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RPM.N - Q1 2027 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 2027 first-quarter earnings conference call. (Operator Instructions)

Please note, this event is being recorded.

I would now like to turn the call over to Matt Schlarb, Vice President of Investor Relations and Sustainability. Please go ahead.

Matt Schlarb - *RPM International Inc - Vice President - Investor Relations & Sustainability*

Thank you, Gary, and welcome to RPM International's conference call for the fiscal 2027 first-quarter. Today, this call is being recorded. Joining today's call are Frank Sullivan, RPM's Chair and CEO; Rusty Gordon, Vice President, and Chief Financial Officer; 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 involve 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 see 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 comparable GAAP financial measures on the RPM website. Also, please note that our comments will be on an as-adjusted basis in all comparisons to the first quarter of fiscal 2026, 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.

Effective June 1, 2026, certain Latin American businesses in the Construction Products and Consumer groups with annual sales of \$128 million and \$15 million, respectively, were placed in -- were moved to the Performance Coatings Group. This change has no impact on consolidated results, and details of the changes can be found in the Form 8-K filed today. Current and prior year results reflect the updated structure.

Now I will turn the call over to Frank.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Thanks, Matt, and thanks to everybody on the call this morning. I'll begin on slide 3 with a high-level overview of our performance. Mike Laroche will review the financial results, then Matt Schlarb will cover our balance sheet cash flow and discuss some of our successes in the emerging markets. And then Rusty Gordon will finish with our outlook.

Our results show we delivered record first-quarter sales, adjusted EBITDA and adjusted EPS despite sluggish end markets and several temporary operating headwinds. These results demonstrate the strength of our balanced business model. Broad-based growth in Performance Coatings Group and Consumer more than offset temporary softness in our Construction Products Group. Additionally, our SG&A optimization actions played a role in offsetting raw material inflation and other expenses.

Slide 4 illustrates how our SG&A optimization actions helped offset gross margin pressure. As expected, we offset raw material inflation on a dollar basis, but gross margins declined 100 basis points as the rate of raw material inflation outpaced pricing and MAP benefits in the quarter.

Even with that pressure, we compensated for this by leveraging SG&A as a percent of sales to maintain the adjusted EBITDA margin, consistent with the prior year quarter. This outcome reflects the benefits of the SG&A focused actions we have implemented across RPM. These savings helped offset the gross margin headwinds while also allowing us to continue investing in growth and serving customers.

We are pleased with the organization's cost discipline and the ability to grow in an uncertain economic environment, and we continue to expect additional pricing and operational improvements to support margins as we face continued inflationary pressures during the balance of our 2027 fiscal year.

Slide 5 highlights emerging markets generating more than 20% revenue growth, fueled by demand for engineered solutions for high-performance buildings and infrastructure. North America delivered solid growth, led by strong performance in our Performance Coatings Group and our Consumer businesses. European growth was primarily driven by acquisitions. Our emerging market success was driven by our Platform Group structure, which oversees operations across RPM businesses in these regions. The Platform Group reports as part of our Performance Coatings Group segment but sells products for businesses across all RPM segments.

Historically, our decentralized structure limited our ability to fully capitalize on emerging market opportunities. Several years ago, we created the Platform Group to have a more cohesive strategy and operations in Africa, Middle East, and the Asia Pacific regions. Following several years of successful growth, at the beginning of this fiscal year, we added South American businesses to the Platform Group as well.

The structure has been successful for multiple reasons. First and foremost, because an excellent management team has leveraged assets where it makes sense, such as shared manufacturing and distribution facilities while still providing autonomy to local sales teams who understand the markets best. Additionally, businesses across RPM have increased cooperation to provide support to our Platform Group in areas including brand management and product development.

The Platform Group is an excellent example of the Power of RPM in action - leveraging our leading products and services alongside the scale of our businesses to drive growth and profitability. The addition of our South American businesses further enhances our ability to capitalize on that scale and accelerate growth in this important region.

So to summarize the quarter, we made tangible progress on SG&A expense reduction which, along with other MAP initiatives and our strategic balance, helped us offset higher inflation and temporary market slowdowns in our Construction Products Group. We'll provide more details on these operational improvements and other aspects of our MAP 2030 at a previously announced Investor Day on November 9 at our Stonhard facilities in Maple Shade, New Jersey.

Scheduled speakers at our Investor Day in November 9 include myself; Dave Dennsteadt, our newly appointed President and Chief Operating Officer; Rusty Gordon, RPM's Vice President and Chief Financial Officer; and our Performance Coatings Group President, Greg Michael. If you would like to attend in person, please contact Matt Schlarb as there is some limited availability. We will also be webcasting the event, which will start around noon Eastern Time.

Details on how to join the event are available on our website.

I'd now like to turn the call over to Mike Laroche to provide more details of our quarter.

Michael Laroche - RPM International Inc - Vice President, Controller, Chief Accounting Officer

Thank you, Frank. Turning to slide 6. First-quarter sales increased to a record, led by our Performance Coatings Group and Consumer segments, which both had solid organic growth. Adjusted EBITDA increased to a record. Higher sales and MAP benefits, including SG&A optimization actions, more than offset raw material inflation, warranty expenses, and bad debt expense.

In non-operating expenses, health care expenses declined, driven by our team's effort to reduce prescription drug costs. Adjusted diluted EPS increased 5.3% to a first-quarter record \$1.98.

Moving to the segment details on slide 7. CPG sales increased, driven by the Kalzip acquisition. Organically, sales declined, reflecting a slowdown in education and health care markets, which together comprise over 1/4 of CPG's end market exposure. We also experienced finished product shortages caused by the supplier raw material constraints in polyurethanes we called out last quarter.

Adjusted EBITDA declined as lower volumes reduced fixed cost absorption, while inflation, bad debt and warranty expenses were additional headwinds. SG&A optimization partially offset these items. While the quarter was below our expectations, several of the profitability headwinds were temporary in nature.

Turning to slide 8, the Performance Coatings Group delivered record results with broad-based growth led by engineered solutions for high-performance buildings, energy, and infrastructure projects, particularly in emerging markets. Food coatings and ingredients also contributed to the strong growth. Adjusted EBITDA and adjusted EBITDA margin increased to a record as improved fixed cost utilization and SG&A optimization actions more than offset inflation.

On slide 9, Consumer sales increased to a record, including 5.2% organic growth. Shelf space wins, new products, and pricing supported this growth. Both adjusted EBITDA and margin increased during the quarter. Higher volumes improved fixed cost utilization, while MAP and SG&A optimization also contributed to increased profitability.

Now I'll turn the call over to Matt to discuss the balance sheet and cash flow.

Matt Schlarb - *RPM International Inc - Vice President - Investor Relations & Sustainability*

Thank you, Mike. Moving to slide 10. We generated another quarter of strong cash flow driven by improved profitability and working capital efficiency. Working capital improved 150 basis points compared to the prior year despite the volatile raw material situation. As a result of the strong cash flow generation, we returned \$90.5 million to shareholders through share repurchases and dividends, an increase of 10.2% year-over-year.

Total debt declined \$263 million as we used some of this cash flow to repay debt. Looking at our leverage, as you will see in our 10-Q filing later today, it has returned to a similar level to where it was prior to The Pink Stuff acquisition in late fiscal 2025, which is the largest acquisition in RPM's history. Subsequently, we have also completed several other acquisitions, including Ready Seal, Kalzip and PAVA resin.

Most recently, we acquired Volteco at the beginning of October. Volteco is an Italy-based leading supplier of below-grade waterproofing solutions used globally in demanding applications.

The company generated calendar year 2025 sales of EUR28 million. Volteco has joined the Construction Products Group and provides complementary technology to their leading waterproofing solutions.

Turning to slide 11, as Frank mentioned, we have taken a more collaborative approach to operating in emerging markets with our platform structure. The investments we have made in the region and in our associates there have contributed to double-digit growth in the region for multiple quarters. Similar to other geographies, our solutions are resonating with owners and builders of high-performance buildings in these markets. As a reminder, high-performance buildings have demanding specifications where the cost of building failure is elevated.

With our people, service, engineered solutions and the trust we have built in the marketplace, we have been winning more of these jobs and are optimistic that emerging markets will be a key growth driver for us in the future.

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

Russell Gordon - *RPM International Inc - Vice President, Chief Financial Officer*

Thank you, Matt. Turning to slide 12, I'll provide an update on raw materials before we get to the outlook. Inflation expectations have increased since we held our last earnings call on July 22. As we mentioned in July, there were shortages in polyurethane feedstocks during the first-quarter, and those became more pronounced than we had expected and negatively impacted sales.

Our procurement team quickly secured additional supply to mitigate the impact, but at a higher cost that, because of FIFO accounting, will impact our P&L. Additionally, the sustained rise in oil and other commodity prices over the past couple of months has caused our inflation expectations to increase in other raw material categories. As a result, we now expect second-quarter inflation will be in the 9% to 11% range, up from our previous estimate of 6% to 8%.

For the third-quarter, we anticipate inflation will be 7% to 9% as inflation remains widespread, but we start to annualize prior year inflation in some raw material categories. We have implemented additional pricing increases across all our segments, which will help offset this inflation, but it will lead to gross margin pressure for the year.

Now moving to the outlook. Our second-quarter outlook is on slide 13. We expect consolidated sales to increase in the low to mid-single-digit range. By segment, we expect CPG sales to increase in the low single-digit range; PCG in the mid to high single-digit range; and Consumer in the low to mid-single-digit range. We expect consolidated EBITDA to also increase in the low to mid-single-digit range. SG&A optimization actions, pricing increases and MAP benefits are expected to offset sluggish end markets, inflation, and start-up costs at new shared facilities.

Next, moving to our full year outlook on slide 14. We are narrowing our fiscal 2027 sales growth to mid-single-digit growth from our previous outlook of 3% to 7%. Adjusted EBITDA is now expected to grow mid-single digits compared to a previous outlook of up 5% to 10%. MAP benefits, including the previously announced \$75 million of SG&A-focused savings and incremental pricing are expected to offset persistent inflation, which has increased from our previous outlook.

Additionally, we'll face start-up costs at new facilities and more challenging comparisons in the second half of the year. Towards the end of the year, we do expect our CPG segment to return to positive organic growth.

That concludes our prepared remarks. We will now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

John Roberts, Mizuho.

John Roberts - Mizuho Securities USA LLC - Analyst

For the CPG segment, for the health care and education markets specifically, what's the outlook there? I think Rusty just said, we expect CPG to be positive by the May quarter. Do we expect education and health care as well or are we just going to offset continued headwinds there?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

I think we'll see a rebound in both of those areas. In the school system area, it is a slowdown in part driven by funding at local levels and state levels, and we're starting to see some of that free up. But given the nature of our Tremco Roofing business in particular where it's most acute. If we don't see it this fall, it really won't show up in terms of activity until the spring of next year.

And in the health care sector, we think it's a temporary slowdown. But again, in both instances, we would expect to see improved results and improved activity in the second half of the year. That's why we've addressed a reduction in our outlook for Q2.

John Roberts - Mizuho Securities USA LLC - Analyst

And then customer bankruptcies have popped up a couple of times now in recent quarters. With the higher interest rates and weak end markets, are you increasing your provisions in your guidance?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Our provisions are appropriate. A prior bankruptcy was related to a retailer that was serving our Industrial Coatings Group. And in this case, we actually took a charge for a defense project that we're on and it was a defense contractor that declared bankruptcy. We wrote off the receivables, but believe that we'll have an opportunity to recover a significant amount of that given the nature of the project.

Operator

John McNulty, BMO Capital Markets.

John McNulty - BMO Capital Markets - Analyst

I guess maybe just to flesh out the CPG side a little bit more, so I guess can you help us to think about how much of the weakness was tied to the education and health care side versus the product shortages due to some of the supplier raw material challenges? And how quickly or are we through the supplier raw material challenge issues, or do they drag on for another quarter or so?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Sure. The polyol issue negatively impacted the Construction Products Group in both our sealants business and roofing business as it relates to urethanes and coatings. And we're one of the leaders in roof restoration coatings. So it was a drag on sales. The shortage issue is now behind us in terms of production, but we're catching up on inventory in Q2.

So we still have some work to do. And it's part of our understanding as to how things will recover. Some of this is work we have to catch up on, on a backlog of projects that we couldn't fulfil because of raw material shortages.

On the weakness in education and health care markets, some of that's just a shrinking backlog, again, principally in Tremco Roofing and our WTI contracting business. And we are seeing efforts to rebuild that and they're moving in the right direction. I think sequentially you'll see an improvement in Q2 over Q1 in our Construction Products Group. But again, given the seasonal nature of our roofing business, that rebuilding backlog will impact our second half of the year and really the spring months, so the end of Q3 and into Q4.

John McNulty - BMO Capital Markets - Analyst

Okay. Fair enough. And then maybe more positively on the Consumer side, saw a nice lift in terms of organic sales. I guess, can you help us to think about how much of that was volume driven? It seems like that business has been struggling for now really a number of years to drive growth.

And it seems like you may be turning the corner. I guess I'm trying to understand if it's any real true end market demand or if it's more about the shelf space that you're picking up and maybe some of the new business wins. Can you help us to think about that and unpack it a bit?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Sure. I'll provide a couple of high-level comments and then turn it over to Matt Schlarb for some more detail. So at a high level, the underlying dynamics, quite candidly, are not getting better. Consumer takeaway and foot traffic in major retail customers of ours is still sluggish. The housing market and housing turnover is not getting better. And with rising interest rates, we don't expect to see that.

We had positive unit volume growth and positive organic growth in Consumer for the first time in a number of quarters. And it's really related to two areas. Market share gains and some new placements, and after a slow start, improving results in The Pink Stuff in our cleaners category. Matt, do you want to add some color to that?

Matt Schlarb - *RPM International Inc - Vice President - Investor Relations & Sustainability*

Yes. Like Frank said, The Pink Stuff, it's nice to see some positive momentum there. Last quarter, we talked about they had experienced slowdowns. We've also had some wins in abrasives. That's the business we acquired a few years ago. The Ready Seal, that's the exterior wood stains business, has performed really well since we acquired it.

Another category we've had some wins is in primers where there, we've taken some shelf space and had some additional pickup at stores through that. So it's a combination of all these different wins that you add them up, and it helps to offset some of the soft economic backdrop that Frank talked about.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

So those new placements, whether it's in abrasives, we're doing really well in retail automotive, some shelf space and, quite candidly, just expansion of our Zinsser primer given some dynamic shifts in the customer base will continue in Q2. And it's nice to see our Consumer business beginning, albeit modestly, to building some positive momentum after a tough couple of years.

Operator

David Begleiter, Deutsche Bank.

David Begleiter - *Deutsche Bank AG - Analyst*

Frank, on the full year guidance, I believe you lowered it by roughly \$25 million at the midpoint. Can you just break that down, what the components of that reduction for the full year guide?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

So it's a little bit of a swag in the sense that I think we have some good visibility into Q2. But we're making some assumptions about, as Rusty highlighted, inflation beginning to trend downward, but still be at a higher level than we anticipated just a few months ago as we get into the spring. And it's really a bet on when we'll see a recovery in our Construction Products Group, and specifically Tremco Roofing. So those are the dynamics there.

And given costs, given inflation and how energy costs have now melded its way into materials, also freight is up meaningfully, whether it's truck transportation, ocean going. And so we're instituting some freight surcharges across a number of our businesses, along with price increases. So it's a pretty dynamic market. I think that's the best we have for you in terms of how we developed the full year guidance.

David Begleiter - *Deutsche Bank AG - Analyst*

Got it. And just on Q2, the price cost differential given the increase in inflation assumptions, I presume you're expecting pricing to lag costs on a dollar basis in Q2. Is that accurate?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

So we have covered dollar-for-dollar inflation in Q1, and we'll probably do a little bit better in Q2. As Rusty mentioned, given FIFO accounting for RPM, you typically see a lag in our reported results between inventory and how it flows through our P&L.

I'll remind folks that when we went through the last bout of inflation, our gross margins from start to finish improved. And I would expect the same thing as we go through this bout of inflation, which to the extent that it is related to disruption in the Middle East, any stability there and return to moderate inflation will allow us to see margin improvement once again.

It's interesting, we saw little or no inflation for a six-month period from the end of calendar '25 through the late spring of '26, and even some reduction in raw materials. We were not planning on price increases. And we've adjusted pretty quickly. I think we and others have learned how to adjust in this volatile market.

Operator

Matthew DeYoe, Bank of America.

Hakim Sanfo - *Bank of America - Analyst*

Hakim on for Matthew. My question is on the warranty charge. Can you provide more color on that, and if we expect to see that going forward or additional charges?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Sure. That's related to a specific business unit of the Construction Products Group in Europe. And that is an element of a likely closure of that business unit, the details of which we'll provide at the Investor Day.

We are looking across our portfolio and either product lines or business units that are under-performing. And from a margin goal perspective, not likely to meet our goals, taking a hard look at a number of fix or exit items, and that falls in that category. So it is unique to that business unit, and we do not anticipate further warranty issues there.

Operator

Patrick Cunningham, Citi.

Alexander Yi - *Citi Research - Analyst*

This is Alex on for Patrick. In Consumer Group, maybe I was hoping you could kind of share some of the growth in Q1. What were some of the new product introductions? Were there any kind of share wins in the business? If you could kind of help us understand the Consumer segment. And I know it's a small part of your overall sales, but maybe on a high level, could you also kind of help us understand what you saw in Europe?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Sure. European sales growth is primarily driven by acquisition activity. Economic dynamics there are not really strong. We're continuing to see profitability improvement there driven by internal actions, consolidation across distribution, different administrative areas. So that's what's happening in Europe.

I'll let Matt repeat what he commented on a few minutes ago. We've had a number of shelf space gains, market share gains and new product introductions in Consumer which were commented on by an earlier question.

Matt Schlarb - *RPM International Inc - Vice President - Investor Relations & Sustainability*

Yes. And I'll just add on to that. In addition to some of the product wins that I mentioned, we're winning in different sales channels places like grocery stores, we've had wins. Digital -- online distribution, that's another place where we've seen good growth. So it's a combination of both new products plus these different sales channels where we're having nice growth.

Operator

Ghansham Panjabi, Baird.

Ghansham Panjabi - *Robert W. Baird & Co Inc - Senior Research Analyst*

Frank, just kind of stepping back a little bit, since you last reported, obviously, interest rates are up quite a bit and oil has flared up again along with raw materials, as you commented on before, do you sense any sort of change as it relates to underlying demand as it relates to conversations with your customers, as it relates to the outlook, et cetera? It doesn't look like you've seen it so far, but of course, there's lagged impacts from some of these dynamics I just touched on.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Sure. Appreciate the question. Long term, not really. You see strength in our PCG business group, and we're still seeing good work in tech, good work in onshoring and manufacturing, still benefiting from data center build-out. And within our Construction Products Group, the one real bright star there is Euclid, for all the same reasons.

We believe that the slowdown in schools is temporary and really related to funding issues, again, at the local and state level, probably to be freed up once we get through this election cycle. And the hospital situation also, we believe, is temporary.

We have some work to do to rebuild the WTI backlog, which is happening. But as I commented earlier, big picture, I think the trends are good specific to RPM. We won't see a return in those businesses to the type of industry beating and peer outperformance that our CPG unit delivered for like the last eight quarters until we get in the spring.

So we see a return to that. But again, part of it is where we are in the seasonal cycle and just being candid about when people can expect to see us get back to the type of top line performance the CPG group has been delivering.

Ghansham Panjabi - *Robert W. Baird & Co Inc - Senior Research Analyst*

Okay. Perfect. And then for the Consumer business, the first-quarter, call it, 5% or so sales growth. You called out shelf space wins and new product introductions, et cetera. As it relates to the growth guidance for 2Q for the segment of low to mid-single digits, is the difference between the two just the new products and the shelf space wins? Or am I reading too much into it because it is a broad range?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

No. It's new products and shelf space wins. It's an improvement in The Pink Stuff and the cleaners category, which has been separated as its own business unit within consumer. And so that's nice to see. And it's self-help and really a lot of good work by our Consumer Group associates because the underlying dynamics in terms of consumer takeaway, foot traffic, housing prices driven by interest rates and housing turnover, we do not see any signs that that's improving.

And so you can see decent results, and you'll see them again in Q2. The whole industry and our whole peer set will be a happier place when the housing turnover starts to perk up and foot traffic starts to pick up a little bit. Would remind you that housing turnover's at a 40-year low. And with rising interest rates and mortgage rates, that's not going to get better until things improve in that realm.

Operator

Frank Mitsch, Fermium Research.

Frank Mitsch - *Fermium Research LLC - Analyst*

I wish your team good luck this Sunday, but we both know I don't mean that.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

You and I need a Fermium-RPM swag, but on the Jets-Browns this weekend.

Frank Mitsch - *Fermium Research LLC - Analyst*

That can be arranged. I'll have to run it by the Board of Directors, but we'll come back. Apologies if I missed it, but what was price versus volume for the company and Consumer in the first-quarter?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

So typically, we haven't provided price on a segment basis. But you're looking at price on a consolidated basis up about 2% across RPM, and unit volume up decently, low to mid-single digits, in Consumer and PCG. And as indicated by our results and particularly specific to Tremco Roofing and WTI, for the first time in a couple of years, modestly negative in the Construction Products Group.

Frank Mitsch - *Fermium Research LLC - Analyst*

Terrific. Very helpful. And this is the second-quarter that your buybacks exceeded \$20 million per quarter. Obviously, with the shares trading where they are, how should investors think about the pace of buybacks from RPM?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

The pace of buybacks at RPM will continue. Our Board has authorized a larger share repurchase. And given where our stock price is, I certainly would expect us to see a continuation of current levels, if not higher.

Operator

Josh Spector, UBS.

Joshua Spector - *UBS AG - Analyst*

I wanted to follow up just on price and kind of think about the cadence here. I mean two things here, is one, it seemed like last quarter, you guys were talking about pricing around 2%. It doesn't sound like it accelerated much sequentially, at least on a year-over-year basis. Are

you having any trouble getting pricing in CPG or any of the other segments versus what you expected? And how do you expect that to ramp over the next couple of quarters?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Sure. So I would expect price in Q2 to be somewhere in the 2.5% to 3.5% range. And the other area where we will recover margin is surcharges around freight. That's one of the larger inflationary issues that's impacting businesses today.

We had announced price increases in Consumer that have gone into effect at the end of Q1 and in the beginning of Q2. And we are in the process of initiating new price increases across most of our Construction Products Group and Performance Coatings Group businesses here in Q2.

Joshua Spector - UBS AG - Analyst

Okay. I guess what I'm struggling with a little bit is that, if CPG volumes are only down modestly, it would mean that pricing in CPG is pretty weak. I think if pricing was similar to the group, it'd be down closer to mid-single digits. So I guess specifically there, is there anything you'd comment to help clarify any of that? And just margins looking at the November quarter, would you expect them to be down much less than the 200 basis points plus you saw in first-quarter?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Yes. Some of that is absorption and plants. Some of that is some continued excess costs as we do the final stage of transitioning out of what was the largest CPG facility in Toronto into mostly our Georgia plant. And so those are some of the extra headwinds.

But again, we covered dollar-for-dollar inflation. We expect to do modestly better than that, and we'll begin gaining, not just recovering inflationary cost, but regaining margin as we roll through the year.

Operator

Abigail Eberts, Wells Fargo.

Abigail Eberts - Wells Fargo Securities LLC - Equity Analyst

Following up on your assumptions for raw material costs, underpinning that, what are your assumptions for when the conflict in the Middle East resolves? Because it looks like you have costs decelerating through the year. I know part of that's pardon the polyol issues getting resolved and comparisons versus the prior year. But are you assuming that the conflict deescalates later on in the year?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Not at this point in time. Again, anticipating, even in the second half of the year, inflation that's in the high single digits is not something that we saw on our radar screen two or three months ago. Certainly, if there is a meaningful stability in the Middle East in the coming months or after the election, and oil prices respond accordingly, I would expect us to get back to lower inflationary periods.

As I indicated earlier in the call, we saw, for a six-month period, little or no inflation in our core raw materials, some declines in certain chemical -- more commodity chemicals, stability and freight costs. We were not planning additional price increases in the spring, and that changed pretty dramatically because of geopolitical events that you're referencing.

So we are not anticipating any good news there. And I think as the markets have indicated, if there's any stability and/or agreements that the markets believe will be sustained, you'll see a corresponding response in oil prices, which, first and foremost, should positively impact freight transportation costs and then get our raw material costs back down. That's not cavalier.

The two dynamics here are oil prices and energy costs and how they've translated now through supply chains. But also demand, which still isn't real robust. And so a sustained relief in energy prices and oil prices will either pick up business demand or will drive down raw material costs given the lack of demand that we saw this spring.

Abigail Eberts - Wells Fargo Securities LLC - Equity Analyst

Got it. And then just on Consumer, don't worry, not another question about shelf space wins. Yes. But you've mentioned the Consumer trading down in terms of product. Does that lead you to be concerned about your ability to push price increases at all?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

No. We've been selective in price increases where we can. And I appreciate your reference to past calls about Consumer price elasticity. I can tell you a good example would be the five-in-one, very unique patented spray nozzle that allows five different spray patterns to come out of a spray can. And what we learned is on the shelf to the general public, it was too high priced. We are picking up really nice shelf space and market share gains in automotive. And what we've discovered is the automotive touch-up spray paint user really values the different spray patterns there.

So we are learning across all of our businesses really from a value perspective where our premium products and our value-added products are appreciated and where they'll be purchased and where we can gain price. And across all our businesses, just like this example, we're also learning where there's price elasticity and where higher premium prices are not going to be successful. So I suspect most businesses are getting more sophisticated as we keep dealing with the volatility in these markets, and that's certainly been true of our Consumer Group.

And it's part of their success now. And so you're seeing a product category that's growing very nicely at a premium price because they found the people that value it.

Operator

Mike Harrison, Seaport Research Partners.

Michael Harrison - Seaport Global Securities - Analyst

I was hoping, Frank, that you could talk a little bit more about the emerging markets success that you've seen, not just in this quarter, though it was very pronounced this quarter, but it seems like there's some momentum building and maybe some sustainable improvement here.

So maybe some color on what you're seeing there. And I'm curious, does the success that you're seeing in emerging markets mean that it might make more sense for you to look at acquisitions or other means to get bigger in those markets now that you seem to have kind of solved the equation?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Sure. I really appreciate the question, Mike. And so the answer is yes to your second question. I think we have a leadership team, an organizational structure approach that will give us more confidence to pursue acquisition opportunities successfully in these emerging markets.

I'll give you the high level here, which is, I think -- really tells you about the trajectory. As recently as five years ago, the Southern Hemisphere and developing world was slightly less than 5% of our consolidated sales. In the first-quarter, it was 8%. And you will see that continuing to grow. We have been growing for almost two years at a high double-digit rate, both in sales and earnings. So you're seeing improved cash flow, improved margin profile, and really good acceleration.

So we've got great brands across RPM, particularly in our industrial businesses, but we just weren't organized in a manner that worked in these developing countries. Today, this RPM platform approach, basically a leadership team in the region is responsible for manufacturing, distribution, and administration across the entirety of RPM products sold in that region. And with the help from the primary brand owner businesses and that RPM entrepreneurial approach to customers in terms of independent sales and marketing, it's really paying off. And we expect that to continue for a lot of years.

And I appreciate your insight. You should expect to see, not large, but more successful additions to growth through acquisitions because we've got a lot more confidence in our ability to integrate them and make them work than we had a few years ago.

Michael Harrison - *Seaport Global Securities - Analyst*

All right. Very helpful. And then I was hoping if you could give some updated thoughts on just the operational front. It sounds like maybe we're still seeing some lingering impact from consolidation and start-up costs and maybe some temporary inefficiencies in your manufacturing costs. Any thoughts on the timing of when we see some of those inefficiency turn into benefits and start to see that flowing through the P&L?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

So I'll give you two quick comments there. Number one, we'll provide more detail on your question at our Investor Day on November 9, so we can do so in a way we're not prepared to now, more specificity about when you'll see the benefits of the consolidated distribution in Europe, when we'll get the transition behind us in CPG. So we'll have that detail by November 9.

The other thing I'd point to, and Matt Schlarb highlighted this in his comments, we're continuing to improve working capital efficiency, and that is good RPM MAP-focused benefits on the factory floor, and there's more to do there. And we'll provide more details at our investor deck.

On our Investor Day, you're going to see the same type of detail that we have provided in our last MAP initiatives. You're going to see a waves plan focused on efficiency and operating improvements. You're going to see goals on growth. I would take the waves plan to the bank because we've shown two of those and we've made them happen. We need to prove to the market that we can hit our growth goals and really talk about the new initiatives that allow us to do that. So we're pretty excited about November 9.

You'll also see our Stonhard operation in Maple Shade, New Jersey. I would bet it's one of the most productive plants in the whole industry. So we look forward to showing that off as well.

Operator

Salvator Tiano, KeyBanc Capital Markets.

Salvator Tiano - *KeyBanc Capital Markets Inc - Equity Analyst*

I was just wondering here, given the spike in interest rates, especially in the past month or so, how's your view on what leverage is appropriate for RPM or what you can do in terms of buybacks or M&A changed recently? Or for now, everything is staying the same?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Sure. So we've always operated with a goal of maintaining an investment-grade rating. We're middle BBB rated today. We have about \$1.2 billion in liquidity between cash and unused committed credit. I think we could use up the entirety of that \$1.2 billion and then some and still maintain an investment-grade rating.

Our debt-to-EBITDA has, while maintaining that low investment-grade rating, been at or above three. And today, we're meaningfully below two. So we've got a lot of room in our balance sheet. We see opportunities. They tend to be small to medium-sized deals and M&A. And as I commented earlier, given weakness across a number of our industry peers and certainly in RPM and our stock price, we have ample dry powder to repurchase shares on an opportunistic basis.

Salvator Tiano - *KeyBanc Capital Markets Inc - Equity Analyst*

Perfect. And besides, obviously, a weakness in the RPM stock price, I wonder, are you seeing perhaps some stress within smaller competitors that potentially could make other deals more attractive going forward?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

I think the biggest thing that's making deals more attractive in this environment is a combination of slow growth and higher interest rates, and P/E that was very aggressive across industries, but in our space as well, let's say, five or seven years ago. And there are two factors there. They're sitting on a lot of properties that are underwater because of economic dynamics that I just referenced.

But more importantly, they're not in the markets with crazy multiples. There were instances in the last five years when, let's say, four or five years ago, when there's a property there and the fourth, fifth and sixth buyers are big strategic public companies, and the first, second and third buyers are P/Es.

That's over. And so you're seeing multiples in the M&A environment down by two or three points, in my opinion, principally because P/E is not the competitive factor in M&A activity today than they were, let's say, five years ago.

Operator

Kevin McCarthy, Vertical Research.

Kevin McCarthy - *Vertical Research Partners LLC - Analyst*

Frank, was the month of September notably better or worse than you might have anticipated across any of your major business lines?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

We will give you the month of September and/or it in conjunction with October and November when we report our second-quarter. Other than to say, from an outlook perspective, nothing's really changed. I think somebody had commented earlier that a good indicator of what our second-quarter will be is kind of what our first-quarter is.

We expect really good strength in PCG, continued stability and benefits from some market share gains and shelf space gains in Consumer, and a sequentially better but still less than what we've been delivering on in the Construction Products Group.

Kevin McCarthy - *Vertical Research Partners LLC - Analyst*

Okay. Fair enough. And then if I may ask a broad question. It strikes me that your Performance Coatings results were quite strong, whereas we've spent a lot of time on the call talking about maybe some volume pressure and other issues in Construction Products. If you compare and contrast those segments, Frank, what accounts for such a large difference there?

Is it the notion that the health care and education customers in CPG are not linked to industrial production, so the IP side is running stronger than maybe some more GDP-oriented businesses? Or have you seen this kind of divergence in the past? Curious to hear your thoughts along those lines.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Sure. I think there's two primary reasons. Good question. One, the Performance Coatings Group is more driven by industrial capital spending. So manufacturing, onshoring, the data center activity. But also importantly, the Performance Coatings Group is where our Platform approach is housed. And so that's also adding to the strength of the Performance Coatings Group numbers. And we, as I said, we expect that to continue.

The Construction Products Group, quite candidly, has had extraordinary two years of performance given the underlying dynamics of commercial construction activity. And so it's disappointing to see a quarterly slowdown. We believe it's temporary for this in the second-quarter. But the underlying dynamics there in commercial construction and broad construction activity have not been great, and that more heavily impacts our CPG versus the industrial capital spending and, more broadly, international presence of the Performance Coatings Group.

Operator

Arun Viswanathan, RBC Capital Markets.

Arun Viswanathan - *RBC Capital Markets Inc - Analyst*

So just wanted to get your thoughts on margins. It looks like there's potentially some extra raw material pressure kind of flowing through. So how do you expect that to kind of evolve over the next few quarters? And do you expect to be successful on some pass-through price? And I guess maybe if you can just elaborate on that by segment, that would be helpful.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Sure. I think that, as we commented earlier, we're successful in passing on the dollar impact of inflation, and that will continue. We'll be gaining on margin improvement as we sequentially go through the year. And then as we've done in the past, it's my expectation that we will recover 100% of any lost margin and maybe a little bit more.

The one area where that will not be true is in freight surcharges. So we are passing on dollar-for-dollar freight surcharges in many of our businesses to customers. And as those freight costs come down back to normal levels, then if and when we rescind those temporary surcharges, that's literally just covering your dollar expense. But we'll pick up margin there too just based on the impact of the higher sales on a lower expense base.

Arun Viswanathan - *RBC Capital Markets Inc - Analyst*

Okay. And maybe as a follow-up I can just ask this a slightly different way. But I think in the past, you talked about 16% EBIT margins, which would be kind of 200 basis points or more at this point recovery, and getting to that point kind of on a structural basis maybe through some of the MAP actions. Is that still kind of in your line of sight? Maybe you can kind of think about how you're thinking about longer-term margin recovery and ultimately growth.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

So two quick comments on that. Number one is we had set out a goal of 42% gross margins and a 26% SG&A on a consolidated basis. We were close to the 42% gross margins and had line of sight to achieving that. And then here we are in another round of inflationary pressures. I am highly confident as we get through this inflation cycle, we will meet or beat that 42% goal.

We struggled for both some cost reasons and lack of revenue growth, so leverage on the top line, on our SG&A goals. We took a very aggressive crack at that with a \$100 million expense reduction program that was initiated in January of last year. So in the grand scheme of things, those previously announced goals were still in play.

On November 9, you will see some pretty good detail of our expectations of our margin goals, cash flow goals, profitability and what we think we can do revenue-wise out to 2030. So I would encourage you to attend our November 9 Investor Day, which is going to be in Maple Shade, New Jersey, right outside of Philadelphia. So 20 minutes from the airport or an easy ride from New York. And that will also be webcast.

Operator

Jeff Zekauskas, JPMorgan.

Jeff Zekauskas - *JPMorgan Chase & Co - Analyst*

You guys did a very nice job of growing your cash flow from operations year-over-year, as well as your EBITDA. Should you be able to do that in 2027? That is, do you think your cash flow from operations will grow versus 2026?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Yes. And it will be a result of continued improvement in working capital, which we are very focused on. An expectation, albeit at a lower rate, of continued positive momentum in earnings growth as we get through the year. And it is an area, again, that we will highlight in a little bit more detail at our November 9 Investor Day.

Jeff Zekauskas - *JPMorgan Chase & Co - Analyst*

And can you give us a little bit of quantification around your expected decreases in medical costs in that, what were they roughly last year? What could they be this year? And is it your general expectation that SG&A expense this year year-over-year should be pretty flat, last year?

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

So I think a couple of things. One, year-over-year, you'll see an improvement in corporate expense. We had huge increases last year in health care expense, which we talked about quarter-by-quarter. I don't have off the top of my head the exact number. We can get that, communicate that in follow-up calls.

But we are seeing a flattening out of those health care costs versus where we were last year. And so corporate other expense will be equal to or slightly down each quarter as we get through the year. And so that's a positive element. And then the second part of your question, Jeff, was?

Jeff Zekauskas - *JPMorgan Chase & Co - Analyst*

I think you captured it, with respect to medical expenses and flattening out of SG&A.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Okay. Yes, you'll see that.

Operator

Vincent Andrews, Morgan Stanley.

Vincent Andrews - *Morgan Stanley - Analyst*

I just had one last question on the health care and education. I just wanted to better understand, is this a few projects? Is this a lot of projects? Is it concentrated in certain states or regions? Was it in the backlog and it's just been delayed?

Or was it stuff you thought you were going to win and put in the backlog that just the timing of it becomes uncertain? Just trying to get a better sense of sort of the visibility you have on it returning later in the year. And just is it waiting on municipal funding or something else that's just sort of technical? So any further color you could provide there, I'd appreciate it.

Frank Sullivan - *RPM International Inc - Chairman of the Board, Chief Executive Officer*

Sure. The simple answer is yes to all of the above. And so without providing any competitive detail, there are some specific regions, and in this case, a lot of states. So for instance, there are some specific states where we have really good market share in education and there has been delayed funding. And so we are specified on projects and the funding has been delayed, and we are at the point where it didn't happen in the summer.

And if it doesn't get initiated now, it's a spring project. Just the nature of the beast. And so in some cases, there are very specific, in this case, state-level projects, that we know we will have, but they've been delayed. In other cases, it's the lack of big projects that we had last year and into the spring that are not repeating. And so the normal cadence of our average activity is fine.

It's the mismatch of some larger projects that, quite candidly, we need to be rebuilding in our WTI, which is our contracting arm backlog.

Operator

(Operator Instructions)

Eric Boyes, Evercore.

Eric Boyes - Evercore Inc. - Analyst

Maybe first, how repeatable is PCG's growth into fiscal 2Q in the second half? I mean relative to 1Q's double-digit growth, does mid to high single digits, is that tougher comps or project timing or seasonality or just kind of margin of safety?

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Sure. In both our PCG and CPG, every quarter's a tougher comp because we've been generating pretty solid results in each of those segments for the last couple of years. But as indicated earlier, the same dynamics that drove results in Q1 seem to be continuing in Q2. So you'll see solid results in our Performance Coatings Group both driven by the dynamics in our core North American and European markets and continued outsized growth from the Platform Southern Hemisphere business activity.

Eric Boyes - Evercore Inc. - Analyst

Okay. Great. I appreciate that. And then I just wanted to clarify, margins again, on gross margin specifically. With inflation kind of trending downward and some of your agility on pricing, could we potentially see year-over-year gross margins positive again in fiscal 3Q?

And then I think it's a little bit a tougher comp in fiscal 4Q, but any color on kind of that gross margin cadence based on what you see today would be appreciated.

Frank Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Certainly. I think we'll start to see some improvement in margin as we get through the year, and anticipating a decline in inflation at some point, whether it's next spring or a year from now. As we have done in the past, we will recover the lost margin and probably then some. So as I commented earlier, 42% gross margins were in our line of sight, excitedly, because we've been talking about them for a few years. And when we get through this margin cycle, we will be at or above that level.

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 Sullivan - RPM International Inc - Chairman of the Board, Chief Executive Officer

Thank you to everybody who participated in our investor call this morning. We're pleased with our first-quarter results and the execution of our associates in what continues to be a VUCA environment. Our focus remains on serving customers, investing in differentiated growth opportunities, and advancing our operational improvements that support stronger profitability and improved cash flow.

We'll be excited to see many of you at our November 9 Investor Day in Maple Shade, New Jersey, outside of Philadelphia. We will also be hosting virtually the RPM Annual Meeting of Stockholders Thursday at 1:30 Eastern Time and would welcome you to participate in that as well.

It is highly likely that at a Board meeting in front of our Annual Meeting of Stockholders, RPM will be announcing the details of our 53rd consecutive increase in cash dividends.

Greatly appreciate your participation in our call today and look forward to having many of you on our Thursday, 1:30 PM Annual Meeting of Stockholders. Have a great day. And go Browns.

Operator

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

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