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The Sherwin-Williams Co. (SHW)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. Thank you for joining The Sherwin-Williams Company's Review of Third Quarter 2023 Results and our Outlook for the Fourth Quarter and Full Year of 2023. This conference call is being webcast simultaneously in listen-only mode 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 at 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 third quarter results compared to the same period a year ago. These results follow our strong first half, and we are again increasing our full year guidance, which John will talk about in just a few minutes. But first, let me touch on a few third quarter highlights. Consolidated net sales were within our guidance range. Consolidated gross margin expanded significantly sequentially and year-over-year, driven by pricing discipline and moderating raw material costs.

To reiterate our commentary from last quarter, we are committed to investing in and profitably growing the business at the same time. The high single-digit increase in SG&A over the prior year third quarter reflects those investments, which are deliberately being made at a higher level to take advantage of the current market uncertainty and are aimed at driving the success of our customers and growth across all businesses.

Operating margin expanded year-over-year and adjusted diluted net income per share grew by a double-digit percentage. EBITDA also grew by a double-digit percentage, with adjusted EBITDA margin of 20.7%, near the high-end of our current 19% to 21% target range. In addition, we returned $566 million to our shareholders through dividends and share repurchases during the quarter.

Let me now turn it over to Heidi, who will provide some commentary on our third 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 & Director, The Sherwin-Williams Co.

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Thank you, Jim. I'll begin with the Paint Stores Group. Third quarter Paint Stores Group sales increased 3.6% against a challenging 21.5% comp. The increase was driven by continued effective pricing and higher pro architectural volume, excluding New Residential. Segment margin improved sequentially and year-over-year to 25.9%, driven by pricing discipline and moderating raw material costs.

Protective & Marine was the fastest growing in the quarter, driven by strong volume, as sales increased by a double-digit percentage against a mid-teens comparison. Industrial flooring, infrastructure, and oil and gas applications remain key drivers. In our pro architectural end markets, Commercial sales were strongest, increasing by a high single-digit percentage versus a high-teens comparison.

Residential Repaint sales increased by a mid single-digit percentage amid continued softness in existing home sales and against a 20% comparison. While this is a solid performance in the current environment, we are not satisfied and Res Repaint continues to be our largest opportunity for growth. Property Maintenance sales grew by a low single-digit percentage against a mid-20s comparison.

New Residential sales were down mid single-digits, with volume down high single-digits, against a mid-20s comparison. As we've previously noted, we anticipated New Residential would be challenging near-term given prior softness in single-family starts. We expect our continued share gains and new account wins to become more and more apparent as starts improve. Our DIY business was down low single-digits against a very difficult low-30s comparison. From a product perspective, interior paint sales were up low single-digits and exterior paint sales were flat, both against double-digit comparisons in last year's third quarter.

Sales in our Consumer Brands Group decreased by 4% in the quarter, primarily due to the divestiture of the China architectural business and softer DIY demand in North America, which was partially offset by selling price increases. Sales in North America, our largest region, decreased by a mid single-digit percentage against a double-digit comparison. The Pros Who Paint category continued to grow, while DIY demand remained muted by inflationary pressures on consumers. We continue to invest here with our strategic retail partners for growth.

In other regions, sales were up high single-digits in Latin America and low double-digits in Europe. Sales in China were down high double-digits, as we completed divestiture of the business on August 1. Adjusted segment margin was 13.8%, which was lower than a year ago primarily due to lower sales volume and lower fixed cost absorption due to lower production volumes.

Sales in the Performance Coatings Group decreased 1% against a low-teens comparison. Volume decreased by a high single-digit percentage, but was partially offset by positive low single-digit contribution from pricing, FX and acquisitions. Adjusted segment margin increased to 19.1% of sales, primarily due to pricing discipline and moderating raw material costs.

Sales in PCG varied significantly by region. Sales were strongest in Europe and increased by a mid-teens percentage. Latin America sales increased by low single-digits against a mid-teens comp. North America sales decreased mid single-digits against a 20% comp. Demand in Asia remained weak, with sales down double-digits against high single-digit growth a year ago. From a division perspective, growth was strongest in our Industrial Wood business, which was up by a low double-digit percentage against a mid single-digit comparison. This growth reflects our ICA acquisition, share gains and a potential bottoming of New Residential construction.

We expect to gain further momentum in this business, as we closed October 1 on the previously announced acquisition of Germany-based Specialized Industrial Coatings Holding comprised of the Oskar Nolte and Klumpp Coatings businesses. We are gaining share and seeing steady demand in Auto Refinish, where sales increased

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by a mid single-digit percentage against a high single-digit comparison. Sales in Coil and General Industrial both decreased by low single-digit percentages against challenging comparisons and varied widely by region.

Packaging sales were down by a mid-teens percentage against a high single-digit comparison. We anticipated this decline, given the near-term destocking by brand owners that we described earlier this year. Packaging sales in the quarter were also slightly impacted by the fire at our Garland, Texas plant. Our business continuity team is executing our contingency plans to minimize the customer impacts from this event near-term. Longer term, we continue to feel very good about our position and growth prospects in this end market, and we expect to bring additional capacity online at our Tournus, France plant by early 2024.

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

John G. Morikis

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

Thank you, Heidi. Our team delivered another strong quarter in an environment characterized by ongoing uncertainty. My thanks go to our 64,000 employees for continuing to focus on our mission and for executing on our strategy. Their energy in serving our customers and providing them with solutions remains a true differentiator.

On our July call, we described the anticipated second half demand backdrop across our businesses. The third quarter played out much as we expected, and we believe the environment remains largely unchanged in the fourth quarter. Paint Stores Group will face another strong year-over-year comparison. Demand in commercial, property maintenance, residential repaint and protective and marine remained stable with new residential remaining soft, as we expected. We have now annualized prior price increases.

In Consumer Brands, North America DIY demand remains soft. Europe demand has stabilized and Latin America markets remain mixed. Performance Coatings demand remains highly variable by end market and by region. We know we cannot defy gravity in terms of the macro environment, what we can do is aggressively pursue new account and share of wallet opportunities to drive market share gains. We are aggressively focused on doing just that.

Moving to the cost side, we're narrowing our full year raw material outlook and we expect costs to be down by high-single digit percentage in 2023 compared to 2022. We expect other costs including wages and other input costs to be up in the mid- to high-single digit range.

We also continue to see the current market uncertainty as an opportunity to press our advantages through greater investment in solutions for our customers that will drive their success and others. Our SG&A spend in the fourth quarter will reflect these investments, leaving full year SG&A to increase in the high-single digit to low-double digit range compared to last year. This approach has served us well many times in the past. We are highly confident it will again now, resulting in continued above-market growth and strong returns.

Now, moving onto our specific guidance, we anticipate our fourth quarter 2023 consolidated net sales will be up or down a low-single digit percentage compared to a high-single digit increase in the fourth quarter of 2022, with volume flat to down slightly. As a reminder, we've largely annualized previous price increases across the business.

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For the full year 2023, we expect consolidated net sales to be up a low-single digit percentage, with volume down a low-single digit percentage. Our sales expectations by segment for the fourth 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 $9.21 to $9.41 per share. We believe this increased range accurately reflects our strong third quarter performance, continued pricing discipline and moderating raw material costs, while also acknowledging the ongoing uncertainty in our seasonally smaller fourth quarter. This guidance includes acquisition-related amortization expense of approximately $0.80 per share and restructuring-related net expense of $0.09 per share.

On an adjusted basis, we expect full year 2023 earnings per share in the range of $10.10 to $10.30. This is an increase of 16.8% at the midpoint compared to last year's $8.73 adjusted earnings per share. [indiscernible] (00:13:34) provided a GAAP reconciliation in the Reg G table within our press release. Our slide deck includes additional information on our assumptions for the year.

As we begin the fourth quarter, we continue to expect choppiness by region and end market. More importantly, we continue to see opportunity amid uncertainty and we are extremely confident in how well our various businesses are positioned. Our strategy is clear, it's working, and it's not changing. We'll continue to provide our customers with differentiated solutions that drive their productivity and their profitability. Our capabilities, products and services are unique. We remain on offense, growing new accounts and share of wallet in the right markets with the right customers.

We also remain focused on developing and retaining talent and improving and simplifying our operations. We expect to finish the year with momentum that will carry us into 2024. I have the utmost confidence in Heidi, Al, our leadership team and our people. Together, we expect to continue outperforming our competitors in 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.

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QUESTION AND ANSWER SECTION

Operator: Certainly. Everyone, at this time, we'll be conducting a question-and-answer session. [Operator Instructions] Your first 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. And first, John, congratulations on a great tenure in the CEO slot. And Heidi, best of luck to you as you take on that role at the end of the year. So I guess the first thing I wanted to just touch on was the strength of the contractor market. Can you give us a little bit of color as to what you're seeing, especially in the residential repaint area? It looks like it's been maybe a little bit stronger than what we would have expected. So just curious your take on how to think about that continuing going forward?

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

A

Yeah. Good morning, John. I think you make a great point here. I want to take a minute before I jump right into res repaint, which I absolutely will. I'll just put this a bit in perspective, you heard from some of our prepared remarks that when we look at our performance in general, and we're posting some stronger results up against really aggressive comps last year, I think that's an important piece that we anchor in as I get into the res repaint view, [ph] Strip or res repaint (00:16:31). Certainly, new res being up against over 20% comps here and still in this environment, continuing to post. So we're really proud of the team to be able to overcome some of that. So I think if I just jump right into res repaint, I'll let you know that, yes, we are gaining share in this market. Demand does vary depending on a few variables.

I think if you look at this and separate a bit those contractors that are more established and well known and are more experienced in marketing their business, they've got the scale and they're confident in their backlog. I would say that's more so true for them than those that have less experience being able to put that type of focus on in marketing their business. So I see there's a bit of a variance there. But we look at this importantly, adversity that these contractors are facing in this choppiness is also an opportunity where I believe that it makes our stores and our reps even more valuable as we're helping them navigate through a lot of this uncertainty and helping to intercept what it is that they're trying to accomplish in their business.

Whether it's leads or making sure that we're helping them finding ways to be more efficient in their process. So I think we've seen this movie before. We're ready for what's ahead. We're putting investments in. John referenced earlier this is the SG&A that you see. And I'll take you back. We saw this coming in 2008 and 2009. And making sure that what came out of that was our desire to be well-positioned as new residential does recover that we've got all the investments in place here to continue to drive res repaint. So this is an opportunity where, and I would say when, our model stands out and when we're able to gain a lot of shares.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Fair enough. And I guess the second question is just around cost verses price. Looks like raws are coming down. But you highlighted in the remarks that other costs are definitely still pushing higher and you're also still investing in the business. So can you help us to think about the need for further pricing? I know you've taken a

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little bit of a pause recently as you normally do in the paint season. But I guess how should we be thinking about the need for further pricings as you push them into 2024? Thank you.

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

Yeah, John, this is Al Mistysyn. And we're in that part of the year where we're going through our operating plans, we're reviewing really demand outlook with our suppliers. I know we've gotten a lot of questions about oil ticking up, and that has to be up for a period of time before we see that flow through, our raw material basket. I think what you will see is the other cost input items increasing. I think merit increases, we'll get back to a more normal level. But you've got health care, freight. Some of the things going on with LTL carriers that are driving overall costs up. So as we typically do, we push back and look for offsets as much as we can. And then, when we can't – don't feel like we have an offset and we need to go out with price, we'll tell our customers first and then we'll talk to the street. So we're going through that process, and we need a little more time to figure that out and we'll let our customers know and then we'll come back and let the street know.

John McNulty
Analyst, BMO Capital Markets Corp.
Q

Thanks very much for the color.

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

Thanks, John

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

Thanks, John.

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

Thank you very much, and good morning, everyone. Wondering if I could just dig into the SG&A a bit more. Understand completely and appreciate what you're doing this year, but how do we think about that into 2024 both in terms of what level of increase is realistic for next year particularly as SG&A is not going to go down but should it grow a lot less than normal just given the big step-up this year?

And then, how do we think about from the outside over the next couple of years measuring the return on that? Is it simply going to come through the volume line in Paint Stores Group, or do you think it's going to be about margin or both? Or – as we – if we're here two years from now and we do a lookback, what do you want us to see specifically in the P&L?

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

Yeah, Vincent, let me start with that last piece, because I think it's really important. And again, I want to reiterate the confidence that we have in our strategy and the fact that we've seen this movie before.

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The investments that we're making you will see in the P&L, and you will see in market share growth. Our teams are invested in executing on these areas. But I think another important area that's crucial that you won't be able to measure on our P&L is the success that we'll bring with our customers as well.

So if you go back to the strategy that we employ, it's focused on driving the success of our customers, and these investments that we're making will clearly help our customers in achieving what it is that they're trying to do. And so I think as you look forward, the expectation should be increased market share and outpacing the market in volume and profitability as well.

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

Yeah, Vincent, I would say certainly as we annualize costs or the investments in our long-term growth initiatives, you're going to see that in the first part of the year. But I'd highlight if you look at our SG&A sequentially second quarter to third quarter, even though we kept investing in Paint Stores Group and reps, Performance Coatings Group, sales and tech service reps and you have investments in the Pro Who Paints, we saw those offset by reductions in our G&A costs or admin SG&A so that we're trying to figure out ways to continue to drive G&A down to offset the incremental costs of those investments.

And yes, we will absolutely measure their return, but as we get into 2024, we're going through our budgeting plan. We're going through key initiatives across each of our functional areas and we'll keep driving those costs lower to help pay for the incremental investments. Vincent?

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

Thank you, Vincent.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC
Q

That's all I had. Thank you.

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

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Hi. Thanks very much. I know that the year-over-year price comparisons are less positive than they've been, but when you look at sequential pricing from the second to the third quarter, were your prices down sequentially in any important product area?

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

Yeah. Jeff, if you look at our pricing, because you annualize pricing throughout each of the segments as we've gone, I know we've talked about Performance Coatings Group basically at some points run a 90-day cycle. So price is still up in the quarter, in the third quarter, up low-single digit, but if you look at that compared to our second quarter, price would add at a mid-single digit percentage in the second quarter.

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So – and as you get into our fourth quarter, you'd be at a lower single-digit impact in our fourth quarter. So that's just annualizing the price increases we've taken throughout 2022. But I would argue and say we have not given that price back, and you can see that in our gross margin performance in the second quarter, up 440 basis points, up in the – third quarter, up 490 basis points. And we expect to be up again in our fourth quarter along with the moderating raw material costs sequentially.

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

Jeff, I would add to that as well. I think our effectiveness is at a record high, and I give the team a lot of credit because it's not just about holding it, it's about demonstrating that value every single day with our contractors.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Okay. Great. And your raw materials were down high-single digits. I would imagine they would be down low-double digits in the fourth quarter if you're going to be down high-single digits for the year. And maybe the fourth quarter is sort of the bottoming of raw materials for the industry in general. Is that fair?

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

You know what, Jeff, I don't know I'd go that far. As I mentioned earlier, I think we have to look at – the market is still demand supply driven. We're working with our suppliers to develop what does industry demand look like across each of the regions. And I think that's going to be a bigger driver of raw material pricing as we get into 2024. I think, as we mentioned on our second quarter call, we expected our third quarter to be our biggest year-over-year change in raw material costs. But certainly, they're going to be down in our fourth quarter as well.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Great. Thank you so much.

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

Thanks, Jeff.

Operator: Thank you. Your next question is coming from Greg Melich from Evercore ISI. Your line is live.

Gregory Scott Melich
Analyst, Evercore ISI
Q

Hi. I have a couple questions. One is, how much did the volume decline year-on-year hurt gross margins in the quarter?

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

Yeah. I think, Greg, when you look at the volume decline being overall down low-single digit, it certainly, as I've talked about, it's always typically the biggest driver of operating margin leverage. When you look at how that mix change is in the quarter, so we talked about Paint Stores Group being flat and then the other two segments being

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down more than that, so it was less of an impact than if Paint Stores was down similar, if that makes sense to you. Because Paint Stores Group has a higher gross margin profile.

Gregory Scott Melich
Analyst, Evercore ISI

Q

Yeah. So it may have hurt but not as much as you'd think given the mix of where the volume decline was?

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

A

Correct.

Gregory Scott Melich
Analyst, Evercore ISI

Q

Okay. And then I guess my follow-up question is more specifically on architectural. Could you give us some update on what the backlog that you're hearing about or what it sounds like from the Pros, particularly in resi repaint. You mentioned how new residential is weak, but I'd love to hear more on the new resi – or I'm sorry, the resi repaint side?

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

A

Yeah. Greg, I think on the res repaint side it's similar to what I mentioned earlier. I think you look at traditionally you're going to see somewhere between 13, 15 weeks out. I would say that backlog has come down by two or three weeks, so a bit more limited in terms of the visibility. But outside of that, again, I would look at it in terms of the size of the contractor, the level of experience, and again ability to market themselves. They've got further outsight line into 2024 versus some of the other smaller contractors that are still trying to find ways to kind of build those backlog.

Gregory Scott Melich
Analyst, Evercore ISI

Q

Great. Thanks. And good luck.

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

A

Thanks, Greg.

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

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

Q

Yeah. Thanks, everyone, and good morning. I guess with the reversal higher and interest rates since you last reported, and just sort of building on the last question, how do you think this dynamic will play out for your six verticals within PSG relative to what you saw with the first iteration of interest rate increases because it seems like some of that was just dampened – some of the impact was damped by the fact that the backlogs were actually very strong coming into this year.

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

A

Well, I think I'd describe it this way, that there's some uncertainty given the challenges an interest rate can have on a market. And I think Heidi and the team are really focused on one very clear mission. We're going to outpace the market. And we've got confidence in the approach that we're taking, the services that we bring, the products that we are introducing. And, quite frankly, we're also taking advantage of other opportunities within the market. And we've got competitors that are changing models, as an example.

And our simplified approach of dealing with one Sherwin-Williams store as it relates to the painting contractor, we believe adds value. So the investments that we're making will enhance that on top of the organic growth that we expect from our stores. And so we're taking advantage of market conditions.

Heidi just mentioned some res repaint customers that may not have had experience going through a cycle yet. They are now turning to our people for guidance and support on, how do you begin advertising? In the past, they just parked their truck in front of a car – I'm sorry a truck in front of a house in a neighborhood, and all the neighbors would flock in. They need help right now, and so they're turning to our people. And our people are playing an important role.

And so when we look at what's happening with interest rates, there's some choppiness, but we also believe it creates opportunity. And we've talked openly about adversity creates opportunity at Sherwin-Williams, and we're capitalizing on that.

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

A

The other piece I would add to that. I think new residential, specifically relative to interest rates, while the single-family completions have been flat or negative year-over-year for eight straight months, we are starting to see the starts are positive year-over-year for three straight months. So we're watching interest rates very closely. It may also signal that we're past the bottom.

So knowing that this is a choppy environment, another point that I think is important here, while others are talking, the market are talking about preparing for the slowdown, it's really important that our teams are laser-focused on preparing for taking disproportionate shares. So we went into COVID with a large majority of exclusive arrangements with these national homebuilders, and we've come out building momentum in the number of exclusive contracts that we have with some of these builders. I think that's a testament to the team's ability to demonstrate our value in this environment.

And I'm going to take it a step further here, and this goes back to some of the discussion on working capital. We talk about managing our working capital really closely. But as we're having these partnerships and trying to demonstrate more of Sherwin-Williams's value proposition, especially in the new residential space and in this environment, helping to get in front of, helping them to streamline and standardize what it is that they're doing in terms of the products that they're bringing to market so they can be as aggressive as possible, helping them look at ways to reduce cycle time. And this all in an effort to of course help them drive increased profitability and productivity but also to be as effective as they can be with their working capital, again, in this environment with a lot of volatility in the interest rates.

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

Q

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Got it. And then in terms of free cash flow allocation, I guess going back to the fact that interest rates are much higher, it looks like you have about a little over $2 billion of debt due for refinancing between 2024 and 2025. How are you thinking about the terminal balance sheet leverage for Sherwin-Williams at this point given the change in the interest rate environment?

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

Yeah. Ghansham, I think you remember coming into the year I said I thought we'd keep our total debt flat with year-end 2022. But as you saw at the end of the third quarter, our net debt to EBITDA leverage ratio was 2.2 times versus 3.11 times, and that was a combination of a strong trailing, if you look at 12-month, EBITDA growth of over – a little over 28%. But we also reduced our total debt by almost $600 million. And I would expect as we kind of forecast at end of the year we'd keep that total debt lower year-over-year by about $600 million, and we'll be firmly in that 2 to 2.5 times range.

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

Okay. Thanks so much. And, John and Heidi, best wishes for the future.

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

Thank you.

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

Thank you, Ghansham.

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

Arun Viswanathan
Analyst, RBC Capital Markets LLC
Q

Great. Thanks for taking my question. I guess I just want to – maybe get your thoughts on protective and the other markets within Industrial. What are you seeing, and maybe if you can just run through some of those verticals, apologies if I missed that earlier? But it seemed like wood was usually strong. We were expecting weakness there, but that was actually better. Protective and marine obviously strong. Refinish, I would imagine is still strong. Packaging, weak. Could you just reiterate what you're seeing in those markets? Thanks.

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

Yes. Good morning, Arun. I think, first and foremost, I think it's indicative that our strategy is working. And when we look at this business and this portfolio, it's really important to share with you what we talk about internally which is we're not trying to be all things to all people. And so when you look across these businesses, making sure that the discipline in how we're thinking about investments, the discipline in when we're investing is certainly a key part of this.

So maybe just a little bit across some of these divisions [indiscernible] (00:34:26) jump in as well. You start with – you mentioned Industrial Wood, there's been a lot of wins here against some regional competitors. And while we

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mentioned earlier US housing is continuing to soften, we think this is an opportunity for us just coming out of completing some key acquisitions that we mentioned in our prepared remarks with Oskar Nolte and Klumpp, feel like we're in a really good position here to continue to drive increased value and return of value to our shareholders. Our gallons per day appear to have bottomed out in all regions. [ph] Again with the (00:35:01) new residential swing back, we expect Industrial Wood to absolutely come along for the ride there.

I'll comment briefly on Automotive Refinish. I think importantly we've had some really good share gain here year-to-date. Installs in North America have been up strong double digits and our core users are growing. We talked a bit about our Collision Core technology and business. That momentum and adoption is continuing. And this is a suite of digital tools and solutions that truly is helping to benefit our business here, and I would also add, along with our North America footprint, similar – think of our Paint Stores Group, similar to that footprint. We're really able to have a better opportunity to control a more consistent customer experience beginning to end here with our Auto Refinish which we think is an incredible differentiator for us.

We talked a bit about General Industrial. Heavy equipment market is holding up, especially in Ag and we expect to see that continue. Building products, general finishing is soft, but we've expected that, so the team is laser focused on pivoting and adapting to the market.

In the Coil side, North America is holding up better than the other regions. Still soft, but the teams are working really hard against some new business wins. And then near-shoring in Mexico continues to create demand for us. So we're managing that across the regions very carefully. One comment on Coil as well. I would say that most of the China coaters are running at about 50% capacity, so we expect there to be some forward opportunity there as well.

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

Arun, I think you mentioned on – your question about P&M, I think the team there is doing a terrific job of really staying focused on the value proposition that we bring into high-value projects. So EV battery plants is an example. Semiconductor plants, Heidi and I were just recently out at one of the largest plants I've ever been on, and our floor coatings teams are all over these businesses. I think the offshore wind and other alternative energy investments as well as water infrastructure, I mean, these are all areas that we're focused on.

And I'll remind you it wasn't long ago we were talking about our protective and marine business at a time when it was under pressure. And we reminded our investors that we take this long-term approach. And I believe these are terrific examples of our continuing to invest even when times were a little tough, knowing that these projects can be delayed but they can't be canceled. Oftentimes, you'll find highly corrosive areas that need to be coated. You might get an extra year or year or two out of those, but they need to be coated. And it's those types of high-value projects that are almost kind of a return – repeat businesses as you maintain those that add to the attractiveness of these coatings. So, we're really quite proud of Karl Jorgenrud, the entire leadership team within our PCG business for what they're delivering, and importantly, if you – I'll remind you of the operating margin goals that we have set for this team at 19%. It's come in at 19%. Our goal of getting up into the high-teens, low-20s. So, they're doing it and they're doing it by bringing value to our customers and to us.

Arun Viswanathan Q
Analyst, RBC Capital Markets LLC

Great. Thanks for that. And if I could just ask one follow-up on the M&A side, given what you said in those different verticals, do you see the need to add capacity inorganically [ph] in any of the (00:38:41) areas, and similarly, divest any businesses? Or what would you share on that side? Thanks.

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

Well, we've said certainly in our investor call recently and we say this consistently, but we don't need M&A to grow. There's a lot of confidence in every segment that we have for us to continue to take share organically. And so, from a capacity standpoint, we've continued to be very strategic about where we are laying that capacity in, and I'll go back to Al's point. All of that is by design. As we look at our 10-year CapEx plans, our 10-year demand plans, certainly we don't want to put anything that's net new into the system if it's not needed. But where we need that capacity, we're going to do that.

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

The one point that I do want to add – and I don't know if Heidi mentioned Packaging or not, but that's an area that we continue to invest. Not so much needed through acquisition or M&A, Arun. It's more through our investment of very unique technology. So, the Packaging business, particularly our V70 product is a very unique technology. And as quickly as we can bring capacity onboard, it's sold out. So, I think that's an area that we will continue to invest in.

Arun Viswanathan
Analyst, RBC Capital Markets LLC
Q

Great. Thanks.

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

You bet.

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. On your gross margins, they were near your long-term target in the quarter, and it sounds like they'll be above that target in Q4. So, given that, how high can it go this cycle? Could they approach or even exceed 50%?

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

David, one caveat to that that I would make. When you look at our fourth quarter gross margin, because you typically see a seasonal architectural slowdown in volumes and sales, the fourth quarter margin may or may not be sequentially improving. It's our smallest quarter. You have year-end adjustments and other year-end adjustments that could have a material impact on the gross margin. Also, I'll just reiterate that price increases aren't going to be as big of a tailwind in our fourth quarter than – as what we saw in our third quarter. And the other side of that, Paint Stores Group is going to grow faster in our fourth quarter. That will help drive gross margin. As we talked about at our Investor Day, look, we are at a current range of 45% to 48%. We set aggressive goals for our teams, and as we consistently achieve that current range, we'll adjust the range. I don't think we're ready to sit here today and make a change to any range or talk about 2024 at this point. But we're going to be consistent in our approach going forward.

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

A

And David, I would just add very simply, there is no ceiling.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Very good. And Heidi and John, just looking at past DIY cycle weaknesses, what does it take or what do you need to see, you think, to see a reversal occur in DIY cycle weakness here?

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

A

Well, clearly, the consumer is feeling some pressure from an inflation perspective, and there'll be some normalization. If it's in wages increases – wage increasing or the spending patterns of consumers, that will take effect. But the fact is this that – I'll remind you that paint is a relatively inexpensive, yet highly impactful opportunity for people that are interested in their homes – staying in their homes to make a difference. And if people decide they're not going to sell the home, they're going stay in place, it's a very viable option.

I'll remind you the average home age now is over 40 years old. So, there's more and more investment in the structures. People aging in place is impacting as well. And additionally, I would say not only does it help the DIY, but as the population is aging, that generally will turn into more of a Res Repaint opportunity, which helps our position in that space as well. We don't want 70-year-old people out there scraping their gutters and eaves of their homes. But inside, yeah, DIY is going to be an important part. There's a cycle, and we're playing the long game here. Whichever way the table tilts, we'll be there.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Very good. Thank you very much.

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

A

You bet.

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. Thanks for taking my question. I guess two [indiscernible] (00:43:43) around the Stores Group. I guess first, when I look at US completion data for New Res, it looked like that was kind of flat. You guys reported down mid single-digits. I assume you get some pricing. I don't know if that's a regional divergence or something else you'd call out. Maybe I'll start with that one first.

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

A

Well, I think what you're experiencing right now is the delay between housing starts and the nine – whatever, 90 days or so after – maybe a little bit longer – after a start before homes are painted. So, our view – and Heidi

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mentioned this. When you look at – and I think where your question is going is around the share – our share of New Residential. Our position here is very strong and getting stronger every day. Heidi mentioned the exclusive arrangements that continue to grow in count. Our relationship with the New Residential builder and our commitment to helping their profitability and success is helping us grow those customers.

It's delayed right now, because the more agreements that we are signing right now and with the pressure on starts, we're not seeing that. But I can tell you with great confidence that as the new homes continue to rise, and they will, I think everyone would agree there is a higher demand than there is supply right now. Family formation continues. There's a hole right now that exists in housing availability. When that comes back, we're going to be the coil spring that we've been in the past, and it's exciting actually to see our teams winning at the rate that they're winning. And it will show up on the scoreboard.

Joshua Spector
Analyst, UBS Securities LLC

Q

Okay. Thanks, and I appreciate that. I just – on the other side of it, when you think about the Resi Repaint side, not just Sherwin but maybe the industry, so I mean, we still have turnover down about a third from the peak a couple of years ago. Has the industry fully digested that? So, if contractor backlogs reflect that, have orders reflected that? And just, I mean, how are you thinking that plays out into next year? Is there another leg-down in the industry to normalize to that if we don't have a step-up or have we already reflected that in the current run rate?

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

A

Yeah. I think it's been reflected. If you take a few quarters back here, we were talking about Res Repaint contractors that in many cases weren't even returning phone calls. I mean, they were – many people were saying that they'd come out and give you a quote in six to nine months, and then it'd be about a year before they could get to the project. So, there has been a more normalized reality, if you will, as it relates to the Residential Repaint contractor. Again, I'll reiterate that this adversity creates opportunity for Sherwin-Williams. You should bet right now as we are here in this moment that our customers are getting visited with Sherwin-Williams representatives. You should also bet that our competitors' customers are getting visited as well. So, we're not playing nice here. We're going after some pretty aggressive market share gains, and we expect to win aggressively.

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

A

And I would add to that too, Josh. I think there's a lot of confusion in the marketplace right now, and our opportunity – John mentioned adversity is our friend, and I couldn't agree more with that. Our strategy is working here, and I'll take you to – we talk about controlled distribution platform. We own the stores. We own the reps. The store manager owns that P&L. The store manager owns staffing, owns the culture of that store. And I think it's really important, because when we talk about that relationship and the consistent experience we can offer these Res Repaint contractors, it's critical that they know exactly what they can get from the experience they can have at Sherwin-Williams. And so, as they're coming in, as they're traveling, as they're trying to grow and take on more, our teams are prepared, trained and ready to get any tools that they need in front of them to help them to become as productive and profitable as possible. So, I'm really confident in how we are prepared to differentiate as we add value to this contractor.

Joshua Spector
Analyst, UBS Securities LLC

Q

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Got it. Thank you, both.

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

Thank you, Josh.

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

Michael J. Harrison
Analyst, Seaport Research Partners
Q

Hi. Good morning. You have opened 36 new paint store locations so far this year. Is the target still 80 to 100? And are you seeing any delays in either the permitting process or the construction process?

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

Mike, yes, we expect to build [ph] as we said it (00:48:39), and no, we do not expect any delays. I think this is really important. When we look at our commitment to the teams, to the Street, we're opening a new store every three days. And there's puts and takes in terms of timing. You can imagine, our strategy is reflecting our desire to chase the density and the volume. In some of those markets, there's unique nuisances where we're timing getting into a certain market in a certain area. But our commitment to getting to those stores is critical because we still continue to see a return on those stores at a rapid clip, and we think there's a lot of opportunities to chase future density there.

Michael J. Harrison
Analyst, Seaport Research Partners
Q

All right. And then, within the Consumer business, one of your competitors suggested that sell-in to the big box retailers had been weaker than sell-out. It suggests that maybe there's been some inventory work done this year. Do you have any thoughts on how point-of-sale with some of your key customers has compared to your volumes into those customers, and I guess whether big box inventories at this point in the year are below where you would expect them to be? Thank you.

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

Well, first of all, we wouldn't comment on anything specific to our customers. So – but what I can share with you is our approach that we're taking [ph] as the partner (00:49:56). And again, we do talk openly about making sure that success is our customers' success. So, when we're looking at making sure that they're at the right inventory levels, helping them thinking through how to manage to optimize their working capital, you can rest assured that those conversations are happening on daily basis. So, we'll let them speak to their specific strategy here.

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

Yeah. And I think that's really important. I like the way that Heidi framed that, that we gauge our success by how successful our customers are. And so, we're actually working with our customers, encouraging them to manage their working capital, so that they can put their cash to work and be more successful. And Al, maybe you want to

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talk a little bit about what the impact of that might be, because we're trying to drive reasonable or acceptable working capital not only for us, but for our customers.

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

Yeah. I'd start with, Mike, that as we typically do, when we saw our inventory gallons decrease sequentially as we – we're getting back to a more typical bell curve. We grow inventory into the summer selling season. We see incremental decreases as we go through the second half, and then we'll build inventory in our fourth quarter. That consistency allows our customers to also manage their inventories better because you're back to a more normal environment.

To that point, I would say we expect our working capital trend towards our 11% to 11.5%. We were at 12% coming out of the third quarter. So, we're well on track for that. And what it's allowing us to do is drive significant cash flow, and you saw that in our third quarter. And that's a combination of strong net income results and working capital management, and we expect to flow that through into our fourth quarter and have a really strong cash here that's allowed us to be very flexible.

Ghansham talked about our ability to pay down debt. But it also allowed us to return cash to our shareholders in dividends and buybacks, and we've returned over $1.4 billion to our shareholders over that time. So, in this high interest rate environment, we get back to our more normal operating cadence with inventory, and you'll see us manage our working capital down, which then allows that consistency to allow our customers to manage their working capital down.

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

And one piece I would add to that as well. I'd like to go back to Al's point here, we put, by design, very intentional capacity to work here, so that as we're partnering closely to manage and optimize working capital and inventory with our partners that we've got the confidence that we have the capacity to build the inventory in time for the season ahead.

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

Thanks, Mike.

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

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. Good morning. John, you've often talked about things like sprayers being a good leading indicator of what you're seeing in your stores with like a one to two-quarter lag. What is that equipment sale telling you today about what the next couple of quarters holds for the store sales?

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

Well, Duffy, I'd say that what it's telling me now is, is that we're ending a season. So, I'd say while we talk about that, typically the greatest correlation between those types of sales and confidence is usually as we go into the

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season. As we're coming out the season, we are continuing to see spray parts right now move. And I'd say right now, as we've talked, there's a choppiness in the market, but we have confidence in our position in the market. And we'll see how this unfolds next year as we go into the paint season. Coming out of it though, it's typically not the best tool to use to gain a level of confidence with contractors.

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

But what we are seeing there too, despite the sprayers, is the backlog of projects for our Commercial contractors continues to be solid well through midpoint of next year, so getting back to more of that normal cycle. So, good indicator of some growth there.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Fair. And then, Heidi, I think you made a comment that your gallons per day had bottomed in your view. And I didn't understand. Was that for the company as a whole or was that for the Paint Stores Group, and that's even inclusive of kind of the seasonal weakness that we generally see in Q4?

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

That was just in wood.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Oh, that was just in wood. Okay. Thank you.

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

Yeah, yeah. Yes, you bet.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC
Q

Thank you, guys.

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

Thanks, Duffy.

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

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC
Q

Yes. Good morning. I was wondering if you could comment on your administrative costs. It looks like they jumped up a bit in the third quarter. And in reading the commentary, you called out two items, namely environmental

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expense and asset disposals. So, a few questions would be, what are the nature and magnitude of those items? And would you expect that line item to come back down in the fourth quarter and beyond?

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

Yeah. Kevin, the year-over-year increase, I would say environmental, a little less than half of that increase year-over-year, and then costs related to our Garland plant fire is a little less than half. And we also are going up against the sale which benefited our gain on sale of – gain on sale of assets last year that benefited our third quarter last year. I would say, I'm glad you asked that question, because I think I want to give a little color around our fourth quarter guidance. Even though we don't give EPS guidance, it's implied and it's backwards. But I think a better way to look at that is our guidance at the operating margin line, and we're expecting our fourth quarter operating margin to be flattish at the midpoint year-over-year compared to a strong fourth quarter last year, with operating profit up over 60% and our operating margin was up 450 basis points.

So, we're not – we are expecting gross margin expansion in our fourth quarter, not as much as we saw in our third quarter. We see raw material moderation. We're not going to get as big of a price tailwind that we got in our third quarter, and I do expect higher SG&A year-over-year because of the long-term investment. So, then that gets us to these non-operating costs, and we have approximately a $60 million increase in our non-operating costs that'll be predominantly in our admin segment, and it's due to the credits that we realized last year in environmental and other income in the fourth quarter that we don't expect to repeat, and really good environmental and these other expense lines to a more normal level.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC
Q

Okay. Thank you for that, Al. And then, as the second question, if your raw material costs were to trend flat from here, would it be reasonable to estimate that you could see relief in 2024 perhaps in the negative low single to mid single-digit percentage range? Or how would you frame that outlook for next year as it relates to raw material costs specifically?

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

Yeah. Kevin, I think with the current environment and the volatility we're seeing both in oil and the choppy demand environment – I know, historically, we've given run rates – a preliminary run rate on raw material. I think it's probably a little too soon for that in the sense that we also have to take a look at the other cost factors in the total input costs. I talked about the merit increases getting back to more normal levels. But healthcare is growing significantly. We have freight costs and there's some things going on, on the LTL freight side of the market that are driving our overall costs up. So, I think it's a little premature to give that level of guidance. I'd rather wait till we get more line of sight – or a better line of sight and give you an update in January.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC
Q

Okay, fair enough. Thank you.

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

Thanks, Kevin.

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

Aleksey Yefremov
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks and good morning. Al, I wanted to follow up on your comments regarding fourth quarter EPS. I guess, historically, it's hard to find a Q4 where sequentially EPS fell by more than $1. You're looking at somewhere around $1.50, $1.55 based on your guidance. Is there anything else going on sequentially beside the year-over-year things that you just pointed out?

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

A

No, I think that's going to be – the bigger driver sequentially you have is the decrease in sales on the seasonality of that. I think what's hard, Aleksey, is you look at our last four years, it has been choppy – really choppy quarter to quarter, including third quarter to fourth quarter. So, I think you got to go back pretty far to find a more normal year. I think the – like I said, the gross margin, I do expect to be higher year-over-year, but sequentially lower because of the tailwind in price. I think SG&A growth is probably higher in this year's fourth quarter sequentially than it has in past years because of the things Heidi talk about, about leaning in harder on investments in our Paint Stores and long-term growth initiatives within PCG and CBG. So, that probably is driving some of it. And it is our smallest quarter. So, some of these year-end adjustments have a bigger impact on our fourth quarter than they would on our third quarter.

Aleksey Yefremov
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks. And then, a quick follow-up on your stores. Of course, you have a large competitor who is shifting strategy. But besides that, are there any players who are either slowing investment or outright closing stores kind of in response to you gaining share?

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

A

So, I'll take that, and it's a great question. I think you're spot on. And I would say that there is, to go back to my comment earlier, great amount of confusion in the marketplace. And this is an opportunity where our consistent strategy, I think, is on full display. And I have a lot of confidence of Justin Binns and his organization and the depth of leadership that we have there. This team is well-prepared to not only execute our strategy, but to adapt to market conditions around it, and I think we've got a competitive advantage in doing that.

And I suppose if we didn't own 5,000 stores and 4,000 reps and have strong customer relationships and data that can help our customers be more successful, I think we too might try to stitch together a strategy that helps to get products placed on the shelf. But this is really an opportunity for us to do what we do well and to demonstrate to our customers a very consistent experience with Sherwin-Williams. We're working with them closely to help fight through a lot of the complexity out there and make sure that they're coming out winning. So, I do think where we're seeing competitors make different choices on store closings or channels, we think, again, this uncertainty is our opportunity.

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

A

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Thanks, Aleksey.

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. Thanks. Within pro architectural, you called out strength in Commercial. I'm just wondering what drove that. It sounds a little contrary to some of the Commercial data points that emerged over the course of the quarter. So, just curious as to the outperformance there.

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

A

Well, I think the way to characterize that would be more back to a normal cycle where you're seeing kind of strong backlog front half, and then it would obviously kind of look to soften a bit in the back half. So, I would characterize it more as a normal cycle. But I do think that this is an opportunity. We talk about the [ph] strength and (01:03:02) position in Commercial for us is amongst the highest of our segments. So, we're going to be hard at work focusing on share gains, making the right decisions, making the right investments. And our people and our resources are aligned and ready to help these customers to respond through the duration of these projects. I think regardless of the demand outlook, we will take share in this environment, and part of our differentiation is we are, with these contractors, at every step of these projects. And so, as they're navigating uncertainty and/or changes that come up in every single project, our team is right there side by side to make sure that they're getting those completed on time.

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

A

Yeah. I think if you look at the Commercial piece, that's where we have the longest visibility and the longest lead time. So, we feel pretty comfortable about what we're seeing in terms of completions into first half of 2024, as Heidi said. I think you might be referencing things like the Architectural Billing Index, which are choppier now. That's why we're saying the back half of 2024, we might start to see a little softness, but feel very comfortable, again, about our ability – if that was to occur, our ability to fill those gaps with perhaps New Res is starting to come back. We'll put our foot on the gas with Res Repaint, Property Maintenance, et cetera.

Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Great. That's helpful. I wanted to follow up on Consumer Brands, just the sequential weakness in margins third quarter versus second quarter. Was it really just the decline in volumes quarter-over-quarter or is there something else that drove the change in the margins?

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

A

No, Garik, it's primarily – well, it's primarily two things. But it's the sequential decline in volume. But also, as we have talked about – and I mentioned on our working capital, we're targeting a year-end inventory level, so that when we come out into 2024, our inventory is in great shape, which means we tweak our production volumes to make sure we stay in line with that targeted inventory level. So, with production gallons being down sequentially a low single-digit number, that does have a – is a headwind for us in this segment.

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Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Understood. Thanks for the help and best of luck.

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

A

Thanks, Garik.

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

Adam Baumgarten
Analyst, Zelman & Associates

Q

Hey, everyone. Just one for me. Just thinking about Europe, it seems like it was a bit better year-over-year across multiple segments. Just curious if that's just comps or maybe you're seeing some kind of bottoming or even improvement in demand on the ground there.

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

A

Well, I'll start, and I'm sure Al will jump in here. I'll go back to, especially on the PCG side, we're not trying to be all things to all people. I think that's a really important point. And we are laser-focused on driving increased operating margins to your point. We're proud of the work that the team has done in delivering a 19% margin in Q3. We'll get some benefit from recent acquisitions. But I'll point to four of our six businesses are up against very strong comps last year, and the team is doing all the right things to ensure that we are taking a very disciplined approach to decision-making, investment pacing, et cetera, as we're watching the market closely and making sure that our investments are pacing with the demand in the market.

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

A

I think four of the six, to your point, had some strong comps. But four of the six had double-digit sales gains in Europe in Q3. And I think putting a bow on what Heidi just said, we're doing that the right way. We're focused on the right segments where we can bring value and that our customers appreciate that value and are willing to pay for it. We're not in this for practice. And so, we're growing and bringing value to our customers. And we're open about the fact that while we bring value to them, our shareholders need to be rewarded as well. That's why we work as hard as we do. So, it's good performance in Europe and it's driving both the sales and bottom line as a result.

Adam Baumgarten
Analyst, Zelman & Associates

Q

Thank you. Good luck.

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

A

Thanks, Adam.

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

A

Thank you.

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

Stephen Byrne
Analyst, BofA Securities, Inc.

Q

Yes. Thank you.

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

A

Hey, Steve.

Stephen Byrne
Analyst, BofA Securities, Inc.

Q

Yes. Thank you. What fraction of your Resi Repaint volumes would you say the Sherwin-Williams paint was selected by the contractor versus selected by the homeowner? And clearly, you've highlighted a multi-pronged approach going after that contractor for loyalty. What would you say you can perhaps do more of to drive loyalty with the homeowner selecting Sherwin that could help you also drive share gains?

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

A

Yeah. Steve, we focus on the Residential Repaint contractor as the applicator, and that's a very big influencer in the decision tree. Other decision influencers would include color specification, which we've been working very hard at, and the homeowner. But typically, what we see is that the homeowner turns to the professional contractor as the expert, and while in some markets with some homeowners, they don't have a specific brand in mind. But the hard work that our teams do on a daily basis in building relationships with that Residential Repaint contractor is the largest driver. And it's exactly why we believe we'll continue to grow share at an outpaced rate going forward. I'll finish with this that we've had terrific success with the Residential Repaint contractor. We've had seven years of double-digit growth. We're just getting started here, and there's a long opportunity and a big opportunity. And that's why we believe investing in Sherwin-Williams is the right approach.

Stephen Byrne
Analyst, BofA Securities, Inc.

Q

And how would you rank the Resi Repaint end market in Paint Stores as an opportunity to gain share as compared to new Commercial, property management and new home construction? How would you rank those in terms of potential share gains?

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

A

We don't. They're all opportunities for us, Steve. And the teams that are focused on Residential Repaint have the greatest opportunity. Then, when you get to the property management...

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Stephen Byrne
Analyst, BofA Securities, Inc.

Q

[indiscernible] (01:09:57).

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

A

When you get to the property management, they have the greatest opportunity. Then, when you get to the Commercial, they have. We need to deliver on each of those segments, as that's how we feed our families. Each one of them offer terrific opportunities. So, when you look at share gains, we've talked openly about Residential Repaint offering the greatest amount of share opportunity, and our position in these other segments are a little bit stronger, but there's terrific opportunities there. But our approach – I want to be very clear. If we were boxers and we're in the center of the ring, we're not looking for – to get to the end of the bout and stand up waiting for our hands to be raised. We went a decisive knockout as it relates to these segments. And so, we're pursuing aggressively each one of these. So, I'm not going to parse out which offers great opportunities. They all do, and we're very determined to get after them.

Stephen Byrne
Analyst, BofA Securities, Inc.

Q

Okay. Thank you.

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, Steve.

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

Good morning. In terms of the investments in 2023 to grow share, I'm curious what the current thinking is about 2024? And I guess specifically, I'm trying to figure out do you sustain incremental investments or does SG&A growth go back to normal trend or perhaps below normal trend? How do you think about that?

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

A

Yeah. Eric, here's how we think about it. And as you know, we manage operating margin, not specific SG&A. And as [ph] last year (01:11:37) showed, our volumes held up better than what we had planned coming into the year. Our gross margin performance and gross margin expansion was a little bit better than what we had coming into this year. So, it allowed us the opportunity to lean in and put more investments in than we normally would. We are certainly going to have growth in investments next year, I would say, back to a more normal level. And then, as

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we see the year unfold with volumes and gross margin and what we see happening going into 2025, that'll dictate how much more investments we put into each of those segments.

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

Eric, I would add to that. I think going hand in hand, you asked the question about SG&A, and we talk a lot about managing operating margin. I think just talking about how we're thinking about the different approach to working capital is an important element here, that a very intentional focus on end-to-end supply chain, but also a broad simplification effort that goes across every business unit to make sure we're as tight as possible. And we talk about our value proposition goes far beyond what's in the can, and we're looking at this through the lens of our customers. And our value proposition can't include idle assets or excessive working capital, as our customers just simply aren't willing to pay for that. So, I think it's obviously always going to be room for improvement here. But as we're looking to manage that closely, [indiscernible] (01:13:05) relative to SG&A and working capital to drive those operating margins.

Eric Bosshard
Analyst, Cleveland Research Co. LLC
Q

Helpful. And then, Al, if I could follow up, in terms of managing to operating margin, is it fair to say, as you solve for 2024, you're managing these different levers for some degree of operating margin expansion? Again, I'm not asking you to comment on 2024. I'm just curious how that thinking can play out.

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

Absolutely, Eric. I think just color around 2024, I mean, we believe the macro environment is still going to be difficult. We're going to see choppy performance on different parts of our business, different segments, different regions, but we absolutely believe that we're going to drive operating margin growth through whatever environment that we see unfold in 2024.

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

We'll outperform the market.

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

That's right.

Eric Bosshard
Analyst, Cleveland Research Co. LLC
Q

Thank you.

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

Thanks, Eric.

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

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Abigail J. Eberts
Analyst, Wells Fargo Securities LLC

Q

Hi, there. This is Abigail on for Mike. I just wanted to press further into the raw material basket. Can you speak to which materials you've seen the most inflation in and where prices might be holding out more?

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

A

Yeah. Abigail, happy to do that. So, as we said, the third quarter was likely the biggest benefit for us from a year-over-year perspective. I would say, as we've commented, the petrochemical side of the basket is where we've seen some relief. TiO2 have been a little bit stickier. But I think Al said it well earlier. As you think about going forward, oil is moving around, and while it hasn't necessarily made its way into those commodities yet, I think it's to be determined of where that heads into next year. So, right now, it's, again, petrochemical side has been probably the greatest relief. TiO2, a little bit stickier. We feel very good about our ability to hold on to the pricing that we've put into the marketplace given the solutions we're providing our customers, and we'll have a better update on where it goes as we get into January.

Abigail J. Eberts
Analyst, Wells Fargo Securities LLC

Q

Okay. Thanks. And then, a quick question about your Packaging destocking that you were referencing. Is that still persistent or has that started to tail off a little bit?

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

A

Well, it's a – I would say that it's similar to what we talked about before. We won't get into very specific details here. But I think it's really important that we're in lock step with the demand environment, making sure that – John mentioned this earlier that as our customers are working through some choppiness right now, that we've got capacity continuing to come online through our Tournus, France site. And as soon as we have that capacity, we're confident not just in our ability to have the capacity to satisfy that demand, but what's behind that are the technology that the market is looking for. So, we're very confident that we're going to have that online here shortly.

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

A

I think there is some destocking. Our customers have spoken about some areas of excessive inventory that they're driving down. And to Heidi's point, as our additional capacity comes back online, we get through the repairs down in Garland, we're going to take this wonderful technology and bring solutions to our customers that allow them to run their plants more efficiently.

Abigail J. Eberts
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you.

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

A

Thank you.

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

A

You bet.

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

Q

Hi. This is [ph] Eric (01:16:52) on for Patrick. Given the DIY consumer is under pressure, have you seen any relative share gains or losses within PSG or CBG? Thank you.

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

A

Well, we're clearly seeing improvement and share gain in our PSG, our Stores business. Heidi mentioned the comparisons to last year in the quarter were all very strong, nearly 20% comparisons, and we've continued to perform very well even against that backdrop. The investments that we're making are easy to point to as key drivers for future share. But I'd drive you back to the core business that we have and the expectations we have for organic growth. Heidi mentioned [ph] quickly in (01:17:41) one of the M&A questions about that we don't need acquisitions. And in Stores, when you look at our business, you could arguably say that this core business in itself is going to be a fantastic show to watch, and it will be. But our expectations are to accelerate growth even faster. So, the investments that we're making will allow us to capture that even quicker.

As it relates to our Consumer business, we've got wonderful partners. We're committed to their growth. Heidi mentioned things like capacity and helping them to drive down their inventory with the reassurance that we have the ability to respond to them. So, from the backside, we're clearly trying to help position them financially. But more importantly, we're introducing new products, we're bringing innovation, we're adding people in our team – on our team to help train their team members. And we do believe there's a continued opportunity to convert people that might be in our customers' stores as shoppers, we can help turn them into buyers of products in our category. So, we're excited. This is a type of market that most don't hope for, I would say, arguably. We don't hope for this type of market, but we know what to do and we're going to turn it into an advantage to our shareholders.

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

A

Thanks, [ph] Patrick (01:19:07).

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

A

[indiscernible] (01:19:09).

Operator: Thank you. Your next question is coming from Aron Ceccarelli from Berenberg. Your line is live.

Aron Ceccarelli
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Hello. Thank you for taking my question and congratulations on the results. I have one on product simplification. You have been doing quite a lot of simplification inside and outside the can, reducing formulation and also right-

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sizing the number of SKUs. Maybe can you help me understand a little bit better where are we in this process and if you can quantify what have been done and where can we go from here? Thank you.

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

Yeah. Aron, I would say we're early innings. Really confident that there's an aggressive roadmap ahead here. And the way I would characterize this is – thinking through this is truly an end-to-end effort across the enterprise. So, you mentioned, whether it's SKU rationalization, formula rationalization, but really starting with raw materials and understanding the basket all the way through to what it is that we're sending out to our customers. But I think an important point here is it's a mindset that we have adopted going forward.

And so, it's part of how we – John mentioned innovation is part of new product development process. I mean, we're going to make sure that we're always looking at opportunities to take complexity out of the business. And I'd take it a step further. If you look at our Performance Coatings Group, we still have a lot of opportunity as we think about even rationalization of footprint. So, the team's hard at work. This isn't going to be something that we land in the next 12 or 24 months. It's something we're going to be constantly looking at going forward.

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

And I think Heidi's strength here is – and she's a humble person and she won't say this. But I will say this, having a front row to this show. We've got a leader that is driving the opportunity to the bottom line. She's got a very respectful approach to our traditions and to our norms. We're a 157-year-old company. There's a lot of things that we do and have done, and many of them are right. And we've got an opportunity, I think, to take a look at those traditions and norms and ask if there's a better way to do that.

And this simplification effort is a great example of that. I think our company's going to come out much stronger, much more efficient, better responsiveness to our customers and an opportunity to pursue business in new ways. We didn't really get into our digital approach and the approach that Heidi's leading there to our teams to better use the data that we have available in ways that we just haven't in the past. We've scratched around the surface. But there are some terrific opportunities that she's leading that I think will further differentiate Sherwin-Williams.

Aron Ceccarelli
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)
Q

Thank you. And I have a follow up on PSG. You touch earlier on, on the Commercial vertical. Maybe can you provide some color on property management, because also this vertical has been incredibly strong this year, and again, Q3 very strong against very tough comps? So, I would like to understand how you think about the momentum when it comes to volume growth going into next year, please.

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

Yeah. The underlying demand is solid. I think we've seen some delayed CapEx and a lot of deferred maintenance that is now being addressed, and we'll continue to see that coming into next year. I would say, relative to apartment turns, they're improving. It's a bit influenced by the return to travel, office, school, driving some of that demand. But much like our momentum in New Residential, we're demonstrating our unique ability here to really serve this property management segment with a consistent experience that I believe only Sherwin-Williams can deliver. And regardless of the size or the location of these contractors, our goal is consistently the same. It's we went to make it as convenient as possible to leverage our stores, our reps, and our segment-specific tools and

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solutions here. So, we're taking share. We're increasing our number of sole-preferred or exclusive contracts, if you will, and we're confident that we're going to continue with our foot on the gas going forward.

Aron Ceccarelli

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you. All the best.

John G. Morikis

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

A

Thank you, Aron.

Operator: Thank you. That concludes our Q&A session. I will now hand the conference back to President and Chief Operating Officer, Heidi Petz, for closing remarks. Please go ahead.

Heidi G. Petz

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

Great. Thank you. So, I expect to close out this year with momentum. I think you've heard that loud and clear here. We believe that we're growing share, and we are – our humility takes us to the point where we say and we recognize that there is no finish line. So, we're determined to move forward here. Going forward, as we look at 2024, here's what I can tell you. I have a clear line of reality. There is going to be some choppiness that we talked about ahead, but we have seen this movie before. And my confidence is in this team, our ability to execute on our strategy that we know is working, our confidence that our key investments that we know will deliver shareholder value. And those combined together is what gives me confidence that we're going to outperform the market. And with any additional questions, please feel free to reach out to Jim and Eric. And we'll conclude with just looking forward to talking with all of you in January about our outlook and our plans, and have a wonderful holiday.

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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