

SHERWIN WILLIAMS CO

Form 10-Q

October 27, 2011

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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, 2011**

**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 103,760,672 shares as of September 30, 2011.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES****STATEMENTS OF CONSOLIDATED INCOME (UNAUDITED)**

Thousands of dollars, except per share data

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales	\$ 2,484,920	\$ 2,172,259	\$ 6,695,257	\$ 5,880,805
Cost of goods sold	1,446,621	1,200,674	3,836,795	3,245,359
Gross profit	1,038,299	971,585	2,858,462	2,635,446
<i>Percent to net sales</i>	<i>41.8%</i>	<i>44.7%</i>	<i>42.7%</i>	<i>44.8%</i>
Selling, general and administrative expenses	760,179	703,672	2,206,857	2,007,762
<i>Percent to net sales</i>	<i>30.6%</i>	<i>32.4%</i>	<i>33.0%</i>	<i>34.1%</i>
Other general expense (income) net	1,600	(817)	2,074	6,214
Interest expense	10,452	11,310	32,874	49,219
Interest and net investment income	(840)	(1,008)	(1,971)	(2,127)
Other expense net	6,632	3,049	6,623	292
Income before income taxes	260,276	255,379	612,005	574,086
Income taxes	80,399	80,121	184,697	184,519
Net income	\$ 179,877	\$ 175,258	\$ 427,308	\$ 389,567
Net income per common share:				
Basic	\$ 1.74	\$ 1.63	\$ 4.06	\$ 3.59
Diluted	\$ 1.71	\$ 1.60	\$ 3.98	\$ 3.53
Average shares outstanding basic	102,151,164	106,454,042	103,939,552	107,366,658
Average shares and equivalents outstanding diluted	104,123,272	108,397,737	106,161,544	109,095,936

*See notes to condensed consolidated financial statements.*

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

Thousands of dollars

	<b>September 30, 2011</b>	<b>December 31, 2010</b>	<b>September 30, 2010</b>
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ <b>46,026</b>	\$ 58,585	\$ 64,948
Accounts receivable, less allowance	<b>1,173,581</b>	916,661	1,069,890
Inventories:			
Finished goods	<b>743,191</b>	743,953	713,343
Work in process and raw materials	<b>223,565</b>	173,748	145,645
	<b>966,756</b>	917,701	858,988
Deferred income taxes	<b>127,090</b>	127,348	121,438
Other current assets	<b>195,940</b>	193,427	209,838
Total current assets	<b>2,509,393</b>	2,213,722	2,325,102
Goodwill	<b>1,106,654</b>	1,102,458	1,085,703
Intangible assets	<b>316,476</b>	320,504	339,188
Deferred pension assets	<b>264,293</b>	248,333	250,679
Other assets	<b>353,837</b>	332,100	267,131
Property, plant and equipment:			
Land	<b>106,322</b>	106,101	94,872
Buildings	<b>671,188</b>	668,506	662,150
Machinery and equipment	<b>1,643,623</b>	1,617,530	1,641,788
Construction in progress	<b>46,019</b>	34,038	26,840
	<b>2,467,152</b>	2,426,175	2,425,650
Less allowances for depreciation	<b>1,527,666</b>	1,474,057	1,512,770
	<b>939,486</b>	952,118	912,880
Total Assets	\$ <b>5,490,139</b>	\$ 5,169,235	\$ 5,180,683
<b>Liabilities and Shareholders Equity</b>			
Current liabilities:			
Short-term borrowings	\$ <b>517,499</b>	\$ 388,592	\$ 354,556
Accounts payable	<b>996,734</b>	909,649	927,616
Compensation and taxes withheld	<b>234,878</b>	253,247	233,771
Accrued taxes	<b>142,717</b>	62,547	139,956
Current portion of long-term debt	<b>10,084</b>	7,875	6,314
Other accruals	<b>452,817</b>	442,030	462,888

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Total current liabilities	<b>2,354,729</b>	2,063,940	2,125,101
Long-term debt	<b>641,257</b>	648,326	705,472
Postretirement benefits other than pensions	<b>297,200</b>	295,896	285,104
Other long-term liabilities	<b>547,026</b>	551,633	421,870
Shareholders' equity:			
Common stock \$1.00 par value: 103,760,672, 107,020,728 and 107,934,798 shares outstanding at September 30, 2011, December 31, 2010 and September 30, 2010, respectively	<b>106,901</b>	231,346	230,731
Preferred stock convertible, no par value: 175,737, 216,753 and 216,753 shares outstanding at September 30, 2011, December 31, 2010 and September 30, 2010, respectively	<b>175,737</b>	216,753	216,753
Unearned ESOP compensation	<b>(175,737)</b>	(216,753)	(216,753)
Other capital	<b>1,304,503</b>	1,222,909	1,182,805
Retained earnings	<b>779,509</b>	4,824,489	4,790,309
Treasury stock, at cost	<b>(237,752)</b>	(4,390,983)	(4,268,545)
Cumulative other comprehensive loss	<b>(317,859)</b>	(278,321)	(292,164)
The Sherwin-Williams Company shareholders' equity	<b>1,635,302</b>	1,609,440	1,643,136
Noncontrolling interest	<b>14,625</b>		
Total shareholders' equity	<b>1,649,927</b>	1,609,440	1,643,136
Total Liabilities and Shareholders' Equity	<b>\$ 5,490,139</b>	<b>\$ 5,169,235</b>	<b>\$ 5,180,683</b>

*See notes to condensed consolidated financial statements.*

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

Thousands of dollars

	Nine Months Ended	
	September 30, 2011	September 30, 2010
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 427,308	\$ 389,567
Adjustments to reconcile net income to net operating cash:		
Depreciation	112,807	100,673
Amortization of intangible assets	23,263	21,774
Stock-based compensation expense	31,775	28,498
Provisions for qualified exit costs	1,338	(57)
Provisions for environmental-related matters	7,344	6,696
Defined benefit pension plans net cost	11,848	13,408
Net increase in postretirement liability	2,047	1,638
Other	1,742	10,626
Change in working capital accounts net	(142,813)	(66,376)
Costs incurred for environmental-related matters	(17,920)	(24,981)
Costs incurred for qualified exit costs	(5,090)	(9,887)
Other	(7,686)	6,031
Net operating cash	445,963	477,610
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(96,883)	(76,116)
Acquisitions of businesses, net of cash acquired	(29,847)	(264,340)
Proceeds from sale of assets	12,198	4,834
Increase in other investments	(66,408)	(71,426)
Net investing cash	(180,940)	(407,048)
<b>FINANCING ACTIVITIES</b>		
Net increase in short-term borrowings	128,326	324,661
Proceeds from long-term debt	28,908	2,386
Payments of long-term debt	(33,665)	(93,166)
Costs associated with repurchase of long-term debt		(22,192)
Payments of cash dividends	(115,651)	(117,686)
Proceeds from stock options exercised	41,503	72,382
Income tax effect of stock-based compensation exercises and vesting	9,538	15,046
Treasury stock purchased	(328,742)	(253,558)
Other	288	(4,815)
Net financing cash	(269,495)	(76,942)



Effect of exchange rate changes on cash	(8,087)	1,999
Net decrease in cash and cash equivalents	(12,559)	(4,381)
Cash and cash equivalents at beginning of year	58,585	69,329
Cash and cash equivalents at end of period	\$ 46,026	\$ 64,948
Income taxes paid	\$ 102,815	\$ 96,063
Interest paid	31,680	54,743
<i>See notes to condensed consolidated financial statements.</i>		

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

Periods ended September 30, 2011 and 2010

**NOTE 1 BASIS OF PRESENTATION**

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

There have been no significant changes in critical accounting policies since December 31, 2010. Accounting estimates were revised as necessary during the first nine months of 2011 based on new information and changes in facts and circumstances. Certain amounts in the 2010 condensed consolidated financial statements have been reclassified to conform to the 2011 presentation.

Effective July 1, 2011, the Company acquired a controlling interest in Leighs Paints with the option to acquire the remaining interest by December 31, 2011. The results of operations for Leighs Paints for this three month period are included in the consolidated results of operations of the Company while the amount attributable to the noncontrolling interest was not material and is not presented separately. The noncontrolling ownership interest in Leighs Paints is presented in the balance sheet as a separate component of equity. See Note 14.

In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 became effective, resulting in the elimination of a tax deduction previously allowed for the Medicare Part D subsidy beginning in years after December 31, 2012. The Company recognized the deferred tax effects of the reduced deductibility of the subsidy during the first quarter of 2010. The resulting one-time increase in income taxes of \$11.4 million reduced basic and diluted earnings per share for the first nine months of 2010 by \$.11 and \$.10, respectively. See Note 11.

The Company primarily uses the last-in, first-out (LIFO) method of valuing inventory. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management's estimates of expected year-end inventory levels and costs are subject to the final year-end LIFO inventory valuation. In addition, interim inventory levels include management's estimates of annual inventory losses due to shrinkage and other factors. The final year-end valuation of inventory is based on an annual physical inventory count performed during the fourth quarter. For further information on inventory valuations and other matters, refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the year ended December 31, 2010.

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The consolidated results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011.

**NOTE 2 IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-8, which amends the Intangibles—Goodwill and Other Topic of the Accounting Standards Codification (ASC). The ASU gives companies the option to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If the more likely than not conclusion is reached, the two-step impairment test must be performed. Otherwise, the two-step impairment test is not necessary. ASU No. 2011-8 is effective for fiscal years beginning after December 15, 2011, but early adoption is permitted. The Company will early adopt ASU No. 2011-8 and perform the optional qualitative assessment as part of its annual goodwill impairment test. The ASU is expected to reduce the number of reporting units for which the two-step impairment step must be performed, but it is not expected to affect the Company's results of operations, financial condition or liquidity.

In June 2011, the FASB issued ASU No. 2011-5, which amends the Comprehensive Income Topic of the ASC. The ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity, and instead requires consecutive presentation of the statement of net income and other comprehensive income either in a continuous statement of comprehensive income or in two separate but consecutive statements. ASU No. 2011-5 is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. It will have no effect on the Company's results of operations, financial condition or liquidity.

In May 2011, the FASB issued ASU No. 2011-4, which amends the Fair Value Measurements Topic of the ASC to help achieve common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. ASU No. 2011-4 does not require additional fair value measurements and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The ASU is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. The ASU will affect the Company's fair value disclosures, but will not affect the Company's results of operations, financial condition or liquidity.

**NOTE 3 DIVIDENDS**

Dividends paid on common stock during each of the first three quarters of 2011 and 2010 were \$.365 per common share and \$.360 per common share, respectively.

**Table of Contents****NOTE 4 COMPREHENSIVE INCOME**

Comprehensive income is summarized as follows:

(Thousands of dollars)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	<b>\$ 179,877</b>	\$ 175,258	<b>\$ 427,308</b>	\$ 389,567
Foreign currency translation adjustments	<b>(74,886)</b>	28,554	<b>(47,998)</b>	13,868
Amortization of net prior service costs and net actuarial losses, net of taxes <sup>(1)</sup>	<b>2,408</b>	2,385	<b>9,093</b>	9,877
Adjustments of marketable equity securities, net of taxes <sup>(2)</sup>	<b>(225)</b>	880	<b>(633)</b>	1,545
Comprehensive income	<b>\$ 107,174</b>	\$ 207,077	<b>\$ 387,770</b>	\$ 414,857

(1) The tax effect of amortization of net prior service costs and net actuarial losses was \$(3,055) and \$(9,016) for the three and nine months ended September 30, 2011 and \$(3,288) and \$(6,912) for the three and nine months ended September 30, 2010.

(2) The tax effect of adjustments of marketable equity securities was \$144 and \$404 for the three and nine months ended September 30, 2011 and \$(563) and \$(988) for the three and nine months ended September 30, 2010.

**Table of Contents****NOTE 5 PRODUCT WARRANTIES**

Changes in the Company's accrual for product warranty claims during the first nine months of 2011 and 2010, including customer satisfaction settlements, were as follows:

(Thousands of dollars)	<b>2011</b>	2010
Balance at January 1	<b>\$ 23,103</b>	\$ 22,214
Charges to expense	<b>23,177</b>	14,315
Settlements	<b>(19,507)</b>	(13,674)
Balance at September 30	<b>\$ 26,773</b>	\$ 22,855

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, 2010.

**NOTE 6 EXIT OR DISPOSAL ACTIVITIES**

Liabilities associated with exit or disposal activities are recognized as incurred in accordance with the Exit or Disposal Cost Obligations Topic of the ASC. Qualified exit costs primarily include post-closure rent expenses, incremental post-closure costs and costs of employee terminations. Adjustments may be made to liabilities accrued for qualified exit costs if information becomes available upon which more accurate amounts can be reasonably estimated.

Concurrently, property, plant and equipment is tested for impairment in accordance with the Property, Plant and Equipment Topic of the ASC, and if impairment exists, the carrying value of the related assets is reduced to estimated fair value. Additional impairment may be recorded for subsequent revisions in estimated fair value.

In the nine months ended September 30, 2011, 3 stores in the Paint Stores Group, 2 manufacturing facilities in the Consumer Group and 5 branches in the Global Finishes Group were closed due to lower demand or redundancy.

During the nine months ended September 30, 2011, amounts charged to SG&A and Cost of goods sold included qualified exit costs and severance costs of \$1.1 million related to these closed facilities. Adjustments to prior provisions of \$0.3 million related to Global Finishes Group facilities closed during 2009 were recorded in Other general expense net in the nine months ended September 30, 2011.

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The following table summarizes the activity and remaining liabilities associated with qualified exit costs at September 30, 2011 and for the nine-month period then ended:

(Thousands of dollars)

Exit Plan	Balance at December 31, 2010	Provisions in Cost of goods sold or SG&A	Actual expenditures charged to accrual	Adjustments to prior provisions in Other general expense - net	Balance at September 30, 2011
<b>Consumer Group manufacturing facilities shutdown in 2011:</b>					
Severance and related costs		\$ 311			\$ 311
<b>Global Finishes Group stores shutdown in 2011:</b>					
Severance and related costs		207	\$ (108)		99
Other qualified exit costs		597	(77)		520
<b>Global Finishes Group stores shutdown in 2010:</b>					
Other qualified exit costs	\$ 1,114		(138)		976
<b>Paint Stores Group stores shutdown in 2010:</b>					
Other qualified exit costs	4			\$ (4)	
<b>Paint Stores Group stores shutdown in 2009:</b>					
Other qualified exit costs	2,022		(663)	(29)	1,330
<b>Global Finishes Group manufacturing facility and branches shutdown in 2009:</b>					
Other qualified exit costs	1,820		(696)	262	1,386
<b>Consumer Group manufacturing facilities shutdown in 2009:</b>					
Other qualified exit costs	721		(186)		535
<b>Consumer Group manufacturing and distribution facilities shutdown in 2008:</b>					
Other qualified exit costs	242		(50)		192
<b>Paint Stores Group manufacturing and distribution</b>					

**facilities, administrative offices  
and stores shutdown in 2008:**

<b>Other qualified exit costs</b>	<b>3,058</b>	<b>(2,083)</b>	<b>(6)</b>	<b>969</b>
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<b>Other qualified exit costs for facilities shutdown prior to 2008</b>	<b>7,066</b>	<b>(1,089)</b>		<b>5,977</b>
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<b>Totals</b>	<b>\$ 16,047</b>	<b>\$ 1,115</b>	<b>\$ (5,090)</b>	<b>\$ 223</b>	<b>\$ 12,295</b>
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For further details on the Company's exit or disposal activities, see Note 6 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

**Table of Contents****NOTE 7 HEALTH CARE, PENSION AND OTHER BENEFITS**

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

	Domestic Defined Benefit Pension Plans		Foreign Defined Benefit Pension Plans		Postretirement Benefits Other than Pensions	
(Thousands of dollars)	2011	2010	2011	2010	2011	2010
<b>Three Months Ended</b>						
<b>September 30:</b>						
Net periodic benefit cost:						
Service cost	\$ 4,007	\$ 4,226	\$ 918	\$ 501	\$ 873	\$ 883
Interest cost	4,707	4,507	1,061	1,040	3,895	4,017
Expected return on assets	(11,610)	(10,578)	(662)	(720)		
Amortization of:						
Prior service cost (credit)	408	416		8	(164)	(164)
Actuarial loss	4,876	4,735	215	347	626	326
Net periodic benefit cost	\$ 2,388	\$ 3,306	\$ 1,532	\$ 1,176	\$ 5,230	\$ 5,062
<b>Nine Months Ended</b>						
<b>September 30:</b>						
Net periodic benefit cost:						
Service cost	\$ 12,021	\$ 12,679	\$ 2,814	\$ 1,490	\$ 2,621	\$ 2,649
Interest cost	14,121	13,521	3,225	3,079	11,685	12,050
Expected return on assets	(34,831)	(31,733)	(2,008)	(2,130)		
Amortization of:						
Prior service cost (credit)	1,226	1,246		22	(492)	(492)
Actuarial loss	14,630	14,207	650	1,027	1,878	978
Net periodic benefit cost	\$ 7,167	\$ 9,920	\$ 4,681	\$ 3,488	\$ 15,692	\$ 15,185

Effective July 1, 2011, the Employee Stock Purchase and Savings Plan was amended to reinstate the Company match to 6% of eligible employee contributions.

Effective October 1, 2011, participation in The Sherwin-Williams Company Salaried Employees' Pension Investment Plan, a defined benefit plan, was frozen for new hires. All newly hired U.S. non-collectively bargained employees will be eligible to participate in The Sherwin-Williams Company Salaried Employees' Revised Pension Investment Plan. For further details on the Company's health care, pension and other benefits, see Note 7 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.



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**NOTE 8 OTHER LONG-TERM LIABILITIES**

The Company initially provides for estimated costs of environmental-related activities relating to its past operations and third-party sites for which commitments or clean-up plans have been developed and when such costs can be reasonably estimated based on industry standards and professional judgment. These estimated costs are determined based on currently available facts regarding each site. If the best estimate of costs can only be identified as a range and no specific amount within that range can be determined more likely than any other amount within the range, the minimum of the range is provided. At September 30, 2011, the unaccrued maximum of the estimated range of possible outcomes is \$101.6 million higher than the minimum.

The Company continuously assesses its potential liability for investigation and remediation-related activities and adjusts its environmental-related accruals as information becomes available upon which more accurate costs can be reasonably estimated and as additional accounting guidelines are issued. Actual costs incurred may vary from these estimates due to the inherent uncertainties involved including, among others, the number and financial condition of parties involved with respect to any given site, the volumetric contribution which may be attributed to the Company relative to that attributed to other parties, the nature and magnitude of the wastes involved, the various technologies that can be used for remediation and the determination of acceptable remediation with respect to a particular site.

Included in Other long-term liabilities at September 30, 2011 and 2010 were accruals for extended environmental-related activities of \$82.2 million and \$89.9 million, respectively. Estimated costs of current investigation and remediation activities of \$60.1 million and \$64.6 million are included in Other accruals at September 30, 2011 and 2010, respectively.

Four 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, 2011. At September 30, 2011, \$101.1 million, or 71.0 percent of the total accrual, related directly to these four sites. In the aggregate unaccrued maximum of \$101.6 million at September 30, 2011, \$70.0 million, or 68.9 percent, related to the four 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.

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

For further details on the Company's Other long-term liabilities, see Note 9 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

### **NOTE 9 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 the ASC, the Company accrues for these contingencies by a charge to income when it is both probable that one or more future events will occur confirming the fact of a loss and the amount of the loss can be reasonably estimated. In the event that the Company's loss contingency is ultimately determined to be significantly higher than currently accrued, the recording of the additional liability may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such additional liability is accrued. In those cases where no accrual is recorded because it is not probable that a liability has been incurred and cannot be reasonably estimated, any potential liability ultimately determined to be attributable to the Company may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued. In those cases where no accrual is recorded or exposure to loss exists in excess of the amount accrued, the Contingencies Topic of the ASC requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred 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 and has been a defendant in a number of legal proceedings, including individual personal injury actions, purported class actions, and actions brought by various counties, cities, school districts and other government-related entities, arising from the manufacture and sale of lead pigments and lead-based paints. The plaintiffs' claims have been based upon various legal theories, including negligence, strict liability, breach of warranty, negligent misrepresentations and omissions, fraudulent misrepresentations and omissions, concert of action, civil conspiracy, violations of unfair trade practice and consumer protection laws, enterprise liability, market share liability, public nuisance, unjust enrichment and other theories. The plaintiffs seek various damages and relief, including personal injury and property damage, costs relating to the detection and abatement of lead-based paint from buildings, costs associated with a public

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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 that seek recovery based upon various legal theories, including the failure to adequately warn of potential exposure to lead during surface preparation when using non-lead-based paint on surfaces previously painted with lead-based paint. The Company believes that the litigation brought to date is without merit or subject to meritorious defenses and is vigorously defending such litigation. The Company has not settled any lead pigment or lead-based paint litigation. The Company expects that additional lead pigment and lead-based paint litigation may be filed against the Company in the future asserting similar or different legal theories and seeking similar or different types of damages and relief.

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

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

**Public nuisance claim litigation.** The Company and other companies are or were defendants in legal proceedings seeking recovery based on public nuisance liability theories, among other theories, brought by the State of Rhode Island, the City of St. Louis, Missouri, various cities and counties in the State of New Jersey, various cities in the State of Ohio and the State of Ohio, the

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City of Milwaukee, Wisconsin and the County of Santa Clara, California and other public entities in the State of California. Except for the Santa Clara County, California proceeding, all of these legal proceedings have been concluded in favor of the Company and other defendants at various stages in the proceedings.

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

The Santa Clara County, California proceeding was initiated in March 2000 in the Superior Court of the State of California, County of Santa Clara. In the original complaint, the plaintiffs asserted various claims including fraud and concealment, strict product liability/failure to warn, strict product liability/design defect, negligence, negligent breach of a special duty, public nuisance, private nuisance, and violations of California's Business and Professions Code. A number of the asserted claims were resolved in favor of the defendants through pre-trial proceedings. The named plaintiffs in the Fourth Amended Complaint, filed on March 16, 2011, are the Counties of Santa Clara, Alameda, Los Angeles, Monterey, San Mateo, Solano and Ventura, and the Cities of Oakland, San Diego and San Francisco. The Fourth Amended Complaint asserts a sole claim for public nuisance, alleging that the presence of lead products for use in paint and coatings in, on and around buildings in the plaintiffs' jurisdictions constitutes a public nuisance. The plaintiffs seek the abatement of the alleged public nuisance that exists within the plaintiffs' jurisdictions.

*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 in state court against the Company, other alleged former lead pigment manufacturers and the Lead Industries Association in September 1999. The claims against the Company and the other defendants 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

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manufacturer of any product that allegedly injured the plaintiff. The case ultimately proceeded to trial and, on November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain damaged or injured as a result. The plaintiff appealed and, on December 16, 2010, the Wisconsin Court of Appeals affirmed the final judgment in favor of the Company and other defendants.

Wisconsin is the only jurisdiction to date to apply a theory of liability with respect to alleged personal injury (i.e., risk contribution/market share liability) that does not require the plaintiff to identify the manufacturer of the product that allegedly injured the plaintiff in the lead pigment and lead-based paint litigation. Although the risk contribution liability theory was applied during the Thomas trial, the constitutionality of this theory as applied to the lead pigment cases has not been judicially determined by the Wisconsin state courts. However, in an unrelated action filed in the United States District Court for the Eastern District of Wisconsin, *Gibson v. American Cyanamid, et al.*, on November 15, 2010, the District Court held that Wisconsin's risk contribution theory as applied in that case violated the defendants' right to substantive due process and is unconstitutionally retroactive.

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

### **NOTE 10 OTHER**

*Other general expense (income) net*

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

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	Three Months Ended September 30,		Nine Months Ended September 30,	
(Thousands of dollars)	2011	2010	2011	2010
Provisions for environmental matters net	\$ 2,694	\$ 1,974	\$ 7,344	\$ 6,696
(Gain) loss on disposition of assets	(1,094)	(2,643)	(5,493)	279
Adjustments to prior provisions for qualified exit costs		(148)	223	(761)
Other general expense (income) net	\$ 1,600	\$ (817)	\$ 2,074	\$ 6,214

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

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

The adjustments to prior provisions for qualified exit costs represent site specific increases or decreases to accrued qualified exit costs as adjustments for costs of employee terminations are required or as information becomes available upon which more accurate amounts can be reasonably estimated. See Note 6 for further details on the Company's exit or disposal activities.

*Other expense net*

Included in Other expense net were the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Thousands of dollars)	2011	2010	2011	2010
Dividend and royalty income	\$ (1,067)	\$ (1,913)	\$ (4,052)	\$ (4,406)
Net expense from financing activities	1,932	1,908	5,881	6,479
Foreign currency related losses	8,971	3,499	11,890	1,125
Other income	(5,877)	(2,424)	(14,213)	(7,348)
Other expense	2,673	1,979	7,117	4,442
Other expense net	\$ 6,632	\$ 3,049	\$ 6,623	\$ 292

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

Foreign currency related losses 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, 2011 and 2010. 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 the ASC. These derivative instrument values were

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included in either Other current assets or Other accruals and were insignificant at September 30, 2011 and 2010. Other income and Other expense included items of revenue, gains, expenses and losses that were unrelated to the primary business purpose of the Company. There were no items within the other income or other expense caption that were individually significant.

**NOTE 11 INCOME TAXES**

The effective tax rate was 30.9 percent and 30.2 percent for the third quarter and first nine months of 2011, respectively, and 31.4 percent and 32.1 percent for the third quarter and the first nine months of 2010, respectively. The decrease in the effective tax rate for the first nine months of 2011 compared to 2010 was primarily due to the impact of an \$11.4 million Federal and State income tax charge in the first nine months of 2010 related to the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act signed into law in March 2010.

At December 31, 2010, the Company had \$31.3 million in unrecognized tax benefits, the recognition of which would have an effect of \$27.4 million on the current provision for income taxes. Included in the balance of unrecognized tax benefits at December 31, 2010, was \$6.0 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. This amount represents a decrease in unrecognized tax benefits comprised of items related to assessed state income tax audits, state settlement negotiations currently in progress and expiring statutes in foreign jurisdictions.

The Company classifies all income tax related interest and penalties as income tax expense. At December 31, 2010, the Company had accrued \$10.2 million for the potential payment of income tax interest and penalties.

There were no significant changes to any of the balances of unrecognized tax benefits at December 31, 2010 during the first nine months of 2011.

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) has substantially completed the audit of the 2004, 2005, 2006 and 2007 tax years. The IRS commenced an examination of the Company's U.S. income tax returns for the 2008 and 2009 tax years in the third quarter of 2011. At this time, the Company has determined that an insignificant payment is due for the 2006 and 2007 audit period.

The Company disclosed in its 2010 Annual Report on Form 10-K and in previous filings that the IRS was auditing the Company's federal tax returns for the 2004 through 2007 years for income taxes and the 2003 through 2009 years for excise taxes. The IRS was auditing transactions related to the Company's ESOP (the Leveraged ESOP Transactions). The Leveraged ESOP Transactions were implemented on August 27, 2003 and August 1, 2006. (See Note 12 of the Company's 2010 Annual Report.) At various times, principal and interest on the debt related to the transactions was forgiven as a mechanism for funding Company contributions of elective

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deferrals and matching contributions to the ESOP. The Company claimed income tax deductions for the forgiven principal and interest on the debt along with dividends. The benefit of the tax deductions related to forgiven principal and interest was reflected in equity and did not flow through the provision for income taxes.

In October 2011, the Company reached a settlement of the IRS' audit of the Company's ESOP. The Company has fully resolved all IRS issues for the 2003 through 2009 tax years relating to the matters disclosed in the Company's current report on Form 8-K dated May 20, 2011 challenging the ESOP related federal income tax deductions claimed by the Company and proposing substantial excise taxes and penalties. The settlement (including interest), which resolves all ESOP related tax issues, will result in an after-tax charge related to federal and state income taxes totaling approximately \$75.0 million, or \$.72 per diluted common share, and an additional reduction in Shareholders' equity of approximately \$51.2 million in the Company's fourth quarter. The Department of Labor's investigation of the Leveraged ESOP Transactions remains open.

As of September 30, 2011, the Company is subject to non-U.S. income tax examinations for the tax years of 2004 through 2010. In addition, the Company is subject to state and local income tax examinations for the tax years 2001 through 2010.



Table of Contents**NOTE 12 NET INCOME PER COMMON SHARE**

(Thousands of dollars except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Basic				
Average common shares outstanding	<b>102,151,164</b>	106,454,042	<b>103,939,552</b>	107,366,658
Net income	\$ <b>179,877</b>	\$ 175,258	\$ <b>427,308</b>	\$ 389,567
Less net income allocated to unvested restricted shares	<b>(2,102)</b>	(1,930)	<b>(4,810)</b>	(4,116)
Net income allocated to common shares	\$ <b>177,775</b>	\$ 173,328	\$ <b>422,498</b>	\$ 385,451
Basic net income per common share	\$ <b>1.74</b>	\$ 1.63	\$ <b>4.06</b>	\$ 3.59
Diluted				
Average common shares outstanding	<b>102,151,164</b>	106,454,042	<b>103,939,552</b>	107,366,658
Stock options and other contingently issuable shares <sup>(1)</sup>	<b>1,972,108</b>	1,943,695	<b>2,221,992</b>	1,729,278
Average common shares outstanding assuming dilution	<b>104,123,272</b>	108,397,737	<b>106,161,544</b>	109,095,936
Net income	\$ <b>179,877</b>	\$ 175,258	\$ <b>427,308</b>	\$ 389,567
Less net income allocated to unvested restricted shares assuming dilution	<b>(2,070)</b>	(1,901)	<b>(4,736)</b>	(4,055)
Net income allocated to common shares assuming dilution	\$ <b>177,807</b>	\$ 173,357	\$ <b>422,572</b>	\$ 385,512
Diluted net income per common share	\$ <b>1.71</b>	\$ 1.60	\$ <b>3.98</b>	\$ 3.53

<sup>(1)</sup> Stock options and other contingently issuable shares excludes 0.1 million shares for the nine months ended September 30, 2011 and September 30, 2010 due to their anti-dilutive effect. There were 0.1 million shares excluded due to their anti-dilutive effect for the three months ended September 30, 2011 and none for the three months ended September 30, 2010.

The Company has two classes of participating securities: common shares and restricted shares, representing 99% and 1% of outstanding shares, respectively. The restricted shares are shares of unvested restricted stock granted under the Company's restricted stock award program. Unvested restricted shares granted prior to April 21, 2010 received non-forfeitable dividends, and the shares are therefore considered a participating security. Effective April 21, 2010, the restricted stock award program was revised and dividends on performance-based restricted shares granted after this date are deferred and payment is contingent upon the awards vesting. Only the time-based restricted shares, which

continue to receive non-forfeitable dividends, are considered a participating security. Basic and diluted earnings per share are calculated using the two-class method in accordance with the Earnings Per Share Topic of the ASC.

**Table of Contents****NOTE 13 REPORTABLE SEGMENT INFORMATION**

The Company reports segment information in the same way that management internally organizes its business for assessing performance and making decisions regarding allocation of resources in accordance with the Segment Disclosures Topic of the ASC. Two operating segments are aggregated to form the Global Finishes Group Reportable Operating Segment (GFG) in accordance with the quantitative thresholds within ASC 280-10-50-12. Management is closely monitoring the quantitative thresholds and the performance trends within GFG on an ongoing basis. Revised Reportable Operating Segments will be established if quantitative thresholds are exceeded for a sustained basis.

	Three Months Ended September 30, 2011				
	Global				
(Thousands of dollars)	Paint Stores Group	Consumer Group	Finishes Group	Administrative	Consolidated Totals
Net external sales	\$ 1,417,765	\$ 351,579	\$ 714,351	\$ 1,225	\$ 2,484,920
Intersegment transfers		615,307	8,174	(623,481)	
Total net sales and intersegment transfers	\$ 1,417,765	\$ 966,886	\$ 722,525	\$ (622,256)	\$ 2,484,920
Segment profit	\$ 236,886	\$ 41,023*	\$ 43,508		\$ 321,417
Interest expense				\$ (10,452)	(10,452)
Administrative expenses and other				(50,689)	(50,689)
Income before income taxes	\$ 236,886	\$ 41,023	\$ 43,508	\$ (61,141)	\$ 260,276
	Three Months Ended September 30, 2010				
	Global				
	Paint Stores Group	Consumer Group	Finishes Group	Administrative	Consolidated Totals
Net external sales	\$ 1,286,063	\$ 340,365	\$ 544,548	\$ 1,283	\$ 2,172,259
Intersegment transfers		519,186	4,689	(523,875)	
Total net sales and intersegment transfers	\$ 1,286,063	\$ 859,551	\$ 549,237	\$ (522,592)	\$ 2,172,259
Segment profit	\$ 225,079	\$ 59,699*	\$ 31,925		\$ 316,703
Interest expense				\$ (11,310)	(11,310)
Administrative expenses and other				(50,014)	(50,014)
Income before income taxes	\$ 225,079	\$ 59,699	\$ 31,925	\$ (61,324)	\$ 255,379

\* Segment profit includes \$6,446 and \$6,787 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores Group during the third quarter of 2011 and 2010, respectively.

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Nine Months Ended September 30, 2011					
	Global				
	Paint Stores Group	Consumer Group	Finishes Group	Administrative	Consolidated Totals
Net external sales	\$ 3,646,079	\$ 1,022,143	\$ 2,023,388	\$ 3,647	\$ 6,695,257
Intersegment transfers		1,609,877	20,666	(1,630,543)	
Total net sales and intersegment transfers	\$ 3,646,079	\$ 2,632,020	\$ 2,044,054	\$ (1,626,896)	\$ 6,695,257
Segment profit	\$ 512,374	\$ 143,484**	\$ 126,388		\$ 782,246
Interest expense				\$ (32,874)	(32,874)
Administrative expenses and other				(137,367)	(137,367)
Income before income taxes	\$ 512,374	\$ 143,484	\$ 126,388	\$ (170,241)	\$ 612,005

Nine Months Ended September 30, 2010					
	Global				
	Paint Stores Group	Consumer Group	Finishes Group	Administrative	Consolidated Totals
Net external sales	\$ 3,381,955	\$ 1,042,731	\$ 1,452,194	\$ 3,925	\$ 5,880,805
Intersegment transfers		1,388,908	13,688	(1,402,596)	
Total net sales and intersegment transfers	\$ 3,381,955	\$ 2,431,639	\$ 1,465,882	\$ (1,398,671)	\$ 5,880,805
Segment profit	\$ 484,795	\$ 177,859**	\$ 94,882		\$ 757,536
Interest expense				\$ (49,219)	(49,219)
Administrative expenses and other				(134,231)	(134,231)
Income before income taxes	\$ 484,795	\$ 177,859	\$ 94,882	\$ (183,450)	\$ 574,086

\*\* Segment profit includes \$18,255 and \$17,208 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores Group during the first nine months of 2011 and 2010, respectively.

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 \$513.8 million and \$22.0 million, respectively, for the third quarter of 2011, and \$376.1 million and \$29.5

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million, respectively, for the third quarter of 2010. Net external sales and segment profit of these subsidiaries were \$1.49 billion and \$83.8 million, respectively, for the first nine months of 2011, and \$995.2 million and \$77.7 million, respectively, for the first nine months of 2010. Long-lived assets of these subsidiaries totaled \$648.2 million and \$632.4 million at September 30, 2011 and September 30, 2010, respectively. Domestic operations accounted for the remaining net external sales, segment profits and long-lived assets. No single geographic area outside the United States was significant relative to consolidated net external sales, income before taxes, or consolidated long-lived assets.

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

**NOTE 14 ACQUISITIONS**

Effective July 1, 2011, the Company acquired a controlling interest in Leighs Paints with the option to acquire the remaining interest by December 31, 2011. Headquartered in Bolton, United Kingdom, Leighs Paints is one of the leading industrial fire protection coatings manufacturers in the world, with a growing global platform driven by technology innovation and quality products. The acquisition strengthens the Global Finishes Group's growing global platform.

Effective October 1, 2010, the Company acquired Pinturas Condor S.A. (Pinturas Condor), the leading paint and coatings company in Ecuador. Pinturas Condor develops and manufactures products to the architectural, industrial and automotive vehicle refinish markets and sells them to a combination of company-owned paint stores and exclusive dealers. Included in the Global Finishes Group, Pinturas Condor strengthens the Company's product finish market position in Ecuador.

Effective September 1, 2010, the Company acquired Becker Industrial Products AB (Acroma). Headquartered in Stockholm, Sweden, Acroma is one of the largest manufacturers of industrial wood coatings globally and a technology leader in water, UV and other wood coatings. The acquisition strengthens the Global Finishes Group's growing global platform for product finishes.

Effective April 1, 2010, the Company acquired Sayerlack Industrial Coatings (Sayerlack). Headquartered in Pianoro, Italy, Sayerlack is a leading coatings innovator in the joinery, furniture and cabinets markets. The acquisition strengthens the Global Finishes Group's growing global platform for product finishes.

The aggregate consideration paid for Pinturas Condor, Acroma and Sayerlack was \$298.2 million, net of cash acquired. All three acquisitions resulted in the recognition of goodwill and intangible assets.

The following unaudited pro-forma summary presents consolidated financial information as if Leighs Paints, Pinturas Condor, Acroma and Sayerlack 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,

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2010 or of future results of operations of the combined companies under ownership and operation of the Company.

(Thousands of dollars except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales	\$2,484,920	\$2,252,866	\$6,727,098	\$6,208,024
Net income	179,877	171,047	426,710	390,541
Net income per common share:				
Basic	\$ 1.74	\$ 1.59	\$ 4.06	\$ 3.60
Diluted	\$ 1.71	\$ 1.56	\$ 3.97	\$ 3.54

**NOTE 15 FAIR VALUE MEASUREMENTS**

The Fair Value Measurements and Disclosures Topic of the ASC applies to the Company's financial and non-financial assets and liabilities. The guidance applies when other standards require or permit the fair value measurement of assets and liabilities. It does not expand the use of fair value measurements. The Company did not have any fair value measurements for its non-financial assets and liabilities during the 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:

	Fair Value at September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Thousands of dollars)				
Assets:				
Deferred compensation plan asset <sup>(1)</sup>	\$ 18,607	\$ 15,966	\$ 2,641	
Liabilities:				
Deferred compensation plan liability <sup>(2)</sup>	\$ 21,553	\$ 21,553		

(1) 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 the ASC. The level 1 investments are valued using quoted market prices multiplied by the number of shares. The level 2 investments are valued based on vendor or broker models. The cost basis of the investment funds is \$18,556.

(2) 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 16 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 the ASC. The fair values of the Company's publicly traded debt are based

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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.

	September 30, 2011		September 30, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(Thousands of dollars)				
Publicly traded debt	\$ 632,412	\$ 689,775	\$ 691,493	\$ 760,623
Non-traded debt	18,929	18,222	20,293	19,623

On July 8, 2011, the Company entered into a new five-year \$1.050 billion credit agreement, which replaces the existing three-year \$500.0 million credit agreement. The new credit agreement may be used for general corporate purposes, including financing working capital requirements and supporting commercial paper borrowings. During the second quarter of 2010, the Company repurchased \$84.9 million of its publicly traded 7.45% debentures due 2097. At September 30, 2010, call warrants with a cost of \$8.9 million that carry rights to call another \$51.6 million of the 7.45% debentures were recorded in Other current assets. These call warrants were designated as a fair value hedge under ASC 815 against changes in value related to the notional amount of \$51.6 million of the 7.45% debentures. Gains or losses were recognized in earnings in the period of the change together with the offsetting gains or losses on the hedged item attributed to the risk being hedged. The objective of the hedge was to protect the related debentures against changes in redemption value due to changes in long-term interest rates and credit ratings. As of September 30, 2010, the fair value of the call warrants increased by \$7.7 million, and the related debenture fair value liability increased by a similar amount. The balance sheet carrying values of the call warrants and the related debentures were adjusted to reflect these changes in value.

**NOTE 17 NON-TRADED INVESTMENTS**

The Company has invested in the U.S. affordable housing and historic renovation real estate markets. These non-traded investments have been identified as variable interest entities. However, because the Company does not have the power to direct the day-to-day operations of the investments and the risk of loss is limited to the amount of contributed capital, the Company is not considered the primary beneficiary. In accordance with the Consolidation Topic of the ASC, the investments are not consolidated. The Company uses the effective yield method to determine the carrying value of the investments. Under the effective yield method, the initial cost of the investments is amortized over the period that the tax credits are recognized. The carrying amount of the investments, included in Other assets, was \$219.3 million and \$128.1 million at September 30, 2011 and 2010, respectively. The liability for estimated future capital contributions to the investments was \$173.3 million and \$74.7 million at September 30, 2011 and 2010, respectively.



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**NOTE 18 CAPITAL STOCK**

Effective March 31, 2011, the Company retired all of its 125.4 million common stock shares held in treasury, which resulted in decreases in Treasury stock, Common stock and Retained earnings of \$4.5 billion, \$0.1 billion and \$4.4 billion, respectively.

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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 6 through 13 and Note 19, on pages 74 through 77, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for more information concerning the Reportable Operating Segments.

The Company's financial condition, liquidity and cash flow remained stable through the first nine months of 2011 in spite of continued soft domestic demand, rising global raw material costs, and tight credit markets. Net working capital decreased \$45.3 million at September 30, 2011 compared to the end of the third quarter of 2010 due to a significant increase in current liabilities partially offset by a significant increase in current assets. 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. Net operating cash decreased \$31.6 million in nine months of 2011 to a cash source of \$446.0 million from a cash source of \$477.6 million in 2010. In the twelve month period from October 1, 2010 through September 30, 2011, the Company generated net operating cash of \$674.9 million.

Consolidated net sales increased 14.4 percent in the third quarter to \$2.485 billion from \$2.172 billion in the third quarter of 2010, and increased 13.8 percent in the first nine months of 2011 to \$6.695 billion from \$5.881 billion in the first nine months of 2010 due primarily to selling price increases, acquisitions and strong organic sales growth by the Global Finishes Group. Consolidated gross profit as a percent of consolidated net sales decreased in the third quarter to 41.8 percent from 44.7 percent in 2010 and decreased to 42.7 percent from 44.8 percent in the first nine months due primarily to rising raw material costs and acquisitions partially offset by selling price increases. Selling, general and administrative expenses (SG&A) decreased as a percent of consolidated net sales to 30.6 percent from 32.4 percent in the third quarter of 2010 and decreased to 33.0 percent from 34.1 percent in the first nine months due primarily to good expense control across all Reportable Operating Segments. Interest expense decreased \$0.9 million in the third quarter and decreased \$16.3 million in the first nine months of 2011 due primarily to costs related to the repurchase of a portion of the Company's 7.45% debentures completed in the second quarter 2010. The effective income tax rate for third quarter 2011 was 30.9 percent compared to 31.4 percent in 2010, and the rate for the first nine months of 2011 was 30.2 percent compared to 32.1 percent in 2010, including a one-time increase in income tax

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expense of \$11.4 million relating to the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (the Acts ) passed by Congress in March 2010. Diluted net income per common share increased to \$1.71 per share for the third quarter of 2011 from \$1.60 per share a year ago and increased to \$3.98 per share from \$3.53 per share in the first nine months, including charges aggregating \$.18 per share related to the repurchasing of debentures and the Acts.

### **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 uncertain economic environment and utilized certain outside sources of economic information when developing the basis for their estimates and assumptions. The impact of the 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 46 through 50, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. There have been no significant changes in critical accounting policies, management estimates or accounting policies followed since the year ended December 31, 2010.

### **FINANCIAL CONDITION, LIQUIDITY AND CASH FLOW**

#### ***Overview***

The Company's financial condition, liquidity and cash flow remained stable through the first nine months of 2011 in spite of continued soft domestic demand, rising global raw material costs, and tight credit markets. Net working capital decreased \$45.3 million at September 30, 2011 compared to the end of the third quarter of 2010 due to a significant increase in current liabilities partially offset by a significant increase in current assets. Inventories increased \$107.8 million and accounts receivable increased \$103.7 million. All other current assets decreased \$27.2 million. Short-term borrowings increased \$162.9 million and accounts payable increased \$69.1 million from September 30, 2010. All other current liabilities decreased \$2.4 million.

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Excluding short-term borrowings, net working capital increases were impacted by increased sales, higher raw material costs, foreign currency exchange rate changes, and acquisitions. 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. In the first nine months of 2011, short-term borrowings increased \$128.9 million and accounts payable increased \$87.1 million from December 31, 2010 primarily due to the seasonal increase in need for working capital and higher raw material costs, and all other current liabilities increased \$74.8 million primarily due to timing of tax payments. Since September 30, 2010, accounts receivable and inventories increased \$211.5 million due primarily to increased sales, higher raw material costs and acquisitions. The remaining current assets decreased \$27.2 million. Accounts receivable and inventories increased \$306.0 million from December 31, 2010 to September 30, 2011 when normal seasonal trends typically require significant growth in these categories. The Company's current ratio was 1.07 at September 30, 2011 compared to 1.09 at September 30, 2010 and 1.07 at December 31, 2010. Total debt at September 30, 2011 increased \$102.5 million to \$1.169 billion from \$1.066 billion at September 30, 2010 and increased as a percentage of total capitalization to 41.7 percent from 39.4 percent at the end of the third quarter last year. Total debt increased \$124.0 million and increased from 39.4 percent of total capitalization at December 31, 2010. At September 30, 2011, the Company had remaining borrowing ability of \$1.318 billion. Net operating cash decreased \$31.6 million in nine months of 2011 to a cash source of \$446.0 million from a cash source of \$477.6 million in 2010 primarily due to an increase in cash used to fund the seasonal increase in net working capital requirements resulting from higher sales partially offset by an increase in net income of \$37.7 million. In the twelve month period from October 1, 2010 through September 30, 2011, the Company generated net operating cash of \$674.9 million and increased total debt \$102.5 million used to invest \$145.9 million in capital additions and improvements and \$63.7 million in acquisitions, purchase \$450.9 million in treasury stock and pay \$154.4 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 decreased \$12.6 million during the first nine months of 2011. Cash requirements for increased sales and normal seasonal increases in working capital, capital expenditures of \$96.9 million, acquisitions of \$29.8 million, net payments made on long-term debt of \$4.8 million, payments of cash dividends of \$115.7 million and treasury stock purchases of \$328.7 million were funded primarily by net cash from operations and net increase in short-term borrowings of \$128.9 million. At September 30, 2011, the Company's current ratio was 1.07 compared to 1.07 at December 31, 2010 and 1.09 a year ago. The decrease from a year ago was due primarily to the year-over-year increase in short-term borrowings and accounts payable more than offsetting increases in accounts receivable and inventories.

Goodwill and intangible assets increased \$0.2 million from December 31, 2010 and decreased \$1.8 million from September 30, 2010. The net increase during the first nine months of 2011 was due primarily to acquisitions of \$25.2 million and capitalization of software of \$9.4 million partially offset by amortization of \$23.3 million and foreign currency translation of \$11.1 million. The net decrease over the twelve-month period from September 30, 2010 resulted from amortization of \$36.5 million and impairments of \$4.5 million partially offset by acquisitions of

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\$22.1 million, capitalization of software of \$11.9 million, and foreign currency translation of \$5.1 million. See Note 5, on pages 51 to 53, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for more information concerning goodwill and intangible assets.

Deferred pension assets increased \$16.0 million during the first nine months of 2011 and increased \$13.6 million from September 30, 2010. The increases during the first nine months and the last twelve months were due primarily to increases in the fair market value of equity securities held by the Company's defined benefit pension plans. See Note 7, on pages 56 to 62, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for more information concerning the Company's benefit plan assets.

Other assets at September 30, 2011 increased \$21.7 million in the first nine months of 2011 and \$86.7 million from a year ago due primarily to increased investments in affordable housing and historic renovation real estate properties along with increases in various other investments during both time periods.

Net property, plant and equipment decreased \$12.6 million in the first nine months of 2011 and increased \$26.6 million in the twelve months since September 30, 2010. The decrease in the first nine months was primarily due to depreciation expense of \$112.8 million, changes in currency translation rates, and sale or disposition of fixed assets partially offset by capital expenditures of \$96.9 million and acquisitions of \$17.3 million. Since September 30, 2010, capital expenditures of \$145.9 million and acquisitions of \$50.8 million were partially offset by depreciation expense of \$152.5 million, dispositions or sale of assets with remaining net book value of \$15.7 million, and changes in currency translation rates. Capital expenditures during the first nine months of 2011 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 \$362.7 million at an average rate of 0.22 percent at September 30, 2011. There were no borrowings under certain other short-term revolving and letter of credit agreements at September 30, 2011. Short-term borrowings outstanding under various foreign programs at September 30, 2011 were \$154.8 million with a weighted average interest rate of 3.3 percent. The Company had unused capacity of \$687.3 million at September 30, 2011 under the commercial paper program that is backed by the Company's revolving credit agreement. The Company entered into a new five-year \$1.05 billion credit agreement on July 8, 2011, which replaces the existing three-year \$500.0 million credit agreement. The new credit agreement may be used for general corporate purposes, including financial working capital requirements and supporting commercial paper borrowings. See Note 8, on pages 62 through 64, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for more information concerning the Company's debt.

Long-term liabilities for postretirement benefits other than pensions did not change significantly from December 31, 2010 and increased \$12.1 million from September 30, 2010. The increase in the liability was due to the increase in the actuarially determined postretirement benefit

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obligation resulting from changes in actuarial assumptions and unfavorable claims experience. See Note 7, on pages 56 to 62, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for more information concerning the Company's benefit plan obligations.

Other long-term liabilities at September 30, 2011 decreased \$4.6 million in the first nine months of 2011, due primarily to an increase of \$12.4 million in non-current and deferred tax liabilities, and increased \$125.2 million from a year ago. The increase of \$125.2 million from a year ago was due primarily to an increase in long-term commitments related to the affordable housing and historic renovation real estate properties of \$98.9 million and an increase in non-current and deferred tax liabilities of \$45.2 million partially offset by a reduction in long-term accruals for extended environmental-related liabilities of \$7.6 million. See Note 1, on pages 46 to 50, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for more information concerning the Company's Non-traded investments.

***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 2011. 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 2011.

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

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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 and adjusts its environmental-related accruals as information becomes available upon which more accurate costs can be reasonably estimated. At September 30, 2011 and 2010, the Company had accruals for environmental-related activities of \$142.3 million and \$154.5 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 \$101.6 million higher than the accruals at September 30, 2011.

Four 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, 2011. At September 30, 2011, \$101.1 million, or 71.0 percent, related directly to these four sites. Of the aggregate unaccrued exposure at September 30, 2011, \$70.0 million, or 68.9 percent, related to the four 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 four 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, 2010. There have been no significant changes in the investigative or remedial status of the four sites since December 31, 2010.

Management cannot presently estimate the ultimate potential loss contingencies related to these four 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 the 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.

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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 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 increased \$128.9 million to \$517.5 million at September 30, 2011 from \$388.6 million at December 31, 2010. Total long-term debt decreased \$4.9 million to \$651.3 million at September 30, 2011 from \$656.2 million at December 31, 2010 and \$711.8 million at September 30, 2010. 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 2011 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, 2010.

Changes to the Company's accrual for product warranty claims in the first nine months of 2011 are disclosed in Note 5.

### ***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. The blast and fragment mitigating systems create a potentially higher level of product liability for the Company (as an owner of and supplier to Life Shield) 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



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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.

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 effect 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, or as a supplier to Life Shield 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 inurrence of a liability or the reduction of a liability. In accordance with the Contingencies Topic of the ASC, the Company accrues for these contingencies by a charge to income when it is both probable that one or more future events will occur confirming the fact of a loss and the amount of the loss can be reasonably estimated. In the event that the Company's loss contingency is ultimately determined to be significantly higher than currently accrued, the recording of the additional liability may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such additional liability is accrued. In those cases where no accrual is recorded because it is not probable that a liability has been incurred and cannot be reasonably estimated, any potential liability ultimately determined to be attributable to the Company may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued. In those cases where no accrual is recorded or exposure to loss exists in excess of the amount accrued, the Contingencies Topic of the ASC requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred 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 and has been a defendant in a number of legal proceedings, including individual personal injury actions, purported class actions, and actions brought by various counties, cities,

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

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

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

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the Company's results of operations, liquidity or financial condition. An estimate of the potential impact on the Company's results of operations, liquidity or financial condition cannot be made due to the aforementioned uncertainties.

*Public nuisance claim litigation.* The Company and other companies are or were defendants in legal proceedings seeking recovery based on public nuisance liability theories, among other theories, brought by the State of Rhode Island, the City of St. Louis, Missouri, various cities and counties in the State of New Jersey, various cities in the State of Ohio and the State of Ohio, the City of Milwaukee, Wisconsin and the County of Santa Clara, California and other public entities in the State of California. Except for the Santa Clara County, California proceeding, all of these legal proceedings have been concluded in favor of the Company and other defendants at various stages in the proceedings. The proceedings initiated by the State of Rhode Island included two jury trials. At the conclusion of the second trial, the jury returned a verdict finding that (i) the cumulative presence of lead pigment in paints and coatings on buildings in the State of Rhode Island constitutes a public nuisance, (ii) the Company, along with two other defendants, caused or substantially contributed to the creation of the public nuisance, and (iii) the Company and two other defendants should be ordered to abate the public nuisance. The Company and two other defendants appealed and, on July 1, 2008, the Rhode Island Supreme Court, among other determinations, reversed the judgment of abatement with respect to the Company and two other defendants. The Rhode Island Supreme Court's decision reversed the public nuisance liability judgment against the Company on the basis that the complaint failed to state a public nuisance claim as a matter of law.

The Santa Clara County, California proceeding was initiated in March 2000 in the Superior Court of the State of California, County of Santa Clara. In the original complaint, the plaintiffs asserted various claims including fraud and concealment, strict product liability/failure to warn, strict product liability/design defect, negligence, negligent breach of a special duty, public nuisance, private nuisance, and violations of California's Business and Professions Code. A number of the asserted claims were resolved in favor of the defendants through pre-trial proceedings. The named plaintiffs in the Fourth Amended Complaint, filed on March 16, 2011, are the Counties of Santa Clara, Alameda, Los Angeles, Monterey, San Mateo, Solano and Ventura, and the Cities of Oakland, San Diego and San Francisco. The Fourth Amended Complaint asserts a sole claim for public nuisance, alleging that the presence of lead products for use in paint and coatings in, on and around buildings in the plaintiffs' jurisdictions constitutes a public nuisance. The plaintiffs seek the abatement of the alleged public nuisance that exists within the plaintiffs' jurisdictions.

*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.

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The plaintiff in Thomas v. Lead Industries Association, et al., initiated an action in state court against the Company, other alleged former lead pigment manufacturers and the Lead Industries Association in September 1999. The claims against the Company and the other defendants 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. The case ultimately proceeded to trial and, on November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain damaged or injured as a result. The plaintiff appealed and, on December 16, 2010, the Wisconsin Court of Appeals affirmed the final judgment in favor of the Company and other defendants.

Wisconsin is the only jurisdiction to date to apply a theory of liability with respect to alleged personal injury (i.e., risk contribution/market share liability) that does not require the plaintiff to identify the manufacturer of the product that allegedly injured the plaintiff in the lead pigment and lead-based paint litigation. Although the risk contribution liability theory was applied during the Thomas trial, the constitutionality of this theory as applied to the lead pigment cases has not been judicially determined by the Wisconsin state courts. However, in an unrelated action filed in the United States District Court for the Eastern District of Wisconsin, Gibson v. American Cyanamid, et al., on November 15, 2010, the District Court held that Wisconsin's risk contribution theory as applied in that case violated the defendants' right to substantive due process and is unconstitutionally retroactive.

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

**Table of Contents*****Shareholders' Equity***

Shareholders' equity increased \$40.5 million to \$1.650 billion at September 30, 2011 from \$1.609 billion at December 31, 2010 and increased \$6.8 million from \$1.643 billion at September 30, 2010. Effective March 31, 2011, the Company retired all of its 125.4 million common stock shares held in treasury, which resulted in decreases in treasury stock, common stock and retained earnings of \$4.5 billion, \$0.1 billion and \$4.4 billion, respectively. The increase in Shareholders' equity for the first nine months of 2011 resulted primarily from net income of \$427.3 million, increased other capital of \$81.6 million resulting primarily from stock option exercises, and minority interest of \$14.6 million recorded in connection with the Leighs Paints acquisition completed on July 1, 2011. These increases in Shareholders' equity were partially offset by the purchase of treasury stock of \$328.7 million, cash dividends paid on common stock of \$115.7 million and an increase in Cumulative other comprehensive loss of \$39.5 million. Purchases of treasury stock for \$450.9 million since September 30, 2010 and an increase in Cumulative other comprehensive loss of \$25.7 million in twelve months, due primarily to unfavorable foreign currency translation effects, more than offset an increase in other capital of \$121.7 million. During the first nine months of 2011, the Company purchased 4.24 million shares of its common stock for treasury purposes through open market purchases. The Company purchased 5.77 million shares of its common stock since September 30, 2010 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, 2011 to purchase 1.51 million shares of its common stock. At a meeting held on October 19, 2011, the Board of Directors authorized the Company to purchase an additional 20 million shares of the Company's stock for treasury purposes. In addition, the Board of Directors increased the quarterly cash dividend from \$.360 per common share to \$.365 per common share. This quarterly dividend will result in an annual dividend for 2011 of \$1.46 per common share or a 34.7 percent payout of 2010 diluted net income per common share.

***Cash Flow***

Net operating cash decreased \$31.6 million in the first nine months of 2011 to a cash source of \$446.0 million from a cash source of \$477.6 million in 2010 primarily due to an increase in cash requirements to fund increased sales and the seasonal increase in net working capital requirements partially offset by increased net income of \$37.7 million and a decrease in costs incurred for environmental-related matters and qualified exit costs of \$11.9 million. In the twelve month period from October 1, 2010 through September 30, 2011, the Company generated net operating cash of \$674.9 million, increased total debt \$102.9 million, invested \$145.9 million in capital additions and improvements and \$63.7 million in acquisitions of businesses, purchased \$450.9 million in treasury stock and paid \$154.4 million in cash dividends to its shareholders of common stock.

***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 2011, the Company entered into forward currency exchange contracts with maturity dates of less than twelve months to hedge against value changes in foreign currency. The Company believes it may be exposed to continuing market risk

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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. The covenant states the Company's leverage ratio is not to exceed 3.00 to 1.00. In connection with the new credit facility entered into on July 8, 2011, the leverage ratio was increased to 3.25 to 1.00. The leverage ratio is defined as the ratio of total indebtedness (the sum of Short-term borrowings, Current portion of long-term debt and Long-term debt) at the reporting date to consolidated Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) for the 12-month period ended on the same date. Refer to the Results of Operations caption below for a reconciliation of EBITDA to Net income. At September 30, 2011, the Company was in compliance with the covenant. The Company's Notes, Debentures and revolving credit agreements 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 8, on page 62 and 63, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for more information concerning the Company's debt and related covenant.

**RESULTS OF OPERATIONS**

Shown below are net sales and income before taxes by segment for the third quarter and first nine months:

<i>(thousands of dollars)</i>	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	Change	2011	2010	Change
<b>Net Sales:</b>						
Paint Stores Group	<b>\$1,417,765</b>	\$1,286,063	10.2%	<b>\$3,646,079</b>	\$3,381,955	7.8%
Consumer Group	<b>351,579</b>	340,365	3.3%	<b>1,022,143</b>	1,042,731	-2.0%
Global Finishes Group	<b>714,351</b>	544,548	31.2%	<b>2,023,388</b>	1,452,194	39.3%
Administrative	<b>1,225</b>	1,283	-4.5%	<b>3,647</b>	3,925	-7.1%
Total	<b>\$2,484,920</b>	\$2,172,259	14.4%	<b>\$6,695,257</b>	\$5,880,805	13.8%

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	Change	2011	2010	Change
<b>Income Before</b>						
<b>Income Taxes:</b>						
Paint Stores Group	<b>\$236,886</b>	\$225,079	5.2%	<b>\$ 512,374</b>	\$ 484,795	5.7%
Consumer Group	<b>41,023</b>	59,699	-31.3%	<b>143,484</b>	177,859	-19.3%
Global Finishes Group	<b>43,508</b>	31,925	36.3%	<b>126,388</b>	94,882	33.2%
Administrative	<b>(61,141)</b>	(61,324)	-0.3%	<b>(170,241)</b>	(183,450)	-7.2%
Total	<b>\$260,276</b>	\$255,379	1.9%	<b>\$ 612,005</b>	\$ 574,086	6.6%

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Consolidated net sales increased in the third quarter and increased in the first nine months of 2011 due primarily to selling price increases, acquisitions, and strong organic sales growth by the Global Finishes Group.

Net sales of all consolidated foreign subsidiaries were up 36.6 percent to \$513.8 million in the quarter and up 49.8 percent to \$1.49 billion in the first nine months versus \$376.1 million and \$995.2 million in the same periods last year. The increases in net sales for all consolidated foreign subsidiaries in the quarter and first nine months were due primarily to acquisitions, which increased net sales 23.6 percent in the quarter and 34.0 percent in the first nine months, and a 4.1 percent positive impact of foreign currency translation rate changes in the quarter and a 5.7 percent positive impact in the first nine months. Net sales of all operations other than consolidated foreign subsidiaries were up 9.7 percent to \$1.97 billion in the quarter and up 6.5 percent to \$5.20 billion in the first nine months as compared to \$1.80 billion and \$4.89 billion in the same periods last year.

Net sales in the Paint Stores Group increased due primarily to selling price increases and improving domestic architectural paint sales volume across most segments for both periods. Net sales from stores open for more than twelve calendar months increased 8.2 percent in the quarter and increased 6.8 percent in the first nine months over last year's comparable periods. Total paint sales volume percentage increases were in the middle to low single digits for the quarter and nearly flat for the first nine months as compared to last year's comparable periods. Sales of non-paint products increased by 8.6 percent over last year's third quarter and increased by 6.6 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 increases in the third quarter were due primarily to selling price increases partially offset by the elimination of a portion of a paint program with a large retail customer. Selling price increases in the first nine months only partially offset the elimination of a portion of a paint program with a large retail customer resulting in net sales decreases as compared to last year. Net sales in the Global Finishes Group stated in U.S. dollars increased in the third quarter and first nine months primarily due to acquisitions, selling price increases, higher paint sales volume, and favorable currency translation rate changes.

Acquisitions increased sales by 16.3 percent and 23.3 percent for the third quarter and first nine months, respectively. Currency translation rate changes increased sales 3.2 percent in the quarter and 4.2 percent in the first nine months. Net sales in the Administrative segment, which primarily consist of external leasing revenue of excess headquarters space and leasing of facilities no longer used by the Company in its primary business, decreased by an insignificant amount in the third quarter and first nine months.

Consolidated gross profit increased \$66.7 million in the third quarter and \$223.0 million in the first nine months of 2011 compared to the same periods in 2010. As a percent of sales, consolidated gross profit decreased to 41.8 percent in the quarter from 44.7 percent in the third quarter of 2010 and decreased to 42.7 percent in the first nine months of 2011 from 44.8 percent last year. The dollar increase for both periods was primarily due to selling price increases and 2010 acquisitions partially offset by higher raw material costs. The decrease as a percent to sales for both periods were due primarily to increasing raw material costs and the impact of 2010 acquisitions partially offset by selling price increases.

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The Paint Stores Group's gross profit was higher than last year in the third quarter by \$33.4 million and higher than last year in the first nine months by \$91.6 million due to higher selling prices partially offset by increasing raw material costs. Increased paint sales volume also contributed to the dollar increase in the third quarter. The Paint Stores Group's gross profit margins in the quarter and first nine months were lower compared to the same periods last year by 2.4 percent and 1.2 percent, respectively. The Consumer Group's gross profit decreased from last year by \$17.7 million in the quarter and decreased \$33.6 million in the first nine months from last year due primarily to increasing raw material costs and lower paint sales volume partially offset by selling price increases for both comparable periods. Rising raw material costs only partially offset by selling price increases caused the Consumer Group's gross profit margins to decline 6.2 percent of sales for the third quarter and decline 2.6 percent of sales for the first nine months compared to the comparable periods last year. The Global Finishes Group's gross profit increased \$44.8 million in the third quarter and increased \$159.0 million in the first nine months compared to the same periods last year, when stated in U.S. dollars, due primarily to acquisitions, selling price increases, increased paint sales volume and favorable currency translation rate changes. The Global Finishes Group's gross profit margins were down 2.0 percent of sales in the quarter and down 2.2 percent of sales for the first nine months compared to last year due to rising raw material costs and the impact of acquisitions partially offset by selling price increases. The Administrative segment's gross profit increased by an insignificant amount in the third quarter and first nine months compared to the same periods last year.

Selling, general and administrative expenses (SG&A) increased \$56.5 million in the third quarter and increased \$199.1 million in the first nine months of 2011 versus last year due primarily to acquisitions, net new store openings, and the impact of currency translation rate changes. As a percent of sales, consolidated SG&A decreased to 30.6 percent in the quarter and decreased to 33.0 percent in the first nine months from 32.4 percent in the third quarter and 34.1 percent in the first nine months of 2010 due to higher sales.

The Paint Stores Group's SG&A increased \$24.6 million in the third quarter and increased \$67.8 million in the first nine months due primarily to net new store openings and general comparable store expenses to maintain customer service. The Consumer Group's SG&A was down slightly for the third quarter and first nine months of 2011 compared to the same periods last year. The Global Finishes Group's SG&A increased \$32.5 million in the quarter and increased \$120.0 million in the first nine months relating primarily to acquisitions, higher sales volume, and currency translation rate changes. The Administrative segment's SG&A increased by \$2.2 million in the third quarter and increased by \$13.9 million in the first nine months due primarily to an increase in stock-based compensation expense for both comparable periods and information systems costs to integrate the 2010 acquisitions.

Other general expense net increased \$2.4 million in the third quarter and decreased by \$4.1 million in the first nine months. The increase in the quarter was primarily due to \$1.5 million lower gains on sale of assets and increased provisions for environmental-related matters of \$0.7 million in the Administrative segment. The decrease in the first nine months was primarily due to increased gains on the sale of assets of \$4.1 million in the Administrative segment.



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Interest expense, included in the Administrative segment, decreased \$0.9 million in the third quarter due to lower average borrowing rates and \$16.3 million in the first nine months due primarily to the write-off of origination costs related to the repurchase of a portion of the Company's 7.45% debentures in 2010.

Other expense net increased \$3.6 million in the third quarter and increased \$6.3 million in the first nine months primarily due to increased foreign currency losses impacting the Global Finishes and Consumer Groups for both periods.

Consolidated income before income taxes increased \$4.9 million in the third quarter due to higher segment profits of the Paint Stores and Global Finishes Groups partially offset by lower profit in the Consumer Group. Consolidated income before income taxes increased \$37.9 million in the first nine months of 2011 due primarily to the higher segment profits of the Paint Stores and Global Finishes Groups and lower Administrative segment expenses partially offset by a decrease in the Consumer Group segment profit.

The effective income tax rate of 30.9 percent for the third quarter of 2011 was slightly lower than the 31.4 percent effective income tax rate for the third quarter of 2010. The effective income tax rate of 30.2 percent for the first nine months of 2011 was lower than the 32.1 effective tax income tax rate for the first nine months of 2010 as a result of a one-time increase in income tax expense of \$11.4 million due to the Acts.

Net income for the quarter increased \$4.6 million to \$179.9 million from \$175.3 million in the third quarter of 2010 and increased \$37.7 million to \$427.3 million from \$389.6 million in the first nine months of 2010. Diluted net income per common share increased 6.9 percent from \$1.60 per share in the third quarter of 2010 to \$1.71 per share in the third quarter of 2011. Diluted net income per common share increased 12.7 percent from \$3.53 in the first nine months of 2010, which included charges aggregating \$.18 per share related to repurchase of debt and the Acts, to \$3.98 in the first nine months of 2011.

In October 2011, the Company reached a settlement of the IRS audit of the Company's ESOP. The Company has fully resolved all IRS issues for the 2003 through 2009 tax years relating to the matters disclosed in the Company's current report on Form 8-K dated May 20, 2011 challenging the ESOP related federal income tax deductions claimed by the Company and proposing substantial excise taxes and penalties. The settlement (including interest), which resolves all ESOP related tax issues, will result in an after-tax charge related to federal and state income taxes totaling approximately \$75.0 million, or \$.72 per diluted common share, and an additional reduction in Shareholders' equity of approximately \$51.2 million in the Company's fourth quarter. The Department of Labor's investigation of the Leveraged ESOP Transactions remains open.

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

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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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
<i>(thousands of dollars)</i>	<b>2011</b>	2010	<b>2011</b>	2010
Net income	<b>\$ 179,877</b>	\$ 175,258	<b>\$ 427,308</b>	\$ 389,567
Interest expense	<b>10,452</b>	11,310	<b>32,874</b>	49,219
Income taxes	<b>80,399</b>	80,121	<b>184,697</b>	184,519
Depreciation	<b>38,000</b>	34,467	<b>112,807</b>	100,673
Amortization	<b>10,136</b>	8,568	<b>23,263</b>	21,774
EBITDA	<b>\$ 318,864</b>	\$ 309,724	<b>\$ 780,949</b>	\$ 745,752

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**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, 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) the duration and severity 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, including the recent acquisitions of Becker Acroma Industrial Wood Coatings, Sayerlack Industrial Wood Coatings, Pinturas Condor and Leighs Paints, 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, Europe, Mexico, 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 foreign markets, such as Asia, Europe, Mexico and South America; (l) increasingly stringent domestic and foreign governmental regulations including those affecting health, safety and 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, 2010.

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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.

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**PART II. OTHER INFORMATION**

Item 1. **Legal Proceedings.**

Reference is made to the following legal proceeding brought by the United States Environmental Protection Agency Region III (the "EPA") in Philadelphia, Pennsylvania, which was reported in the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010. On June 23, 2010, the Company received correspondence from EPA alleging that the Company had violated the Resource Conservation and Recovery Act and the State of Maryland Hazardous Waste Management Regulations at the Company's manufacturing facility in Baltimore, Maryland. The EPA alleged various violations, including those relating to handling drums, totes and other containers, addressing spills of hazardous waste, and recordkeeping and other regulatory activities. During the third quarter of 2011, the Company entered into a consent agreement and final order with the EPA pursuant to which the Company paid a civil penalty of \$570,000 in settlement of the EPA's allegations.

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 8 and 9 of the Notes to Condensed Consolidated Financial Statements, which is incorporated herein by reference.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

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

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Number of Shares Purchased as Part of a Publicly Announced Plan	Number of Shares That May Yet Be Purchased Under the Plan
July 1 – July 31 Share repurchase program <sup>(1)</sup>	2,140,000	\$ 74.66	2,140,000	2,010,000
August 1 – August 31 Share repurchase program <sup>(1)</sup>	500,000	\$ 72.56	500,000	1,510,000
September 1 – September 30 Share repurchase program <sup>(1)</sup>				1,510,000
Total Share repurchase program <sup>(1)</sup>	2,640,000	\$ 74.26	2,640,000	1,510,000

- <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. The Company had remaining authorization at September 30, 2011 to purchase 1,510,000 shares. At a meeting held on October 19, 2011, the Board of Directors authorized the Company to purchase an additional 20.0 million shares of the Company's stock for treasury purposes. 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 5. Other Information.

During the fiscal quarter ended September 30, 2011, the Audit Committee of the Board of Directors of the Company approved permitted non-audit services to be performed by Ernst & Young LLP, the Company's independent registered public accounting firm. These non-audit services were approved within categories related to domestic advisory and compliance services and tax compliance.

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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

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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, 2011

By: /s/ A.J. Mistysyn  
A.J. Mistysyn  
Vice President-Corporate Controller

October 27, 2011

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