SHERWIN WILLIAMS CO
Form 10-Q
April 24, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the Period Ended March 31, 2009

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the transition period from __________ to __________

Commission file number 1-04851
THE SHERWIN-WILLIAMS COMPANY

(Exact name of registrant as specified in its charter)

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

(216) 566-2000

(Registrant s telephone number including area code)

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

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

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

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

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

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

Common Stock, $1.00 Par Value 117,092,100 shares as of March 31, 2009.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME (UNAUDITED)
Thousands of dollars, except per share data

	Three months ended March 31,	
	2009	2008
Net sales	**$ 1,550,677**	$ 1,781,682
Cost of goods sold	**870,071**	1,001,174
Gross profit	**680,606**	780,508
Percent to net sales	***43.9%***	*43.8%*
Selling, general and administrative expenses	**608,848**	651,707
Percent to net sales	***39.3%***	*36.6%*
Other general expense net	**10,405**	115
Interest expense	**12,202**	17,673
Interest and net investment income	**(636)**	(516)
Other income net	**(1,106)**	(1,500)
Income before income taxes	**50,893**	113,029
Income taxes	**13,614**	35,083
Net income	**$ 37,279**	$ 77,946
Net income per common share:		
Basic	**$ 0.32**	$ 0.65
Diluted	**$ 0.32**	$ 0.64
Average shares outstanding basic	**115,946,629**	119,498,294
Average shares and equivalents outstanding diluted	**118,029,772**	122,096,866

See notes to condensed consolidated financial statements.

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

	March 31, 2009	December 31, 2008	March 31, 2008
Assets			
Current assets:			
Cash and cash equivalents	**$ 42,245**	$ 26,212	$ 20,125
Accounts receivable, less allowance	**785,640**	769,985	931,448
Inventories:			
Finished goods	**734,168**	749,405	827,188
Work in process and raw materials	**104,648**	114,795	126,277
	838,816	864,200	953,465
Deferred income taxes	**97,676**	97,568	104,704
Other current assets	**143,312**	151,240	184,900
Total current assets	**1,907,689**	1,909,205	2,194,642
Goodwill	**1,009,069**	1,006,712	1,002,066
Intangible assets	**299,629**	299,963	352,414
Deferred pension assets	**214,816**	215,637	405,132
Other assets	**132,684**	124,117	148,806
Property, plant and equipment:			
Land	**85,383**	85,485	83,535
Buildings	**585,175**	580,216	568,621
Machinery and equipment	**1,521,639**	1,564,221	1,548,831
Construction in progress	**21,743**	26,560	74,181
	2,213,940	2,256,482	2,275,168
Less allowances for depreciation	**1,365,471**	1,396,357	1,367,391
	848,469	860,125	907,777
Total Assets	**$ 4,412,356**	$ 4,415,759	$ 5,010,837
Liabilities and Shareholders Equity			
Current liabilities:			
Short-term borrowings	**$ 765,130**	$ 516,438	$ 1,039,306
Accounts payable	**629,965**	738,093	781,370
Compensation and taxes withheld	**127,151**	194,787	140,562
Accrued taxes	**51,436**	58,510	88,333
Current portion of long-term debt	**14,988**	13,570	15,350
Other accruals	**373,482**	415,338	399,026
Total current liabilities	**1,962,152**	1,936,736	2,463,947

Long-term debt	**297,754**	303,727	293,499
Postretirement benefits other than pensions	**249,384**	248,603	263,427
Other long-term liabilities	**321,107**	321,045	370,352
Shareholders equity:			
Common stock $1.00 par value: 117,092,100, 117,035,117 and 119,096,798 shares outstanding at March 31, 2009, December 31, 2008 and March 31, 2008, respectively	**227,793**	227,147	226,054
Preferred stock convertible, no par value: 216,753, 216,753, and 257,048 shares outstanding at March 31, 2009, December 31, 2008 and March 31, 2008, respectively	**216,753**	216,753	257,048
Unearned ESOP compensation	**(216,753)**	(216,753)	(257,048)
Other capital	**1,026,439**	1,016,362	913,236
Retained earnings	**4,241,586**	4,245,141	3,969,284
Treasury stock, at cost	**(3,499,045)**	(3,472,384)	(3,299,537)
Cumulative other comprehensive loss	**(414,814)**	(410,618)	(189,425)
Total shareholders equity	**1,581,959**	1,605,648	1,619,612
Total Liabilities and Shareholders Equity	**$ 4,412,356**	$ 4,415,759	$ 5,010,837

See notes to condendsed consolidated financial statements.

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

	Three months ended March 31,	
	2009	2008
OPERATING ACTIVITIES		
Net income	**$ 37,279**	$ 77,946
Adjustments to reconcile net income to net operating cash:		
Depreciation	**35,883**	35,823
Amortization of intangibles and other assets	**6,228**	5,310
Stock-based compensation expense	**2,352**	9,205
Provisions for qualified exit costs	**6,384**	
Provisions for environmental-related matters	**6,201**	
Defined benefit pension plans net cost (credit)	**9,004**	(1,989)
Net increase in postretirement liability	**700**	530
Other	**4,002**	2,622
Change in working capital accounts net	**(208,088)**	(176,599)
Costs incurred for environmental-related matters	**(6,634)**	(2,364)
Costs incurred for qualified exit costs	**(2,345)**	(1,059)
Other	**(3,234)**	(9,955)
Net operating cash	**(112,268)**	(60,530)
INVESTING ACTIVITIES		
Capital expenditures	**(22,436)**	(39,824)
Acquisitions of businesses, net of cash acquired	**(13,018)**	(15,373)
Proceeds from sale of assets	**274**	87
Increase in other investments	**(15,422)**	(4,740)
Net investing cash	**(50,602)**	(59,850)
FINANCING ACTIVITIES		
Net increase in short-term borrowings	**249,587**	380,597
Net decrease in long-term debt	**(6,624)**	(113)
Payments of cash dividends	**(41,643)**	(42,038)
Proceeds from stock options exercised	**6,907**	5,686
Income tax effect of stock-based compensation exercises and vesting	**1,407**	1,166
Treasury stock purchased	**(22,310)**	(220,114)
Other	**(4,275)**	(5,019)
Net financing cash	**183,049**	120,165
Effect of exchange rate changes on cash	**(4,146)**	(6,985)

Net increase (decrease) in cash and cash equivalents		**16,033**		(7,200)
Cash and cash equivalents at beginning of year		**26,212**		27,325
Cash and cash equivalents at end of period	**$**	**42,245**	$	20,125
Income taxes paid	**$**	**12,661**	$	9,409
Interest paid		**71,875**		22,289

See notes to condensed consolidated financial statements.

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THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Periods ended March 31, 2009 and 2008

Note A BASIS OF PRESENTATION

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

There have been no significant changes in critical accounting policies since December 31, 2008. Accounting estimates were revised as necessary during the quarter based on new information and changes in facts and circumstances. A change in the estimate of the number of restricted stock awards that will vest based on the Company s performance against specified financial goals decreased first quarter stock-based compensation expense by $6.2 million, resulting in increased net income of $4.5 million and increased basic and diluted earnings per share of $.04. The estimate of awards that will vest will continue to be reviewed and adjusted as necessary.

The Company uses the last-in, first-out (LIFO) method of valuing inventory. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management s estimates of expected year-end inventory levels and costs are subject to the final year-end LIFO inventory valuation. In addition, interim inventory levels include management s estimates of annual inventory losses due to shrinkage and other factors. The final year-end valuation of inventory is based on an annual physical inventory count performed during the fourth quarter. For further information on inventory valuations and other matters, refer to the consolidated financial statements and footnotes thereto included in the Company s Form 10-K for the year ended December 31, 2008.

The consolidated results for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the year ending December 31, 2008.

Note B IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Financial Accounting Standards (FAS) No. 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. This FSP amends FAS No. 132, Employers Disclosures about Pensions and Other Postretirement Benefits, to provide guidance on disclosures about plan assets of defined benefit pension and other postretirement benefit plans. The FSP requires disclosures about how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs and significant concentrations of risk within plan assets. The FSP is effective for fiscal years ending after December 31, 2009, and the provisions are not required for earlier periods presented for comparative purposes. The FSP will not have any impact on the Company s results of operations, financial condition or liquidity.

In June 2008, the FASB issued FSP Emerging Issues Task Force (EITF) No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, which clarifies EITF No. 03-6, Participating Securities and the Two-Class Method Under FAS No. 128. Under the FSP, unvested share-

based payment awards that contain rights to receive non-forfeitable dividends (whether paid or unpaid) are considered participating securities, and the two-class method of computing earnings per share is required for all periods presented. The Company adopted EITF No. 03-6-1 as of January 1, 2009 and calculated basic and diluted earnings per share under both the treasury stock method and the two-class method. There is not a significant difference in the per share amounts under the two methods for the three months ended March 31, 2009 and 2008, and the treasury stock method continues to be disclosed. See Note L.

Effective January 1, 2009, the Company adopted FSP FAS No. 142-3, which amends the factors that must be considered in developing renewal or extension assumptions used to determine the useful life over which to amortize the cost of a recognized intangible asset under FAS No. 142, Goodwill and Other Intangible Assets. The FSP requires an entity to consider its own assumptions about renewal or extension of the term of the arrangement, consistent with its expected use of the asset, and is an attempt to improve consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141, Business Combinations. The FSP does not have a significant impact on the Company s results of operations, financial condition or liquidity.

Effective January 1, 2009, the Company adopted FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 Accounting for Derivative Instruments and Hedging Activities. FAS No. 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under FAS No. 133, and how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. The statement does not have an impact on the Company s results of operations, financial condition or liquidity.

Effective January 1, 2009, the Company adopted FAS No. 141(R), Applying the Acquisition Method. FAS No. 141(R) provides guidance for the recognition of the fair values of the assets acquired upon initially obtaining control, including the elimination of the step acquisition model. The standard does not have a significant impact on the Company s results of operations, financial condition or liquidity.

Effective January 1, 2009, the Company adopted FAS No. 160, Accounting for Noncontrolling Interests. FAS No. 160 clarifies the classification of noncontrolling interests in consolidated statements of financial position and the accounting for and reporting of transactions between the reporting entity and holders of such noncontrolling interests. Under the standard, noncontrolling interests are considered equity and should be reported as an element of consolidated equity, and net income will encompass the total income of all consolidated subsidiaries and there will be separate disclosure on the face of the income statement of the attribution of that income between the controlling and noncontrolling interests. FAS No. 160 does not have a significant impact on the Company s results of operations, financial condition or liquidity.

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements. FAS No. 157 provides guidance for using fair value to measure assets and liabilities and only applies when other standards require or permit the fair value measurement of assets and liabilities. It does not expand the use of fair value measurements. In accordance with FSP FAS No. 157-2, Effective Date of FASB Statement No. 157, the Company adopted FAS No. 157 for its financial assets and liabilities as of January 1, 2008, and for its non-financial assets and liabilities as of January 1, 2009. FAS No. 157 does not have a significant impact on the Company s results of operations, financial condition or liquidity. See Note O.

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Note C DIVIDENDS

Dividends paid on common stock during the first quarters of 2009 and 2008 were $.355 per common share and $.35 per common share, respectively.

Note D COMPREHENSIVE INCOME

Comprehensive income is summarized as follows:

(Thousands of dollars)	Three months ended March 31,	
	2009	2008
Net income	**$ 37,279**	$ 77,946
Foreign currency translation adjustments	**(8,881)**	7,605
Amortization of net prior service costs and net actuarial losses, net of taxes [1]	**4,639**	1,574
Adjustments of marketable equity securities and derivative instruments used in cash flow hedges, net of taxes [2]	**45**	(1)
Comprehensive income	**$ 33,082**	$ 87,124

(1) The tax effect of amortization of net prior service costs and net actuarial losses was $(2,890) and $(983) for the three months ended March 31, 2009 and 2008, respectively.

(2) The tax effect of adjustments of marketable equity securities and derivative instruments used in cash flow hedges was $(35) and $.3 for the three months ended March 31, 2009 and 2008, respectively.

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Note E PRODUCT WARRANTIES

Changes in the Company s accrual for product warranty claims during the first quarters of 2009 and 2008, including customer satisfaction settlements during the quarters, were as follows:

(Thousands of dollars)	**2009**	2008
Balance at January 1	**$ 18,029**	$ 19,596
Charges to expense	**4,297**	3,258
Settlements	**(4,632)**	(4,378)
Balance at March 31	**$ 17,694**	$ 18,476

For further details on the Company s accrual for product warranty claims, see Note 1 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

Note F EXIT OR DISPOSAL ACTIVITIES

Liabilities associated with exit or disposal activities are recognized as incurred in accordance with FAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. Qualified exit costs primarily include post-closure rent expenses, incremental post-closure costs and costs of employee terminations. Adjustments may be made to liabilities accrued for qualified exit costs if information becomes available upon which more accurate amounts can be reasonably estimated. Concurrently, property, plant and equipment is tested for impairment in accordance with FAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, and, if impairment exists, the carrying value of the related assets is reduced to estimated fair value. Additional impairment may be recorded for subsequent revisions in estimated fair value.

In the first quarter 2009, 19 stores in the Paint Stores Group and four branches in the Global Finishes Group were closed due to lower demand or redundancy. Provisions of $2.0 million for qualified exits costs resulting from the closure of these facilities were recorded in Selling, general and administrative expenses in the first quarter. The provisions were charged to the Paint Stores Group for $1.0 million and to the Global Finishes Group for $1.0 million. In addition, there were adjustments to prior provisions related to manufacturing facilities, distribution facilities, stores and branches closed in 2008. Adjustments to prior provisions of $4.4 million were recorded in Cost of goods sold, Selling, general and administrative expense or Other general expense-net in the first quarter. Adjustments of $3.5 million were charged to the Paint Stores Group, $0.8 million were charged to the Consumer Group and $0.1 were charged to the Global Finishes Group.

During 2008, four manufacturing and three distribution facilities, five administrative offices and 92 stores and branches were closed. The closure and disposal of two manufacturing facilities and two administrative offices in the Paint Stores Group were planned at the time of acquisition. The total qualified exit costs for the acquired facilities, included as part of the purchase price allocations in accordance with FAS No. 141, were $1.7 million. One additional manufacturing and two distribution facilities and 79 stores in the Paint Stores Group, one manufacturing and one distribution facility in the Consumer Group, and three administrative offices and 14 branches in the Global Finishes Group were closed due to excess capacity or redundancy. Provisions of $7.1 million for qualified exit costs resulting from the closure of these facilities were recorded in Cost of goods sold or Selling, general and administrative expenses in 2008. Of the total provisions, $5.5 million was charged to the Paint Stores Group, $0.9 million was charged to the Consumer Group and $0.7 million was charged to the Global Finishes Group.

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The following table summarizes the activity and remaining liabilities associated with qualified exit costs at March 31, 2009 and for the three-month period then ended:
(Thousands of dollars)

Exit Plan	Balance at December 31, 2008	Provisions in Cost of goods sold, SG&A or acquired	Actual expenditures charged to accrual	Adjustments to prior provisions in Other general expense - net	Balance at March 31, 2009
Paint Stores Group stores shutdown in 2009:					
Other qualified exit costs		**$ 950**	**$ (140)**		**$ 810**
Global Finishes Group branches shutdown in 2009:					
Other qualified exit costs		**1,003**	**(133)**		**870**
Paint Stores Group manufacturing and distribution facilities, administrative offices and stores shutdown in 2008:					
Severance and related costs	**$ 324**		**(1)**		**323**
Other qualified exit costs	**4,450**		**(584)**	**$ 3,475**	**7,341**
Consumer Group manufacturing and distribution facilities shutdown in 2008:					
Severance and related costs	**449**	**657**	**(264)**		**842**
Other qualified exit costs	**150**	**143**	**(180)**		**113**
Global Finishes Group administrative offices and branches shutdown in 2008:					
Severance and related costs	**397**		**(321)**		**76**
Other qualified exit costs	**240**	**156**	**(191)**		**205**
Paint Stores Group manufacturing facility shutdown in 2007:					
Severance and related costs	**33**		**(9)**		**24**
Other qualified exit costs	**1,859**		**(190)**		**1,669**
Consumer Group manufacturing facility shutdown in 2007:					
Other qualified exit costs	**2,036**				**2,036**
Other qualified exit costs for facilities shutdown prior to 2003	**11,686**		**(332)**		**11,354**
Totals	**$ 21,624**	**$ 2,909**	**$ (2,345)**	**$ 3,475**	**$ 25,663**

For further details on the Company s exit or disposal activities, see Note 5 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

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Note G HEALTH CARE, PENSION AND OTHER BENEFITS

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

(Thousands of dollars)	Domestic Defined Benefit Pension Plans		Foreign Defined Benefit Pension Plans		Postretirement Benefits Other than Pensions	
	2009	2008	**2009**	2008	**2009**	2008
Three months ended March 31:						
Net periodic benefit cost (credit):						
Service cost	**$ 5,316**	$ 4,906	**$ 306**	$ 637	**$ 848**	$ 927
Interest cost	**4,617**	4,569	**735**	1,072	**3,924**	4,085
Expected return on assets	**(9,201)**	(13,219)	**(453)**	(667)		
Amortization of:						
Prior service cost (credit)	**387**	188	**11**	15	**(164)**	(159)
Actuarial loss	**7,208**	269	**78**	241	**72**	53
Net periodic benefit cost (credit)	**$ 8,327**	$ (3,287)	**$ 677**	$ 1,298	**$ 4,680**	$ 4,906

For further details on the Company s health care, pension and other benefits, see Note 6 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

NOTE H OTHER LONG-TERM LIABILITIES

The Company initially provides for estimated costs of environmental-related activities relating to its past operations and third-party sites for which commitments or clean-up plans have been developed and when such costs can be reasonably estimated based on industry standards and professional judgment. These estimated costs are determined based on currently available facts regarding each site. If the best estimate of costs can only be identified as a range and no specific amount within that range can be determined more likely than any other amount within the range, the minimum of the range is provided. At March 31, 2009, the unaccrued maximum of the estimated range of possible outcomes is $114.0 million higher than the minimum.

The Company continuously assesses its potential liability for investigation and remediation-related activities and adjusts its environmental-related accruals as information becomes available upon which more accurate costs can be reasonably estimated and as additional accounting guidelines are issued. Actual costs incurred may vary from these estimates due to the inherent uncertainties involved including, among others, the number and financial condition of parties involved with respect to any given site, the volumetric contribution which may be attributed to the Company relative to that attributed to other parties, the nature and magnitude of the wastes involved, the various technologies that can be used for remediation and the determination of acceptable remediation with respect to a particular site. Included in Other long-term liabilities at March 31, 2009 and 2008 were accruals for extended environmental-related activities of $128.2 million and $131.5 million, respectively. Estimated costs of current investigation and remediation activities of $52.6 million and $60.4 million are included in Other accruals at March 31, 2009 and 2008, respectively.

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Five of the Company s currently and formerly owned manufacturing sites account for the majority of the accrual for environmental-related activities and the unaccrued maximum of the estimated range of possible outcomes at March 31, 2009. At March 31, 2009, $137.9 million, or 76.2 percent of the total accrual, related directly to these five sites. In the aggregate unaccrued maximum of $114.0 million at March 31, 2009, $76.2 million, or 66.9 percent, related to the five manufacturing sites. While environmental investigations and remedial actions are in different stages at these sites, additional investigations, remedial actions and monitoring will likely be required at each site. Management cannot presently estimate the ultimate potential loss contingencies related to these sites or other less significant sites until such time as a substantial portion of the investigation at the sites is completed and remedial action plans are developed. In the event any future loss contingency significantly exceeds the current amount accrued, the recording of the ultimate liability may result in a material impact on net income for the annual or interim period during which the additional costs are accrued. Management does not believe that any potential liability ultimately attributed to the Company for its environmental-related matters will have a material adverse effect on the Company s financial condition, liquidity, or cash flow due to the extended period of time during which environmental investigation and remediation takes place. An estimate of the potential impact on the Company s operations cannot be made due to the aforementioned uncert