

SHERWIN WILLIAMS CO

Form 10-Q

October 22, 2008

Table of Contents

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

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the Period Ended September 30, 2008**

or

**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 Prospect Avenue, N.W., 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 No

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 Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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 116,902,299 shares as of September 30, 2008.

TABLE OF CONTENTS

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Item 4. CONTROLS AND PROCEDURES

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 2. Unregistered Sales of Securities and Use of Proceeds

Item 6. Exhibits

SIGNATURES

INDEX TO EXHIBITS

EX-10(a)

EX-10(b)

EX-31(a)

EX-31(b)

EX-32(a)

EX-32(b)

Table of Contents**THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME (UNAUDITED)**

Thousands of dollars, except per share data

	Three months ended September		Nine months ended September	
	30, 2008	2007	30, 2008	2007
Net sales	\$ 2,268,658	\$ 2,197,042	\$ 6,279,885	\$ 6,151,408
Cost of goods sold	1,308,169	1,208,654	3,565,985	3,385,083
Gross profit	960,489	988,388	2,713,900	2,766,325
<i>Percent to net sales</i>	<i>42.3%</i>	<i>45.0%</i>	<i>43.2%</i>	<i>45.0%</i>
Selling, general and administrative expenses	681,352	670,433	2,010,043	1,955,073
<i>Percent to net sales</i>	<i>30.0%</i>	<i>30.5%</i>	<i>32.0%</i>	<i>31.8%</i>
Other general (income) expense - net	(1,470)	3,185	(75)	10,209
Impairment of trademarks and goodwill			23,912	
Interest expense	15,200	17,048	51,006	52,415
Interest and net investment income	(929)	(1,808)	(2,323)	(12,591)
Other (income) expense - net	194	5,213	(4,006)	239
Income before income taxes	266,142	294,317	635,343	760,980
Income taxes	89,061	93,968	208,633	246,222
Net income	\$ 177,081	\$ 200,349	\$ 426,710	\$ 514,758
Net income per common share:				
Basic	\$ 1.53	\$ 1.59	\$ 3.64	\$ 3.99
Diluted	\$ 1.50	\$ 1.55	\$ 3.57	\$ 3.88
Average shares outstanding - basic	115,828,466	125,958,878	117,182,407	128,887,107
Average shares and equivalents outstanding - diluted	118,183,353	129,592,682	119,662,014	132,601,488

See notes to condensed consolidated financial statements.

Table of Contents**THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

Thousands of dollars

	September 30, 2008	December 31, 2007	September 30, 2007
Assets			
Current assets:			
Cash and cash equivalents	\$ 40,927	\$ 27,325	\$ 21,233
Accounts receivable, less allowance	1,072,964	870,675	1,097,342
Inventories:			
Finished goods	745,316	756,087	761,340
Work in process and raw materials	118,143	131,378	125,002
	863,459	887,465	886,342
Deferred income taxes	103,725	104,600	123,452
Other current assets	195,816	179,515	191,945
Total current assets	2,276,891	2,069,580	2,320,314
Goodwill	1,002,802	996,613	1,001,700
Intangible assets	337,354	351,144	350,567
Deferred pension assets	412,537	400,553	399,185
Other assets	154,655	138,078	155,375
Property, plant and equipment:			
Land	86,531	83,008	80,730
Buildings	580,965	561,794	553,724
Machinery and equipment	1,566,085	1,516,534	1,479,116
Construction in progress	44,011	65,322	71,160
	2,277,592	2,226,658	2,184,730
Less allowances for depreciation	1,392,675	1,327,286	1,303,986
	884,917	899,372	880,744
Total Assets	\$ 5,069,156	\$ 4,855,340	\$ 5,107,885
Liabilities and Shareholders Equity			
Current liabilities:			
Short-term borrowings	\$ 715,953	\$ 657,082	\$ 656,379
Accounts payable	882,313	740,797	837,934
Compensation and taxes withheld	183,775	224,300	208,587
Accrued taxes	204,719	70,669	172,790
Current portion of long-term debt	13,459	14,912	10,338
Other accruals	410,640	433,625	407,999

Edgar Filing: SHERWIN WILLIAMS CO - Form 10-Q

Total current liabilities	2,410,859	2,141,385	2,294,027
Long-term debt	297,391	293,454	293,971
Postretirement benefits other than pensions	265,218	262,720	305,710
Other long-term liabilities	357,402	372,054	369,381
Shareholders' equity:			
Common stock - \$1.00 par value: 116,902,299, 122,814,241 and 125,614,552 shares outstanding at September 30, 2008, December 31, 2007 and September 30, 2007, respectively	226,761	225,577	225,377
Preferred stock - convertible, no par value: 216,753, 324,733 and 352,460 shares outstanding at September 30, 2008, December 31, 2007 and September 30, 2007, respectively	216,753	324,733	352,460
Unearned ESOP compensation	(216,753)	(324,733)	(352,460)
Other capital	956,533	897,656	865,591
Retained earnings	4,235,925	3,935,485	3,873,830
Treasury stock, at cost	(3,459,452)	(3,074,388)	(2,891,326)
Cumulative other comprehensive loss	(221,481)	(198,603)	(228,676)
Total shareholders' equity	1,738,286	1,785,727	1,844,796
Total Liabilities and Shareholders' Equity	\$ 5,069,156	\$ 4,855,340	\$ 5,107,885

See notes to condensed consolidated financial statements.

- 3 -

Table of Contents**THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS (UNAUDITED)**

Thousands of dollars

	Nine months ended September 30,	
	2008	2007
OPERATING ACTIVITIES		
Net income	\$ 426,710	\$ 514,758
Adjustments to reconcile net income to net operating cash:		
Depreciation	107,330	100,964
Amortization of intangibles and other assets	16,887	17,311
Impairment of trademarks and goodwill	23,912	
Stock-based compensation expense	27,064	23,925
Provisions for environmental-related matters	1,757	22,268
Defined benefit pension plans net credit	(6,164)	(4,323)
Net increase in postretirement liability	2,182	6,359
Other	(4,348)	(8,790)
Change in working capital accounts - net	26,140	(103,274)
Costs incurred for environmental - related matters	(12,605)	(6,560)
Costs incurred for qualified exit costs	(3,835)	(1,087)
Other	(12,445)	2,204
Net operating cash	592,585	563,755
INVESTING ACTIVITIES		
Capital expenditures	(91,799)	(117,206)
Acquisitions of businesses, net of cash acquired	(48,465)	(248,185)
Increase in other investments	(12,130)	(33,357)
Decrease in short-term investments		21,200
Proceeds from sale of assets	8,772	19,660
Other	(12,007)	(11,469)
Net investing cash	(155,629)	(369,357)
FINANCING ACTIVITIES		
Net increase in short-term borrowings	60,166	273,156
Net increase (decrease) in long-term debt	678	(201,149)
Payments of cash dividends	(124,162)	(123,137)
Proceeds from stock options exercised	25,744	64,412
Income tax effect of stock-based compensation exercises and vesting	8,002	32,146
Treasury stock purchased	(379,941)	(680,247)
Other	(5,819)	(9,594)
Net financing cash	(415,332)	(644,413)

Effect of exchange rate changes on cash	(8,022)	2,078
Net increase (decrease) in cash and cash equivalents	13,602	(447,937)
Cash and cash equivalents at beginning of year	27,325	469,170
Cash and cash equivalents at end of period	\$ 40,927	\$ 21,233
Income taxes paid	\$ 45,336	\$ 126,587
Interest paid	20,678	61,822

See notes to condensed consolidated financial statements.

- 4 -

Table of Contents

**THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)**

Periods ended September 30, 2008 and 2007

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 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.

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, 2007.

The consolidated results for the three months and nine months ended September 30, 2008 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 June 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Emerging Issues Task Force (EITF) No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. Under the FSP, unvested share-based payment awards that contain rights to receive nonforfeitable dividends (whether paid or unpaid) are participating securities, and should be included in the two-class method of computing EPS. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those years, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

In May 2008, the FASB issued Financial Accounting Standard (FAS) No. 162, The Hierarchy of Generally Accepted Accounting Principles. The statement is intended to improve financial reporting by identifying a consistent hierarchy for selecting accounting principles to be used in preparing financial statements that are prepared in conformance with generally accepted accounting principles. Unlike Statement on Auditing Standards (SAS) No. 69, The Meaning of Present in Conformity With GAAP, FAS No. 162 is directed to the entity rather than the

Table of Contents

auditor. The statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board (PCAOB) amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with GAAP," and is not expected to have any impact on the Company's results of operations, financial condition or liquidity.

In April 2008, the FASB issued 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 is effective for fiscal years beginning after December 15, 2008, and the guidance for determining the useful life of a recognized intangible asset must be applied prospectively to intangible assets acquired after the effective date. The FSP is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

In March 2008, the FASB issued 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 is effective for financial statements issues for fiscal years and interim periods beginning after November 15, 2008, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

In December 2007, the FASB issued 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 is effective for acquisitions made in fiscal years beginning after December 15, 2008, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

In December 2007, the FASB issued 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 is effective prospectively for fiscal years beginning after December 15, 2008, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

Table of Contents

In February 2007, the FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. FAS No. 159 allows companies to elect to measure certain assets and liabilities at fair value and is effective for fiscal years beginning after November 15, 2007. Adoption of this standard is optional. If adopted, the standard is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

Effective January 1, 2008, the Company adopted FASB EITF Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements and EITF Issue No. 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements. Both of these EITFs state that an employer should recognize a liability for postretirement benefits based on these life insurance arrangements. The Company recognized a cumulative-effect adjustment of \$2.1 million reducing the January 1, 2008 balance of retained earnings and creating a long-term liability. The adoption of these EITFs will not have a significant impact on the Company's future results of operations, financial condition or liquidity.

The Company also adopted EITF Issue No. 06-11, Accounting for Income Tax Benefits on Dividends on Share-Based Payment Awards as of January 1, 2008. This EITF indicates that tax benefits of dividends on unvested restricted stock are to be recognized in equity as an increase in the pool of excess tax benefits. Should the related awards forfeit or no longer become expected to vest, the benefits are to be reclassified from equity to the income statement. The adoption of this EITF 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. FAS No. 157, as issued, is effective for fiscal years beginning after November 15, 2007. FASB Staff Position (FSP) FAS No. 157-2 was issued in February 2008 and deferred the effective date of FAS No. 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities. Accordingly, as of January 1, 2008, the Company adopted FAS No. 157 for financial assets and liabilities only. The Company is still in the process of evaluating the impact that FAS No. 157 will have on its pension related financial assets and its nonfinancial assets and liabilities.

Table of Contents

The following table summarizes the Company's non-pension financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2008:

(Thousands of dollars)	Fair Value at September 30, 2008	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 ^(A)	\$ 15,180	\$ 15,180		
Net currency derivative asset ^(B)	23		\$ 23	
Total assets at fair value	\$ 15,203	\$ 15,180	\$ 23	
Liabilities:				
Deferred compensation plan liability ^(C)	\$ 20,733	\$ 20,733		
	\$ 20,733	\$ 20,733		

(A) The Company maintains an executive deferred compensation plan structured as a rabbi trust. The investment assets of the rabbi trust consist of marketable securities valued using quoted market prices multiplied by the number of shares owned.

(B) The net currency derivative asset represents the fair value of foreign currency

swaps. The swaps are valued using the banks proprietary models.

- (C) The deferred compensation plan liability represents the Company's liability under its deferred compensation savings plan and is valued based on quoted market prices.

The adoption of FAS No. 157 for financial assets and financial liabilities had no effect on the Company's results of operations, financial condition or liquidity. The adoption of the Statement for nonfinancial assets and nonfinancial liabilities in 2009 is also expected to not have an effect on Company's results of operations, financial condition or liquidity.

Note C DIVIDENDS

Dividends paid on common stock during each of the first three quarters of 2008 and 2007 were \$.35 per common share and \$.315 per common share, respectively.

Table of Contents**Note D COMPREHENSIVE INCOME**

Comprehensive income is summarized as follows:

(Thousands of dollars)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net income	\$ 177,081	\$ 200,349	\$ 426,710	\$ 514,758
Foreign currency translation adjustments	(39,173)	16,970	(23,509)	29,217
Amortization of net prior service costs and net actuarial losses	(69)	1,260	1,966	3,872
Adjustments of marketable equity securities and derivative instruments used in cash flow hedges, net of taxes	639	(376)	(1,334)	700
Comprehensive income	\$ 138,478	\$ 218,203	\$ 403,833	\$ 548,547

Note E PRODUCT WARRANTIES

Changes in the Company's accrual for product warranty claims during the first nine months of 2008 and 2007, including customer satisfaction settlements, were as follows:

(Thousands of dollars)	2008	2007
Balance at January 1	\$ 19,596	\$ 25,226
Charges to expense	20,031	22,228
Settlements	(22,373)	(26,413)
Balance at September 30	\$ 17,254	\$ 21,041

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, 2007.

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

Table of Contents

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 nine months of 2008, one manufacturing facility and two distribution facilities in the Consumer Group were closed. Total qualified exit costs for the facilities were \$3,805,000. Two acquired manufacturing facilities and two administrative offices in the Paint Stores Group were also closed. The closures in the Paint Stores Group were planned at the time of acquisition. The total qualified exit costs for the acquired facilities were \$1,668,000, included as part of the purchase price allocation in accordance with FAS No. 141.

During 2007, two manufacturing facilities were closed. One closed facility, in the Paint Stores Group, was planned at the time of acquisition for closure and disposal. The total qualified exit costs for the acquired facility were \$2,635,000, included as part of the purchase price allocation in accordance with FAS No. 141. The other closed facility, in the Consumer Group, was an older facility replaced by a new manufacturing facility. Provisions of \$1,213,000 for severance and related costs resulting from the closure of the facility were incurred in 2007.

The following table summarizes the activity and remaining liabilities associated with qualified exit costs at September 30, 2008 and for the nine-month period then ended:

Table of Contents

(Thousands of dollars)

Exit Plan	Balance at December 31, 2007	Provisions in Cost of goods sold or acquired	Actual expenditures charged to accrual	Balance at September 30, 2008
Consumer Group manufacturing and two distribution facilities shutdown in 2008:				
Severance and related costs		\$ 805	\$ (677)	\$ 128
Other qualified exit costs		3,000	(11)	2,989
Paint Stores Group manufacturing facilities and administrative offices shutdown in 2008:				
Severance and related costs		1,396	(1,271)	125
Other qualified exit costs		272	(205)	67
Paint Stores Group manufacturing facility shutdown in 2007:				
Severance and related costs	\$ 650		(530)	120
Other qualified exit costs	1,726		(322)	1,404
Consumer Group manufacturing facilities shutdown in 2005:				
Other qualified exit costs	163		(163)	
Consumer Group manufacturing facilities shutdown in 2004:				
Other qualified exit costs	80		(28)	52
Other qualified exit costs for facilities shutdown prior to 2003	10,899		(628)	10,271
Totals	\$ 13,518	\$ 5,473	\$ (3,835)	\$ 15,156

Note G HEALTH CARE, PENSION AND OTHER BENEFITS

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

Table of Contents

(Thousands of dollars)	Domestic Defined Benefit Pension Plans		Foreign Defined Benefit Pension Plans		Postretirement Benefits Other than Pensions	
	2008	2007	2008	2007	2008	2007
Three months ended September 30:						
Net periodic benefit (credit) cost:						
Service cost	\$ 5,248	\$ 4,610	\$ 621	\$ 715	\$ 926	\$ 1,177
Interest cost	4,382	4,030	1,033	927	4,085	4,231
Expected return on assets	(13,273)	(12,648)	(645)	(622)		
Amortization of:						
Prior service cost (credit)	730	305	16	15	(158)	(159)
Actuarial loss	(537)	342	229	315	53	1,282
Net periodic benefit (credit) cost	\$ (3,450)	\$ (3,361)	\$ 1,254	\$ 1,350	\$ 4,906	\$ 6,531
Nine months ended September 30:						
Net periodic benefit (credit) cost:						
Service cost	\$ 15,059	\$ 13,830	\$ 1,903	\$ 2,105	\$ 2,780	\$ 3,531
Interest cost	13,521	12,090	3,185	2,729	12,255	12,693
Expected return on assets	(39,712)	(37,944)	(1,985)	(1,830)		
Amortization of:						
Prior service cost (credit)	1,107	915	47	45	(475)	(477)
Actuarial loss	0	1,026	711	925	160	3,846
Net periodic benefit (credit) cost	\$ (10,025)	\$ (10,083)	\$ 3,861	\$ 3,974	\$ 14,720	\$ 19,593

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, 2007.

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 September 30, 2008, the unaccrued maximum of the estimated range of possible outcomes is \$119.8 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

Table of Contents

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 September 30, 2008 and 2007 were accruals for extended environmental-related activities of \$124.2 million and \$150.4 million, respectively. Estimated costs of current investigation and remediation activities of \$60.3 million and \$39.6 million are included in Other accruals at September 30, 2008 and 2007, respectively.

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 September 30, 2008. At September 30, 2008, \$138.7 million, or 75.2 percent of the total accrual, related directly to these five sites. In the aggregate unaccrued maximum of \$119.8 million at September 30, 2008, \$76.8 million, or 64.1 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 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, 2007.

Table of Contents**Note I LITIGATION**

In the course of its business, the Company is subject to a variety of claims and lawsuits, including 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 incurrance of a liability or the reduction of a liability. In accordance with Statement of Financial Accounting Standards (FAS) No. 5, *Accounting for Contingencies*, 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 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, FAS No. 5 requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred if even the possibility may be remote.

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 a defendant in a number of legal proceedings, including individual personal injury actions, purported class actions, actions brought by the State of Ohio, 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 are seeking recovery 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 is also a defendant in legal proceedings arising from the manufacture and sale of non-lead-based paints which 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 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.

Table of Contents

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, such as the jury verdict against the Company and other defendants in the State of Rhode Island action and the Wisconsin State Supreme Court's July 2005 determination that Wisconsin's risk contribution theory may apply in the lead pigment litigation (both discussed in more detail below), 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. (The jury verdict in the State of Rhode Island action was subsequently reversed by the Rhode Island Supreme Court. See Rhode Island lead pigment litigation below.) 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. Any potential liability that may result from such litigation or such 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.

Rhode Island lead pigment litigation. During September 2002, a jury trial commenced in the first phase of an action brought by the State of Rhode Island against the Company and the other defendants. The sole issue before the court in this first phase was whether lead pigment in paint constitutes a public nuisance under Rhode Island law. In October 2002, the court declared a mistrial as the jury, which was split four to two in favor of the defendants, was unable to reach a unanimous decision.

The State of Rhode Island retried the case and on February 22, 2006, 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. On February 28, 2006, the Court granted the defendants' motion to dismiss the punitive damages claim, finding insufficient evidence to support the State's request for punitive damages. Final judgment was entered against the Company and two other defendants on March 16, 2007. The

Table of Contents

Company and two other defendants appealed the final judgment to the Rhode Island Supreme Court 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. This decision reverses 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 and concludes the case in favor of the Company and the other defendants.

Other public nuisance claim litigation. The Company and other companies are or were defendants in other legal proceedings seeking recovery based on public nuisance liability theories including claims brought by the County of Santa Clara, California and other public entities in the State of California, the City of St. Louis, Missouri, the City of Milwaukee, Wisconsin, various cities and counties in the State of New Jersey, various cities in the State of Ohio and the State of Ohio.

The Santa Clara County, California proceeding was initiated in March 2000. The named plaintiffs are the County of Santa Clara, County of Santa Cruz, County of Solano, County of Alameda, County of Kern, City and County of San Francisco, San Francisco Housing Authority, San Francisco Unified School District, City of Oakland, Oakland Housing Authority, Oakland Redevelopment Agency and the Oakland Unified School District. The proceeding purports to be a class action on behalf of all public entities in the State of California except the State and its agencies. The plaintiffs' second amended complaint asserted claims for 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, and the third amended complaint alleges similar claims including a claim for public nuisance. Various asserted claims were resolved in favor of the defendants through pre-trial demurrers and motions to strike. In October 2003, the trial court granted the defendants' motion for summary judgment against the remaining counts on statute of limitation grounds. The plaintiffs appealed the trial court's decision and on March 3, 2006, the Court of Appeal, Sixth Appellate District, reversed in part the demurrers and summary judgment entered in favor of the Company and the other defendants. The Court of Appeal reversed the dismissal of the public nuisance claim for abatement brought by the cities of Santa Clara and Oakland and the City and County of San Francisco, and reversed summary judgment on all of the plaintiffs' fraud claim to the extent that the plaintiffs alleged that the defendants had made fraudulent statements or omissions minimizing the risks of low-level exposure to lead. The Court of Appeal further vacated the summary judgment holding that the statute of limitations barred the plaintiffs' strict liability and negligence claims, and held that those claims had not yet accrued because physical injury to the plaintiffs' property had not been alleged. The Court of Appeal affirmed the dismissal of the public nuisance claim for damages to the plaintiffs' properties, most aspects of the fraud claim, the trespass claim and the unfair business practice claim. The plaintiffs have filed a motion for leave to file a fourth amended complaint. On April 4, 2007, the trial court entered an order granting the defendants' motion to bar payment of contingent fees to private attorneys. The plaintiffs appealed the trial court's order and on April 8, 2008 the California Court of Appeal reversed the trial court's order. The defendants filed a petition for review with the California Supreme Court requesting the Supreme Court to review the decision of the Court of Appeal.

Table of Contents

The City of St. Louis proceeding was initiated in January 2000. The City initially alleged claims for strict liability, negligence, fraudulent misrepresentation, negligent misrepresentation, concert of action, conspiracy, public nuisance, restitution and indemnity. Following various pre-trial proceedings during which many of the asserted claims were dismissed by the trial court or voluntarily dismissed by the City, on June 10, 2003, the City filed its fourth amended petition alleging a single count of public nuisance. Following further pre-trial proceedings, on January 18, 2006, the trial court granted the defendants' motion for summary judgment based on the City's lack of product identification evidence. The City has appealed the trial court's January 18, 2006 decision and a prior trial court decision. On June 12, 2007, the Missouri Supreme Court affirmed summary judgment for the Company and other defendants. This decision concludes the case in favor of the Company and the other defendants.

The City of Milwaukee proceeding was initiated in April 2001 against Mautz Paint Co. and NL Industries, Inc. On November 7, 2001, the Company acquired certain assets of Mautz Paint Co. and agreed (under terms and conditions set forth in the purchase agreement) to defend and indemnify Mautz Paint Co. for its liability, if any, to the City of Milwaukee in this action. The City's complaint included claims for continuing public nuisance, restitution, conspiracy, negligence, strict liability, failure to warn and violation of Wisconsin's trade practices statute. Following various pre-trial proceedings during which several of the City's claims were dismissed by the court or voluntarily dismissed by the City, on August 13, 2003, the trial court granted defendants' motion for summary judgment on the remaining claims. The City appealed and, on November 9, 2004, the Wisconsin Court of Appeals reversed the trial court's decision and remanded the claims for public nuisance, conspiracy and restitution to the trial court. On February 13, 2007, the trial court entered an order severing and staying the claims against Mautz Paint Co. The action against NL Industries proceeded to trial and the jury found that the presence of lead paint in Milwaukee is a public nuisance, but that NL Industries was not at fault for the public nuisance. The City of Milwaukee is appealing the jury verdict finding that NL Industries did not intentionally cause a public nuisance and the trial court's denial of the City's post-trial motions.

In December 2001 and early 2002, a number of cities and counties in New Jersey individually initiated proceedings in the Superior Court of New Jersey against the Company and other companies asserting claims for fraud, public nuisance, civil conspiracy, unjust enrichment and indemnity. The New Jersey Supreme Court consolidated all of the cases and assigned them to the Superior Court in Middlesex County. By order dated November 4, 2002, the Superior Court granted the defendants' motion to dismiss all complaints. The plaintiffs appealed and, on August 17, 2005, the Appellate Division affirmed the dismissal of all claims except public nuisance. The Appellate Division reinstated the public nuisance claim in each case. On November 17, 2005, the New Jersey Supreme Court granted defendants' petition for certification to review the reinstatement of the public nuisance claims. On June 15, 2007, the New Jersey Supreme Court reversed the Appellate Division's decision and reinstated the dismissal of the public nuisance claims. This decision concludes the case in favor of the Company and the other defendants.

In 2006 and 2007, a number of cities in Ohio individually initiated proceedings in state court against the Company and other companies asserting claims for public nuisance, concert of action, unjust enrichment, indemnity and punitive damages. Also in September 2006, the

Table of Contents

Company initiated proceedings in the United States District Court, Southern District of Ohio, against certain of the Ohio cities which initiated the state court proceedings referred to in the preceding sentence and John Doe cities and public officials. The Company's proceeding sought declaratory and injunctive relief to prevent the violation of the Company's federal constitutional rights in relation to such state court proceedings. All of these Ohio cities' actions have been voluntarily dismissed by the plaintiff cities. Accordingly, on August 28, 2008, the Court granted, with prejudice, the Company's motion to dismiss the remaining proceedings in the United States District Court, Southern District of Ohio.

In April 2007, the State of Ohio filed an action against the Company and other companies asserting a claim for public nuisance. The State of Ohio seeks compensatory and punitive damages. Simultaneously, the State of Ohio filed a motion to consolidate this action with the action previously filed by the City of Columbus (one of the Ohio cities referred to in the preceding paragraph) and a motion to stay this action pending the Ohio Supreme Court's resolution of the mandamus action in *State ex rel. The Ohio General Assembly v. Brunner*, Case No. 2007-0209. In September 2007, the trial court entered an order to reinstate these actions due to the Ohio Supreme Court's decision on the mandamus action in *State ex rel. The Ohio General Assembly v. Brunner*.

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, claims for damages allegedly incurred by the children's parents or guardians, and claims for damages allegedly incurred by professional painting contractors. 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 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 include 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) due to the plaintiff's inability to identify the manufacturer of any product that allegedly injured the plaintiff. Following various pre-trial proceedings during which certain of the plaintiff's claims were dismissed by the court, on March 10, 2003, the trial court granted the defendants' motion for summary judgment, dismissing the case with prejudice and awarding costs to each defendant. The plaintiff appealed and on June 14, 2004, the Wisconsin Court of Appeals affirmed the trial court's decision. On July 15, 2005, the Wisconsin Supreme Court reversed in part the trial court's decision and decided, assuming all of plaintiff's facts in the summary judgment record to be true, that the risk contribution theory could then apply to excuse the plaintiff's lack of evidence identifying any of the Company's or the other defendant's products as the cause of the alleged injury. The case was remanded to the trial court for further proceedings and a trial commenced on October 1, 2007. On November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain

Table of Contents

damaged or injured as a result. The plaintiff filed post-trial motions for a new trial which were denied by the trial court. On March 4, 2008, final judgment was entered in favor of the Company and other defendants. The plaintiff has filed an appeal of the final judgment.

Wisconsin is the first jurisdiction to apply a theory of liability with respect to alleged personal injury (i.e.: risk contribution/market share liability) which 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.

Insurance coverage litigation. On March 3, 2006, the Company filed a lawsuit in the Common Pleas Court, Cuyahoga County, Ohio against its liability insurers, including certain Underwriters at Lloyd's of London. The lawsuit seeks, among other things, (i) a declaration from the court that costs associated with the abatement of lead pigment in the State of Rhode Island, or any other jurisdiction, are covered under certain insurance policies issued to the Company and (ii) monetary damages for breach of contract and bad faith against the Lloyd's Underwriters for unjustified denial of coverage for the cost of complying with any final judgment requiring the Company to abate any alleged nuisance caused by the presence of lead pigment paint in buildings. This lawsuit was filed in response to a lawsuit filed by the Lloyd's Underwriters against the Company, two other defendants in the Rhode Island litigation and various insurance companies on February 23, 2006. The Lloyd's Underwriters' lawsuit asks a New York state court to determine that there is no indemnity insurance coverage for such abatement related costs, or, in the alternative, if such indemnity coverage is found to exist, the proper allocation of liability among the Lloyd's Underwriters, the defendants and the defendants' other insurance companies. 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. Both the Ohio state court and New York state court actions have been stayed.

Table of Contents**Note J OTHER (INCOME) EXPENSE***Other general (income) expense net*

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

(Thousands of dollars)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Provisions for environmental matters-net	\$ 1,046	\$ 14,551	\$ 1,757	\$ 22,268
(Gain) on disposition of assets	(2,516)	(11,366)	(1,832)	(12,059)
Total (income) expense	\$ (1,470)	\$ 3,185	\$ (75)	\$ 10,209

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 FASB Interpretation (FIN) No. 39, Offsetting of Amounts Related to Certain Contracts an Interpretation of APB Opinion No. 10 and FASB Statement No. 105. See Note H for further details on the Company's environmental-related activities.

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

Other (income) expense net

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

(Thousands of dollars)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Dividend and royalty income	\$ (2,334)	\$ (830)	\$ (5,878)	\$ (2,768)
Net expense from financing and investing activities	1,615	1,314	4,513	4,215
Foreign currency related losses	2,306	4,539	537	1,388
Other income	(2,549)	(1,050)	(6,539)	(6,264)
Other expense	1,156	1,240	3,361	3,668
Total income	\$ 194	\$ 5,213	\$ (4,006)	\$ 239

The net expense from financing and investing activities includes the net gain or loss relating to the change in the Company's investment in certain long-term asset funds and financing fees.

Foreign currency related losses included foreign currency transaction gains and losses and realized and unrealized gains and losses from foreign currency option and forward contracts. The Company had foreign currency option and forward contracts outstanding at September 30, 2008

Table of Contents

and 2007. All of the outstanding contracts had maturity dates of less than twelve months and were undesignated hedges with changes in fair value being recognized in earnings in accordance with FAS No. 133. These derivative instrument values were included in either Other current assets or Other accruals and were insignificant at September 30, 2008 and 2007.

Other income and Other expense included items of revenue, gains, expenses and losses that were unrelated to the primary business purpose of the Company. Each individual item within the other income or other expense caption was immaterial; no single category of items exceeded \$1,000,000.

Note K INCOME TAXES

The effective tax rates were 33.5 percent and 32.8 percent for the third quarter and the first nine months of 2008, respectively, and 31.9 percent and 32.4 percent for the third quarter and the first nine months of 2007, respectively. There were no significant items that lead to the differences in the effective tax rates between 2008 and 2007.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. Effective January 1, 2007, the Company adopted FIN No. 48, Accounting for Uncertainty in Income Taxes. In accordance with FIN No. 48, the Company recognized a cumulative-effect adjustment of \$3.4 million, increasing its liability for unrecognized tax benefits, interest, and penalties and reducing the January 1, 2007 balance of Retained earnings.

At December 31, 2007, the Company had \$39.4 million in unrecognized tax benefits, the recognition of which would have an affect of \$34.2 million on the current provision for income taxes. Included in the balance of unrecognized tax benefits at December 31, 2007, was \$4.8 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 represents a decrease in unrecognized tax benefits comprised of items related to assessed state income tax audits, state settlement negotiations currently in progress and expiring statutes in foreign jurisdictions.

The Company accrued income tax interest and penalties related to unrecognized tax benefits in the current provision for income taxes. At December 31, 2007, the Company had accrued \$12.2 million and \$3.6 million for the potential payment of income tax interest and penalties, respectively.

As of September 30, 2008, the Company is subject to U.S. Federal income tax examinations for the tax years 2004 through 2007 and to non-U.S. income tax examinations for the tax years of 2001 through 2007. In addition, the Company is subject to state and local income tax examinations for the tax years 1992 through 2007.

There were no significant changes to any of these amounts during the third quarter or first nine months of 2008.

Table of Contents**Note L NET INCOME PER COMMON SHARE**

(Thousands of dollars except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Basic				
Average common shares outstanding	115,828,466	125,958,878	117,182,407	128,887,107
Net income	\$ 177,081	\$ 200,349	\$ 426,710	\$ 514,758
Net income per common share	\$ 1.53	\$ 1.59	\$ 3.64	\$ 3.99
Diluted				
Average common shares outstanding	115,828,466	125,958,878	117,182,407	128,887,107
Non-vested restricted stock grants	1,166,900	1,142,600	1,164,700	1,155,351
Stock options and other contingently issuable shares	1,187,987	2,491,204	1,314,907	2,559,030
Average common shares assuming dilution	118,183,353	129,592,682	119,662,014	132,601,488
Net income	\$ 177,081	\$ 200,349	\$ 426,710	\$ 514,758
Net income per common share	\$ 1.50	\$ 1.55	\$ 3.57	\$ 3.88

Note M 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 FAS No. 131, Disclosures about Segments of an Enterprise and Related Information.

Table of Contents

(Thousands of dollars)	Three months ended September 30, 2008				Consolidated Totals
	Paint Stores Group	Consumer Group	Global Finishes Group	Administrative	
Net external sales	\$ 1,410,461	\$ 355,669	\$ 500,772	\$ 1,756	\$ 2,268,658
Intersegment transfers		478,328	33,927	(512,255)	
Total net sales and intersegment transfers	\$ 1,410,461	\$ 833,997	\$ 534,699	\$ (510,499)	\$ 2,268,658
Segment profit	\$ 240,999	\$ 26,320	\$ 45,337		\$ 312,656
Interest expense				\$ (15,200)	(15,200)
Administrative expenses and other				(31,314)	(31,314)
Income before income taxes	\$ 240,999	\$ 26,320 *	\$ 45,337	\$ (46,514)	\$ 266,142
	Three months ended September 30, 2007				
	Paint Stores Group	Consumer Group	Global Finishes Group	Administrative	Consolidated Totals
Net external sales	\$ 1,400,937	\$ 349,442	\$ 444,947	\$ 1,716	\$ 2,197,042
Intersegment transfers		463,495	37,458	(500,953)	
Total net sales and intersegment transfers	\$ 1,400,937	\$ 812,937	\$ 482,405	\$ (499,237)	\$ 2,197,042
Segment profit	\$ 248,377	\$ 64,147	\$ 48,020		\$ 360,544
Interest expense				\$ (17,048)	(17,048)
Administrative expenses and other				(49,179)	(49,179)
Income before income taxes	\$ 248,377	\$ 64,147 *	\$ 48,020	\$ (66,227)	\$ 294,317

* Segment profit includes \$6,584 and \$7,105 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores

Group during the third quarters of 2008 and 2007, respectively.

	Nine months ended September 30, 2008				Consolidated Totals
	Paint Stores Group	Consumer Group	Global Finishes Group	Administrative	
Net external sales	\$3,796,645	\$ 1,026,483	\$ 1,451,545	\$ 5,212	\$ 6,279,885
Intersegment transfers		1,306,138	107,019	(1,413,157)	
Total net sales and intersegment transfers	\$3,796,645	\$ 2,332,621	\$ 1,558,564	\$ (1,407,945)	\$ 6,279,885
Segment profit	\$ 534,736	\$ 127,929	\$ 136,438		\$ 799,103
Interest expense				\$ (51,006)	(51,006)
Administrative expenses and other				(112,754)	(112,754)
Income before income taxes	\$ 534,736	\$ 127,929 *	\$ 136,438	\$ (163,760)	\$ 635,343
	Nine months ended September 30, 2007				Consolidated Totals
	Paint Stores Group	Consumer Group	Global Finishes Group	Administrative	
Net external sales	\$3,817,283	\$ 1,047,295	\$ 1,281,454	\$ 5,376	\$ 6,151,408
Intersegment transfers		1,278,891	104,723	(1,383,614)	
Total net sales and intersegment transfers	\$3,817,283	\$ 2,326,186	\$ 1,386,177	\$ (1,378,238)	\$ 6,151,408
Segment profit	\$ 608,911	\$ 202,823	\$ 132,296		\$ 944,030
Interest expense				\$ (52,415)	(52,415)
Administrative expenses and other				(130,635)	(130,635)
Income before income taxes	\$ 608,911	\$ 202,823 *	\$ 132,296	\$ (183,050)	\$ 760,980

* Segment profit includes \$20,528 and \$19,618 of mark-up on intersegment transfers

realized as a
result of
external sales by
the Paint Stores
Group during
the first nine
months of 2008
and 2007,
respectively.

Table of Contents

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 plus distribution costs. International intersegment transfers were accounted for at values comparable to normal unaffiliated customer sales. Administrative expenses and other included administrative expenses of the Company's corporate headquarters, interest expense which was unrelated to retail real estate leasing activities, interest and net investment income, certain foreign currency transaction gains or losses related to dollar-denominated debt and foreign currency option and forward contracts, certain expenses related to closed facilities and environmental-related matters, and other expenses which were not directly associated with any reportable operating segment.

Net external sales and segment profit of all consolidated foreign subsidiaries were \$299.7 million and \$22.6 million, respectively, for the third quarter of 2008, and \$245.8 million and \$22.7 million, respectively, for the third quarter of 2007. Net external sales and segment profits of these subsidiaries were \$867.8 million and \$70.8 million for the first nine months of 2008, and \$694.5 million and \$57.1 million, respectively, for the first nine months of 2007. Long-lived assets of these subsidiaries totaled \$234.3 million and \$220.1 million at September 30, 2008 and September 30, 2007, respectively. Domestic operations accounted for the remaining net external sales, segment profits and long-lived assets. The Administrative segment did not include any significant foreign operations. 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 N ACQUISITIONS

During the third quarter of 2008, the Company closed a definitive agreement to acquire the liquid coatings subsidiaries of Inchem Holdings International Limited (Inchem). Headquartered in Singapore, Inchem produces coatings applied to wood and plastic products in Asia. These waterborne, solvent-based, and ultraviolet curable coatings are applied to furniture, cabinets, flooring, and electronic products. The coatings are made and sold in China, Vietnam and Malaysia, and distributed to 15 other Asian countries. The acquisition was accounted for as a purchase and the preliminary valuation resulted in the recognition of goodwill. Results of operations were included in the consolidated financial statements since the date of acquisition.

During the first quarter of 2008, the Company acquired Becker Powder Coatings, Inc. (Becker), a subsidiary of Sweden-based AB Wilh. Headquartered in Columbus, Ohio, Becker produces powder coatings applied to appliances, metal furniture, fixtures, equipment, and electronic products manufactured throughout North America. This acquisition will strengthen Global Finishes Group's position in the powder coatings market. The acquisition was accounted for as a purchase and the preliminary valuation resulted in the recognition of goodwill. Results of operations were included in the consolidated financial statements since the date of acquisition.

Table of Contents

In October 2005, an indirect wholly owned subsidiary of the Company acquired a 25 percent interest in Life Shield Engineered Systems LLC (Life Shield). In October 2007, the subsidiary acquired the remaining 75 percent interest in Life Shield by acquiring all of the outstanding membership interests. In late December 2007, the Company acquired substantially all the assets and business of Flex Recubrimientos, S.A. de C.V. and related companies (Flex group). These acquisitions were treated as purchases and resulted in the recognition of goodwill. The acquisition of Flex group resulted in the recognition of identifiable intangible assets. Results of operations for the entire business of Life Shield and for Flex group were included in the consolidated financial statements since the dates of acquisition. During the third quarter of 2007, the Company acquired substantially all of the stock of Pinturas Industriales S.A. (PISA), substantially all of the assets and business of Napko, S.A. de C.V. (Napko), the brand names, formulas and patents of the VHT[®] brand paint line (VHT), and 100 percent of the stock of Columbia Paint & Coatings Co. (Columbia). All four acquisitions were accounted for as purchases and results of operations of the acquired businesses were included in the consolidated financial statements since the dates of acquisition. The acquisitions of Napko and Columbia resulted in the recognition of goodwill and all four acquisitions resulted in the recognition of identifiable intangible assets.

During the second quarter of 2007, the Company acquired substantially all of the assets and business of Nitco Paints Private Limited (Nitco) and 100 percent of the stock of M. A. Bruder & Sons Incorporated (MAB). Both acquisitions were accounted for as purchases, resulted in the recognition of goodwill and identifiable intangible assets, and their results of operations were included in the consolidated financial statements since the dates of acquisition.

The following unaudited pro-forma summary presents consolidated financial information as if Nitco, MAB, PISA, Napko, VHT, Columbia, the entire business of Life Shield, Flex group, Becker, and Inchem had been acquired as of the beginning of each period presented. The pro-forma consolidated financial information does not necessarily reflect the actual results that would have occurred had the acquisitions taken place on January 1, 2007 or of future results of operations of the combined companies under ownership and operation of the Company.

(Thousands of dollars except per share data)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net sales	\$ 2,271,183	\$ 2,230,216	\$ 6,298,192	\$ 6,320,345
Net income	177,076	202,474	426,336	519,416
Net income per common share:				
Basic	\$ 1.53	\$ 1.61	\$ 3.64	\$ 4.03
Diluted	\$ 1.50	\$ 1.56	\$ 3.56	\$ 3.92

Table of Contents

Note O DEBT

See Note 7 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for a complete description of the Company's borrowing arrangements.