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PRESENTATION

Operator

Good morning, and welcome to the RPM International's Fiscal 2023 Second Quarter Earnings Conference Call.

(Operator Instructions)

And please note that this event is being recorded. I would now like to turn the conference over to Matt Schlarb, Senior Director of Investor Relations. Please go ahead.

Matt Schlarb

Thank you, Cole, and welcome to RPM International's conference call for the fiscal 2023 2nd quarter. Today's call is being recorded. Joining today's call are Frank Sullivan, RPM's Chairman and CEO; Rusty Gordon, Vice President and Chief Financial Officer; and Mike Laroche, Vice President, Controller and Chief Accounting Officer. This call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com.

Comments made on this call may include forward-looking statements based on current expectations that involve risks and uncertainties, which could cause actual results to be materially different. For more information on these risks and uncertainties, please visit RPM's reports filed with the SEC.

During this conference call, references may be made to non-GAAP financial measures. To assist you in understanding these non-GAAP terms, RPM has posted reconciliations to the most directly comparable GAAP financial measures on the RPM website. Also, please note that our comments will be on an as-adjusted basis and all comparisons are to the second quarter of fiscal 2022, unless otherwise indicated.

We have provided a supplemental slide presentation to support our comments on this call. It can be accessed in the Presentations and Webcasts section of the RPM website at www.rpminc.com. At this time, I would like to turn the call over to Frank.

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

Thanks, Matt. I'll begin today's call by sharing commentary on our consolidated performance for the second quarter. Mike will provide details on our financial results, and then I'll turn the call back over to Matt to provide some business updates. And then finally, Rusty Gordon will conclude our prepared remarks with our outlook for Q3.

After our prepared remarks, we'll be pleased to answer your questions. In the second quarter, we continued to build on recent momentum to deliver both record second quarter sales and adjusted EBIT. This represents the tenth consecutive quarter of record revenue and four consecutive quarters of record adjusted EBIT, an impressive accomplishment in today's uncertain economic and volatile climate.

An important factor in achieving these results is our MAP 2025 operating improvement program. Across RPM, associates have embraced MAP '25 principles of collaboration and efficiency to successfully implement initiatives and help drive top and bottom line growth and performance. MAP 2025, which officially began at the beginning of this fiscal year, is off to a strong start. And we are on track to meet or exceed our first year EBIT target improvement of $120 million from MAP initiatives.

This hard work was evident in our second quarter results where we achieved strong revenue growth as well as significant adjusted EBIT margin improvement. Importantly, we achieved these positive results despite meaningful macroeconomic headwinds, including intensifying weakness in Europe, FX headwinds and a slowdown in some of our end markets.

Turning to the next slide. Revenue growth was broad-based with all 4 of our segments achieving record second quarter sales. This was accomplished primarily through the implementation of pricing increases in response to continued inflation. We also generated volume growth in several of our businesses that benefited from continued reshoring and infrastructure spending as well as from improved material availability.

Importantly, we not only generated strong sales growth but also expanded margins to achieve record second quarter adjusted EBIT on a consolidated basis at 3 of our 4 segments. This was driven by the successful execution of margin enhancement initiatives across the organization.

The one outlier segment that did not achieve record second quarter adjusted EBIT was the Construction Products Group, which was most acutely impacted by macroeconomic headwinds because of its relatively outsized exposure to Europe and to new residential home construction in North America. Looking at sales by geography on the next slide, Europe is clearly the laggard among the regions we serve with sales down nearly 12% for RPM and unit volume down even at a greater rate.

This was driven by weak macroeconomic conditions, including persistently high inflation. Additionally, FX weighed heavily on our results in Europe. FX translation also negatively impacted our sales in emerging markets, so we still achieved healthy growth in these regions, thanks to the hard work of our associates to align our businesses and products with growing end markets and to successfully increase prices in response to cost inflation.

Demand in North America remained strong through the second quarter with growth in all of our segments. Growth in the region was fueled by price increases in response to continued inflation and strengthen our businesses to serve customers who are reshoring manufacturing to the U.S. and it serve infrastructure-related activities.

Better material availability also contributed to organic growth in a number of our businesses in the quarter. I'll now turn the call over to Mike Laroche to discuss our consolidated and segment financial results in more detail.

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

Thanks, Frank. Sales increased 13.4%, excluding FX, which was at 4.1% headwind. The result was a 9.3% increase in reported sales to a second quarter record of $1.79 billion compared to $1.64 billion in the prior year period. Organic sales growth was 12.4% or $204.1 million, and acquisitions contributed 1% to sales or $15.7 million.

As mentioned, FX decreased sales by 4.1% for $67.6 million. Our consolidated adjusted EBIT increased 36.4% to a second quarter record of $214.7 million compared to $157.3 million reported in the prior year period. Second quarter adjusted EBIT margins expanded 240 basis points compared to the prior year period.

We achieved this expansion despite significant foreign currency translation headwinds and continued cost inflation. Adjusted diluted earnings per share were a second quarter record at $1.10, representing an increase of 39.2% compared to the $0.79 in the prior year period.

Turning to the next slide. Our Construction Products Group generated second quarter record net sales of $634.1 million, an increase of 3.2% compared to the prior year period. Organic sales growth was 6.9%, with acquisitions contributing 1.5% and foreign currency translation reducing sales by 5.2%. Sales growth was driven by the restoration systems for commercial roofing, facades and parking structures.

Admixtures and repair products for concrete continued to gain share during the quarter. Price management in response to continued cost inflation also contributed to CPG's revenue growth. Partially offsetting this growth, demand was weak in Europe and in new residential home construction, both areas where CPG has a higher exposure than the RPM average.

Demand in these 2 areas was particularly weak at the end of the second quarter. These headwinds, along with the negative impact from FX, unfavorable mix, and reduced fixed cost leverage at plants, including the Corsicana, Texas facility that was acquired in fiscal 2022 second quarter, resulted in adjusted EBIT declining 12% to $80.4 million.

As a reminder, unadjusted EBIT declined 40% in the quarter versus the prior year period. That was primarily due to a $41.9 million gain from the sale of real estate assets in Q2 2022 that did not recur this quarter. This gain was excluded from adjusted EBIT in Q2 2022. As you can see on the next slide, the Performance Coatings Group achieved record fiscal second quarter net sales with revenue of $335.2 million, an increase of 10.8% compared to the second quarter of fiscal 2022.

Organic sales increased 15.4%, acquisitions added 0.6% and foreign currency translation was a 5.2% headwind. Flooring systems, protective coatings and FRP grading all generated double-digit revenue growth. Manufacturing customers fueled the increase, including demand from those who are reshoring their production to the U.S. such as pharmaceuticals, food and beverage, EV manufacturing and electronics companies.

Good demand in energy markets and price increases in response to continued inflation also contributed to the growth. Adjusted EBIT increased 16.6% to a second quarter record of $46.2 million. The growth was driven by positive volumes and price increases. Partially offsetting these positive factors, foreign exchange translation was a headwind to adjusted EBIT.

Turning to the next slide. The Specialty Products Group reported record second quarter sales of $212.1 million, an increase of 9.5% compared to the prior year period. Organic sales increased 11.5%, acquisitions added 0.9%, and foreign currency translation was a headwind of 2.9%. Second quarter sales were led by strength in the food coating and the additives business as a result of strategically refocusing sales management and selling efforts.

In the disaster restoration business, the response of Hurricane Ian contributed to strong sales growth and its ability to quickly meet increasing demand was aided by prior operational improvement investments. Price increases in response to continued inflation also contributed to the sales growth. SPG generated record second quarter adjusted EBIT of $30 million or an increase of 43.2% compared to adjusted EBIT of $20.9 million in the prior year period.

The increase was driven by strong sales growth and benefits from MAP 2025 initiatives. Moving to the following slide. The Consumer Group grew sales 15.3% to $610.4 million, which is a record for the second quarter. Organic sales increased 17.5%, acquisitions contributed 0.4%, and foreign currency translation was a headwind of 2.6%. The Consumer Group sales growth was driven by price increases to catch up with continued cost inflation and strong sales growth in North America.

Adjusted EBIT increased 180.3% in the fiscal 2023 second quarter to $94.2 million, which was a second quarter record. Successful implementation of MAP 2025 initiatives, many of which were enabled by improved material supply as well as strong sales growth were key drivers to the increase in profitability. As a reminder, the Consumer Group experienced extraordinarily low profitability in Q2 2022 as a result of an explosion at an alkyd resin suppliers plant that caused severe supply disruptions and from high material cost inflation that was not offset by commensurate price increases.

This contributed to the strong second quarter of 2023 year-over-year growth. Now I'd like to turn the call over to Matt to discuss capital allocation.

Matt Schlarb

Thanks, Mike. During the second quarter of fiscal 2023, we paid cash dividends of $54.2 million or $1.68 per share on an annualized basis. On a per share basis, this represents an increase of 5% compared to fiscal 2022 and is the 49th consecutive year we have raised our dividend. Over the course of these 49 years, our strategically balanced business model has given us the ability to continually generate steadily improving cash flows and return over $3.1 billion to shareholders via dividends during this period.

With regard to investments in working capital, for several quarters, we have talked about increases in working capital driven by higher raw material inventories that were designed to improve supply chain resiliency. As material availability has significantly improved, we have begun normalizing our purchases of raw materials in Q2 2023, and we expect these actions to contribute to improve working capital levels in Q3 2023.

On the topic of M&A, we have completed 6 acquisitions so far in fiscal year 2023. These have been small deals, and we have remained disciplined as multiples from any potential targets have been elevated above historical levels. With the recent rise in interest rates and changes in economic forecasts, multiples appear to be normalizing, and we have a strong pipeline of potential acquisition targets.

We expect to continue to be active in M&A and have the financial flexibility to do so, but we'll retain our disciplined approach to valuations with a sharp focus on value creation. Looking ahead, while long-term visibility remains limited, we expect economic headwinds to persist in the fiscal third quarter of 2023. Although we are not immune to economic challenges, the balanced portfolio of businesses, I just referred to, has historically helped us navigate economic slowdowns.

Our varied businesses tend to perform differently throughout the economic cycle, which helps reduce the volatility of our results and insulate us from downturns. Additionally, several of our businesses are positioned to continue to benefit from positive reshoring and infrastructure spending trends, which we expect to continue in the future. We have also positioned our businesses to primarily focus on maintenance and restoration markets, which tend to be less economically sensitive than new construction or OEM demand.

As you can see from Slide 12, approximately 2/3 of our revenue is generated by demand for maintenance and restoration products and services. The reason maintenance and restoration demand tends to outperform new construction during times of economic slowdowns is demonstrated by the example on Slide 13.

When compared to buying or building new, our products offer a compelling value proposition during periods when budgets are in sharper focus. This is true not only for consumers but also commercial and industrial customers as well. As an example, within our Consumer segment, Rust-Oleum offers a suite of complementary and easy-to-use products that homeowners can utilize to renovate their bathrooms at a fraction of the cost of a typical bathroom remodel.

Rust-Oleum also offers products to renovate other areas of the house, including kitchens, garages and furniture. With that, I'd like to turn the call over to Rusty to cover our guidance and outlook.

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

Thanks, Matt. As Matt mentioned, we expect the headwinds that we have recently experienced to continue in the third quarter of fiscal 2023. These include slowing overall economic activity, rising interest rates, reducing construction activity and negatively impacting existing home sales, which have declined for 10 consecutive months, the bull of effect as some customers temporarily moderating purchases to normalize inventory levels as material availability has improved.

A strong U.S. dollar compared to the third quarter of fiscal 2022, and lastly, continued year-over-year cost inflation.

Through a combination of these headwinds, results in November and December have been meaningfully below the prior months in fiscal year 2023. At this point, it is too early to determine how much of the recent slowdown is due to weakening economic conditions versus the short-term impact of inventory normalization. Customer feedback on the reduced demand has been mixed as has recent economic data.

Taking all these factors into account, we anticipate third quarter fiscal 2023 consolidated sales will increase in the low single-digit to mid-single-digit percentage range compared to the prior year record results. By segment, we expect PCG to be the leader with sales up in the high single-digit to low double-digit range compared to the prior year record results.

The strength is being driven by growth in businesses serving manufacturers who are reshoring their production to the U.S., including strength in energy-related markets. Additionally, PCG is expected to benefit from CS-168 initiatives, which are part of our MAP 2025 Commercial Excellence program.

Consumer sales are expected to increase in the mid-single-digit range compared to prior year record results, led by pricing increases in response to year-over-year inflation Additionally, now that our material availability has increased, we have begun implementing new marketing and advertising initiatives, which we expect to benefit growth in the coming quarters. Partially offsetting this growth, we expect that the low levels of housing turnover will have a negative impact on consumer volumes.

SPG sales are expected to be flat to prior year record results. Here, strength in food coatings and additives and disaster restoration equipment in response to recent winter storms is expected to be offset by volume declines at businesses serving OEM customers, which are more economically sensitive.

As an example, some OEM customers have extended shutdowns of their facilities above and beyond the usual holiday time frame for the first time in several years. We anticipate that CPG sales will decline in the low single-digit to mid-single-digit range compared to the prior year record period as it continues to be weighed down by a weak European economy and softening construction activity.

With the softening macro environment, we are reducing production at some of our plants to be better balanced with expected demand. As a result, we expect to reduce inventories, which have been temporarily elevated to navigate supply chain challenges and positively impact our cash flows. We also expect that these actions will lead to lower fixed cost absorption and be a headwind to earnings. Taking all this into account, we anticipate that third quarter fiscal 2023 adjusted EBIT will be in the range of $75 million to $85 million compared to the prior year record amount of $80.6 million. Included in this guidance are the expectations for year-over-year headwinds from FX and cost inflation. This concludes our prepared comments. We will now be pleased to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question today will come from John McNulty with BMO Capital Markets.

John Patrick McNulty - *BMO Capital Markets Equity Research - MD & Senior U.S. Chemicals Analyst*

So I guess the first one would just be on the raw material environment. It looks like a lot of base chemicals, coatings raw materials, construction raw materials have started to slide, I guess can you speak to what you're seeing in the raws that you're buying today? And how much they may be coming off? And then, I guess, tied to that, is it fair to assume that you don't have that in the 3Q guide just because of your FIFO accounting and it probably doesn't impact you yet, you probably get the benefit more in the May quarter. I guess how should we be thinking about that?

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

I think that's correct. So in the second quarter, year-over-year, inflation was up about 17%. It was down sequentially in the quarter, about 3%. We are experiencing better recovery on the spot market, as you're suggesting today. But because of FIFO accounting, that's not going to show up until the end of the fourth quarter or into the first quarter of next year. I can give you a couple of data points.

Again, we're seeing sequential improvements, but there's still some significant areas of inflation year-over-year. Metal packaging is up 59% in the quarter. Alkyd resin were up 30% in the quarter versus the prior year. But we are in the marketplace starting to see sequential improvements.

John Patrick McNulty - *BMO Capital Markets Equity Research - MD & Senior U.S. Chemicals Analyst*

Got it. Got it. Fair enough. And then I guess on the destocking side, I guess can you help us to think about -- it sounds like there's a little bit of confusion out there and even your customers aren't necessarily sure how much of it is destocking versus actual demand. I guess, can you give us a little bit more color as to which channels may be seeing kind of the heaviest level of destocking and the negative impact of that, and where things maybe are kind of running more hand to mouth and more kind of in line with demand? I guess how should we be thinking about that?

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

Sure. And it's a great question. Historically, when we would talk about destocking or any of our peer competitors or companies that deal in consumer markets, it tended to be understood as a reference to inventory adjustments by major retailers, big-box consumers discount. In this case, it's really inventory adjustments across the whole supply chain.

So with many of our customers in industrial markets, we are in a similar fashion. Supply chains were so broken, you saw people buying what they could get. While our inventory is higher than it should be, in the quarter, we've seen a meaningful improvement from higher than usual raw materials to finished goods, which is the proper step of a cash conversion cycle.

And so across our customer base, you're seeing people take actions to readjust inventory levels from kind of the extraordinary actions people had to take over the last 1.5 years or 2 years in light of supply chain disruptions. So specifically, in the third quarter, Rusty referenced the Specialty Products group. And we've seen for the first time for the last couple of years, some of our OEM customers did not take their usual shutdowns during the Christmas to New Year's time frame.

In this case, they have, and some are extending it into January. And part of this is, inventory level adjustments as opposed to necessarily recessionary moves. So there's some volatility there that's going to play out with more certainty in the next couple of months.

John Patrick McNulty - *BMO Capital Markets Equity Research - MD & Senior U.S. Chemicals Analyst*

Got it. And then maybe if I can squeeze in one quick one just on MAP '25, can you just give us an update on where you are? I think you were at about $30 million run rate in the prior quarter. I guess, can you help us to understand where you're at? It sounds like you may have some upside to the $120 million target for this year.

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

I will hit that $120 million target this year, but one of the things that people have to adjust relative to original expectations in Q3 is most of the MAP '25 programs are focused at the gross profit level. So it's greater efficiencies. It's establishing greater levels of capacity through greater efficiencies, it's a much more deliberate data usage on managing cost price mix, and it's having a good effect.

The reason that's relevant to Q3 is, it doesn't flow through your P&L until you sell something. And given the seasonal low of our third quarter revenues, the impact in Q3 of MAP '25 will be less than what you saw in Q1 and Q2, and then you'll see a disproportionately larger impact of MAP '25 in Q4 because of our higher sales.

Just to qualify that further. I think that's an important thing to note that the MAP '25 benefits will -- because of where we're targeting them, be driven proportionally by a revenue basis as opposed to taking our communications about, for instance, $120 million and dividing it by 12 or dividing it by 4, it won't play out that way.

Operator

And our next question will come from Frank Mitsch with Fermium Research.

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

And Happy New Year to you and everybody there. The comment was made that November and December saw a significant slowdown. So I was wondering if you could kind of quantify, maybe on a percentage basis or a dollar basis or what have you, the negative year-over-year impact that you've seen particularly in December.

And as part of that, I'd be curious as to what your -- what's being embedded in terms of recovery in January and February in the $75 million to $85 million operating income.

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

Sure. So I'll try and address it in 2 ways. Number one, the biggest negative impact in Q2 and at the end of Q2, and going into Q3 is regional and it's Europe. Europe was down 11% in revenues. If you assume price in there, you can make some assumptions that Europe was down even greater on unit volume. And -- while we don't disclose EBIT by region, EBIT in the European market was off by more than 50% year-over-year.

And we have a disproportion out of a $1 billion base of business, roughly half of that is in our Construction Products Group. And so that gives you a sense of the greatest challenge that we're facing, which is regional. We also saw a slowdown in residential, which today with Nudura and a few other product lines out of a $2.7 billion Construction Products Group, we have about a $200 million exposure to residential new construction.

And including some of our consumer businesses, I'd say our total exposure to residential new construction in North America is about $300 million. The last comment I'll make again, which makes the performance at the end of Q2 and the beginning of Q3, difficult is we had a weather event, not dissimilar to a year ago, that impacted the entire United States. And so that slowed down results for us as we start off this third quarter.

And -- it will be interesting to see how much of -- some of the weakness relative to what we originally got in Q3 is circumstantial relative to inventory adjustments and weather events versus recessionary.

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

Got you. That's very helpful. And interestingly, there's a lot of discussion regarding destock among the customer base, et cetera, your inventory levels continue to tick higher. I'm wondering how we should be thinking about that.

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

And as we sit here today, our inventory levels are being adjusted appropriately. We had more normal cash flow in the quarter and I think you'll expect -- should expect to see better cash generation out of us in the coming quarters relative to focus on inventory adjustments. It's happening across the whole supply base in our customer base and not just -- again, I want to make sure that people don't equate destocking to consumer big customers.

This is basically the supply chain across almost every business or industry that we serve adjusting back to normal levels of inventory. So that is circumstantial and that's playing out as we speak because we're not the only company who's got higher levels of inventory in relationship to trying to adjust to the supply chain challenges in the last 2 years.

Operator

And our next question will come from Josh Spector with UBS.

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

So just curious if you could comment on pricing. One, I apologize if I missed it, but can you comment on what pricing was in the quarter? And then specifically for construction, if you're having weaker demand, I mean given how that business is more project-based pricing, is that having any impact on your ability to get further pricing? Or are you having to give some of that up given some of the destocking?

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

We have not provided price detail by segment. But on a consolidated basis, price was in the 15% to 16% range on average across RPM in the second quarter. And unit volume was up in some of our businesses down in the CPG and particularly in Europe. So on a total basis, unit volume in the quarter was down about 3%.

We have held on to our pricing pretty much everywhere. And as the supply chains adjust, typically in the past, there are very few areas where we would have to get back price. Some of it is in more commodity spaces. One example is in silicones in the Construction Products Group. There have been extraordinary spikes in silicone costs over the last 1.5 years, and that was a real problem for us in cost price/mix. There are significant declines in silicone prices. So you're likely to see some price adjustments in more commodity areas like that. Other than that, historically, we have tended to hold on to our price across RPM, and we intend to do that through this cycle as well.

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

Okay. And then I was just wondering if you could comment on consumer in terms of what you're seeing. I mean, you've had strong volumes in the first quarter on some restocking and supply availability improvement, I think some of your competitors have noted some destocking in that chain. Are you now seeing more of that? Or I mean my assumption is you're kind of assuming negative volumes in consumer, at least for next quarter. So just curious what the driver is among that.

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

Sure. I think that's correct. There has been some destocking. I think that's stabilized. Consumer takeaway has still been very volatile from one week to the next. It could be down in units 10% or up 2 or 3 depending on the retailer. We have lost over the last year, about $40 million in market share. And I believe that, that market share adjustment is over. And that's been in some categories of spray paint and wood stains and finishes in a big box account.

Our consumer group is pretty excited about the spring, and we're going to be initiating advertising and promotional initiatives in the spring, much larger than we have over the last couple of years. It's a combination of some new product introductions, some new market share opportunities.

And finally, a supply chain such that we can deliver at the high fill rate levels that historically we've been able to deliver at. So we've done a lot of work, both through MAP '25, and then specifically on the operations side at Rust-Oleum around some supply challenges and manufacturing efficiencies.

Those have been addressed, and we'll be in a really strong position to be able to meet demand and also to drive demand in the spring selling season. So that's one area of strength for us as we look into the finish of fiscal '23.

Operator

Your next question will come from John Roberts with Credit Suisse.

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

It sounds like M&A discussions are picking up. Can you provide some color on whether it's in the weak areas like Europe or construction products? Or is it broad-based across your businesses?

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

It's kind of broad-based across our businesses. We have done 6 transactions this year, all very small product lines, but there have been some nice additions to construction products. Through some of the big construction product mergers, we were able to pick up pieces of concrete -- I'm sorry, of cement additives, which was a category that Euclid Chemical was not in.

We've also invested internally and through some regional acquisitions and panelization for greater energy efficiency and wall construction. So some exciting areas for us, small acquisitions that with our distribution should be able to double or triple revenues in the coming years. So -- that's pretty much what we've been seeing.

As Matt commented on, we've been holding our discipline, and we are seeing valuations coming down. And I suspect that we'll continue to see small to medium-sized acquisition activity in the coming quarters.

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

And then how much more price do you need to get to fully get caught up on alkyd silicones and metal containers?

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

I think we have the price that we need now in the marketplace. I think the final straw of margin recovery is going to come through holding on to the price that we've got as raw materials cycle back to more normal cost levels -- and when you look at our consumer Group, the year-over-year improvement in EBIT is impressive.

It has as much to do with how poorly we performed a year ago as it does today. We're still not back to record EBIT levels, but we expect to get there both through some commodity cycle recovery and the benefits of the MAP 2025 program.

Operator

And our next question will come from Aleksey Yefremov with KeyBanc Capital Markets.

Aleksey V. Yefremov - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

I wanted to ask about the bidding activity that you see mainly in construction products and performance segments. More may be looking over the next 2, 3 quarters, perhaps outside the residential projects area where you highlighted the weakness.

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

Sure. So the -- as you would guess, and you're seeing in the numbers in our results, the residential piece has been weak and Europe has been weak. We have a very strong backlog in our roofing and waterproofing division going into the spring. And so as we sit here today, it looks like the spring and summer seasons for that portion of our Construction Products Group, which is the largest and most profitable will be strong. But we'll see.

Again, the volatility that we're seeing in different parts of our business, it's hard to understand how much of some of the underperformance here that we're expecting in Q3 is inventory destocking across customers and adjustments and/or weather-related here as we start the quarter versus recessionary.

As we sit here today, we have a very strong backlog. And I think there's some comfort in the fact that unlike residential construction or normal commercial construction, there's been a lot of federal money and state and local money that will be going into school construction, into health care. And those are 2 very strong end-use markets for our roofing waterproofing division.

Aleksey V. Yefremov - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

And then I understand it's hard to differentiate between demand weakness and destocking, I mean, customer side, but your intentional reduction of inventory, is it possible to estimate how much that's hurting EBIT in the third quarter?

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

Yes, it's a good question. And it's definitely a drag on EBIT. We have dropped shifts in certain places where we had previously been operating on a 3-shift basis. And that was not demand driven. That was inventory adjustment driven. And when you do that, your overhead absorption takes a hit. And so that's temporary.

And you're seeing that in a number of places across RPM. So there's a deliberate effort to get inventory levels in a number of our businesses back to a normal pace, and that will hurt us in the seasonally low third quarter as these actions, again negatively impact overhead absorption. I'd like to think, I don't know how quickly we'll adjust it, but it will be adjusted through the spring and the summer selling seasons, which are our strong seasons. And so those temporary negative impacts on gross margin should pick back up.

Operator

And our next question will come from Steve Byrne with Bank of America.

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

How much of your MAP 2025 would you say is driven by targets on the manufacturing side versus initiatives on commercial improvement? And in the former, do you expect to get more active in raw material manufacturing and in the, do you -- is it more driven by cross-selling?

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

So it's mostly, Steve, focused on areas that would affect gross profit. And so it is a continuation of what we call MS-168, which is driving lean manufacturing disciplines on a consistent basis across our manufacturing base. We had in our original MAP program, done so very effectively but really in our top 50 plants.

And there's another 75 plants out there that are more small to medium sized that our ability to get to effectively was interrupted by COVID. And so that's having an effect. There will be some modest plant consolidation, nothing to the extent of the original MAP program, but some modest plant consolidation. And so those are 2 big areas.

Then the other area is literally being in a position today to use data much more effectively to understand cost price mix better and to be able to drive a more deliberate margin profile that we want relative to really not having that data all the way to a salesperson level such that we can really be deliberate and effective there. And so those are the primary areas that will affect principally gross profit margin -- yes, the last piece of that we talked about is we do expect somewhere between $100 million and $200 million of gross margin recovery from commodity cycle improvement as well, which is consistent with the margin recovery that we've had in past commodity cycles and in reference to a response to an earlier question.

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

I asked about the cross-selling because one of the takeaways for us from the events you had in Cleveland with Construction Products was an apparent awareness that cross-selling was an opportunity there. And just would like to hear your view on that, Frank. Is this an area that you think that RPM has some significant opportunity to cross-sell between businesses and perhaps regionally? Do you have aspirations for sales, ex-North America, to meaningfully increase above the 20% level that it's at now?

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

Absolutely. So as you saw in the Investor Day presentation, over the last 4 years, our internal cross-selling efforts have increased from $60 million annually to $180 million. And certainly, the opportunity for that to double in the coming years exists.

One example is because of the success we've had with Arnette Polymers, which is a pre-polymer and raw material resin division of Stonhard and then the Corsicana plant which, while it's part of our Construction Products Group, today is principally serving consumer and Rust-Oleum. We are utilizing the leadership there to create a resin center of excellence in Europe, to create the same type of stability and certainty in supply, competitive advantage in raw materials and cost selling.

And that's going to play out over the next 12 or 18 months. So that's one of many concrete examples of trying to continue to accelerate what's been a pretty good story in terms of intercompany supply and/or cross-selling revenue benefits.

Operator

And our next question will come from Ghansham Panjabi with Robert W. Baird.

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

I guess, Frank, on the inventory adjustment dynamic, as you kind of think about it, do you see this as sort of a multi-quarter phenomenon or one that's going to disproportionately impact one of your smaller quarters, which is 3Q and then things sort of normalize from there?

And then just related to that, just given all the complexity in the current operating environment, is there any historical payrolls that you can think of that are sort of equivalent to what you're seeing at this point?

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

Sure. Thank you. It will have a disproportionate negative impact on Q3, and that's certainly part of our guidance. As you trying to ramp down production in this case in a few specific areas to address inventory imbalances as opposed to absolute demand. And I had commented earlier about the overhead absorption hit.

It will be less in Q4 and into Q1. I think it will take another 6 or 9 months for us to get inventory back to where we want. It's just a slow and steady progression. But you're already seeing this. Our inventory levels quarter-over-quarter on a relative days basis haven't improved much.

But there's been a significant shift from what was a higher-than-usual carrying of raw material inventory into finished goods, which is obviously the cash conversion cycle that we like to see. Now we got to sell it and turn it into cash. And I've never seen -- we've talked about destocking in the past when some of our big consumer customers would work to get to the next level of inventory stock efficiency.

And that certainly happened to us and others and people have talked about its impact circumstantially when it's happened. In my career, I've never seen the supply chain disruptions and then related inventory imbalances. And so for instance, there was demand we couldn't meet in some of our consumer businesses over the last year because of these things.

So we would have certain customers order in excess more than what they probably needed because they wanted to get what they could sell. We had customers in our Construction Products Group over the last year doing the same thing. So you just had odd circumstances across multiple businesses and channels and industries in terms of order flow caused by this supply chain disruption.

And with a settling down of supply chains, which I think were back to normal, now you're seeing people try and modulate back into a normal inventory level and a refocus on working capital position back to something that's more normal and more stable and more predictable.

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

I know there's a lot going on. And for my second question, in terms of your comments related to the weakening in volumes late in the quarter, which specific businesses and end markets were the most impacted? I know you called out new construction, but just more color on that.

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

Sure. As we think about Q3 going into the spring, we saw solid performance from our Consumer Group, and we would expect to see that continue. We saw really solid performance in our Performance Coatings Group. And given their infrastructure function and focus and heavy industry focus, and some of the onshoring and infrastructure dollars out there, we expect that to continue.

The weakness was really in the Construction Products Group at -- particularly as we start Q3. I can't tell you sitting here whether it's a sustained weakness that's continuing that's more recession-like or whether some of it was a result of the winter storm that impacted all North America. We saw weakness in the OEM portion of our specialty products group or our Specialty Products Group is about $800 million.

About half of that is OEM coatings, powder coatings, liquid, metal, wood stains and finishes. And again, some of that could be circumstantial. Over the last couple of years, the normal between Christmas, New Year shutdowns that some of our cabinet maker customers, door customers, RV customers had traditionally, they did not have, well, they had those again this year.

And some of that is extending into January. And how much of that is in anticipation of continuing recessionary pressure as opposed to some of these inventory adjustments, we won't know for another month or 2.

Operator

And our next question will come from Jeff Zekauskas with JPMorgan.

Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Your corporate costs are annualizing at $132 million versus something like a little less than $100 million last year. And even in 2021, maybe your corporate costs were $113 million. What's going on there? Is this a large onetime increase for this year? Or is it something more permanent? Why are corporate costs up so much?

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

Jeff, this is Rusty here. Corporate costs are up primarily from 2 categories: it's pension and insurance. In terms of pension, our assets have been hit in the pension plan, and that leads to higher nonservice-related pension costs as well as the fact we've had pay and wage inflation higher than our actuarial assumptions. Also, in terms of insurance, as you know, there have been several property events and insurance costs are up as a result.

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

The other thing I would add to that as a result of our MAP to Growth program as well as MAP 2025, our corporate staff has increased by about 30%. Now it starts on a relatively low basis of, let's say, 90 people, and I'd say we're up to about 125, 130. That's in areas of IT, which we are driving center-led in a number of areas.

It's in a team of continuous improvement in engineering professionals that number about 12, and it's a team of corporate staff procurement people of about 8, none of which existed in the corporate payroll 3 or 4 years ago.

Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So your SG&A expense, I think, adjusted was up -- a little bit more than 10% this quarter versus a 9% increase in sales. And it sounds like volumes are not growing as or not as strong as you expected. Is there anything you're going to do to reduce your SG&A levels and get them below your rate of sales growth?

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

Sure. We look at SG&A levels across all our businesses on a regular basis. Some of the SG&A increases are along the lines of what Rusty talked about in terms of wage increases. It's been a challenging, not for everybody, a challenging employment environment.

And so inflation is not only raw material, in fact raw material inflation is stabilizing and coming down, but wage inflation is here, and it's here to stay. So that's part of it. The other issue is a return to -- I don't know that we'll ever get back to pre-COVID levels of travel and entertainment, but we're certainly getting back to more ordinary levels of investment in those categories than what we experienced during the COVID period because they were damn near 0.

And that includes in-person sales meetings, traveling to customers and getting our people on site in front of customers more aggressively than we did, let's say, 12 or 18 months ago.

Operator

And our next question will come from Kevin McCarthy with Vertical Research Partners.

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

Frank, just to extend the discussion on the monthly cadence and the concept of destocking, have you seen any customers following the closure of the calendar year-end books that have become more liberal in their orders more willing to resume a more normal cadence of purchasing? And if so, where might you be seeing that? It didn't sound as though that's very prevalent from your remarks.

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

Yes. I think that our third quarter is probably the wrong period of time, especially this quarter, to be able to answer that question. Europe is the biggest driver of the deteriorating performance. And again, if you follow my comments, the world is not ending for RPM by any way, shape or form.

I talked about in Q2, regionally, Europe was down 11%. And given price increases, you can assume that unit volume was down more, and then EBIT was off 50% in Europe. Gives you a sense of the strength of RPM anywhere else. We are seeing the weakness that we talked about.

And Kevin, it's too soon for us to be able to say how much of it was weather related, how much of it is inventory-driven shutdowns and OEM customers versus how much of it is full on recession. And so I don't think we can answer that question today with any certainty. If you want to ask that in our April call, I think we'd be in a much better position to have some clarity around that question.

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

Okay. Fair enough. And I just had maybe a couple of quick housekeeping ones. First, did you give a MAP savings number for the quarter? Or if not, would you comment on that? And then second, I wanted to ask about some verbiage in your press release. I think it mentioned some unfavorable mix and fixed cost leverage at Corsicana, in particular. And just wondering if you could elaborate on those dynamics.

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

Sure. The fixed cost leverage, both at Corsicana, which is serving consumer, and some of our construction products businesses, also Carboline in terms of alkyd resins, it's not just Corsicana, it's knocking off some weekend activity in plants or knocking off a shift to try and make inventory adjustments basically to slow down production so that we can get our inventory back in line. And so the overhead absorption hit as a result of that, it's going to negatively impact Q3. I don't recall the other...

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

Just MAP savings in the quarter...

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

Yes. We -- I think we've commented the conclusion of not providing MAP savings every quarter. Our target is $120 million for fiscal '23, which we're comfortable in hitting. I think we've disclosed, Rusty or Matt, what have we disclosed year-to-date in the prior -- in the first quarter...

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

It was $30 million.

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

$30 million -- yes, $30 million in the first quarter. So I think you can extrapolate that across the quarter, particularly as it relates to understanding since most of this is being driven at the gross profit level. It will -- that $120 million will flow around that basis in proportion to our revenue growth by quarter.

Operator

And our next question will come from Mike Sison with Wells Fargo.

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

Yes, just 1 question, Frank. If you think about the current environment and you have a lot of EBIT growth anchored with the MAP program going forward, if it started to stay this way for a while, is it challenging to grow EBIT even with the MAPs program? And maybe another way to look at it is, what do you think needs to happen in the external environment to get back to the growth that you were showing prior to the third quarter?

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

So a couple of things. I think we need to be effective in the sales and marketing and promotion activities that we expect to generate consumers, and we're excited about that in the spring. So you'll see some new product rollouts and again, a higher level of advertising and promotion because we have gotten ourselves back to the point of being able to supply on a very high-level efficient basis.

And I think we have a number of growth initiatives around Nudura. That's just -- that's a business that grew from $40 million to $100 million. It's a big -- it's got a disproportionate amount of that work in residential. We have a lot of work to do to get that specified into commercial markets, particularly schools and other areas, and we're working on that. And the economic circumstances are not going to change that focus.

So we have a number of exciting areas for us that we're going to continue to invest in, notwithstanding what's going on with the economy. Broadly speaking, Mike, we've got to see the Fed quit raising interest rates. And we've got to see some stability in housing and things like that. And so those are the macro issues that are not only affecting us, but I think they're affecting everybody.

And so that's -- I guess that's the best answer I would have to an earlier question, we manage our SG&A unit by unit. We'll continue to do that where appropriate. But we are not in a position where we see any need to come out with any broad-based expense reduction program. We're still focused on executing our MAP program and selectively investing aggressively in a number of growth initiatives.

Operator

And our next question will come from Vincent Andrews with Morgan Stanley.

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

Just 2 quick ones for me. Frank, I just wanted to clarify, the $40 million of market share in spray paint and wood stains, did you gain that? Or did you lose that? I just didn't follow it.

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

We have lost that over the last 12 months. And I think that's in relationship to -- it wasn't unique to us, but the challenges that we faced in meeting demand because of supply disruptions. And so that was a -- between spray paint, where we've had a bare gain, a modest amount of spray paint in Home Depot and also some wood stains and finishes, about $30 million or $40 million of market share loss. And I believe that's over.

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

Okay. And then Rusty, you mentioned increasing marketing ad spend. And I just wanted to clarify whether that was an actual increase versus, say, 2019 levels or whether it's a just sort of normalization because you took it down when you didn't have sufficient raw materials to actually make the product. So why would you advertise? So can you just clarify what's going on there?

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

Yes. This is Frank. It's a little bit of both. It will be up year-over-year just because we didn't spend a lot in the face of the supply chain challenges. But we're working to get back to normal levels pretty quickly. And we've got some exciting new product introductions that we'll talk about in the spring.

And we have some exciting new products. We have some new market share opportunities, and we have our operations in a position to lean in hard to support all of that. So we're going to get back to an advertising and promotion level that's more consistent with the past and there will be necessary to support that growth.

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

Okay. Is there any quantification of that just in terms of -- I assume that will fall into SG&A as well? Or is that already in the...

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

That's involving SG&A. And we'll be in a better position to provide details on that in April.

Operator

(Operator Instructions)

Our next question will come from Arun Viswanathan with RBC Capital Markets.

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

A lot of my questions have been answered, but maybe I'll try this in a slightly different way. So -- it sounded like the construction products sales cadence really slowed down in November, December. And it sounded like -- I don't know if that was surprising. So would you say that we're still in early innings of this slowdown?

And you noted that maybe it will take 6 to 9 months for inventories to be worked off. Is that kind of how you feel about the demand trends as well? And maybe you can just comment on if that's the case for some of your other businesses as well.

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

So at some point, we're going to be rounding easier comps in Europe because Europe, we've been talking about since last spring has been deteriorating. And so I don't -- we're not in early innings there at all. We're in the teeth of a pretty good recession in demand destruction.

And so I think, boy, 6 months from now, 9 months from now, at the very least, we'll be stabilizing and moving in the right direction there. Part of that is geopolitical circumstantial in terms of the Russian war on Ukraine, in terms of energy markets in Europe and those things. The one area, and again, it's about $300 million, about $200 million in Construction Products and $100 million in Consumer, is our exposure to residential, new construction.

And -- I wouldn't say it surprised us, but that has slowed down significantly and profitable business there. And I think you need to see stabilization of what the Fed is doing on interest rates before you're going to see stabilization, both in the new home construction space and better housing turnover, which also drives a nice chunk of our consumer business in terms of remodeling.

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

And then if I could just follow up on price/cost. So given some of these potentially sluggish demand trends and destocking that's going on, do you expect to give back some of the price initiatives that you've achieved in a little bit more rapid fashion? How do you kind of plan to maintain the margin trajectory and recovery that you kind of had hoped for and experienced through the last couple of years?

Are there other measures other than pricing like mix or anything else that we should think about? Or how do you plan to keep some of that margin recovery?

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

Sure. In the past cycles, we've been able to maintain the vast majority of the price increases that we've initiated, and we would expect to do exactly the same thing here. If you look at our performance in past commodity cycles on the down cycle, we should pick up $100 million to $200 million of margin benefit and we're working hard to do that, and we intend to do it.

And as I said, even consumer with the very strong recoveries are showing there and certainly, some of that is price driven, while the year-over-year performance is really strong we're not yet back yet record margins. And we intend to get there through a combination of maintaining price where it's appropriate and the benefits of the MAP '25 program.

Operator

And this will conclude our question-and-answer session. I'd like to turn the conference back over to Frank Sullivan for any closing remarks.

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

Thank you, Cole. Thanks to all of you for your participation in our investor call today. We're pleased with our second quarter results, which reflect the resiliency of our balanced business model and the extraordinary efforts of our associates around the globe.

We're carefully monitoring early signs of economic slowing, but are confident in our ability to manage effectively through the entire business cycle. We look forward to providing you with details of our results in April. We'll have a much better sense of where we're headed in terms of what seems to be an exciting opportunity for continuing growth in our Consumer Group and Performance Coatings Group and hopefully, some improving performance out of construction products and specialty products as well. Thanks again for your time on today's call, and best wishes for a happy, healthy and successful new year.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time.
