

SHERWIN WILLIAMS CO

Form 10-Q

October 27, 2009

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**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, 2009**

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 West Prospect Avenue, Cleveland, Ohio

44115-1075

(Address of principal executive offices)

(Zip Code)

**(216) 566-2000**

(Registrant's telephone number including area code)

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

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  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 113,340,736 shares as of September 30, 2009.



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Thousands of dollars, except per share data

|   | Three months ended September<br>30, |              | Nine months ended September<br>30, |              |
|---|-------------------------------------|--------------|------------------------------------|--------------|
|   | 2009                                | 2008         | 2009                               | 2008         |
| Net sales   | \$ <b>1,996,909</b>                 | \$ 2,268,658 | \$ <b>5,495,413</b>                | \$ 6,279,885 |
| Cost of goods sold                                    | <b>1,067,926</b>                    | 1,308,169    | <b>2,990,482</b>                   | 3,565,985    |
| Gross profit  | <b>928,983</b>                      | 960,489      | <b>2,504,931</b>                   | 2,713,900    |
| <i>Percent to net sales</i>                           | <i>46.5%</i>                        | <i>42.3%</i> | <i>45.6%</i>                       | <i>43.2%</i> |
| Selling, general and administrative<br>expenses       | <b>654,246</b>                      | 681,352      | <b>1,916,095</b>                   | 2,010,043    |
| <i>Percent to net sales</i>                           | <i>32.8%</i>                        | <i>30.0%</i> | <i>34.9%</i>                       | <i>32.0%</i> |
| Other general expense (income) net                    | <b>6,869</b>                        | (1,470)      | <b>20,325</b>                      | (75)         |
| Impairment of trademarks and<br>goodwill              |                                     |              |                                    | 23,912       |
| Interest expense                                      | <b>8,471</b>                        | 15,200       | <b>31,029</b>                      | 51,006       |
| Interest and net investment income                    | <b>(518)</b>                        | (929)        | <b>(1,813)</b>                     | (2,323)      |
| Other expense (income) net                            | <b>1,267</b>                        | 194          | <b>(2,369)</b>                     | (4,006)      |
| Income before income taxes                            | <b>258,648</b>                      | 266,142      | <b>541,664</b>                     | 635,343      |
| Income taxes  | <b>83,440</b>                       | 89,061       | <b>171,154</b>                     | 208,633      |
| Net income  | \$ <b>175,208</b>                   | \$ 177,081   | \$ <b>370,510</b>                  | \$ 426,710   |
| Net income per common share:                          |                                     |              |                                    |              |
| Basic   | \$ <b>1.54</b>                      | \$ 1.53      | \$ <b>3.23</b>                     | \$ 3.64      |
| Diluted   | \$ <b>1.51</b>                      | \$ 1.50      | \$ <b>3.17</b>                     | \$ 3.57      |
| Average shares outstanding basic                      | <b>113,447,570</b>                  | 115,828,466  | <b>114,863,697</b>                 | 117,182,407  |
| Average shares and equivalents<br>outstanding diluted | <b>115,697,528</b>                  | 118,183,353  | <b>116,787,896</b>                 | 119,662,014  |

*See notes to condensed consolidated financial statements.*

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

Thousands of dollars

|  | September<br>30,<br>2009 | December<br>31,<br>2008 | September<br>30,<br>2008 |
|--|--------------------------|-------------------------|--------------------------|
| <b>Assets</b>                              |                          |                         |                          |
| Current assets:                            |                          |                         |                          |
| Cash and cash equivalents                  | \$ 32,770                | \$ 26,212               | \$ 40,927                |
| Accounts receivable, less allowance        | 901,199                  | 769,985                 | 1,072,964                |
| Inventories:                               |                          |                         |                          |
| Finished goods                             | 641,527                  | 749,405                 | 745,316                  |
| Work in process and raw materials          | 84,966                   | 114,795                 | 118,143                  |
|  | 726,493                  | 864,200                 | 863,459                  |
| Deferred income taxes                      | 99,389                   | 97,568                  | 103,725                  |
| Other current assets                       | 162,863                  | 151,240                 | 195,816                  |
| Total current assets                       | 1,922,714                | 1,909,205               | 2,276,891                |
| Goodwill                                   | 1,011,015                | 1,006,712               | 1,002,802                |
| Intangible assets                          | 298,430                  | 299,963                 | 337,354                  |
| Deferred pension assets                    | 215,525                  | 215,637                 | 412,537                  |
| Other assets                               | 169,153                  | 124,117                 | 154,655                  |
| Property, plant and equipment:             |                          |                         |                          |
| Land                                       | 84,802                   | 85,485                  | 86,531                   |
| Buildings                                  | 596,634                  | 580,216                 | 580,965                  |
| Machinery and equipment                    | 1,526,214                | 1,564,221               | 1,566,085                |
| Construction in progress                   | 22,123                   | 26,560                  | 44,011                   |
|  | 2,229,773                | 2,256,482               | 2,277,592                |
| Less allowances for depreciation           | 1,397,160                | 1,396,357               | 1,392,675                |
|  | 832,613                  | 860,125                 | 884,917                  |
| Total Assets                               | \$ 4,449,450             | \$ 4,415,759            | \$ 5,069,156             |
| <b>Liabilities and Shareholders Equity</b> |                          |                         |                          |
| Current liabilities:                       |                          |                         |                          |
| Short-term borrowings                      | \$ 410,994               | \$ 516,438              | \$ 715,953               |
| Accounts payable                           | 728,420                  | 738,093                 | 882,313                  |
| Compensation and taxes withheld            | 180,833                  | 194,787                 | 183,775                  |
| Accrued taxes                              | 140,053                  | 58,510                  | 204,719                  |
| Current portion of long-term debt          | 10,564                   | 13,570                  | 13,459                   |
| Other accruals                             | 415,252                  | 415,338                 | 410,640                  |

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|   |                     |              |              |
|---|---------------------|--------------|--------------|
| Total current liabilities   | <b>1,886,116</b>    | 1,936,736    | 2,410,859    |
| Long-term debt  | <b>289,421</b>      | 303,727      | 297,391      |
| Postretirement benefits other than pensions   | <b>250,795</b>      | 248,603      | 265,218      |
| Other long-term liabilities   | <b>320,266</b>      | 321,045      | 357,402      |
| Shareholders' equity:   |                     |              |              |
| Common stock - \$1.00 par value:<br>113,340,736, 117,035,117 and 116,902,299 shares<br>outstanding at September 30, 2009, December 31, 2008<br>and September 30, 2008, respectively | <b>228,421</b>      | 227,147      | 226,761      |
| Preferred stock - convertible, no par value:<br>216,753, 216,753 and 216,753 shares outstanding at<br>September 30, 2009, December 31, 2008 and<br>September 30, 2008, respectively | <b>216,753</b>      | 216,753      | 216,753      |
| Unearned ESOP compensation  | <b>(216,753)</b>    | (216,753)    | (216,753)    |
| Other capital   | <b>1,069,582</b>    | 1,016,362    | 956,533      |
| Retained earnings   | <b>4,492,042</b>    | 4,245,141    | 4,235,925    |
| Treasury stock, at cost   | <b>(3,753,043)</b>  | (3,472,384)  | (3,459,452)  |
| Cumulative other comprehensive loss   | <b>(334,150)</b>    | (410,618)    | (221,481)    |
| Total shareholders' equity  | <b>1,702,852</b>    | 1,605,648    | 1,738,286    |
| Total Liabilities and Shareholders' Equity  | <b>\$ 4,449,450</b> | \$ 4,415,759 | \$ 5,069,156 |

*See notes to condensed consolidated financial statements.*

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

Thousands of dollars

|   | Nine months ended September<br>30, |            |
|---|------------------------------------|------------|
|   | 2009                               | 2008       |
| <b>OPERATING ACTIVITIES</b>   |                                    |            |
| Net income  | \$ 370,510                         | \$ 426,710 |
| Adjustments to reconcile net income to net operating cash:          |                                    |            |
| Depreciation  | 109,611                            | 107,330    |
| Amortization of intangible assets                                   | 18,819                             | 16,887     |
| Impairment of trademarks and goodwill                               |                                    | 23,912     |
| Stock-based compensation expense                                    | 20,151                             | 27,064     |
| Provisions for qualified exit costs                                 | 15,339                             |            |
| Provisions for environmental-related matters                        | 18,534                             | 1,757      |
| Defined benefit pension plans net cost (credit)                     | 24,776                             | (6,164)    |
| Net increase in postretirement liability                            | 1,900                              | 2,182      |
| Other   | 7,484                              | (4,348)    |
| Change in working capital accounts net                              | 72,930                             | 26,140     |
| Costs incurred for environmental - related matters                  | (26,706)                           | (12,605)   |
| Costs incurred for qualified exit costs                             | (6,414)                            | (3,835)    |
| Other   | (11,293)                           | (12,445)   |
| <br>  |                                    |            |
| Net operating cash  | <b>615,641</b>                     | 592,585    |
| <b>INVESTING ACTIVITIES</b>   |                                    |            |
| Capital expenditures  | (63,556)                           | (91,799)   |
| Acquisitions of businesses, net of cash acquired                    | (14,093)                           | (48,465)   |
| Proceeds from sale of assets  | 1,751                              | 8,772      |
| Increase in other investments                                       | (30,297)                           | (24,137)   |
| <br>  |                                    |            |
| Net investing cash  | <b>(106,195)</b>                   | (155,629)  |
| <b>FINANCING ACTIVITIES</b>   |                                    |            |
| Net (decrease) increase in short-term borrowings                    | (106,777)                          | 60,166     |
| Net (decrease) increase in long-term debt                           | (22,248)                           | 678        |
| Payments of cash dividends  | (124,634)                          | (124,162)  |
| Proceeds from stock options exercised                               | 27,329                             | 25,744     |
| Income tax effect of stock-based compensation exercises and vesting | 6,868                              | 8,002      |
| Treasury stock purchased  | (276,222)                          | (379,941)  |
| Other   | (4,240)                            | (5,819)    |
| <br>  |                                    |            |
| Net financing cash  | <b>(499,924)</b>                   | (415,332)  |



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|  |                  |           |
|--|------------------|-----------|
| Effect of exchange rate changes on cash        | <b>(2,964)</b>   | (8,022)   |
| Net increase in cash and cash equivalents      | <b>6,558</b>     | 13,602    |
| Cash and cash equivalents at beginning of year | <b>26,212</b>    | 27,325    |
| <br>   |                  |           |
| Cash and cash equivalents at end of period     | <b>\$ 32,770</b> | \$ 40,927 |
| <br>   |                  |           |
| Income taxes paid                              | <b>\$ 69,264</b> | \$ 45,336 |
| Interest paid                                  | <b>37,921</b>    | 20,678    |

*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 September 30, 2009 and 2008

**Note A BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (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, 2008. Accounting estimates were revised as necessary during the first nine months of 2009 based on new information and changes in facts and circumstances.

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

The consolidated results for the three and nine months ended September 30, 2009 are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

The Company has evaluated events and transactions occurring subsequent to September 30, 2009 through October 27, 2009, the date of the issuance of the financial statements, in accordance with the Subsequent Events Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). During this period, there were no recognized subsequent events requiring recognition in the financial statements, and no non-recognized subsequent events requiring disclosure.

**Note B IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In June 2009, the FASB issued Financial Accounting Standards (FAS) No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles. The statement makes the ASC the single source of authoritative U.S. accounting and reporting standards, but it does not change U.S. GAAP. The Company adopted the statement as

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of September 30, 2009. Accordingly, the financial statements for the interim period ending September 30, 2009, and the financial statements for future interim and annual periods will reflect, the Codification references. The statement has no impact on the Company's results of operations, financial condition or liquidity. The guidance in FAS No. 168 is included in the General Principles Topic of FASB ASC.

In June 2009, the FASB issued FAS No. 166, *Accounting for Transfers of Financial Assets* and FAS No. 167, *Amendments to FASB Interpretation (FIN) No. 46(R)*. FAS No. 166 removes the concept of a qualifying special-purpose entity (SPE) from FAS No. 140 and eliminates the exception for qualifying SPEs from the consolidation guidance of FIN No. 46(R). FAS No. 167 changes the analysis that must be performed to determine the primary beneficiary of a variable interest entity (VIE), amends certain guidance in FIN No. 46(R) for determining whether an entity is a VIE and requires enhanced disclosures about involvement with VIEs. Both statements are effective for periods beginning on or after January 1, 2010. The Company is currently evaluating the impact the statements will have on its results of operations, financial condition, liquidity, or disclosures. The impact or additional disclosure is not expected to be significant. The guidance in FAS No. 167 is included in the Consolidation Topic of FASB ASC; FAS No. 166 is not yet integrated into FASB ASC.

In May 2009, the FASB issued FAS No. 165, *Subsequent Events*. FAS No. 165 defines subsequent events as events or transactions that occur after the balance sheet date, but before the financial statements are issued. It defines two types of subsequent events: recognized subsequent events, which provide additional evidence about conditions that existed at the balance sheet date, and non-recognized subsequent events, which provide evidence about conditions that did not exist at the balance sheet date, but arose before the financial statements were issued. Recognized subsequent events are required to be recognized in the financial statements, and non-recognized subsequent events are required to be disclosed. The statement requires entities to disclose the date through which subsequent events have been evaluated, and the basis for that date. FAS No. 165 is consistent with current practice and does not have any impact on the Company's results of operations, financial condition or liquidity. See Note A for the required disclosure. The guidance in FAS No. 165 is included in the Subsequent Events Topic of FASB ASC.

In April 2009, the FASB issued three fair value-related FASB Staff Positions (FSP): (i) FSP FAS No. 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS No. 115-2), (ii) FSP FAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset and Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS No. 157-4) and (iii) FSP FAS No. 107-1 and Accounting Principles Board Opinion (APB) No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS No. 107-1), which are effective for interim and annual reporting periods ending after June 15, 2009. FSP FAS No. 115-2 amends the existing accounting requirements for other-than-temporary impairment for debt securities by modifying the requirement for recognizing other-than-temporary impairments, changing the terminology used to assess the probability of cash flows and requiring additional disclosures. FSP FAS No. 157-4 amends FAS No. 157, *Fair Value Measurements* to provide additional guidance on estimating fair value when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal activity for the asset or liability. FSP FAS No. 107-1 extends the disclosure requirements of FAS No. 107, *Disclosures About Fair Value of*

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Financial Instruments to interim financial statements. The Company adopted the FSPs as of June 30, 2009. They do not have a significant impact on the Company's results of operations, financial condition or liquidity. The guidance in FSP FAS No. 115-2, FSP FAS No. 157-4 and FSP FAS No. 107-1 is included in the Investments and Fair Value Measurements and Disclosures Topics of FASB ASC.

In December 2008, the FASB issued FSP FAS No. 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets. This FSP amends FAS No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits, to provide guidance on disclosures about plan assets of defined benefit pension and other postretirement benefit plans. The FSP requires disclosures about how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs and significant concentrations of risk within plan assets. The FSP is effective for fiscal years ending after December 15, 2009, and the provisions are not required for earlier periods presented for comparative purposes. The FSP will not have any impact on the Company's results of operations, financial condition or liquidity. The guidance in FSP FAS No. 132(R)-1 is included in the Defined Benefit Plans Subtopic of the Compensation - Retirement Benefits Topic of FASB ASC.

In June 2008, the FASB issued FSP Emerging Issues Task Force (EITF) No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, which clarifies EITF No. 03-6, Participating Securities and the Two-Class Method Under FAS No. 128. Under the FSP, unvested share-based payment awards that contain rights to receive non-forfeitable dividends (whether paid or unpaid) are considered participating securities, and the two-class method of computing earnings per share is required for all periods presented. The Company adopted EITF No. 03-6-1 as of January 1, 2009, however, because the use of the two-class method does not have a significant impact on the basic and diluted earnings per share calculations for the three and nine months ended September 30, 2009, the treasury stock method continues to be disclosed. See Note L. The guidance in EITF No. 03-6-1 is included in the Earnings Per Share Topic of FASB ASC.

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

Effective January 1, 2009, the Company adopted FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 Accounting

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for Derivative Instruments and Hedging Activities. FAS No. 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under FAS No. 133, and how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. The statement does not have an impact on the Company's results of operations, financial condition or liquidity. The guidance in FAS No. 161 is included in the Derivatives and Hedging Topic of FASB ASC.

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

Effective January 1, 2009, the Company adopted FAS No. 160, Accounting for Noncontrolling Interests. FAS No. 160 clarifies the classification of noncontrolling interests in consolidated statements of financial position and the accounting for and reporting of transactions between the reporting entity and holders of such noncontrolling interests. Under the standard, noncontrolling interests are considered equity and should be reported as an element of consolidated equity, and net income will encompass the total income of all consolidated subsidiaries and there will be separate disclosure on the face of the income statement of the attribution of that income between the controlling and noncontrolling interests. FAS No. 160 does not have a significant impact on the Company's results of operations, financial condition or liquidity. The guidance in FAS No. 160 is included in the Consolidation Topic of FASB ASC. In September 2006, the FASB issued FAS No. 157, Fair Value Measurements. FAS No. 157 provides guidance for using fair value to measure assets and liabilities and only applies when other standards require or permit the fair value measurement of assets and liabilities. It does not expand the use of fair value measurements. In accordance with FSP FAS No. 157-2, Effective Date of FASB Statement No. 157, the Company adopted FAS No. 157 for its financial assets and liabilities as of January 1, 2008, and for its non-financial assets and liabilities as of January 1, 2009. FAS No. 157 does not have a significant impact on the Company's results of operations, financial condition or liquidity. See Note O. The guidance in FAS No. 157 is included in the Fair Value Measurements and Disclosures Topic of FASB ASC.

**Note C DIVIDENDS**

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

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Comprehensive income is summarized as follows:

| (Thousands of dollars)   | Three months ended<br>September 30, |            | Nine months ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2009                                | 2008       | 2009                               | 2008       |
| Net income   | \$ 175,208                          | \$ 177,081 | \$ 370,510                         | \$ 426,710 |
| Foreign currency translation adjustments   | 29,003                              | (39,173)   | 62,327                             | (23,509)   |
| Amortization of net prior service costs and net actuarial losses, net of taxes <sup>(1)</sup>                                | 4,684                               | (69)       | 13,999                             | 1,966      |
| Adjustments of marketable equity securities and derivative instruments used in cash flow hedges, net of taxes <sup>(2)</sup> | 230                                 | 639        | 142                                | (1,334)    |
| Comprehensive income   | \$ 209,125                          | \$ 138,478 | \$ 446,978                         | \$ 403,833 |

(1) The tax effect of amortization of net prior service costs and net actuarial losses was \$(2,905) and \$(8,695), respectively, for the three and nine months ended September 30, 2009, and \$43 and \$(1,228), respectively, for the three and nine months ended September 30, 2008.

(2) The tax effect of adjustments of marketable equity securities and derivative instruments used in cash flow hedges was \$(125) and \$(91), respectively, for

the three and  
 nine months  
 ended  
 September 30,  
 2009, and \$83  
 and \$853,  
 respectively, for  
 the three and  
 nine months  
 ended  
 September 30,  
 2008.

**Note E PRODUCT WARRANTIES**

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

| (Thousands of dollars)      | <b>2009</b>          | 2008          |
|-----------------------------|----------------------|---------------|
| Balance at January 1        | <b>\$ 18,029</b>     | \$ 19,596     |
| Charges to expense          | <b>16,339</b>        | 20,031        |
| Settlements                 | <b>(17,805)</b>      | (22,373)      |
| <br>Balance at September 30 | <br><b>\$ 16,563</b> | <br>\$ 17,254 |

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

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**Note F 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 FASB 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 FASB ASC Topic No. 360-10-35 (formerly 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 2009, 28 stores in the Paint Stores Group, 3 manufacturing facilities in the Consumer Group, and 1 manufacturing facility and 19 branches in the Global Finishes Group were closed due to lower demand or redundancy. Provisions of \$10.9 million for qualified exit costs resulting from the closure of these facilities were recorded in Cost of goods sold and Selling, general and administrative expenses in the first nine months. Provisions of \$1.1 million, \$5.6 million and \$4.2 million were charged to the Paint Stores Group, Consumer Group and Global Finishes Group, respectively. In addition, there were adjustments to prior provisions related to manufacturing facilities, distribution facilities, stores and branches closed in 2008. Adjustments to prior provisions of \$4.5 million were recorded in Cost of goods sold, Selling, general and administrative expense or Other general expense-net in the first nine months of 2009. Adjustments of \$4.4 million, \$(0.1) million and \$0.2 million were charged to the Paint Stores Group, Consumer Group and Global Finishes Group, respectively.

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



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The following table summarizes the activity and remaining liabilities associated with qualified exit costs at September 30, 2009 and for the nine-month period then ended:

| (Thousands of dollars)   | Balance at<br>December<br>31,<br>2008 | Provisions<br>in<br>Cost of<br>goods<br>sold or<br>SG&A | Actual<br>expenditures<br>charged to<br>accrual | Adjustments<br>to<br>prior<br>provisions<br>in Other<br>general<br>expense -<br>net | Balance at<br>September<br>30,<br>2009 |
|--|---------------------------------------|---|---|---|--|
| <b>Exit Plan</b>   |                                       |   |   |   |  |
| <b>Paint Stores Group stores shutdown in 2009:</b>   |                                       |   |   |   |  |
| Other qualified exit costs   |                                       | \$ 1,071  | \$ (461)  |   | \$ 610                                 |
| <b>Consumer Group manufacturing facilities shutdown in 2009:</b>   |                                       |   |   |   |  |
| Severance and related costs  |                                       | 5,130   | (471)   |   | 4,659                                  |
| Other qualified exit costs   |                                       | 503   | (68)  |   | 435                                    |
| <b>Global Finishes Group manufacturing facility and branches shutdown in 2009:</b>                                       |                                       |   |   |   |  |
| Severance and related costs  |                                       | 524   | (289)   |   | 235                                    |
| Other qualified exit costs   |                                       | 3,659   | (589)   |   | 3,070                                  |
| <b>Paint Stores Group manufacturing and distribution facilities, administrative offices and stores shutdown in 2008:</b> |                                       |   |   |   |  |
| Severance and related costs  | \$ 324                                | 868   | (871)   |   | 321                                    |
| Other qualified exit costs   | 4,450                                 | 142   | (1,944)   | \$ 3,375  | 6,023                                  |
| <b>Consumer Group manufacturing and distribution facilities shutdown in 2008:</b>  |                                       |   |   |   |  |
| Severance and related costs  | 449                                   | 82  | (33)  | (187)   | 311                                    |
| Other qualified exit costs   | 150                                   |   | (59)  |   | 91                                     |
| <b>Global Finishes Group administrative offices and branches shutdown in 2008:</b>                                       |                                       |   |   |   |  |
| Severance and related costs  | 397                                   |   | (397)   |   | 0                                      |
| Other qualified exit costs   | 240                                   | 156   | (223)   | 16  | 189                                    |
| <b>Paint Stores Group manufacturing facility shutdown in 2007:</b>   |                                       |   |   |   |  |
| Severance and related costs  | 33                                    |   | (9)   |   | 24                                     |

|   |                  |                  |                   |                 |                  |
|---|------------------|------------------|-------------------|-----------------|------------------|
| <b>Other qualified exit costs</b>                                       | <b>1,859</b>     |                  | <b>(357)</b>      |                 | <b>1,502</b>     |
| <b>Consumer Group manufacturing facility shutdown in 2007:</b>          |                  |                  |                   |                 |                  |
| <b>Other qualified exit costs</b>                                       | <b>2,036</b>     |                  | <b>0</b>          |                 | <b>2,036</b>     |
| <b>Other qualified exit costs for facilities shutdown prior to 2003</b> | <b>11,686</b>    |                  | <b>(643)</b>      |                 | <b>11,043</b>    |
| <b>Totals</b>   | <b>\$ 21,624</b> | <b>\$ 12,135</b> | <b>\$ (6,414)</b> | <b>\$ 3,204</b> | <b>\$ 30,549</b> |

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

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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<br>Benefit Pension Plans |             | Foreign Defined<br>Benefit Pension Plans |          | Postretirement<br>Benefits<br>Other than Pensions |           |
|---|---|-------------|--|----------|---|-----------|
|   | 2009                                      | 2008        | 2009                                     | 2008     | 2009  | 2008      |
| <b>Three months ended<br/>September 30:</b> |   |             |  |          |   |           |
| Net periodic benefit cost<br>(credit):      |   |             |  |          |   |           |
| Service cost                                | \$ 4,538                                  | \$ 5,248    | \$ 341                                   | \$ 621   | \$ 848  | \$ 926    |
| Interest cost                               | 4,625                                     | 4,382       | 828                                      | 1,033    | 3,924   | 4,085     |
| Expected return on assets                   | (9,211)                                   | (13,273)    | (510)                                    | (645)    |   |           |
| Amortization of:                            |   |             |  |          |   |           |
| Prior service cost (credit)                 | 374                                       | 730         | 12                                       | 16       | (164)   | (158)     |
| Actuarial loss (gain)                       | 7,208                                     | (537)       | 89                                       | 229      | 72  | 53        |
| Net periodic benefit cost<br>(credit)       | \$ 7,534                                  | \$ (3,450)  | \$ 760                                   | \$ 1,254 | \$ 4,680  | \$ 4,906  |
| <b>Nine months ended<br/>September 30:</b>  |   |             |  |          |   |           |
| Net periodic benefit cost<br>(credit):      |   |             |  |          |   |           |
| Service cost                                | \$ 13,614                                 | \$ 15,059   | \$ 980                                   | \$ 1,903 | \$ 2,543  | \$ 2,780  |
| Interest cost                               | 13,874                                    | 13,521      | 2,366                                    | 3,185    | 11,772  | 12,255    |
| Expected return on assets                   | (27,634)                                  | (39,712)    | (1,457)                                  | (1,985)  |   |           |
| Amortization of:                            |   |             |  |          |   |           |
| Prior service cost (credit)                 | 1,120                                     | 1,107       | 36                                       | 47       | (492)   | (475)     |
| Actuarial loss                              | 21,624                                    |             | 253                                      | 711      | 215   | 160       |
| Net periodic benefit cost<br>(credit)       | \$ 22,598                                 | \$ (10,025) | \$ 2,178                                 | \$ 3,861 | \$ 14,038   | \$ 14,720 |

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

**NOTE H OTHER LONG-TERM LIABILITIES**

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

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the minimum of the range is provided. At September 30, 2009, the unaccrued maximum of the estimated range of possible outcomes is \$108.3 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 September 30, 2009 and 2008 were accruals for extended environmental-related activities of \$121.9 million and \$124.2 million, respectively. Estimated costs of current investigation and remediation activities of \$52.5 million and \$60.3 million are included in Other accruals at September 30, 2009 and 2008, 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, 2009. At September 30, 2009, \$132.0 million, or 75.7 percent of the total accrual, related directly to these five sites. In the aggregate unaccrued maximum of \$108.3 million at September 30, 2009, \$70.9 million, or 65.4 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.

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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, 2008.

**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 inurrence of a liability or the reduction of a liability. In accordance with the Contingencies Topic of FASB 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 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 FASB ASC 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, 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

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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, 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 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.) 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.** The State of Rhode Island initiated an action in October 1999 against the Company and other companies asserting, in part, that lead pigment in paint constitutes a public nuisance under Rhode Island law. The claim for public nuisance was originally tried to a jury in 2002 and 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. 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

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claim as a matter of law. This decision concluded 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 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 County of Santa Clara, California and other public entities in the State of California, and the City of Milwaukee, Wisconsin.

The City of St. Louis proceeding was initiated in January 2000 against the Company and other companies asserting claims for strict liability, negligence, fraudulent misrepresentation, negligent misrepresentation, concert of action, conspiracy, public nuisance, restitution and indemnity. Following various pre-trial proceedings, the City alleged a single count of public nuisance. Following further pre-trial proceedings, the trial court granted the defendants' motion for summary judgment based on the City's lack of product identification evidence. The City appealed and, on June 12, 2007, the Missouri Supreme Court affirmed summary judgment for the Company and other defendants, concluding the case in favor of the Company and the other defendants.

A number of cities and counties in New Jersey individually initiated proceedings in the Superior Court of New Jersey in 2001 and 2002 against the Company and other companies asserting claims for fraud, public nuisance, civil conspiracy, unjust enrichment and indemnity. The cases were consolidated and assigned to the Superior Court in Middlesex County. The Superior Court granted the defendants' motion to dismiss all complaints. Following an appeal by the plaintiffs, the Appellate Division reinstated the public nuisance claims and affirmed the dismissal of all other claims. On June 15, 2007, the New Jersey Supreme Court reversed the Appellate Division's decision to reinstate the public nuisance claims, concluding the case in favor of the Company and the other defendants.

A number of cities in Ohio individually initiated proceedings in state court in 2006 and 2007 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 Company initiated proceedings in the United States District Court, Southern District of Ohio, against those Ohio cities, John Doe cities and public officials seeking 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 sought compensatory and punitive damages. On February 6, 2009, the State of Ohio voluntarily dismissed this action.

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.

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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 appealed the jury verdict finding that NL Industries did not intentionally cause a public nuisance and the Wisconsin Court of Appeals affirmed the trial court's final judgment. The City of Milwaukee filed a petition for review with the Wisconsin Supreme Court to review the Wisconsin Court of Appeals' decision. The Wisconsin Supreme Court denied the City of Milwaukee's petition to review the Wisconsin Court of Appeals' decision. On September 25, 2009, the trial court dismissed the case, with prejudice, against Mautz Paint Co. pursuant to a stipulation of the parties. This dismissal concluded the case in favor of the Company.

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



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the California Supreme Court and the Supreme Court has decided to review the Court of Appeals decision. Proceedings in the trial court are stayed pending the appeal.

**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 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

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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. The Ohio state court action has been stayed and the New York state court action has been dismissed.

**Note J OTHER EXPENSE (INCOME)**

*Other general expense (income) net*

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

| (Thousands of dollars)                                   | Three months ended |            | Nine months ended |          |
|--|--------------------|------------|-------------------|----------|
|  | September 30,      |            | September 30,     |          |
|  | 2009               | 2008       | 2009              | 2008     |
| Provisions for environmental matters net                 | \$ 9,383           | \$ 1,046   | \$ 18,534         | \$ 1,757 |
| Gain on disposition of assets                            | (2,514)            | (2,516)    | (1,413)           | (1,832)  |
| Adjustments to prior provisions for qualified exit costs |                    |            | 3,204             |          |
| Total expense (income)                                   | \$ 6,869           | \$ (1,470) | \$ 20,325         | \$ (75)  |

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 FASB ASC. See Note H for further details on the Company's environmental-related activities.

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

The adjustments to prior provisions for qualified exit costs represent site specific increases or decreases to accrued qualified exit costs as information becomes available upon which more accurate amounts can be reasonably estimated. See Note F for further details on the Company's exit or disposal activities.

**Table of Contents***Other expense (income) net*

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

| (Thousands of dollars)                              | Three months ended |            | Nine months ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2009               | 2008       | 2009              | 2008       |
| Dividend and royalty income                         | \$ (947)           | \$ (2,334) | \$ (2,518)        | \$ (5,878) |
| Net expense from financing and investing activities | 1,142              | 1,615      | 2,825             | 4,513      |
| Foreign currency related gains                      | 2,445              | 2,306      | 1,476             | 537        |
| Other income  | (2,627)            | (2,549)    | (8,143)           | (6,539)    |
| Other expense                                       | 1,254              | 1,156      | 3,991             | 3,361      |
| Total expense (income)                              | \$ 1,267           | \$ 194     | \$ (2,369)        | \$ (4,006) |

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

Foreign currency related gains included foreign currency transaction gains and losses and realized and unrealized net gains from foreign currency option and forward contracts. The Company had foreign currency option and forward contracts outstanding at September 30, 2009 and 2008. 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 the Derivatives and Hedging Topic of FASB ASC. These derivative instrument values were included in either Other current assets or Other accruals and were insignificant at September 30, 2009.

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 \$1.0 million.

**Note K INCOME TAXES**

The effective tax rates were 32.3 percent and 31.6 percent for the third quarter and the first nine months of 2009, respectively, and 33.5 percent and 32.8 percent for the third quarter and the first nine months of 2008, respectively.

The decrease in the effective tax rates for the 2009 periods compared to 2008 were due to the relative effect that various favorable adjustments had on the third quarter and the first nine months of 2009 compared to 2008.

At December 31, 2008, the Company had \$38.1 million in unrecognized tax benefits, the recognition of which would have an effect of \$32.4 million on the current provision for income taxes. Included in the balance of unrecognized tax benefits at December 31, 2008 was \$7.5 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

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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 classifies all income tax related interest and penalties as income tax expense. At December 31, 2008, the Company had accrued \$15.6 million for the potential payment of income tax interest and penalties.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. The Internal Revenue Service (IRS) commenced an examination of the Company's U.S. income tax returns for the 2006 and 2007 tax years in the fourth quarter of 2008. Fieldwork is anticipated to be completed prior to December 31, 2009. At this time, the Company cannot determine if an additional payment may be due. The IRS substantially completed the audit of the 2004 and 2005 tax years. The Company has paid \$1.3 million to date related to the audit. The 2004 and 2005 audit remains open as it relates to the Company's ESOP. As of September 30, 2009, the Company is subject to non-U.S. income tax examinations for the tax years of 2002 through 2008. In addition, the Company is subject to state and local income tax examinations for the tax years 1992 through 2008.

There were no significant changes to any of these amounts during the third quarter of 2009.

**Note L NET INCOME PER COMMON SHARE**

| (Thousands of dollars except per share data)             | Three months ended<br>September 30, |             | Nine months ended September<br>30, |             |
|--|-------------------------------------|-------------|------------------------------------|-------------|
|  | <b>2009</b>                         | 2008        | <b>2009</b>                        | 2008        |
| Basic  |                                     |             |                                    |             |
| Average common shares outstanding                        | <b>113,447,570</b>                  | 115,828,466 | <b>114,863,697</b>                 | 117,182,407 |
| Net income   | \$ <b>175,208</b>                   | \$ 177,081  | \$ <b>370,510</b>                  | \$ 426,710  |
| Net income per common share                              | \$ <b>1.54</b>                      | \$ 1.53     | \$ <b>3.23</b>                     | \$ 3.64     |
| Diluted  |                                     |             |                                    |             |
| Average common shares outstanding                        | <b>113,447,570</b>                  | 115,828,466 | <b>114,863,697</b>                 | 117,182,407 |
| Non-vested restricted stock grants                       | <b>998,395</b>                      | 1,166,900   | <b>1,049,844</b>                   | 1,164,700   |
| Stock options and other contingently issuable shares (1) | <b>1,251,563</b>                    | 1,187,987   | <b>874,355</b>                     | 1,314,907   |
| Average common shares assuming dilution                  | <b>115,697,528</b>                  | 118,183,353 | <b>116,787,896</b>                 | 119,662,014 |
| Net income   | \$ <b>175,208</b>                   | \$ 177,081  | \$ <b>370,510</b>                  | \$ 426,710  |
| Net income per common share                              | \$ <b>1.51</b>                      | \$ 1.50     | \$ <b>3.17</b>                     | \$ 3.57     |

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- (1) Stock options and other contingently issuable shares excludes 3.0 million and 3.2 million shares for the three months ended September 30, 2009 and 2008, respectively, and 3.1 million and 3.2 million shares for the nine months ended September 30, 2009 and 2008, respectively, due to their anti-dilutive effect.

Basic and diluted earnings per share are calculated in accordance with the Earnings Per Share Topic of FASB ASC. In June 2008, the FASB issued FSP Emerging Issues Task Force (EITF) No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, which clarifies EITF No. 03-6,

Participating Securities and the Two-Class Method Under FAS No. 128, and is now included in the Earnings Per Share Topic of FASB ASC. Under this guidance, unvested share-based payment awards that contain rights to receive non-forfeitable dividends (whether paid or unpaid) are considered participating securities, and the two-class method of computing earnings per share is required for all periods presented.

Under the Company's restricted stock award program, non-forfeitable dividends are paid on unvested shares of restricted stock and the restricted stock must therefore be considered a participating security. However, because basic and diluted earnings per share for the three and nine months ended September 30, 2009 are not significantly different than the per share amounts calculated using the treasury stock method, the treasury stock method continues to be disclosed.

**Table of Contents****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 the Segment Disclosures Topic of FASB ASC.

| (Thousands of dollars)                     | Three months ended September 30, 2009 |                |                |                | Consolidated Totals |
|--|---------------------------------------|----------------|----------------|----------------|---------------------|
|  | Paint Stores Group                    | Consumer Group | Finishes Group | Administrative |                     |
| Net external sales                         | \$ 1,220,717                          | \$ 330,450     | \$ 444,138     | \$ 1,604       | \$ 1,996,909        |
| Intersegment transfers                     |                                       | 361,601        | 47,490         | (409,091)      |                     |
| Total net sales and intersegment transfers | \$ 1,220,717                          | \$ 692,051     | \$ 491,628     | \$ (407,487)   | \$ 1,996,909        |
| Segment profit                             | \$ 230,193                            | \$ 56,473      | \$ 29,658      |                | \$ 316,324          |
| Interest expense                           |                                       |                |                | \$ (8,471)     | (8,471)             |
| Administrative expenses and other          |                                       |                |                | (49,205)       | (49,205)            |
| Income before income taxes                 | \$ 230,193                            | \$ 56,473*     | \$ 29,658      | \$ (57,676)    | \$ 258,648          |

  

|  | Three months ended September 30, 2008 |                |                |                | Consolidated Totals |
|--|---------------------------------------|----------------|----------------|----------------|---------------------|
|  | Paint Stores Group                    | Consumer Group | 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          |

\* Segment profit includes \$5,157 and \$6,584 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores

Group during  
the third  
quarters of 2009  
and 2008,  
respectively.

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|  | Nine months ended September 30, 2009 |                   |                   |                |                        |
|--|--------------------------------------|-------------------|-------------------|----------------|------------------------|
|  | Global                               |                   |                   |                |                        |
|  | Paint<br>Stores<br>Group             | Consumer<br>Group | Finishes<br>Group | Administrative | Consolidated<br>Totals |
| Net external sales                         | \$ 3,289,164                         | \$ 985,090        | \$ 1,216,340      | \$ 4,819       | \$ 5,495,413           |
| Intersegment transfers                     |                                      | 988,946           | 130,273           | (1,119,219)    |                        |
| Total net sales and intersegment transfers | \$ 3,289,164                         | \$ 1,974,036      | \$ 1,346,613      | \$ (1,114,400) | \$ 5,495,413           |
| Segment profit                             | \$ 480,261                           | \$ 152,762        | \$ 66,120         |                | \$ 699,143             |
| Interest expense                           |                                      |                   |                   | \$ (31,029)    | (31,029)               |
| Administrative expenses and other          |                                      |                   |                   | (126,450)      | (126,450)              |
| Income before income taxes                 | \$ 480,261                           | \$ 152,762*       | \$ 66,120         | \$ (157,479)   | \$ 541,664             |
|  | Nine months ended September 30, 2008 |                   |                   |                |                        |
|  | Global                               |                   |                   |                |                        |
|  | Paint<br>Stores<br>Group             | Consumer<br>Group | Finishes<br>Group | Administrative | Consolidated<br>Totals |
| 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             |

\* Segment profit includes \$13,732 and \$20,528 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores Group during



the first nine  
months of 2009  
and 2008,  
respectively.

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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 Operating 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 \$271.5 million and \$23.4 million, respectively, for the third quarter of 2009, and \$299.7 million and \$22.6 million, respectively, for the third quarter of 2008. Net external sales and segment profit of these subsidiaries were \$739.5 million and \$27.8 million, respectively, for the first nine months of 2009, and \$867.8 million and \$70.8 million, respectively, for the first nine months of 2008. Long-lived assets of these subsidiaries totaled \$248.2 million and \$234.5 million at September 30, 2009 and September 30, 2008, 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 N ACQUISITIONS**

During the first quarter of 2009, the Company closed a definitive agreement to acquire Altax Sp. zo.o. (Altax). Headquartered in Poznan, Poland, Altax is a leading innovator of protective woodcare coatings and serves multiple channels, including industrial, professional and DIY. Included in the Consumer Group, the acquisition provides a platform for growth in Central Europe. The aggregate consideration paid for Altax was \$11.8 million, net of cash acquired, including the assumption of certain financial obligations. The acquisition was accounted for as a purchase and the valuation resulted in the recognition of goodwill and intangible assets.

In December 2008, the Company closed a definitive agreement to acquire Euronavy-Tintas Maritimas e Industriais S.A. of Portugal (Euronavy). Headquartered in Lisbon, Portugal, Euronavy is a leading innovator of marine and protective coatings applied to ships, off shore

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platforms, storage tanks, steel, concrete and flooring. Included in the Global Finishes Group, the acquisition strengthens the Company's global platform of protective and marine coatings. Results of operations were included in the consolidated financial statements starting in 2009.

In September 2008, the Company purchased certain assets of the Wagman Primus Group, LP (Wagman). The acquired assets are related to imported raw materials of brushes and foreign manufactured applicators and will allow greater flexibility and control in the importation of applicators and related products for the Consumer Group. Results of operations were included in the consolidated financial statements since the date of acquisition.

In July 2008, the Company acquired 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. This acquisition strengthens the Global Finishes Group's product offering throughout Asia. Results of operations were included in the consolidated financial statements since the date of acquisition.

In February 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 strengthens Global Finishes Group's position in the powder coatings market. Results of operations were included in the consolidated financial statements since the date of acquisition.

The aggregate consideration paid for Euronavy, Inchem, Wagman and Becker was \$64.1 million, net of cash acquired, including acquisition costs and the assumption of certain financial obligations. The acquisitions were accounted for as purchases and resulted in the recognition of intangible assets. The Euronavy, Inchem and Becker acquisitions also resulted in the recognition of goodwill.

The following unaudited pro-forma summary presents consolidated financial information as if Altax, Euronavy, Wagman Primus, Inchem and Becker 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, 2008 or of future results of operations of the combined companies under ownership and operation of the Company.

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| (Thousands of dollars except per share data) | Three months ended<br>September 30, |             | Nine months ended<br>September 30, |             |
|--|-------------------------------------|-------------|------------------------------------|-------------|
|  | 2009                                | 2008        | 2009                               | 2008        |
| Net sales                                    | \$1,996,909                         | \$2,277,023 | \$5,495,683                        | \$6,319,688 |
| Net income                                   | 175,208                             | 177,358     | 370,144                            | 426,791     |
| Net income per common share:                 |                                     |             |                                    |             |
| Basic  | \$ 1.54                             | \$ 1.53     | \$ 3.22                            | \$ 3.64     |
| Diluted                                      | \$ 1.51                             | \$ 1.50     | \$ 3.17                            | \$ 3.57     |

**NOTE O FAIR VALUE MEASUREMENTS**

The Fair Value Measurements and Disclosures Topic of FASB 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 third 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<br>at<br>September<br>30,<br>2009 | Quoted Prices<br>in<br>Active<br>Markets |   |  |
|---|--|--|---|--|
|   |  | for Identical<br>Assets<br>(Level 1)     | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets:   |  |  |   |  |
| Deferred compensation plan asset <sup>(A)</sup>     | \$ 16,108                                    | \$ 16,108                                |   |  |
| Total assets at fair value                          | \$ 16,108                                    | \$ 16,108                                |   |  |
| Liabilities:  |  |  |   |  |
| Net currency derivative liability <sup>(B)</sup>    | \$ 14  |  | \$ 14   |  |
| Deferred compensation plan liability <sup>(C)</sup> | 19,203                                       | \$ 19,203                                |   |  |
| Total liabilities at fair value                     | \$ 19,217                                    | \$ 19,203                                | \$ 14   |  |

(A) The deferred compensation plan asset consists of the investment funds maintained for the future payments under

the Company's executive deferred compensation plan, which is structured as a rabbi trust. The investments are marketable securities accounted for under the Debt and Equity Securities Topic of FASB ASC. They are valued using quoted market prices multiplied by the number of shares.

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(B) The net currency derivative liability represents the fair value of foreign currency swaps. The swaps are valued using the banks proprietary models.

(C) The deferred compensation plan liability is the Company's liability under its executive deferred compensation plan. The liability represents the fair value of the participant shadow accounts, and the value is based on quoted market prices.

**NOTE P FINANCIAL INSTRUMENTS**

The table below summarizes the carrying amount and fair value of the Company's publicly traded debt and non-publicly traded debt in accordance with the Fair Value Measurements and Disclosures Topic of FASB ASC. The fair values of the Company's publicly traded debt are based on quoted market prices. The fair values of the Company's non-traded debt are estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

|                        | <b>September 30, 2009</b> |                  |
|------------------------|---------------------------|------------------|
|                        | <b>Carrying</b>           | <b>Fair</b>      |
| (Thousands of dollars) | <b>Amount</b>             | <b>Value</b>     |
| Publicly traded debt   | <b>\$268,520</b>          | <b>\$357,388</b> |
| Non-traded debt        | <b>31,465</b>             | <b>29,490</b>    |

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

**SUMMARY**

The Sherwin-Williams Company, founded in 1866, and its consolidated wholly owned subsidiaries (collectively, the Company ) are engaged in the development, manufacture, distribution and sale of paint, coatings and related products to professional, industrial, commercial and retail customers primarily in North and South America with additional operations in the Caribbean region, Europe and Asia. The Company is structured into three reportable operating segments Paint Stores Group, Consumer Group and Global Finishes Group (collectively, the Reportable Operating Segments ) and an Administrative Segment in the same way it is internally organized for assessing performance and making decisions regarding allocation of resources. See pages 5 through 7, page 10 and Note 18, on pages 72 through 74 in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, for more information concerning the Reportable Operating Segments.

The decline in the U.S. housing market that began to reduce architectural paint sales volume in 2007 expanded into other U.S. paint markets served by the Company in 2008, reducing manufacturing volume. The economic downturn in the U.S. spread into foreign markets during the last half of 2008, contributing to an overall decline in the business of the Company. Paint sales volume remained depressed in the third quarter and first nine months of 2009. In respect to the challenging global economic conditions, management of the Company continued to review and consistently perform additional valuation procedures to ensure that the values of the Company's assets and liabilities were based on the latest information available on which to base such valuations. Specifically, management determined that: the collectibility of accounts receivable was properly estimated; current estimated market values of inventories exceeded cost; fair market values of goodwill and intangible assets approximated or exceeded current carrying values; the useful lives and fair market values of property, plant and equipment were established in relation to the current lower manufacturing and sales demand; any necessary impairments of property, plant and equipment and accrual of qualified exit costs were recorded for all closed sites being held for disposal; and all sales allowances, returns, discounts, warranties and complaint allowances were reasonably stated in respect to the current economic conditions and declining business environment.

The Company's financial condition, liquidity and cash flow remained strong through the first nine months of 2009 in spite of the continuing challenging global economic conditions that included significant reductions in demand, increased manufacturing costs related to lower volume throughput, tight credit markets and severe fluctuations in foreign currency rates. Net working capital improved \$170.6 million at September 30, 2009 compared to the end of the third quarter of 2008 due primarily to a larger proportional decrease in current liabilities than current assets. Short-term borrowings decreased \$305.0 million from September 30, 2008 and all other current liabilities decreased \$219.8 million. The Company has been able to arrange sufficient short-term borrowing capacity at reasonable rates even as credit markets remain tight and the Company has sufficient total available borrowing capacity to fund its current operating needs.

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Short-term borrowings decreased \$105.4 million from December 31, 2008, due to the control over working capital, and all other current liabilities increased \$54.8 million. Since September 30, 2008, Accounts receivable and Inventories were down \$308.7 million and the remaining current assets decreased \$45.4 million. Accounts Receivable and Inventories decreased \$6.5 million from December 31, 2008 to September 30, 2009 when normal seasonal trends typically require significant growth in these categories. The use of a portion of Net operating cash to reduce Total current liabilities more than Total current assets improved the Company's current ratio to 1.02 at September 30, 2009 from .94 at September 30, 2008 and compared to .99 at December 31, 2008. Total debt at September 30, 2009 decreased \$315.8 million to \$711.0 million from \$1,026.8 million at September 30, 2008 and decreased as a percentage of total capitalization to 29.5 percent from 37.1 percent at the end of the third quarter last year. Total debt decreased \$122.8 million and decreased from 34.2% of total capitalization at December 31, 2008. At September 30, 2009, the Company had remaining borrowing ability of \$1.215 billion. Net operating cash increased \$23.1 million in nine months of 2009 to \$615.6 million from \$592.6 million in 2008 primarily due to a net decrease in cash used to fund working capital requirements of \$46.8 million that was partially offset by an increase in costs incurred for environmental matters of \$14.1 million and a reduction in net income adjusted for non-cash items of \$8.2 million. In the twelve month period from October 1, 2008 through September 30, 2009, the Company generated net operating cash of \$899.3 million and invested \$34.3 million in acquisitions, \$89.0 million in capital additions and improvements, reduced its total debt \$313.3 million, purchased \$289.8 million in treasury stock and paid \$165.6 million in cash dividends to its shareholders of common stock.

Results of operations for the Company in the third quarter and first nine months of 2009 continued to suffer from a decrease in end-market demand for coatings and other building materials caused by the effects of the expanding global economic downturn and a lingering depressed U.S. housing market. Consolidated net sales decreased 12.0 percent in the third quarter to \$1.997 billion from \$2.269 billion in the third quarter of 2008 and decreased 12.5 percent in the first nine months to \$5.495 billion from \$6.280 billion in the first nine months of 2008 due primarily to paint sales volume declines resulting from contracted demand in the domestic market for more than two years that expanded into the global markets beginning in the second half of 2008. Net sales in the Paint Stores Group decreased 13.5 percent in the quarter to \$1.221 billion and decreased 13.4 percent to \$3.289 billion in the first nine months due primarily to continuing weak residential and commercial architectural paint sales volume and lower sales in industrial coatings and non-paint categories partially offset by improving DIY customer sales. Net sales in the Paint Stores Group from stores open more than twelve calendar months decreased 13.5 percent in the quarter and 13.3 percent in the first nine months of 2009. Net sales in the Consumer Group decreased 7.1 percent to \$330.5 million in the quarter and 4.0 percent to \$985.1 million in the first nine months due primarily to lower volume sales to most of the Group's retail customers. Net sales in the Global Finishes Group stated in U.S. dollars declined 11.3 percent in the quarter to \$444.1 million and 16.2 percent to \$1.216 billion in the first nine months due primarily to decreased paint volume sales and unfavorable currency translation rates partially offset by acquisitions and selling price increases. Gross profit as a percent of consolidated net sales increased in the third quarter to 46.5 percent from 42.3 percent in 2008 and increased to 45.6 percent from 43.2 percent in the first nine months due primarily to lower freight and other distribution costs, reduced expenses related to cost control initiatives and



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favorable product sales mix partially offset by higher costs related to lower manufactured volume and unfavorable currency translation rates. Third quarter gross profit margins approached a more normal level in 2009 versus last year's depressed gross profit margins caused by rapidly escalating raw material costs. Selling, general and administrative expenses (SG&A) increased as a percent of consolidated net sales to 32.8 percent from 30.0 percent in the third quarter of 2008 and increased to 34.9 percent from 32.0 percent in nine months due primarily to the sales decline as good expense control across all Reportable Operating Segments resulted in total SG&A spending that was \$27.1 million lower than in the third quarter of 2008 and \$93.9 million lower than in the first nine months last year. Other general expense net increased in the third quarter and first nine months of 2009 due primarily to increased accruals for environmental-related matters and exit costs related to closed properties. Interest expense decreased \$6.7 million in the third quarter and \$20.0 million in the first nine months of 2009 due to lower short-term borrowings and borrowing rates. The effective income tax rate for third quarter 2009 was 32.3 percent compared to 33.5 percent in 2008 and the rate for the first nine months of 2009 was 31.6 percent compared to 32.8 percent in 2008. Diluted net income per common share increased to \$1.51 per share for the third quarter 2009 from \$1.50 per share a year ago and decreased to \$3.17 per share from \$3.57 per share in the first nine months.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation and fair presentation of the consolidated unaudited interim financial statements and accompanying notes included in this report are the responsibility of management. The financial statements and footnotes have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and contain certain amounts that were based upon management's best estimates, judgments and assumptions that were believed to be reasonable under the circumstances. Management considered the impact of the current global economic recession and utilized certain outside sources of economic information when developing the basis for their estimates and assumptions. The impact of the deteriorating global economic conditions on the estimates and assumptions used by management was believed to be reasonable under the circumstances. Management used assumptions based on historical results, considering the current economic trends, and other assumptions to form the basis for determining appropriate carrying values of assets and liabilities that were not readily available from other sources. Actual results could differ from those estimates. Also, materially different amounts may result under materially different conditions, materially different economic trends or from using materially different assumptions. However, management believes that any materially different amounts resulting from materially different conditions or material changes in facts or circumstances are unlikely to significantly impact the current valuation of assets and liabilities that were not readily available from other sources.

A comprehensive discussion of the Company's critical accounting policies and management estimates and significant accounting policies followed in the preparation of the financial statements is included in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 1, on pages 44 through 49, in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. There have been no significant changes in critical accounting policies, management estimates or accounting policies followed since the year ended December 31, 2008.

**Table of Contents****FINANCIAL CONDITION, LIQUIDITY AND CASH FLOW*****Overview***

The Company's financial condition, liquidity and cash flow remained strong through the first nine months of 2009 in spite of continued challenging global economic conditions that included significant reductions in demand, increased manufacturing costs related to lower volume throughput, tight credit markets and significant fluctuations in foreign currency translation rates. Net working capital improved \$170.6 million at September 30, 2009 compared to the end of the third quarter of 2008 due primarily to a larger proportional decrease in current liabilities than current assets. Short-term borrowings decreased \$305.0 million from September 30, 2008 and all other current liabilities decreased \$219.8 million. The Company was able to arrange sufficient short-term borrowing capacity at reasonable rates even as credit markets remained tight and the Company has sufficient total available borrowing capacity to fund its current operating needs. Short-term borrowings decreased \$105.4 million from December 31, 2008 and all other current liabilities increased \$54.8 million. Since September 30, 2008, Accounts receivable and Inventories were down \$308.7 million and the remaining current assets decreased \$45.4 million. Accounts Receivable and Inventories decreased \$6.5 million from December 31, 2008 to September 30, 2009 when normal seasonal trends typically require growth in these categories. The use of a portion of Net operating cash to reduce Total current liabilities more than Total current assets improved the Company's current ratio to 1.02 at September 30, 2009 from .94 at September 30, 2008 and compared to .99 at December 31, 2008. Total debt at September 30, 2009 decreased \$315.8 million to \$711.0 million from \$1,026.8 million at September 30, 2008 and decreased as a percentage of total capitalization to 29.5 percent from 37.1 percent at the end of the third quarter last year. Total debt decreased \$122.8 million and decreased from 34.2% of total capitalization at December 31, 2008. At September 30, 2009, the Company had remaining borrowing ability of \$1.215 billion. Net operating cash increased \$23.1 million in the third quarter of 2009 to \$615.6 million from \$592.6 million in 2008 primarily due to a net decrease in cash used to fund working capital requirements of \$46.8 million that was partially offset by an increase in costs incurred for environmental matters of \$14.1 million and a reduction in net income adjusted for non-cash items of \$8.2 million. In the twelve month period from October 1, 2008 through September 30, 2009, the Company generated net operating cash of \$899.3 million and invested \$34.3 million in acquisitions, \$89.0 million in capital additions and improvements, reduced its total debt \$313.7 million, purchased \$289.8 million in treasury stock and paid \$165.6 million in cash dividends to its shareholders of common stock.

***Net Working Capital, Debt and Other Long-Term Assets and Liabilities***

Cash and cash equivalents increased \$6.6 million during the first nine months of 2009. Cash used for capital expenditures of \$63.6 million, payments of cash dividends of \$124.6 million, treasury stock purchases of \$276.2 million and reduction of \$105.4 million in short-term borrowings were funded primarily by net cash from operations. At September 30, 2009, the Company's current ratio was 1.02, an improvement from the current ratio of .99 at December 31, 2008 and from .94 a year ago. The improvements in the current ratio were primarily due to the reduction in short-term borrowings and control over Accounts receivable and Inventories.

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Goodwill and intangible assets increased \$2.8 million from December 31, 2008 and decreased \$30.7 million from September 30, 2008. The net increase during the nine months of 2009 was due to acquisitions and capitalization of software costs of \$14.5 million partially offset by amortization and currency translation rate changes of \$11.8 million. The net decrease over the twelve-month period from September 30, 2008 resulted from acquisitions and capitalization of software costs of \$24.5 million and other adjustments, primarily currency translation rate changes of \$56.0 million that were more than offset by impairments of \$53.9 million and amortization of \$57.3 million. See Note 3, on pages 50 to 52, in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, for more information concerning goodwill and intangible assets.

Deferred pension assets remained relatively unchanged during the first nine months of 2009 and decreased \$197.0 million from September 30, 2008. The decrease in the last twelve months was due primarily to a decline in the fair market value of equity securities held by the Company's defined benefit pension plans. See Note 6, on pages 55 to 60, in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 for more information concerning the Company's benefit plan assets.

Net property, plant and equipment decreased \$27.5 million in the first nine months of 2009 and decreased \$52.3 million in the twelve months since September 30, 2008. The reduction in the nine months of 2009 was primarily due to capital expenditures of \$63.6 million and changes in currency translation rates that were more than offset by depreciation expense of \$109.6 million and the disposition of assets with remaining book value. Since September 30, 2008, capital expenditures of \$89.0 million and acquired assets of \$34.3 million were more than offset by depreciation expense of \$145.5 million and dispositions of assets with remaining net book value and changes in currency translation rates. Capital expenditures during the first nine months of 2009 primarily represented expenditures associated with improvements and normal equipment replacement in manufacturing and distribution facilities in the Consumer Group and normal equipment replacement in the Paint Stores and Global Finishes Groups.

Short-term borrowings related to the Company's domestic commercial paper program outstanding were \$179.7 million at an average rate of .3 percent at September 30, 2009. Short-term borrowings under certain revolving and letter of credit agreements were \$200 million at an average rate of .3 percent at September 30, 2009. Short-term borrowings outstanding under various foreign programs at September 30, 2009 were \$31.4 million with a weighted average interest rate of 6.1 percent. The Company had unused maximum borrowing availability of \$665.0 million at September 30, 2009 under the commercial paper program that is backed by the Company's revolving credit agreement. There was an additional \$550.0 million available under other committed credit facilities. There were no significant changes in long-term debt during the third quarter or first nine months of 2009 or in the twelve months since September 30, 2008. See Note 7, on page 60, in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, for more information concerning the Company's debt.

Long-term liabilities for defined benefit pension and other postretirement benefit plans increased slightly over December 31, 2008 and decreased \$14.4 million from September 30, 2008. The changes in the liability resulted primarily from the reduction in the actuarially determined

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postretirement benefit obligation resulting from changes in actuarial assumptions. See Note 6, on pages 55 to 60, in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 for more information concerning the Company's benefit plan obligations.

Other long-term liabilities at September 30, 2009 decreased \$37.1 million from a year ago due primarily to a decrease at the end of 2008 in non-current deferred tax liabilities of \$20.5 million and a reduction in long-term accruals for extended environmental-related liabilities of \$2.4 million.

***Environmental-Related Liabilities***

The operations of the Company, like those of other companies in the same industry, are subject to various federal, state and local environmental laws and regulations. These laws and regulations not only govern current operations and products, but also impose potential liability on the Company for past operations. Management expects environmental laws and regulations to impose increasingly stringent requirements upon the Company and the industry in the future. Management believes that the Company conducts its operations in compliance with applicable environmental laws and regulations and has implemented various programs designed to protect the environment and promote continued compliance.

Depreciation of capital expenditures and other expenses related to ongoing environmental compliance measures were included in the normal operating expenses of conducting business. The Company's capital expenditures, depreciation and other expenses related to ongoing environmental compliance measures were not material to the Company's financial condition, liquidity, cash flow or results of operations during the first nine months of 2009. Management does not expect that such capital expenditures, depreciation and other expenses will be material to the Company's financial condition, liquidity, cash flow or results of operations in 2009.

The Company is involved with environmental investigation and remediation activities at some of its currently and formerly owned sites (including sites which were previously owned and/or operated by businesses acquired by the Company). In addition, the Company, together with other parties, has been designated a potentially responsible party under federal and state environmental protection laws for the investigation and remediation of environmental contamination and hazardous waste at a number of third-party sites, primarily Superfund sites. The Company may be similarly designated with respect to additional third-party sites in the future.

The Company accrues for estimated costs of investigation and remediation activities at its currently and formerly owned sites 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 based on currently available facts regarding each site. The Company accrues a specific estimated amount when such an amount and a time frame in which the costs will be incurred can be reasonably determined. 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 accrued by the Company in accordance with applicable accounting rules and interpretations. The Company continuously assesses its potential liability for investigation and remediation activities

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and adjusts its environmental-related accruals as information becomes available upon which more accurate costs can be reasonably estimated. At September 30, 2009 and 2008, the Company had accruals for environmental-related activities of \$174.4 million and \$184.5 million, respectively.

Due to the uncertainties of the scope and magnitude of contamination and the degree of investigation and remediation activities that may be necessary at certain currently or formerly owned sites and third party sites, it is reasonably likely that further extensive investigations may be required and that extensive remedial actions may be necessary not only on such sites but on adjacent properties. Depending on the extent of the additional investigations and remedial actions necessary, the Company's ultimate liability may result in costs that are significantly higher than currently accrued. If the Company's future loss contingency is ultimately determined to be at the maximum of the range of possible outcomes for every site for which costs can be reasonably estimated, the Company's aggregate accruals for environmental-related activities would be \$108.3 million higher than the accruals at September 30, 2009.

Five of the Company's currently and formerly owned sites accounted for the majority of the accruals for environmental-related activities and the unaccrued maximum of the estimated range of possible outcomes at September 30, 2009. At September 30, 2009, \$132.0 million, or 75.7 percent, related directly to these five sites. Of the aggregate unaccrued exposure at September 30, 2009, \$70.9 million, or 65.4 percent, related to the five sites. While environmental investigations and remedial actions are in different stages at these sites, additional investigations, remedial actions and/or monitoring will likely be required at each site. A comprehensive description of the five currently and formerly owned sites that account for the majority of the accruals for environmental-related activities is included in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. At one of the two formerly owned facilities in New Jersey, a partial remediation plan has been agreed too and some remedial measures have been taken. The full extent of the remedial action has not been determined or agreed to by the appropriate governmental agency. There have been no significant changes in the investigative or remedial status of the other four sites since the year ended December 31, 2008.

Management cannot presently estimate the ultimate potential loss contingencies related to these five sites or other less significant sites until such time as a substantial portion of the investigative activities at each site is completed and remedial action plans are developed.

In accordance with the Asset Retirement Obligations Topic of FASB ASC, the Company has identified certain conditional asset retirement obligations at various current manufacturing, distribution and store facilities. These obligations relate primarily to asbestos abatement and closures of hazardous waste containment devices. Using investigative, remediation and disposal methods that are currently available to the Company, the estimated cost of these obligations is not significant.

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

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any potential liability ultimately attributed to the Company for its environmental-related matters or conditional asset retirement obligations 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 and conditional asset retirement obligations 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 governmental agency approval, as necessary, with respect to investigation and remediation activities, and the indefinite amount of time necessary to conduct remediation activities.

***Contractual Obligations, Commercial Commitments and Warranties***

Short-term borrowings decreased \$105.4 million to \$411.0 million at September 30, 2009 from \$516.4 million at December 31, 2008. Total long-term debt decreased \$17.3 million to \$300.0 at September 30, 2009 from \$317.3 million at December 31, 2008. See the Financial Condition, Liquidity and Cash Flow section of this report for more information. There have been no other significant changes to the Company's contractual obligations and commercial commitments in the third quarter or first nine months of 2009 as summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

Changes to the Company's accrual for product warranty claims in the first nine months of 2009 are disclosed in Note E.

***Contingent Liabilities***

Life Shield Engineered Systems, LLC (Life Shield) is a wholly-owned subsidiary of the Company. Life Shield develops and manufactures blast and fragment mitigating systems and ballistic resistant systems. The blast and fragment mitigating systems and ballistic resistant systems create a potentially higher level of product liability for the Company (as an owner of and raw material supplier to Life Shield and as the exclusive distributor of Life Shield's systems) than is normally associated with coatings and related products currently manufactured, distributed and sold by the Company.

Certain of Life Shield's technology has been designated as Qualified Anti-Terrorism Technology and granted a Designation under the Support Anti-terrorism by Fostering Effective Technologies Act of 2002 (SAFETY Act) and the regulations adopted pursuant to the SAFETY Act. Under the SAFETY Act, the potentially higher level of possible product liability for Life Shield relating to the technology granted the Designation is limited to \$6.0 million per occurrence in the event any such liability arises from an Act of Terrorism (as defined in the SAFETY Act). The limitation of liability provided for under the SAFETY Act does not apply to any technology not granted a designation or certification as a Qualified Anti-Terrorism Technology, nor in the event that any such liability arises from an act or event other than an Act of Terrorism. Life Shield maintains insurance for liabilities up to the \$6.0 million per occurrence limitation caused by failure of its products in the event of an Act of Terrorism. This commercial insurance is also expected to

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cover product liability claims asserted against the Company as the distributor of Life Shield's systems. The Company expects to seek Designation and Certification under the SAFETY Act for certain products supplied by the Company to Life Shield.

Management of the Company has reviewed the potential increased liabilities associated with Life Shield's systems and determined that potential liabilities arising from an Act of Terrorism that could ultimately affect the Company will be appropriately insured or limited by current regulations. However, due to the uncertainties involved in the future development, usage and application of Life Shield's systems, the number or nature of possible future claims and legal proceedings, or the affect that any change in legislation and/or administrative regulations may have on the limitations of potential liabilities, management cannot reasonably determine the scope or amount of any potential costs and liabilities for the Company related to Life Shield or to Life Shield's systems. Any potential liability for the Company that may result from Life Shield or Life Shield's systems cannot reasonably be estimated. However, based upon, among other things, the limitation of liability under the SAFETY Act in the event of an Act of Terrorism, management does not currently believe that the costs or potential liability ultimately determined to be attributable to the Company through its ownership of Life Shield, as a supplier to Life Shield or as a distributor of Life Shield's systems arising from the use of Life Shield's systems will have a material adverse effect on the Company's results of operations, liquidity or financial conditions.

***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 incurrence of a liability or the reduction of a liability. In accordance with the Contingencies Topic of FASB 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 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 FASB ASC 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

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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 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.

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 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.) 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.



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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.** The State of Rhode Island initiated an action in October 1999 against the Company and other companies asserting, in part, that lead pigment in paint constitutes a public nuisance under Rhode Island law. The claim for public nuisance was originally tried to a jury in 2002 and 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. 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. This decision concluded 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 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 County of Santa Clara, California and other public entities in the State of California, and the City of Milwaukee, Wisconsin.

The City of St. Louis proceeding was initiated in January 2000 against the Company and other companies asserting claims for strict liability, negligence, fraudulent misrepresentation, negligent misrepresentation, concert of action, conspiracy, public nuisance, restitution and indemnity. Following various pre-trial proceedings, the City alleged a single count of public nuisance. Following further pre-trial proceedings, the trial court granted the defendants' motion for summary judgment based on the City's lack of product identification evidence. The City appealed and, on June 12, 2007, the Missouri Supreme Court affirmed summary judgment for the Company and other defendants, concluding the case in favor of the Company and the other defendants.

A number of cities and counties in New Jersey individually initiated proceedings in the Superior Court of New Jersey in 2001 and 2002 against the Company and other companies asserting claims for fraud, public nuisance, civil conspiracy, unjust enrichment and indemnity. The cases were consolidated and assigned to the Superior Court in Middlesex County. The Superior Court granted the defendants' motion to dismiss all complaints. Following an appeal by the plaintiffs, the Appellate Division reinstated the public nuisance claims and affirmed the dismissal of all other claims. On June 15, 2007, the New Jersey Supreme Court reversed the Appellate Division's decision to reinstate the public nuisance claims, concluding the case in favor of the Company and the other defendants.

A number of cities in Ohio individually initiated proceedings in state court in 2006 and 2007 against the Company and other companies asserting claims for public nuisance, concert of

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action, unjust enrichment, indemnity and punitive damages. Also in September 2006, the Company initiated proceedings in the United States District Court, Southern District of Ohio, against those Ohio cities, John Doe cities and public officials seeking 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 sought compensatory and punitive damages. On February 6, 2009, the State of Ohio voluntarily dismissed this action.

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 appealed the jury verdict finding that NL Industries did not intentionally cause a public nuisance and the Wisconsin Court of Appeals affirmed the trial court's final judgment. The City of Milwaukee filed a petition for review with the Wisconsin Supreme Court to review the Wisconsin Court of Appeals' decision. The Wisconsin Supreme Court denied the City of Milwaukee's petition to review the Wisconsin Court of Appeals' decision. On September 25, 2009, the trial court dismissed the case, with prejudice, against Mautz Paint Co. pursuant to a stipulation of the parties. This dismissal concluded the case in favor of the Company.

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.

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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 and the Supreme Court has decided to review the Court of Appeal's decision. Proceedings in the trial court are stayed pending the appeal.

**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 damaged or injured as a result. The plaintiff filed post-trial motions

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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. The Ohio state court action has been stayed and the New York state court action has been dismissed.

***Shareholders' Equity***

Shareholders' equity increased \$97.2 million to \$1.703 billion at September 30, 2009 from \$1.606 billion at December 31, 2008 and decreased \$35.4 million from \$1.738 billion at September 30, 2008. The increase in Shareholders' equity resulted primarily from increased retained earnings, increased common stock and other capital resulting from stock option exercises and, in the first nine months of 2009, a decrease in Cumulative other comprehensive loss. Partially offsetting the increase in equity in the first nine months were the purchases of treasury stock for \$276.2 million. Purchases of treasury stock for \$289.8 million since September 30, 2008 and an increase in Cumulative other comprehensive loss of \$112.7 million in twelve months due primarily to losses associated with Deferred pension assets, net of taxes more than offset the increases in twelve months. During the first nine months of 2009, the Company purchased 4,878,000 shares of its common stock for treasury purposes through open market purchases. The Company purchased 5,128,000 shares of its common stock since September 30, 2008 for treasury. The Company acquires its common stock for general corporate purposes and, depending on its cash position and market conditions it may acquire additional shares in the future. The Company had remaining authorization at September 30, 2009 to purchase 14.87 million shares of its common stock.

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Total increases in common stock and other capital of \$54.5 million during the first nine months of 2009 and \$114.7 million during the last twelve months were due primarily to the recognition of stock-based compensation expense and stock option exercises. Retained earnings increased \$246.9 million during the first nine months due to net income after taxes exceeding \$124.6 million in cash dividends paid and increased \$256.1 million from September 30, 2008 due to net income that was only partially offset by \$165.6 million in cash dividends paid. At a meeting held on July 16, 2009, the Board of Directors increased the quarterly cash dividend from \$.35 per common share to \$.355 per common share for the third time in 2009. This quarterly dividend, if approved in the remaining quarter of 2009, would result in an annual dividend for 2009 of \$1.42 per common share or a 35.5 percent payout of 2008 diluted net income per common share. The Board of Directors considered the increase in the proposed cash dividend payout for 2009 appropriate, representing a percentage payout of 2008 diluted net income per common share exceeding 30.0 percent, in respect to the Net operating cash achieved by the Company and the anticipated short-term negative impact on the Company's earnings of the current economic malaise.

***Cash Flow***

Net operating cash increased \$23.1 million in nine months of 2009 to \$615.6 million from \$592.6 million in 2008 primarily due to a net decrease in cash used to fund working capital requirements of \$46.8 million that was partially offset by an increase in costs incurred for environmental matters of \$14.1 million and a reduction in net income adjusted for non-cash items of \$8.2 million. In the twelve month period from October 1, 2008 through September 30, 2009, the Company generated net operating cash of \$899.3 million and invested \$34.3 million in acquisitions, \$89.0 million in capital additions and improvements, reduced its total debt \$313.3 million, purchased \$289.8 million in treasury stock and paid \$165.6 million in cash dividends to its shareholders of common stock. Since the beginning of 2008, the Company acquired five companies that have been included in the consolidated financial results of the Company since the date of acquisition. See Note N for a full description of all acquisitions.

***Market Risk***

The Company is exposed to market risk associated with interest rate, foreign currency and commodity fluctuations. The Company occasionally utilizes derivative instruments as part of its overall financial risk management policy, but does not use derivative instruments for speculative or trading purposes. In the first nine months of 2009, the Company entered into option and forward currency exchange contracts with maturity dates of less than twelve months to hedge against value changes in foreign currency. The Company also entered into swaps in the first nine months of 2009 to partially hedge forecasted future commodity purchases. These hedging contracts were designated as cash flow hedges and were insignificant at September 30, 2009. The Company believes it may be exposed to continuing market risk from foreign currency exchange rate and commodity price fluctuations. However, the Company does not expect that foreign currency exchange rate and commodity price fluctuations or hedging contract losses will have a material adverse effect on the Company's financial condition, results of operations or cash flows.

***Financial Covenant***

Certain borrowings contain a consolidated leverage covenant. At September 30, 2009, the Company was in compliance with the covenant. The Company's Notes, Debentures and

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revolving credit agreement contain various default and cross-default provisions. In the event of default under any one of these arrangements, acceleration of the maturity of any one or more of these borrowings may result. See Note 7, on page 60, in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, for more information concerning the Company's debt and related covenant.

**RESULTS OF OPERATIONS**

Shown below are net sales and the percentage change for the third quarter and first nine months by segment:

| <i>(thousands of dollars)</i>           | <b>2009</b>         | <b>Change</b> | <b>2008</b>  |
|---|---------------------|---------------|--------------|
| <b>Three months ended September 30:</b> |                     |               |              |
| Paint Stores Group                      | <b>\$ 1,220,717</b> | -13%          | \$ 1,410,461 |
| Consumer Group                          | <b>330,450</b>      | -7%           | 355,669      |
| Global Finishes Group                   | <b>444,138</b>      | -11%          | 500,772      |
| Administrative                          | <b>1,604</b>        | -9%           | 1,756        |
| Net sales                               | <b>\$ 1,996,909</b> | -12%          | \$ 2,268,658 |
| <b>Nine months ended September 30:</b>  |                     |               |              |
| Paint Stores Group                      | <b>\$ 3,289,164</b> | -13%          | \$ 3,796,645 |
| Consumer Group                          | <b>985,090</b>      | -4%           | 1,026,483    |
| Global Finishes Group                   | <b>1,216,340</b>    | -16%          | 1,451,545    |
| Administrative                          | <b>4,819</b>        | -8%           | 5,212        |
| Net sales                               | <b>\$ 5,495,413</b> | -13%          | \$ 6,279,885 |

Consolidated net sales decreased in the third quarter and first nine months of 2009 due primarily to weak paint sales volume and unfavorable foreign currency translation rate changes partially offset by the impact of five acquisitions completed since the beginning of 2008.

Net sales of all consolidated foreign subsidiaries were down 9.4 percent to \$271.5 million in the quarter and down 14.8 percent to \$739.5 million in the first nine months versus \$299.7 million and \$867.8 million in comparable periods last year. The decreases in net sales for all consolidated foreign subsidiaries in the quarter and first nine months were due to a 17.5 percent negative impact of foreign currency exchange rates in the quarter and a 12.9 percent negative impact in the first nine months. Acquisitions added 2.4 percent to net sales of all consolidated foreign subsidiaries in the quarter and 3.0 percent in the first nine months. Net sales of all operations other than consolidated foreign subsidiaries were down 12.4 percent to \$1.73 billion in the quarter and down 12.1 percent to \$4.76 billion in nine months as compared to \$1.97 billion and \$5.41 billion in the same periods last year.

Net sales in the Paint Stores Group decreased due primarily to continuing weak residential and commercial architectural paint sales volumes and lower sales in industrial coatings and non-paint categories partially offset by improving DIY customer sales. Net sales from stores open for

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more than twelve calendar months decreased 13.5 percent in the quarter and 13.3 percent in the first nine months over last year's comparable periods. Total paint sales volume percentage decreases were in the high-teens for the quarter and first nine months as compared to the third quarter and first nine months last year. Sales of non-paint products decreased by 15.6 percent over last year's third quarter and decreased 16.3 percent over last year's first nine months. A discussion of changes in volume versus pricing for sales of products other than paint is not pertinent due to the wide assortment of general merchandise sold.

Net sales of the Consumer Group decreased due primarily to lower volume sales to most of the Group's retail customers partially offset by additional sales to existing customers related to new products.

The Global Finishes Group's net sales decreased when stated in U.S. dollars due primarily to lower paint sales volume and unfavorable currency translation rate changes that were partially offset by acquisitions and selling price increases. Unfavorable currency translation rate changes decreased net sales of this Group in U.S. dollars by 6.4 percent in the quarter and by 8.4 percent in the first nine months. Acquisitions increased net sales of the Global Finishes Group by 1.4 percent in the quarter and by 1.8 percent in the first nine months.

Shown below are segment profit and the percent change for the third quarter and first nine months by segment:

| <i>(thousands of dollars)</i>           | 2009       | Change | 2008       |
|---|------------|--------|------------|
| <b>Three months ended September 30:</b> |            |        |            |
| Paint Stores Group                      | \$ 230,193 | -4%    | \$ 240,999 |
| Consumer Group                          | 56,473     | 115%   | 26,320     |
| Global Finishes Group                   | 29,658     | -35%   | 45,337     |
| Administrative                          | (57,676)   | 24%    | (46,514)   |
| Income before income taxes              | \$ 258,648 | -3%    | \$ 266,142 |
| <b>Nine months ended September 30:</b>  |            |        |            |
| Paint Stores Group                      | \$ 480,261 | -10%   | \$ 534,736 |
| Consumer Group                          | 152,762    | 19%    | 127,929    |
| Global Finishes Group                   | 66,120     | -52%   | 136,438    |
| Administrative                          | (157,479)  | -4%    | (163,760)  |
| Income before income taxes              | \$ 541,664 | -15%   | \$ 635,343 |

Consolidated income before income taxes was unfavorably impacted by a reduction in gross profit of \$31.5 million in the third quarter and \$209.0 million in the first nine months of 2009 compared to the same periods in 2008. As a percent of sales, consolidated gross profit increased to 46.5 percent in the quarter from 42.3 percent in the third quarter of 2008 and improved to 45.6 percent in the first nine months of 2009 from 43.2 percent last year. The dollar decreases in consolidated gross profit relate solely to the decline in sales volume and related costs, including unfavorable currency translation rates. The increases as a percent to sales were due primarily to

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price increases initiated over the past eighteen months, cost control efforts primarily in the Consumer Group and improved freight and other distribution costs partially offset by incremental site closing costs. Selling, general and administrative expenses (SG&A) decreased \$27.1 million in the quarter and \$93.9 million in the first nine months of 2009 versus last year due primarily to good expense control throughout the Company partially offset by incremental store closing costs. As a percent of sales, consolidated SG&A increased to 32.8 percent in the quarter and to 34.9 percent in the first nine months from 30.0 percent in the third quarter and 32.0 percent in the first nine months of 2008.

The Paint Stores Group's gross profit in the third quarter was lower than last year by \$42.2 million and lower than last year in the first nine months by \$139.5 million due to lower paint sales volume and lower non-paint sales. The Paint Stores Group's gross profit margins in the quarter and nine months were up more than consolidated margins in the same periods due primarily to reductions in freight and distribution costs and a favorable product sales mix. The Consumer Group's gross profit increased from last year by \$31.4 million in the quarter due primarily to cost control efforts and reductions in freight and related distribution costs. Third quarter gross profit margins approached a more normal level in 2009 versus last year's depressed gross profit margins caused by rapidly escalating raw material costs. Consumer Group's gross profit in the first nine months increased from last year by \$26.2 million due primarily to cost control efforts and reductions in freight and related distribution costs partially offset by lower sales, lower volume throughput in the manufacturing and distribution facilities and incremental costs related to site closings. Consumer Group's gross profit margins were up compared to the comparable periods last year as cost control efforts of the past eighteen months and reduced site expenses helped overall profitability. The Global Finishes Group's gross profit decreased \$16.5 million in the third quarter and \$94.2 million in the first nine months when stated in U.S. dollars due to decreased sales volume, unfavorable currency translation rates and increased manufacturing and distribution costs relating to lower production and sales volumes. The Global Finishes Group's gross profit margins in the quarter and nine months were down slightly compared to the comparable periods last year. Unfavorable currency translation rate changes decreased the Group's gross profit by \$10.8 million in the quarter and \$41.6 million in the first nine months. In the Paint Stores Group, SG&A decreased \$25.1 million in the quarter and \$58.8 million in the first nine months due primarily to good expense control in relation to soft sales volumes partially offset by some incremental costs related to store closings. The Consumer Group's SG&A increased \$3.3 million in the quarter and \$6.7 million in the first nine months due primarily to the impact of acquisitions. The Global Finishes Group's SG&A decreased \$9.3 million in the quarter and \$34.2 million in the first nine months relating primarily to unfavorable currency translation rate changes of \$7.6 million in the quarter and \$31.2 million in the first nine months partially offset by acquisition expenses. Administrative expenses in the third quarter of 2009 increased \$11.2 million over 2008 due primarily to an increase of \$8.3 million in provisions for environmental-related matters and increased benefit costs not directly related to the Reportable Operating Segments that were partially offset by a reduction in interest expense of \$6.7 million. Administrative expenses decreased \$6.3 million in the first nine months versus 2008 due primarily to reductions in interest



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expense of \$20.0 million and a reduction in stock based compensation of \$7.0 million in the first quarter of 2009 partially offset by an increase of \$16.8 million in provisions for environmental-related matters and increased benefit costs not directly related to the Reportable Operating Segments.

Consolidated income before income taxes decreased \$7.5 million in the third quarter and decreased \$93.7 million in the first nine months of 2009 due primarily to the lower segment profits of the Reportable Operating Segments partially offset by the reduction in administrative expenses.

The effective tax rate for the third quarter of 32.3 percent and 31.6 percent for the first nine months were below the effective tax rates for the third quarter and first nine months of 2008 of 33.5 percent and 32.8 percent, respectively.

Net income for the quarter decreased \$1.9 million to \$175.2 million from \$177.1 million in the third quarter of 2008 and decreased \$56.2 million to \$370.5 million from \$426.7 million in the first nine months of 2008. Diluted net income per common share in the quarter increased 0.7 percent to \$1.51 per share from \$1.50 per share in the third quarter of 2008 and decreased in the first nine months 11.2 percent to \$3.17 per share from \$3.57 per share in the first nine months of 2008 as lower net income exceeded the impact of a lower tax rate and the reduction in the diluted average shares and equivalents outstanding from the comparable periods of 2008.

Management considers a measurement that is not in accordance with U.S. generally accepted accounting principles a useful measurement of the operational profitability of the Company. Some investment professionals also utilize such a measurement as an indicator of the value of profits and cash that are generated strictly from operating activities, putting aside working capital and certain other balance sheet changes. For this measurement, management increases net income for significant non-operating and non-cash expense items to arrive at an amount known as Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). The reader is cautioned that the following value for EBITDA should not be compared to other entities unknowingly. EBITDA should not be considered an alternative to net income or cash flows from operating activities as an indicator of operating performance or as a measure of liquidity. The reader should refer to the determination of net income and cash flows from operating activities in accordance with U. S. generally accepted accounting principles disclosed in the Statements of Consolidated Income and Statements of Consolidated Cash Flows. EBITDA as used by management is calculated as follows:

| <i>(thousands of dollars)</i> | Three months ended |            | Nine months ended |            |
|-------------------------------|--------------------|------------|-------------------|------------|
|                               | September 30,      |            | September 30,     |            |
|                               | 2009               | 2008       | 2009              | 2008       |
| Net income                    | \$ 175,208         | \$ 177,081 | \$ 370,510        | \$ 426,710 |
| Interest expense              | 8,471              | 15,200     | 31,029            | 51,006     |
| Income taxes                  | 83,440             | 89,061     | 171,154           | 208,633    |
| Depreciation                  | 36,411             | 36,182     | 109,611           | 107,330    |
| Amortization                  | 6,623              | 6,213      | 18,819            | 16,887     |
| EBITDA                        | \$ 310,153         | \$ 323,737 | \$ 701,123        | \$ 810,566 |

**Table of Contents****CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

Certain statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based upon management's current expectations, estimates, assumptions and beliefs concerning future events and conditions and may discuss, among other things, anticipated future performance (including sales and earnings), expected growth, future business plans and the costs and potential liability for environmental-related matters and the lead pigment and lead-based paint litigation. Any statement that is not historical in nature is a forward-looking statement and may be identified by the use of words and phrases such as expects, anticipates, believes, will, result, will continue, plans to and similar expressions. Readers are cautioned not to place undue reliance on any forward-looking statements. Forward-looking statements are necessarily subject to risks, uncertainties and other factors, many of which are outside the control of the Company, that could cause actual results to differ materially from such statements and from the Company's historical results and experience.

These risks, uncertainties and other factors include such things as: (a) continuation of the current negative global economic and financial conditions; (b) general business conditions, strengths of retail and manufacturing economies and the growth in the coatings industry; (c) competitive factors, including pricing pressures and product innovation and quality; (d) changes in raw material and energy supplies and pricing; (e) changes in the Company's relationships with customers and suppliers; (f) the Company's ability to attain cost savings from productivity initiatives; (g) the Company's ability to successfully integrate past and future acquisitions into its existing operations, as well as the performance of the businesses acquired; (h) risks and uncertainties associated with the Company's ownership of Life Shield Engineered Systems LLC; (i) changes in general domestic economic conditions such as inflation rates, interest rates, tax rates, unemployment rates, higher labor and healthcare costs, recessions, and changing governmental policies, laws and regulations; (j) risks and uncertainties associated with the Company's expansion into and its operations in Asia, Mexico and South America and other foreign markets, including general economic conditions, inflation rates, recessions, foreign currency exchange rates, foreign investment and repatriation restrictions, legal and regulatory constraints, civil unrest and other external economic and political factors; (k) the achievement of growth in developing markets, such as Asia, Mexico and South America; (l) increasingly stringent domestic and foreign governmental regulations including those affecting the environment; (m) inherent uncertainties involved in assessing the Company's potential liability for environmental-related activities; (n) other changes in governmental policies, laws and regulations, including changes in accounting policies and standards and taxation requirements (such as new tax laws and new or revised tax law interpretations); (o) the nature, cost, quantity and outcome of pending and future litigation and other claims, including the lead pigment and lead-based paint litigation, and the effect of any legislation and administrative regulations relating thereto; and (p) unusual weather conditions.

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Readers are cautioned that it is not possible to predict or identify all of the risks, uncertainties and other factors that may affect future results and that the above list should not be considered to be a complete list. Any forward-looking statement speaks only as of the date on which such statement is made, and the Company undertakes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

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**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is exposed to market risk associated with interest rate, foreign currency and commodity fluctuations. The Company occasionally utilizes derivative instruments as part of its overall financial risk management policy, but does not use derivative instruments for speculative or trading purposes. The Company enters into option and forward currency exchange contracts and commodity swaps to hedge against value changes in foreign currency and commodities. The Company believes it may experience continuing losses from foreign currency translation and commodity price fluctuations. However, the Company does not expect currency translation, transaction, commodity price fluctuations or hedging contract losses to have a material adverse effect on the Company's financial condition, results of operations or cash flows. There were no material changes in the Company's exposure to market risk since the disclosure included in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

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**Item 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chairman and Chief Executive Officer and our Senior Vice President Finance and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 and Rule 15d-15 of the Securities Exchange Act of 1934, as amended ( Exchange Act ). Based upon that evaluation, our Chairman and Chief Executive Officer and our Senior Vice President Finance and Chief Financial Officer concluded that as of the end of the period covered by this report our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and accumulated and communicated to our management including our Chairman and Chief Executive Officer and Our Senior Vice President Finance and Chief Financial Officer, to allow timely decisions regarding required disclosure. There were no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings.**

As previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, on January 27, 2006, the Company received correspondence from the United States Attorney's Office in Los Angeles, California informing the Company that it was a target of a grand jury investigation in connection with claimed violations of environmental laws relating to the handling and shipment of used drums and containers at the Company's Garland, Texas manufacturing facility. The Company has been informed by the United States Attorney's Office that it has declined prosecution of the Company thereby concluding the investigation.

For information with respect to certain environmental-related matters and legal proceedings, see the information included under the captions entitled "Environmental-Related Liabilities and Litigation" of Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes H and I of the Notes to Condensed Consolidated Financial Statements, which is incorporated herein by reference.

**Item 2. Unregistered Sales of Securities and Use of Proceeds.**

A summary of the repurchase activity for the Company's third quarter is as follows:

| Period                                  | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid<br>Per<br>Share | Number of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plan | Number of<br>Shares<br>That May Yet<br>Be<br>Purchased<br>Under<br>the Plan |
|---|---|--|--|---|
| July 1 - July 31                        |   |  |  |   |
| Share repurchase program <sup>(1)</sup> | 111,088                                   | \$ 54.25                                 | 111,088  | 18,638,912  |
| Employee transactions                   |   |  |  | NA  |
| August 1 - August 31                    |   |  |  |   |
| Share repurchase program <sup>(1)</sup> | 1,406,353                                 | \$ 60.40                                 | 1,406,353  | 17,232,559  |
| Employee transactions                   |   |  |  | NA  |
| September 1 - September 30              |   |  |  |   |
| Share repurchase program <sup>(1)</sup> | 2,360,164                                 | \$ 59.52                                 | 2,360,164  | 14,872,395  |
| Employee transactions                   |   |  |  | NA  |
| Total                                   |   |  |  |   |
| Share repurchase program <sup>(1)</sup> | 3,877,605                                 | \$ 59.69                                 | 3,877,605  | 14,872,395  |
| Employee transactions                   |   |  |  | NA  |

<sup>(1)</sup> All shares were purchased through the Company's publicly announced share repurchase program. On October 19,

2007, the Board of Directors of the Company authorized the Company to purchase, in the aggregate, 30.0 million shares of its common stock and rescinded the previous authorization limit. The Company had remaining authorization at September 30, 2009 to purchase 14,872,395 shares. There is no expiration date specified for the program. The Company intends to repurchase stock under the program in the future.

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Item 6. Exhibits.

31(a) Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer (filed herewith).

31(b) Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer (filed herewith).

32(a) Section 1350 Certification of Chief Executive Officer (filed herewith).

32(b) Section 1350 Certification of Chief Financial Officer (filed herewith).

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE SHERWIN-WILLIAMS COMPANY

October 27, 2009

By: /s/ J.L. Ault  
J.L. Ault  
Vice President-Corporate Controller

October 27, 2009

By: /s/ L.E. Stellato  
L.E. Stellato  
Senior Vice President, General Counsel  
and Secretary

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**INDEX TO EXHIBITS**

| Exhibit No. | Exhibit Description   |
|-------------|---|
| 31(a)       | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer (filed herewith). |
| 31(b)       | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer (filed herewith). |
| 32(a)       | Section 1350 Certification of Chief Executive Officer (filed herewith).             |
| 32(b)       | Section 1350 Certification of Chief Financial Officer (filed herewith).             |
| 101.INS     | XBRL Instance Document  |
| 101.SCH     | XBRL Taxonomy Extension Schema Document   |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document                              |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document                               |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document                                     |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document                                |