, we've got other things moving. Currency is still going to be a little bit of a headwind. We're going to finally have 100% of the load-in from the HGTV program completed.

We want to make sure you know that the store group will be the driver in the second quarter just like it has been for the last many quarters.

John Morikis (President & CEO):

Don, just so I make sure I get your question right, were you referencing first quarter or second quarter?

Don Carson (Analyst - Susquehanna Financial Group / SIG):

I was referencing second quarter, just low to mid single-digits revenue growth, but wanted to also get your comments on your outlook for the industry architecture for the year as a whole. We had subpar growth last year. What kind of growth are you seeing this year?

John Morikis (President & CEO):

Right. We don't forecast those gallons, specifically, but I would tell you that in speaking with many of our customers around the country, there's a general sense of confidence and bullishness that is very exciting to us. Many of them are looking at the book of business they have and are excited about the outlook for the year.

So we're going to be very responsive to them and try to ensure we are the benefactors of that, but our customers are feeling very good. Very good.

Don Carson (Analyst - Susquehanna Financial Group / SIG):

Okay. Thank you.

Bob Wells (SVP, Corporate Communications):

Thanks, Don.

Operator:

Arun Viswanathan

Arun Viswanathan (Analyst - RBC Capital Markets):

Hello. Good morning.

Bob Wells (SVP, Corporate Communications):

Good morning, Arun.

Arun Viswanathan (Analyst - RBC Capital Markets):

Hi. I guess I just wanted to ask that question again. Very impressive same-store sales growth in the first quarter. Do you think the industry, you guys have been comping 1.5 times to 2 times the industry, so would you say the industry was up 5% or 6% in the quarter, or was there something specific that drove you guys well above the industry? And do you expect your numbers to continue in that range?

Bob Wells (SVP, Corporate Communications):

You know, Arun, this is Bob. When we estimate industry volume, we typically do so, in part, by listening to the reports of our publicly traded peers and along with our volume growth, and triangulating to get what we estimate to be the market growth.

For one quarter, for first quarter, it's a little too early to tell, because we haven't seen enough market data, yet, how much the market grew in the first quarter. Going forward, our expectations are based not on any macro assumption for market growth, but as John indicated, on the feedback that we're getting from our contractor customers on their order book volume.

John Morikis (President & CEO):

We're working very closely with them on the projects they are looking at and estimating and many of them have already booked and they are feeling, as I said, very positive about the year.

Bob Wells (SVP, Corporate Communications):

It appears that industry growth accelerated in the first quarter. Ours certainly did, but it's a little too early to make a call on the industry at this point.

Arun Viswanathan (Analyst - RBC Capital Markets):

Okay, great. Maybe you can also just give us an update. Are you seeing the price increases in TiO2? I know you described it's safe to assume that prices aren't going to go any lower, but why are the producers actually having any success with increases if supply/demand is still in your favor? Thanks.

Bob Wells (SVP, Corporate Communications):

I think the simple answer to that is because they may be getting some price increases justified solely on the poor financial health of the industry. We do not believe the supply/demand fundamentals support the increases that are in the market today. At the very least, I think it's safe to say that the increases in the market, the announcements that the producers have made have stopped the downward trajectory in TiO2 pricing.

We said a few quarters ago that it felt like TiO2 was approaching a bottom, and clearly there is a bottom in the market, and we think we are there. We would expect flat pricing as probably the best case scenario, and whether these price increases gain traction as we go forward, time will tell.

Our TiO2 costs are still down significantly year-over-year because of the downward trajectory of the course of 2015.

Arun Viswanathan (Analyst - RBC Capital Markets):

Great, thanks. And if I could, just one more. On the non-paint sales in your paint stores, could you just describe what you're seeing there on sprayer equipment and so on? Thanks.

John Morikis (President & CEO):

Very positive numbers. In spray equipment, ladders, applicators, caulk, across the line we're having a very good performance. Gives us confidence about the future.

Bob Wells (SVP, Corporate Communications):

Thanks, Arun.

Operator:

PJ Juvekar, Citi

PJ Juvekar (Analyst - Citigroup):

Yes. Good morning.

Bob Wells (SVP, Corporate Communications):

Good morning, PJ.

PJ Juvekar (Analyst - Citigroup):

John, you mentioned the contractor order book is quite strong. Is that driven by residential business with remodel, or is it more driven by commercial side of things

John Morikis (President & CEO):

I'm sorry, PJ. I thought you were done.

PJ Juvekar (Analyst - Citigroup):

Can you drill down a little bit on the commercial and industrial side? Thank you.

John Morikis (President & CEO):

Yes. I would say it's on both sides of the business, both residential and non-res. The confidence in our contractors and the discussions that we have going with them are very positive on both sides.

Bob Wells (SVP, Corporate Communications):

And just as a reminder from previous calls, while it certainly appears that non-residential starts are slowing in late 2015 and early 2016, our business tracks more closely with project completion, so we are painting projects that were started more than a year ago, and the pace of starts in 2014 and the first half of 2015 were very healthy, and those are the projects we're on now. And looking forward, if you believe the Dodge forecast, non-res starts should be healthy this year and for the next couple of years.

PJ Juvekar (Analyst - Citigroup):

Okay, thank you. That's helpful. And a quick question for Sean. Sean, you always said that your costs tend to lag oil prices by two to three quarters, so with this recent moving oil price, do you expect later in the year that you'll begin to see your costs begin to inch up? Thank you.

Sean Hennessy (CFO):

I think that was what I was trying to imply when the question came up about the gross profit, the incremental profit in the first quarter versus the remainder of the year.

Again, gross margins in the first quarter was benefited from paint volume in our North American supply chain and the mix toward Paint Stores Group. The raw material deflation was a material factor, and we think that material factor will continue to diminish as we go throughout the year, and I think the basket in total, which oil is part of.

Bob Wells (SVP, Corporate Communications):

Thanks, PJ.

PJ Juvekar (Analyst - Citigroup):

Thank you.

Operator:

Mike Harrison.

Mike Harrison (Analyst - Seaport Global Securities):

Hi. Good morning.

Bob Wells (SVP, Corporate Communications):

Good morning, Mike.

Mike Harrison (Analyst - Seaport Global Securities):

I was curious if you could comment on what impact the timing of the Easter holiday may have had on your sales. Presumably that would have been a drag year-on-year on contractor sales, but maybe a positive for DIY?

Sean Hennessy (CFO):

I think that's a pretty good thought. The DIY was probably strengthened by the change from the second quarter to the first quarter, and the contractor and that period we had a couple of days where it was probably depressed because of Easter holiday.

Mike Harrison (Analyst - Seaport Global Securities):

I was also wondering if you could comment on the efforts that you are making at Lowe's to get the paint department employees a little more familiar with the HGTV Home product line? Can you maybe give a little bit of detail on what your expectations for underlying volume growth will be adjusted for the load-in that we are lapping here?

John Morikis (President & CEO):

I can certainly talk about our efforts there in Lowe's. We are choosing not to talk about the gallons or forecast for our customer. I think it's only appropriate that we let them speak to those expectations, but that said, our efforts are, I think, right on track.

We have continued to work on training the Lowe's associates and making them familiar with our products. We had a terrific opportunity with the introduction of the Infinity product that you mentioned to get some of the product out into the hands of the Lowe's associates, applying some of it and making them familiar with the product.

The process of training them on our entire product line, as well as colors, continues and we're feeling pretty good about the momentum we have there. Our goal is clearly to, and has always been, focus on driving customers into all of our customers and you're asking specifically about Lowe's. Our goal is to drive customers into that department, make sure the employees there are very familiar with every aspect of our product and our color systems, and we think we're well on our way.

Mike Harrison (Analyst - Seaport Global Securities):

Thanks, very much.

Bob Wells (SVP, Corporate Communications):

Thank you, Mike.

Operator:

Nils Wallin, CLSA.

Nils Wallin (Analyst - CLSA Americas, LLC):

Good morning. Thanks for taking my question. I'm curious about Consumer. I know there has been some moving parts in there besides Lowe's in the past, but when you break out Lowe's and the load-in and the new products, is there a reason that is not seeing any sort of organic growth?

John Morikis (President & CEO):

We actually are experiencing organic growth. In Consumer, we had January and February sales this year with no history from Lowe's. As I mentioned in my opening comments, we are experiencing good traction in many segments within that business unit, so we're actually feeling very good about the momentum that business unit has.

Bob Wells (SVP, Corporate Communications):

The entire national account category is doing very well, and John also mentioned industrial and MRO customers are up year-over-year.

Nils Wallin (Analyst - CLSA Americas, LLC):

Got it. Thanks. And then in your 9%, or so, same-store sales in Paint Stores Group, how much of that was the new SKUs being pushed through the legacy Comex stores?

Sean Hennessy (CFO):

We feel very good about those stores, and what we have said is we believe we're going to have 100% of our purchase price cash and all of it will be cash neutral. And actually, I think we're going to beat the third quarter.

We've always said that in the third year anniversary, which would have been this September, we're going to have 100% of our cash back. We're probably going to be quicker because those stores are doing very well. Now they are fully integrated, and it's hard for us to breakout results Comex stores and non-Comex stores, but when we look at the markets they are in, they are doing well.

John Morikis (President & CEO):

I would add to that, though, I think getting specifically to your question. Bringing those high-end products into those stores has been a definite win to those stores in the market and our customers. In many cases, the portfolio of products they were offering through many of those Comex stores were more focused on the new residential side, less on the DIY side, so to your point, as we introduce residential repaint and DIY customers into those stores at the higher end band of our product line, it certainly helping us, as Sean discussed.

Bob Wells (SVP, Corporate Communications):

And one final point on that, Nils. Keep in mind when you're asking the impact on comps, you're talking about roughly 275 stores on a base of 4100, so it's not really that significant.

Nils Wallin (Analyst - CLSA Americas, LLC):

Fair point. Thanks. I'll pass it along.

Operator:

Dmitry Silversteyn.

Dmitry Silversteyn (Analyst - Longbow Research):

Morning, guys, and congratulations on a solid start to the year.

Bob Wells (SVP, Corporate Communications):

Thank you, Dmitry.

Dmitry Silversteyn (Analyst - Longbow Research):

A couple questions that I want to follow up on. First of all, when you talk about your Latin America business, and obviously it's challenged by all kinds of things, but I'm interested in which raw material pricing has been going up on you that impacted margins.

And also, what is your outlook like for the volume performance of that business? It's been comping down volume for a couple of quarters now. Is it industry related, or are you de-emphasizing growth in that market? What's going on with the volumes there as well as raw material costs?

John Morikis (President & CEO):

I'd like to just talk about the de-emphasizing growth question, and then I'll turn it over to Sean. The answer is no. We are not ever de-emphasizing growth.

There are some things, to your point, in the market that we can't control, and there are a lot of things that we can control, and we're working very hard on those things that we can control to better position ourselves in the market. I'll turn it over to Sean to answer the rest of your questions.

Sean Hennessy (CFO):

One of the parts you asked about, the raw material cost, and the cost that's still going up in Latin America. It's 100% currency, and I'll tell you why. The Global Finishes Group is doing a great job looking for efficiencies, and we're doing fine there on the conversion cost, but Latin America buys the majority of its raw material in US currency and dollar-denominated, and when you look at it, the currency devaluation has the same effect on raw materials as inflation. So the raw materials really are negatively affected by the currency.

When you ask about in total, what are you thinking about on the conditions down there. We don't expect to see improved economic conditions in the region in 2016. I think we've been consistent with this for a long time.

We think that applies to currency and buy-in demand. We're starting to see currencies change a little positively. The Brazilian real went from 410, and we thought it could get close to 425. Now it's down in the 350, 360, but in US dollars are very close to the breakeven levels. So our plan for 2016 calls for the segment to report a profit, but a loss is not outside the realm of possibilities, and there's a risk of negative results for one or two more quarters just like the first quarter.

Dmitry Silversteyn (Analyst - Longbow Research):

Got you. That's helpful, Sean.

Switching quickly to Stores Group. Since you've increased your Canadian exposure there, there's been a little bit of a foreign exchange headwind there. Can you talk about what the magnitude of that was in the first quarter?

Sean Hennessy (CFO):

I can tell you exactly. Just give me a second, Dmitry. I thought I had it right here. It was very small. Just over $4 million, 3/10 of a percent of sales, so we're pretty happy the way Canada is going. Bob, in his remarks, so Canada is coming on for us pretty good.

John Morikis (President & CEO):

We have a good team up there dedicated on Canada, Western Canada, with the influx of the acquisition of General has given us a new platform up there. A lot of competition up there, as well, but we're working hard and earning our space there.

Dmitry Silversteyn (Analyst - Longbow Research):

Thank you, very much. That's all the questions I had.

Bob Wells (SVP, Corporate Communications):

Thank you, Dmitry.

Operator:

Chuck Cerankosky.

Chuck Cerankosky (Analyst - Northcoast Research):

Good morning, everyone. Great quarter.

Bob Wells (SVP, Corporate Communications):

Thank you, Chuck.

Chuck Cerankosky (Analyst - Northcoast Research):

I'd like to revisit the Paint Stores Group performance of that 9% comps growth. Any help in price per gallon there either from a few price increases getting through or average price per gallon sold improving maybe because the industrial is getting stronger?

Sean Hennessy (CFO):

You know, Chuck, when you look at it just to let you know, we haven't really had a price increase in Paint Stores Group since 2014. Price did not help us at all. The deterioration of what was happening to us last year because of the protective, Marine, John's comments earlier, told you we didn't have as much of a headwind there, but it was just solid volume growth there.

Chuck Cerankosky (Analyst - Northcoast Research):

All right. Do you think any of that is market share growth? Could the market have been growing that strongly?

Sean Hennessy (CFO):

We believe, if you take a look at it, I think we will know later in the year. Bob mentioned when some of the other public companies, we look at their results, but we feel pretty good about the way that Paint Stores Group has developed with the products, the distribution and people, we feel pretty good that we are taking market share.

John Morikis (President & CEO):

There are some pretty good programs, Chuck, that we are executing on very well, and I have to hand it to our leadership team there, as well as the team in the field. They are doing a terrific job of by market finding those customers that offer opportunity and really earning their business.

We are proud of that team and expect it's going to continue. That momentum will continue.

Chuck Cerankosky (Analyst - Northcoast Research):

John, are you speaking of the field reps? Is that reflected in the somewhat higher SG&A spending I think Sean mentioned earlier?

John Morikis (President & CEO):

Well, we do have some stores that have annualized and reps, so we are investing in there, because we feel very good about the momentum we have, so I'm speaking to the new reps and new stores, but it's a big base. We have a lot of stores and sales reps that have been out there for some time, and they are really embracing the new programs and initiatives we have to grow market share, as well as introducing new products to customers who are responding favorably.

Chuck Cerankosky (Analyst - Northcoast Research):

All right. Thank you. Best of luck for the rest of the year.

Bob Wells (SVP, Corporate Communications):

Thanks, Chuck.

Operator:

Ivan Marcuse

Ivan Marcuse (Analyst - KeyBanc Capital Markets):

Hi. Thanks for taking it. Real quick, what were the gross profit changes in the segments?

Sean Hennessy (CFO):

Hang on a second, I've got it right here. Paint Stores Group was up $122 million. Consumer was up $15 million. Global Finishes was up $5.2 million, and Latin America was actually negative $12.7 million.

Ivan Marcuse (Analyst - KeyBanc Capital Markets):

Great. Thanks. And then environmental costs were bumped up. Is there anything special in there, or is it just the timing of how these things flow through.

Sean Hennessy (CFO):

Actually, we had an accrual for the Passaic River. It was specifically the Passaic River. There were negotiations going on between the EPA and the consortium of companies that will be involved in the cleanup.

We are very, very small piece, and there was a major change in what the cleanup on the Passaic River is going to be, so even though we are a less than 5% player in this Passaic River, all of a sudden, we had to increase our accrual by $17 million, so you can imagine the total cost went up dramatically. So the plan is now in place, and we will start doing it, and we believe we have the majority of the expense for the Passaic River now covered.

Ivan Marcuse (Analyst - KeyBanc Capital Markets):

And you might have said this in the beginning of the call and I missed it, and I apologize if I did. Interest expense. Are you planning on issuing any debt before Valspar closes, and do you expect interest expense to maintain where it is right now, or how would you expect that to go up and down?

Sean Hennessy (CFO):

Right. I think we do not plan on issuing debt before the close. We've put our bridge in place. We've put a term loan in place, so our acquisition financing is in place. The first quarter, you see the expense was really more involved with the bridge financing, but the second quarter and beyond, we're going to have the term loan in there, also, so that's why acquisition financing is in place.

What we have done is put some interest rate swaps, I mean Treasury rate locks on, so in the Q, you're going to see we've entered into a series of Treasury rate locks on a combined notion amount of $1.7 billion. We will go higher than that.

We have taken some of the interest rate change of risk off the table. And throughout the year, depending on the day, you will see us take some more off the table.

Ivan Marcuse (Analyst - KeyBanc Capital Markets):

Okay. Thank you.

Bob Wells (SVP, Corporate Communications):

Thanks Ivan.

Operator:

Rosemarie Morbelli.

Rosemarie Morbelli (Analyst - Gabelli & Company):

Good morning, everyone.

Bob Wells (SVP, Corporate Communications):

Good morning, Rosemarie.

Rosemarie Morbelli (Analyst - Gabelli & Company):

Sean, if I understood you properly, you have made up the gap in the gross margin in the first quarter. If we keep the following three quarters at a flat level with last year, than we should be higher for the full year. Is that, more or less, the trend you are expecting, or do you think the Q2 gross margin will still be above last year?

Sean Hennessy (CFO):

I think we should have slight positive, we will be positive in the second quarter. I think for the full year, your characterization of flat, we'll be in that area. I think after the second quarter, after we see some raw materials, I think we can give you a better picture on what we think the gross margin. We'll narrow it down, but I think your characterization of the full-year is probably pretty good.

Rosemarie Morbelli (Analyst - Gabelli & Company):

Okay, thanks. And you mentioned you were focusing on other areas outside of the oil and gas industry and were successful. Could you give us a better feel for what you are doing and where?

John Morikis (President & CEO):

I would just say we look at the industrial business regularly. We try to find those opportunities that offer us both the opportunity to move gallons but also bring solutions to our customers, and we've really identified some of those that we really have some unique technologies, that help provide solutions and getting assets back in service quicker, to provide protection against various ambient conditions, and we have good momentum.

Rosemary, I'd rather not get into any of the specifics of where they are. We'd rather just put the points on the scoreboard right now.

Rosemarie Morbelli (Analyst - Gabelli & Company):

Sure. And if you look at your existing customers in that category, and I'm thinking the Caterpillar type of companies, are you seeing an improvement there, or are we still in the doldrums?

John Morikis (President & CEO):

I would say our relationship with them is improving, with many of those heavy equipment. The business itself, I would say their outlook, I think they have spoken as to how their business is performing.

Rosemarie Morbelli (Analyst - Gabelli & Company):

All right, so no change. Thank you, very much.

Bob Wells (SVP, Corporate Communications):

Thanks Rosemarie.

Operator:

Scott Rednor.

Scott Rednor (Analyst - Zelman & Associates):

Hi. Good morning. Just real quick, any notable difference between your exterior gallons and interior gallons in the Stores Group this quarter?

Sean Hennessy (CFO):

We had a good interior and a very good exterior, so exterior was strong.

Scott Rednor (Analyst - Zelman & Associates):

So, Sean, within the guidance maybe just help us see that potentially that normalizes, how do you think about that? Is there still easy comparables through the balance of the year or is there some risk that some of that got pulled forward?

Sean Hennessy (CFO):

We've been talking a lot, and it's interesting. You go back to after last second quarter, last year, if you remember, because of the weather in the second quarter, and so forth. We saw a really nice top gain in the fourth quarter, and people talked about the weather there. This quarter, you've heard different customers say they had the opportunity to catch up, including builders. We're sort of interested in that situation. I think the second quarter will give us a complete vision of that.

John Morikis (President & CEO):

I would say, going back to the comments I made earlier, Scott. The take-away I have, the confidence I have revolves around the book of business that these customers are referencing as to going forward. So, to Sean's point, we may have had some that got pushed back. We may have had actually some that got pulled forward, but they are looking down the pipe and saying, it looks good.

Scott Rednor (Analyst - Zelman & Associates):

Great. Thanks, guys.

Bob Wells (SVP, Corporate Communications):

Thanks, Scott.

Operator:

Jay McCanless.

Jay McCanless (Analyst - Sterne Agee):

Good morning, everyone. Just one quick question With the flooding that we've seen in Houston and some of the heavier rains we continue to see in Texas, what impact have you seen from that, yet, and can you maybe quantify what Texas and that part of the world means for the Paint Stores Group?

John Morikis (President & CEO):

Well, it has impacted our business as we've had stores and customers impacted naturally. Texas is a good part of our business. We have good representation there and good distribution of stores. I don't know, right now, how to quantify that for the year.

There will be some slowdown in the near-term, and then there will be a pick up on the other side as repairs are done, so it's hard to say in a year how that will impact us. Obviously, in the very short-term, when you have stores close, Jay, the obvious, those stores being closed will impact it, but on the other side, we will pick up some business as repairs are done.

Jay McCanless (Analyst - Sterne Agee):

Got it. Okay. Great. Thank you.

Bob Wells (SVP, Corporate Communications):

Thanks, Jay.

Operator:

Greg Melich.

Greg Melich (Analyst - Evercore ISI):

Hi. Thanks. A couple questions. If you could update us on your guidance for raw materials. If I remember, at the beginning of the year, you thought for the full-year the industry would be down, do you think that's still the case, and have you changed that at all as part of your updated guidance? And I have a follow-up.

Bob Wells (SVP, Corporate Communications):

Greg, this is Bob. We have not changed our outlook for raw materials. As a reminder, to put a finer point on it, we expected raw materials for the full year to be down low, mid single digits, so less than 5%, but in the mid-single-digit range. That's for the full year. Q1 was at the high-end of the mid-single-digit range, because we're annualizing full-year declines from 2015, so actually most of the savings year-over-year are already locked in based on the history that we're going up against last year. We think the price of many of the raw materials that we have used have stabilized, and so the benefit will diminish as we go through the year, but the benefit is already locked.

Greg Melich (Analyst - Evercore ISI):

Got it. And then two other questions. One on Global Finishes and a little bit of housekeeping. Remind me how you do (inaudible). Is that in the comp, not in the comp? Is it in the total sales? And then Global Finishes, I know you took some great costs out there, but how much longer can sales not grow and profits grow?

Sean Hennessy (CFO):

First of all, no, the comp stores are the Paint Stores Group. We don't report any type of comp metric for the Global Finishes Group. I think, again, we feel very good about operationally, what we're doing there.

I think what helps there, and it goes back to John's comments. If you compare it to the Latin America group, our volume has been good. When you look at the total, the volume has been good, and so when we get volume, we get the opportunity to basically increase that margin.

I would say it's not going to be, we definitely talked about over the years, we need some more market share in the Global Finishes Group to really get it kicked and going, but because of the volume gains, they have been able to get margin improvement.

Greg Melich (Analyst - Evercore ISI):

So basically, FX took sales down a little bit, but you had some sales growth, and that was enough to get that nice margin expansion?

Sean Hennessy (CFO):

Yes.

Greg Melich (Analyst - Evercore ISI):

And just to be clear, was there an extra day in the quarter because of February 29?

Sean Hennessy (CFO):

You know, when you put everything together, February 29 was there, but we also had Easter, and going back, there was an extra day, but Good Friday, just because of the way things are never that week, that Friday is never the same as a normal Friday.

Moving that Good Friday into the first quarter here is why I answered the question earlier. Yes, we got a day, but it just felt like it was negated by the Easter move.

Greg Melich (Analyst - Evercore ISI):

I got it. Thanks, a lot. Great job

Bob Wells (SVP, Corporate Communications):

Thank you, Greg.

Operator:

John Roberts.

John Roberts (Analyst - UBS):

Thank you. I have a longer-term question. The Valspar SEC filing indicated there was a second company that whoever acquired Valspar might also be interested in acquiring the other company, as well, but it indicated Sherwin-Williams wouldn't be able to acquire the other company. Would that simply be size, or do you think maybe after you pay down some debt from the Valspar deal, you might have an opportunity to do another significant transaction?

John Morikis (President & CEO):

First, we don't know who that company was, and that's not something we would want to comment on without having that information, John.

John Roberts (Analyst - UBS):

Okay. I was fishing, obviously, since it's out there.

John Morikis (President & CEO):

Thanks for your honesty.

John Roberts (Analyst - UBS):

Thank you. Good quarter, guys.

Bob Wells (SVP, Corporate Communications):

Thank you, John.

Operator:

Thank you. It appears we have no further questions at this time, so I'd like to give the floor back over to Mr. Wells for any additional concluding comments.

Bob Wells (SVP, Corporate Communications):

Thank you, Operator.

Let me close with two items. The first being we are frequently asked actual diluted share count outstanding on December 31, I'm sorry on March 31. It was 92,495,113 for those of you who are still on the line.

The second item is a reminder that our annual financial community presentation is scheduled for Thursday May 26. It's at our headquarters in Cleveland. The program will consist of our customary morning presentation with a question-and-answer session followed by a reception and lunch with company management.

In the afternoon, we are going to head down to our green technology center, which is home to Sherwin-Williams global architectural paint research and development where we'll have a showcase for many of our latest technologies in both architectural and industrial products.

If you have not yet signed up and would like to attend, registration is still open. Please send me an email at RJWells@Sherwin.com, and I will reply with a link to our registration site.

As always, I'll be available over the next few days to handle any follow-up questions that arise as you digest this morning's call. I'd like to thank you again for joining us today, and thanks for your continued interest in Sherwin-Williams .

Operator:

Thank you. Ladies and gentlemen, this does conclude today's public conference.