



Conference Call Transcript

RPM - Q2 2004 RPM International Inc Earnings Conference Call

Event Date/Time: Jan. 09. 2004 / 9:00AM ET

Event Duration: N/A

CORPORATE PARTICIPANTS**Frank C Sullivan**

RPM International Inc - President, Chief Executive Officer, Director

Glenn R. Hasman

RPM International Inc - Vice President of Finance & Communications

CONFERENCE CALL PARTICIPANTS**Mark Altear (ph)**

Credit Suisse First Boston - Analyst

Saul Ludwig

McDonald Investments - Analyst

Mitchell Golden (ph)

RH Capital - Analyst

Jeffrey Zekauskas

JP Morgan - Analyst

Frank Gupak (ph)

Prudential Financial - Analyst

Arthur Winston (ph)

Pilot Advisors - Analyst

PRESENTATION**Operator**

Good day, and welcome to RPM International conference call for the fiscal 2004 second quarter. Today's call is being recorded.

This call is also being webcast live and can be accessed through the RPM website at www.rpminc.com. A taped telephone replay will be available two hours after this call concludes until 11:59 PM eastern standard time on Friday, January 16th and can be accessed by dialing 888-286-8010. The confirmation code is 74319769. A webcast replay and written transcript will also be made available through the RPM website. The webcast replay will also be available approximately two hours after this call ends. The written transcript will be available two to three business days after this call concludes.

Comments made on this call may include forward-looking statements based on current expectations that involve risks and uncertainties which could cause the results of RPM to differ materially from management's current expectations. For more information on these risks and uncertainties please review RPM's quarterly earnings releases and periodic reports filed with the Securities and Exchange Commission.

The information in this conference call related to projections or other forward-looking statements may be relied upon subject to the previous Safe Harbor statement and may continue to be used while this call remains on the active portion of the RPM website.

During this conference call, RPM's spokespersons may reference non-GAAP financial measures. To assist you in understanding such non-GAAP terms, as well as to comply with the S.E.C. requirements, RPM has posted reconciliations to their most directly comparable GAAP financial measures including disclosure on reasons for their use of non-GAAP measures on the company website in the investor relations section under webcasts/presentations.

At this time, I would like to turn the call over to RPM's President and Chief Executive Officer Mr. Frank Sullivan for opening remarks. Please go ahead, sir.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Thank you.

Good morning and welcome to the RPM International Inc, second quarter conference call.

We are pleased to report record results for our 2004 second quarter ended November 30, 2003. Glenn Hasman, RPM's Vice President of Finance and Communications, will provide a review of our financial results for the quarter and for the six month period year to date. Following this, I will update our asbestos liability situation and provide comments on our second quarter as well our outlook for the third quarter and the balance of the year.

Glenn.

Glenn Hasman - RPM International Inc - Vice President of Finance & Communications

Thank you very much Frank. Good morning everyone.

I will first discuss through our income statements for the second quarter and six-months, then I'll touch on some of the highlights in our balance sheet and our cash flow statements. This year's net sales grew 14%, up \$72 million over the prior year to a record second quarter sales level, as Frank mentioned. Our organic sales growth was 10% or ahead \$52 million, and that includes 3% from net favorable foreign exchange affects mainly against the Canadian dollar and the euro. Seven product line acquisitions during the past 12 months added the remaining \$20 million or 4% of net sales growth.

Industrial segment net sales reached \$330.3 million or 56% of RPM's total growing 15% or by \$44 million year over year. Organic industrial segment growth was also ahead 10% or by \$28 million, and that includes 4% from net favorable foreign exchange effects. Our industrial growth was much stronger this quarter, nearly throughout the segment. Roofing services revenues continued to grow rapidly as well, ahead 38%. The balance of industrial growth was from three product line acquisitions, which added \$16 million or 5% to net sales growth.

Consumer segment net sales reached \$259.5 million or the remaining 44% of RPM's total, growing 12% or by \$28 million year over year.

Organic consumer segment growth was also 10%, or \$24 million ahead of the prior year, including 2% from net favorable foreign exchange. Our main customer product lines of Rust-Oleum, DAP and Zinsser all continued to show solid growth year over year. The balance of consumer growth came from four product line acquisitions during the past 12 months which added a total of \$4 million or 2% of net sales growth.

Moving to gross profit. Our gross profit margin of 45.1% this year, is up from 44.9% last year. The leverage benefits from our higher product sales volume, our productivity gains and higher margin influence from our acquisitions more than offset higher raw material and packaging costs this quarter which negatively impacted our gross margin by 70 basis points. We expected certain higher oil-based material costs, including acetones and solvents,

would continue to affect our results this quarter. In addition, growth continued in certain strategic but lower margin product lines and services.

Industrial segment gross margins improved quarter over quarter to 45.4% from 45% last year, for the reasons just mentioned, even though we've had continued growth in our services businesses, which carry lower gross margins.

Consumer segment gross margins quarter over quarter declined slightly to 44.7% from 44.9%. Despite positive leverage from our higher organic sales volume in this segment, significant productivity gains and other ongoing cost reduction efforts, this margin decline is essentially the result of higher raw material and packaging costs that have mainly affected this segment. We continue to manage through these higher material costs which are not expected to be as significant a factor for the balance of this fiscal year.

Moving to SG&A expenses. These are improved 10 basis points to 34.7% of sales this year from 34.8% last year. This generally reflects positive leverage from our higher sales volume including our continued growth in industrial services sales requiring lower SG&A support and lower cost influence from our acquisitions. We have made a number of marketing and other growth related investments this year in both operating segments which partly offset these benefits.

Industrial segment SG&A was at 33.6% of sales this year compared to 32.9% last year. Our benefits from higher organic sales volume were more than offset by growth related investments, an insurance recovery that we had last year to the tune of \$1.6 million, and higher reserves associated with our exterior insulating/finishing systems which may continue.

Consumer segment SG&A was at 32.3% of sales this year, compared with 32.4% last year. We also benefited in this segment from higher organic sales volume, partially offset by growth in related investments here as well, including advertisements for the product line we've discussed before namely Epoxy Shield.

Corporate and other expenses decreased to \$9.6 million this second quarter from last year's \$10.8 million. Asbestos related product liability costs of \$2.2 million were being accrued for last year versus none this year. Partly offsetting this improvement were higher insurance and legal costs related primarily to corporate governance issues that are affecting essentially all U.S. publicly held companies.

Moving now to EBIT, or earnings before interest and taxes, those reached \$61.3 million this year ahead 16.5% or by \$8.7 million over last year's \$52.6 million. There is also a margin of improvement, to 10.4% of sales from 10.2% last year. This is generally the positive result of our higher sales volume, including

our accretive acquisitions, despite the 70 basis points margin impact from higher material costs.

Industrial segment EBIT was at 38.9% ahead \$4.4 million or almost 13%, on 15% sales growth, for a margin of 11.8% of sales comparing to last year's \$34.5 million or 12% of sales in the industrial segment. Consumer segment EBIT of \$32 million this year, was ahead \$3.1 million or by 11%, on 12% sales growth, a margin of 12.3% of sales compared to last year's \$28.9 million or 12.5% of sales. This combined operating EBIT growth totaled \$7.5 million or ahead almost 12%, generally the result of growth of sales this quarter including the accretive results of our recent acquisitions, being partially offset by the higher raw material costs and a number of growth related investments we have made as we head into an economic recovery.

Moving to interest expense net, these are down \$300,000 quarter over quarter. This essentially reflects lower interest rate savings year over year, less higher net debt costs associated with our acquisitions.

Our tax rate was at 35.5% this year versus last year's 35.1%. This generally reflects slight changes we expect in our geographic mix of earnings.

Net income then reached a new second quarter record of \$35.2 million increasing \$5.6 million or by 19% over last year's nearly \$30 million. Margin on sales strengthened to 6% from last year's 5.7% and again, despite the 70 basis points impact from higher material costs. Our diluted earnings per share reached a record 30 cents from last year's 26 cents, ahead 15%.

I will now move into discussion of the six-month results beginning with net sales. Through the first half of the year, net sales reached a record of \$1.18 billion ahead 11% or \$120 million over last year's six-month sales level. Organic sales growth was ahead 8% or by \$81 million, including 3% from net favorable foreign exchange, again, mainly against the Canadian dollar and the euro. Nine product line acquisitions during the past 12 months added the remaining \$38 million of sales growth or 4%.

Industrial segment net sales reached \$646.5 million, 55% of RPM's total, growing 12% or by \$68 million year over year. The organic industrial segment growth was ahead 7%, \$38 million ahead, which included 3% from net favorable foreign exchange. As reviewed, industrial growth mentioned has strengthened this second quarter, and that was nearly throughout the segment which helped boost the six-month results. Roofing services revenues have grown rapidly year over year as well, ahead 42%. The balance of industrial growth comes from 5 product line acquisitions which added \$30 million or 5% of the net sales growth.

Consumer segment net sales reached \$533.4 million, the remaining 45% of the RPM total, growing 11% or by \$52 million year over year. Organic consumer segment growth was ahead 9% or by \$43

million, which included 2% of net favorable foreign exchange. Our main product lines, again Rust-Oleum, Zinsser, and DAP, all continued to show solid growth year over year. The balance of our consumer growth comes from four product line acquisitions, adding a total of \$8 million or 2% of our net sales growth.

Gross profits through six-months. Gross profit margin reached 45.9% comparing with 46.3% last year. While this margin difference did narrow considerably after the second quarter, the leverage benefits from our higher product sales volume, productivity gains and higher margin influence from acquisitions were more than offset by higher raw material and packaging costs which have negatively impacted gross margin by 60 basis points through six-months.

Industrial segment gross margins declined slightly year over year to 46.3% from 46.5%, this is principally the result of our continued growth of services businesses which carry lower gross margins.

Consumer segment gross margins have also declined year over year to 45.5% from 46% of sales and despite the positive leverage again here from our higher organic sales volume, significant productivity gains in this segment and other ongoing cost reduction efforts. This margin decline is essentially the result of the higher raw material packaging costs that have mainly been affecting this segment. Again, these higher material costs are not expected to be as significant a factor for the balance of the fiscal year.

SG&A expenses through six-months are improved 30 basis points to 33.9% of net sales from 34.2% last year, for much the same reasons that were given for the second quarter, positive leverage from higher sales volume, continued growth in services sales requiring lower SG&A support, and lower cost influence from our acquisitions, and we've made a number of marketing and other growth related investments this year in both operating segments which partially offset these benefits.

Industrial segment SG&A was 33% of sales this year, comparing with 32.8% last year, the benefits from, again, higher organic sales volume were more than offset by growth related investments, that insurance recovery which took place in the second quarter a year ago to the tune of \$1.6 million, and higher liability reserves associated with our exterior insulating finishing systems.

Consumer segment SG&A at 31.6% of sales this year compares to 31.8% last year, also benefiting from organic higher sales volume, partly being offset by growth-related investments made in this segment.

Corporate/other expenses decreased to \$18.6 million this year from \$20.3 million last year. Asbestos related product liability costs had been accrued to the tune of \$4.4 million last year versus none this year. A partial offset was higher insurance and legal costs once again related primarily to corporate governance issues that have affected essentially all U.S. publicly held companies.

EBIT through six-months \$141.5 million this year, is ahead 11%, or \$13.8 million from last year's \$127.7 million. Margins held steady at 12%, generally the positive result of our higher sales volume including our accretive acquisitions despite the 60 basis point margin impact from higher material costs through six-months.

Industrial segment EBIT of \$86 million is ahead \$6.4 million or by 8% for a margin on sales of 13.3% of sales compared to last year's \$79.6 million EBIT or 13.8% of sales.

Consumer segment, \$74.2 million of EBIT, up \$5.7 million or by 8.4%, for a margin of sales of 13.9% compared to last year's \$68.4 million or \$14.2% of sales. This combined operating EBIT growth totaling \$12.1 million over last year was ahead 8.2%, generally the result of our solid sales growth including the accretive results of our recent acquisitions, being partly offset by the higher raw material costs so far this year and growth related investments.

Interest expense, net through six-months is down \$1.2 million year over year, the big story here again reflecting essentially lower interest rate savings year over year, less our higher net debt costs associated with acquisitions.

Tax rate, 35.5% this year, 35.0% last year, same reasons as the second quarter, generally reflecting the result of slight changes of geographic mix of earnings that we expect this year.

Net income reached a new six-month record of \$82.9 million increasing \$9.1 million or by 12% over the prior year. Margin on sales has held at 7% through both periods despite the loss of basis points, 60 basis points through higher material costs. Diluted earnings per share reached a record 71 cents versus last year's 64 cents or ahead by 11%.

We will now move to some highlight discussions of the balance sheet and, again, as we have been doing, we - given our seasonality, we would like to make some comparisons back to last November, 2002.

Net accounts receivable are up by \$59.3 million, acquisitions account for \$8.4 million of that difference, foreign exchange translation effects account for another \$15.4 million of that difference and the balance is through sales increases in both segments, particularly surging in the second quarter.

Inventories are up by \$14.1 million, acquisitions account for \$4.5 million of that difference, foreign exchange accounts for another \$9.5 million of that difference. Annually, our day's outstanding in inventory have improved year over year by 9% or by six days in the industrial segment, by 5% or five days in the consumer segment or by 7% or 5.5 days in total. And these improvements reflect our ongoing efforts to continually economize our inventory levels in connection with our ongoing class A efforts.

Prepaid expenses are ahead by \$33.4 million, marketable securities related to our captive insurance are ahead by \$18.4 million of that, much of which equates to increased market values year over year. Our work in progress with our services business have grown, and that accounts for \$5.7 million of that growth in prepaid expenses. Foreign exchange translation accounts for another \$1.7 million of that growth.

Accounts payable were ahead by \$17.1 million, acquisitions account for \$11.6 million of that and foreign exchange translation accounts for really the remaining difference of about \$5.5 million year over year.

Total debt is at \$723.2 million at November 30, '03, that's up \$31.6 million year over year, entirely related to acquisitions. Our total debt to capital stands at 43.3% at this November, comparing with 43% a year ago and down from 45.3% this past May 31. RPM's available liquidity as of November 30, '03, including our cash balance, stands now at \$579 million.

Liabilities related to asbestos are in two parts. Current liability is at \$49.2 million, that represents our estimated pretax payments required during the next 12 months, related to our asbestos liability and under long term liabilities another \$69 million which compares to \$103 million at May 31 that difference reflects our pretax payments of \$26.4 million that have been made during the past six-months, net of the remaining insurance and a reclass up to current liabilities in the amount of \$7.6 million. This \$69 million long term liability balance represents our estimated asbestos related payments that may be required beyond the next 12 months.

Moving to the cash flow statement. After six-months, our cash flows from operations amount to \$65.9 million this year compared with \$90.5 million last year, or down \$24.6 million. Asbestos related payments, net of taxes, have accounted for \$17.6 million of this year over year change. The remaining \$7 million difference, and even more actually, represents timing in our working capitals as a result of our year over year business growth during the second quarter. In fact, our net cash flows following the quarter have been quite strong generating an additional, nearly \$30 million to date.

Capital spending is slightly ahead of last year but still well within the depreciation and amortization range.

We remain on target to achieve our free cash flow generation this fiscal year in the neighborhood of \$60 million, that compares with last year's \$60 million. That's after our estimated asbestos related payments this fiscal year. We define free cash flow as cash flow from operations less capital spending, less dividends, and you are welcome to visit our website for further clarification on exactly how we derive free cash flow.

I will now turn the call back over to Frank Sullivan.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Thank you, Glenn.

I would now like to update our asbestos liability situation and give you some comments on the quarter and our outlook for the balance of the year before taking your questions.

Second quarter gross settlements and defense costs were \$18 million versus \$17 million gross in the first quarter. We continue to work on clearing out old law cases from Ohio, Mississippi and particularly in Texas. We have seen a positive impact from these state law changes as filings in Ohio, Mississippi and Texas have slowed dramatically over the past several months, especially malignancy cases. As we have noted in previous calls, Illinois continues to be a very challenging jurisdiction for RPM and all other asbestos defendants.

It is also important to note that there has been some seasonality to our quarterly asbestos costs over the last couple of years with a bigger portion of our costs generally occurring in the first half of our fiscal year. As we indicated when we first took our asbestos liability reserve charge, we expect to see the benefits of these state law changes in the late spring or early summer of 2004, given the timing lag of when a case is first filed to when it becomes active.

Our active cases in the quarter, increased by 606 to 2737, up from 2131 last quarter. Ninety percent of the increase are nonmalignancy filings and more than half of the total increase came from one law firm in one state. Given the favorable liability law in the applicable state we fully expect to see these cases dismissed for little or no cost. Historically, we have had an 85% dismissal rate for nonmalignancy claims.

On the legislative front, the various tort reform measures in Texas, Mississippi, Ohio and West Virginia have had or are expected to have a positive impact going forward. Additionally, it appears as if the Ohio legislature is set to pass an asbestos specific reform law that will further improve the fairness of this situation for Ohio companies and cases filed in the state.

At the Federal level, Senate Majority Leader Frist, has publicly stated that the Fair Act is one of his legislative priorities for the session and he will bring it to the Senate floor for a vote in March at the latest. Establishment of a Federal trust fund would certainly bring more predictability and finality to this issue, not only for RPM but also thousands of companies facing asbestos litigation.

Year-to-date our cost and claims experience are consistent with assumptions we made related to our \$140 million asbestos liability reserve. We will continue to review our reserve each quarter and as we have been doing for many years, will continue to report our cases and cost information quarterly.

During our second quarter, we had continuing solid results from our consumer businesses and a noticeable pickup in order activity and quotes in our industrial businesses. This is particularly true at some of our more project sensitive and economically sensitive Stonecor group companies, which is the first pickup for these companies in nearly two-years. It is important to note that excluding foreign exchange and acquisitions, industrial segment core growth was approximately 6%.

For our third quarter, we expect continuing solid performance from our consumer businesses and continuing positive growth and hopefully building momentum from our industrial businesses. Solid core growth, combined with the foreign exchange impact of a lower dollar, as well as continuing good results from some of our smaller acquisitions, could result in low double-digit revenue growth and corresponding income growth for RPM on a consolidated basis for the third quarter.

A couple notable events in the second quarter included the issuance of \$200 million of 10 year senior notes at 6.25% interest rate. While this is an increase in interest costs over our current short-term floating borrowing rates, we view this fixed rate on a 10 year bond as very attractive and also as a good replacement for the 7% senior notes which will mature in June of 2005.

The difference in this fixed interest rate versus our expectations for floating rates for the balance of the year will likely have a 2 cent dilutive impact for the 2004 fiscal year, though I feel confident that the strong results of our operations will be able to overcome that 2 cents difference relative to our original goals and expectations for the 2004 performance.

At our annual meeting of shareholders we announced an 8% increase in RPM's cash dividend which represents RPM's 30th consecutive cash dividend increase to shareholders. With a 3.4% dividend yield, this continues to be an attractive part of total return for RPM shareholders. I also feel that it is a sign from our board of their confidence in our excellent long term prospects despite some of the current challenges we face. As I have indicated in the past, I believe that a track record of increasing dividends is one simple indicator of the quality of earnings in a business.

During the quarter, we completed one acquisition, the \$7 million purchase of the Gloucester Company, which produces the Phenoseal high performance regional adhesives product. This business has been integrated into our DAP subsidiary and we are excited about the prospects of leveraging this specialty regional product line across DAP's North American customer base.

Acquisitions like this, that we have been able to buy for fair value and lever either across or within existing RPM businesses are enhancing our results. While these transactions are small, the return on investment and return on capital is the best that we have ever seen relative to the current favorable capital markets and our

ability to date to effectively integrate or fit these businesses into existing RPM companies.

Our cash flow was somewhat modest in the quarter. This was principally the result of our strong second quarter revenues related to timing differences. As Glenn commented, we have seen very strong cash flow since the end of the second quarter, generating an additional \$30 million of after tax cash flow available for debt reduction. We have been seeing excellent cash flow throughout the third quarter, and expect this to continue for the balance of the year.

I would expect that we will complete a couple of small acquisitions during the balance of the year, most likely in Europe, where we have spent a fair amount of time over the last 18 months. If the growth in our industrial businesses continues to build momentum, it is also likely results will be stronger than originally planned for this fiscal year and in our current expectations, but we will see how the industrial economy continues to work.

Decisions made by past management and our experience over the last couple of years has put RPM today in a position in which we are poised for continuing solid growth. Our structure allows us to integrate businesses or product lines better than we ever have and we have a leadership team, particularly at the operating level, which is also the best we have ever had and I believe the best in our industry.

I'd now be pleased to answer your questions.

QUESTION AND ANSWER

Operator

Ladies and gentlemen, if you wish to ask a question, please key star 1 on your touchtone telephone. If your question has been answered, or you wish to withdraw your question, please key star 2. Once again, to ask a question, please key star 1 on your touchtone telephone.

Your first question comes from Gene Shawn of Credit Suisse First Boston. Please go ahead.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Good morning.

Mark Altear - Credit Suisse First Boston - Analyst

Good morning, this is Mark Altear on his line at Credit Suisse.

A couple of questions. Could you break down interest income and interest expense?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

I don't -- we don't have that detail.

Glenn Hasman - RPM International Inc - Vice President of Finance & Communications

It's investment, income, if you will, is pretty slight, up both for the quarter and the six-months, year over year, the difference, that is. The actual change was about half million dollars, I believe, for the six-months, a couple hundred thousand for the second quarter.

Mark Altear - Credit Suisse First Boston - Analyst

Okay. Thank you.

And the second, the number of cases went up 606. Can you give out the change of disposals and then the sort of gross up and gross down?

Frank Sullivan - RPM International Inc. President and Chief Executive Officer

RPM - Q2 2004 RPM International Inc Earnings Conference Call

I don't have that detail. It will be highlighted in our Q, which will be published on Monday or Tuesday of next week.

Mark Altair - Credit Suisse First Boston - Analyst

Okay.

And then the last thing on that. You have also said in the Q, that there are many people, each case is not necessarily one person. Do you have a rough idea of how many people you are talking about in these cases?

Frank Sullivan, RPM International Inc. President and Chief Executive Officer

We haven't disclosed those numbers, but in our case, most often, it is a single Plaintiff associated with a single malignancy case that drives our costs. We have had some instances in past cases here in Cleveland, where we would have one case associated with multiple Plaintiffs in a steel plant filing, for instance. And those are typically the kind of cases that are easy to dismiss for us because our products were never used in industrial settings. So that is also the reason why most of our cases are one Plaintiff or a case although we do have some multiple Plaintiff cases like the example I gave.

Mark Altair - Credit Suisse First Boston - Analyst

Okay. Thank you.

Operator

Your next question comes from the line of Saul Ludwig at McDonald Investments.

Saul Ludwig - McDonald Investments - Analyst

Good morning, guys.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Good morning.

Saul Ludwig - McDonald Investments - Analyst

Congratulations on a great quarter. You spoke a little bit about the additional reserves taken for Dryvit EIFS litigation. Could you give us some quantification of that and maybe a little update on where that litigation stands?

Frank Sullivan- RPM International Inc –President and Chief Executive Officer

I don't have any further update on where the litigation stands, other than it was approved by the lower court and is on appeal, and the appellate court is set to hear it. We are confident that we will prevail in that instance, and I think we will move ahead with the national class action settlement. We have upped our reserves for product warranty and liability claims to Dryvit. The net impact of this year will be in the neighborhood of 4 or \$5 million, above where we were last year. So, 1 million to \$1.5 million a quarter.

Saul Ludwig - McDonald Investments - Analyst

Uh-huh.

Okay, next question, there seems to be some reclassification from the way you reported it a year ago from -- between cost of sales and SG&A.

Frank Sullivan- RPM International Inc -President and Chief Executive Officer

There are some slight differences in freight, but it is not material at all to our results or our margins.

Saul Ludwig - McDonald Investments - Analyst

No, no. It just put it in a different bucket. I was wondering what the nature of the switch out was.

Frank Sullivan - RPM International Inc -President and Chief Executive Officer

It was related to freight, freight costs in a couple of categories.

Saul Ludwig - McDonald Investments - Analyst

Uh-huh.

Frank Sullivan- RPM International Inc - President and Chief Executive Officer

And, again, the impact or the dollars are really not meaningful, either to, obviously to the bottom line, but also to margins.

Saul Ludwig - McDonald Investments - Analyst

In the past, you talked about things were sluggish at Home Depot. Is the pick up that you have seen in your consumer business,

RPM - Q2 2004 RPM International Inc Earnings Conference Call

suggest that the Home Depot situation has also improved, and how do you see that going forward?

Frank Sullivan - RPM International Inc - President and Chief Executive Officer

I think this fall we have seen a good performance at Home Depot, and I think they have been working as a Corporation on a lot of issues relative to inventory systems and IT, , as well as personnel. And I think a lot of the issues that were of concern to broad constituencies, including the stock market, have been addressed. They have ongoing challenges, but we are seeing good improvement there across all of our product lines.

Saul Ludwig - McDonald Investments - Analyst

And finally, Frank, this improvement in industrial is, you know, a long time coming economically speaking, and it's obviously beginning to work its way through to you guys.

You said that, in your comments, you know, and -- if this strength were to continue, maybe your results for the year would be better than expected. If we were to see a continuation of the same growth rate that we saw in the second quarter, in both the third and the fourth quarters, this is anif, not a projection?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Right.

Saul Ludwig - McDonald Investments - Analyst

How much difference could that make on the bottom line?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Well, I couldn't tell you, Saul, other than, you know, as we indicated at the beginning of this year, we could sense that the economy was turning for our industrial businesses for the first time in more than two-years, and started investing into that. Whether it was some new programs, this very aggressive investment in the maintenance and service business at Tremco, expanding sales forces in a number of our other businesses, and so far, our timing has been right, and if the industrial pickup holds, and we see some of the quote activity that is out there start to firm up, then I think we have an opportunity to exceed our original goals for this year and expectations. But that's a very contingent upon -- very contingent....

Saul Ludwig - McDonald Investments - Analyst

Got you.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Upon our seeing continuing strength in the industrial segment, which we are happy to report.

Saul Ludwig - McDonald Investments - Analyst

Uh-huh.

And then just a final comment, I was encouraged to hear you say that you think you might be able to do a couple of acquisitions in Europe. I know you set up a European operation in Brussels, a lot of trips over there. Are these deals you are looking at closing, are they these \$5 / \$10 million-size companies or are they something more substantial?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

No, they are relatively small product lines or businesses. In one case, it will be a free-standing business, and the types of transaction that we are looking at over there are anywhere from \$10 million business to \$100 million business and things in between.

The couple that we are working on now will be towards the smaller end or middle end of that range, and we are pretty excited about the prospects for some good solid product line or privately-held business acquisitions in European marketplace. We have staffed up accordingly and now have a four person corporate group based outside of Brussels that is doing a real nice job for us.

Saul Ludwig - McDonald Investments - Analyst

Great. Thank you very much and keep up the good news.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Thanks, Saul.

Operator

Your next question comes from the line of Mitchell Golden of RH capital. Please go ahead.

Mitchell Golden - RH Capital - Analyst

RPM - Q2 2004 RPM International Inc Earnings Conference Call

Hi, guys, congratulations on a good quarter.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Thank you.

Mitchell Golden - RH Capital - Analyst

Just a little more color. You guys clearly on the top line really did well, and not all of it trickled down to the bottom line and you went through some of the reasons. Can you talk about how much of it is investments into growth versus some of the other things you talked about in terms of raw materials costs, overall?

Frank Sullivan - RPM International Inc - President and Chief Executive Officer

I can give you some color on some different expense items here and there. We probably got an additional \$1.5 million or \$2 million of expense with personnel in Europe.

It is my expectation that through some purchasing savings, some treasury savings, and the types of things we do well here in Europe -- I'm sorry, here in the U.S., that we will cover those costs over the next year or two. And that is excluding the positive impact of any acquisition activity we build over there. The combination of higher D&O insurance, Sarbanes-Oxley 404, all the types of issues that are hitting most public companies will cost us, this year, on a full-year basis, somewhere in the neighborhood of 5 or 6 million bucks.

Some of that cost will be mitigated in future years, because, for instance, the Sarbanes-Oxley 404 requirements are relatively expensive to set up, but once we get going with those the maintenance costs on an annual basis will be somewhat less. The balance of it is pretty much investments. - Rust-Oleum in the first quarter and a little bit in the second quarter, was doing national advertising for the first time in five years, national TV advertising. We have ramped up investment in expanding our sales forces which in some cases were down where they were a few years ago, so those maybe gives you some color on the type of non-beneficial costs that we are seeing this year and overcoming, as well as some of the investment that we are seeing and so far that is paying off, and as the industrial activity is continuing to build. I think the timing of our investments in those areas will pay off.

Lastly, I would expect the -- as we improve the first quarter to the second quarter in terms of bottom line leverage, I would expect to see us continue to do that in the third quarter and the fourth quarter as more of that revenue growth, if -- as we continue to get it, hits our bottom line in a more meaningful manner.

Mitchell Golden - RH Capital - Analyst

Great, thank you.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Thank you.

Operator

Your next question comes from the line of Jeff Zekauskas from JP Morgan. Please go ahead.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Good morning, Jeff.

Jeffrey Zekauskas - JP Morgan - Analyst

Can you talk about the pricing dynamic in the industrial and in the consumer segment, that is to what extent were your prices up or down or flat?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Our prices were relatively flat throughout the first six-months of the year, and where that has impacted us has been in the raw material area, with flat pricing. We have seen, as Glenn said, about 60 or 70 basis points of higher raw material prices, that have not been passed through. We do not see that same impact for the balance of the year, and some of the areas that were impacting us have abated a little bit.

In terms of ongoing pricing, our industrial segment continues to be an area where we have much more flexibility and, quite honestly, much more market ability to get price increases or price adjustments where necessary, than is the case in our consumer segment. Although again in our consumer segment, I think we are in a better position with the niche products that we have and the brand names we have than the people that are in commodity areas.

Jeffrey Zekauskas - JP Morgan - Analyst

You spoke about your raw materials, perhaps, trending down later in the year. Is that because of longer term agreements that you have to purchase raw materials or some other factor? Because it just seems that, you know, just about everything is moving up right now.

Frank Sullivan - RPM International Inc - President and Chief Executive Officer

We are not seeing that, you know, there was a hard push on stuff, and issues related to oil last spring. Keep in mind most of our companies are on a FIFO basis, so that we would get the impact of some higher raw material pricing perhaps a month or two later than somebody that is on an LIFO. And so really it was spring and summer costs that we saw that were driving it up. But there were a number of key areas where there were attempts at getting strong price increasing, and it is just not coming through.

The other part of it is that we continue to get better at leveraging RPM's \$2 billion, roughly half of which is material purchases, across all of our businesses, so that we can become a more meaningful customer to one or two critical suppliers, which is a far different story than how RPM operated five or seven years ago. But we are not seeing today the same type of pricing pressure from the raw material side in a number of key raw materials that we saw last spring or in the summer.

Jeffrey Zekauskas - JP Morgan - Analyst

On the asbestos side, either precisely or just the order of magnitude, what was the order of magnitude or the precise number of cases settled during the quarter?

Frank Sullivan RPM International Inc - President and Chief Executive Officer

I don't have that detail. It will be published in our Q which will be released on Monday or Tuesday of next week. You know, the increase in cases was 606.

Jeffrey Zekauskas - JP Morgan - Analyst

Uh-huh.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

90% of those were nonmalignancy cases, and from a qualitative standpoint, the increase is principally nonmalignant cases, which have had little or no impact on us from a cost perspective.

Jeffrey Zekauskas - JP Morgan - Analyst

Right. That's why the number of cases settled is relevant.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

That's correct. You know, we have, some of the reasons that costs are up, and again, without the exact numbers, we have worked pretty diligently and we communicated this year end and the last quarterly conference call, to work off, if you will, old case law cases. Because, you know, it's our view that there will be, and I think we are seeing it, a significant difference in settlement costs of old law cases in states like Ohio or Texas or Mississippi, versus what we would expect in cases that have been filed since those state law changes have come into effect. In fact, in those states in particular, we have seen a dramatic decline in new filings, which is a pretty positive.

Jeffrey Zekauskas - JP Morgan - Analyst

Okay. Thank you very much.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Thank you.

Operator

Your next question comes from the line of Frank Gupak(ph) with Prudential Financial. Please go ahead.

Glenn Hasman - RPM International Inc - Vice President of Finance & Communications

Good morning.

Frank Gupak - Prudential Financial - Analyst

Good morning.

Three questions, first could you just give us a run down on what is out on the revolver, and how much CP and what's on the accounts receivable now that you have done the debt deal and have a little bit of cash flow you got in since the end of the quarter?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Yes, we have a \$500 million revolving credit facility, it's due in June of '05 and it is totally unutilized at this point. We have a \$125 million receivable securitization program, that is totally unutilized at this point. And we have a roughly \$100 / \$125 million

RPM - Q2 2004 RPM International Inc Earnings Conference Call

commercial paper program, and we have about \$90 million outstanding on the commercial paper program as we speak.

Frank Gupak - Prudential Financial - Analyst

Okay, great.

Second question, Frank. Just so I have the numbers as you talked about them on the asbestos side. You have paid, on the gross basis, roughly \$35 million year-to-date.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

That's correct.

Frank Gupak - Prudential Financial - Analyst

Roughly 26 after insurance?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

That's correct. On a pretax basis.

Frank Gupak - Prudential Financial - Analyst

And your guidance has been about 50 for the full-year on a pretax basis and the after tax impact somewhere in the low 30s? Do I have those numbers still right?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

That's correct.

And my crystal ball isn't better than anyone else's, but our seasonality has been such that our case load and our costs have been higher in the first half of the year, and I think that's what we expect to continue. We were not a whole lot different this time last year in terms of costs.

Frank Gupak - Prudential Financial - Analyst

And my last one, you talked about maybe 30 million of cash influx since the end of the quarter. Should we think that is roughly 2/3 working cap, 1/3 just kind of funds from ops, is that the way to think about that or is it all working capital?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

I think it is mostly working capital although certainly with higher profit levels, it is -- that should be meaningful for the year. Keep in mind, we are in our third quarter, where percentages, percentage gains could look impressive, but for us, particularly in the bottom line, it is a relatively seasonal low because of the winter impact on both a number of our major consumer and industrial product lines. So the biggest chunk of cash flow that we will benefit from in the third quarter will be fall working capital.

Frank Gupak - Prudential Financial - Analyst

Okay, and just my last one, you are sort of \$60 million free cash flow thought for the year.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

Yes.

Frank Gupak - Prudential Financial - Analyst

Is that really a working cap generation of cash in that number or is it argely that working cap would be about flat?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

No, working capital would be a slight use of cash in the year. I think we are pretty comfortable that our after tax, after capital, after dividends and after asbestos costs will be about 60 million bucks which is about where we were last year. And so funds from operations will be, the difference between our improved performance from a cash generation perspective versus last year, will be used to fund our after tax tax asbestos costs.

Frank Gupak - Prudential Financial - Analyst

Okay. Thank you.

Glenn Hasman - RPM International Inc - Vice President of Finance & Communications

Thank you.

Operator

RPM - Q2 2004 RPM International Inc Earnings Conference Call

Your next question comes from the line of Arthur Winston with Pilot Advisors. Go ahead.

Arthur Winston - Pilot Advisors - Analyst

Good morning, great quarter, thank you.

I didn't hear what you said or I didn't understand what you said about the acquisitions and some of the effect of returns are bigger than usual. And could you just review what you said, because I didn't pick it up.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

If you go back to RPM many years ago we bought businesses and allowed them to free stand. And through the 90s, we really focused on buying some very big, for us, premium brands, the Rust-Oleums, the Tremcos. Today we have six group companies, group platforms, and what we are able to do better today, I think, as a result of our structure and also a lot of the lessons we've learned in our reorganization and the plant focus we have, is buy product lines or services and integrate them much more aggressively.

We continue to buy businesses on a free-standing basis, privately held companies but the product line I reference is a product line called Phenoseal, they are a high margin, was a family-owned, regional producer and marketer of an adhesive caulk, and they were sold predominantly in the New England, northeast area. We are pretty excited about the opportunity to integrate that business pretty much down the line into our DAP business and then take that on a national basis.

We have taken similar transactions, for instance, the Koch waterproofing business that we bought last spring is now part of Tremco business; we bought Boral, an Australian companies ad mixture business that's part of of Euclid, and our ability to operationally lever those acquisitions is pretty good. So while these transactions might be \$7 million or \$40 million or \$20 million in revenue size, our ability to, after our acquisition costs, put that revenue on our bottom line with good income and cash flow, is tremendous. Now, to the \$2 billion whole, you know, one of those little small deals isn't going to make a huge difference, but to a \$100 million RPM company, or a \$300 or \$400 million RPM group, those are great opportunities to continue to enhance their product depth, their market penetration and their cash flow and profitability.

Arthur Winston - Pilot Advisors - Analyst

Should we anticipate an acceleration in the number of these little fill-in things or it is all happenstance?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

It is a combination of working at them and happenstance. I mean, we work at them pretty hard. We get information from brokers and bankers. We pursue a lot of contacts directly with private business owners. We are doing that much more aggressively in Europe than we ever have. So I would anticipate three to five of these types of transactions per year. And if we can do that and it adds \$100 million, plus or minus, of revenues and we can put the profits or cash flow on our bottom line, that will continue to be a good part of our ability to outperform our industry and I think deliver consistent double digit sales and earnings results.

Arthur Winston - Pilot Advisors - Analyst

Thank you very much.

Operator

Sir, we have time for one more question. Your final question comes from the line of Jeff Zekauskas from JP Morgan. Please go ahead.

Jeffrey Zekauskas - JP Morgan - Analyst

Just some house cleaning questions. In the cash flow statement, where does the asbestos payout fall?

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

I believe it falls in the items not affecting cash and other.

Jeffrey Zekauskas - JP Morgan - Analyst

Okay.

And, secondly, for tax purposes, what tax rate do you use on your asbestos liabilities?

Glenn Hasman - RPM International Inc - Vice President of Finance & Communications

37.5%.

Jeffrey Zekauskas - JP Morgan - Analyst

37.5%.

RPM - Q2 2004 RPM International Inc Earnings Conference Call

And the amount that you paid out this quarter was something like \$18.6 million?

Frank Sullivan - RPM International Inc - President and Chief Executive Officer

Roughly \$18 million.

Jeffrey Zekauskas - JP Morgan - Analyst

Okay.

Frank Sullivan - RPM International Inc - President and Chief Executive Officer

And that includes, these numbers are, the only difference between these numbers and numbers that we had before is that these numbers include defense costs.

Jeffrey Zekauskas - JP Morgan - Analyst

That is fine. I was just trying to calculate it from the financial statement. Thank you.

Operator

Sir, please proceed with your closing remarks.

Frank Sullivan - RPM International Inc - President, Chief Executive Officer, Director

If there are no other questions, we thank everybody for joining our conference call this morning, and we look forward to giving you the highlights of what should be a solid third quarter. We are excited about another year of record results in the top line and bottom line for RPM and wish everybody a happy, healthy and successful new year, thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation. You may now disconnect

DISCLAIMER

CCBN reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES CCBN OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

© 2004, CCBN, Inc. All Rights Reserved.