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The Sherwin-Williams Co. (SHW)

Financial Community Meeting

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MANAGEMENT DISCUSSION SECTION

Robert J. Wells

SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

Good morning, everybody. Those in the back would you please take your seats as soon as possible because we are ready to get the program underway. My name is Bob Wells. I manage the IR program at Sherwin-Williams. I know I've met many of you. I look forward to meeting those of you who I have not yet met.

I'd like to welcome you all and thank you for attending this, the first annual Financial Community Presentation of the new Sherwin-Williams. I'd also like to welcome those who are joining us by webcast this morning. Thanks for making time to be part of this.

At Sherwin-Williams we always start meetings, we have a habit of starting meetings with what we call a safety grabber. It is a safety tip pertinent to the audience in the meeting, and in this particular case, our safety grabber is what to do in the very, very, very unlikely case of an emergency where we would have to evacuate the building. You see back and back there the exit signs pointing to the right, there is a staircase out those doors to the right. There is also an escalator out the doors to the left that would be shut off in the case of an emergency so it acts as a staircase. In the very, very unlikely case that we would have to evacuate, please move with haste, but cautiously.

In your binders, before the tab with my name on it, you will see an agenda. We've posted or we've noted a scheduled break at 9:40 AM, depending on the length of the presentations prior to the break, could be 10:00 AM, but we will definitely give you a break by 10:00 AM if not earlier.

You'll also see the customary management seating chart that shows where the Sherwin-Williams management will be seated, what tables at lunch. The purpose of that seating chart is to allow you to sit with the people for who or of whom you have questions, and it is always in good form at The Sherwin-Williams luncheon to move tables. So, have a salad with one member of management, grab an entrée, go to a different table, and you can have dessert at a third table. That is all not only allowed, but encouraged.

And then, finally, you will see a forward-looking statements declaration that looks like this and I'm calling particular attention to this declaration this morning because over the course of the morning we will make some forward-looking statements. And I ask that you simply familiarize yourself with the language, the terms and limitations of this forward-looking statement declaration because they do – it does pertain to the forward-looking information that we are going to share with you this morning, and my hunch is that this is not the first time your attention will be called to a forward-looking statement declaration in this presentation.

Now, if you would turn past the tab with my name on it, I'm going to go through a brief, high level overview of the industry. Emphasis on high level. Before I dive in to the material, let me give you two disclaimers here. The first is that this industry overview is not intended to be comprehensive. The fact is, as our portfolio of businesses have expanded geographically and categorically, it is impossible to do a comprehensive review of all the drivers, of all of our businesses in the time allotted.

You'll find that as usual I'm going to spend a disproportionate amount of time talking about the North American architectural paint market, that's for a couple of reasons. One, because our business is still very heavily skewed toward North American architectural paint. But, two, because architectural paint demand is actually a very good indicator of demand for a lot of the industrial categories that we sell. Paint – architectural paint is strongly correlated with sales of products like industrial wood finishes that are applied to furniture, cabinetry, joinery, wood building products. Or coil coatings that are applied to HVAC equipment, appliances, metal building products, metal extrusions, et cetera. So, we see the architectural paint demand as being a pretty good indicator of demand for a lot of other products.

The second disclaimer I would offer is I'm going to cite certain data sources over the industry overview, including KNG Research, IHS Global Insight. And while the data I'm going to cite, we believe, is directionally helpful in efforts like understanding relative size of market segments across the industry. We believe that it is unreliable from an absolute volume or industry size standpoint. In other words, while we're showing industry size from various data sources, I wouldn't rely on that information. We think generally speaking, these sources tend to understate the size of the industry for all the geographies.

So, with that, let's dive in. This is the global paint and coatings market, divided by the three broad categories we often talk about, the largest being OEM finishes, factory applied finishes, including auto OEM. Followed pretty closely by architectural paint and then a small category, representing roughly 20% of the market being special purpose, which is kind of catch-all category that includes a number of sub-categories.

We show this split based on revenues rather than gallons because of the significant variation in average cost per gallon across the categories. We find looking at the same market breakdown by gallons is distorted and misleading, and dollars is a better way to look at it. Again, don't place too much credence on the gallon or dollar values in the box to the right there.

This is that same breakdown by geography. And not surprisingly, you can see that Asia Pacific is the largest region in terms of paint and coatings demand representing roughly 45% of global coatings demand and is skewed somewhat toward industrial products particularly OEM, 51% of global demand for OEM coatings.

The Americas represent about 28% of global coatings demand. And they – that region is skewed a little more toward architectural paint with Europe representing about 25% of global coatings demand and pretty balanced across architectural and industrial. This is the same breakdown only by projected growth rates rather than share of the global market.

What I should have on the slide that I'm sure you've already figured out is that these are average annual growth rates. These are not five-year growth projections. Again, not surprisingly Asia Pacific is forecasted to grow at a rate well in excess of the rest of the world. North America is actually, is expected to have pretty strong demand for architectural paint. And then the rest of the world, South America and Europe, moderate growth rates, modest growth rates, yet positive in all, all categories.

So, let's take and go down to another layer of detail on that first pie chart I showed you.

This again is the global paints and coatings market but here, we break down the OEM Coatings category by five subcategories, the largest being General Industrial, that purple wedge, followed by Auto OEM, Industrial Wood, Coil coatings and Packaging coatings. And then under Special Purpose, the three main components of Special Purpose, the largest of which being Protective & Marine coatings in the gray wedge there, followed by auto refinish products and then a catch-all category called Other, which consists primarily of traffic marking coatings and aerosol concentrates.

If you look at that same pie chart, that same breakdown by region, a couple of interesting things emerge. One is that in Europe, the market for auto refinish is very strong. It's a big wedge there. Obviously in Asia Pacific, big opportunities in General Industrial and Protective & Marine. General Industrial is a strong category in the Americas as well. But again, the Americas, very heavily skewed toward Architectural paint.

These are the top 10 paint and coatings producers worldwide, and this ranking is based on paint and coatings combined. According to KNG, who gave us this breakdown, even after the combination of Sherwin-Williams and Valspar, PPG remains the largest paint and coatings company in the world. Our math differs a little from this, but that point is immaterial. Why? Because we have never aspired to be the largest coatings company in the world, only the most profitable.

The main point of this slide is the same point I've made in years past showing you this data, and that is while the paint and coatings industry is some – globally is somewhat consolidated at the top with 10 producers representing about 55% of global volume, it is still highly fragmented at the bottom with the other 45% of the industry representing some 5,000 firms. Most of these firms being either local or regional architectural paint suppliers or technology companies that have a unique technology in some industrial segment but generally lack the distribution to grow.

If you broke the same top 10 suppliers down by architectural paint on the left and industrial paint on the right, you see that Sherwin-Williams rises to the top in Architectural. We are the number one producer worldwide of architectural paints. Based on the combination of Valspar and Sherwin, we are now a strong number three in Industrial Coatings and we are number one in many industrial sub categories.

Here is that same chart I started out with only for the North American market. So, we're drilling down geographically now and you can see in North America, OEM coatings is the second largest category. It trails architectural paints and once again don't rely too heavily on the numbers in the box to the right because we think that the especially the dollar volume is unreliable.

Our business as I indicated earlier remains heavily skewed toward North American architectural paint. The architectural paint market in North America represent 65% to 70% of our sales. And also as I indicated, it is a pretty reliable indicator of demand for coatings and other industrial categories, industrial wood, coil and even general industrial finishes used in coating construction equipment and machinery, et cetera.

Again there's a strong correlation between that blue wedge that I call out in the other two. I know most of you have seen this chart before. This is industrial – I'm sorry. This is architectural coatings volume for the U.S. market. It is – these estimates are supplied to us by the American Coatings Association. And the ACA pegged 2016 volume at 782 million gallons. You'll also notice that I removed that normalized band that used to run across the top of this chart. I did so because that band was often misinterpreted as the top of the market. Once volume get back there, you're not going to be able to grow anymore and your close, so this must not be a growth – North American Architectural must not be a growth story. We couldn't disagree with that more and I'll explain why in a minute.

But just think about this; architectural demand is approaching its prior peak. We're about 30 million gallon short of the prior peak that we hit in 2004. And yet, today, the residential and non-residential repaint markets combined are below 20% of the market, are less than 20%. I'm sorry, that's – I misstated there. Architect – residential and non-residential repaint markets combined are more than 80% of gallon volume. So, more than 80% of those 782 million gallons were used to repaint existing structures, both residential and non-residential. That market, the repaint market is 15% larger than it was at the peak of the last cycle. So, we're 30 million gallons below the last peak, but the repaint market is 15% larger than it was then.

What's more and this is one of the reoccurring themes or thesis-es of this presentation, we are not building enough residential space in the current market by a pretty wide margin. And I'm going to go into more detail on that in a minute.

But first, this is our current estimate of the breakdown in the U.S. architectural paint market between DIY and professionals. And by the way, we think Canada is – this is U.S. data, but we think Canada is following a pretty similar pattern. We say U.S. and Canada up there, but this is actually numbers for the U.S.

The long-term trend, this 30-plus year chart that you see, from the pro – from the DIY to the pro is being driven primarily by demographics. The aging of the population, first and foremost among them, but also to paycheck households, second homeownership, and a number of other factors that are driving more and more people to hire contractors.

But we've recently commented on the fact that this shift appears to be accelerating and we think the acceleration is being driven by the wealth effect created by rising home values, rising equity values, a steadily improving job market that has not yet translated to rapidly rising wages, but it is driving job security and consumer confidence to all-time highs.

Regardless of what's driving this shift, the shift benefits our paint stores group model or our paint stores model in North America for a number of reasons. And the pros preferred a shop in the specialty paint store channel that has been true for as long as we've been tracking the pro-to-DIY share. This breaks down the market in a little more detail across pro and DIY, the DIY portion, the 39%, being the large blue wedge in the bottom, and then you can see on the left-hand side new non-residential construction, new residential construction, combining to equal about 18% of gallon volume. The repaint market's residential and non-residential being about 82%.

If you turn – if we were to turn the residential activity up to where we think it should be, that is 1.5 million to 1.7 million starts and I'll explain kind of what's driving that number in a minute. These two categories on the left, the new non-residential and new residential would increase to more than 20% of total gallons. If you go back to the last cycle at the peak of the last cycle, new construction represented low to mid-20% of the market. It reached by our estimate as high as 24% of the market.

So, we are under-building in this market today. That is one of the reasons we think there's a lot of sustainable growth in the architectural paint market in North America ahead. This is primarily what is driving our thesis on residential construction and why we believe we are falling behind on residential construction. It's based on household formation rates. This data on this slide is from the U.S. Census Bureau which is estimating current household formation to be about 1 million net new households a year on an annual rate. We actually believe that household formation is running stronger than 1 million a year. We believe the rate is closer to 1.3 million to 1.4 million and what is even more noteworthy is we believe that rate is sustainable for the next 8 to 10 years.

The population cohort that is forming these households today is very large and very late in moving out on their own. But at this stage , we believe it would take a severe economic shock to stem the flow of new households. This chart depicts kind of what we see as a growing deficit in homebuilding or in housing supply. And you can see on the left-hand chart, that gray line depicts vacancy rate and it is plunging rapidly as we are not building enough homes to supply the increasing demand for housing from new households. On the right hand, you see the dotted line represents cumulative housing surplus or deficit. And, again, that line, too, has been declining pretty rapidly.

While these charts are theoretical in nature, they help illustrate a point that's very real. For a number of reasons, we're not putting enough new housing stock in place to meet the growing demand. That problem is particularly acute at the entry-level end of the market. To the far left there, you see existing home supply for sale of entry-level homes were below 3 months' supply. And even the first time move-up and second time move-up homes are well-below the historical average. Only luxury homes are in ample supply in this market. And, as you can see on the right-hand side of this chart, that is driving significant upward – causing significant upward pressure on average selling prices in the entry level and move-up ends of the housing market.

For those who believe that the six consecutive years of growth in housing starts means we should be nearing the end of the cycle, I would offer this chart. Prior to the Great Recession, you need to go back to the troughs of 1992 and 1982 to find years in which we built fewer houses than we're projected to build this year and those two years are close to this year. So, we're likely to see very strong household formation for the next 8 years to 10 years and we're building as though we're in a recession.

This is combining new homes for sale and existing homes for sale, and it's expressed as a percentage of total households. And you can see the two black lines bracketing 2% to 2.5%, which has been kind of the historical average of percent, of total households for sale in any given time. We're 100 basis points to 150 basis points below average. I think I have sufficiently beaten the point that we're running low on housing to death.

In every dark cloud, there's a silver lining and the silver lining here is that with fewer homes on the market for sale, more current homeowners are spending more to remodel their current homes. We're seeing this across the market from first-time home buyers to baby boomers who are staying in place and remodeling their homes. We expect continued strength in remodeling, in the remodeling segment.

And as we have indicated many times, we have seen double-digit growth in our residential repaint business for 14 of the last 16 quarters, and the two quarters that didn't grow double-digit, grew 9.8%. So, very strong remodeling activity.

Yet if you look at residential fixed investment, that is the cost of the homes plus the cost of all improvements and contents of the homes, we're still on the left hand chart. We're still well below the long-term historical average of residential fixed investment as a percent to GDP. What this means is that we have our ways to go in residential spending. A lot of that money will go into remodeling. On the non-residential side, on the right, you can see spending is closer to the long-term average.

Most indicators in the non-residential market are looking very positive. The commercial, industrial and institutional sectors of the ABI are all in positive territory and pointing upward. U.S. manufacturing, as measured by the PMI, has been in positive territory and moving upward since mid-2015.

Multi-family construction, which we count as a component of the non-residential market simply because these facilities are managed more like businesses than like homes, starts are forecast to slow in coming years. You can see on the far-left side of this chart. But completions should trend higher for the next few years. That is due to the long lead time between start and completion. And as a reminder, our business correlates much more strongly with completions than starts. Paint is one of the last trades in. So, if you track completions, you're really seeing a better indicator of paint demand than if you're tracking starts, which would correlate more closely with demand for steel and concrete.

Here is a breakdown of the PMI I mentioned earlier. It's an indicator of positive manufacturing momentum in the U.S. in our view. And I've realized that the latest figures for September just came out yesterday. I did not update this chart. Through August, however, we've seen steady progress in most measures of domestic manufacturing activity. And while the addition of Valspar gives us a more global footprint, we have significant exposure to U.S. manufacturing and these indicators are generally positive.

One specific market I'd call out, for example is appliances, appliance shipments. And you can see following a sustained dip from 2007 to 2011 or 2012 during the great – the so called Great Recession. Appliance volumes have rebounded to near pre-recession levels and are on a positive trend, a reflection of the strong rate of remodeling activity that we're witnessing in North America.

This data also pertains to North America. It is demand forecast across a number of industrial coatings categories for the U.S. and Canada and you can see steady strengthening over those 3 years across most OEM categories. And while we don't take this data completely at face value, the trends are positive and we believe accurately indicates strengthening demand in domestic manufacturing activity.

In the market for auto refinished products, demand is a function of aggregate number of vehicles in used and miles driven. The point is, the collision rate tends to be fairly constant with miles driven and vehicles in service. Both of these factors are on a very positive trajectory. And while there are other important factors influencing these markets, the fundamental drivers of refinished demand are positive.

And then moving to Protective & Marine, it's been a difficult category for us over the past few years due to our significant exposure to the oil and gas markets. That's the bar there on the left that we actually had to rescale the negative range of this chart for in 2015. As a reminder, our Protective & Marine business skews very heavily toward the protective side. We do very little OEM marine business.

And while we've seen positive growth in other segments of the market over the last few years, oil and gas has been a significant drag on our business and a very difficult drag to overcome. You can see why. These are CapEx figures for the four largest oil and gas producers in the world. And needless to say, they have stepped down dramatically between 2013 and 2016. While we sell many protective coatings used to or resell many protective coatings used to maintain wellheads, pipelines, the exterior of storage tanks, we sell lining products for the interior of storage tanks to protect the contents. And this massive step-down in maintenance CapEx has impacted the protective coatings market, our protective coatings business, significantly.

The good news is that as we indicated the last two quarters, that business is showing some signs of life. Our business year-to-date is positive for the first time in a few years. And just to underscore the point, since April of 2017, North American rig count has doubled, has more than doubled, showing steady signs of improvement. And as you can see from this, the North American rig count is really the only part that crashed in 2014 and is showing improvement today.

And then let me close with a big picture slide. The chart on the left tracks business confidence by region and the last data point was August of 2017. The chart on the right is consumer confidence for the same regions over the same time period. And while the data reflects some good – while the data reflects some geopolitical risks, both measures are trending in positive directions. And that's kind of how I would characterize our overall outlook on the industry, near and midterm positive but not without risks.

With that, let me turn the podium over to John Morikis, our Chairman and CEO for a company overview.

John G. Morikis

Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

Well, good morning, everyone. Welcome to you, all, including those who are joining us via the webcast to a very special community presentation. As Bob mentioned, this is our first since combining the talents, resources and strengths of The Sherwin-Williams Company and Valspar. I think you'll find this morning's program both informative and productive.

As always, the question-and-answer period following our presentations will be what you make of it. So, I really encourage you to make the best of that time and it's a terrific opportunity to spend time with our leaders here.

My assignment this morning is to set the stage for the presentations to follow by providing a high-level overview of the company, our reportable segments, and some of the ways the business has changed with the addition of Valspar. I'll conclude my remarks with some observations on the first 125 days of integration. In fact, today is 125 days since we closed on Valspar.

I began last year with the summary of what we believe makes Sherwin-Williams a compelling investment. Many of these qualities have not changed in decades. Our long-tenured management team and successful management training programs. Our strong balance sheet, cash flow generation and shareholder-friendly capital allocation. Our track record of delivering attractive returns to shareholders over the long term.

This year, let me focus on two important points. First, that the core Sherwin-Williams portfolio of businesses has and will continue to deliver strong operating results. While 2017 has brought its share of challenges, the strength and resilience of our core business is apparent in our year-to-date results and will be even more apparent in the periods ahead. Second, that the acquisition of Valspar is an extraordinary fit for the company. It provides geographic scale and balance, exposes us to new very attractive categories and end markets, and results in significant synergy opportunities that will augment our results for years to come.

Let me touch briefly on each of these points. If you look at the summary of our results, excluding Valspar expenses over the past three years, the strong earnings leverage in this business is pretty obvious. From 2014 to 2016 for example, consolidated sales grew at a modest, but respectable compounded average rate of 3.3%, which resulted in average annual earnings per share growth of about 19%. EBITDA, net income, and dividends also grew at strong double-digit rates.

This earnings leverage was the result of three factors. First and foremost, the effect of higher architectural production volumes in North America. As we often say, this is a very volume-sensitive business model. Second, the integration of the Comex North American stores completed in 2014 reduced some operating costs, improved sales mix, and drove higher utilization in our legacy manufacturing facilities. And finally, the impact of raw material deflation. The latter two factors, Comex integration and raw material deflation, increased net income as a percent of sales by 150 basis points for the full year 2015.

The story is similar when you look at the first half 2017 versus the first half 2016. On a core basis, without Valspar or the change in revenue classification, apples-to-apples, our revenue grew 3.4% year-over-year. EBITDA, net income and earnings per share all grew double-digits. Importantly, our gross margin was flat on a comparable basis, pretty impressive in the early stages of a raw material inflationary cycle. These three illustrations, with the corresponding numbers based on 2016 pro forma results, depict how we intend to manage the business and report results going forward.

The alignment of the various business units within these segments is logical and complementary, and it underscores the outstanding fit of the two companies. In every case, these combinations, once integrated, will enhance the operating scale, product and brand offerings, growth and operating margin expansion opportunities of each segment.

The Americas Group was formed by combining our former Paint Stores Group segment with our Latin America Coatings Group. The Valspar ProSolutions business was also folded into this segment. Integrating these businesses was the logical evolution of collaboration between Paint Stores and Latin America Coatings Group that began three years ago. You'll hear more from Jay Davisson later this morning about how this combination is providing benefits in the areas of technology sharing, improved store operating protocols, and working capital management.

Consumer Brands Group was formed by the combination of Sherwin-Williams' legacy Consumer Group and Valspar's former Paints segment. The Valspar Automotive Refinish business, which had been reported as part of the Paints segment, was moved to our Performance Coatings segment that I'll introduce in just a moment.

Brand awareness and perception plays a powerful role in the consumer paint market worldwide, and this combination brings together some of the most recognized and respected brands in the industry. It also expands our global presence in various architectural product categories, with branded businesses in Australia, New Zealand, China, and the United Kingdom.

While there are a lot of moving parts to our new Consumer Brands Group, Aaron Erter, Group President and General Manager, will be up later this morning to describe many of the opportunities this new segment presents.

And finally, our Performance Coatings Group combines our former Global Finishes Group segment with Valspar's Coatings segment. As I mentioned a moment ago, we also moved Valspar's Automotive Refinish business from the Paints segment to Performance Coatings and combined it with the legacy Sherwin-Williams' Automotive business.

We've been pretty candid all along about the benefits we expect to realize from this combination. It improves our operating scale outside of North America in many geographies where lack of scale depressed our margins. It extends our Industrial Coatings capabilities into the Packaging and Coil Coatings categories with leadership positions in outstanding technology. Perhaps most importantly, it brings a number of outstanding executive leaders to Sherwin-Williams, and David Sewell will be up here later this morning to introduce them to you.

I believe this comparison should be familiar to most of you, but we feel it's a pretty compelling illustration. The chart on your left represents Sherwin-Williams' four reportable segments prior to the Valspar acquisition. As you can see, Paint Stores Group accounts for nearly 65% of consolidated revenues and generates operating margin well-above the segment average of 18.5%. Well, I have good news. Paint Stores Group is still part of our company and will continue to be a significant growth driver and source of profit for decades to come. We often refer to this as the engine of the company. It provides growth and we expect that to continue.

But look at the other two segments on the chart on your right. Their scale is vastly improved, and we believe the upside in operating margins across the company is significantly enhanced by this combination. In fact, if you add the synergy targets we communicated when we announced the deal to pro forma 2016 results, the average operating margin across the company increases 90 basis points to 19.4%. A good portion of the scale improvement you saw on those two segments fall in some important geographic markets in Asia Pacific and Europe. As Bob mentioned in his industry overview, which Europe and Asia Pacific combined, represent almost

70% of global paint and coatings demand, and encompass some of the fastest-growing coatings markets worldwide.

A larger share of our new revenues, post integration, will come from the sale of Industrial Coatings products. That point alone is not particularly noteworthy, but the addition of the Packaging and Coil Coatings businesses combined with significantly enhanced technology capabilities to accelerate product innovation across all categories is important. We like businesses in which customers value superior technology and product performance. They tend to be more defensive and earn higher returns over time, and that's what Valspar brings.

From my perspective, the Sherwin-Williams brand portfolio includes many category leaders, brands like our namesake, Sherwin-Williams, Purdy, Minwax, Thompson's WaterSeal, and Krylon are leaders in their respective categories. The same can be said for brands like Valspar Paints, Cabot, Wattyl, DeBeer and Huarun. A brand represents the performance promise to the customers that buy its products, and these brands have built a strong reputation for consistently keeping their promise.

I mentioned the enhanced technology capabilities that result from this combination. Here are just a few example of important technologies that have been commercialized in one or more product line in recent years. While this list represents a very small portion of our combined revenue and profit, today's unique technology, if it drives real measureable performance improvements, can become tomorrow's industry standard. Also, in technology development, a past result usually is a guarantee or at least a strong predictor of future results. You'll hear more about our new product development efforts over the course of the morning.

People development is both a competitive strength and core competency of our company. We often use the terms talent supply chain or talent pipeline to describe the process. Our talent pipeline is designed to have the right people in the right place at the right time, with the proper skill set and training to fulfill most of our manpower requirements. How successful is it? Here are some of the metrics we track. Last year, we hired more than 1,500 new management trainees across all our business units. That's a record for us. Because we recruit and develop people with our future manpower needs in mind, the vast majority of openings in leadership positions are filled by internal candidates. 93% of leadership roles across the company are filled by internal candidates.

We also pride ourselves on retention, which translates to depth and breadth of experience. Our leadership ranks post acquisition averages 17 years of industry experience. So I mentioned earlier that this is our 125th day of a combined company. And as you would expect, it's been very busy and very exciting.

Pulled out a couple of areas here that I wanted to talk to. First and foremost is the combined culture and both of these cultures are rooted in a improved performance mentality. We're very excited about how these businesses are coming together. And we've been working very hard in delivering clarity to our leadership teams.

We believe having leaders close to the customers that clearly understand where we are going as a company allows them to make quick decisions that are in line with our strategy. So we're excited about the combination of these cultures and the way that we're coming together.

Very excited about the talent. We've often referred to this organization coming into Sherwin-Williams as the greatest infusion of talent in the company's history. It's talent that's deep within the organization. I got an opportunity to spend quite a bit of time with Valspar leaders and employees all the way down to the customer level. And we're very impressed with the quality of employees that are joining our company.

We've also had a lot of time to spend time with our customers in this period, both myself and our leadership team, and have been very impressed with the great relationships that exist between Valspar and the customers. Getting great feedback about the quality of people I just mentioned.

Innovation has been something that's been constant as we visited with customers, how important the pipeline of innovation has been to that relationship. The service and the quality have been outstanding areas of performance by Valspar to their customers. These are all areas that we expect to continue to invest and improve on. We're also finding terrific opportunities in areas such as sales as our teams are coming together to look and work on those areas where we can leverage relationships, products, assets, really capturing what it is that we're out to do, which is to have an outstanding company that grows even faster.

We're working on areas to improve the balance sheet. We see the tools that we have inside our company, the systems, tools and processes, as areas of leverage where we can run a better and improved balance sheet as a combined organization. And finally, from a supply chain standpoint, we've been working very hard to understand the needs of the customers so that we can best align our supply chain to fit those needs.

And as you would expect, we've been hard at work at aligning the structure of the organization. We had a very good plan going in. But it was limited, limited by those areas that we could really discuss with the Valspar team by the FTC process. Post-close, we've been working very diligently at executing and refining that strategy to make sure that it fits our goals.

Finally, this is the lineup of the speakers for the balance of the morning. Al Mistysyn is no stranger to most of you. Al took over as Chief Executive Officer – congratulations, Al. Be sure you congratulate Al when you see him today. As CFO on January 1 of this year. He's done a terrific job and he's had some big shoes to fill, backfilling Sean Hennessy who is also here today.

This is Jay Davisson's seventh year presenting at our FCP. Six years as President of the Paint Stores Group and this year, The Americas Group. There is nobody that knows the professional painting contractor better than Jay Davisson. So if you have a chance, make sure you spend time with Jay.

Aaron Erter, President of our Consumer Brands segment is a newcomer to the Sherwin-Williams team but a veteran of Valspar. I encourage you to take the opportunity to meet Aaron. I think you'll find him to be both passionate and knowledgeable about his business.

David Sewell and Joel Baxter are both veteran FCP presenters. David took on quite a big role here when Sherwin-Williams and Valspar were combined leading the Performance Coatings Group. And as you can tell by my previous comments, we have very high expectations of David and a lot of confidence in his ability to deliver.

And Joel is rock star supply chain guru. I think I just used two metaphors in one single introduction. Joel is responsible for much of the value capture in this transaction. And we couldn't be more confident and more excited about his leadership.

So, again, I'd like to thank you all for your interest in our company. We look forward to a very productive day here with you. And I'd like to invite Al to come up and share his thoughts with you. Thank you.

Allen J. Mistysyn

Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.

Good morning and thank you for joining us today. Boy, what a surprise. A public promotion. Who knew? This morning I'm going to take you through our financial priorities that I believe drive shareholder value, review our key 2020 financial targets, give an update on our acquisition integration and our cost and revenue synergies, highlight the strong cash flow generation of the business, confirm our capital allocation policy and finally give you a brief update on the third quarter and fourth quarter. I just mentioned that there's an appendix at the end of my presentation that will support the pro forma numbers throughout.

I believe Bob was referring to my presentation when he talked about the forward-looking declaration. And I will have forward-looking earnings, sales earnings and EPS growth. And those are all covered by this declaration.

So let's start with the financial priorities. And if you go left to right on this screen, it's really a rough semblance of our level of importance and sense of urgency. We continue to focus on organic revenue growth. And our expectations is that we will grow faster than the markets we participate in.

We have been able to expand our operating margins in all economic environments. And in the long term, our expectation is that we will gross margin expansion. In the short term, we have implemented price increases to offset the raw material inflation. And while maintaining strict and tight control on our SG&A so that we see leverage in our SG&A, our operating margins will continue to expand. And with the increased synergies that we expect to achieve on the acquisition, we'll accelerate that operating margin expansion.

Improve free cash flow. We will continue to build on the historically strong free cash flow generation of the company. And I define free cash flow in this specific instance and today the specific instance about net operating cash less CapEx. And if you look at the combined businesses from 2011 through 2015, our free cash flow generated was about 7.7%. And I'll talk about how we're going to accelerate that pace.

We have a consistent capital allocation policy and I'll explain that as we go through this. And then we have clear portfolio choices. We'll continue to review our portfolio of businesses and brands and their fit with our long-term strategy.

This charts shows revenue before and after acquisition by segment on the top and by geography on the bottom. And as John talked about, Valspar brings increased presence outside of the U.S. and brings scale to our industrial businesses that gives us a strong basis for growth.

Bob talked about the favorable market trends we're seeing in the U.S. as it relates to demographics, household formation and infrastructure, all driving the continued shift from do-it-yourself to do-it-for-me. And as he talked about this position, our Paint Stores Group is positioned well to capitalize on these trends. And I'll put a finer point on that by [ph] telling you (00:48:52) from 2012 to 2016, our Paint Stores sales have grown at a compounded rate, average rate of 9.5%. And we believe the demand is there to continue this momentum.

I'll talk about sustainability and technology together. We operate in stringent regulatory environments across the globe. We continue to see the trend to lower VOC products and from solvent-borne to waterborne technologies. And John talked about the importance of innovation. In the last five years, the combined company has invested over $1.4 billion in R&D to bring new technologies to meet and exceed our customers' demands.

We have a proven history of operational execution. This chart shows our EBITDA from – the combined EBITDAs of the companies from 2012 to 2016, and you can see a nice growth of 380 basis points in that time period. And we believe we have additional runway ahead.

This is a chart that many of you've seen before, and it shows the allocation of run rate synergies by category in the pie chart, and the long-term run rate synergies on the bars. After 125 days, the acquisition integration is going well and we're making a lot of progress across many of our businesses, functions and geographies, enough so that at this point we are increasing our long-term run rate synergies target to $385 million to $415 million versus the original target of $320 million.

We have added a long-term revenue synergy that we have not previously had in our original estimate, and we're expecting that to grow at about $65 million, $25 million of which should be in the pie chart that you see. But as we continue to execute on our revenue synergy activities, we'll expect this to grow over time. We've also increased the upper end of our cost synergy target by $30 million, as I believe we're ahead of where we thought we would be on SG&A synergies. Finally, approximately two-thirds of our cost to achieve will be incurred through the end of next year.

This chart shows the cumulative effect of the synergies through 2020. The point here is the synergies are significant and are meaningful contribution to our growth in EBITDA, EPS and free cash flow.

Slide shows our expected strong EBITDA growth and margin expansion through 2020, while continuing to invest in growth in our business. We're targeting EBITDA growth of $1 billion to $1.5 billion. This is a compounded average growth rate of 8.5% to 11.5% and a margin expansion of 220 basis points to 440 basis points.

We will achieve these results by maintaining focus on our core operating disciplines, focus on profitable sales growth and market share – growing market share; focus on continue to expand our core operating margins; relentless focus on the targeted cost in revenue synergies that we've laid out for ourselves to accelerate that operating margin growth; focus on asset utilization in improving a return on net assets employed and increasing our net operating cash generation.

We also drive cash generation through reduced working capital. Chart here shows working capital in dollars on the bars and the percent of sales is the line. We have a long history of working capital improvements, including with acquisition. And this is why we like showing a longer-term view of working capital. So for example, in 2010, we completed three acquisitions and you see an uptick in our working capital as a percent of sales. And then over time as we integrate the acquisition and implement our systems, tools and processes, you can see a nice steady decline and Joel will talk more about those in his presentation.

We believe working capital management is a core competency of our company. If you look at Valspar, they operate their company with a working capital on the high teens and we believe we can drive that metric down and generate additional cash flow. By the way, we also believe we have room on our existing businesses for working capital improvements and we'll continue to focus on those areas.

All with the idea of driving adjusted free cash flow, as you see here. This, again, is defined as net operating cash, less CapEx. We have historically targeted net operating cash generation of 10% to 10.5% of sales. And with the operating leverage and significant synergies, we expect to see we're increasing that operating cash range to 12% to 12.5% of sales. We believe we can get our capital expenditures below 2% and get our free cash flow range to 10% to 10.5% of sales, which will be about approximately $2 billion of free cash flow generation that gives us great flexibility. It allows us to reinvest in our business in both CapEx or in acquisitions, but also allows us to pay a dividend and buyback shares of stock.

This chart shows net operating cash for the combined businesses from – and the uses of that cash from 2011 through 2015 on the pie chart on the left, and from 2016 through 2020 with the pie chart on the right. The highlight here is that approximately 64% or $7.2 billion of cash was returned to shareholders in the form of dividends and share buybacks for the five years through 2015. This includes $1 billion worth of – that was set as debt that we took out for Comex, Mexico. That ultimately did not go through when we utilized that cash to buy back shares.

The expectation is, we'll generate approximately $10 billion from 2016 through 2020. Short-term, our focus will be on paying down debt. But an important reminder here is that we made a commitment that we would buy no shares of our stock in 2016 and 2017, and we will limit the dividend increase to $0.04 a share in 2017 and 2018 to conserve cash, and make sure we have availability to pay down that debt and we've lived up to those commitments.

We will start returning cash to our shareholders at our historic rates starting in 2019 and 2020, as we reduce our debt to more sustainable level. We will have significant cash outflows for acquisition-related costs over the next year-and-a-half through the end of 2018. But the future drivers of our cash flow are the same core operating principles that I talked about earlier, including our focus on improving our working capital.

We've had a consistent, and we'll have a consistent capital allocation philosophy. We're targeting a high BBB rating. We're driving our debt-to-EBITDA leverage ratio to 2% to 2.5% – or 2 times to 2.5 times. And we will not hold cash going forward. We will continue to put that cash to use in the form of CapEx, investing back on our business, dividends, strategic M&A. And absent acquisitions, we will buyback our stock. I'm going to talk about this in a little bit more detail here in a minute.

Starting with the debt-to-EBITDA leverage, the bars show debt and EBITDA, and the line is the leverage target. We reduced our debt-to-EBITDA leverage to a more sustainable level quickly and with a strong EBITDA growth, we expect our leverage ratio to be below 3 times by the end of next year, ultimately with the target that I talked about, getting to 2 times to 2.5 times.

Our capital expenditures, this shows dollars and as a percent of sales. We are targeting a CapEx range of 1.6% to 2% of sales. We have a disciplined approach to our capital expenditures. We spend about 60% to 65% of our CapEx on high ROI projects, that includes new stores, facility productivity improvements and raw material usage efficiencies. We are confident in our ability to return our CapEx to below 2%, which is the Sherwin legacy historic run rate.

Dividends per share. Chart shows a consistent, accelerating dividend growth. 2017 will be the 39th consecutive year of increasing dividends. Our dividend policy is to return 30% of prior year earnings to our shareholders and we will continue with that policy. I mentioned the 2017 and 2018 increases, but we expect to return 30% of prior year earnings in 2020 with an interim step in 2019.

M&A. Strategic M&A will be an important component of our growth strategy. We have a long track record of successful acquiring and integrating targets and getting above average returns on those acquisitions. As our debt-to-EBITDA leverage trends towards our target, we will return to our disciplined approach to M&A and acquisitions. We target companies that accelerate our long-term strategy and leveraging our capabilities to accelerate sales growth and operating margin expansion.

This slide highlights the legacy Sherwin-Williams treasury stock acquired since 2010. You can see here, we acquired 29 million shares for approximately $4.6 billion. But in 2016 and 2017, you can see, we did not buy any shares as we committed to. But we take a consistent, long-term approach to stock purchase, and prior to 2016, we had purchased our stock every quarter for the previous 15 years. 2018 we'll start offsetting option dilution, and then beyond 2018, as our debt gets to a more sustainable level, absent acquisitions, we'll buy back our stock similar to the targets we have in the past. We have a strong financial profile. As I mentioned, we are not going to hold cash, we're going to put that cash to use. We expect our debt to be at $10.85 billion by the end of this year, and we have significant liquidity sources available to us.

Now, let me take a quick brief look at our third quarter and our year. As most of you know, we issued a press release on September 28th, updating our guidance for the third quarter due to the impact of a number of natural disasters in North America that specifically affected our TAG organization. As we reported, we're having a strong start to the quarter with comp store sales up 6.7% through August, but with over 600 stores impacted by the storms, we just cannot keep up that pace. We reduced our TAG sales $50 million to $70 million in the quarter and reduced our consolidated sales outlook to low-single-digits from low to mid-single-digits.

And we revised – and with the lost sales days, the costs related to the clean up and the short-term impact of raw material costs, we revised our EPS guidance for consolidated excluding Valspar to $4.10 to $4.20 a share from $4.40 to $4.60 a share, a decrease of $0.35 from the midpoint. We believe this is a short-term impact, expect to see a rebound in our sales over the next few quarters, but the timing is uncertain. We'll monitor our sales through October and give you an update on the year on our third quarter conference call. I know you're looking for more than that, but that's just where we're at.

This is the Regulation G table we provided as part of the press release. You can see the revised guidance that I just mentioned at the very bottom of the table and the impact that has on our consolidated excluding Valspar related costs in the yellow highlighted bar. All the other EPS guidance numbers remain the same. So, to recap our financial outlook assumptions to 2020. Net sales compounded growth rate at 4% to 6%; EBITDA margin expansion 220 basis points to 440 basis points to 18.8% to 21%; strong free cash flow generation of 10% to 10.5% of sales; and core EPS compounded average growth rate of 9% to 12%.

So, in summary, we're building on a foundation of strength. We will achieve our 2020 financial targets by focusing on the core disciplines that we know: continue to grow market share; invest in our controlled distribution model; and continue to increase our operating margins with the focus on our synergies; accelerate that operating margin growth; improve our return on net assets employed; and drive strong free cash flow, that gives us the ability to reinvest in our business, in CapEx, and acquisitions, and also allows us to pay down our debt and return significant cash to our shareholders in the form of dividends and share buybacks. The management team is committed to delivering that core EPS growth of 9% to 12% through 2020.

Thank you. And with that, it's my pleasure to introduce President and General Manager, Jay Davisson.

Jay Davisson

President, The Americas Group, The Sherwin-Williams Co.

Good morning, everybody. Today, I'll talk about The Americas Group, which consists of the United States, Canada and South America. When you look at the TAG organization that's made up of six operating divisions, four of which are located in the United States, we have one division that manages the Canadian operation, and one division in Latin America that manages three different regions. We have the Andean region, which is basically Mexico, Ecuador, Peru, and Colombia. We then move down to what we refer to as our South Cone, which is basically Uruguay, Chile, and Argentina. And then our third region is Brazil.

Overall results for The Americas Group ending 2016, we have $8.5 billion in revenue and about $1.6 billion in profit, improving our return on sales about 11%, about 100 basis points improvement in ROS. First half of 2017, revenues were up about 7.2% without the revenue reclassification. Segment profits improved about 10% or 50 basis points as a percent of sales without reallocation.

This is kind of a snapshot of our density – of our store locations in North America. Today, we average about one store per 36,000 households. We still believe – and I'll talk a little bit later about this – there's plenty of room for expansion with our controlled distribution model. As Bob mentioned, we've got about 122 million households, if we were to take that 36,000 down to 25,000, which is kind of a ballpark target for us, it would support about 5,200 stores. If you look at a three to four-year growth rate of household formations and we take that number to 22,000, it supports 6,100 stores. So, we still have ample room to continue to grow our controlled distribution model in North America.

When you look at North America stand-alone, 2016 revenues grew about 6.4% without the reclassification, they were up about 8% in total, and segment profits improved 120 basis points to 20.6% of sales, about $190 million profit improvement. We started out 2016 fairly strong with revenues growing about 7.2% without the reclassification and up over 10% including the reclassification. Segment profits improved over 10%, about $80 million, and our return on sales were up about 50 basis points.

Continuing with North America, we've got a very strong brand position, especially in regards to the painting contractor. We are number one in paint brand awareness. We are number one preferred brand by professional painters. We have [indiscernible] (01:08:47) of being America's Most Trusted Brand. And this year, J.D. Power rated Sherwin-Williams Highest in Customer Satisfaction among interior paints. This is our sixth J.D. Power award in four years.

We will end 2017 with 4,268 locations in North America. And, again, that's about a 2% to 2.5% growth rate. We feel comfortable with that growth rate, especially with our human capital and bench-building capabilities and we don't want to go at a faster pace than that. I know there's been a lot of questions that I receive on why not do this faster. It's an even pace for us that allows us to continue to generate cash and returns for our shareholders. Again, our next target is 5,000 stores on our way towards that 6,000 mark, and the demographic support continued investment in growth with our controlled distribution model.

We'll end this year with 91 store openings net new, and it's down a little bit from 109 stores last year and 111 stores the year before, and some of that is due to the storm activity. We have a lot of stores coming up in Houston, Florida and the Caribbean, and it put a little crunch on our new store openings, because of that impact.

We want to continue to widen this gap that we have today between our Paint Store competitors in the marketplace. The closest competitor to us today, with company-owned stores, is PPG. 650 stores in the U.S. and 257 stores up in Canada, and our goal is to continue to widen this gap. We open more stores in a year than most of our Paint Store chain competitors have in total.

This is the important part in my opinion. We'll end the year with 2,873 sales reps on the street, building relationships with our wholesale customers. We will open about 135 territories this year, on top of what we opened in the last two years, well over 120. These are full-time, outside sales reps meeting with customers face-to-face on a daily basis. Our rep force enables us to go to the customer and service their needs instead of that customer having to come into our facilities to get service. It also provides us with very deep insights to what the needs of our customers are, both from a product standpoint and a service standpoint.

Our store count differentiation is big, but our rep differentiation between our competition is even bigger and our reps drive about 70% of our wholesale business. And we've got a pretty simple sales philosophy within TAG, friends buy from friends. This allows us to make a lot of friends when we're out in front of customers on a daily basis.

Our biggest store is about to open. As we speak, we have over 50% of our stores up and running on BOPIS, buy online pickup in store. Round three of our stores will begin in October, and we'll finish up all stores being BOPIS capable in November. Our customers are always looking for ways to improve their productivity, and we believe that e-commerce is going to improve that by offering 24/7 access, allowing our customers to order when they want to on any device that they want to.

So, we're going to be able to leverage what we call the digital access, along with our brick-and-mortar stores, and our professional selling organization, to service customers in a whole new way. We think this will enhance our current trademark customer service to new levels and continue to widen that differentiation gap in assisting our customers to not only become more productive but more profitable.

What sets us apart from our competitors? If you think about this on a daily basis, we have over 15,000 store managers, assistant managers, sales rep and district leaders out in the field connecting with our wholesale customers one-on-one. We're providing unmatched knowledgeable services and we utilize over 2,500 delivery vehicles, making more than 2 million deliveries a year, sometimes same day or next day to our customer base.

We also differentiate ourselves by being the leader in color. We provide the strongest color tools in the market to our customer base. And the exceptional product quality and innovation that we provide, we believe, is unmatched, and those 4,200-plus locations are very convenient and close to our customer base. So, on top of that, now we're adding e-commerce capabilities.

Again, I think, this is engagement with that wholesale customer really differentiates us, because we value their input, their feedback, and that input and feedback drives many of our initiatives and we listen, because we are committed to the customer. We train our teams to understand each and every customer, what their unique needs are, what challenges they're running up against. And more importantly, how we provide solutions to those questions and needs that our customers have, whether it's product, whether it's color, technical. Our programs that we put in place help our teams succeed with their customer. They're all targeted by unique markets that we serve, with the customer in mind and we're always going to be customer-centric. It drives what we do and how we do it.

So, here's a couple of examples, I'd like to give you on how we develop products for our professional customers, because every segment has unique deliverables that our customer expect. When you look at res repaint for example, they want quality products that enhance their callbacks and their confidence with their customers, so we've extended our best-in-class Emerald Urethane line, because it delivers a much more smooth vinyl appearance, it becomes more sustainable in the marketplace. It's a softer finish, with a hard finish for touchup. We also increased our new product activity with a product we call Rejuvenate. This is an exterior product that basically takes old wood siding and makes it look new and it's a one-coat application, and our res repaint contractors love this product.

When you look at our commercial customers, they want to increase their productivity and their profitability. They want us to design products that meet and exceed MPI specifications. So, we've come up with ProMar 200 High Performance Zero VOC acrylic products. They're made for the commercial segment, the light industrial segment and they really drive productivity with our customers. They're getting in and out of those jobs at a much faster pace than they were before. We've opened up new products for the new res market. Builders Solution, Painter's Edge, offer exceptional touchup, again with the productivity and profitability in mind for our customers to get them in and out of that job faster.

And for property managers, we've developed a product that we call Extreme Cover [ph] Interior (01:16:47) Stain Blocking Paint and Primer in One. It is a very efficient all-in-one coating for our customers to go in and it's very durable and it stands up against repeated washings, exceptional blocking against stains like grease, grime, food and cigarette smoke.

Again, all of this has been generated from feedback from our customers on what they need and what their expectations are and our goal is to go out every day and exceed those expectations, because every market has unique needs. Every segment has unique needs and we're focused on that customer utilizing their feedback, so that we can develop the technologies that are best for each market and each segment.

New product innovation is definitely a core competency for TAG. We've had a strong run of architectural product introductions in the marketplace. Today, those products represent 20% to 30% of our total architectural gallons each and every year. But being cognizant of working capital, as you've heard prior, this graph illustrates that we continue to reduce working capital by reducing our SKU count. 2017 will show a 33% reduction in our SKUs. It does two things. It reduces working capital, both our finish goods inventory and the raw material inventory required to make those products. But more importantly, it makes it much simpler for our sales organization and our customer base when you can narrow that product line down as we're trying to do in North America.

I say customer-centric. I really mean customer-obsessed, because everything we do revolves around the customer. And we center a lot of those efforts on what we refer to as G3. Acquiring new customers is the lifeblood of our company, building loyalty and relationships with those customers, and providing the right products and tools to make their jobs successful. The focus that we have is delivering results. We've generated about 350,000 new accounts every year for the last two years and we're on pace to exceed that this year. And that's why we're confident, as we continue to build our customer base portfolio, we have growth opportunities in front of us, because it takes a little while through that selling process to get the customer up and going.

We've done an excellent job increasing our sales of premium products, not only to our existing customer base, as we move them up in quality over time, but even bringing new customers into the fold. They're starting out with higher quality products, because they see the value in a higher quality product from a productivity standpoint and how it makes their customers feel, as they leave that job. All of our marketing initiatives are targeted at this lifecycle we have with the customer in each segment; G1, G2 and G3. Our marketing initiatives kind of drive our process.

Our focused efforts have resulted in revenue volume gains across all of our focused segments. These circles kind of represent the appropriate size of our markets. And as you can see, Res Repaint here is our biggest market opportunity. And Bob has mentioned that 14 quarters out of the last 16 quarters, we have seen double-digit growth rates there. We don't see that stop and again, it remains an opportunity for us. And that's where these sales rep investments have primarily occurred over the last three years or four years, targeting this segment specifically.

We've taken our other wholesale segments and grown mid-to-high single-digits. And we've accomplished this customer-by-customer. Again, building those relationships in the field with both small contractors and large contractors. Speaking of large contractors, many of you probably know this, but when you look at our national account activities, we have exclusive agreements with the top five builders in the United States, and we have exclusive agreements with 15 of the top 20 builders in the United States. When you flip to the Property Management segment, again exclusive agreements with 16 of the top 20. Those nine that we don't have, I can guarantee you, we're aggressively working on, as we speak.

So, our professional architectural coatings growth year-to-date is about $240 million in growth. We expect that to be about $500 million in growth this year, just on the wholesale segment side. So, we feel pretty confident there. Everyone's probably wanting to know about price, so this is one of those forward-looking statements. Although it occurred yesterday, we announced a price increase to our wholesale customer base and our DIY customers in the range of 3% to 5% effective October 1. We've spent the last 60 days to 75 days communicating that increase to our customers. So, this isn't anything driven by hurricane, raw material activity; this has just been the progression of raw materials accelerating over the last four months or five months.

And as we do every year, if our cost rise, we sit down with our customers and talk to them about why we need to raise prices to get that back. So, our hope is that this increase on October 1, carries us through 2018; if raw materials by some chance continue to rise at a greater rate than that, we will go back out in the market and execute another price increase.

The best differentiation we have, in my opinion is our people. And we have nearly 32,000 employees in North America. You've heard this, we recruit, hire and train 1,500-plus MTPs every year. And I can tell you this and we're excited about this, our organization is becoming more diverse as we continue to hire more ethnicity and females into our organization, and they're now starting to make strides in management positions within the company. So, we're on the right pace, our retention remain strong. John pointed that out. Our turnover rates with our store managers and reps are below 7%. And typically, in a retail environment like this, you're in the high-20s or high-30s, so we're confident in that.

And what I'm most proud of is how our people really demonstrated that Sherwin-Williams has a family culture. And they did that because of this hurricane and earthquake impact that we had. It was felt far and wide and thankfully, no serious injuries occurred to our employees, but it impacted about 5,000 of our employees. 40 of those employees experienced significant asset losses, homes destroyed, cars destroyed. Several of our customers were also impacted and I can tell you that we are working with them to assist in getting them back up and running and their business moving.

Leadership from across the entire company coordinated all the hurricane preparations, maintaining communications daily with our employee group to ensure that their safety was first of mind. And we're providing support. In conjunction with our sister division in Global Supply Chain, we've distributed and continue to distribute humanitarian aid from water and generators to food and diapers to not only our employees, but our customer base as well as those communities that we serve. Latest update from last night, we have about 250 employees in Puerto Rico, and we made contact now with every employee except for 20, and that was hundreds two days ago. So, the field organization continues to do a good job of making sure everybody is safe and sound.

As Bob mentioned, at one point in time, over 600 of our stores were closed for two days to three days. We have 36 stores in Puerto Rico, all of which remained closed today. But we have been able to get out and assess damages on 28 of those facilities and fortunately, none of those have serious damage, and we'll be able to get back and running with those 28 that we've gotten to, to assess as soon as we can get power restored to the Island. I'm really proud of the Sherwin-Williams family, because the employees across the entire company along with our vendors and even some of our customers have donated to our employee relief fund, and it grows each and every day.

As far as effects that'll benefit us in the future, we're starting to see today some impact in the Houston market. There was a tremendous amount of damage that occurred, a lot of flooding, a lot of drywall being replaced. So, we'll see some residual effect in Houston. I don't think we'll see much residual impact in Florida as there wasn't a lot of damage to structures. But Puerto Rico, there's a lot of damage, and it's going to take months before we start seeing any benefit of the rebuild there.

Moving on to Latin America. It continues to have economic and political headwinds that are basically out of our control. So, we're focusing on those things that we can control. And I believe that it's when, not if, Latin America turns around, we're doing the things today to position ourselves to take full advantage of that when it does occur. Latin America is a young resilient country. I believe we've got opportunities there and view this as a growth swath opportunity for our corporation down the road.

2016 results were definitely not where we wanted them to be as revenues declined, profitability went backwards. A little better picture in 2017, we've got about a 6.9% revenue growth. Most of that primarily price-driven, and our profits are basically flat year-to-date. I do think that the political environments beginning to stabilize in countries like Brazil and Argentina, and the economies are starting to show some good signs moving forward.

When you look at brand awareness in Latin America, we're strong in Argentina, Chile and Ecuador, and we're getting better. We're now where we need to be in both Mexico and Brazil, our two largest markets. And we're number three and number two in those markets, and our goal is to continue to build that brand awareness to get to number one.

We'll end this year with 356 company-owned stores in Latin America along with 705 dedicated dealers. And for those of you who don't know, a dedicated dealer looks and feels exactly like a Sherwin-William store inside and out. We just don't own the asset or the employees. We think we can continue to grow our dedicated dealer model, especially in Brazil and in Mexico, and it's our largest segment of business when you go to Argentina.

Controlled Distribution delivers our company a higher average selling price and better profitability. Our goal is to shrink the time it takes for those stores to become profitable and we're getting better at that, and it differs by country. So, we're going to be moderate in our investment approach to Controlled Distribution because we've got to get productivity improvements moving in the right direction.

One thing that's going to help that is our investment and our outside sales organization. We now have 539 or will end this year with 539 professional sales reps on the street. Doing the same things that we're doing in North America, focused on different market segments, becoming the experts in those segments, and we're doing an awful lot of training regarding productivity improvements with our reps. We've invested in the CRM system to help improve those productivity numbers with stores and with our rep force.

I think the segment approach is going to enable our teams to become experts. Our customers want expertise. And again, utilizing a sales force to be in the field, finding out the needs and wants of those customers, and then us reacting accordingly is important. We're continuing to utilize best practices and learnings from North America and South America.

And one example I would give you there as we invested in a dedicated national and regional account organization. We've had some nice wins. We have supply agreements now with South America's largest hotel group, IHG. The same thing with the largest owner operator of retail facilities, GPA, and this is the first formal paint program these companies have ever had.

We're taking advantage of some of our North American relationships. We have secured 300 Walmart remodels in Brazil. We received exclusive supply agreements in Mexico and Brazil with Prologis. Again, utilizing relationships that we have in North America to customers in South America. We've also secured exclusives in Mexico and

Ecuador with Yum! Brands, and we've secured supply agreements with Latter Day Saints and Jehovah Witnesses in South America, which is about 30,000 facilities across South America. So, again, I think we're doing the right things. We just got to accelerate that.

We're implementing the best practices with our G3 approach, acquiring new customers, heavy focus on new account development in all countries in Latin America that's starting to bear fruit because we're developing those relationships, getting input and feedback to drive future programs. And what's more important here is introducing higher value, better-quality premium products into the marketplace through our customers.

We've worked diligently to minimize the channel conflict that we had in Latin America and most of our countries. We now have a product portfolio for company-owned stores and dedicated dealers that differentiates that of the non-dedicated dealers, distributors, mass merchants, and home centers. And we've also introduced a super premium line of the market in Brazil with SuperPaint. The key here that I think is going to allow us to win is we now have dedicated sales organizations managed by dedicated management teams focused on each channel that we play in Latin America.

And at the same time, we're upgrading the products we sell into the home centers. We made a decision two years ago to exit OPP or opening price point product lines in the home centers. That's where we lived before. We're now focused on standard and premium products sellout through these home centers.

And an important introduction was developing a wholesale commercial line of products for our wholesale customers to meet their productivity requirements and really establish a specification position on new commercial projects in Latin America. So, we now have a standard and premium product line for our wholesale customers. It's really played a part in enabling us to convert some of the American partner national accounts in Latin America because these are ProMar 200 and ProMar 400 quality products.

And the same as in North America, big focus on SKU consolidation in Latin America. We've added new products in each country over the last 2 years while reducing our SKU count over 50%. Again, resulted in improved working capital ratios, and I can tell you that we're not finished with this rationalization project in Latin America. We still have too many SKUs and opportunities to continue to drill that down.

From a people standpoint, we want to capitalize on the Paint Stores Group programs that drive sales competency within our organization. We have over 1,300 employees in Latin America. We've reduced our third party outside, hire employees by 95%, so that we've got better control of our training programs, and we've begun in the last 2 years recruiting, hiring and training management trainees in every country in Latin America. We've revamped and really ramped up our training programs for the field organization as well as the executive leadership teams in Latin America, and we continue to infuse some North American talent as we build the bench in Latin America for future growth. We've infused North American talent in key markets in Latin America to help move that needle.

Latin America and South America is not where we wanted to be, but we are designing a structure, a process and a culture, I think, that positions us well when these economies do turn that will deliver success and the results we need in Latin America. In total, the Americas group will continue working by utilizing best practices and the knowledge in North America and transferring that down South where appropriate, staying disciplined in our focused segment approach and our controlled distribution model, remaining very diligent with our pricing practices especially in Latin America, managing our cash appropriately, growing profitable gallons. It's all about volume for us. And developing that talent for the future.

So, I thank you for that and it's my pleasure, I get to introduce Aaron Erter who we refer to as the rookie. And I'm learning from Aaron because he's not going to come up right away. He has an intro video. So, I'm going to let you watch his video first as he makes his way to the stage.

Thank you very much.

[Video Presentation] (01:35:27-01:37:36)

Aaron M. Erter

President, Consumer Brands Group, The Sherwin-Williams Co.

All right. Usually, we get applause after that. Anyone? There you go. First applause of the day. Hey, good morning. I'm Aaron Erter and it's my pleasure to present to you our Consumer Brands business. As Jay said, I am the rookie so I think part of being the rookie is you go after Jay and the Paint Stores Group. So, Jay, you're a show off.

Hey, one of the things I just want to talk about a little bit is we're so excited as joining together as two teams come into one. As John said, it's 125 days in. So, hopefully you can see by the video, it captures some of the excitement that we have as a Consumer Brands Group. So, what I want to do is I want to take you through what we're looking at from a Consumer Brands business and the opportunities we see in front of us. As John mentioned – and I won't go through this, belabor this point – it's really the legacy diversified brands business of Sherwin-Williams; which manage brands like HGTV, Purdy, Minwax, Dupli-Color, Krylon, the list goes on and on; joining the Valspar Paint segment; which has brands like Valspar, Cabot, Wattyl which is our Australian brand and then also Huarun.

I think it was important because we couldn't talk to each other for almost 18 months as we joined is really to declare a vision as one group. And I want to share this with you of what our brand's vision is all about. It's really providing the highest quality and most innovative products, brands and services that create superior value for our consumers, retail partners and shareholders.

So how have we been doing with the integration? The team talked about this to start the meeting. But I want to speak specifically to the Consumer Brands Group. It's been a very busy and, like I said, exciting 125 days. Really pleased with our progress. Some of the things and important milestones that we've achieved is really putting the two teams together, forming our leadership team but also integrating our sales and marketing organizations across the globe.

Still a lot to do. And we think there are some opportunities particularly as it pertains to things like global product transfer for the rest of our regions, which we'll talk more about. The number one thing that we've tried to do within this integration is really have no disruption to our customers and we've achieved that.

Just to break out our business a little bit, because it is a global business, is we go to market primarily in four regions with the Consumer Brands Group; North America being the largest for us by far, Australia and New Zealand, China and Europe. The products we sell are primarily architectural interior and exterior paints, stains, aerosols and specialty products. Our business is primarily through retail accounts like home improvement centers, hardware stores. But we also sell through distributors. And in places like Australia, we have our own company-owned stores.

And if you look at our customer segment, it really spans the gamut. Our customer targets differ by region with North America and Europe being similar with an emphasis on the DIYer but also the small contractor through our retail partnerships. And in Australia and New Zealand and China, we're focused on the DIYer. But we're also focused on many different segments of the pro as well.

This is a slide that Bob had up. And I think I just want to comment on it because it affects our business so much as we're focused on the DIYer. We look at this and we think that we're well-positioned with our Consumer Brands Group.

Obviously, we're well-positioned as a company because of what Jay just went through. But we're there to help our retail partners to take more share of what this DIY business is. In addition, there is the multi-category contractors out there that like to shop these retail partners where we're well-positioned to help them with those customers as well.

So just to comment on our performance, first half of the year. This is legacy SW Consumer Brands, but also has a month of Valspar in it. Because obviously we're not happy with this performance for the first half of the year. We had some challenges in Europe because of their economy.

And really as we look at it in the U.S., the biggest part of our business, there has been softness in most of our channels. Some more so than others. And a lot of that has to do with the shift in DIY we talked about. But also we were dealing with some inventory issues with some of our customers there. But we do see things getting better as we move forward. And we'll talk a little bit more about that from a longer-term perspective.

So let me take you through as we look – as our growth potential moving forward. And like I said, we've been together 125 days. And what we've really been focused on as a team is customer, number one; making sure we're integrating the teams and focused on our synergy targets; but really assembling and developing the best team. So we thought it was critical that we bring some clarity to the two combined teams. And I'm proud of what we've come up with in our focus areas.

So as we look to the future, there is solid growth potential. And part of the reason is just the industry. Bob outlined it. But we think that we're well-positioned as this industry grows not only in North America but the rest of the world. The combination of the two groups gives us very strong retail partnerships across many channels.

And then John talked about this. We have what we believe is a really strong stable of brands, arguably the best brands in the business. And they're supported by our innovation machine. And we call it innovation not just in the can but what we're able to bring out of the can as well. And then I'll take you through specifically by region some of the global growth drivers that we see.

So let's talk more specifically about our partnerships. They really transcend globally and with some of the largest retailers in the world like Lowe's, Ace, B&Q, Mitre 10. Whether it be legacy Valspar or legacy Sherwin-Williams, we have longstanding partnerships with these retailers. And they look to us to help them drive their paint business.

We have the ability to impact that more than ever with our combined offering. The partnerships will only be enhanced by the strong stable of brands we talked about that we can bring to these partners and not only help them drive their paint business but their entire department by offering complete solutions and really leveraging our technologies across our portfolio for these customers across the globe.

So the foundation that really supports all our brands out there is innovation. And everyone talks about innovation. One of the things that has been a pleasant surprise or actually very encouraging as I come over to Sherwin-

Williams is the focus on the consumer. Being a legacy Valspar person, that was something that we always prided ourselves in is looking at consumer insights. And I see that even more so at Sherwin-Williams.

And what we drive is innovation in and out of the can and we do it in a few different ways. We do it from a product standpoint. And some examples of that is our colorant technology, HydroChroma colorant technology. We even do it with the can, our twist-and-pour cans that make it easier for the consumer.

But this innovation is also supported by product quality. Jay talked a little bit about the product quality piece. And we're proud as we look at, not only Sherwin-Williams being named J.D. Power number one in satisfaction for interior paint but Valspar was rated number one for customer satisfaction in exterior paint.

I think a big opportunity as we look to innovation in the future is also how we can simplify the painting process. And you look at the DIY chart out there and there's a lot of different reasons people talk about why has this gone down. I think a big part of it is we have to make the process simpler for our end consumer.

And part of that is not only with how they use the product but how they shop for the product. And some of these simplification solutions we brought like with our HGTV lineup. And having a color palette when you go in the store, you can't make a mistake when you pick any two colors together. That brings them confidence. That's going to help them want to paint even more.

And then we talked about bringing all these solutions together for whole-department solutions for our customers. So one of the things that we're really, really proud of is what we've done in HGTV and particularly at Lowe's. So not to belabor you with videos, but we'll roll the video to give you an example of this and bring it to life.

[Video Presentation] (01:47:16-01:48:34)

Okay. No applause needed. Hey. So, now what I want to take you through is some of our global growth drivers. And as I mentioned before, 125 days in. I think a lot of times the teams wake up and decide what to do first because there's so many things. And what we've tried to do is be very prescriptive by region on what they focus on. So, let me take you through some of those now.

So, let's start out with North America and I'm not going to go through all the market dynamics because Bob really – he went through this. I think one thing to remember is what we think about DIY and we see some of the decline of DIY, and then you'll look at some of the potential for the future is painting is still the number one DIY activity. It's the most impactful thing someone can do to their house, their apartment, whatever else. It doesn't cost a lot of money. So, our job is to help people paint more and we think we're well positioned to do that with some of our retail partners.

We see really our growth in North America is expanding our sales with the best-in-class retail model which I'll take you through, retail service model, that's really driving enhanced portfolio of brands with unique product and retail service technologies, and all of those combine to help shoppers become buyers. So, let's go through some of this now.

We have what we believe as many of our customers where we've employed this and we've done it not only in North America but around the globe, a best-in-class retail service model. We offer unique solutions by retailers that are really anchored in paint. And you can go across our retail partners, whether that be Lowe's with Valspar and HGTV, whether that be ACE with Valspar and their private label, the list goes on and on. It's anchored in paint and we offer unique, for those customers, traffic-driving, marketing vehicles. And then when they're in the store, we offer solutions that help convert shoppers to buyers, like some of our retail merchandising solutions you see here.

All of this comes to life by our people, and they're the ones who are executing this retail service model. We think that we have the best in the industry and what they're helping these retail partners with is not only in sales and engaging customers in the store, but also strategy and using analytics, tools to help them make the best decisions for their departments and for their businesses. And then one of the key things that we really do is training. This is training our retail associates in the stores day in and day out when we can't be there on how to convert shoppers to buyers.

So, you can see our stable of brands here, and we've talked a lot about it. And it's a best-in-class offering. I have six of the brands up here, because these are what I would call our hero brands, and they span across many of our retailers. And moving forward, these are the brands we expect to put our investment behind, and they can offer our retailers, along with a paint offering, a complete solution. We're confident that we can grow these brands, and we have a lot of experience in doing so, and let me tell you a little bit about one of those brands. I think a lot of questions as the acquisition came into place is what's the fate of the Valspar brand? What are we going to do with the Valspar brand? The Valspar brand is going to be one of these key hero brands for our Consumer Brands business moving forward.

And if you look at the performance of Valspar, and this is to illustrate how we build brands and what we think we can do with some of these brands I just mentioned, you can see Valspar has been around really just 10 years. And if you look at DIY purchase intent, it's number two out there. It has best-in-class Net Promoter Scores, and it's really the anchor for our retail service model moving forward.

So, just to highlight North America, we really have a value proposition that combines best-in-class retail service model, driving our hero brands across 10,000 distribution points, providing department solutions in one package to our retail partners.

And I think the other thing to note, and Joel's going to come up here, is we're able to package all of this together, right? Package it all together and deliver it to our retail partners from many distribution points. That's the value proposition we have in North America. Really like no other.

Okay. So, that's North America. Now, we span Australia and New Zealand. Just to give you a little color on Australia and New Zealand, it's a fairly mature market. Housing is strong coming off recent highs, but holding at good levels. Remodeling is strong, and we're seeing reinvestment from capital growth.

Our business covers DIY and Pro across Australia and New Zealand. Like I said, we have 90 company paint stores. I think what's important here is Valspar had this business, right? So, what are we going to different moving forward as we become Sherwin-Williams? Our key growth drivers here is really growth in our paint store channel, leveraging the Paint Store Group, Jay's group, and that expertise, and then really increase our penetration in the hardware channel. So, let me take you through some of these.

Like I said, we have 90 paint stores and we operated these under Valspar with limited knowledge on how to operate a Paint Store Group, and I'm going to owe Jay a lot after this presentation because as you see, we're going to be leveraging a lot of the experience we have in his group. And really, it comes down to a few different things that we need to do right away, and they're basic things. We need to segment our customers to focus our offering to each segment, which is a key strength in Jay's group. We need to leverage the whole product portfolio to be able to bring new products to this market and products to round out the needs of the professional in that group. And then finally, we really need to embed a sales culture that Jay talked about, and that can be using some of the tools like G3 that Jay talked about.

And then increasing our – as we look at our retail model in Australia, we need to increase our penetration in the DIY hardware channel, and that's really important post the Masters closure in 2016, which we had exclusive offering with Valspar. We have a strong local brand in Wattyl. That's over 100 years old, and the awareness is great. We think we can only bring the stature of Wattyl up by leveraging some of the technologies we have in Sherwin-Williams to that brand.

We also – just like we talked about in North America, is really leveraging the whole brand portfolio to some of our retail customers. So, with Australia and New Zealand, very simple one-two punch, we think we have a tight focus that can make significant difference to this business moving forward.

Okay. Moving along to China, and I'll just briefly cover some of the market dynamics, is mid-single digit GDP. It's a fragmented market. So, the top four players in China own 40% of the market. And we see a lot of government regulation affecting this business, and we expect that to continue moving forward. We do have the top-selling Chinese brand in Huarun out there. It's the number three brand, and we've developed strong local market knowledge. Now, it's a matter of what do we do with that. So, our growth drivers in China are really growing the retail channel with a focus on our Huarun brand and then the project channel. So, let me take you through this.

And before I get into it very quickly, let me tell you how the China market is comprised. It's comprised of branded paint stores, so these are usually or at least through us controlled by distributors. So, you could go into a store and see nothing but Huarun. Non-branded stores, which is a mixture of all different brands together usually driven by distributors. Home improvement centers which are pretty negligible as far as their market share, and then home deco companies. So, this is becoming more and more popular.

As you go into China, you would buy a shell, a concrete shell of apartment, and then you would fit it out, is what they call it. So, these home deco companies would come and do everything including painting. So, that's a growing part of the market. And then the project channel, and this is more suited to the real estate developer and we serve this in our paint store group in the U.S. today. So, there's a lot of knowhow that we can benefit from.

So, here's how we're going to win. It's growth in the retail channel. We need to expand our branded store base with our distributor partners. And we're going to be able to do that by offering a complete offering and leveraging our global technology, elevate the Huarun brand but also bring some of the other brands that we have. In addition, we think that we can have a lot of industry knowhow from our Paint Store Group to help our distributors in how they execute their business.

The second growth driver in China is expand in the Project Channel, and this is one, like I said, a new channel for us, and it's taking the playbook right out of our Paint Store Group. China is growing rapidly and a lot of this commercial construction is growing in leaps and bounds, and we need to take an advantage of it, and we can do that through our Paint Store learnings.

Okay. So, we're almost around the globe, and I'll end here with Europe. Europe, as a market, it's the largest Deco Paint Market in the world, and the way they go to market is a vast majority of the business in architectural is pre-tinted paint. So, we came in to this business with Valspar in 2015 in partnership with B&Q, and we offered what was pretty revolutionary at that time a pre-tinted business. So, that would be having the whole merchandising selection, the color wall, you pick your color, and you can have it tinted out there. So, our relationship is now almost two years growing with B&Q. The business is growing well, and then we think moving forward is going to be a key component of our growth strategy. Also, obviously, Kingfisher owns B&Q, and we look at the success we have with B&Q to be able to build on that through the rest of Continental Europe. So, how are we going to do that?

Taking this retail model that we have that we, I believe, perfected in the United States, we've implemented in Europe and use that team to not only sell more of our Valspar brand and product, but expand the portfolio. We do have the number one Wood Care business in Europe with Ronseal. So, we'll be able to increase the sales of those, but also round out the portfolio and have our team sell a complete solution to our retail partners like B&Q.

All right. So just to sum up, we see a lot of potential in the Consumer Brands business. We mentioned all of these and it's exciting time for us. It's new 125 days in, so we look forward to talking to you again soon and also tracking our progress. So, I appreciate the time. Thank you.

And with that, we are now going to adjourn to a 15-minute break. Okay. Thank you.

[Break] (02:00:41-02:23:30)

David B. Sewell

President & GM-Product Finishes Division, The Sherwin-Williams Co.

All right. Well, good morning. It's really great to be here. It's really an exciting time for our company and truly an exciting time for our Industrial businesses. And what I'd like to start with is expand upon what John talked about earlier, and that's an overview of The Sherwin-Williams and Valspar businesses before the acquisition.

On the left of your slide, you can see the three Sherwin-Williams divisions that made up our Global Finishes Group, and on the right of the slide where the Valspar Industrial business is. The integration of our two companies provides global scale, complementary technologies and businesses like Automotive, Industrial Wood, and General Industrial. And it also provides entry into new categories such as packaging and coil coatings.

Combined, we have created our newly named Performance Coatings Group. We have restructured our Industrial businesses, organizing into seven divisions around customers with similar segments, substrates, and application methods.

Perhaps one of the biggest changes was with our – previously known as our Product Finishes division in The Sherwin-Williams Global Finishes Group. We have completed an evolution toward segmented teams splitting into two businesses, our Industrial Wood division and our General Industrial division. This new structure provides focus and expertise while also leveraging the synergy opportunities that we have.

Our Performance Coatings team is comprised with a fairly balanced blend of both legacy Sherwin-Williams and Valspar leaders who I'm truly very proud to have the opportunity to work with. Each division is led by a strong leader and together, they have about 175 years combined experience in the coatings and chemicals sector. All of these leaders are here today, and I hope you'll have the opportunity to meet with them and ask them any questions that you may have.

Our divisions are supported by a tremendous global network of blending facilities, branches, R&D labs, application centers and manufacturing sites. Part of The Sherwin-Williams's DNA is proximity to our customers. Our customers benefit from local supply, local blending, local service and local expertise. And as this map illustrates, together with Valspar, we have even more ways to stay close to our customers and provide localized solutions.

Valspar's labs, plants and distribution points align extremely well with our strategy. And over 300 global industrial blending and mixing facilities are true differentiators in the marketplace, putting our strengths together and our customers absolutely win.

As we come together as a performance coatings group, these are the areas that we are really focused on, and it all starts with the relentless focus on our customers. With that closeness to the customer comes focus and speed. We're also able to innovate more with this deeper and more intimate customer relationship. At the same time, we know that the talent in our local teams gets stronger with collaboration, and with shared assets and resources that optimize our efficiency to grow our bottom line.

Our global teamwork and collaboration has never been more important. Here's a look at the transformation of our business that comes with the addition of Valspar. 43% of our sales now come from outside of North America versus the 32% before the acquisition. This really enables us to build scales in these growth regions and also have complete solutions for our global customers.

The collaboration across regions is just part of the puzzle. Just as vital is connection along the entire value chain where we offer complete development support across all of our businesses. It starts with color and design. Consumer trends are shifting toward color customization. OEMs need dynamic, industrial, global platforms, and quick turnaround for color matching. It continues with the need for our customers' operational efficiency. We offer value-added design engineering to help customers build out their finishing operation. We are a consultant, provide equipment sales, and the ability to offer complete turnkey solutions.

Understanding that barriers to change could be high for industrial coatings manufacturers. Our application centers minimize that. We can replicate our customers' exact finishing conditions, so they don't need to take their line down for testing. We also do extensive product testing that meets or exceeds customer and industry association standard specifications, and always providing local, on-site, technical support for our customer line trials. So, our goal is to support our customer from conception to their finished product.

Our financial performance in the first half of 2017 includes one month of Valspar sales. As you can see, our sales has grown 26.9% with growth in our combined Sherwin-Williams and legacy businesses. This doesn't include sales through Jay's Americas Group, where we leverage the extensive store platform. Our SG&A has been well controlled, but we have felt the impact of rapidly growing raw material prices. We are working very closely with our customers on our price actions across all our businesses and regions to offset the inflationary environment that we're experiencing. And Valspar was in a tough position with the impending sale, but now that we are closed, we feel very good with the progress that we are making.

What I'd like to do is go into a little bit of detail on each of our divisions and provide an overview of our segment focus, our value proposition, some integration growth opportunities, and some unique innovations. And to begin, I'd like to start with our Industrial Wood division. Key initiatives are driven by segmentation focus, new points of distribution, sales excellence initiatives, technology advancements, geographical expansion, and value capture. We have just completed an expansion of our Global Color and Design studio in the heart of the furniture capital in North Carolina. And this state-of-the-art facility works with our customers on global color trends and has complete on-site application center, where our customers can see these new trends on their substrates in a matter of minutes. All application environments are available at this design studio.

And government policy is driving a trend from solvents to more environmentally friendly solutions, particularly waterborne coatings. This is a trend we're seeing across all of our businesses, and we feel that this is a tremendous opportunity for us. With the integration of Valspar, we now have global color, design presence supporting forward-looking and truly innovative trends, cutting-edge technology solution development through use of our virtual color library. And tintable solutions, a service differentiator that provides small batch blends at facilities and customer sites, creating a unique value-add that will also capture additional revenue and margin.

Our wood end users have to address the evolution of their industry with what can be disruptive conversion to their business. It may be in a finishing method, switching or installing UV finishing operations and maybe switching from a solvent-borne to a waterborne product, or it may be adding pigmented coatings to a stain line. We offer dedicated support and processes to help customers make those conversions easy, pain-free and minimally disruptive, all while enhancing performance to allow our customers drive their return on investment.

And leveraging Valspar and Sherwin-Williams' technologies and global connectivity is providing a more complete customer solution, enabling us to pursue growth in areas like flooring and other markets in emerging regions. The market demand for waterborne coatings continues to escalate in this business. And we believe we have a truly innovative technology and drop-in solution for our customers.

We recently exhibited at the American Woodworking and Finishing Society Show, and booth visitors such as cabinetmakers, furniture OEMs, wood building product manufacturers, true experts in the industry were all provided 14 panels and asked, if they were finished with waterborne or solvent-borne technologies. Results only ended up about 50/50, the same as a random guess. So, they could not tell the difference between our waterborne technology and solvent-borne, which is typically, very, very easy to identify.

In addition to this, we have iconic brands using our wood coatings, like Louisville Slugger. And if you think about a coating that needs to look great while withstanding a 95-mile per hour fast ball. And then add more stringent VOC requirements with manufacturing in Downtown Louisville, it makes for a very demanding application. Here's a brief video I'd like to share with you.

[Video Presentation] (02:34:36-02:35:13)

So, I think that demonstrates how we're able to leverage technologies across businesses to the benefit of our customers.

Moving to our General Industrial business, this division provides solutions to a very diverse segment base of customers. So, we have to tailor our value chain to each industry depending on their top needs. However, as OEMs, there are several common needs such as reliability of coating performance, productivity, supply chain, color and appearance, globalization, but also localization. Delivering this reliability locally to all of our customer locations across the globe is a core value proposition. We also have complete portfolios and programs across the value chain.

One of the very exciting opportunities with Valspar and Sherwin-Williams coming together is leveraging our industrial facilities throughout the world. These facilities open up new opportunities for growth with custom blending that factory-direct shipping is unable to service, providing a complete service solution for our customers. In addition, having our complete portfolio is critical as the product requirements are demanding. Whether it be stringent environmental regulations or meeting demanding performance or weatherability requirements, helping OEM customers improve productivity is always a focus and consistent color and performance is needed across all technology platforms, and this is where we really flourish.

Looking at our General Industrial integration, Valspar brings strong OEM specification position, and combined with Sherwin-Williams, vast resources, feet on the street, and their relationships with Tier-1 and Tier-2 suppliers, this makes for a fantastic combination. Valspar also provides scale and distribution for General Industrial in Europe, accelerating the momentum Sherwin-Williams has seen with our investments with key customers in the region.

One of the benefits of our combined resources and scale is the ability for further segmentation to laser-focus on emerging segments where we have a unique offering in areas like signs and containers. And with this scale, we have the opportunity to grow in South America and Southeast Asia with transportation coatings which is providing new and exciting opportunities for growth.

The container market which I just mentioned is a core segment for a new product called AquaGuard. This is yet another waterborne technology that allows container manufacturers in China to comply with VOC restrictions without sacrificing performance or corrosion resistance. This is truly an innovative technology that reduces corrosion at least 60% compared to the commonly used zinc coatings.

In China, a key geography of the container industry, the Chinese government is now mandating the use of waterborne coatings. So with AquaGuard, the zinc-free product not only provides an environmental solution, but provides lower overall equipment weight, saving on transportation costs for our customers. With its impressive corrosion protection, it also expands to other applications such as transportation componentry, in truck underbody and underhood applications. And this demonstrates the value of our General Industrial Division. While the segments may appear diverse, we are able to rapidly share and adopt innovative solutions across the segment.

In our Automotive division, our business mainly focuses on the aftermarket. In North America, the trend of consolidation continues, and multi-shop operators are now operating hundreds of collision shop locations across the United States and Canada. And our unique branch platform positions us to be the only supplier that has controlled distribution that can service all of these shops consistently across the region. In Automotive, we also have two segmented teams for the Automotive OE Interior and Aerospace businesses. These are specification-driven businesses, and our recent Class F General Motors approval provide sole specification for Sherwin-Williams around the world.

I mentioned our control distribution model in North America. But now with Valspar, we can expand our channel strategy with the strong brands that have been added to our portfolio. Our customers require continual productivity gains, and we will now be able to leverage the best of these technologies across all of our channels. And addition, this expansion not only helps us in North America but in Europe and Asia and South America as well.

We really have some exciting innovation growth opportunities in Automotive. The addition of strong brands like House of Kolor and U.S. Chemical will only add to our channel offerings. The De Beer line offers premium, waterborne coatings in Europe and Australia, as well as geographic platform to build upon where Sherwin-Williams was not participating before. And our fast line assortment of abrasives, adhesives and complete range of associated products give our customers a one-stop shop experience.

And our training centers located around the world provides additional resources for painters and shop owners where we can now reach more customers with our integration. This allows us to be a business partner that can provide hands-on training to allow our customers to become more efficient. And this is a theme I'll just continue to hit on and that is our opportunities with waterborne coatings. And our new automotive clear coat 200, CC200, is a great indication of that growth.

It's one thing to simply replace a solvent product with waterborne and achieve sustainability. But many times, you can sacrifice performance. This product not only doesn't compromise, it enhances and delivers better performance than a Solvent Borne. Here's a quick listen to what one of our customers had to say about this new technology.

[Video Presentation] (02:42:30-02:43:12)

Moving over to our protective and marine business. This business really focuses on segments that require asset and corrosion protection across very challenging environments. The team has recently gone through a transformation and completed our global core product line which provides 20 core products and technologies that are available around the world. And this is a really important development because many of our specifiers that John mentioned earlier are global in nature. So, they want and need to specify products that meet their demanding requirements that are readily available wherever their applications are around the world. It allows us to reduce complexity, improve service with a new global and complete portfolio.

In addition to our technology, another differentiator is our ability to leverage the over 4,500 distribution points of our paint stores group in the Americas. This allows us to provide unprecedented service levels that our competitors are unable to replicate. This value proposition provides us an excellent position in the Americas and we can now leverage that with our scalability in Europe and Asia for further growth. And with the addition of Valspar, our product portfolio is now even more complete with the addition of a technology called fusion bonded epoxy powder.

This technology was part of the Valspar functional coatings business and we have integrated that with the Protective and Marine business and this allows us to provide even more solutions to our customers. With applications like steel rebar and pipe, there is a natural synergy with our fire protection products in our oil and gas segments. So, now in addition to our liquid coating

So, now in addition to our liquid coating technologies these same OEMs are in need of powder technology solutions. We now have the capability to offer both. And lastly, with the Valspar footprint in Australia with our Wattyl brand, this provides the footprint to expand our reach in this area with Sherwin-Williams products to fill out our portfolio. And also allows us to leverage the global specification position with our new global core products.

Just to share a little bit more about this technology, this statistic for the National Association of Corrosion Engineers really stops you in your tracks. Of every dollar spent in the developed world, corrosion consumes $0.03 or $0.04. So, when you think about a market opportunity for corrosion-inhibiting platform and a market that is growing at a 5.2% CAGR like pipe, this makes for a fantastic opportunity and fusion-bonded epoxy powder provides flexible performance in the most extreme temperatures.

Our newly acquired packaging coatings business provides us a leading position in a very attractive market. It's a business that is truly global across the entire value chain. So, having global products to meet those specifications with the ability to serve locally with local tech support is vital to success, and with changing regulations, delivering innovative technology solutions is paramount. This is a business that fits so well into our model, global and innovative products with demanding requirements across the entire value chain.

And when we talk about innovation, which is especially crucial in packaging, the big number that jumps out is [ph] 170 (02:47:17). That is the number of patents we hold for Packaging Coatings. And as the food and beverage industry continues to move from BPA to non-BPA coatings, 49 of those patents are related to non-BPA. Our R&D and focus is to step in where the industry needs us to be.

And one of the most exciting patents revolves around our non-BPA epoxy coatings which I'll expand on in just a minute. But this unique technology gives us productivity and performance that's required in this space. With the value chain that includes coil coaters and can makers, brand owners and retailers, the packaging team has a depth of expertise for all scenarios.

One of the ways we're able to stay as a leader in innovation is our ability to leverage our own resin technology platform. And while on the surface, it may not seem that there would be much growth synergies across divisions with our Packaging Division, we have already identified this unique resin technology for other division business needs where customers are asking for specific solutions that these resins can provide.

So, just talking about our valPure V70 which is truly a game-changing product, so much so that Libbys brand of vegetables puts the valPure logo on all of its cans to show consumers their commitment to non-BPA. This patented technology is incredibly exciting, because it's a non-BPA epoxy coating, the only one of its kind in the industry. And by utilizing an epoxy, this allows our customers much more flexibility and a friendly [ph] drop-in (02:49:09) solution. Customers prefer applying an epoxy coating and Valspar provides the solution – and valPure supplies the solution.

Coil & Extrusion is really a dynamic segment. And as you look across the value chain, Valspar's team has made great headway with architects, delivering innovative color solutions. Sherwin-Williams also has a great presence with architects and is able to supply small-batch, quick turnaround liquid and powder from our company-owned stores.

When you envision a large commercial project, a hotel, a hospital, a stadium, it's not just the exterior and the coil and the extrusions, we're able to service the powder-coated railings and everything from the benches to the door handles. Valspar brings the coil innovations that the architects need to bring their vision to life, and Sherwin-Williams fills in the rest of the portfolio and brings the logistics to execute this vision down to the smallest detail.

So, in addition to the value proposition I described, there are other aspects of the value chain where the team focuses on, such as NGOs, which is non-government organizations. The value chain isn't just driven by architects. There are other specifiers who are performance-driven and applicators who need ease of use, value and performance.

Our PVDF Fluropon coating meets or exceeds both AAMA and ASTM testing specifications. Our customers, applicators and coaters recognize Sherwin-Williams as having an extremely robust application window, allowing them to manufacture with flexibility and confidence in our products.

And you can see this combined organization and value proposition is paying off with terrific projects like the T-Mobile Arena in Las Vegas where the new Vegas Golden Knights NHL team will play. The coil-coated building panels and shingles are vibrant and demonstrate how important being a leader in color truly is. We also have active projects to blend, match, and deliver Valspar products from our network of industrial facilities, which will provide significant incremental growth opportunities.

Utilizing our local facility provides even greater local, custom color solutions that our customers require, which is a need that can now be delivered with Valspar and Sherwin-Williams coming together. So, now when we work with

OEMs, whether it'd be with Coil, Powder, Protective & Marine, or General Industrial, we can provide a complete solution as a combined company.

The final innovation I'd like to highlight is our Fluropon Effects Nova. As I mentioned, color innovation is so critical to success and this new, patent pending color space for architects has never been achieved before in 70% PVDF coating systems. It has lasting and outstanding performance and durability with that eye-catching sparkle. It has incredible versatility as a highly customizable system that could be match to nearly any color with a gold, silver, or copper sparkle. These unique and innovative colors combined with product performance and unmatched service capability are simply world class.

So, in summary, I think the Sherwin-Williams and Valspar industrial businesses are simply better together for our customers. If you'll recall the map I showed earlier with all of the Sherwin-Williams dots, we are where our customers are. If a customer wants a truckload delivery in Seattle, Washington or 5 pounds of powder in Bologna, Italy, or if a customer in Malaysia needs someone to help them on one of their lines on a Saturday morning, we are there to deliver. More technology, more locations, more local resources, it is essential to who we are, and it requires a tremendously customer-centric model.

And when we put our two models together, we achieve that relentless focus on the customer. There's no challenge that's too great for our teams. No location too far for us to reach. And with dedicated segment teams, we are deep into specific segments and the unique dynamics each industrial customer faces. We thrive on solving our customers' most difficult problems. It's truly an exciting time.

I appreciate the opportunity to share it with you. Thank you very much, and it is my pleasure to introduce Joel Baxter, President of our Global Supply Chain.

Joel D. Baxter

President & General Manager Global Supply Chain Division Consumer Brands Group, The Sherwin-Williams Co.

Thank you, David. Good morning, everyone. It's my pleasure to present an update on the Global Supply Chain organization. And I'd like to begin with a manufacturing and distribution global footprint review. So, this is the combined, as of June 1, manufacturing and distribution footprint for our companies. I've denoted the legacy Sherwin-Williams in dark blue and the legacy Valspar in light blue. So, these are company-owned manufacturing, distribution as well as a number of third-party warehouses that came as part of the Valspar acquisition.

Since day one, we've had 16,000 team members coming together as one focused organization and sharing best practices across the world through our end-to-end supply chain. And our end-to-end supply chain is unique. We have one of the company's three research and development organizations. We do innovation resource center research work for the company, as well as architectural development for [ph] Jay and Aaron's (02:55:50) businesses.

So, our end-to-end supply chain goes through all of these functional areas to our customer. And we use feedback from our customers to really drive our priorities and our continuous improvement efforts. And whether that's our internal sister divisions or the end users of our product. This continuous improvement runs through a disciplined global business management system. And we've already introduced this process to the supply chain leaders in legacy Valspar so that we can come together to make this system even better in the future.

The foundational elements are shown at the top here, and our execution roadmap, which you've heard other speakers refer to and cuts across our company, is our people, systems, tools and processes. That's where we get our leverage to drive efficiency and deliver results that drives that customer satisfaction through more efficiency and cost reduction while positioning the supply chain to support accelerated growth in any of the businesses that you've heard about this morning.

Three key areas of focus that we lead for the company: operational excellence, global procurement, and innovation excellence. As I noted earlier, we do a lot of the innovation resource centers of excellence work for the company that goes across all of our sister divisions. But beginning with operational excellence, and I was happy that Bob started with a safety contact this morning, because that's the number one priority for our company. With nearly 60,000 employees, we want to keep our people safe, and we've done a pretty good job.

This is a three-year comparison of our recordable case rate versus the paint and coatings industry over all, and I was able to include legacy Valspar in 2016. We maintain a significantly lower rate and this is the first time in my time with the company that we've ever acquired a company that had a lower accident rate than we did. So, we are really excited about bringing these two strong safety cultures together, because keeping people safe in our business is job number one. And secondly, it's good for morale and it helps us lower our cost.

Another long time metric of ours that's been very important to our success in the Global Supply Chain is related to first pass quality. It's getting it right the first time in manufacturing through precision and consistency that delivers repeatable quality to our customers while reducing cost and capital. Although I show it on this slide for the last three years, this actually dates back in legacy Sherwin-Williams to 2002. That's a long time to be working on driving improvement, and today, we're closing in an 80% right the first time through all of our factories across the world.

Now, precision and consistency is not the only thing, the reduction in cycle time is very important. So, here's another way to think about it. Every 1% improvement in this metric allows us to make hundreds of thousands of additional gallons without adding any cost. So, it's about getting that flow-through. We're establishing this baseline to make sure we're measuring it the same way with the teammates that joined us doing first, and I look forward to being able to drive improvement in the combined organization and talk about that in the future.

First pass quality support our service efforts, you've heard from everybody up here, are laser-focused on the customer and that's very important to what our team does, serving customers is our job number one right after safety. We maintain product availability on time in the high 98-plus percentile. And for 2016, we're able to capture the product availability on time for the legacy Valspar company. So, in the spirit of this business management system and leveraging our systems tools and processes, we see an opportunity as one organization now to drive even higher service levels to our customers.

And I thought it was important to talk to you a little bit about a very important part of our service model in North America, and that's our company fleet. 2017 is our 35th year of operating our own company fleet. This team of dedicated company drivers does a terrific job of getting product not only to our Stores, our Consumer Brands, to the Performance Coatings, on time faster than anybody else in our space. They're recognized for safety excellence as noted here with a plaque on the screen.

This year's National Private Truck Council first place winner for excellence in highway safety, and we've just been notified by the Environmental Protection Agency that we're 2017 SmartWay winner and SmartWay award winner, and this is for energy and conservation and sustainability on the highway. So, it's one of the most fuel-efficient fleets you'll find with very low emissions and we're always working to get better in our spirit of continuous improvement.

And lastly, Jay touched on this with the hurricanes that happened. This team did an incredible job in the Southwest and Southeast, helping our organizations recover. We always say it this way, we deliver water and food and generators, and then we'll deliver coatings products after that. But this team sprung into action and has done an incredible job and I wanted to recognize them for these efforts.

A couple of important financial metrics for Global Supply Chain. One is managing average working capital as a percent of sales. We operate and have maintained negative working capital averages over the last three years. We had a little bit of a reduction last year as we did a one-time inventory build for some new business, as well as to finish some automation projects and manufacturing inside of our existing architectural footprint. But we continue to drive this, we're going to work to make improvements in the future as we bring our two companies together, and I'm really excited about the opportunities that I see.

Another important metric for Global Supply Chain that we managed for the company is average net fixed assets. This a three-year view of our net fixed assets. In 2016, legacy Sherwin-Williams had a one-time increase as we opened a brand new distribution center in the southwest part of the United States. Having been in the other one 25 years, it was time to open a new one and I've been able to capture the average net fixed assets for legacy Valspar. So, as we come together, we're going to focus on flowing through incremental volume while we drive to combine net fixed assets down. And the way that we do all of this is through a relentless focus on operational excellence, cost savings, and continuous improvement.

This chart only goes back to 2008, but this is another long time focus for us. It dates back to 1998. So, we're coming up next year on 20 years of driving this process, and each and every year, through our business management system, we find more annualized cost savings in 2016 was no difference. Again, working with the legacy Valspar team, the joint supply chain, the baseline, the activity there, and come together to keep driving improvement, and this now represents tens and millions of dollars of annualized cost savings. It's not a cumulative number.

The second critical focus area for us, global procurement, our global procurement team is coming up on 10 years of being one organization and they've done an amazing job of helping us achieve visibility to raw materials no matter where they're sourced at in the world. At the same time, over that same time period, they've led the efforts to simplify our portfolio and play a significant role in working capital management.

As every year, there's always a number of activities that are impacting the year-over-year trends relative to raw material cost and pricing. And so, I just highlighted a few of them for presentation this morning. So, on the favorable side, the synergy opportunities that we are actively working on in achieving to be determined. I could do without another hurricane, I think the rest of my friends in the room could as well. But natural disasters, you can't plan for them, but when they come, you respond to them, and because we've dealt with them in the past, we're pretty good at it.

And I want to say, our global procurement organization has done an amazing job of dealing with the disruptions in the Gulf Coast, ensuring that we stayed supplied of raw materials and we've had no negative impact on our customers. That's the power of our global procurement team and your own transportation company as well. And then unfavorable-wise, foreign exchange rate volatility continues and we've experienced year-over-year titanium dioxide price increase.

So, with these factors as well as others, I wanted to share with you our estimate of the 2017 average industry cost for a typical coatings product. So, this is industry estimate, publicly available data, doesn't reflect any one company or another, just our estimate based on that data versus 2016. So, by our estimates, we see resins and latex representing 44% of the purchases and coming in with a price increase of 3% to 5% for the industry. Pigments at 26%, up in the range 4% to 7%. Containers at 12%, up 3% to 5%. And then solvents at 8%, up 7% to 11%. And additives at 10%, the only category that's down 2% to 3%. So, definitely a year-over-year increase for the industry relative to raw materials.

There is a number of other areas that the procurement team plays a significant role in partnership with our research and development team, and that's related to these three long-term strategic focus areas: related to alternate supply, internal development, and efficiency projects.

So for example, as it relates to TiO_2, we work on long-term strategic initiatives no matter what's going on with pricing in the marketplace. So sulfate, over the years, the quality continues to improve. That's opening up more formulation space versus chloride, high hiding technologies are now a normal part of our formulation platform, and then efficiency projects where we relentlessly work to get more utilization out of every pound of TiO_2 that we consume.

And the same holds true for the other major purchasing category; resins and latex. It's a dual-sourcing strategy of internal versus external. Our own internal development of proprietary technology in manufacturing control coupled with our external suppliers in the innovation that they bring to the table. We believe this dual-sourcing strategy gives us the best view in run rate on new innovation, while helping us maintain our cost.

The relationship with procurement and R&D supports our Innovation Resource Center and efforts. This slide shows our dedicated team of scientists who we put together just under two years ago to work on company-wide new innovation. So, they collaborate. In fact, this whole team has come from multiple R&D organizations with varying degrees of background and experience. So, you'll have industrial experience here, you'll have architectural experience and so on. But their number one focus is on bringing new innovation that can be levered simultaneously to multiple divisions of the company. And they're really off to a great start and have recently transferred some of the first technology out of this group to be commercialized in divisions.

We think the IRC, as we call it, are going to help us continue this run rate of new products with speed of execution. I put up on this chart going back to 2011 when we really, on the architectural front, started to hit double-digit new product launches. And Jay specifically talked about the percent of sales range that new products are contributing now.

So, we've hit this double-digit pace and I would point out 2015 where we hit a high watermark of 40 new architectural products, followed up by 24 and 25. So this new Innovation Resource Center coupled with the work that we've been doing since 2011 to drive more speed to market and reducing that time, is really paying dividends and the proof positive is on this slide.

And we're not stopping there. As we move into the future, our innovation pipeline is full. It's a disciplined, longstanding process for our company rooted in a stage-gate foundation that you see at the top of the slide, always begins with the customers' critical needs. Our marketing team does a great job of updating these critical attributes for the customer such as maintenance and durability, visual appearance, custom solutions, sustainability, and time and labor.

And if you recall, you heard Jay talk specifically about those products that are addressing those needs. It goes through our stage-gate process represented here by the large and small blue circles, and it's only a visual representation. The actual pipeline itself wouldn't fit on the big screen that's projecting on. So, we're really excited because this is how we're going to keep driving more innovation while reducing our time to market as we move into the future, making sure that we're going to lead when it comes to new product innovation.

So in summary, I want to just tell you, we're really excited about all the team members that joined us June 1, including many of them that are in this room today. On the supply chain side, we're coming together as a focused organization already leveraging systems, tools and processes, accelerating continuous improvement, a 20-year-old effort at Sherwin-Williams while we complete our integration work and never ever taken our eyes off the customer. You've heard it time and again and our team knows we got to deliver best-in-class service to our customers while we complete the rest of this work.

Thank you very much for your time this morning. Bob?

Robert J. Wells

SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

Thank you, Joel. Joel is a very precise guy, as I'm sure you can tell. It's unlike him to get us off to – on Q&A 12 minutes late. So, before we get started in Q&A, actually in anticipation of one of the questions you're likely to ask, I'm going to pass the microphone over to Al to make a clarification on one of his slides.

Allen J. Mistysyn

Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.

So, at the break we got a couple of questions about the dividend range for 2020, and that is based on the 2019 GAAP EPS, not adjusted or core EPS. The way we're going to work this is that, I'm going to have the microphone here so I can pass it to any member of the Sherwin team to answer questions. But John is going to be our master of ceremonies for the Q&A.

John G. Morikis

Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

Bob is called a lot of things, but never a master of ceremonies.

Robert J. Wells

SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

Let's start with Kevin. Actually hang on just a minute. Microphone is coming. Please wait for the microphone for the webcast purposes.

QUESTION AND ANSWER SECTION

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Thank you. Kevin McCarthy, Vertical Research Partners. With regard to pricing, a two-part question, if I may. On the 3% to 5% increase that you proposed for October 1, should we expect the realization of that to be similar or different as compared to the round of increase that you had in your stores 9 or 10 months ago?

And then second part. I know you don't like to get granular on the consumer pricing efforts, but recognizing your efforts to improve margins there, what can you tell us about pricing opportunity outside of your company-owned stores, please?

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

Jay, take the stores piece first.

Jay Davisson
President, The Americas Group, The Sherwin-Williams Co.

A

Yeah. Looking at our stores, I think the first time we executed a price increase since December and the December was in 2014, so the effectiveness of our last price increase in December was very solid and it was solid early on. This one has come to fruition a little sooner than we had anticipated. So going out with an October 1 price increase isn't going to be as effective as the last one early in the process, and primarily because we have contractual obligations with a lot of our major national accounts, and those don't come to fruition until January, some late-January. So we won't see quite the effectiveness as early as we did the last one, but overall, we always seem to get there.

One thing I would add to that is, the December price increase typically has a tendency to fall off six to eight months afterwards. This one has held even stronger than any price increase we've had before, and we anticipate the same thing for the 2017 price increase.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

And Kevin, I'll answer your second question regarding pricing in consumer. You're right. We don't generally talk about pricing in customer. But you did see and have seen pricing in the market as it relates to raw materials increasing, so you should expect that we're out having those discussions.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

Go with Chris next.

Christopher S. Parkinson
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. Chris Parkinson from Credit Suisse. I guess, I'll keep [indiscernible] (03:15:41) but regarding your store growth initiatives and the pathway to 5,000. Can you just remind us of your key drivers as mainly just home prices, existing home sales, just the key demographics that roll into that? Highlight any markets which you feel that you're inadequately represented?

And then also, over the last three years, you've still been averaging 90 to 100 stores roughly. Have you seen any difference at all regarding the cadence of the revenue ramps of those stores over the last three years versus in the past? In other words, is it the same, is it actually a little bit faster? Just anything that gives us a little guidance on how to anticipate those through the balance of the decade? Thank you.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

Okay. First part of the question, I think we can continue the expansion. Again, that 2% to 2.5% growth rate, we feel comfortable with primarily because of human capital and we want to make sure that we pace that appropriately so that we're not under serving, putting people in jobs too soon.

The components we look at – again, I think we talked about this a little bit last night, consumer confidence is a main driver, unemployment, and then house values. And when we continue to see those three moving in the right direction, we feel very confident in accelerating and maintaining the pace that we have with new stores.

As far as cadence on performance in our new stores, about three years ago, our goal was to shrink that profit – shrink the time to profitability gap. So most of our investments in sales reps have been to support our new store openings. So we have seen a faster volume gain in our new stores, and we've shrunk that profitability gap about 18 months. So it's gone from an average of three to four years down to 18 months. It differs by market, cost of entry in New York and California much higher than Houston or Atlanta, so we have markets where it takes us four years still to become profitable, and some markets where we're profitable within six to eight months.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

The other Chris.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

[ph] This side, Chris (03:17:46).

Christopher Evans
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. It's Chris Evans, Goldman Sachs. You guys increased your synergy target in the presentation today. And I noticed specifically your manufacturing synergies increased a bit. I was wondering if you could sort of go through the components that went through your synergy increase. And specifically on manufacturing, the number seem a little light for the scale of the acquisition, the overlap in Architectural, I'm just kind of wondering if you could give more color.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.

A

Yeah. So, we – a lot of the information we have around manufacturing specifically, we received June 1. So that comes with what it'd cost to manufacture, the capacity utilization, the products within the sites. And what we have tried to do is accelerate the North American rationalizations of those sites, and that's why you saw a slight uptick as we've gotten more information. As we go through the process, it takes six to nine months to shut a factory. And as we go through that process and see the products moving to – or the receiving sites, so to speak, what is that cost impact to us? As we get through that process, we'll have better clarity on that and we'll update accordingly.

Looking outside the U.S., and we look at our industrial factories, that's a longer cycle to get after time to close, how to move the product, making sure the technology is right, the receiving factories have the right capacity and be able to do that. That's a [ph] longer perm, (03:19:23) and that's where you're going to see us – have to really decide how that works to update that overall guidance.

The other synergy benefit is really in SG&A, and it's more on the G&A side. We had a better line of sight coming in, hitting the ground running June 1, and we've updated accordingly. And I would say, we got more to go there, but time will give us – after 125 days, it's just too soon to even – to go any more higher than that.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.
A

Yeah. I think it's safe to say that North American Architectural, we can get a line of sight on that from everything from raw materials, equipment needed in a plant, every aspect of that. To Al's point, the ability to really and truly understand the customers' needs, rest of the world as well the technology, it's a different animal. Our goal is always – and I hope you caught this from everyone of our presenters. It starts with a customer. Our goal is not to get a plant down, it's to keep a customer and be efficient. And so through that process, we start with a customer look back, making sure we understand what the customers' needs are and how to best fulfill those needs.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

I'm going to take Don up here first and then Steve over on this side.

Donald David Carson
Analyst, Susquehanna Financial Group LLLP
Q

Don Carson with Susquehanna. Question for Al. Al, historically, you'd always focused on both the gross margin and SG&A, the sales target. Obviously, you've got adjustments for purchase accounting, but can you talk about your expectations there? And then near term, what's the dynamic between price increase and raw material increase? Are you expecting another few quarters of gross margin compression?

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.
A

The first question on gross margin, we've historically given a range on gross margin and our current range is 48.5% to 51.5%. As you all know, Valspar's gross margin run slightly lower than our legacy Sherwin, but their SG&A was lower. So you're going to see a little bit of compression just for that. And I'm saying, our margin range should be about 45% to 48%, and I'm talking core, not including the adjustments.

We don't talk about a range for SG&A, but we certainly expect to get leverage on our SG&A both just from our core operating growth in the volumes that we see there, but also from the synergies. And then as far as pricing goes, we are flat through the first half. We felt very good about that. We might see a small tick-down in our gross margins in the near term, but over time, we expect our gross margins to expand.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

Steve?

Steve Byrne
Analyst, Bank of America Merrill Lynch

Q

Steve Byrne, BofA. I have a question about this Huarun brand and pardon me if I butchered it. But can you talk a little bit about that retail model that it sells through, the target end market and more importantly, the longer-term growth opportunity and how do you get there?

Aaron M. Erter
President, Consumer Brands Group, The Sherwin-Williams Co.

A

Yeah. Sure. So the Huarun brand, as I've said, is the top selling Chinese domestic brand. Valspar bought that back in – correct me if I'm wrong, but probably 2006, 2007. So the retail model it sells through, in China, we talked about retail being about 60% of the market of branded and non-branded stores. So if you go to China, it's set up where it's all paint. So there's a number of paint stores in one area and they could be branded Nippon, Huarun, you name it. And it's really run through distributors.

So what we do is help the distributor set up those branded stores. We'll provide merchandising, we'll provide signage. And consumers can come in, in those stores along with pros to buy paint. Also along with that, they run non-branded stores which would be like going into a hardware channel that's a paint department that has a number of different brands.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

So the opportunity we see there is twofold. One, having had discussions with many of them, they're very interested in some of that institutional knowledge that we have in running stores, how can we help them make their stores better. So you're likely to see us try to play that role to assist our partners in running more efficient, better operating stores.

And secondly, as Aaron mentioned while he was up here, we have a basket of technology that's available to us that we want to bring to that market. We're not going there to be the lowest price on a generic flat wall paint. If we can bring technology that helps our people, our customers set themselves apart and be rewarded, then we're interested in that business.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

We're going to go do Arun next over here.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Arun Viswanathan, RBC. I just had a question on the long-term targets. It does appear that you're expecting a pretty large jump in some of your financial metrics from 2019 to 2020. So, A, is that correct? Is that because of the deleveraging rolling off and the cost to achieve rolling off and the buybacks increasing? And then, B, maybe you can just comment on how you look at the market from a cyclical perspective. Are we nearing the upper end of [ph] architectural gallons (03:24:52) in North America? I think we'll be at [ph] 780 (03:24:54) this year or do you see continued growth for the foreseeable future?

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.

A

So, let me – yeah, the long-term targets we feel are very strong. We're getting those both on the core operating improvements over time, and I'll start with – as you know, 2017, we're talking about – or margins specifically to Valspar are under pressure and we expect to – as we can roll price increase and pass that raw material inflation to our customers, we're going to start getting that back. It's continued volume through our Paint Stores Group and the leverage we get through – on the operating margin in Paint Stores Group, but also in global supply chain, improvement in our core Consumer businesses. We had a tough first half and we certainly don't expect to perform that way going forward. And then, certainly, the focus on getting those synergy targets both the cost side and the revenue side is really going to – as we flow those through our P&L, we're going to see that leverage for sure.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

As far as industry volume expectations, there's two things that I mentioned in my presentation we think is going to drive growth in the market for the foreseeable future. The first is we're under-building. Did everybody get that point when I was up there? We're under-building. We think we could actually see something along in the order magnitude of 40% growth in housing starts which would be sustainable.

The second is, I mentioned that the repaint market is actually 15% larger than it was during the last cycle and we have not yet returned to the rate of repaint or the repaint cycle, which tends to compress over time as the economy improves, as home values increase. So we have not returned to the frequency of repainting that we saw at the peak of the last cycle and the market is 15% larger. So what I don't expect though is to see the peak and crash that we saw last time. I think you're going to see slow growth in the housing market with 8 to 10 years potentially of sustainably high volumes.

Let's go to Eric and then Ghansham.

Eric Bosshard
Analyst, Cleveland Research Co. LLC

Q

Eric Bosshard, Cleveland Research. You mentioned revenues a little bit. I think you outlined 4% to 6% revenue growth over the next three years. And so, curious – I know you don't want to talk about it by segment, but by segment how do those behave relative to the 4% to 6%? And then secondly, related to that, you also today, I think, for the first time, [ph] called out (03:27:33) revenue synergies. I'm curious where you see those being realized.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

I don't think he wants to talk about it by segment.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.

A

I think it's what we've talked about in our past. Our strongest revenue growth is going to continue to be from our Paint Stores Group. We talk about consumer and I think historically, we've talked about a low-single-digit trend and even prior to having HGTV HOME by Sherwin-Williams [ph] through Lowes (03:28:04), maybe even a little bit lower than that. And our expectation is that our Consumer Group will perform better than it has for sure.

I think what you're going to see in our Performance Coatings Group, we're going to say low-single-digits, but our expectation is we're going to beat that growth rate. Looking ahead, maybe slightly different. If you look at volume, 2% to 3%. Price could be 1% to 2%. You look at the acquisitions and revenue synergies, about 1%. And then,

[ph] you're (03:28:37) going to put in the headwinds on FX. We believe the U.S. economy is the strongest in the world. You're going to have some FX throughout. How much? Maybe [ph] 1% to 2% (03:28:47), it's hard to tell. But that's kind of how you build the 4% to 6% versus looking specifically by segment.

As far as where the revenue synergies are going to come, I would ask David maybe to talk to the Performance Coatings Group synergies, revenue synergies.

David B. Sewell
President & GM-Product Finishes Division, The Sherwin-Williams Co.
A

Thanks, Al. I think we're really pleasantly surprised by what we think the opportunities are, [ph] right? (03:29:14) One of them I'd highlight is our facilities are industrial blending facilities. We are already in process of taking many of the Valspar customers. They had a direct model, shipped directly from the factory [ph] where (03:29:28) we are now closer to the customer. We can do smaller batch, custom color, quick turnaround. This is all organic incremental growth for us by leveraging these facilities. So we feel very good about that.

We also feel very good about the Functional Coatings business that we mentioned, by combining that with our Protective & Marine business. That's a product line we didn't have, but we had that great connection with our customers on our liquid coatings. So we're already seeing value there as well. And the other piece that we're excited about too is the resin technology, that's internal now. That gives us a lot of innovation opportunities by developing our own resins.

And then also, there's some technology platforms that go across divisions, which are pretty enlightening as well. So it's really been a terrific opportunity. And being only 125 days, we're really discovering quite a few of those revenue growth [ph] opportunities (03:30:31).

Joel D. Baxter
President & General Manager Global Supply Chain Division Consumer Brands Group, The Sherwin-Williams Co.
A

I think it's safe to say across all your business units, in fact across the entire company. As we have worked hard to get our teams together, we're finding more and more opportunities that are coming out of every one of these sessions. So we're really excited about the momentum here.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

Let's go to Ghansham [ph] here (03:30:47).

Ghansham Panjabi
Analyst, Robert W. Baird & Co., Inc.
Q

Good morning. Ghansham Panjabi, Robert W. Baird. I guess a question on your e-commerce initiatives. Maybe you can give us a sense as to how that's being received by your customers, are they demanding that increasingly? And does that change your view in terms of the number of stores that's added to your footprint in the U.S. over time?

And the second question I had was just given your pro forma footprint, the change in terms of cyclicality across businesses globally and also the end markets, what is the right long-term leverage threshold for Sherwin going forward? Thanks.

Jay Davisson
President, The Americas Group, The Sherwin-Williams Co.
A

On the e-commerce side, I think I would be brave enough to say most painting contractors are not early adaptors to technology. But they do see value in that and primarily our larger customer base. It's a productivity enhancement for them.

I don't think it impacts at all our potential store growth, because, again, I think the digital experience along with the control distribution model and our rep force, it just enhances the value proposition that we provide to those customers. So I don't see it impeding with our stores. A comment was made earlier. Is it going to pull away from the need for additional sales reps?

Actually, what this is doing is it's freeing up our sales reps, because instead of that customer calling the rep to place this order for the store, they can place it directly off of their iPhone or their tablet or their laptop, giving our reps more time to make more calls or be more productive with that individual customer.

So this is a win-win in our opinion. I don't think the utilization is going to be 100%. Some customers are going to want to use this tool, some are or not. But so far, we've got, I guess, great feedback early, primarily from the larger contractor base. We're coming out with our PRO app to coincide with this e-commerce [indiscernible] (03:32:36) activity in the fourth quarter. And I think the ease of utilization of being on a job site and just placing or hitting a reorder button is going to be something that our residential repaying contractors are going to want to use.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.
A

I think that's a really important point. It's building on and really separating ourselves from our competition. When you think about the relationship that we have with our customers, we focus greatly on how we can make them more successful, more profitable. And so, to Jay's point, a contractor that's working on [ph] the evenings (03:33:06) now has the ability to see his or her specific pricing. They understand their projects, the cost of raw material or cost of finished goods or products going into their projects.

So the opportunity to really build on this is important. And as Jay mentioned, it's not only that sales reps' productivity is going to increase, it's the store as well. Those orders coming in through digital process as supposed to a phone call and we know that it's accurate and right because it's a reorder on a specific project. It's going to help our sales reps, our stores and our customers to be more productive.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.
A

On the leverage ratio, I think we feel comfortable on the long-term ratio at 2% to 2.5%.

Jay Davisson
President, The Americas Group, The Sherwin-Williams Co.
A

Times.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.
A

Times, yeah. [ph] 2.5% – 2.5 times (03:33:51). And that's going to be dependent on the acquisition pipeline. The more acquisitions we have and as we ramp up that activity, it may trend down towards the 2 times. It gives a lot of flexibility. And with the significantly liquidity sources we have available to us, it still allows us not carry cash and take the cash we generated, put it back into the business and return it to our shareholders.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

[indiscernible] (03:34:23) I was paying attention. We're going to go to Mike next.

Michael J. Sison
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi. Mike Sison, KeyBanc. When you think about the 2020 EBITDA growth goal, you're going to need about $1.25 billion to get there. From 2016, you get $400 million from run rate synergies, [ph] leaves (03:34:44) about $850 million in EBITDA left. And the reason I ask is that I wonder how much of the cumulative savings is part of that as a bridge and then how much of the rest of that is just the organic growth.

Aaron M. Erter
President, Consumer Brands Group, The Sherwin-Williams Co.

A

Yeah, I think [ph] it (03:35:03) might be a little light on the synergy growth impact, but I think you're going to see it in core. And if you just took the revenue synergies and the ramp-up and cost synergies plus our core, you're going to get to a higher number than what we're showing there. And I think the difference is we're still going to invest back in our business. In that time period, we're going to put another 400 stores.

As one example, we're going to invest in our Consumer Brands. We're going to invest in our Performance Coatings Group, continue to invest in R&D and ramp that up as we go forward. So core, [ph] so sure (03:35:42) is a big part of that synergy. It's going to be the next big part. And then, there's going to be a cost that we're going to put in that continues to invest in our growth.

Michael J. Sison
Analyst, KeyBanc Capital Markets, Inc.

Q

And just as a quick follow-up, is there any particular reason – I mean Amazon has disrupted a lot of industries. Is there any reason the paint industry can't be disrupted by Amazon?

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

There are difficulties in servicing the DIY market online without a brick-and-mortar platform. Suffice it to say that an e-commerce model is significantly enhanced by having inventory close to the customer. The vast majority of gallons, north of 90% of gallons sold into the DIY market are modified before delivery, meaning they're tinted and shaken. And so having a tinting and shaking operation close to the customer is a real advantage. Paint's also hard to ship. It's heavy and it's – the weight-to-value ratio is very high. Many air carriers will not take paint airfreight mainly because if the cap blows off, it paints the inside of the cargo hold, which can be really problematic when it paints over labels. But it is challenging to – the traditional e-commerce platform is very challenging in this market. We don't necessarily look at it as where the competitive risks are. We see this as a huge opportunity. Having the brick-and-mortar platform that we have really enhances our ability to launch this capability.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

One thing I'd add onto that also is just having that local brick-and-mortar allows a consumer to stop in and visit those – get those colors firsthand as opposed to on a visual monitor, which is another issue when you think about choosing a color. And once that paint is tinted, it's forever. So having the ability to stop in firsthand and see that color is important.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

We're going to go to Dmitry next. I'm working from front to back, so be patient.

Dmitry Silversteyn
Analyst, Longbow Research LLC
Q

Dmitry Silversteyn with Longbow Research. I was kind of curious. In one of your first slides, you talked about portfolio review. I assume that means some divestitures may be coming. So maybe provide a little bit more color on that, where you're looking. And conversely, you do have M&A as part of your growth projections for the next three years. Given the debt leverage, am I right in thinking that this is probably more of a 2019 and post-2019 event or do you see enough flexibility in your balance sheet right now to consummate smaller bolt-on deals over the next 12 to 18 months, let's say?

And then, as a follow-up, just on the EBITDA CAGR, you're looking at about 8.5% to 11.5% EBITDA growth over the next four years. And that matches pretty closely with your 9% to 12% EPS growth. So I was just wondering why there is not a little bit more leverage on the EPS line given that you will be paying down debt over that timeframe and assuming if you have any cash left over maybe even repurchasing shares or making M&A deals?

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.
A

Thank you, Dmitry. Let me take the first couple of those. Then I'll turn it over to Al. First, you shouldn't read by anything that we put up there as far as brand or review of – any specifics as to that means that something must have been or to be divested or not. I think it's a good practice that we constantly look at all our businesses, brands, everything. It's a discipline just like Jay mentioned SKUs. We're constantly reviewing everything for a fit. But there was no signaling at anything – no intended signal on anything that was put up today to say this is something or a process that's specific to divestiture.

Second, regarding M&A, you're right. We're probably out of the market here for the short period of time. But that doesn't mean that we're not active in discussions. We know many of those transactions take a long time to foster and develop. And so we're interested in beginning those dialogues in those areas where we've not, continuing them where we have. And we expect it in the not-too-distant future that we're going to be very active. So building those relationships right now are important.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.
A

And the difference between the EPS and the EBITDA growth, we do have some interest reductions as we're paying down the debt. I would say we probably flat-lined the tax rate as well. When you look at the free cash flow, when you look at – because I got this question I want to clarify. 2011 to 2015, free cash flow generation was about 7.7% on average. We had a strong 2016, both ourselves and core Valspar. So you look at the growth to 10% to 10.5%. It doesn't grow as fast as the EBITDA. But we have to have some upside to cash. And as the upside happens, we would put that back in share buybacks and then maybe you'd see a little bit extra in the EPS growth.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

Let's take Chuck next. Right next to you, [ph] Dave (03:40:51).

Chuck Cerankosky
Analyst, Northcoast Research Partners LLC

Q

Chuck Cerankosky, Northcoast Research. I'd like to talk a little bit about an issue we're hearing from paint contractors and that's the labor supply shortage. What are you guys seeing in your own business not only at the store level where the employees interface with the customers but also in North American manufacturing, transportation, et cetera?

Jay Davisson
President, The Americas Group, The Sherwin-Williams Co.

A

On the store side of things with our customer base, the labor issue is still there. The feedback that I'm getting from the majority of our larger customers, it's not to the level it was a year and a half ago especially on the union side, especially in metro markets like Chicago and New York. They feel that the union pool of painters is where they need it to be. But you're going to have labor constraints. There's a lot of help that we're trying to supply whether it's helping them with their recruiting efforts. We do a lot of training for our customers [ph] on time (03:41:48) when they onboard new employees. We're working with local high schools and community colleges to build some programs to help with entry level painting positions for our contractor base. It's going to be ongoing for a while.

We're not seeing an issue as far as our store employees go and hiring in talent. That seems to be still working in our favor. But I think the labor issue is going to be ongoing. You're seeing a lot of customers seeing opportunities. So their labor is spinning off and opening new businesses. And we're there to be able to capture that because of the relationships we have not with just the contractor themselves but all the painters underneath of them. So that's spurring some of our new account growth. The labor issue is real. I think it's just going to hurt us a little bit from a production standpoint because it's not just painting contractors. This is all trades on a commercial project. This is electricians. This is drywallers, framers, roofers. It's causing longer-term projects to be done.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

And Joel will talk to our plant.

Joel D. Baxter
President & General Manager Global Supply Chain Division Consumer Brands Group, The Sherwin-Williams Co.

A

Yeah. I think as it relates to manufacturing, distribution and transportation; the labor markets are tight, but we've used targeted automation in our factories and distribution centers to drive return as well as lower our demand for labor. And then on our transportation side, we've maintained a very low turnover with our drivers. They're all company drivers and they've given a lot of input into how we've evolved our equipment and they all get home a lot. So I think compared to the industry when it comes to drivers, we've been very successful and doing much better on a turnover basis. So we've continued to grow our fleet right along with the rest of our business. So targeted automation and then really being a employer of choice with our fleet.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

Let's go to Mike next.

Michael Joseph Harrison
Analyst, Seaport Global Securities LLC

Q

Hey. Mike Harrison with Seaport Global. You talked quite a bit about the shift to waterborne coatings. I was wondering if you can kind of categorize. Are we in the early stages, middle stages or late stages as you look at the industrial markets? How does your technology in waterborne compare to your competitors' or your capabilities compared to competitors'? And then the last piece of that question – sorry, I've forgotten. Go ahead. Just maybe some more detail on the waterborne shift.

David B. Sewell
President & GM-Product Finishes Division, The Sherwin-Williams Co.

A

No problem. It's definitely a trend we're seeing. It's still in the early stages, although there are some areas that have mandated it. I've talked about China. We're seeing a transformation in China right now because of the air quality in that area. They're literally shutting down factories right now because of high VOCs. They're mandating in some segments like the container industry. So we see that as an opportunity. We see that as a disruption. We feel like because of our investments in R&D in waterborne technologies and I mentioned some of the data points earlier, we really have a great solution there.

The other thing about waterborne and why we feel like we have an advantage is many times it's just not a drop-in solution for our customers. They have to reconfigure their lines and their equipment. And that's why having all of those local technical resources to support our customers makes it a much easier switch for them to be successful. It's a little bit different in other parts of the world. You see a lot more in parts of Europe. The United States, California, obviously, a little bit more than others. And then you get into Southeast Asia. They're not really into waterborne much at all. So it's a little varied by geography. I encourage you to talk to our business leaders as well. You'll see a little bit of difference in our divisions. But it's a trend that's coming and you just can't stop it. And we want to be in front of it and be really seen as the solution provider for waterborne coatings for our customers.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

And a much better solution provider given the combination of the companies in technology, resources, people, everything.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

Let's go one chair to the right to Vincent.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Vincent Andrews from Morgan Stanley. Two hopefully quick ones. The first is, the working capital at Valspar. It seems like there's an opportunity to take some out. So, could you discuss or maybe size that opportunity in what you're going to do to go after it?

And then, secondly, I noticed on the share repurchase slide, from 2018 to 2020, you're looking to spend about $1.3 billion on share repurchases but that effectively just keeps the share count flat. So I just wanted to make sure I was reading that the right way.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.
A

Yeah. So, the Valspar opportunity working capital, as I've mentioned, are high-teens. I think where we would start is bringing that to the mid-teens and then look for opportunities after that. And I think, what you got to think about with these large counts, our management team coming and working with the sales team, there's got to be a level of confidence that when that customer orders the product, it's able to be delivered and delivered timely. If you don't have that level of confidence, you're going to carry safety stock both at the customer or at the distribution center at the factory. So, we have to build that confidence with our customer base to say, we don't carry safety stock, and we're going to deliver when you need it and on time.

On the share repurchase, we're looking at exercising options of about $1 million a year. So, the ramp up in share buybacks over the next few years is really going to offset that dilution. So you see only a slight decrease in the level of overall share. So that's why you don't see a big decrease.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

I'm spending too much time on this side of the room. Rosemarie, can we bring a microphone upfront?

Rosemarie Jeanne Morbelli
Analyst, G.research LLC
Q

Thank you. I was wondering if you could – Rosemarie Morbelli with Gabelli. I was wondering if you could talk about the conversion to non-BPA coatings inside food cans and beverage. Regulations are in Europe, but are they as well coming into other countries or exports need to become – you can guess.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.
A

Sure, yeah. We'll have [ph] Sam (03:48:30) take that question for you.

A

Thanks very much for the question, yeah. So with regards to the transition...

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.
A

[ph] Sam (03:48:36), why don't you stand up?

A

Okay. With regards to the transition to non-BPA, clearly customers have made progress especially on the food side in the European market, and customers have made significant progress in the North American market, especially with food. When it comes to beverage, it's been a little bit more regional. So, clearly [ph] France as which seeing (03:49:02) as far as beverage is concerned in Europe, and then we have Prop 65 coming up here in North America in California, and that's going to drive another large conversion in North America.

So, it's continuing. I think food is largely headed in that direction, and a large portion of the market is already switched, and then beverage is a bit behind it.

Rosemarie Jeanne Morbelli
Analyst, G.research LLC

Q

So, what percentage has already switched and how much are we looking at if you can put it in dollar terms?

A

Maybe not to be so specific, but a majority of the food market has already switched in those two regions, and then less than half as far as beverage is concerned.

Rosemarie Jeanne Morbelli
Analyst, G.research LLC

Q

Thank you. And I was wondering if you could touch on the raw material cost increases following the shutdowns in Houston?

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

All right. May I have Joel take that. Joel?

Joel D. Baxter
President & General Manager Global Supply Chain Division Consumer Brands Group, The Sherwin-Williams Co.

A

Yeah. I think, there is – obviously with the problems in the Gulf Coast, you had disruptions. So, we – like I told you, during the presentation, we were able to source material, but some time, we bought on the spot market to make sure we supplied our customers. So, there are some, I'd say, some short-term recovery of that as the feedstocks all get back up in the pipeline, but I don't think there's a – that it's the long-term shift and some raw material changes there. The feedstocks got to get back in stock, and some spot buying to get the customer service when all that chemical manufacturing was offline.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

On the isle there.

Scott A. Mushkin
Analyst, Wolfe Research LLC

Q

Thanks. Scott Mushkin from Wolfe Research. So, I had a couple of questions. One of the things on The Paint Stores Group, I guess, the Americas Group, you mentioned that 36,000 – one store every 36,000 people, could be one store every 25,000 people. I was wondering where you got those numbers from and how confident you are that that's the right place to go?

Second question around the stores is, I think you said a 33% reduction in SKUs this year. How far into that process are we, and is there any expectation that that could actually ding sales as you go through it? Thanks.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.
A

We got to the 36,000 by dividing the number of stores we currently have by the household formations, not too difficult. But again, I think what you got to do is, you got to project what household formations are going to do, and that's hit or miss. Huge opportunities, we think, lie ahead of us in household formations, which will allow us to come to the number we feel is correct for our stores per household. We get to that number of 25,000 by looking at our most dense markets that we have today. They are our most profitable market. So, if we can continue to build density within our major metro markets, we know that when we add stores in those markets, they get to profitability faster, they're more sustainable, and their volumes, years one and two, are much higher than some markets where we aren't as dense.

So we're going to continue to keep monitoring that model. But we do believe that we can get to a point in time in some markets where we're at 20,000 households per store that won't be an average across the U.S., but I think we can get there.

And the second part of that question was on the SKU rationalization. It's just continuous. We're constantly looking at what SKUs we have in the market, which ones of those are underperforming. Anything that typically delivers less than 20,000 to 50,000 gallons a year, we really assess, talk to our customers about the true need for this product. All of our product innovation dictates what SKUs we want to reduce.

We don't go to a customer and say, hey, by the way, this SKU is going away. We want you to use this one. We talk about the new technology and the new innovation and the higher-quality products and say, we want you to try this product. We think you'll get benefit from it. And as they buy in and latch on to those products, we then eliminate SKUs because those volumes go down. So I don't think SKU elimination necessarily impedes our sales activity. It just encourages us to continue to innovate and make higher-quality products.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

John, way in the back, and then we'll...

John Roberts
Analyst, UBS Securities LLC
Q

John Roberts, UBS Research. Aaron was clear that the Valspar brand will be invested in. I didn't see much on the Dutch Boy brand. Are we going to disinvest in Dutch Boy?

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.
A

No.

John Roberts
Analyst, UBS Securities LLC
Q

And then, secondly, you had two major competitors almost combine this year. You've had Nippon Paint come in to the U.S. within your billion-dollar acquisition. Do you think industry consolidation is going to move to another level here somewhere out in the next few years? You'll be reloaded in a couple of years. I don't know where your big gaps still are in terms of your longer-term strategic plans.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

John, I'm sorry. Could you repeat that?

John Roberts
Analyst, UBS Securities LLC

Q

So, just – it was clear your gaps were regional and industrial, and Valspar helped fill that. Is that still kind of where you see the longer-term gaps in your portfolio that – once you get your debt down, and if consolidation goes up to a bigger level here with some of your competitors, we're still going to try to build out industrial bigger in regional on architectural.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

Yeah. Thank you for that question. I'm sorry, I didn't hear the first time. I would say, the way we're looking at that is business by business, right? And so, there are some, as you've referred to, our geographic opportunities that we'll be interested in, others are technology opportunities that we're interested in. And so, business by business, we'll have ongoing dialogues with our leadership team here about where are those voids. And our strategy will drive those investments from an M&A standpoint. And so, where there is a void from a geographic standpoint, we want to talk to that leader about what opportunities exist in that area, and some areas from a technology standpoint where we can acquire technology and put it through the entire system, that will be the focus.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

This is a deep room and my eyes aren't that good. Dan, next.

Daniel Jester
Analyst, Citigroup Global Markets, Inc.

Q

Dan Jester from Citi. Just another one on raw materials. If I remember, or if I heard correctly in Jay's comments about the price increase 3% to 5%, I think you said that that should go through the raw material expectations for 2018. If that's the case, could you give us any kind of color about what you're expecting for 2018 and break it down by resins or pigments, that'd be great. Thanks.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

Well, just to be clear, and we [ph] can (03:55:52) add on to this. I think Jay's comment was more geared towards we believe, given our line of sight right now, that that should cover us. But then, if there is in fact additional activity needed, I think we've demonstrated in the past when that need arises that we've been willing to have those discussions with our customers based on the services and value that we're providing.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

An important point. As most of you know, we will give a formal raw material inflation outlook for 2018 on our year-end earnings call. We typically wait till year-end, because the picture gets a lot clearer over the next few months. At this point, we're dealing with what we consider to be transitory inflation in some of the petrochemicals that should roll off as feedstock supply improves, but we'll see. It's a little premature to call 2018 right now.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

All right. Chris and then, Sophie, you're next.

Chris Silvio Perrella
Analyst, Bloomberg LP (Research)
Q

Chris Perrella, Bloomberg Intelligence. Al and Aaron, with the consumer group, the margin on that segment was peaking around low-20% on that. With the acquisition, it looks like there's going to be growth investment to push out in Europe, to push growth in Australia and New Zealand, and maybe a little bit in the U.S. here. How should we think about the peak margin performance of that business and sort of what the growth investments going to be in that unit over the next couple of years?

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.
A

Well, we expect it to grow. We're going through as we're consolidating both sales organizations and talking about the long-term strategy and what investments that's going to take to accomplish those long-term goals. And as we get through that process, we'll start laying out targets – operating margin targets for each of the segments. We won't be sharing that with the Street, but certainly our expectation is the same.

As we consolidated through organizations of Valspar paints, organization operating margin was in the low teens. Our Sherwin operating margins – legacy Sherwin operating margins were close to that 20%. We're expecting to bring that paint's margin up – the legacy Valspar paint margins up towards our 20%, and then grow it from there. And I think that's the way I would look at that.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.
A

There will be a number of levers that we'll pull to accomplish that; technology, helping our customers to be successful, the synergies that we'll be able to attract through manufacturing and purchasing. All of those, we think, can help that business become more profitable.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.
A

Let's go to Silke next.

Silke Kueck
Analyst, JPMorgan Securities LLC
Q

Thank you. Silke Kueck, JPMorgan. I have a question for Aaron. So Aaron, you have been around when Valspar lost the business – a piece of business at Lowe's to Sherwin, and you probably were out when Stanley merged with Black & Decker. And so, like I was wondering like what your sort of like – what you think the challenges are, like holding on to businesses at big-box retailers and what you sort of like learned from the experience?

And my second question is for Al. Like normally at year-end, there's like some life for inventory adjustments that happen. And I was wondering whether this is happening this year or that's in the fourth quarter on what you think the magnitude of that may be?

Aaron M. Erter
President, Consumer Brands Group, The Sherwin-Williams Co.

A

Okay. I think your question, just let me make sure I have it right, is the challenges we've learned from being around in Valspar, also Stanley Black & Decker, right?

Silke Kueck
Analyst, JPMorgan Securities LLC

Q

How do you hold on to the business?

Aaron M. Erter
President, Consumer Brands Group, The Sherwin-Williams Co.

A

How do you hold on to the business? That's what we think about every day. Everyone talked about this, and I think the way you hold on to business, as you understand, first of all, your end user and what they need which you can translate that to your retail partner. And then if you always are thinking about that first, I think you have a good chance of holding on to the business. And that involves bringing the latest technologies, bringing the latest service. Those are all key pieces as we hold on to the business.

I think as we look at challenges and opportunities, right off the bat, I think we saw as a challenge is, you had two teams that were going against each other in the marketplace, so to speak. So it was bringing them together and get a clarity of mission right away, and that's what we tried to do. And we have integrated the two teams in the last 125 days. Now, our sights are set on here's the clarity of purpose and what your objectives are. So we've been successful in doing that.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

Okay.

Allen J. Mistysyn
Chief Financial Officer & Senior VP-Finance, The Sherwin-Williams Co.

A

So on the LIFO question, when we updated our guidance due to the storms and we saw a short-term increase in our raw material costs, we did update our full-year LIFO estimate. And as you know, we put three quarters of that as we get through our third quarter and we update it. And that update is included in the third quarter guidance. So there is a LIFO impact in our third quarter, there will be a LIFO impact in our fourth quarter. And as we talked about, as we start getting through the sales cadence in October and looking at what that's going to look like with the fourth quarter, we'll update the fourth quarter guidance including that additional LIFO expense.

Robert J. Wells
SVP-Corporate Communications & Public Affairs, The Sherwin-Williams Co.

A

I have bad news and good news. The bad news is, we have time for one more question. The good news is, we have time for lots more questions at lunch which is right out those doors. Any last question? [ph] Dennis (04:01:33).

Dmitry Silversteyn
Analyst, Longbow Research LLC

Q

Dmitry Silversteyn with Longbow. I guess, just a question for Jay around the Latin American group which is now part of your area of supervision. A lot of things that were described or that you've described in your slides as far as what you're doing to improve the operations there sounds like low-hanging fruit, if you will, if you pardon the expression. Why wasn't that done earlier and why – is it the combination with your North American store group that allows you to do a lot of these things that you couldn't do to LatAm operations when they were standalone business? Or why is the timing now and not five years ago, given how long this business has been struggling with margins and growth?

Jay Davisson
President, The Americas Group, The Sherwin-Williams Co.

A

I can't answer why it's taken so long, but I will agree with you that the strengths that we have within the stores group in North America and the best practices that we utilize, were taking those down to Latin America and it's causing us to look at things a little bit differently than they may have been looked at in that past. So, we're just using the best practices and the knowledge of what we would do well in North America and applying those practices in Latin America.

John G. Morikis
Chairman, President & Chief Executive Officer, The Sherwin-Williams Co.

A

So Dmitry, I wasn't involved in the business five years ago. I could speak to that and share with you that this was a business – the timeframe that you're thinking about was operating in 10% plus operating margins. And adversity brings out the best of a company, I believe. And so, we find ourselves in a situation where historically, we had businesses down there operating almost as independent companies, investing in technology, a lot of things by country as opposed to the path that Jay is taking, which is importing institutional knowledge, looking at it more on a regional basis, dialing down specifically in countries down there that micro markets are the way you have to look at it not even country-wide.

And so, we're really I think becoming a better company as a result of that. Would we have liked to have done that back then? Yeah. But we didn't. And we're in a situation now where we're looking reality in the face, and we're looking for how do we react to this, what's present in front of us. And we're taking, we believe, the right steps to do that.

Thank you all for today. We're going to be in lunch. [indiscernible] (04:03:52), down to the lobby there. We hope to see you all then. Thank you.