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RPM.N - Q2 2024 RPM International Inc Earnings Call

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**OVERVIEW:**

Company Summary

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## PRESENTATION

**Operator**

Good morning, and welcome to the RPM International Fiscal Second Quarter 2024 Earnings Conference Call. (Operator Instructions) Please note, 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.

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**Matthew Schlarb** - *RPM International Inc. - Senior Director of IR*

Thank you, Gary, and welcome to RPM International's conference call for the fiscal 2024 second quarter. Joining today's call are Frank Sullivan, RPM's Chair and CEO; Rusty Gordon, Vice President and Chief Financial Officer; and Michael Laroche, Vice President, Controller and Chief Accounting Officer. The call is also being webcast and can be accessed live or replayed on the RPM website at www.rpminc.com.

Comments made on this call may include forward-looking statements based on current expectations that involve risks and uncertainties, which could cause actual results to be materially different. For more information on these risks and uncertainties, please review RPM's 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 2023, unless otherwise indicated. We have provided a supplemental slide presentation to support our comments on the call. It can be accessed in the Presentations and Webcasts section of the RPM website at www.rpminc.com.

Additionally, as a reminder, certain businesses in Asia Pacific that were previously part of the Construction Products Group are now being managed in reporting under the Performance Coatings Group effective June 1, 2023.

As a result, all references to CPG and PCG today reflect the updated structure. The recast businesses generate approximately $100 million in annual sales, and this change has no impact on consolidated results. At this time, I'd like to turn the call over to Frank.

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

Thank you, Matt, and welcome to everybody joining us on our call today. I'll start with an overview of our second quarter performance, then I'll turn the call over to Mike Laroche to discuss the financials in more detail. Matt will then provide an update on the balance sheet and the recent opening of an R&D facility, and Rusty will cover our outlook. At the end of the prepared remarks, we'll be pleased to answer your questions.

Starting with our second quarter results on Slide 3. We generated our eighth consecutive quarter of record sales and adjusted EBIT. While revenue growth was slightly positive because of softness in certain end markets, we continued our trend of good margin expansion led by our MAP 2025 initiatives. This resulted in double-digit adjusted EBIT growth, which is squarely in the guidance we provided and in addition to the strong growth we generated in the prior year quarter.

The MAP 2025 initiatives were also a key reason we generated all-time record cash flow of $408.6 million from operating activities during the quarter. Enhanced collaboration between commercial and operational functions means we are now able to respond to customer demand more quickly without having to build large safety stocks as we have done in the past. And this is having a positive impact on working capital.

Through the first 6 months of fiscal 2024, we generated $767.8 million of cash flow from operating activities, which surpassed our previous all-time fiscal year record.

Turning to Slide 4. Sales were led by our Construction Products Group and Performance Coatings segment, which benefited from their focus on repair and maintenance as well as their positioning to serve strong demand for infrastructure, reshoring and high-performance buildings with their engineered solutions. Volumes declined in the Consumer and Specialty Products Group segments as demand in DIY and especially OEM end markets, particularly those with residential exposure remained soft. Both of those segments have been pressured for the past year as individuals have focused their spending on travel and entertainment and existing home turnover has been at a multi-decade low.

Pricing was positive in all segments and helped offset lower overall volumes. Despite these challenging end markets, we achieved another quarter of strong margin expansion led by our MAP 2025 initiatives. Margin expansion was strongest at the Construction Products Group and the Performance Coatings Group which both generated positive volume during the quarter.

This demonstrates the potential for our MAP 2025 enabled margin expansion in our businesses underperforming when volumes begin to grow again. As a reminder, second quarter growth was in addition to a strong quarter in the prior year period. The 2-year stack growth for sales and adjusted EBIT was 9.3% and 50.6% respectively.

Moving to Slide 5. I'm pleased to report that the changes we recently made to our management structure are showing good progress. In Europe, new management teams have focused their sales strategy and implemented MAP 2025 initiatives to grow sales and expand margins. In Africa, Middle East and Asia Pacific, which are now aligned under our Performance Coatings Group management, our businesses are realizing the potential of increased collaboration in our operations. Sales in Africa, Middle East grew 13% and Asia Pacific increased 6.4%, and we're realizing operational synergies that are leading to even greater profitability growth. Overall, I'm proud of our associates' performance in the second quarter. We're executing exceedingly well and the things that we can control and the hard work we are doing on MAP 2025 initiatives is enabling collaboration, efficiencies and cash flow that benefit us now. And I'm optimistic that we have even greater opportunities in the future.

I'd now like to turn the call over to Matt Schlarb, to cover our financial -- I'm sorry, Mike Laroche to cover our financial results in more detail. Mike?

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

Thanks, Frank. Starting on Slide 6. Consolidated sales increased slightly as positive volumes at the Construction Products Group and Performance Coatings Group. Higher pricing and favorable FX were offset by end market weakness in consumer and the Specialty Products Group. MAP 2025 benefits, including the commodity cycle, drove 320 basis points of gross margin improvement. Improved fixed cost leverage at the Construction Products Group and the Performance Coatings Group also contributed to gross margin expansion.

SG&A as a percentage of sales increased during the quarter as we reinvest MAP savings and long-term growth initiatives and to incentivize the sale of higher-margin products and services. Inflation in areas like wages, benefits and health care expenses added to the increase in SG&A. Expense reduction actions taken at the end of fiscal 2023 helped mitigate the increase, and we are taking additional actions to limit SG&A increases in the second half of 2024. Adjusted EBIT grew -- adjusted EPS grew 10.9% to $1.22 and which is a second quarter record and was driven by adjusted EBIT growth with an increase in interest rates being offset by debt paydowns.

Turning to the Construction Products Group results on Slide 7. They achieved record Q2 sales led by concrete admixtures, which continued to benefit from reshoring and infrastructure projects as well as market share gains. The segment also benefited from increased demand for high-performance buildings, both new and renovations with particular strength in sealants and wall cladding. As Frank mentioned, Europe is benefiting from a more focused sales strategy, and this includes CPG, which is our largest segment in Europe. Adjusted EBIT increased to a second quarter record led by higher sales, improved fixed cost leverage and MAP 2025 benefits. As a result of the strong financial performance, variable compensation increased and was partially offset by expense reduction actions put in place at the end of fiscal 2023.

On Slide 8, the Performance Coatings Group achieved record second quarter sales driven by strong demand for the segment's engineered turnkey flooring systems due to heavy activity in reshoring capital projects and market share gains. The businesses in Africa, Middle East and the Asia Pacific were all recently aligned under PCG management contributed to the segment's growth. This volume growth resulted in improved fixed cost leverage and along with MAP 2025 benefits generated all-time record adjusted EBIT during the quarter.

Moving to Slide 9. Specialty Products Group sales declined as specialty OEM demand remained weak, particularly in end markets that have exposure to residential housing, including furniture, doors, windows and cabinets. The divestiture of the noncore furniture warranty business last fiscal year reduced sales, and the segment also faced challenging comparisons to the prior year period when the disaster restoration business benefited from the response to Hurricane Ian in Florida, which did not repeat in fiscal 2024. The reduced volumes resulted in unfavorable deleveraging and adjusted EBIT declines, which were partially offset by expense reduction actions implemented at the end of fiscal 2023. SPG also continued strategic investments in long-term growth initiatives which weighed on adjusted EBIT margins. Matt will talk about one of those growth investments shortly. Please note that adjusted EBIT excludes a $4 million expense related to an adverse legal ruling for a divested business.

Turning to Slide 10. The consumer group was pressured by soft takeaway at retail stores from DIY customers, as they focus their time and spending on travel and entertainment rather than projects around the house and as housing turnover hit multiyear lows. Certain retailers were also more cautious with inventory levels, which pressured volumes. Market share gains, strength in international markets and increased pricing to catch up with prior material and current labor inflation helped limit the volume declines. As a reminder, consumer faced challenging comparisons as sales increased 15.3% in the prior year period. Despite challenging end markets, consumers still generated record second quarter adjusted EBIT. This was achieved primarily due to MAP 2025 benefits and strength in international markets and was in addition to strong growth in the prior year when adjusted EBIT increased over 180%.

Now I'd like to turn the call over to Matt, who will cover the balance sheet, cash flow and provide an investment update.

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**Matthew Schlarb** - *RPM International Inc. - Senior Director of IR*

Thank you, Mike. Moving to Slide 11. We continue to make significant progress on improving working capital, primarily through lower inventories, which decreased $287 million from prior year levels. This, combined with our improved profitability, resulted in an all-time record cash flow from operating activities of $408.6 million in the second quarter.

As Frank mentioned, our cash flow in the first 6 months of the fiscal year has surpassed our previous 12-month fiscal year record. Year-to-date, we have returned $113.3 million of cash to shareholders through dividends. And in October, we achieved our 50th consecutive year of increasing our dividend and accomplishment only 41 other publicly traded companies can claim. This sustained dividend growth has been enabled by our strategic balance are focused on repair and maintenance and our entrepreneurial spirit, all of which help us grow throughout economic cycles. We have also returned additional cash to shareholders through share repurchases, which totaled $225 million to date. Finally, we have continued to repay debt. And at the end of the second quarter of 2024, total debt is $592 million lower than the prior year. These debt repayments have helped mitigate the impact of rising rates on interest expense and provided flexibility to take advantage of future opportunities.

Moving to Slide 12. As Mike mentioned, our segments are making investments to accelerate long-term growth, and we'd like to highlight one of those investments, the RPM Innovation Center of Excellence. We recently accelerated the ribbon cutting on this new state-of-the-art facility located in Greensboro, North Carolina. This facility is the first of its kind at RPM, where multiple businesses can collaborate and share resource to help drive innovation. This is particularly important for some of our smaller businesses that do not have the scale or local talent to run a comprehensive R&D lab by themselves. Additionally, the Innovation Center of Excellence serves as a showcase to customers, but they can visit and see firsthand our ability to find solutions to their challenges.

Also, by sharing resources, we are eliminating the need to duplicative equipment in multiple labs, which will control long-term expenses. The facility is being overseen by Specialty Products Group because many of their businesses are prime candidates to utilize it, and we already have businesses from all 4 segments collaborating there today.

Now I'd like to turn the call over to Rusty to cover the outlook.

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

Thanks, Matt. Before we start, just to clarify, the year-to-date share repurchases are $25 million, just so that's clear. Now I'll go on with the outlook.

On Slide 13, you can see our third quarter outlook, which, as a reminder, is our seasonally slowest quarter. Market trends in Q3 are expected to be similar to Q2 as strength in CPG and SPG international markets and market share gains are offset by weakness in DIY and specialty OEM markets. The expected result is flat sales to the record prior year period. On consolidated adjusted EBIT -- or excuse me, our consolidated adjusted EBIT growth is expected to accelerate and increased 25% to 35% over the prior year record results driven by MAP 2025 benefits, including in Europe, which is an area of focus for us and less challenging prior year comparisons. This adjusted EBIT outlook is inclusive of growth and efficiency investments we are making in our businesses and at the corporate level, which will weigh on short-term margins.

I'll add that we are also taking actions to limit SG&A growth in the second half of the year. By segment, CPG and PCG are expected to continue to benefit from their focus on repair and maintenance and from continued spending on infrastructure, high-performance building and reshoring projects. Market share gains are also expected to contribute to sales growth. We are expecting sales in both segments to increase in the mid-single-digit range. In SPG, we have not seen an inflection point in demand with housing turnover hovering near multiyear low levels. As a result, we expect sales to decline in the mid-teen percentage range. In Consumer, we expect sales to decline by low single digits as soft DIY demand is expected to be partially offset by market share gains.

Moving to our full year outlook on Slide 14. And we are lowering our sales expectations for the year due to lingering softness in the DIY and specialty OEM markets. Our new outlook for the year is sales growth in the low single-digit range versus a prior expectation of mid-single-digit growth. Despite the reduction in the sales outlook, we continue to make good progress achieving MAP 2025 benefits and as a result, are affirming our adjusted EBIT outlook of growth in the low double-digit to mid-teen range. This includes benefits we are capturing from the commodity cycle as overall raw material prices decline, while we maintain pricing.

This concludes our prepared remarks. We will now be pleased to answer your questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question today comes from John McNulty with BMO Capital Markets.

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

So I wanted to dig into consumer a little bit. So it was down a little bit north of 5%. Your original expectation for it in the quarter was up low single digits. It doesn't look like it was priced because you got pricing across all the businesses. So I guess, can you help us peel back the young in a little bit on volumes? How much was kind of -- was it down on just consumer takeaway versus some of the destocking that you're seeing? And then also, can you speak to some of the share gain offset that you had and maybe quantify that a little bit for us as well?

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

Sure. On a consolidated basis, price in the quarter was up slightly less than 2%. And so that should give you a sense, that's a little bit less in consumer. And it's just a month after month of negative consumer takeaway. I would note that we are outperforming our directly comparable consumer paint peers in terms of volume. But it's been a consistently minus low single digit, minus mid-single-digit consumer POS over the last 8 to 9 months. And we don't see that changing until possibly this spring.

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

Okay. And when you think about some of the destocking that you've seen in the business because I think you highlighted at a couple of retailers, that was an issue. As far as where inventories are or at some of these bigger retailers, I guess would you say they're kind of about where they normally would be going into the beginning of the spring paint season? Are they below, I guess, how would you characterize that?

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

I think they're back to normal. You've seen a significant readjustment in supply chains, both with our customers and also as we noted within RPM. Last -- this time last year, we talked about our efforts to really focus on operating efficiency and cash flow and that we would do so at the expense of profitability in terms of overhead absorption. And that's happened throughout the last 12 months, but the execution of the RPM people in this quarter is exceptional. We have reduced debt by almost $600 million over the last 12 months. We've generated record levels of cash flow in the 6-month period. Our cash conversion cycle versus 1 year ago is almost improved by 30 days. And so the things that we can control are being executed very well. I think we're really happy with that. As you're seeing in the third quarter, expectation to be able to generate a 25% to 35% EBIT growth on what essentially is the same sales as last year, gives you a good sense of the improvements we've made.

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

Got it. No, makes sense. And actually, maybe to that, if I can squeeze one last one in. You saw some notable margin lift despite a pretty soft volume environment. I guess, can you help us to think about how much of that was from the price versus raws benefit versus some of the MAP improvements?

And then I guess maybe the third bucket would be just general mix improvements. But I guess, can you help us to parse out where some of that real improvement was coming in?

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

Sure. We went cost price mix positive in most of our businesses starting in the summer and will be cost price mix positive relative to raw material inflation in our price increase efforts in consumer in the third quarter. I'll just use consumer as an example. Over an 18- to 24-month period, we absorbed about $500 million of higher cost raw material, labor and things like that. And as is normal in these cycles, we lose margin, spend time catching up, and we will be cost price mix, margin positive in consumer for the first time in Q3. And you can see we've been that way in PCG and CPG going back to the beginning of the summer. I think you can also see that the strong leverage when we've got volume in the PCG and CPG performance. And we would expect the same in our Specialty Products Group and Performance Coating -- I'm sorry, in Consumer Group, once we start generating positive unit volume.

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**Operator**

The next question is from David Huang with Deutsche Bank.

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**Yifei Huang** - *Deutsche Bank AG, Research Division - Research Associate*

I guess on construction, can you talk about the trends you're seeing by end markets? And I guess specific to infrastructure and reshoring. Are you seeing any project delays either because of slower government approval or people are just delaying their projects in 2024 because of lower construction cost expectations?

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

We have not seen much in the way of project delays. On the project delays that we would experience tend to be weather related in the -- particularly in the Construction Products Group. And so far, we're in pretty good shape there. It actually feels like and some of this is what happens when the government commits $1 trillion of infrastructure and other stimulus that there is a manufacturing renaissance happening. And so we are specified on some major onshoring projects, particularly in the technology area, and that's coming. You're seeing the follow-on of that with suppliers. And so we're in a pretty good space with, for instance, Stonhard flooring, our Carboline high-performance coatings, Euclid Chemical and admixtures, a lot of the construction chemicals business.

Also, just as a reminder, our Tremco Roofing business is about $800 million and 95% of that is reroofing and/or renovation. And so we're not very exposed to the commercial construction cycle there. And so that's doing really well. Lastly, we have been moving with our WTI business into some asset management areas, including an acquisition of -- a couple of years ago, Pure Air, and that is the refurbishment and renovation of commercial HV and industrial HVAC systems, and that business is showing some really strong growth as well.

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**Yifei Huang** - *Deutsche Bank AG, Research Division - Research Associate*

Okay. Got it. And then on raw material, how much was raw material costs during the quarter? And I guess, when do you expect the deflation benefits to peak?

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

Sure. Matt, do you want to take that?

**Matthew Schlarb** - *RPM International Inc. - Senior Director of IR*

Sure. Yes. So we -- raw materials were down about 5% in the second quarter. Now other things like labor are still going up, and it varies by product category like some things, particularly in the consumer segment, like acetone was up 25%, metal packaging and TiO2 were pretty flat. Propylene was a little bit up. But other raw materials were down. That brought the overall average down about 5%. So we think that we'll probably hit a peak of raw material deflation sometime in the third or fourth quarter of fiscal 2024.

**Operator**

The next question is from Josh Spector with UBS.

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

So, I just wanted to follow up on the comments on SG&A. So, your inflation in the first half is about 8% year-on-year. talked about some discrete items driving that and some actions to reduce that in the second half. So, what are your expectations for second half SG&A inflation? And then how does that carry into fiscal '25?

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

Sure. You should see SG&A grow at a lesser rate in the second half of the year, particularly in the fourth quarter as we round our performance last year. And as we talked about, there are some specific areas that we are committed to investing in relationship to being in a good position to capture growth when the market turns. Matt mentioned one of those today. We committed tens of millions of dollars to the establishment of a new R&D center. It's part of our Woodfinishes group and our Specialty Coatings group. Their performance in the last year hasn't been particularly good because of their direct or indirect exposure to things in housing, which has been a really tough market environment.

Nonetheless, we are committed to investments there, to investments in our Legend Brands business in terms of air handling, it's humidification equipment and a number of areas there. We have been investing significantly in some new product categories in our consumer group. And we're seeing placements of some new DAP spray products and recapture some Rust-Oleum market share as well coming this spring. So we've been very deliberate about the balance between harvesting MAP savings and reinvesting in what we believe is future growth opportunities.

Yes. I guess I would add one other -- yes, I would add one other thing to that. We track that growth investment spending separately. And so if we get to the point where the soft landing turns into something a little more difficult economically, our ability to turn on a dime and cut tens of millions of dollars of SG&A could happen pretty quickly.

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

That's helpful. And if I kind of carry that forward. So can you remind us of the expectation for the realized MAP to Growth savings in fiscal '24, excluding raw material and price cost movements and your comments on investment. Has that increased versus your prior expectations in that maybe the realization of those savings is less because you're investing more? Or is it the same calculus you're running to previously?

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

Sure. I'll let Matt give you the details on the numbers in terms of what we communicated. But our investment programs are essentially the same. And so while they haven't increased in terms of the things that we've been doing in the MAP program. At this stage, they also have not been cut back. So we are committed to a number of initiatives in -- across a number of our SBUs with the goal of being in a good position to harvest growth when the economy gets a little bit stronger.

**Matthew Schlarb** - *RPM International Inc. - Senior Director of IR*

Yes. And related to the MAP savings, in prior calls, we communicated a run rate basis of $160 million and a P&L rate of about $100 million. We're still on track for that. The thing is those savings and those benefits are actually being masked by a lot of the under absorption we've had from lower-than-expected volumes.

**Operator**

The next question is from Jeff Zekauskas with JPMorgan.

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

As a base case, how much is variable compensation likely to be up this year?

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

I don't know that we have that number specifically, but in a number of our businesses, we have addressed commercial disciplines that didn't exist before in terms of some CRM programs and other things such that we've replaced some old compensation structures in Tremco Roofing and part of our Construction Products Group with more variable compensation associated with pricing and margin. And so that's part of the increase in SG&A, which goes hand in glove with the increase in gross margin profitability.

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

And can you make some general remarks on your outlook on demand in the United States over the next 12 months in your various businesses? And how you think it might change as the year progresses?

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

Sure. Back to the Construction Products Group and Performance Coatings Group, we're really well positioned with what continues to be a huge slug of federal stimulus in the areas that we have long been positioned to serve. And so I think we feel pretty good about that over the next 12 months.

The halt of the most aggressive in history interest rate rise campaign by the Fed will start to produce some better results. I mean our Specialty Products Group, in particular, their largest business unit is our industrial coatings, we're in wood stage and finishes. We sell into items that directly or indirectly go into new homes, whether it's windows, doors, wood trim. And those markets have been negative since December of last year, which, if you go back and model their declining performance because the first 6 months of fiscal '23 look great. And then you model the Fed impact of interest rates on the housing market, both in terms of new home construction, in terms of housing turnover, if you read the headlines, people being stuck in homes because of low interest rate mortgages. It's had a direct negative impact there.

And then I also think in the consumer side, we're seeing the last messages across the industry of maybe the COVID boom where people did a lot of projects and redecorating. And as Mike said, headlines suggest that they're spending out there by consumers, but they're not on goods, they're more on services. I think as the interest rate environment improves, you're going to see improvement in both consumer activity and in the housing activity. And at the same time, we'll be rounding significantly easier comparables.

And so if we are -- just to finish this, if we are seeing an interest rate environment that begins to modestly improve in a housing market, both in terms of new construction, and turnover improve, you're going to see our numbers pick up both in our consumer DIY businesses as well as our Specialty Products Group.

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**Operator**

The next question is from Vincent Andrews with Morgan Stanley.

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

Could you talk a little bit about -- we're a little bit far enough along in this reshoring and infrastructure activity that maybe you have some insight into how lumpy it's going to be for your business in terms of -- is there a sell-in on these particular products -- projects that you're spec-ed in on? And as those projects are completed, do you have a very orderly hand off to another suite of projects that's sort of the same volume or more? Or how should we think about the potential lumpiness of this benefit to your business?

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

Yes. Sure. Back to my earlier comments, it feels like we're in a mini manufacturing renaissance because while we're being specified on a lot of these larger onshoring projects. In some cases, they haven't even put a shovel in the ground. And so on some larger projects that could be multimillion dollars, they will add some lumpiness to our results, as you suggest. But that's down the road. What we're seeing now is just being a pretty solid industrial capital spending number and market share gains targeted to point two in terms of new products with our Construction Products Group or Performance Coatings Group, but there's been a preference in some instances for our Stonhard flooring because we not only provide the material, but we supply the labor.

So we do a turnkey project in an environment where labor has been challenging. That's provided a competitive advantage for us. The same thing is true in our Tremco Roofing business with our WTI business. And so having a labor component, both in elements of Tremco and in the Stonhard division of our Performance Coatings Group has also helped us from a competitive advantage.

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

And then as a follow-up, in areas like consumer, where the volume is challenged, are you facing any pressure from your retail partners to either price promote more or to step up media or ad spend or any type of things that might encourage foot traffic?

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

Sure. We're facing pressure from customers across RPM businesses for modest price reductions here and there. As I mentioned, specific to consumer, we absorbed over -- that was our largest hit in terms of raw material costs. We absorbed about $500 million of rising costs over an 18- or 24-month period. And frustratingly, it remains the one segment that's still seeing some inflation. There are some tariff items around tinplate, which goes directly to metal cans and a couple of other chemicals like acetone that are -- that have not experienced the meaningful raw material reduction, some broader chemical categories have like epoxy, resins or silicones.

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**Operator**

The next question is from Mike Harrison with Seaport Research Partners.

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

Frank, I was hoping maybe you could give us a little bit more detail on the improvement that you've seen in the construction business in Europe related to the more focused sales strategy and the benefits that you saw in Asia Pacific and Africa and the Middle East in your Performance Coatings business, where there's some better coordination going on. Maybe just, again, some more detail on the changes that you've made there. And it sounds like you expect some additional improvement to come. Just wanted to gauge your confidence around how much more legs you could have from those actions?

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

Sure, sure. And it's a great question. So I think the -- first, you got to step back and recall our 2020 MAP to Growth operating improvement program. We made a lot of good progress there. But our progress was interrupted by the COVID pandemic. Most of our early efforts in the first couple of years of the 2020 MAP to Growth program, we're focused on North America. And particularly in what we call MS-168 operating focus, we were interrupted in getting at Europe. Post COVID and with MAP '25, we've had tremendous cooperation between our Construction Products Group and our Performance Coatings Group. But across all 4 of our segments, the President -- the Group President of our Performance Coatings Group relocated with his family in Europe. And he's providing direct senior leadership oversight on executing. The simplest way to think about it is a MAP to Growth initiative in Europe.

Likewise, we had too many small, far away uncoordinated locations in the developing world. And we have coordinated and consolidated the oversight of those with a leadership team out of South Africa, and they've done an exceptional job. And so now in the Middle East and Africa, in India, in Southeast Asia, we are approaching the market as RPM, not by products. Certainly, it's all of our products. But in terms of oversight of asset allocation, accounting and finance, IT systems, we're consolidating more of that under 1 group, and we're having real good benefits. We're getting the right people in the right places. We're eliminating redundant costs by -- as you'll recall, at one point, we closed the books in 104 places every month, so we're addressing that. And so all these have had a really positive impact.

The last thing I'll say is, in Europe we had a pretty strong performance in the quarter. The U.K. was the first of the major markets that we're involved in that really went into a recession. And so it feels like there's some spending activity there. I would say Continental Europe is not economically doing particularly well. So most of what you're seeing there is self-help and the good execution on what I would call a European MAP to Growth initiative with senior leadership on the ground overseeing it.

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

All right. And then you guys have done a really nice job managing working capital, and obviously, that's showing up in the cash flow. But as you look across your segments, are your internal inventory levels where they need to be at this point? Just kind of trying to think about how we should look at production rates and fixed cost absorption, particularly in that specialty business and maybe consumer as we're kind of moving through the seasonally slower period in Q3 and then get into the spring pickup in Q4.

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

Sure. There is more room for us to improve in working capital. It will be incrementally smaller in the coming quarters because, again, as you recall, this time last year, we talked about tackling inventories in particular and the underlying operating efficiencies, and we've been doing that very effectively. And there -- as I mentioned earlier on the call, we picked up almost 30 days over the last 12 months in our cash conversion cycle. There's not another 30 days to pick up, but there is incremental improvement that we will be generating in the coming quarters and the coming years.

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**Operator**

The next question is from Mike Sison with Wells Fargo.

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

Frank, you mentioned that the consumer group could or maybe you could see an inflection point in the spring. What do you think -- what are you looking for to see any indicators, anything you're looking for to maybe give you confidence that, that could happen?

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

Sure. I think we need to get into the spring months, which is our typical strongest selling season. We introduced the Rust-Oleum 5 in 1 and Stops Rust this time last year. We've introduced a highly anticipated new DAP spray product. It's essentially a single component that replaces a prior 2-component product. So we've got a number of new product areas. We're also picking up a little bit of lost market share from the prior year. And so some of it is going to be some new product placements and others of it is going to be a sense that if the economy picks up a little bit, particularly as it relates to housing turnover, you'll see improvement in our Consumer and Specialty Products Group.

As a reminder, and I think all of you on the call know this, housing turnover, particularly for us, is more an indicator of economic activity, the new home construction. We're not directly involved in new home construction, except in our Specialty Products Group and to a lesser extent, at DAP. But when you have housing turnover, a lot of repair maintenance and a lot of fix up for people that are selling and then a lot of repair maintenance and redecorating for the buyers and that activity has been at multi-decade lows over the last 12 months.

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

Got it. And then just a quick follow-up. I apologize if I missed this. What did you think pricing would be in the third and the fourth quarter? And then are there some sort of -- some new -- some of the home improvement guys. They want to get a lot of the inflation back from their suppliers. So it sounds like they're pushing for price decreases. How do you sort of handle that in the consumer group? And are there other ways to really keep some of the pricing that you achieved over the last several years?

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

Yes. I don't think about it so much as pricing as I do margin. Some of that goes along with new product introductions, some of it goes along with category management activities that we have with big customers. And quite candidly, some of it is finally recapturing the lost margin during the commodity cycle activity. I don't -- to add to your earlier part of the question, I don't anticipate much in the way of price in Q3 or Q4. The exception might be in a few areas like consumer, I think people are paying attention to what's happening with this tariff negotiation around tinplate. There's some consolidation there in the industry. It's a frustrating item. So there are a couple of areas that we're paying attention to. Now whether that drives additional price increases or not, time will tell. But broadly speaking, across RPM, we don't anticipate much in the way of price in Q3 or Q4.

**Operator**

The next question is from Aleksey Yefremov with KeyBanc.

**Unidentified Analyst**

This is Ryan on for Aleksey. I kind of want to just piggyback off of the last pricing question there. So I was wondering if you can maybe talk about how pricing is trending on bids for new projects in both CPG and PCG?

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

So in general, we have held price across most RPM businesses, very few exceptions, and the exceptions tend to be more commodity spaces around epoxy, resins or silicones. We participate in line striping and in bridge and highway work and that tends to be a little more price sensitive because they tend to have basic coatings that are more directly related to the underlying chemical raw materials.

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**Unidentified Analyst**

Okay. That's helpful. And then can you just maybe talk about what you guys are seeing in the repair and maintenance business. Obviously, it's held up relatively well. Is this business still growing? Or any color here would be great.

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

Absolutely. It's holding up really well. You can see that in our Construction Products Group. The vast majority of that is repair and maintenance. And then also industrial capital spending, which seems to be pretty solid, that also impacts our Performance Coatings Group. So we're pushing, as I mentioned earlier, other opportunities, I mentioned the Pure Air acquisition of a couple of years ago in the last 2 calls, we're seeing some nice growth there. And that was really in response to customers who talk to Tremco and our WTI services component. When we're up on their roof, can we help them with their HVAC equipment? And we didn't have an answer to that question for many, many years, and we do now. So we're able to sell more on the same roof and/or sell new components with the same sales force. And we're pretty excited about it. And over time, I think we'll look for other opportunities as we think about this business more as an asset management, asset maintenance business as opposed to just a purely roofing materials business.

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**Operator**

The next question is from Stephen Byrne with Bank of America.

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**Stephen V. Byrne** - *BofA Securities, Research Division - MD of America Equity Research & Research Analyst*

Frank, with respect to the new innovation center down in North Carolina, I was curious whether you're seeing any responses and changes between the various segments? Is there any increase in collaboration between them? And maybe more specifically, do you expect that multi-segment R&D center to benefit primarily from across a transfer of technology from one segment to another? Or do you think that it will have more effect on cross-selling at the more of the commercial level between the segments?

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

That's a great question. And if you recall, one of the key elements of our original MAP to Growth program was going from a relatively decentralized RPM with a holding company perspective to thinking about functions and disciplines in 3 areas. One is remaining independent and entrepreneurial. The other would be centralized and then the middle one is center-led. We have effectively centralized our procurement across RPM that's helped us meaningfully. That was a big element of the original MAP to Growth program. We are center-led in manufacturing and operations, and we are instituting a common playbook for our manufacturing facilities across the globe, We'll continue, but on a smaller basis. And the original MAP to Growth program, we closed about 25 facilities. You'll see a few incremental closures, particularly related to our activities in Europe.

And the R&D center was really born of our operations asking us and recognizing that there's an opportunity for better collaboration across our businesses. So I think it's going to be sharing best practices. And I think it will be cross-fertilization of technologies that can play, for instance, from an industrial sector into the consumer sector. We're pretty excited about it. It's going to take time to be realized, but it goes hand in glove with really trying to look at RPM as a formerly pretty much holding company with 40 or 50 independent units to recognizing what can we centralize and what can be center-led to take advantage of collaboration. Our 4 Group Presidents are doing an extraordinary job of leading that collaboration in terms of their actions and their words, and it's filtering down through the organization in a very positive way.

As I said, I -- the execution in this quarter of the things that we control was really good. And I would expect more of that to come. Obviously, results will be impacted by the underlying economic activity.

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**Stephen V. Byrne** - *BofA Securities, Research Division - MD of America Equity Research & Research Analyst*

And maybe just continuing with this potential for cross-selling. I wanted to ask you a little bit about specialty group. Are you reevaluating that segment in any way? Are there businesses in there that you would view as maybe not having either sufficient growth potential or maybe they just no potential for cross-selling with your other businesses and thus, some might be targeted for divestiture?

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

Sure. It's a great question. And we look at divestitures regularly, a possibility of divestitures regularly with our Board. But I can tell you in this MAP '25 program, in many ways, we're going just the opposite. We've had some challenges in our DayGlo business, but we've had huge success with our net polymers and then the Corsicana chemical plant that we bought in Texas. It's part of our Construction Products Group. We're taking those leadership teams and working with DayGlo to create a resin center of excellence in Europe and expect the same type of benefits in Europe that we're gaining from having some control over some key chemical raw materials.

Our Legend Brands business as a new MRO, if you will, focus that will allow for a more steady state as opposed to the swings of the weather events that have really spiked their business from one quarter to the next or one year to the next. And there's some real complementary efforts there with our Construction Products Group that is already in that asset management business. But we regularly look at opportunities to divest. And as you all know, the M&A market has been pretty dead. And so the -- whether it's on the buy side or on the sell side, we'll have to see interest rates come down and M&A activity and valuations come back up, and that plays both ways.

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**Operator**

The next question is from Frank Mitsch with Fermium Research.

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

Happy New Year. If I could just follow up on that last question kind of begs the -- it does beg the question about your thoughts on uses of cash. You just discussed the M&A markets a little bit. And I made the comment before about your buybacks today overstated. I don't know if that was a Freudian slip to try and signal that you guys are thinking about increasing your buybacks at these levels? What are your thoughts there, M&A versus buybacks?

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

So we are committed to buying back dilution in every year. And then -- boy, throughout my career here, we've been pretty strategic as to when we get aggressive in buybacks relative to how we perceive value. And that will continue. But we will be a more common, more regular buyer of our stock quarter by quarter, along with increasing our dividend. Frank, if you look at the opportunities we have with a higher level of permanent cash flow a year ago, we talked about -- and I think it might have been a question from you, focus on cash generation, and we indicated it would be to pay down debt. We've done that very successfully. But our dividend payout ratio over 20 years has gone from the mid-50s to the mid-30s. Our cash flow has increased dramatically, and we're in a better position to be a regular buyer of our stock and/or continue our dividend program unless in relationship to buying our stock, we see some sizable acquisition opportunities at the right value.

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

Got you. Very helpful. And if I could come back earlier, I believe it was Matt made the comment that unabsorbed fixed costs are kind of masking the benefits of the MAP program or what have you. And I guess I was thinking that for fiscal 2024 unabsorbed fixed costs would be materially less than they were in fiscal '23. How are you thinking about the interplay between this fiscal year and last fiscal year on that item?

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

Sure. They should be less than fiscal '23 in the second half. Unfortunately, not as much of a recovery as we had hoped because of our original expectation on volume growth, which as we covered in today's call, we're not seeing yet in consumer or the Specialty Products Group. But you're seeing in this quarter, and you'll see in future quarters a real strong leverage to the bottom line of our Construction Products Group and Performance Coatings Group because of the MAP '25 benefits. When we have good volume and it's going to be coming, you're going to see nice leverage.

**Operator**

The next question is from Kevin McCarthy with Vertical Research Partners.

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

A question on your sales mix by geography. If I look at Slide 5, it seems to me that there's a very large disparity between your negative 3% in North America and what looks to be an average of positive 9% to 10% overseas. It doesn't look like currency was a big factor this quarter. So I'm curious, can you speak to why you're doing so well overseas, what are maybe the 2 or 3 most important drivers in your view and how sustainable those might be? And do you think that in future quarters, we'll continue to see faster growth overseas versus the U.S.?

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

Sure. So I commented earlier on the call, Kevin, that what we're seeing, particularly in Europe is just a better focus and better organized approach. Think of it as a Map to Growth for Europe. And so we are driving efficiencies there. We're also having a more focused sales effort in a bunch of our businesses. And then lastly, we're rounding some easier comps, particularly in the U.K. that went into a recession before most of the other markets that we serve.

We also organized in what we call a platform approach for the developing world and it's having a real positive effect. So unless there is a some type of further disruption in a world of plenty of disruptions. I would expect that we would see really solid growth in Europe and the rest of the world and that the growth in North America probably is not going to be a lot different in the coming quarter than you see here, again, because of the year-over-year flat to negative in Consumer and Specialty Products Group, Hopefully, that will change in Q4, but we will see.

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

Okay. That's helpful. And then I wanted to follow up on the discussion regarding Specialty Products. Can you speak to the margin level and outlook there, Frank, I'm cognizant that you had a step down when you divested the higher-margin Guardian business there. First half of the year, it seems to be running 9%, 10%. How would you characterize the current level versus normal? And do you have a target for that segment margin looking out a couple of years? How can we think about the likely trajectory there?

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

Yes, that's a great question. And yes, we do. the Specialty Products Group should be generating in a better economic environment, mid to slightly higher teen EBIT margins. And they've been there before. The Guardian Products business was an outsized EBIT margin, but that was a $40 million business. And so our expectations are within an economic recovery in a few years that Specialty Products group will be back to the mid-single -- I'm sorry, mid double-digit, mid-teens EBIT growth. And to an earlier question, I'm very confident we can get there. We're taking advantage of this opportunity now to synergize a few things. But if we don't get back there, then we would take a look at that Specialty Products group or pieces of it in relationship to RPM's future.

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**Operator**

The next question is from Ghansham Panjabi with Baird.

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

Happy New Year. Just going back to the lower consolidated sales guidance for fiscal year '24. Can you just sort of clarify what specific segment or segments it is due to? And is the offset in maintaining your EBIT guidance, just purely incrementally more favorable price cost?

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

No. The EBIT guidance is a favorable price/cost mix and significant improvements from our MAP '25 initiatives. And as Frank Mitsch asked earlier, some better overhead absorption versus last year when we really tackled inventory shut down production in a number of places. So we've been very aggressive in rightsizing inventories. And after quite candidly, 30 years of my career talking about improving working capital, finally getting around to getting it done on a sustainable basis. So that's been our focus. And we're executing and it's happening. So we're excited about that.

But the EBIT margin improvement is a combination of cost price mix, which finally turned positive this fiscal year and the benefits of the MAP '25 program in our operations. One of the key things to that is that the vast majority of the MAP '25 initiatives are related to commercial activities in terms of how we incentivize salespeople relative to margins. It's focused on conversion costs and a number of areas there. So the impact is mostly a gross margin impact which means you don't realize it until you sell something. So it's not like an SG&A cut that you can annualize over -- divide by 12 and annualize over a year. It really flows into your P&L as you move units.

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

Okay. And then on the consumer business, I mean, if you kind of zoom out, there's been a lot of ups and downs over the years with COVID and supply chain shortages, et cetera, and then, of course, interest rates. What is the base case at RPM at this point for calendar year '24 in terms of volumes? Are you expecting a better year? I mean, obviously, interest rates impacted the markets last year, but that, in theory, should be in the base -- that should be in the base from last year.

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

Sure. I think you're asking about maybe fiscal '25, which starts on June 1. Our fill rates are back in the high 90s across the board. That was not true 2 years ago. We are at lower levels of inventory. And last year, for the first time in my career, shut down production in January and February to rightsize inventories where typically we'd be adding inventory to sell into a big spring season. So we've gotten much more agile in our manufacturing ability so that we don't have to have the same size as safety stock. So those are the improvements that we have made. But fill rates are where they need to be. I think inventories, for the most part, in the supply chain or where they need to be.

And we just need to help with our retail customers, drive consumers back into the stores, help them think of projects that they can do. And the real first opportunity for us to do that will be this spring because of the seasonality of the business in particular. You see we expect good leverage in the third quarter, but the third quarter is not where we expect to see any revenue surprises because of the weather seasonality of some of our industrial businesses and certainly our consumer group.

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**Operator**

(Operator Instructions) The next question is from Arun Viswanathan with RBC Capital Markets.

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

Happy New Year. So I guess, first up, I just wanted to go back to kind of the sales outlook. It looks like it's kind of a tale of 2 cities here with the consumer and Specialty Products group may be a little bit more sluggish, while restoring infrastructure drives more strength in Construction Products and PMC. Would you see that maybe switching as we move into the back half of calendar '24, maybe I'll just start with that and just see if that's kind of in line with your thinking?

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

No. We think that the Construction Products Group and Performance Coatings Group will have a solid second half of fiscal '24 and the dynamics that we had talked about earlier in terms of stimulus infrastructure bills and increases in industrial capital spending and a resurgence in manufacturing should go well for those business units and product lines in fiscal '25. I think the thing that we're focused on is continuing to improve our businesses and operating leverage with the expectation, whether it's in Q4 or as we get into fiscal '25 seeing some positive unit volume growth out of consumer and a return to growth in most of our Specialty Products Group companies.

And again, that's where we're most exposed to OEM coatings to residential construction. And we're not alone in having a very difficult challenge. There are certain segments of manufacturing that have had a tough year and anything that touches housing in the last year has not done very well.

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

Got it. And then you mentioned fiscal '25. I think previously you had put out some MAP 2025 targets of that 16% adjusted EBIT margin. Do you still see that in the cards? I think we're maybe a couple of hundred basis points below that on an annual basis right now. But maybe what's kind of the bridge to getting there? What are some of the factors that we would need to see to realize that level of margin performance?

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

Sure. I think we're on target for that. I think whether we can achieve that on the timeliness or within the time frame that we communicated depends on when we see the turn in positive unit growth in consumer and our Specialty Products Group, but we'll have a pretty robust appraisal of that when we release our fourth quarter results in July and talk about the balance of our 2025 fiscal year, which is the end of the MAP '25 program.

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

And just lastly, I think this question you may have offered some comments, but I just wanted to ask again. Within any of the businesses, are there any particular areas that you think are just likely -- not likely to recover as you see and maybe candidates for divestiture? How is kind of the portfolio review going?

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

Sure. Yes, not at this time, but back to your earlier question. One of the key elements of getting to that 16% consolidated EBIT margin is a Specialty Products Group whose group level EBIT margins are in the mid-teens or slightly higher which is up from about a 9% or 10% level today. So there needs to be a significant recovery there, and we're focused on it. Without that, we will not hit the 16% consolidated goal.

**Operator**

This concludes our question-and-answer session. I would 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. We appreciate everybody's participation in our investor call this morning and for your continuing interest in RPM. I'd also like to thank our associates for their tremendous dedication and their hard work in fiscal 2024. We are executing at a high level, and you can see it in our results. And lastly, to all on the call. We wish you a happy, healthy and prosperous new year. Thank you, and have a great day.

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.