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The Sherwin-Williams Co. (SHW)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. Thank you for joining the Sherwin-Williams Company Review of Second Quarter 2023 Results and our Outlook for the Third Quarter and Full Year of 2023. This conference call is being webcast simultaneously in listen-only by Issuer Direct via the Internet at www.sherwin.com. An archived replay of this webcast will be available at www.sherwin.com beginning approximately two hours after this conference call concludes.

This conference call will include certain forward-looking statements as defined under the US Federal Securities laws with respect to sales, earnings and other matters. Any forward-looking statement speaks only as of the date on which such statement is made, and the company undertakes no obligation to update or revise any forward-looking statement whether as a result of new information, future events or otherwise. A full declaration regarding forward-looking statements is provided in the company's earnings release transmitted earlier this morning. After the company's prepared remarks, we will open the session to questions.

I'll now turn the call over to Jim Jaye, Senior Vice President, Investor Relations and Communications.

James R. Jaye

Senior Vice President, Investor Relations & Corporate Communications, The Sherwin-Williams Co.

Thank you, and good morning to everyone. Joining me on the call today are John Morikis, Chairman and CEO; Heidi Petz, President and Chief Operating Officer; Al Mistysyn, Chief Financial Officer; and Jane Cronin, Senior Vice President of Enterprise Finance.

Sherwin-Williams delivered excellent second quarter results compared to the same period a year ago. These results, coupled with a similar strong performance in the first quarter, lead to an excellent first half that exceeded the expectations we laid out back in January. Given the strong first half, and current visibility into our second half, we are significantly increasing our full year guidance, which John will talk about in just a few minutes, but first, let me touch on a few second quarter highlights.

Consolidated net sales in the quarter exceeded our expectations and grew by a mid-single-digit percentage. Sales in all three reportable segments came in above our guided range. Gross margin significantly improved sequentially and year-over-year, driven by strong volume in the Paint Stores Group and moderating raw material costs. Pricing discipline remained strong.

SG&A expense increased over the prior-year quarter though the year-over-year percentage increase was lower than that of our first quarter. Excluding the impact of incremental acquisition and restructuring costs, SG&A increased 8% year-over-year. Approximately 85% of that second quarter increase was related to investments in Paint Store Group long-term growth initiatives with the remainder driven by increases in compensation and benefits.

We are highly confident these growth investments will deliver strong returns and benefit our customers. And while we recognize SG&A expense was higher year-over-year in the quarter, we ultimately manage the business to drive operating profit and margin, both of which expanded meaningfully in the quarter. We are committed to investing in and profitably growing the business at the same time.

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Segment margin in all three reportable segments expanded sequentially and year-over-year. We also delivered strong double-digit growth in adjusted diluted net income per share and EBITDA with adjusted EBITDA margin of 20.9%, near the high-end of our current long-term 19% to 21% target range.

Let me now turn it over to Heidi who will provide some commentary on our second quarter results by segment. John will follow Heidi with comments on our outlook before we move on to your questions.

Heidi G. Petz

President & Chief Operating Officer, The Sherwin-Williams Co.

Thank you, Jim. I'll begin with the Paint Stores Group. Second quarter Paint Stores Group sales were ahead of our expectations and increased 10%, driven by mid-single-digit volume growth and continued effective pricing. Segment margin improved 280 basis points to 24.3%.

Growth was led by our Protective & Marine business which was up strong double-digits and was driven by industrial, flooring, infrastructure and oil and gas applications, and our pro architectural end-markets, the strongest performers were Commercial and Property Maintenance, both of which increased by double-digit percentages. Residential Repaint was close behind, with sales up by a high-single-digit percentage. Demand in this market is being somewhat tempered by the extended period of weak existing home sales.

New residential sales were flat against a double-digit comparison, reflecting a softer start that we saw at the end of last year which have continued into this year. As we've previously noted, we anticipated new residential would be challenging in 2023, though we are performing better than the market as we continue to focus on new accounts and share gains. Our DIY business was up strong double-digits, albeit against a softer comparison where sales were impacted by supply chain challenges. From a product perspective, interior and exterior paint sales were both up high-single-digits, with interior sales growing faster and representing a larger part of the mix.

Sales in our Consumer Brands Group also exceeded our guidance and increased by 5.1% in the quarter, primarily driven by mid-single-digit pricing. Sales in North America, our largest region, increased by a low single-digit percentage. We continued to invest here with our strategic retail partners for growth. In other regions, sales were up strong double-digits in Latin America and Europe. Sales in China were down double-digits, and we expect the previously announced divestiture of the China business to be completed in the third quarter. Adjusted segment margin was 15.7%, up 470 basis points year-over-year.

Sales in the Performance Coatings Group increased less than a percent against a strong 15.2% comparison. Volume decreased low single-digits but was offset by mid-single-digit increases in price. Adjusted segment margin increased 420 basis points to 18% of sales, which is within the range we have been targeting for this business.

Sales in PCG varied significantly by region. In North America, sales increased low single-digits against a nearly 30% comp. Sales in Europe were up mid-single-digits. Latin America sales were down less than a percent, also against a strong comp of over 20%. Demand in Asia remained weak, with sales down double-digits against a soft period a year-ago.

From a division perspective, growth was strongest in Auto Refinish, which is up by a high-single-digit percentage, followed by General Industrial, which was up mid-single-digits. Industrial Wood sales were up less than 1% as softness in new residential continued to impact demand for furniture, cabinetry and flooring.

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Coil sales were down mid-single-digits, driven mainly by Europe, which was impacted by last year's Russia exit and against a nearly 40% comparison. Packaging sales were also down low double-digits against a 20%-plus comp. We anticipated this decline, given the near-term destocking by brand owners that we described on our last call. We continue to feel very good about our position in growth prospects in this end-market.

With that, let me turn it to John for his comments on our outlook for the third quarter and the full year.

John G. Morikis

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

Thank you, Heidi. As we said in January, we expected to have a strong first half of the year. Our team exceeded those expectations and I want to thank all 64,000 of our employees for their relentless focus on serving our customers and for driving continuous improvement across the organization.

We also understand that a good first half does not make a good year. We know we have work to do and that's exactly where we are focused. On our April call, we said we would have a much better idea of how the year might unfold as we got deeper into the painting season. Here is what we are seeing as we begin the second half, along with our plans for seizing the opportunities in front of us.

In Paint Stores Group, we're facing a strong comparison to the second half a year-ago where sales were up 19%. We see customer backlogs as being solid in Commercial, Property Maintenance and Protective & Marine throughout the second half and we expect to deliver very solid strong growth in these end-markets.

Residential Repaint should also be good for us as based on contractor feedback, though visibility here is only about six to eight weeks and existing home sales are likely to remain weak. There's some recent optimism from new residential homebuilders regarding starts, but it won't be enough to move the needle meaningfully for us in 2023. We are more tied to completions which are slowing. While we are confident we are growing share, we expect new residential volume will be challenging for us in the second half, though the year will likely come in closer to down high-single-digits compared to the down 10% to 20% full year range we provided in January.

In DIY, double-digit growth in the first half was aided by softer comparisons to the prior year where supply chain headwinds impacted our sales. We do not expect this pace of growth to continue as comparisons become much more difficult in the second half of the year.

In Consumer Brands, North America DIY demand remains soft. Europe demand has stabilized, and Latin America markets remain mixed. In Performance Coatings, many of our customers continue to report a high level of uncertainty regarding demand. Auto Refinish demand remains an exception and is solid in most regions, with shortages in parts and technicians increasing shop backlogs.

Installations of our systems in North America are up strong double-digits year-to-date. This continues to bode well for future sales in this business. General Industrial end-markets are choppy, with North American customers reporting mixed demand by end-markets served. Industrial Wood demand remains soft, though some positive signs in new residential construction indicate we may have reached a bottom. In Coil, demand is holding up better in the Americas versus Europe and Asia. And finally, in Packaging, customers are returning to just-in-time versus just-in-case supply chain management, resulting in destocking that we expect will continue in the second half. The longer-term view here is still very robust, with customers already committed to fill the additional capacity we're bringing on this year.

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Let me be very clear in our expectations here. We do not accept the excuse that markets are soft and, therefore, our opportunities are limited. Our job is not to report conditions, but to influence results. We know we cannot defy gravity in terms of the macro environment, but in every business, we are aggressively pursuing new accounts and share of wallet opportunities to drive market share gains.

Moving to the cost side. We are revising our raw material outlook. We now expect costs to be down by mid-to-high single-digit percentage in 2023 compared to 2022. We expect to see decreases across several commodity categories, though the ranges likely will vary widely. We expect other costs, including wages and other input costs, to be up in the mid-to-high single-digit range.

Compared to the guidance we laid out in January, full year sales growth and raw material costs are trending better than we anticipated. With this first half outperformance, we expect considerable year-over-year operating margin expansion and earnings growth for the year. At the same time, these dynamics also afford us the opportunity to accelerate growth and service investments at a higher-level than anticipated at the beginning of the year. As a result of these disciplined and enterprise-wide investments, which will drive our customers continued success, we now expect the year-over-year increase in SG&A to be in the high-single-digit to low double-digit range for the full year. As in the past, we are highly confident in our ability to drive future above-market growth and our returns will justify the actions we are taking now.

Now moving on to our specific guidance. We anticipate our third quarter 2023 consolidated net sales will be up or down a low single-digit percentage compared to the third quarter of 2022, with volume down low-to-mid single-digits. For the full year 2023, we expect consolidated net sales to be up a low single-digit percentage, with a volume down a low single-digit percentage.

Our sales expectations by segment for the third quarter and the full year are included in the slide deck issued with our press release this morning. We are increasing our full year 2023 diluted net income per share to be in the range of $8.46 to $8.86 per share. We believe this increased range accurately reflects our first half outperformance, continued pricing discipline and moderating raw material costs, while also acknowledging the ongoing uncertainty in the second half demand environment.

This guidance includes acquisition-related amortization expense of approximately $0.81 per share. It also includes net expense related to our previously announced targeted restructuring actions of $0.03 per share. On an adjusted basis, we expect full year 2023 earnings per share in the range of $9.30 to $9.70. This is an increase of 14.5% at the midpoint compared to our prior adjusted guidance of $7.95 to $8.65 per share. We provided a GAAP reconciliation in the Reg G table within our press release. Our slide deck includes additional information on our updated assumptions for the year, along with guidance on our expectations for currency exchange, effective tax rate, CapEx, depreciation and amortization, and interest expense.

We've also provided an update on our previously announced restructuring effort. One-time costs will be lower than previously anticipated. The estimated annual savings from our actions are unchanged. As we begin the second half, we'll remain focused on what we can control. Across the business, this means growing new accounts and share of wallet. It also means developing and retaining talent, improving and simplifying our operations and managing price-cost dynamics. We remain confident in our differentiated strategy, our capabilities and our product and service solutions.

Should the demand environment prove to be better than we are currently assuming, we would expect to deliver better results. What we can't control is the market. We're not interested in trying to time the economic recovery. What we are interested in is taking full advantage of it when it eventually arrives. This means investing in our

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growth now, ahead of the curve. This approach has served our customers and our shareholders well over multiple past cycles. I have every confidence that it will do so once again. Above all, I have the utmost confidence in our leadership team and our people. They are the true differentiators. Together, we expect to continue outperforming our competitors and the market.

This concludes our prepared remarks. And with that, I'd like to thank you for joining us this morning. And we'll be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] Your first question is coming from Greg Melich from Evercore ISI. Your line is live.

Gregory Scott Melich
Analyst, Evercore ISI

Q

Hi. Thanks, and congrats, guys, on a great quarter.

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

A

Hi, Greg.

Gregory Scott Melich
Analyst, Evercore ISI

Q

Heidi, I'd love to go a little bit into the deceleration that you still expect into the third quarter. I think it sounds like volume – if total sales are kind of flattish that we expect volume to be down low-to-mid singles and maybe give us a little more color on why you expect that deceleration and what you're seeing.

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

Yeah. Hi, Greg. I think it's a great question. I think if you look across our entire enterprise right now, I would just qualify this or characterize this as choppy. I think that's true both by division and by region. When you break it down, our volume is down low-to-mid single-digits. If you look at Paint Stores Group alone, down low single-digits. I would say that's primarily due to the new residential slowdown, but confident in the increase in starts that we're seeing. Remember, that's against a really tough comp of 19%. It's a bit offset by some of the heavy impact that we're seeing with both PCG and CBG, but I'm confident in our ability to drive above-market growth here.

Gregory Scott Melich
Analyst, Evercore ISI

Q

Got it. And I guess my second question is on getting back to that margin range that you have a 46% gross margin. Could you remind us of the range that you were targeting and is there a potential to be above that in the cycle given that it sounds like at least the pricing environment's remaining quite rational?

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

A

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Yeah, Greg. This is Al Mistysyn. And we're really pleased with the performance of our gross margin. As a reminder, our target is mid 45% to 48%. As we have talked about in the past, in a raw material inflationary environment, we put pricing to offset those dollars, and then as raw materials moderate, we start seeing the benefit of that pricing to increase our gross margin and helps us cover the continued investments we make to help our customers drive value in their business. So I'd expect the sequential gross margin to be similar to what I saw in – what we saw in the second quarter.

Price, as you know, we'll start annualizing the price increases in our third quarter, specifically the September [ph] 6% to (00:20:25) 10% in Paint Stores Group plus the other items, other segments that have put pricing in. So for the full year, I think our gross margin, depending on where Paint Stores Group volume is, could be in that 45% to 46% range. And then, as you know, we'll evaluate that 45% to 48% range over time. As we get consistency in that range, we'll look to raise the bar and move that target up.

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

A

Yeah. So I'd say we refer to that as our current range and I'd say in addition to every point that Al just made, the additional steps that we're taking on a regular basis, in reviewing the programs that we have, the investments that we're making, the mix of our products, everything that we're doing, goes into driving that margin. It's not simply just a price. There's a lot of activity on the operations side to drive inefficiency. We talked last year about some of the inefficiencies as we served our customers, we were shipping product from one point in the country into the other. And so as we continue to optimize our supply chain, we expect to continue to drive that as well.

Gregory Scott Melich
Analyst, Evercore ISI

Q

And it sounds like even with the lower raw material expectation for this year, your pricing expectations are unchanged. Is that fair?

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

A

Yeah, that's correct. As we continue to invest in our business and bring more value to our customers, we'll invest into that and drive their profitability and, naturally, we'd expect that our shareholders participate in that as well.

Gregory Scott Melich
Analyst, Evercore ISI

Q

That's great and good luck.

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

A

Yes. Thank you, Greg.

Operator: Thank you. Your next question is coming from Vincent Andrews from Morgan Stanley. Your line is live.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

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Thank you. Two questions on SG&A. I guess first, if you could just help us understand, I know we talked about this in the past, but the incremental spending for this year, what detail can you give us in terms of what it targets? And then secondly, should the back half of the year play out better than you forecast, do you have more SG&A activity that you could get into in the back half of the year than you are already guiding to or is this SG&A guidance done for the year?

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

A

Yeah, Vincent. Let me kick it off kind of my thinking on it and then I'll ask Al to get into some of the details. First, we are going to adjust our investments to market conditions, and these are things that we monitor closely. We monitor the trends in the market as you just mentioned, the activities and opportunities, cost, even the activities of our competitors. We've seen this before. We'll capitalize on the market opportunities. The competitive shifts and missteps that our competitors make, these are all opportunities.

So to your point, as we see raw material trends and these are part of our dataset, all roll into what you should expect to see from Sherwin-Williams, we're going to be aggressive. We're going to drive market share and invest in our businesses, and I think it comes down to when you have confidence in your strategy and confidence in your leadership team like we do, you can invest. And while others are adjusting their strategies, we're going to take advantage of any shifts. We will be on the attack.

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

A

As you know, we're all about managing operating margin growth and operating margin growth over the long term. So in your comment about will we be done with SG&A commentary as the second half goes on, I would say no. I think as we see how the demand environment and volumes unfold and as they're at or above our expectations, we'll look at that. We'll look at gross margin performance in the second half. And the beautiful thing about our model is we can be very agile across each of the segments, both field sales and tech service reps, reps with the Pros Who Paint within the Consumer Brands Group. So if we see a path of a higher gross margin than what we have on our current outlook, we'll look to put more investments in our long-term growth initiatives to drive higher share as the market returns.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, guys. Appreciate it.

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

A

Thank you, Vincent.

Operator: Thank you. Your next question is coming from John McNulty from BMO. Your line is live.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah, good morning. Thanks for taking my question. So in the Paint Stores Group, you had been looking for kind of a flattish guide. Now you're looking for up mid-to-high single-digits. When you look at the major sub-segments

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of that group, I guess where are you surprised the most? Where are things kind of working out better than you expected?

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

A

So let me start with new residential because I think that's an important piece, and maybe what we'll do here, John, is I'll start with new residential and maybe talk about commercial and then I'll ask Heidi to talk about some additional segments because to be truthful with you, we're very pleased with the execution of our team. We talk a lot about our secret weapon, and we've talked about the recruitment and retention of this team. They are truly executing. We couldn't be any more proud.

In new residential, I think it's clear to all of us, there's pressure in the new residential space. Our flat sales in this quarter, I believe, are indicative of the share gains we're executing. We talked about penetrating that top 100 builders for the last couple quarters, and quite honestly, we're working on that and we're experiencing terrific success. In fact, even deeper into some of the more custom homebuilders as well.

It's growing, and we expect to continue to grow there. We continue to execute on our strategy of bringing solutions to these builders to make them more successful and I think that's the key and core behind everything we do. So in the builder's area, the efficiency that we're bringing, in our supply chain, to help them, and innovation, quality, consistency, even as they're adapting in the different substrates to help defray costs, we're working with them to ensure we have the right coatings for them.

Importantly, I just talked about our people. I think our stores and our reps in this area, they're doing a fantastic job of staying close and in contact with not only our builders but their applicators, which is very unique, and we've got a distribution platform that wherever our builders are building, whatever developments they're pursuing, our stores are where they are building and where they might want to build. So we're not out there promising if you will invest here, we'll invest with you. Our people are there and our assets are there and we're capitalizing on that.

So we're growing share. We've not experienced the depth of decline as you mentioned. We originally projected, although I would say we do expect to see softness in the second half. We talked about our strategy here and our commitment to favorably position the company and we think this segment absolutely demonstrates that.

In the Commercial side, I'd say we're experiencing very good performance. And again, I think it highlights the advantages of our control distribution. We expect the balance of 2023 to be strong. We're really focused on the sub-segments inside Commercial going forward. So again, really leveraging the value of this control distribution model.

Our reps and our specification teams are really dialing into those areas that provide opportunity. And even within those areas that might be strong now that could dry up, even in those areas, we know that there will be opportunities, could be in tenant buildout, or wherever in Commercial it might shift, we're going to be there. So again, our focus on applicators, the specifiers and the owners, we believe, will pay off for us. Res Repaint is another area that I think is really important to talk about. Let me turn it over to Heidi.

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

Yeah. And as you know, we've had seven years of double-digit growth here in this segment and we're confident in our execution, but it's important to know that we're never complacent. And doing what we know how to do we believe will take share, especially in this environment. While it's currently positive, we know a slowdown is

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coming, and it's also being tempered by, as we mentioned in our prepared remarks, by the extended period of weak existing homes. So having said that, even in that challenging environment, paint will continue to outperform other categories, since it is an inexpensive and highly impactful category.

There's been a lot of speculation about next year and I will tell you that the bidding activity has somewhat normalized, and believe it or not, these are actually very good times for Sherwin-Williams where we believe that adversity brings about opportunity for us. In large part, our controlled model, as many of us talked about previously, this allows us to dig deeper, and not just trying to sell our contractors product, but really taking the time to intersect them where they are in their business and helping them to focus on growth and profitability.

We have a lot of data that we've talked about in the past, but I think – and we won't get into specifics or details here, but it's important that the team is working hard, John mentioned the talent and the frontline here, mining this data for opportunity and getting very surgical in addition to the data leveraging our rep force so that we can be very thoughtful as we approach these contractors and making sure that we're taking advantage of the talent that we've got out there. So we're currently focused on building these relationships and confident that we'll continue to see some aggressive share gains here.

And then briefly on the DIY relative to stores, and I think John, your question was specific to stores. Sales were up double-digits in Q2 against a fairly soft comp. We don't expect this to continue at this pace, but I will note there's been some very positive foot traffic in our stores relative to this segment. And with that, maybe just a brief touch on P&L.

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

Well, Property Maintenance I think is another area that performed a little bit better than we expected, and we have a lot of confidence here. A lot of the delayed maintenance we believe now has been addressed. Apartment turnovers are strong and bodes well for us. And again, I think even the idea of return to travel, office and school, all help and we leverage our national platform of stores and reps to be able to really capture that business as well. So it's a good business for us and one that performed better as well.

Protective & Marine was another area that – in our stores that performed stronger than I would say we expected. I'll say that here, not to our team. We expect more from our team would be the answer I'd give them. Our core business is very strong, double-digit growth, but we've been investing in this business and our expectations are high of this team. We've got terrific leaders in this area, and we have been making investments in areas – we've announced a number of acquisitions, for example, in flooring. That's helped us get into some really key opportunities in food and beverage, pharma, even airport hangars, all have been very strong. Energy has been very strong for us. It's another great example where we focus on everything from extraction to processing as well as alternative energy.

Government activity here is trying to stimulate. It's been good for us as well. We see business in the area of mega plants for chips that have been good for us, as well as I mentioned alternative energy where we really have done a very nice job of bringing technology from all aspects. We're taking into wind farms, for example. There's one that's been promoted in the Northeast. That's going to be a terrific opportunity to bring our marine coatings as well as our heavy-duty petrochem technology to bear in a very unique way. So we're bringing technology. We're bringing the strength of a distribution platform, specifications and it's driving businesses very strong.

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.
A

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Just one piece I would add to that. John mentioned the recent acquisition in flooring. I think that really is a great illustration of how we're looking at this as a broader portfolio of both technologies and services that we're bringing together in terms of our value proposition. But if I look specifically at something like the EV battery plants or semiconductors, we're not just excited for those projects, but candidly for the infrastructure that will eventually surround those projects as well. So we feel we're very uniquely positioned to take advantage of that wave.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Great. Thanks very much for the detailed color. Appreciate it.

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

A

Thanks, John.

Operator: Thank you. Your next question is coming from Christopher Parkinson from Mizuho. Your line is live.

Christopher Parkinson
Analyst, Mizuho Securities USA LLC

Q

Great. Thank you so much. I was just hoping to get a little bit more color on your longer-term thoughts on PC margins just given the competitive dynamics in each of the respective end-markets. Obviously, ongoing price-cost, I think it's safe to say it's significantly better than we thought at least for the quarter, but going to that kind of unofficial 20% marker, I'm assuming you're feeling pretty good about that, but if you could just give an update on the longer-term thoughts there, it would be very helpful. Thank you so much.

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

A

Yeah, Chris, thanks for your question. I'll start and kick it to Al. You're right. We do feel very good, very proud of Karl Jorgenrud and his entire team. That leadership team is really focused on doing this the right way. So the solutions that we're bringing our customers and the focus and discipline that we're bringing is part of the strategy we keep repeating. And as we do that, we bring value to our customers, and we've been successful.

The discipline in that is that it's not every gallon is necessarily a good gallon for us, as a result. We're focused on key segments, key customers, we're trying to introduce technology and services that help them to make more money and, again, as a result, we believe that our shareholders should participate in that, but the push is to make our customer successful and have discipline doing that and that's exactly what the PCG team is doing.

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

A

Yeah. Chris, I think the takeaway that I'd leave you with is as we've progressed through 2022 and into 2023, you start seeing consistency in that segment operating margin in either the bottom of the range or in the range. And a couple additional points. One, they've got the discipline to get price. And when you look at the last two-years, 2021 and 2022, they took the brunt of the 40% increase in raw material costs and they were able to get price while still driving volume. And when we look at the acquisitions that were made last year and the integration activities and the synergies that the team is working on, we feel very good about coming out of this year with the operating margins of those acquisitions being accretive to PCG. And then they're also focused on a number of other initiatives, whether it's SKU rationalization, simplification, to make operations more efficient, that can better

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serve their customer at a higher-level. So I think you've put those things together and that team is on a strong trajectory to hit that 20% target and then we'll ask for more from there.

Christopher Parkinson
Analyst, Mizuho Securities USA LLC

Q

Got it. And just a very quick follow-up and also quite frankly a corollary of what you just said. I don't need to get ahead of myself with this next remark, but it seems things are generally progressing a little bit better-than-expected. Obviously, that's reflected in the guidance range, so on and so forth. When we take a step back and you look at your portfolio, obviously, you've taken a few extra actions over the last 12 to 18 months in both divesting as well as acquiring. Can you just give kind of a very quick update on where you stand with that thought process? Are there any technologies which you still feel you're focusing on? Are there still assets which you would consider divesting just given the actions over the last quite frankly five-plus years? Any update there would be very helpful. Thank you.

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

A

Chris, we've done 20 transactions since announcing Valspar, 16 were acquisitions and 6 were divestitures. What we're focused on is and where we want to grow are those areas that we can bring value, that we would be rewarded for bringing solutions to our customers, and we take a hard and disciplined look in other areas. So we've divested – the Valspar wood divestiture was required by the FTC. We've divested Guardsman, which came with Valspar, Wattyl in Australia which came with Valspar, we've announced the Huarun in China, came with Valspar, and the specialty aerosol plant that we've recently announced also came with Valspar.

The one legacy Sherwin business was the thermoplastic road marking business. Here at Sherwin, we're focused on high-value products and areas. So that didn't fit our portfolio. But we've done a lot of really good deals that we believe that can help drive value for our shareholders, while bringing solutions to our customers. And that discipline to your question on will we continue, that discipline continues every day here. We're having discussions every day about programs, the hard discussions about customers, geographies. We don't want to just put flags on a map. We're here to create value for our shareholders, and it's sometimes hard-to-make those decisions, but quite frankly, we look at all of these businesses as part of our capital allocation.

When we put our money in to buy Valspar and we inherited a lot of these businesses, that was capital that was allocated. And if it doesn't meet the threshold for our shareholder return, then we make those difficult decisions, and that's part of who we are. And when we're out looking for acquisitions, it's not just what's for sale. We take a very disciplined approach. We've got a team led by Bryan Young here and our team that does a wonderful job in helping to identify what would be fit if it's for sale or not. And if it's not for sale, we go try to have those honest discussions with the owners about why it might be a better fit with Sherwin. So it's a disciplined approach that we take. We're proud of it. We're not out just trying to buy volume or sales or book of business. It has to fit strategically or we're not interested.

Christopher Parkinson
Analyst, Mizuho Securities USA LLC

Q

Thank you for your thoughts.

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

A

Thanks, Chris.

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Operator: Thank you. Your next question is coming from Ghansham Panjabi from RW Baird & Company. Your line is live.

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

Q

Thank you, operator. Good morning, everybody. John, as you kind of think about 2023 specific to Paint Stores Group, what do you think the common theme is as it relates to the volume outperformance across your various categories? I'm just curious is the customer backlogs that were a bit stronger than relative to what you initially thought or market share gains or something else. And then on Residential Repaint, do you think that vertical could be directionally less sensitive to existing home sales on a go-forward basis relative to the historical baseline?

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

A

Well, how about if I take the first piece and I'll throw it to Heidi on the resale because she's working very closely on that. I think there's a number of areas, Ghansham. I don't want to spend a lot of time on this, because I did just hit this, but I think the foundation of our strategy and our focus really comes down to the people that I just mentioned.

We talked about this management trainee program that we've had for over 40 years. We recruit 1,500 college graduates every year, so we're recruiting and we're training and developing the best talent we believe, and yes, we've made some compensation adjustments that's appeared in our SG&A to retain this talent and we think that's a great investment and we'd make it every day because we're going to win or lose by our people. And so when you ask about what's happening in the market, I think quite honestly, our people are executing.

It's a very choppy market out there right now. There were times when you would talk with customers and they would say they've not advertised in five years, and some of our customers had never advertised at all. They were spin-off of working for someone else and the market had been so hot that they just put a sign up in the first house they painted and then it started to roll.

Now, with the adversity in the market, we look that much more attractive to painting contractors that are looking for assistance and looking for help and we welcome that. It's the reason we have over 3,000 sales reps and nearly 5,000 stores in the market. We don't look at our position nationally. We look at our business market by market, customer by customer, and we're trying to address their needs. And so I don't think that there's a lot of wind in the sales of a lot of people on the architectural side.

There's a good book of backlog business as Heidi mentioned, but there's some uncertainty and there's some choppiness and our people are there to paraphrase this, almost to hold the hands of these important customers and help them through that and as a result, we get rewarded. So we're executing really well in a choppy market. That's how I would respond, how we're performing in the market.

Regarding Res Repaint specifically, Heidi, maybe I'll have you to answer that.

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

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Yeah. Ghansham, the – good question. In terms of reliance on resale, I think that the inverse is true as well, which is that those that are staying in place, making sure that they're aware that – this is really about the opportunity to raise value of their home if they choose to stay. We mentioned earlier it's inexpensive and highly impactful project.

I mentioned the data earlier. I'd like to go back to that. I think it's a great example of how we're able to penetrate and not be reliant on the resale market. And then in terms of our ability to go back, I'll give you an example again without getting into too much detail. Mining for the data those customers that haven't bought paint in a while, for customers based on a certain demographic that we know, are more likely – are certain regions that are more likely to reengage in the category. I mentioned earlier our team. Something that really differentiates us in this space is we've got 1,500 graduates every year that really own the P&L in their store and they're hunting for this exact customer. So a lot of respect for the people out that are building these relationships and making sure that whether it's a homeowner, or a contractor, making sure that we're being very surgical in terms of how we approach these really important customers.

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

And I'd add one thing to that as well, Ghansham. What you're seeing with the softness in existing home sales, this extended period, what we're seeing is people can't wait. So that's driving them to new res, and I think that's also supporting some of the new res business. And we've spoken many times about our business as a table, whichever way the market may tilt I think is a great example. As John walked through new res, telling you how well prepared and how much value we bring in that area, as these folks simply can't find a home to move into because the inventory is so low, are going to go new-build and we're right there.

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

Got it. And then for my second question on PCG, several categories seem to have been impacted by destocking across the various regions. Where are we in that process do you think? You gave some comments on Packaging. What about the other major verticals? Thanks.

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

Well, I would like to talk about Packaging because if there is one, Ghansham, that fits your description there, it would be Packaging. We've got customers working through softer demand and overstock. And as we see that continue, it's likely going to continue through Q3, perhaps even Q4, but we feel really confident. This is a strong team with a growing position with great technology. We've talked about this V70 unique technology that is really fantastic, and we hear it from our customers.

It's a plug and play, it's really highly efficient. It's superior in its ability to keep flavor protection of the product. Next-gen non-BPA. It's just a fantastic product and it's been very well received by our customers. So we've got confidence in this business. It's just going to be bumpy. And while we have high expectations, we often push hard. We also have to be realistic with our team. So we're feeling good there.

When you look at the rest of the businesses inside our PCG business, we mentioned it's bumpy. We've got some that might be more resilient as others. We talked about Auto Refinish. This is a team that's really hitting on all cylinders, pun intended, that is really leveraging the technology combination from Valspar and Sherwin together, along with a platform of stores.

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Many people think about stores through our architectural Paint Stores Group, but we bring the same value through our automotive stores direct to customer, and we are really growing business there as well. Our General Industrial business is one that is kind of a mixed bag. If you look at areas such as large ag and construction, it's doing well while our building products and general finishing is soft. So when you look at this business and you look around wherever you are right now, the office, every substrate that you see likely is one of two businesses, General Industrial or Industrial Wood, and our businesses there offer terrific opportunity, but they're going to be a little bit bumpy.

In Coil, I would say, we had a decrease in Coil, largely driven by Europe and Asia. North America is holding up a little bit better than other regions, but again, it – team is bringing a unique responsiveness to customer's needs in a way that help us grow market share even in a down-market.

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

Thank you so much.

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

You bet.

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

Thank you.

Operator: Thank you. Your next question is coming from Jeff Zekauskas from JPMorgan Securities. Your line is live.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Thanks very much. Is it fair to say that in...

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

Good morning.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Is it fair to say that in the first half, raw materials were down by a low-to-mid single-digit rate, and in the second half, as the base case, they should be down by a high-single-digit rate?

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

Yeah, Jeff, I would say you are correct. Maybe not quite high-single-digit on the second half, but close to it, yes.

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Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Great.

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

A

Third quarter actually will be up by high – will be the – there's improvement year-over-year.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Will be the highest, yes. And as a base case, for 2024, when you look across your businesses, do you expect your general level of prices to be higher or lower or flat?

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

A

Sitting here today, Jeff, we continue to talk about our pricing and our ability to maintain pricing as the raw materials moderate because of the solutions that we drive. I don't think we're ready to talk about incremental pricing for 2024. We have – we look at the total input cost basket to determine if we need a price or don't need a price. And as you know, any price discussions we have, we'd have them with our customers first, then talk to the street. So we have time to talk about 2024 over the next quarter and a half.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you so much.

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

A

Thank you, Jeff.

Operator: Thank you. Your next question is coming from David Begleiter from Deutsche Bank. Your line is live.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. John, how should we be thinking about second half earnings in terms of cadence between Q3 and Q4?

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

A

Yeah, David, I mean, when you look at the earnings, as John and Heidi talked about, our visibility in demand which is going to drive our performance through the second half is limited. So we have a better line of sight in our third quarter than our second quarter. We're not – we don't give EPS – or fourth quarter. We don't give EPS guidance, but couple of other things I would note. I do expect to see a seasonal slowdown in architectural in our fourth quarter, which will impact our gross margin as it historically has done. So I believe this is a year that is a second half more what I would say typical than some of the last three years, but our third quarter is typically a stronger quarter and I'd expect that to continue.

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David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Very good. And, John, one of your competitors announced a couple of homebuilder wins over the last few months. Why do you think they won that business, and you may have lost that business? And overall, how is the competitive landscape in that portion of the business? Thank you.

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

A

Yeah. Thanks for that. I'd start with every single customer's important to us, everyone. I also think it's important that you understand how we think. To us, we play every day in the World Series, and we want to sweep the Series, we want to win every single game, but we're also realists. We're not going to expect every one of our pitchers to throw a perfect game or to win every game as a shutout, but I'll tell you this. I believe we have the best team, the best resources and great momentum. So even if our competitors score an occasional run or if our pitchers throw an occasional ball here or there, we're not going to panic. We've got we believe the right team. We'll sweep the Series and we're out there right now. We believe if you look at that top 100 builders and the penetration that we have, we're growing it and growing it aggressively and we expect that to continue, and we're doing that at all our competitor's expense. We just don't choose to talk about it.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you very much.

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

A

You bet.

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

A

Thanks, David.

Operator: Thank you. Your next question is coming from Mike Sison from Wells Fargo. Your line is live.

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Hey, guys. Nice quarter. With the third quarter volumes potentially being down, do you think things are bottoming? As I think about the fourth quarter volumes, look like they could be flattish to maybe even up. And how do you think about 2024 volume growth next year? Do you think it's – we could be in a position to start growing again?

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

A

Yeah. Mike, take one more run of that question here maybe. I missed...

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

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Yeah. I guess from the third quarter – I guess I'm trying to understand if you think things are bottoming here in the third and then potential for volume growth for the total entity maybe into the fourth and into 2024.

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

A

Yeah. I think that's a challenge to answer. I'd say if you look at new residential, we're suggesting that we've outperformed, for example, in new residential and that we expect the balance of the year to be a little bumpier. Housing starts are starting to come back as I talked about in my prepared remarks, but even homes that are – they break ground today, it's likely going to be for the future, likely next year before we start painting those. And so I don't – I'd say we're probably bouncing around here a little bit. We'll see what happens, but our approach has been right now that as the market is soft, our goal is to outperform it, and going forward, between Q3 and Q4, gallons, I'd say it's likely going to trend about where we are.

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

A

On Paint Stores Group, if you look at – we said projected to be flat to up low single-digits, but when you look at the dollars sequentially, they're pretty close, and that's with new res declining more in our third quarter than we expected in our fourth quarter, which tells you we have some strength in our other segments that John and Heidi talked about and it's going up against the 21.5% comp last year. So when you think about the second half, Paint Stores Group has a tough comp. I'd say the other segments as we talked about are choppy and it's by business, by region. I think some businesses in certain regions have bottomed out. I think there's still challenges that we see in Asia-Pacific, but as an example Europe in our second half, we expect to do better than what we did in the first half. 2024, that's a whole different discussion that we'll have as we get into January and our year-end call.

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

One piece I would add to that I think is just – an indicator is the strength of the backlogs, I think if you look at stronger and more solid backlogs across Commercial, Property Maintenance and P&M. And I would also say it's not just the backlog. It's the way in which we're interacting with these customers. We're closer to these customers than we've ever been before, which is in large part based under control distribution model, but it's also based on coming out of the last few years of a lot of challenges. I think we've all essentially become better planners together. So those backlogs are a component, but also our closeness to the customer gives me a lot of confidence in the outlook.

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you.

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

A

Thanks, Mike.

Operator: Thank you. Your next question is coming from Arun Viswanathan from RBC Capital Markets. Your line is live.

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Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question. I guess I just wanted to follow up on that last point as far as backlog. Could you potentially provide us with some backlogs across maybe some of the different market segments that you're seeing in PSG? I know when you started out the year, you noted that there was quite a few jobs still in the backlog on the new side through the first half, but then it's really kind of limited after that. So how would you characterize the backlog now? If you could provide a little bit more granularity on that. Thanks.

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

A

Yeah, Arun, I'd say – Heidi, if you don't mind, I'll jump in here. I think if you look at the points that Heidi is making, I think there's two points. You're asking one very good question, but there's another element here that I want to tie to this this. One is if you look across the various segments say, okay, Commercial we see strong, Residential Repaint a little bit choppy with resales, but we can see out six to eight months, Property Maintenance strong, DIY has been strong, but it's on softer comps so we don't expect that to continue, I think all of those are opportunities for us to continue to grow market share and we will.

The other point though that I think she spoke to that I think is important is coming through COVID and in the shortage, we've worked much closer with our customers in ways that quite honestly I wish I would have had that opportunity when I was in the store. We're now working collaboratively with what projects are taking place now, what's next, even to the point where if it rains, my fallback is this position. And the fact that we've got our reps and our stores out there close to the backlog and close with our customers, closer than ever before, is a terrific advantage that we're trying to leverage. So by segment, I would say yeah, we see new residential likely to slow down a little bit as the slowdown works its way to the painting phase of the homes that weren't started eight months ago. Property Maintenance, we're really leveraging the fact that their CapEx money is freeing up. Our national agreements are opportunities for us, and the others, as I described. So it's a good market for us because there's a lot of adversity in the market and that's what we thrive on.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

That's helpful. And then a follow-up on the raw materials side. Could you just maybe provide us with some idea of what you've been procuring at in the second quarter? I would imagine it's maybe down mid-to-high single-digits? And does that flow through I guess in the second half and have you seen any declines in TiO2 as well or do you expect any of those? Thanks.

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

A

Yeah, Arun. So our raw material basket in the second quarter was down in that high-single-digit range. And what was really driving that deflation for us, as you might expect, was the petrochemical side of the basket, resins and solvents, even plastic packaging. The decline in some of the key feedstocks such as propylene, it's now flowing through into the things that we're buying, and we expect that to continue. This is a cycle that we've seen many times over the years.

With regard to TiO2, your question there, those costs were still a little bit elevated for us, but we expect to see them starting to trend in a more positive direction as the year goes on. Some of the key input costs on TiO2 are elevated right now. Chlorine being one of the main ones, and I'd also say some suppliers are also trying to

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manage their capacity a little bit more tightly, but with demand soft here, you're going to see or we believe we're going to see and expect to see some decreases in the TiO2 pricing.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Thanks.

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

A

You bet.

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

A

Thanks, Arun.

Operator: Thank you your text question is coming from Duffy Fischer from Goldman Sachs. Your line is live.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

Yeah, good morning. I was hoping you could help me just triangulate a little bit, when you look at the midpoint of your guide, what it implies is the back half versus the first half this year is going to be down 22% on EPS, but when you look at the last seven years, the average is for that to be up 6% and it's been up five of the seven years. So when you add to that, the raw materials should be better in the second half versus the first. I just have a hard time triangulating that new resi will be a big enough negative to take the earnings down on a sequential basis first half to second half. So could you just talk through what else might be negative first half to second half?

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

A

Yeah, Duffy. It starts with that sales outlook down mid-single-digit from – for second half versus first half, less price would be in that, so we've got a nice tailwind in the first half for price that helped drive our gross margin. And so you also see lower volume specifically in Consumer and Performance Coatings Group. So I think as you would expect, you're going to get lower gross profit dollars. I do still expect gross margin expansion on our second half not quite as good as year-over-year anyway that we saw in our first half because of our comps, and then you do get some help on the raw material reduction, but that is partially offset by lower fixed cost absorption in our second half due to lower production volumes.

I think SG&A even, we talked about SG&A in the opening, and being more aggressive at adding investments for our long-term growth strategy both in-stores, reps, field tech service reps, and the final piece is these non-operating costs that I'd call out that are probably going to be an incremental $60 million to $70 million headwind versus our first half because some of the gains that we had on sale of assets and marketable securities. So I think those are the things that are driving that sequential movement.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then just, again, if we ever get back to normal, whatever that is, do you still believe that your structural footprint in the second half earnings profile is better than the first half earnings profile for the company?

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

A

Yeah, Duffy, I try to go back to a normal year, 2019. So to your point, I'm not sure what normal is, but I think as we continue to see growth in our Performance Coatings Group that's less seasonal, you might not see as big of an increase in our second half versus our first half as we move forward, but if we get back to the way Paint Stores Group ran, our consumer business ran, then yeah, you should typically see that.

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

A

Duffy, I guess I'd just add on to the investment strategy that Al mentioned. We're 157-year-old company. We're not trying to run the company for a perfect quarter here. We've got confidence in our strategy. It's a proven strategy with proven leadership team through a proven and growing asset base, in stores and the facilities that we're running. So to Al's point, we're going to invest into that, and we played a long game here. We know what we're doing and, quite frankly, we're going to do more of it.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

Perfect. Thank you, guys.

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

A

Thank you, Duffy.

Operator: Thank you. Your next question is coming from Adam Baumgarten from Zelman & Associates. Your line is live.

Adam Baumgarten
Analyst, Zelman Partners LLC

Q

Hey. Good afternoon, guys. Just curious if you could give an update on the Pros Who Paint business and how that's been trending.

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

Yes. Good question, Adam. I think there's a lot of growing – certainly growing interest here as it relates to how we're partnering with our strategic retail partners and certainly the investment that's following that with a lot of confidence in growth to be gained there. And I won't get into a lot of the details because I think those are certainly for our retail partners to share, but I can tell you that the level of collaboration and alignment from the planning standpoint, certainly understanding how the calendar lays out, laying in key events throughout the year, making sure that the data is aligned, that the reps are aligned, that the structures are aligned, we're just getting started here and we've got a lot of confidence in where this can go.

Adam Baumgarten
Analyst, Zelman Partners LLC

Q

Got it. Thanks. And then maybe just if you could discuss some of the simplification efforts you're making across the enterprise and kind of the timeline there and the impacts you ultimately expect that to have on the business.

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Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

Yeah, it's a great question. I will tell you that that's going to be a journey on to itself. So when you think about it, how we're kind of broadly defining this is truly looking end-to-end. Al mentioned this earlier where we're looking to bring some efficiencies certainly with our global supply chain team, Al mentioned the Performance Coatings Group, I'd say true for all groups and for our supply chain as well, really understanding all the way from the raw materials, a question was asked earlier, Jim mentioned how we're thinking about procurement in general.

The conversations that we're having are I would say a lot more detailed relative to the sub-supplier level and making sure that when we step back and look at our supplier strategy, there's a distinction between strategic suppliers and transactional suppliers. So we're having those very important conversations at the front-end. And then as I take you all the way through, Al mentioned our rationalization efforts that are underway, but as you can imagine, as we simplify the basket and continue the rationalization efforts from a customer-facing standpoint, it puts us in a much more optimized and efficient standpoint from an operational, manufacturing, logistics and so there's a lot of milestones that the team is setting forward here.

This will be a multiyear journey as I mentioned but I would expect that we'll see some customer-facing updates as it relates to how we can compete with a more aggressive portfolio of products here in the short run and then you'll see that continue to show up to the bottom-line as we move faster and faster towards automation and the like.

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

A

The only thing I would add to that, Adam, is we talk about efficiencies, but we also are focused on these efforts to increase our capacity so that we're not having to put capital back into capacity, and then also looking at opportunities for working capital reductions. So John talked about the divestitures and the part of our capital allocation philosophy. It's really a strong and focus on delivering cash generation back to our targets that we laid out and also how we best utilize our assets.

Adam Baumgarten
Analyst, Zelman Partners LLC

Q

Thanks. Best of luck.

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

A

Thank you, Adam.

Operator: Thank you. Your next question is coming from Josh Spector from UBS. Your line is live.

Joshua Spector
Analyst, UBS Securities LLC

Q

Yeah, hi. So just a follow-up on working capital, specifically inventory. So your inventory stepped down a few million – a few hundred million sequentially. Just curious if you'd say you have your volumes of inventory at the right level for what you're expecting in terms of second half volumes or if you're continuing to destock that inventory through the year and really what that means, your expectations for working capital for 2023. Thanks.

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

Sure, Josh. As typically is the case as we get into the summer selling season, we will see a sequential decrease in our inventory gallons as you mentioned, I think you'll see a sequential decrease in our third quarter which is also typical and then, we'll build inventory back in our fourth quarter to our targeted numbers that are a bit similar to prior – similar to last year, but to more historic levels. So I feel very good about where our inventories are at today.

That being said, we'll adjust production through the second half to maintain that targeted year-end inventory. I don't want to get us too far ahead going into next year, so we'll monitor demand trends closely and adjust production schedules accordingly. We'll try to push that working capital back towards our target by year-end of 11.5%. I think that's going to be a little difficult, considering accounts payable is – because of the lower production is what's driving our increase over that 13%, but we'll get that working capital back towards the target of 11% to 11.5% going forward.

Joshua Spector
Analyst, UBS Securities LLC
Q

Okay. Thank you.

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

Thanks, Josh.

Operator: Thank you. Your next question is coming from Steve Byrne from Bank of America. Your line is live.

Stephen Byrne
Analyst, Bank of America Merrill Lynch
Q

Yes. Thank you. This 10% roughly increase in SG&A that you're expecting for the year, can you talk a little bit about what exactly is driving that? Is that underlying wages? Is it variable comp to incentivize aggressive effort in sales? Is that head count? Is it something else? Is it the digital app? What would you say is driving that? What are the primary buckets driving a 10% increase in SG&A?

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

Yeah, Steve. I don't think it's in our best interest to lay out exactly what our investments are to be truthful with you. I would say that we have a proven leadership team. We've been at this for a long time. We see opportunities and we invest. Many of the topics that you brought up are areas of investment. So yes, we're going to invest in securing our people, the retention of our people, the training of our people. We're going to add reps through our stores and through other channels that are important to us. We're investing in innovation and digital.

We're not going to get into any specifics deeper than that, but we believe and, quite frankly, we're very proud that when we make an investment, that our shareholders can count on a return. And we've demonstrated the discipline to be able to do that.

Stephen Byrne
Analyst, Bank of America Merrill Lynch
Q

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And then on your cost structure, Al, if I heard you right, I think you've indicated low single-digit deflation in raw material costs, and I believe that was not current purchases but what flowed through COGS in the second quarter. Is there something else that was a meaningful change year-over-year in cost structure like freight or logistics or something because your gross profit increased year-over-year significantly more than revenue? There seems to be maybe something else in there other than just low single-digit raws.

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

A

Steve, we had better than low single-digit raw in the second quarter. If that's what I said, that wasn't correct. We had more like high-single-digit reduction in raw material costs. And what I said is the offset – partially offset by lower fixed-cost absorption because we have lower production volumes in our second quarter mainly because we had to rebuild inventories last year and we didn't have to redo that. So we're at more typical production schedule this year than last year. So that's maybe what the little bit of a headwind would have been in the quarter versus raw material benefits.

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

A

With a more optimized supply chain this year versus last year, Steve. Last year literally, we were taking raws wherever we could make them or get them, manufacturing paint, and sending it to customers wherever they needed it, and we absorb that into our margin. But I think, again, it speaks to the commitment we make to our customers and why they can count on us.

Stephen Byrne
Analyst, Bank of America Merrill Lynch

Q

That's helpful. Thank you.

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

A

Thanks, Steve.

Operator: Thank you. Your next question is coming from Patrick Cunningham from Citi. Your line is live.

Patrick Cunningham
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you. You talked about the fixed-cost strategy for lower production volumes. How much lower our utilization rates versus historical levels? And if the recent uptrend maybe in-housing starts or commercial and property hangs in there, would you expect to bump up to historic high utilization rates in 2024 and perhaps even pre build more additional inventory in 4Q? Thank you.

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

A

Patrick, we don't talk about capacity utilization. I will tell you this, that we've added some capacity so we've got the ability to be more responsive to our customer's needs. When we talked about taking working capital down, Al comments about getting down in that 11.5% range. We have confidence in our ability to do that, while improving service to our customers, as we go through the simplification efforts that Heidi's leading the company on the operational side as well as the capacity that we have.

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Patrick Cunningham
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you.

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

A

Thanks, Patrick.

Operator: Thank you. Your next question is coming from Aleksey Yefremov from KeyBanc. Your line is live.

Aleksey Yefremov
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks. I just have one question on DIY, you have easy comps in the first half, getting to harder comps in the second half. What is the underlying trend here for your business and the market overall? Is it sequentially still decelerating, improving or stable?

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

I'll start with that. I think if you look at DIY in our Paint Stores Group, I'd give you a slightly different response versus what we're seeing in the rest of our business, and largely, based on the premise that there's a slightly different segment in a customer that's looking for more service that wants more of that specialty paint store experience. So as I mentioned earlier, we're seeing traffic up in our stores. I think the challenge on the softness, and you'll see this on the Consumer Brands side as well, we've gotten back into a strong position of inventory. You'll see some more promotional activity that's been happening in an effort to drive traffic, but still continue to see some of that softness coming in in the current state at least through the balance of the year.

Aleksey Yefremov
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks a lot.

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

A

Thank you.

Operator: Thank you. Your next question is coming from Kevin McCarthy from Vertical Research Partners. Your line is live.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Yes. Good afternoon. In your Consumer business, can you speak to the outlook for repair and remodeling activity? And given that backdrop, do you expect your market share among Pros Who Paint to rise or fall or stay about the same over the next year or so?

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

A

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We expect our market share to grow. And if you look at what's happening from a Lyra standpoint, predictions on what's going to happen right now, I'd say there's a slowing in the remodel business, but the truth be told is that this is an opportunity for us. In our business, there are a lot of people that talk about percentages and most large percentage increases on a relatively small business. And quite frankly, this is a new and growing opportunity for us. So the dollars are not where we believe they can be percentage-wise. We have significant increases, and we expect those increases to continue as we partner with our customers who are interested in growing this.

And importantly, I think understand the strategy here. There are customers, particularly those that paint as a part of their project, that prefer a home center model. Some of those customers might find their way into our stores and the natural question is a concern about cannibalization. We're not concerned with that. We'll gladly put that share of business up knowing that there's a significant opportunity for us to grow with our partners to pursue the remodeler, if you will, whose using paint on a project. So yes, it's going to grow. We're focused on it with our customers, and we're determined the group combine, so we expect positive growth.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Okay. Thank you for that, John. And secondly, if I may, perhaps for Al. It appears as though your 2023 CapEx outlook declined by $100 million to $700 million. Why is that? Is that a function of timing, or any meaningful changes to the project roster?

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

A

Yeah, Kevin. It's all related to timing. We're still moving forward with the Statesville expansion that we had talked about earlier this year. We're still moving forward with the warehouse automation project that we had talked about and continued driving the packaging capacity expansions that we talked about. So it's just timing. And with a better line of sight to the second half, we thought we'd update that number.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Perfect. Thank you so much.

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

A

Thanks, Kevin.

Operator: Thank you. Your next question is coming from Mike Harrison from Seaport Global. Your line is live.

Michael J. Harrison
Analyst, Seaport Research Partners

Q

Hi. Good afternoon. You've completed a handful of acquisitions and you're integrating those in the Performance Coatings business. Can you just give us an update on how you're seeing those operating and commercial synergies progressing on some of the key deals that you've completed?

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

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Yeah, Mike. It's a great question. I think there's a whole host of acquisitions John mentioned earlier, and I would say the team is laser-focused on, first and foremost, making sure that these integrations are seamless to the customer. We're very focused on the integration at the team level. I think when you look at some of our – the acquisitions that have been around technologies and our ability to quickly – the tech transfer has been an area of focus so that we're able to get those products outside of one necessary region and, in some cases, moving across the country or moving them across globally. So we're really focused on making sure we're getting the value capture out of some of these and the synergies that we know are there, but there's a lot of great work being done by the teams to make sure that we're keeping our customers focused on a fuller assort and then a fuller portfolio of choices based on these acquisitions.

Michael J. Harrison
Analyst, Seaport Research Partners

Q

All right. And then you mentioned in the Consumer business that you were seeing stabilization in Europe. I was hoping that you could maybe provide a little bit more detail on what you're seeing there and maybe what your expectations look like for the second half in Europe, both in terms of demand and as you think about the price-cost front.

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

A

You're talking about on the Consumer side in Europe?

Michael J. Harrison
Analyst, Seaport Research Partners

Q

Consumer in Europe, yes.

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

A

Yeah. So first, to capture this, it's a relatively small percentage of our overall business. We're proud of our relationship there. We play kind of a niche role if you will in tinted paint through the Valspar brand. This came to us with our acquisition. We've got a terrific relationship that we're interested in growing and I'd say that momentum that we have is good and we're excited about it.

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

That too is just based on some of the economic recovery, that stability we're seeing coming in and I think it's playing to our favor based on this tinted program that's unique in a lot of these countries.

Michael J. Harrison
Analyst, Seaport Research Partners

Q

Thanks very much.

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

A

Thanks, Mike.

Operator: Thank you. Your next question is coming from John Roberts from Credit Suisse. Your line is live.

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John Roberts
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. Could you just remind us how big US new res is as a percent of total sales? And even though your paint doesn't get applied until completion, I think you bid it closer to the start, so what's the – can you quantify at all what the bidding activity has been? Or the backlog?

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

A

John, new residential is a mid-teens percentage of our Paint Stores Group.

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

A

And we don't bid house, John. We quote our customers on a regular basis, and those are fluid discussions that we have with our customers, so it varies by customer, the timing of any agreements that we have and we just work closely with our customers to ensure that they have as much lead time to any adjustments to pricing as possible.

John Roberts
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Even the largest homebuilders?

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

A

Even the largest.

John Roberts
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

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

A

Thank, John.

Operator: Thank you. Your next question is coming from Eric Bosshard from Cleveland Research. Your line is live.

Eric Bosshard
Analyst, Cleveland Research Co. LLC

Q

Clarity on two things if you could. First of all, on raws, the [ph] 5% to 9% (01:22:14) full year, what was the first half of raw material?

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

A

Yeah. The first half – I'd say our second half is going to be better than the first half, Eric. In the first quarter, it was a pretty modest – if you remember, we said it's a pretty modest deflation. It got better. I mentioned sort of a high-

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single-digit range in the second quarter. It'll be better in the second half with probably the third quarter, probably the peak year-over-year benefit.

Eric Bosshard
Analyst, Cleveland Research Co. LLC
Q

Okay. And then secondly, relative to the original guidance, is the increased relative to what you thought the year looked like, is that even between the first half and second half or is that more first half loaded?

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

Yeah. Eric, I'd say it's more first half loaded. And as we talked about, we expected a strong first half. And demand as we again talked about was stronger in our first half. So it's more first half loaded.

Eric Bosshard
Analyst, Cleveland Research Co. LLC
Q

Okay. And then is there anything different that makes it more first half loaded? I understand the comparisons exist. There were comparisons in the first half as well. Is there something that creates more benefit in the first half than the second half?

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

Yeah. The comparisons are better, we get more price tailwind in our first half, and even with that, within admin, we had some gains on sale of assets and stuff like that, but maybe helped us a nickel in the second quarter, but yeah, the comps are going to get steeper, and then it's the outlook on the choppy demand environment, and I would say that's why you don't see a bigger tailwind in our second half plus the investments we're making for future growth.

Eric Bosshard
Analyst, Cleveland Research Co. LLC
Q

Okay. That makes sense. Thank you.

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

Thank you, Eric.

Operator: Thank you. Your next question is coming from Garik Shmois from Loop Capital. Your line is live.

Garik Shmois
Analyst, Loop Capital Markets LLC
Q

Oh, hi. Thank you. Just want to follow up on the strength you're seeing in Commercial within Paint Stores Group. It runs a little bit contrary to some of the macro that's been a bit choppier on Commercial. So maybe just wondering how much of that is maybe share gains versus a particular vertical that you've been overexposing yourselves to.

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

A

We do believe we're gaining share there. It's a great opportunity again to highlight this control distribution. The approach that we take has been grounded in the focus on the applicator, on the specifier and the owner through a distribution platform that is first class. And so our reps are working hand-in-hand with our customers.

I would say that many of our customers would see our reps almost as part of their team, and the more challenging the market, the more valuable that sales rep is, and the facilities that we build to service those needs, so yeah. I think we're growing share. I think there's a good – really good momentum through the balance of the year, rolling into next year. From there as I mentioned earlier, while we're not waiting for the business to finish up, we're very focused on those sub-segments that I mentioned earlier that are a bit more resilient that we're focused on to continue the momentum.

Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Okay. Thanks. And wanted to follow up on Resi Repaint, you talked about contractor visibility and backlog several times. So just wondered if you could put that in context, is the visibility in backlog that you're hearing from your contractor customers. Are these back to more normalized levels at this point or are we still running below normal given some of the headwinds over the last several quarters?

Heidi G. Petz
President & Chief Operating Officer, The Sherwin-Williams Co.

A

I'd say they're back to more normalized levels. I think you'll see depending on the size of the Resi Repaint contractor, some of that are willing to take on more and have the labor and the support and resources to do that and some that are smaller in size and that might be more governed by shortage in labor. We're really trying to intercept them at that point and help them focus on how they can be as productive as possible so everything from our propped assortment to our tools to our reps and how we're engaging these contractors, making sure that when they're on the job site, they're as productive as possible, how they bid, how they quote, how they get paid, so really trying to help them from an entire business standpoint, regardless of the maturity or their size.

Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Got it. Thanks again.

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

A

Thanks, Garik.

Operator: Thank you. That concludes our Q&A session. I'll now hand the conference back to Jim Jaye for closing remarks. Please go ahead.

James R. Jaye
Senior Vice President, Investor Relations & Corporate Communications, The Sherwin-Williams Co.

I just want to thank everybody again for joining our call today. I hope you heard come through loud and clear. Our team is aligned and committed to growing our business profitably, but we're also going to invest in growth, in customer-facing initiatives that's going to drive our success and our customer's success over the long-term.

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I'll remind you that our annual Financial Community Presentation is going to be held here in Cleveland on August 24. In addition to John, Heidi and Al, you're going to hear directly from our Group Presidents at the event and they're looking forward to sharing their plans in each of those operating groups and you'll hear how they're planning to execute and drive those businesses forward as we described on much of the call today. You can register for that event at our website, and we look forward to seeing you at that event. So thank you again for your interest in Sherwin. Have a great rest of your day.

Operator: Thank you, everyone. This concludes today's event. You may disconnect at this time and have a wonderful day. Thank you for your participation.

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