SHERWIN WILLIAMS CO
Form 10-Q
October 29, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the Period Ended September 30, 2015
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the transition period from to
Commission file number 1-04851

THE SHERWIN-WILLIAMS COMPANY
(Exact name of registrant as specified in its charter)

OHIO (State or other jurisdiction of incorporation or organization)	34-0526850 (I.R.S. Employer Identification No.)
101 West Prospect Avenue, Cleveland, Ohio (Address of principal executive offices)	44115-1075 (Zip Code)

(216) 566-2000
(Registrant’s telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one:)

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practical date.

Common Stock, $1.00 Par Value – 93,100,515 shares as of September 30, 2015.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME AND COMPREHENSIVE INCOME (UNAUDITED)
Thousands of dollars, except per share data

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net sales	$3,152,285	$3,150,570	$8,734,708	$8,560,121
Cost of goods sold	1,577,733	1,679,615	4,497,721	4,613,612
Gross profit	1,574,552	1,470,955	4,236,987	3,946,509
Percent to net sales	49.9 %	46.7 %	48.5 %	46.1 %
Selling, general and administrative expenses	993,625	984,366	2,922,046	2,837,637
Percent to net sales	31.5 %	31.2 %	33.5 %	33.1 %
Other general expense - net	9,117	11,873	17,415	12,071
Interest expense	16,995	16,025	42,231	48,793
Interest and net investment income	32	(764)	(943)	(2,110)
Other expense (income) - net	4,061	(14,593)	4,493	(19,237)
Income before income taxes	550,722	474,048	1,251,745	1,069,355
Income taxes	176,231	147,808	395,913	336,211
Net income	$374,491	$326,240	$855,832	$733,144
Net income per common share:				
Basic	$4.04	$3.42	$9.22	$7.53
Diluted	$3.97	$3.35	$9.04	$7.39
Average shares outstanding - basic	92,196,458	94,800,191	92,398,962	96,744,423
Average shares and equivalents outstanding - diluted	93,894,872	96,714,043	94,263,333	98,670,999
Comprehensive income	$321,738	$269,970	$758,373	$682,402

See notes to condensed consolidated financial statements.

THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
Thousands of dollars

	September 30, 2015	December 31, 2014	September 30, 2014
Assets			
Current assets:			
Cash and cash equivalents	$91,029	$40,732	$261,346
Accounts receivable, less allowance	1,413,946	1,130,565	1,408,967
Inventories:			
Finished goods	871,008	841,784	866,908
Work in process and raw materials	181,822	191,743	179,734
	1,052,830	1,033,527	1,046,642
Deferred income taxes	107,063	109,087	101,815
Other current assets	259,368	252,869	260,965
Total current assets	2,924,236	2,566,780	3,079,735
Goodwill	1,146,726	1,158,346	1,167,047
Intangible assets	265,113	289,127	295,251
Deferred pension assets	252,188	250,144	304,207
Other assets	498,593	420,625	457,480
Property, plant and equipment:			
Land	120,140	125,691	129,309
Buildings	694,121	698,202	703,351
Machinery and equipment	1,965,773	1,952,037	1,916,091
Construction in progress	82,672	59,330	48,360
	2,862,706	2,835,260	2,797,111
Less allowances for depreciation	1,847,539	1,814,230	1,783,826
	1,015,167	1,021,030	1,013,285
Total Assets	$6,102,023	$5,706,052	$6,317,005
Liabilities and Shareholders’ Equity			
Current liabilities:			
Short-term borrowings	$36,805	$679,436	$55,621
Accounts payable	1,216,342	1,042,182	1,266,167
Compensation and taxes withheld	330,144	360,458	344,815
Accrued taxes	187,904	86,744	192,464
Current portion of long-term debt	3,183	3,265	502,278
Other accruals	519,818	508,581	507,037
Total current liabilities	2,294,196	2,680,666	2,868,382
Long-term debt	1,920,150	1,122,715	1,122,699
Postretirement benefits other than pensions	280,530	277,892	273,706
Other long-term liabilities	630,982	628,309	700,282
Shareholders’ equity:			
Common stock—$1.00 par value:			
93,100,515, 94,704,173 and 95,997,693 shares outstanding at September 30, 2015, December 31, 2014 and September 30, 2014, respectively	115,613	114,525	114,211
Other capital	2,287,106	2,079,639	2,019,493
Retained earnings	3,093,265	2,424,674	2,345,016

Treasury stock, at cost	(3,950,402)	(3,150,410)	(2,754,998)
Cumulative other comprehensive loss	(569,417)	(471,958)	(371,786)
Total shareholders' equity	976,165	996,470	1,351,936
Total Liabilities and Shareholders' Equity	$6,102,023	$5,706,052	$6,317,005

See notes to condensed consolidated financial statements.

THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS (UNAUDITED)
Thousands of dollars

	Nine Months Ended	
	September 30, 2015	September 30, 2014
OPERATING ACTIVITIES		
Net income	$855,832	$733,144
Adjustments to reconcile net income to net operating cash:		
Depreciation	126,972	125,761
Amortization of intangible assets	19,969	22,611
Stock-based compensation expense	47,838	43,813
Provisions for qualified exit costs	7,488	10,229
Provisions for environmental-related matters	18,688	11,034
Defined benefit pension plans net cost	5,365	5,440
Net increase in postretirement liability	(111)	4,455
Other	3,895	1,214
Change in working capital accounts - net	(107,833)	(58,866)
Costs incurred for environmental-related matters	(8,151)	(7,018)
Costs incurred for qualified exit costs	(5,822)	(8,726)
Other	(61,626)	(1,781)
Net operating cash	902,504	881,310
INVESTING ACTIVITIES		
Capital expenditures	(157,990)	(135,903)
Proceeds from sale of assets	11,159	1,037
Increase in other investments	(14,946)	(30,677)
Net investing cash	(161,777)	(165,543)
FINANCING ACTIVITIES		
Net decrease in short-term borrowings	(634,315)	(35,947)
Proceeds from long-term debt	797,460	—
Payments of long-term debt	—	(290)
Payments of cash dividends	(187,242)	(162,178)
Proceeds from stock options exercised	74,020	73,192
Income tax effect of stock-based compensation exercises and vesting	86,801	56,197
Treasury stock purchased	(766,087)	(1,094,070)
Other	(42,027)	(23,397)
Net financing cash	(671,390)	(1,186,493)
Effect of exchange rate changes on cash	(19,040)	(12,817)
Net increase (decrease) in cash and cash equivalents	50,297	(483,543)
Cash and cash equivalents at beginning of year	40,732	744,889
Cash and cash equivalents at end of period	$91,029	$261,346
Income taxes paid	$235,838	$173,430
Interest paid	33,992	44,055

See notes to condensed consolidated financial statements.

THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Periods ended September 30, 2015 and 2014

NOTE 1—BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

There have been no significant changes in critical accounting policies since December 31, 2014. Accounting estimates were revised as necessary during the first nine months of 2015 based on new information and changes in facts and circumstances. Certain amounts in the 2014 condensed consolidated financial statements have been reclassified to conform to the 2015 presentation.

The Company primarily uses the last-in, first-out (LIFO) method of valuing inventory. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management’s estimates of expected year-end inventory levels and costs are subject to the final year-end LIFO inventory valuation. In addition, interim inventory levels include management’s estimates of annual inventory losses due to shrinkage and other factors. The final year-end valuation of inventory is based on an annual physical inventory count performed during the fourth quarter. For further information on inventory valuations and other matters, refer to the consolidated financial statements and footnotes thereto included in the Company’s Form 10-K for the year ended December 31, 2014.

The consolidated results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015.

NOTE 2—IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2015, the Company adopted Accounting Standards Update (ASU) No. 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects," which allows companies to elect to use the proportional amortization method to account for investments in qualified affordable housing projects if certain conditions are met. Under the proportional amortization method, which replaces the effective yield method, the cost of the investment is amortized in proportion to the tax credits and other tax benefits received to income tax expense. The adoption of ASU No. 2014-01 did not have a material effect on the Company's results of operations, financial condition or liquidity.

In April 2015, the Financial Accounting Standards Board (FASB) issued ASU No. 2015-03, "Simplifying the Presentation of Debt Issuance Costs," which requires companies to present debt issuance costs associated with a debt liability as a deduction from the carrying amount of that debt liability on the balance sheet rather than being capitalized as an asset. The standard is effective for interim and annual periods beginning after December 15, 2015, and retrospective presentation is required. The Company will adopt ASU No. 2015-03 as required. The ASU will not have a material effect on the Company's results of operations, financial condition or liquidity.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue Recognition - Revenue from Contracts with Customers," which is a comprehensive revenue recognition standard that will supersede nearly all existing revenue recognition guidance under U.S. GAAP. The issuance of ASU No. 2015-14 in August 2015 delays the effective date of the standard to interim and annual periods beginning after December 15, 2017. Either full retrospective adoption or modified retrospective adoption is permitted. The Company is in the process of evaluating the impact of the standard.

NOTE 3—DIVIDENDS

Dividends paid on common stock during each of the first three quarters of 2015 and 2014 were $.67 per common share and $.55 per common share, respectively.

NOTE 4—CHANGES IN CUMULATIVE OTHER COMPREHENSIVE LOSS

The following tables summarize the changes in Cumulative other comprehensive loss for the nine months ended September 30, 2015 and 2014:

(Thousands of dollars)	Foreign Currency Translation Adjustments	Net Actuarial (Losses) Gains and Prior Service Costs Recognized for Employee Benefit Plans	Unrealized Net (Losses) Gains on Available-for-Sale Securities	Total Cumulative Other Comprehensive Loss
Balance at December 31, 2014	$(354,384)	$(118,167)	$ 593	$ (471,958)
Other comprehensive loss before reclassifications[1]	(98,120)		(1,557)	(99,677)
Amounts reclassified from other comprehensive (loss) income[2]		1,734	484	2,218
Net other comprehensive (loss) income	(98,120)	1,734	(1,073)	(97,459)
Balance at September 30, 2015	$(452,504)	$(116,433)	$ (480)	$ (569,417)

[1] Net of taxes of $966 for unrealized net losses on available-for-sale securities.

[2] Net of taxes of $(593) for net actuarial losses and prior service costs recognized for employee benefit plans and $(303) for realized losses on the sale of available-for-sale securities.

(Thousands of dollars)	Foreign Currency Translation Adjustments	Net Actuarial (Losses) Gains and Prior Service Costs Recognized for Employee Benefit Plans	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Total Cumulative Other Comprehensive Loss
Balance at December 31, 2013	$(250,942)	$(70,611)	$ 509	$ (321,044)
Other comprehensive (loss) income before reclassifications[3]	(52,206)	(570)	616	(52,160)
Amounts reclassified from other comprehensive (loss) income [4]		1,512	(94)	1,418
Net other comprehensive (loss) income	(52,206)	942	522	(50,742)
Balance at September 30, 2014	$(303,148)	$(69,669)	$ 1,031	$ (371,786)

[3] Net of taxes of $244 for net actuarial losses and prior service costs recognized for employee benefit plans and $(387) for unrealized net gains on available-for-sale securities.

[4] Net of taxes of $(556) for net actuarial losses and prior service costs recognized for employee benefit plans and $59 for realized gains on the sale of available-for-sale securities.

6

NOTE 5—PRODUCT WARRANTIES

Changes in the Company’s accrual for product warranty claims during the first nine months of 2015 and 2014, including customer satisfaction settlements, were as follows:

(Thousands of dollars)

	2015	2014
Balance at January 1	$27,723	$26,755
Charges to expense	28,021	25,250
Settlements	(27,182)	(26,297)
Balance at September 30	$28,562	$25,708

For further details on the Company’s accrual for product warranty claims, see Note 1 to the Consolidated Financial Statements in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

NOTE 6—EXIT OR DISPOSAL ACTIVITIES

Liabilities associated with exit or disposal activities are recognized as incurred in accordance with the Exit or Disposal Cost Obligations Topic of the ASC. Qualified exit costs primarily include post-closure rent expenses, incremental post-closure costs and costs of employee terminations. Adjustments may be made to liabilities accrued for qualified exit costs if information becomes available upon which more accurate amounts can be reasonably estimated. Concurrently, property, plant and equipment is tested for impairment in accordance with the Property, Plant and Equipment Topic of the ASC, and if impairment exists, the carrying value of the related assets is reduced to estimated fair value. Additional impairment may be recorded for subsequent revisions in estimated fair value.

In the nine months ended September 30, 2015, twenty-three stores in the Paint Stores Group, three branches in the Global Finishes Group and two stores in the Latin America Coatings Group were closed due to lower demand or redundancy. In addition, the Global Finishes Group exited a business in Europe.

The following table summarizes the activity and remaining liabilities associated with qualified exit costs at September 30, 2015:

(Thousands of dollars)

Exit Plan	Balance at December 31, 2014	Provisions in Cost of goods sold or SG&A	Actual expenditures charged to accrual	Balance at September 30, 2015
Paint Stores Group stores shutdown in 2015:				
Other qualified exit costs		$25		$25
Global Finishes Group exit of a business in 2015:				
Severance and related costs		1,257		1,257
Other qualified exit costs		4,515		4,515
Paint Stores Group stores shutdown in 2014:				
Other qualified exit costs	$280	142	$(168)	254
Consumer Group facilities shutdown in 2014:				
Severance and related costs	2,732	1,223	(3,386)	569
Other qualified exit costs	781		(601)	180
Global Finishes Group exit of business in 2014:				
Severance and related costs	104	326		430
Other qualified exit costs	1,080		(564)	516
Paint Stores Group facility shutdown in 2013:				
Severance and related costs	654		(632)	22
Other qualified exit costs	1,205		(273)	932
Global Finishes Group stores shutdown in 2013:				
Severance and related costs	28		(28)	
Other qualified exit costs for facilities shutdown prior to 2013	1,652		(170)	1,482
Totals	$8,516	$7,488	$(5,822)	$10,182

For further details on the Company’s exit or disposal activities, see Note 5 to the Consolidated Financial Statements in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

NOTE 7—HEALTH CARE, PENSION AND OTHER BENEFITS

Shown below are the components of the Company's net periodic benefit cost (credit) for domestic defined benefit pension plans, foreign defined benefit pension plans and postretirement benefits other than pensions:

(Thousands of dollars)	Domestic Defined Benefit Pension Plans		Foreign Defined Benefit Pension Plans		Postretirement Benefits Other than Pensions	
	2015	2014	2015	2014	2015	2014
Three Months Ended September 30:						