SHERWIN WILLIAMS CO
Form 10-Q
July 22, 2015

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

FORM 10-Q

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one:)

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common Stock, $1.00 Par Value – 93,210,645 shares as of June 30, 2015.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net sales	$3,132,139	$3,042,995	$5,582,423	$5,409,551
Cost of goods sold	1,602,153	1,633,342	2,919,988	2,933,997
Gross profit	1,529,986	1,409,653	2,662,435	2,475,554
Percent to net sales	48.8 %	46.3 %	47.7 %	45.8 %
Selling, general and administrative expenses	999,224	969,183	1,928,421	1,853,271
Percent to net sales	31.9 %	31.8 %	34.5 %	34.3 %
Other general expense - net	9,971	770	8,298	198
Interest expense	12,885	16,374	25,236	32,768
Interest and net investment income	(553)	(757)	(975)	(1,346)
Other expense (income) - net	677	(5,147)	432	(4,644)
Income before income taxes	507,782	429,230	701,023	595,307
Income taxes	157,845	137,783	219,682	188,403
Net income	$349,937	$291,447	$481,341	$406,904
Net income per common share:				
Basic	$3.78	$3.00	$5.18	$4.14
Diluted	$3.70	$2.94	$5.08	$4.06
Average shares outstanding - basic	92,260,367	96,599,869	92,500,213	97,716,539
Average shares and equivalents outstanding - diluted	94,124,695	98,541,909	94,427,191	99,688,557
Comprehensive income	$361,580	$305,178	$436,637	$412,432

See notes to condensed consolidated financial statements.

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

	June 30, 2015	December 31, 2014	June 30, 2014
Assets			
Current assets:			
Cash and cash equivalents	$75,068	$40,732	$267,198
Accounts receivable, less allowance	1,454,045	1,130,565	1,402,803
Inventories:			
Finished goods	945,918	841,784	892,488
Work in process and raw materials	186,058	191,743	198,694
	1,131,976	1,033,527	1,091,182
Deferred income taxes	107,902	109,087	102,733
Other current assets	236,137	252,869	244,202
Total current assets	3,005,128	2,566,780	3,108,118
Goodwill	1,151,720	1,158,346	1,174,654
Intangible assets	273,882	289,127	306,985
Deferred pension assets	251,684	250,144	304,582
Other assets	446,931	420,625	440,365
Property, plant and equipment:			
Land	122,503	125,691	131,234
Buildings	696,426	698,202	711,079
Machinery and equipment	1,980,796	1,952,037	1,916,103
Construction in progress	69,274	59,330	40,313
	2,868,999	2,835,260	2,798,729
Less allowances for depreciation	1,863,680	1,814,230	1,792,433
	1,005,319	1,021,030	1,006,296
Total Assets	$6,134,664	$5,706,052	$6,341,000
Liabilities and Shareholders' Equity			
Current liabilities:			
Short-term borrowings	$1,159,284	$679,436	$64,739
Accounts payable	1,253,894	1,042,182	1,244,574
Compensation and taxes withheld	267,352	360,458	264,652
Accrued taxes	193,834	86,744	190,368
Current portion of long-term debt	3,179	3,265	502,125
Other accruals	479,696	508,581	458,826
Total current liabilities	3,357,239	2,680,666	2,725,284
Long-term debt	1,122,756	1,122,715	1,122,420
Postretirement benefits other than pensions	279,650	277,892	272,095
Other long-term liabilities	617,677	628,309	696,242
Shareholders' equity:			
Common stock—$1.00 par value: 93,210,645, 94,704,173 and 97,787,954 shares outstanding at June 30, 2015, December 31, 2014 and June 30, 2014, respectively	115,394	114,525	114,001
Preferred stock—convertible, no par value: 5,722 shares outstanding at June 30, 2014	—	—	5,722

Unearned ESOP compensation	—	—	(5,722)
Other capital	2,241,197	2,079,639	1,980,760
Retained earnings	2,780,764	2,424,674	2,072,118
Treasury stock, at cost	(3,863,351)	(3,150,410)	(2,326,404)
Cumulative other comprehensive loss	(516,662)	(471,958)	(315,516)
Total shareholders' equity	757,342	996,470	1,524,959
Total Liabilities and Shareholders’ Equity	$6,134,664	$5,706,052	$6,341,000

See notes to condensed consolidated financial statements.

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

	Six Months Ended	
	June 30, 2015	June 30, 2014
OPERATING ACTIVITIES		
Net income	$481,341	$406,904
Adjustments to reconcile net income to net operating cash:		
Depreciation	84,581	83,513
Amortization of intangible assets	13,720	15,146
Stock-based compensation expense	32,578	29,563
Provisions for qualified exit costs	1,482	9,439
Provisions for environmental-related matters	11,560	(175)
Defined benefit pension plans net cost	3,576	3,626
Net increase in postretirement liability	(111)	2,970
Other	(2,373)	3,100
Change in working capital accounts - net	(238,809)	(202,068)
Costs incurred for environmental-related matters	(5,573)	(4,955)
Costs incurred for qualified exit costs	(5,045)	(3,877)
Other	(27,907)	(11,606)
Net operating cash	349,020	331,580
INVESTING ACTIVITIES		
Capital expenditures	(87,542)	(66,870)
Proceeds from sale of assets	8,021	373
Increase in other investments	(1,486)	(17,488)
Net investing cash	(81,007)	(83,985)
FINANCING ACTIVITIES		
Net increase (decrease) in short-term borrowings	484,636	(31,925)
Payments of long-term debt	—	(752)
Payments of cash dividends	(125,251)	(108,836)
Proceeds from stock options exercised	57,420	59,442
Income tax effect of stock-based compensation exercises and vesting	72,529	45,253
Treasury stock purchased	(679,449)	(665,492)
Other	(34,081)	(23,354)
Net financing cash	(224,196)	(725,664)
Effect of exchange rate changes on cash	(9,481)	378
Net increase (decrease) in cash and cash equivalents	34,336	(477,691)
Cash and cash equivalents at beginning of year	40,732	744,889
Cash and cash equivalents at end of period	$75,068	$267,198
Income taxes paid	$45,319	$33,994
Interest paid	25,234	33,893

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 June 30, 2015 and 2014

NOTE 1—BASIS OF PRESENTATION

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

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

The Company primarily uses the last-in, first-out (LIFO) method of valuing inventory. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management’s estimates of expected year-end inventory levels and costs are subject to the final year-end LIFO inventory valuation. In addition, interim inventory levels include management’s estimates of annual inventory losses due to shrinkage and other factors. The final year-end valuation of inventory is based on an annual physical inventory count performed during the fourth quarter.

For further information on inventory valuations and other matters, refer to the consolidated financial statements and footnotes thereto included in the Company’s Form 10-K for the year ended December 31, 2014.

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

NOTE 2—IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

On April 1, 2015, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2015-03, "Simplifying the Presentation of Debt Issuance Costs," which requires companies to present debt issuance costs associated with a debt liability as a deduction from the carrying amount of that debt liability on the balance sheet rather than being capitalized as an asset. The standard is effective for interim and annual periods beginning after December 15, 2015, and retrospective presentation is required. The Company will adopt ASU No. 2015-03 as required. The ASU will not have a material effect on the Company's results of operations, financial condition or liquidity.

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

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

NOTE 3—DIVIDENDS

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

NOTE 4—CHANGES IN CUMULATIVE OTHER COMPREHENSIVE LOSS

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

(Thousands of dollars)

	Foreign Currency Translation Adjustments	Net Actuarial (Losses) Gains and Prior Service Costs Recognized for Employee Benefit Plans	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Total Cumulative Other Comprehensive Loss
Balance at December 31, 2014	$(354,384)	$(118,167)	$ 593	$ (471,958)
Other comprehensive loss before reclassifications[1]	(45,554)		52	(45,502)
Amounts reclassified from other comprehensive (loss) income[2]		853	(55)	798
Net other comprehensive (loss) income	(45,554)	853	(3)	(44,704)
Balance at June 30, 2015	$(399,938)	$(117,314)	$ 590	$ (516,662)

(1) Net of taxes of $(34) for unrealized net gains on available-for-sale securities.

(2) Net of taxes of $(699) for net actuarial losses and prior service costs recognized for employee benefit plans and $33 for realized gains on the sale of available-for-sale securities.

(Thousands of dollars)

	Foreign Currency Translation Adjustments	Net Actuarial Losses (Gains) and Prior Service Costs Recognized for Employee Benefit Plans	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Total Cumulative Other Comprehensive Loss
Balance at December 31, 2013	$(250,942)	$(70,611)	$ 509	$ (321,044)
Other comprehensive loss before reclassifications[3]	4,612	(570)	516	4,558
Amounts reclassified from other comprehensive (loss) income[4]		1,015	(45)	970
Net other comprehensive loss	4,612	445	471	5,528
Balance at June 30, 2014	$(246,330)	$(70,166)	$ 980	$ (315,516)

(3) Net of taxes of $244 for net actuarial losses and prior service costs recognized for employee benefit plans and $(324) for unrealized net losses on available-for-sale securities.

(4) Net of taxes of $(417) for net actuarial losses and prior service costs recognized for employee benefit plans and $28 for realized gains on the sale of available-for-sale securities.

NOTE 5—PRODUCT WARRANTIES

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

(Thousands of dollars)

	2015	2014
Balance at January 1	$27,723	$26,755
Charges to expense	14,470	14,446
Settlements	(14,955)	(16,351)
Balance at June 30	$27,238	$24,850

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

NOTE 6—EXIT OR DISPOSAL ACTIVITIES

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

In the six months ended June 30, 2015, nineteen stores in the Paint Stores Group, two stores in the Global Finishes Group and one store in the Latin America Coatings Group were closed due to lower demand or redundancy. No provisions were incurred for the 2015 store shutdowns due to the timing of lease cancellations and movement of employees to other locations.

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

(Thousands of dollars)

Exit Plan	Balance at December 31, 2014	Provisions in Cost of goods sold or SG&A	Actual expenditures charged to accrual	Balance at June 30, 2015
Paint Stores Group stores shutdown in 2014:				
Other qualified exit costs	$280	$142	$(135)	$287
Consumer Group facilities shutdown in 2014:				
Severance and related costs	2,732	1,224	(2,981)	975
Other qualified exit costs	781	6	(479)	308
Global Finishes Group exit of business in 2014:				
Severance and related costs	104		(104)	
Other qualified exit costs	1,080	110	(61)	1,129
Paint Stores Group facility shutdown in 2013:				
Severance and related costs	654		(507)	147
Other qualified exit costs	1,205		(205)	1,000
Global Finishes Group stores shutdown in 2013:				
Severance and related costs	28		(28)	
Other qualified exit costs	138		(99)	39
Other qualified exit costs for facilities shutdown prior to 2013	1,514		(446)	1,068
Totals	$8,516	$1,482	$(5,045)	$4,953

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

NOTE 7—HEALTH CARE, PENSION AND OTHER BENEFITS

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

(Thousands of dollars)	Domestic Defined Benefit Pension Plans		Foreign Defined Benefit Pension Plans		Postretirement Benefits Other than Pensions	
	2015	2014	2015	2014	2015	2014
Three Months Ended June 30:						
Net periodic benefit cost (credit):						
Service cost	$5,755	$5,637	$1,325	$1,548	$621	$608
Interest cost	6,237	6,525	2,271	2,694	2,796	3,196
Expected return on assets	(13,024)	(12,665)	(2,430)	(2,740)		
Amortization of:						
Prior service cost (credit)	328	459			(1,132)	(125)
Actuarial loss	843		484	355	253	
Net periodic benefit cost (credit)	$139	$(44)	$1,650	$1,857	$2,538	$3,679
Six Months Ended June 30:						
Net periodic benefit cost (credit):						
Service cost	$11,509	$11,274	$2,650	$3,095	$1,242	$1,217
Interest cost	12,474	13,051	4,542	5,388	5,591	6,391
Expected return on assets	(26,048)	(25,331)	(4,861)	(5,480)		
Amortization of:						
Prior service cost (credit)	655	918			(2,264)	(251)
Actuarial loss	1,686		969	711	506	
Net periodic benefit cost (credit)	$276	$(88)	$3,300	$3,714	$5,075	$7,357

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, 2014.

NOTE 8—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 June 30, 2015, the unaccrued maximum of the estimated range of possible outcomes is $90.6 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 June 30, 2015 and 2014 were accruals for extended environmental-related activities of $121.2 million and $82.7 million, respectively. Estimated costs of current investigation and remediation activities of $16.9 million and $15.4 million are included in Other accruals at June 30, 2015 and 2014, respectively.

Two 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 June 30, 2015. At June 30, 2015, $87.2 million, or 63.2 percent of the total accrual, related directly to these two sites. In the aggregate unaccrued maximum of $90.6 million at June 30, 2015, $59.0 million, or 65.1 percent, related to the two 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 uncertainties.

Management expects these contingent environmental-related liabilities to be resolved over an extended period of time. Management is unable to provide a more specific time frame due to the indefinite amount of time to conduct investigation activities at any site, the indefinite amount of time to obtain environmental agency approval, as necessary, with respect to investigation and remediation activities, and the indefinite amount of time necessary to conduct remediation activities.

For further details on the Company's Other long-term liabilities, see Note 8 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

NOTE 9 – LITIGATION

In the course of its business, the Company is subject to a variety of claims and lawsuits, including, but not limited to, litigation relating to product liability and warranty, personal injury, environmental, intellectual property, commercial, contractual and antitrust claims that are inherently subject to many uncertainties regarding the possibility of a loss to the Company. These uncertainties will ultimately be resolved when one or more future events occur or fail to occur confirming the incurrence of a liability or the reduction of a liability. In accordance with the Contingencies Topic of the ASC, the Company accrues for these contingencies by a charge to income when it is both probable that one or more future events will occur confirming the fact of a loss and the amount of the loss can be reasonably estimated. In the event that the Company's loss contingency is ultimately determined to be significantly higher than currently accrued, the recording of the additional liability may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such additional liability is accrued. In those cases where no accrual is recorded because it is not probable that a liability has been incurred and the amount of any such loss cannot be reasonably estimated, any potential liability ultimately determined to be attributable to the Company may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued. In those cases where no accrual is recorded or exposure to loss exists in excess of the amount accrued, the Contingencies Topic of the ASC requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred.

Lead pigment and lead-based paint litigation. The Company's past operations included the manufacture and sale of lead pigments and lead-based paints. The Company, along with other companies, is and has been a defendant in a number of legal proceedings, including individual personal injury actions, purported class actions, and actions brought by various counties, cities, school districts and other government-related entities, arising from the manufacture and sale of lead pigments and lead-based paints. The plaintiffs' claims have been based upon various legal theories, including negligence, strict liability, breach of warranty, negligent misrepresentations and omissions, fraudulent misrepresentations and omissions, concert of action, civil conspiracy, violations of unfair trade practice and consumer protection laws, enterprise liability, market share liability, public nuisance, unjust enrichment and other theories. The plaintiffs seek various damages and relief, including personal injury and property damage, costs relating to the detection and abatement of lead-based paint from buildings, costs associated with a public education campaign, medical monitoring costs and others. The Company has also been a defendant in legal proceedings arising from the manufacture and sale of non-lead-based paints that seek recovery based upon various legal theories, including the failure to adequately warn of potential exposure to lead during surface preparation when using non-lead-based paint on surfaces previously painted with lead-based paint. The Company believes that the litigation brought to date is without merit or subject to meritorious defenses and is vigorously defending such litigation. The Company has not settled any material lead pigment or lead-based paint litigation. The Company expects that additional lead pigment and lead-based paint litigation may be filed against the Company in the future asserting similar or different legal theories and seeking similar or different types of damages and relief.

Notwithstanding the Company's views on the merits, litigation is inherently subject to many uncertainties, and the Company ultimately may not prevail. Adverse court rulings or determinations of liability, among other factors, could affect the lead pigment and lead-based paint litigation against the Company and encourage an increase in the number and nature of future claims and proceedings. In addition, from time to time, various legislation and administrative regulations have been enacted, promulgated or proposed to impose obligations on present and former manufacturers of lead pigments and lead-based paints respecting asserted health concerns associated with such products or to overturn the effect of court decisions in which the Company and other manufacturers have been successful.

Due to the uncertainties involved, management is unable to predict the outcome of the lead pigment and lead-based paint litigation, the number or nature of possible future claims and proceedings or the effect that any legislation and/or administrative regulations may have on the litigation or against the Company. In addition, management cannot reasonably determine the scope or amount of the potential costs and liabilities related to such litigation, or resulting from any such legislation and regulations. The Company has not accrued any amounts for such litigation. With respect to such litigation, including the public nuisance litigation, the Company does not believe that it is probable that a loss has occurred, and it is not possible to estimate the range of potential losses as there is no prior history of a loss of this nature and there is no substantive information upon which an estimate could be based. In addition, any potential liability that may result from any changes to legislation and regulations cannot reasonably be estimated. In the event any significant liability is determined to be attributable to the Company relating to such litigation, the recording of the liability may result in a material impact on net income for the annual or interim period during which such liability is accrued. Additionally, due to the uncertainties associated with the amount of any such liability and/or the nature of any other remedy which may be imposed in such litigation, any potential liability determined to be attributable to the Company arising out of such litigation may have a material adverse effect on the Company’s results of operations, liquidity or financial condition. An estimate of the potential impact on the Company’s results of operations, liquidity or financial condition cannot be made due to the aforementioned uncertainties.

Public nuisance claim litigation. The Company and other companies are or were defendants in legal proceedings seeking recovery based on public nuisance liability theories, among other theories, brought by the State of Rhode Island, the City of St. Louis, Missouri, various cities and counties in the State of New Jersey, various cities in the State of Ohio and the State of Ohio, the City of Chicago, Illinois, the City of Milwaukee, Wisconsin and the County of Santa Clara, California and other public entities in the State of California. Except for the Santa Clara County, California proceeding, all of these legal proceedings have been concluded in favor of the Company and other defendants at various stages in the proceedings.

The proceedings initiated by the State of Rhode Island included two jury trials. At the conclusion of the second trial, the jury returned a verdict finding that (i) the cumulative presence of lead pigment in paints and coatings on buildings in the State of Rhode Island constitutes a public nuisance, (ii) the Company, along with two other defendants, caused or substantially contributed to the creation of the public nuisance and (iii) the Company and two other defendants should be ordered to abate the public nuisance. The Company and two other defendants appealed and, on July 1, 2008, the Rhode Island Supreme Court, among other determinations, reversed the judgment of abatement with respect to the Company and two other defendants. The Rhode Island Supreme Court’s decision reversed the public nuisance liability judgment against the Company on the basis that the complaint failed to state a public nuisance claim as a matter of law.

The Santa Clara County, California proceeding was initiated in March 2000 in the Superior Court of the State of California, County of Santa Clara. In the original complaint, the plaintiffs asserted various claims including fraud and concealment, strict product liability/failure to warn, strict product liability/design defect, negligence, negligent breach of a special duty, public nuisance, private nuisance, and violations of California’s Business and Professions Code. A number of the asserted claims were resolved in favor of the defendants through pre-trial proceedings. The named plaintiffs in the Fourth Amended Complaint, filed on March 16, 2011, are the Counties of Santa Clara, Alameda, Los Angeles, Monterey, San Mateo, Solano and Ventura, the Cities of Oakland and San Diego and the City and County of San Francisco. The Fourth Amended Complaint asserted a sole claim for public nuisance, alleging that the presence of lead pigments for use in paint and coatings in, on and around residences in the plaintiffs’ jurisdictions constitutes a public nuisance. The plaintiffs sought the abatement of the alleged public nuisance that exists within the plaintiffs’ jurisdictions. A trial commenced on July 15, 2013 and ended on August 22, 2013. The court entered final judgment on January 27, 2014, finding in favor of the plaintiffs and against the Company and two other defendants (ConAgra Grocery Products Company and NL Industries, Inc.). The final judgment held the Company jointly and severally liable with the other two defendants to pay $1.15 billion into a fund to abate the public nuisance. The Company strongly disagrees with the judgment. On February 18, 2014, the Company filed a motion for new trial and a motion to vacate the judgment. The court denied these motions on March 24, 2014. On March 28, 2014, the Company filed a notice of appeal to the Sixth District Court of Appeal for the State of California. The filing of the notice of appeal effects an automatic stay of the judgment without the requirement to post a bond. The appeal is fully briefed, and the parties are waiting for the Sixth District Court of Appeal to set a date for oral argument. The date for oral argument is at the discretion of the Sixth District Court of Appeal. The Company expects the Sixth District Court of Appeal to issue its ruling within 90 days following oral argument. The Company believes that the judgment conflicts with established principles of law and is unsupported by the evidence. The Company has had a favorable history with respect to lead pigment and lead-based paint litigation, particularly other public nuisance litigation, and accordingly, the Company believes that it is not probable that a loss has occurred and it is not possible to estimate the range of potential loss with respect to the case.

Litigation seeking damages from alleged personal injury. The Company and other companies are defendants in a number of legal proceedings seeking monetary damages and other relief from alleged personal injuries. These proceedings include claims by children allegedly injured from ingestion of lead pigment or lead-containing paint and claims for damages allegedly incurred by the children’s parents or guardians. These proceedings generally seek compensatory and punitive damages, and seek other relief including medical monitoring costs. These proceedings include purported claims by individuals, groups of individuals and class actions.

The plaintiff in Thomas v. Lead Industries Association, et al., initiated an action in state court against the Company, other alleged former lead pigment manufacturers and the Lead Industries Association in September 1999. The claims against the Company and the other defendants included strict liability, negligence, negligent misrepresentation and omissions, fraudulent misrepresentation and omissions, concert of action, civil conspiracy and enterprise liability. Implicit within these claims is the theory of “risk contribution” liability (Wisconsin’s theory which is similar to market share liability, except that liability can be joint and several) due to the plaintiff’s inability to identify the manufacturer of any product that allegedly injured the plaintiff. The case ultimately proceeded to trial and, on November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain damaged or injured as a result. The plaintiff appealed and, on December 16, 2010, the Wisconsin Court of Appeals affirmed the final judgment in favor of the Company and other defendants.

Wisconsin is the only jurisdiction to date to apply a theory of liability with respect to alleged personal injury (i.e., risk contribution/market share liability) that does not require the plaintiff to identify the manufacturer of the product that allegedly injured the plaintiff in the lead pigment and lead-based paint litigation. Although the risk contribution liability theory was applied during the Thomas trial, the constitutionality of this theory as applied to the lead pigment cases has not been judicially determined by the Wisconsin state courts. However, in an unrelated action filed in the United States District Court for the Eastern District of Wisconsin, Gibson v. American Cyanamid, et al., on November 15, 2010, the District Court held that Wisconsin’s risk contribution theory as applied in that case violated the defendants’ right to substantive due process and is unconstitutionally retroactive. The District Court's decision in Gibson v. American Cyanamid, et al., was appealed by the plaintiff to the United States Court of Appeals for the Seventh Circuit. On July 24, 2014, the United States Court of Appeals for the Seventh Circuit reversed the judgment and remanded the case back to the District Court for further proceedings. On January 16, 2015, the defendants filed a petition for certiorari in the United States Supreme Court seeking that Court's review of the Seventh Circuit's decision, and on May 18, 2015, the United States Supreme Court denied the defendants' petition. Also, in Yasmine Clark v. The Sherwin-Williams Company, et al., the Wisconsin Circuit Court, Milwaukee County, on March 25, 2014, held that the application to a pending case of Section 895.046 of the Wisconsin Statutes (which clarifies the application of the risk contribution theory) is unconstitutional as a violation of the plaintiff’s right to due process of law under the Wisconsin Constitution. On April 8, 2014, defendants filed a petition requesting the Wisconsin Court of Appeal to hear the issue as an interlocutory appeal. On August 21, 2014, the Wisconsin Court of Appeal granted defendants' petition.

Insurance coverage litigation. The Company and its liability insurers, including certain underwriters at Lloyd’s of London, initiated legal proceedings against each other to primarily determine, among other things, whether the costs and liabilities associated with the abatement of lead pigment are covered under certain insurance policies issued to the Company. The Company’s action, filed on March 3, 2006 in the Common Pleas Court, Cuyahoga County, Ohio, is currently stayed and inactive. The liability insurers’ action, which was filed on February 23, 2006 in the Supreme Court of the State of New York, County of New York, has been dismissed. An ultimate loss in the insurance coverage litigation would mean that insurance proceeds could be unavailable under the policies at issue to mitigate any ultimate abatement related costs and liabilities. The Company has not recorded any assets related to these insurance policies or otherwise assumed that proceeds from these insurance policies would be received in estimating any contingent liability accrual. Therefore, an ultimate loss in the insurance coverage litigation without a determination of liability against the Company in the lead pigment or lead-based paint litigation will have no impact on the Company’s results of operation, liquidity or financial condition. As previously stated, however, the Company has not accrued any amounts for the lead pigment or lead-based paint litigation and any significant liability ultimately determined to be attributable to the Company relating to such litigation may result in a material impact on the Company’s results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued.

Litigation related to Consorcio Comex. As previously disclosed, the Company entered into a definitive Stock Purchase Agreement (as subsequently amended and restated, the “Purchase Agreement”), with Avisep, S.A. de C.V. (“Avisep”) and Bevisep, S.A. de C.V. (“Bevisep”) to, among other things, acquire the Mexico business of Consorcio Comex, S.A. de C.V. (the "Acquisition"). Under the terms of the Purchase Agreement, either the Company or Avisep and Bevisep had the right to terminate the Purchase Agreement in the event that the closing of the Acquisition did not occur on or prior to March 31, 2014 and such party was not in material breach of the Purchase Agreement.

On April 3, 2014, the Company sent notice to Avisep and Bevisep that the Company was terminating the Purchase Agreement. On April 3, 2014, the Company filed a complaint for declaratory judgment in the Supreme Court of the State of New York, New York County, requesting the court to declare that the Company had used commercially reasonable efforts as required under the Purchase Agreement and has not breached the Purchase Agreement. On August 7, 2014, the case was removed by Avisep and Bevisep to the United States District Court for the Southern District of New York. On April 11, 2014, Avisep and Bevisep initiated an arbitration proceeding against the Company in the International Court of Arbitration contending that the Company breached the Purchase Agreement by terminating the Purchase Agreement and not utilizing commercially reasonable efforts under the Purchase Agreement, which allegedly caused Avisep and Bevisep to incur damages. On June 1, 2015, Avisep and Bevisep filed their statement of claim in the arbitration alleging damages of approximately $85 million. The Company continues to believe that the claims are without merit and will continue to vigorously defend against such claims.

Titanium dioxide suppliers antitrust class action lawsuit. The Company is a member of the plaintiff class related to Titanium Dioxide Antitrust Litigation that was initiated in 2010 against certain suppliers alleging various theories of relief arising from purchases of titanium dioxide made from 2003 through 2012. The Court approved a settlement less attorney fees and expense, and the Company timely submitted claims to recover its pro-rata portion of the settlement. There was no specified deadline for the claims administrator to complete the review of all claims submitted. In October 2014, the Company was notified that it would receive a disbursement of settlement funds, and the Company received a pro-rata disbursement net of all fees of approximately $21.4 million. The Company recorded this settlement gain in the fourth quarter of 2014.

NOTE 10—OTHER

Other general expense - net

Included in Other general expense - net were the following:

(Thousands of dollars)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Provisions for environmental matters - net	$10,510	$259	$11,560	$(175)
(Gain) loss on disposition of assets	(539)	511	(3,262)	373
Total	$9,971	$770	$8,298	$198

Provisions for environmental matters - net represent site-specific increases or decreases to environmental-related accruals as information becomes available upon which more accurate costs can be reasonably estimated and as additional accounting guidelines are issued. Environmental-related accruals are not recorded net of insurance proceeds in accordance with the Offsetting Subtopic of the Balance Sheet Topic of the ASC. See Note 8 for further details on the Company's environmental-related activities.

The (gain) loss on disposition of assets represents net realized (gains) losses associated with the disposal of fixed assets previously used in the conduct of the primary business of the Company.

Other expense (income) - net

Included in Other expense (income) - net were the following:

(Thousands of dollars)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Dividend and royalty income	$(1,039)	$(1,195)	$(2,120)	$(2,246)
Net expense from financing activities	2,197	2,547	5,164	5,469
Foreign currency transaction related losses (gains)	1,722	(1,830)	2,860	1,028
Other income	(4,843)	(6,973)	(10,340)	(13,279)
Other expense	2,640	2,304	4,868	4,384
Total	$677	$(5,147)	$432	$(4,644)

The net expense from financing activities includes the net expense relating to the change in the Company's financing fees.

Foreign currency transaction related losses (gains) represent net realized losses (gains) on U.S. dollar-denominated liabilities of foreign subsidiaries and net realized and unrealized losses (gains) from foreign currency option and forward contracts. There were no foreign currency option and forward contracts outstanding at June 30, 2015 and 2014.

Other income and Other expense included items of revenue, gains, expenses and losses that were unrelated to the primary business purpose of the Company. There were no other items within the other income or other expense caption that were individually significant.

NOTE 11—INCOME TAXES

The effective tax rate was 31.1 percent and 31.3 percent for the second quarter and first six months of 2015, respectively, compared to 32.1 percent and 31.6 percent for the second quarter and first six months of 2014, respectively. The decrease in the effective tax rate for the second quarter of 2015 compared to 2014 was primarily due to the recognition of previously unrecognized tax benefits.

At December 31, 2014, the Company had $31.6 million in unrecognized tax benefits, the recognition of which would have had an effect of $28.2 million on the current provision for income taxes. Included in the balance of unrecognized tax benefits at December 31, 2014 was $4.4 million related to tax positions for which it was reasonably possible that the total amounts could significantly change during the next twelve months. During the first six months of 2015, the Company recognized tax benefits related to partnership investments and the completion of IRS audits of the Company's U.S. income tax returns for the 2010, 2011 and 2012 tax years. At June 30, 2015, the Company had $25.3 million in unrecognized tax benefits, the recognition of which would have an effect of $22.2 million on the current provision for income taxes. Included in the balance of unrecognized tax benefits at June 30, 2015 was $1.0 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. This amount primarily relates to expiring statutes in federal, foreign and state jurisdictions.

The Company classifies all income tax related interest and penalties as income tax expense. At December 31, 2014, the Company had accrued $5.7 million for the potential payment of income tax interest and penalties. There were no significant changes to these balances during the first six months of 2015.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As of June 30, 2015, there are no examinations being conducted by the IRS, however, the Company is still open for examination for the 2013 and 2014 tax years.

As of June 30, 2015, the Company is subject to non-U.S. income tax examinations for the tax years of 2007 through 2014. In addition, the Company is subject to state and local income tax examinations for the tax years 2004 through 2014.

NOTE 12—NET INCOME PER COMMON SHARE

(Thousands of dollars except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Basic				
Average common shares outstanding	92,260,367	96,599,869	92,500,213	97,716,539
Net income	$349,937	$291,447	$481,341	$406,904
Less net income allocated to unvested restricted shares	(1,539)	(1,722)	(2,014)	(2,245)
Net income allocated to common shares	$348,398	$289,725	$479,327	$404,659
Basic net income per common share	$3.78	$3.00	$5.18	$4.14
Diluted				
Average common shares outstanding	92,260,367	96,599,869	92,500,213	97,716,539
Stock options and other contingently issuable shares (1)	1,864,328	1,942,040	1,926,978	1,972,018
Average common shares outstanding assuming dilution	94,124,695	98,541,909	94,427,191	99,688,557
Net income	$349,937	$291,447	$481,341	$406,904
Less net income allocated to unvested restricted shares assuming dilution	(1,510)	(1,690)	(1,977)	(2,205)
Net income allocated to common shares assuming dilution	$348,427	$289,757	$479,364	$404,699
Diluted net income per common share	$3.70	$2.94	$5.08	$4.06

(1) Stock options and other contingently issuable shares excluded 21,243 shares due to their anti-dilutive effect for the three and six months ended June 30, 2015. Stock options and other contingently issuable shares excluded 2,932 shares for the six months ended June 30, 2014. There were no options excluded due to their anti-dilutive effect for the three months ended June 30, 2014.

The Company has two classes of participating securities: common shares and restricted shares, representing 99% and 1% of outstanding shares, respectively. The restricted shares are shares of unvested restricted stock granted under the Company's restricted stock award program. Time-based restricted shares receive non-forfeitable dividends, while dividends on performance-based restricted shares are deferred and payment is contingent upon the awards vesting. The time-based restricted shares are considered a participating security, therefore, basic and diluted earnings per share are calculated using the two-class method in accordance with the Earnings Per Share Topic of the ASC.

NOTE 13—REPORTABLE SEGMENT INFORMATION

The Company reports segment information in the same way that management internally organizes its business for assessing performance and making decisions regarding allocation of resources in accordance with the Segment Disclosures Topic of the ASC. The Company has determined that it has four reportable operating segments: Paint Stores Group, Consumer Group, Global Finishes Group and Latin America Coatings Group (individually, a "Reportable Segment" and collectively, the “Reportable Segments”).

(Thousands of dollars)	Three Months Ended June 30, 2015					
	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	$1,984,985	$490,042	$505,767	$ 150,068	$ 1,277	$3,132,139
Intersegment transfers		768,663	1,188	10,484	(780,335)	
Total net sales and intersegment transfers	$1,984,985	$1,258,705	$506,955	$ 160,552	$ (779,058)	$3,132,139
Segment profit	$433,381	$114,247	$57,268	$ 4,031		$608,927
Interest expense					$ (12,885)	(12,885)
Administrative expenses and other					(88,260)	(88,260)
Income before income taxes	$433,381	$114,247	$57,268	$ 4,031	$ (101,145)	$507,782

	Three Months Ended June 30, 2014					
	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	$1,882,592	$433,356	$544,597	$ 181,221	$ 1,229	$3,042,995
Intersegment transfers		766,080	2,202	9,927	(778,209)	
Total net sales and intersegment transfers	$1,882,592	$1,199,436	$546,799	$ 191,148	$ (776,980)	$3,042,995
Segment profit	$375,857	$92,488	$54,865	$ 5,660		$528,870
Interest expense					$ (16,374)	(16,374)
Administrative expenses and other					(83,266)	(83,266)
Income before income taxes	$375,857	$92,488	$54,865	$ 5,660	$ (99,640)	$429,230

	Six Months Ended June 30, 2015					
	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	$3,446,490	$841,732	$975,323	$ 316,299	$ 2,579	$5,582,423
Intersegment transfers		1,376,201	2,962	20,553	(1,399,716)	
Total net sales and intersegment transfers	$3,446,490	$2,217,933	$978,285	$ 336,852	$ (1,397,137)	$5,582,423
Segment profit	$609,957	$169,653	$96,168	$ 13,531		$889,309
Interest expense					$ (25,236)	(25,236)
Administrative expenses and other					(163,050)	(163,050)
Income before income taxes	$609,957	$169,653	$96,168	$ 13,531	$ (188,286)	$701,023

	Six Months Ended June 30, 2014					
	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	$3,242,595	$758,655	$1,042,236	$ 363,609	$ 2,456	$5,409,551
Intersegment transfers		1,312,642	3,615	20,049	(1,336,306)	
Total net sales and intersegment transfers	$3,242,595	$2,071,297	$1,045,851	$ 383,658	$ (1,333,850)	$5,409,551
Segment profit	$522,122	$143,576	$101,342	$ 15,647		$782,687
Interest expense					$ (32,768)	(32,768)
Administrative expenses and other					(154,612)	(154,612)
Income before income taxes	$522,122	$143,576	$101,342	$ 15,647	$ (187,380)	$595,307

In the reportable segment financial information, Segment profit was total net sales and intersegment transfers less operating costs and expenses. Domestic intersegment transfers were accounted for at the approximate fully absorbed manufactured cost, based on normal capacity volumes, plus customary distribution costs. International intersegment transfers were accounted for at values comparable to normal unaffiliated customer sales. The Administrative segment includes the administrative expenses of the Company's corporate headquarters site. Also included in the Administrative segment was interest expense, interest and investment income, certain expenses related to closed facilities and environmental-related matters, and other expenses which were not directly associated with the Reportable Segments. The Administrative segment did not include any significant foreign operations. Also included in the Administrative segment was a real estate management unit that is responsible for the ownership, management and leasing of non-retail properties held primarily for use by the Company, including the Company's headquarters site, and disposal of idle facilities. Sales of this segment represented external leasing revenue of excess headquarters space or leasing of facilities no longer used by the Company in its primary businesses. Gains and losses from the sale of property were not a significant operating factor in determining the performance of the Administrative segment.

Net external sales and segment profit of all consolidated foreign subsidiaries were $476.8 million and $22.4 million, respectively, for the second quarter of 2015, and $576.7 million and $39.9 million, respectively, for the second quarter of 2014. Net external sales and segment profit of these subsidiaries were $933.3 million and $40.7 million, respectively, for the first six months of 2015, and $1.106 billion and $72.6 million, respectively, for the first six months of 2014. Long-lived assets of these subsidiaries totaled $521.0 million and $614.6 million at June 30, 2015 and June 30, 2014, respectively. Domestic operations accounted for the remaining net external sales, segment profits and long-lived assets. No single geographic area outside the United States was significant relative to consolidated net external sales, income before taxes, or consolidated long-lived assets.

Export sales and sales to any individual customer were each less than 10 percent of consolidated sales to unaffiliated customers during all periods presented.

NOTE 14—FAIR VALUE MEASUREMENTS

The Fair Value Measurements and Disclosures Topic of the ASC applies to the Company's financial and non-financial assets and liabilities. The guidance 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. The Company did not have any fair value measurements for its non-financial assets and liabilities during the second quarter. The following table presents the Company's financial assets and liabilities that are measured at fair value on a recurring basis, categorized using the fair value hierarchy:

(Thousands of dollars)

	Fair Value at June 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Deferred compensation plan asset [(1)]	$24,749	$1,733	$23,016	