

SHERWIN WILLIAMS CO  
Form 10-Q  
July 24, 2013

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 June 30, 2013

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  
(State or other jurisdiction of  
incorporation or organization)

34-0526850  
(I.R.S. Employer  
Identification No.)

101 West Prospect Avenue,  
Cleveland, Ohio  
(Address of principal executive offices)  
(216) 566-2000  
(Registrant's telephone number including area code)

44115-1075  
(Zip 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  (Do not check if a smaller reporting company) 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 – 102,683,128 shares as of June 30, 2013.



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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES  
STATEMENTS OF CONSOLIDATED INCOME (UNAUDITED)

Thousands of dollars, except per share data

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2013	2012	2013	2012	
Net sales	\$2,713,889	\$2,573,022	\$4,881,057	\$4,709,366	
Cost of goods sold	1,480,310	1,422,425	2,684,627	2,648,930	
Gross profit	1,233,579	1,150,597	2,196,430	2,060,436	
Percent to net sales	45.5	% 44.7	% 45.0	% 43.8	%
Selling, general and administrative expenses	837,124	810,207	1,615,803	1,567,886	
Percent to net sales	30.8	% 31.5	% 33.1	% 33.3	%
Other general expense - net	485	3,086	4,432	8,123	
Interest expense	15,069	10,230	30,380	20,567	
Interest and net investment income	(698	) (625	) (1,447	) (1,167	)
Other expense (income) - net	715	(104	) (2,006	) (5,091	)
Income before income taxes	380,884	327,803	549,268	470,118	
Income taxes	123,597	99,990	175,796	142,089	
Net income	\$257,287	\$227,813	\$373,472	\$328,029	
Net income per common share:					
Basic	\$2.51	\$2.23	\$3.65	\$3.20	
Diluted	\$2.46	\$2.17	\$3.57	\$3.13	
Average shares outstanding—basic	101,665,737	101,446,643	101,813,398	101,758,496	
Average shares and equivalents outstanding—diluted	103,896,780	104,003,128	104,031,718	104,100,046	
Comprehensive income	\$213,283	\$214,846	\$330,871	\$346,619	

See notes to condensed consolidated financial statements.

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

Thousands of dollars

	June 30, 2013	December 31, 2012	June 30, 2012
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents	\$741,084	\$862,590	\$46,616
Accounts receivable, less allowance	1,299,679	1,032,508	1,237,832
<b>Inventories:</b>			
Finished goods	809,586	732,359	851,827
Work in process and raw materials	175,258	187,965	179,651
	984,844	920,324	1,031,478
Deferred income taxes	129,732	126,730	148,685
Other current assets	187,096	207,086	159,391
<b>Total current assets</b>	<b>3,342,435</b>	<b>3,149,238</b>	<b>2,624,002</b>
Goodwill	1,171,503	1,156,005	1,122,274
Intangible assets	311,947	347,553	314,913
Deferred pension assets	250,989	249,911	232,591
Other assets	379,439	366,134	394,200
<b>Property, plant and equipment:</b>			
Land	99,579	102,336	101,336
Buildings	718,015	677,944	665,162
Machinery and equipment	1,812,541	1,750,729	1,702,849
Construction in progress	39,087	56,582	47,588
	2,669,222	2,587,591	2,516,935
Less allowances for depreciation	1,717,031	1,621,695	1,578,540
	952,191	965,896	938,395
<b>Total Assets</b>	<b>\$6,408,504</b>	<b>\$6,234,737</b>	<b>\$5,626,375</b>
<b>Liabilities and Shareholders' Equity</b>			
<b>Current liabilities:</b>			
Short-term borrowings	\$50,664	\$69,035	\$604,985
Accounts payable	1,117,459	922,999	1,102,148
Compensation and taxes withheld	218,633	314,892	231,828
Accrued taxes	170,447	52,104	126,556
Current portion of long-term debt	2,632	3,689	4,246
Other accruals	407,670	513,717	462,040
<b>Total current liabilities</b>	<b>1,967,505</b>	<b>1,876,436</b>	<b>2,531,803</b>
Long-term debt	1,631,951	1,632,165	635,589
Postretirement benefits other than pensions	320,219	320,223	298,798
Other long-term liabilities	621,299	614,109	620,932
<b>Shareholders' equity:</b>			
<b>Common stock—\$1.00 par value:</b>			
102,683,128, 103,270,067 and 102,632,285 shares outstanding at June 30, 2013, December 31, 2012 and June 30, 2012, respectively	112,454	111,623	109,682
<b>Preferred stock—convertible, no par value:</b>			
68,049, 101,086 and 128,390 shares outstanding at June 30, 2013,			

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December 31, 2012 and June 30, 2012, respectively	68,049	101,086	128,390
Unearned ESOP compensation	(68,049	) (101,086	) (128,390
Other capital	1,773,060	1,673,788	1,429,209
Retained earnings	1,496,639	1,226,467	1,003,693
Treasury stock, at cost	(1,101,633	) (849,685	) (654,043
Cumulative other comprehensive loss	(412,990	) (370,389	) (349,288
Total shareholders' equity	1,867,530	1,791,804	1,539,253
Total Liabilities and Shareholders' Equity	\$6,408,504	\$6,234,737	\$5,626,375

See notes to condensed consolidated financial statements.

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

Thousands of dollars

	Six Months Ended	
	June 30, 2013	June 30, 2012
<b>OPERATING ACTIVITIES</b>		
Net income	\$373,472	\$328,029
Adjustments to reconcile net income to net operating cash:		
Depreciation	78,301	75,507
Amortization of intangible assets	14,127	12,963
Stock-based compensation expense	23,977	21,945
Provisions for qualified exit costs	367	1,582
Provisions for environmental-related matters	1,769	9,093
Defined benefit pension plans net cost	9,975	9,855
Net increase in postretirement liability	1,800	1,800
Other	1,417	494
Change in working capital accounts—net	(195,322)	(220,890)
Costs incurred for environmental-related matters	(6,892)	(20,165)
Costs incurred for qualified exit costs	(5,955)	(1,907)
Other	5,039	(16,194)
Net operating cash	302,075	202,112
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(72,126)	(69,972)
Acquisitions of businesses, net of cash acquired	(5,000)	(43,993)
Proceeds from sale of assets	2,586	8,979
(Increase) decrease in other investments	(52,854)	14,848
Net investing cash	(127,394)	(90,138)
<b>FINANCING ACTIVITIES</b>		
Net (decrease) increase in short-term borrowings	(17,407)	260,193
Proceeds from long-term debt		1,846
Payments of long-term debt	(949)	(12,164)
Payments of cash dividends	(103,300)	(80,438)
Proceeds from stock options exercised	40,622	88,182
Income tax effect of stock-based compensation exercises and vesting	35,654	36,612
Treasury stock purchased	(232,522)	(362,623)
Other	(18,855)	(27,546)
Net financing cash	(296,757)	(95,938)
Effect of exchange rate changes on cash	570	(2,116)
Net (decrease) increase in cash and cash equivalents	(121,506)	13,920
Cash and cash equivalents at beginning of year	862,590	32,696
Cash and cash equivalents at end of period	\$741,084	\$46,616
Income taxes paid	\$34,666	\$97,709
Interest paid	30,942	20,899

See notes to condensed consolidated financial statements.

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

Periods ended June 30, 2013 and 2012

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, 2012. Accounting estimates were revised as necessary during the first six months of 2013 based on new information and changes in facts and circumstances.

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, 2012.

The consolidated results for the three and six months ended June 30, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013.

NOTE 2—IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-2, which amends the Comprehensive Income Topic of the Accounting Standards Codification (ASC). The updated standard requires the presentation of information about reclassifications out of accumulated other comprehensive income. ASU No. 2013-2 is effective for fiscal years and interim periods within those years beginning after December 15, 2012. The Company has adopted the standard on a prospective basis as required. The updated standard affects the Company's disclosures but has no impact on its results of operations, financial condition or liquidity.

NOTE 3—DIVIDENDS

Dividends paid on common stock during each of the first two quarters of 2013 and 2012 were \$.50 per common share and \$.39 per common share, respectively.

**NOTE 4—CHANGES IN CUMULATIVE OTHER COMPREHENSIVE LOSS**

The following table summarizes the changes in Cumulative other comprehensive loss for the six months ended June 30, 2013:

(Thousands of dollars)

	Foreign Currency Translation Adjustments	Net Actuarial (Losses) Gains and Prior Service Costs Recognized for Employee Benefit Plans	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Total Cumulative Other Comprehensive Loss
Beginning balance	\$(204,195 )	\$(166,595 )	\$ 401	\$ (370,389 )
Other comprehensive (loss) income before reclassifications <sup>(1)</sup>	(48,421 )	12,190	99	(36,132 )
Amounts reclassified from other comprehensive (loss) income <sup>(2)</sup>		(6,450 )	(19 )	(6,469 )
Net other comprehensive (loss) income	(48,421 )	5,740	80	(42,601 )
Ending balance	\$(252,616 )	\$(160,855 )	\$ 481	\$ (412,990 )

<sup>(1)</sup> Net of taxes of \$(7,794) for net actuarial gains and prior service costs recognized for employee benefit plans and \$(62) for unrealized net gains on available-for-sale securities.

<sup>(2)</sup> Net of taxes of \$4,124 for net actuarial gains and prior service costs recognized for employee benefit plans and \$12 for unrealized net gains on available-for-sale securities.

**NOTE 5—PRODUCT WARRANTIES**

Changes in the Company's accrual for product warranty claims during the first six months of 2013 and 2012, including customer satisfaction settlements, were as follows:

(Thousands of dollars)

	2013	2012
Balance at January 1	\$22,710	\$22,071
Charges to expense	11,031	11,710
Settlements	(12,134 )	(10,842 )
Balance at June 30	\$21,607	\$22,939

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, 2012.

**NOTE 6—EXIT OR DISPOSAL ACTIVITIES**

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

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

In the six months ended June 30, 2013, three stores in the Paint Stores Group, one branch in the Global Finishes Group and four stores in the Latin America Coatings Group were closed due to lower demand or redundancy.

The following table summarizes the activity and remaining liabilities associated with qualified exit costs at June 30, 2013:

(Thousands of dollars)	Balance at December 31, 2012	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 June 30, 2013
Exit Plan					
Paint Stores Group stores shutdown in 2013:					
Other qualified exit costs		\$27	\$ (16 )		\$11
Paint Stores Group stores shutdown in 2012:					
Other qualified exit costs	\$313		(44 )	\$ (1 )	268
Global Finishes Group facility shutdown in 2012:					
Severance and related costs	2,236		(1,548 )	261	949
Other qualified exit costs	3,430		(3,530 )	100	
Global Finishes Group branches shutdown in 2011:					
Other qualified exit costs	290		(93 )		197
Other qualified exit costs for facilities shutdown prior to 2011	2,288		(724 )	(20 )	1,544
Totals	\$8,557	\$27	\$ (5,955 )	\$ 340	\$2,969

For further details on the Company's exit or disposal activities, see Note 5 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

#### 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:

(Thousands of dollars)	Domestic Defined Benefit Pension Plans		Foreign Defined Benefit Pension Plans		Postretirement Benefits Other than Pensions	
	2013	2012	2013	2012	2013	2012
Three Months Ended June 30:						
Net periodic benefit cost:						
Service cost	\$5,397	\$4,732	\$1,160	\$893	\$766	\$736
Interest cost	4,267	4,331	1,903	1,724	3,045	3,380
Expected return on assets	(10,342 )	(11,211 )	(1,782 )	(1,677 )		
Amortization of:						
Prior service cost (credit)	455	398			(82 )	(164 )
Actuarial loss	3,488	5,485	442	252	984	428
Net periodic benefit cost	\$3,265	\$3,735	\$1,723	\$1,192	\$4,713	\$4,380
Six Months Ended June 30:						
Net periodic benefit cost:						
Service cost	\$10,793	\$9,464	\$2,320	\$1,785	\$1,531	\$1,472
Interest cost	8,534	8,662	3,805	3,449	6,091	6,760
Expected return on assets	(20,684 )	(22,421 )	(3,564 )	(3,354 )		

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Amortization of:

Prior service cost (credit)	911	796			(164	) (328	)
Actuarial loss	6,976	10,971	884	503	1,967	857	
Net periodic benefit cost	\$6,530	\$7,472	\$3,445	\$2,383	\$9,425	\$8,761	

For further details on the Company's health care, pension and other benefits, see Note 6 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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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 June 30, 2013, the unaccrued maximum of the estimated range of possible outcomes is \$85.6 million higher than the minimum.

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

Included in Other long-term liabilities at June 30, 2013 and 2012 were accruals for extended environmental-related activities of \$93.8 million and \$83.9 million, respectively. Estimated costs of current investigation and remediation activities of \$17.1 million and \$42.9 million are included in Other accruals at June 30, 2013 and 2012, respectively. Two of the Company's currently and formerly owned manufacturing sites account for the majority of the accrual for environmental-related activities and the unaccrued maximum of the estimated range of possible outcomes at June 30, 2013. At June 30, 2013, \$58.5 million, or 52.8 percent of the total accrual, related directly to these two sites. In the aggregate unaccrued maximum of \$85.6 million at June 30, 2013, \$56.6 million, or 66.1 percent, related to the two manufacturing sites. While environmental investigations and remedial actions are in different stages at these sites, additional investigations, remedial actions and monitoring will likely be required at each site.

Management cannot presently estimate the ultimate potential loss contingencies related to these sites or other less significant sites until such time as a substantial portion of the investigation at the sites is completed and remedial action plans are developed. In the event any future loss contingency significantly exceeds the current amount accrued, the recording of the ultimate liability may result in a material impact on net income for the annual or interim period during which the additional costs are accrued. Management does not believe that any potential liability ultimately attributed to the Company for its environmental-related matters will have a material adverse effect on the Company's financial condition, liquidity, or cash flow due to the extended period of time during which environmental investigation and remediation takes place. An estimate of the potential impact on the Company's operations cannot be made due to the aforementioned uncertainties.

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

For further details on the Company's Other long-term liabilities, see Note 8 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

#### NOTE 9 – LITIGATION

In the course of its business, the Company is subject to a variety of claims and lawsuits, including, but not limited to, litigation relating to product liability and warranty, personal injury, environmental, intellectual property, commercial, contractual and antitrust claims that are inherently subject to many uncertainties regarding the possibility of a loss to the Company. These uncertainties will ultimately be resolved when one or more future events occur or fail to occur confirming the incurrence of a liability or the reduction of a liability. In accordance with the Contingencies Topic of the ASC, the Company accrues for these contingencies by a charge to income when it is both probable that one or more future events will occur confirming the fact of a loss and the amount of the loss can be reasonably estimated. In the event that the Company's loss contingency is ultimately determined to be significantly higher than currently

accrued, the recording of the additional liability may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such additional liability is accrued. In those cases where no accrual is recorded because it is not probable that a liability has been incurred and the amount of any such loss cannot be reasonably estimated, any potential liability ultimately determined to be attributable to the Company may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued. In those cases where no accrual is recorded or

exposure to loss exists in excess of the amount accrued, the Contingencies Topic of the ASC requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred.

Lead pigment and lead-based paint litigation. The Company's past operations included the manufacture and sale of lead pigments and lead-based paints. The Company, along with other companies, is and has been a defendant in a number of legal proceedings, including individual personal injury actions, purported class actions, and actions brought by various counties, cities, school districts and other government-related entities, arising from the manufacture and sale of lead pigments and lead-based paints. The plaintiffs' claims have been based upon various legal theories, including negligence, strict liability, breach of warranty, negligent misrepresentations and omissions, fraudulent misrepresentations and omissions, concert of action, civil conspiracy, violations of unfair trade practice and consumer protection laws, enterprise liability, market share liability, public nuisance, unjust enrichment and other theories. The plaintiffs seek various damages and relief, including personal injury and property damage, costs relating to the detection and abatement of lead-based paint from buildings, costs associated with a public education campaign, medical monitoring costs and others. The Company 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 City of Chicago, Illinois, the City of Milwaukee, Wisconsin and the County of Santa Clara, California and other public entities in the State of California. Except for the Santa Clara County, California proceeding, all of these legal proceedings have been concluded in favor of the Company and other

defendants at various stages in the proceedings.

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



The Santa Clara County, California proceeding was initiated in March 2000 in the Superior Court of the State of California, County of Santa Clara. In the original complaint, the plaintiffs asserted various claims including fraud and concealment, strict product liability/failure to warn, strict product liability/design defect, negligence, negligent breach of a special duty, public nuisance, private nuisance, and violations of California's Business and Professions Code. A number of the asserted claims were resolved in favor of the defendants through pre-trial proceedings. The named plaintiffs in the Fourth Amended Complaint, filed on March 16, 2011, are the Counties of Santa Clara, Alameda, Los Angeles, Monterey, San Mateo, Solano and Ventura, 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. A trial commenced on July 15, 2013.

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 included strict liability, negligence, negligent misrepresentation and omissions, fraudulent misrepresentation and omissions, concert of action, civil conspiracy and enterprise liability. Implicit within these claims is the theory of "risk contribution" liability (Wisconsin's theory which is similar to market share liability) due to the plaintiff's inability to identify the manufacturer of any product that allegedly injured the plaintiff. The case ultimately proceeded to trial and, on November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain damaged or injured as a result. The plaintiff appealed and, on December 16, 2010, the Wisconsin Court of Appeals affirmed the final judgment in favor of the Company and other defendants.

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

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

for the lead pigment or lead-based paint litigation and any significant liability ultimately determined to be attributable to the Company relating to such litigation may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued.

Department of Labor (DOL) leveraged ESOP settlement. As previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, on February 20, 2013, the Company reached a settlement with the DOL of the DOL's investigation of transactions related to the Company's ESOP that were implemented on August 1, 2006 and August 27, 2003. The DOL had notified the Company, among others, of potential enforcement claims asserting breaches of fiduciary obligations and sought compensatory and equitable remedies. The Company resolved all ESOP related claims with the DOL by agreeing, in part, to make a one-time payment of \$80.0 million to the ESOP, resulting in a \$49.2 million after tax charge to

earnings in the fourth quarter of 2012. The Company made this required \$80.0 million payment to the ESOP during the first quarter of 2013.

Import duty assessment settlement. During the second quarter of 2013, the Company recorded a charge of \$11.8 million to Cost of goods sold due to an assessment as a result of audits brought by the Brazilian government related to the handling of import duties on products brought into the country for the years 2006 through 2008, resulting in an after-tax charge of \$8.4 million. The Company elected to accept a voluntary amnesty program offered by the government to resolve this issue rather than incur significant legal expenses to contest the assessment in court. The Company's import duty processes were changed beginning in 2009, however, years subsequent to 2008 remain open to audit. No additional accruals for potential assessments have been recorded.

#### NOTE 10—OTHER

Other general expense - net

Included in Other general expense - net were the following:

(Thousands of dollars)	Three Months Ended		Six Months Ended		
	June 30, 2013	2012	June 30, 2013	2012	
Provisions for environmental matters—net	\$1,446	\$3,988	\$1,769	\$9,093	
(Gain) loss on disposition of assets	(1,173	) (814	) 2,323	(935	)
Adjustments to prior provisions for qualified exit costs	212	(88	) 340	(35	)
Total	\$485	\$3,086	\$4,432	\$8,123	

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 (income) - net

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

(Thousands of dollars)	Three Months Ended		Six Months Ended		
	June 30, 2013	2012	June 30, 2013	2012	
Dividend and royalty income	\$(813	) \$(851	) \$(3,637	) \$(2,101	)
Net expense from financing activities	2,845	1,041	4,743	4,021	
Foreign currency transaction related losses (gains)	3,196	1,374	5,944	(3,704	)
Other income	(7,107	) (5,229	) (14,419	) (8,480	)
Other expense	2,594	3,561	5,363	5,173	
Total	\$715	\$(104	) \$(2,006	) \$(5,091	)

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

Foreign currency transaction related losses (gains) represent net realized losses (gains) on U.S. dollar-denominated liabilities of foreign subsidiaries and net realized and unrealized losses (gains) from foreign currency option and forward contracts. There were no foreign currency option and forward contracts outstanding at June 30, 2013 and

2012.

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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 32.5 percent and 32.0 percent for the second quarter and first six months of 2013, respectively, compared to 30.5 percent and 30.2 percent for the second quarter and first six months of 2012, respectively. The increase in the effective tax rate for the second quarter and first six months of 2013 compared to 2012 was primarily due to the impact of additional state income tax expense as well as a reduction in tax benefits related to federal income tax credits.

At December 31, 2012, the Company had \$28.1 million in unrecognized tax benefits, the recognition of which would have an effect of \$25.0 million on the current provision for income taxes. Included in the balance of unrecognized tax benefits at December 31, 2012, was \$7.0 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 federal audits of partnership investments, assessed state income tax audits, state settlement negotiations currently in progress and expiring statutes in federal and foreign jurisdictions.

The Company classifies all income tax related interest and penalties as income tax expense. At December 31, 2012, the Company had accrued \$6.2 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, 2012 during the first six months of 2013.

On January 2, 2013, the American Taxpayer Relief Act (ATRA) was enacted which retroactively reinstated and extended the Federal Research and Development Tax Credit from January 1, 2012 to December 31, 2013. As a result, the Company recognized a \$2.0 million discrete tax benefit during the first quarter of 2013. The other provisions of the Act will have a negligible impact on the Company's effective tax rate in 2013.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. 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. Fieldwork was completed during the second quarter of 2013. At this time, the Company has determined that an insignificant payment is due for issues under review during this audit period. The Company has fully resolved all IRS issues for the 2003 through 2009 tax years relating to the matters challenging the ESOP related federal income tax deductions claimed by the Company. With the exception of \$2.0 million of interest related to the 2008 tax year, all ESOP related settlement payments have been made to the IRS.

As of June 30, 2013, the Company is subject to non-U.S. income tax examinations for the tax years of 2006 through 2012. In addition, the Company is subject to state and local income tax examinations for the tax years 2002 through 2012.

## NOTE 12—NET INCOME PER COMMON SHARE

(Thousands of dollars except per share data)	Three Months Ended		Six Months Ended	
	June 30,	2012	June 30,	2012
	2013		2013	
<b>Basic</b>				
Average common shares outstanding	101,665,737	101,446,643	101,813,398	101,758,496
Net income	\$257,287	\$227,813	\$373,472	\$328,029
Less net income allocated to unvested restricted shares	(1,639)	(1,908)	(2,278)	(2,689)
Net income allocated to common shares	\$255,648	\$225,905	\$371,194	\$325,340
Basic net income per common share	\$2.51	\$2.23	\$3.65	\$3.20
<b>Diluted</b>				
Average common shares outstanding	101,665,737	101,446,643	101,813,398	101,758,496
Stock options and other contingently issuable shares <sup>(1)</sup>	2,231,043	2,556,485	2,218,320	2,341,550
Average common shares outstanding assuming dilution	103,896,780	104,003,128	104,031,718	104,100,046
Net income	\$257,287	\$227,813	\$373,472	\$328,029
Less net income allocated to unvested restricted shares assuming dilution	(1,607)	(1,865)	(2,235)	(2,633)
Net income allocated to common shares assuming dilution	\$255,680	\$225,948	\$371,237	\$325,396
Diluted net income per common share	\$2.46	\$2.17	\$3.57	\$3.13

<sup>(1)</sup> There were no options excluded due to their anti-dilutive effect for the three and six months ended June 30, 2013 and 2012.

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. Accordingly, the shares are considered a participating security and the two-class method of calculating basic and diluted earnings per share is required. 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.

## NOTE 13—REPORTABLE SEGMENT INFORMATION

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

(Thousands of dollars)	Three Months Ended June 30, 2013					
	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	\$1,606,509	\$393,660	\$513,524	\$198,991	\$1,205	\$2,713,889
Intersegment transfers		658,202	3,740	9,691	(671,633)	
Total net sales and intersegment transfers	\$1,606,509	\$1,051,862	\$517,264	\$208,682	\$(670,428)	\$2,713,889
Segment profit	\$332,972	\$79,042	<sup>(1)</sup> \$54,462	\$856		\$467,332
Interest expense					\$(15,069)	(15,069)
Administrative expenses and other					(71,379)	(71,379)
Income before income taxes	\$332,972	\$79,042	\$54,462	\$856	\$(86,448)	\$380,884
	Three Months Ended June 30, 2012					
	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	\$1,488,109	\$397,749	\$498,693	\$187,281	\$1,190	\$2,573,022
Intersegment transfers		655,276	1,935	11,649	(668,860)	
Total net sales and intersegment transfers	\$1,488,109	\$1,053,025	\$500,628	\$198,930	\$(667,670)	\$2,573,022
Segment profit	\$266,982	\$80,757	<sup>(1)</sup> \$48,032	\$9,281		\$405,052
Interest expense					\$(10,230)	(10,230)
Administrative expenses and other					(67,019)	(67,019)
Income before income taxes	\$266,982	\$80,757	\$48,032	\$9,281	\$(77,249)	\$327,803

<sup>(1)</sup> Segment profit includes \$8,108 and \$7,968 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores Group during the second quarter of 2013 and 2012, respectively.

## Six Months Ended June 30, 2013

	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	\$2,774,446	\$702,240	\$1,000,342	\$401,627	\$2,402	\$4,881,057
Intersegment transfers		1,165,906	5,031	19,912	(1,190,849)	
Total net sales and intersegment transfers	\$2,774,446	\$1,868,146	\$1,005,373	\$421,539	\$(1,188,447)	\$4,881,057
Segment profit	\$462,685	\$133,014	<sup>(2)</sup> \$88,393	\$21,695		\$705,787
Interest expense					\$(30,380)	\$(30,380)
Administrative expenses and other					(126,139)	(126,139)
Income before income taxes	\$462,685	\$133,014	\$88,393	\$21,695	\$(156,519)	\$549,268

## Six Months Ended June 30, 2012

	Paint Stores Group	Consumer Group	Global Finishes Group	Latin America Coatings Group	Administrative	Consolidated Totals
Net external sales	\$2,611,187	\$718,122	\$981,768	\$395,874	\$2,415	\$4,709,366
Intersegment transfers		1,158,776	4,265	22,624	(1,185,665)	
Total net sales and intersegment transfers	\$2,611,187	\$1,876,898	\$986,033	\$418,498	\$(1,183,250)	\$4,709,366
Segment profit	\$379,694	\$136,063	<sup>(2)</sup> \$76,669	\$29,168		\$621,594
Interest expense					\$(20,567)	\$(20,567)
Administrative expenses and other					(130,909)	(130,909)
Income before income taxes	\$379,694	\$136,063	\$76,669	\$29,168	\$(151,476)	\$470,118

<sup>(2)</sup> Segment profit includes \$14,278 and \$14,644 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores Group during the first six months of 2013 and 2012, 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 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 \$531.6 million and \$5.6 million, respectively, for the second quarter of 2013, and \$491.9 million and \$32.5 million, respectively, for the second quarter of 2012. Net external sales and segment profit of these subsidiaries were \$1.048 billion and \$31.2 million, respectively, for the first six months of 2013, and \$993.8 million and \$67.3 million, respectively, for the first six months of 2012. Long-lived assets of these subsidiaries totaled \$765.9 million and \$637.7 million at June 30, 2013 and June 30, 2012, 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**

On November 9, 2012, the Company entered into a definitive Stock Purchase Agreement to purchase all of the issued and outstanding shares of Consorcio Comex, S.A. de C.V. (Comex) for an aggregate purchase price of approximately \$2.34 billion, including assumed debt. The Stock Purchase Agreement was amended on June 24, 2013 to extend the date by which the

agreement can be terminated by either party to August 31, 2013. Comex is a leader in the paint and coatings market in Mexico with headquarters in Mexico City. Completion of the transaction is subject to certain conditions and regulatory approvals. On July 17, 2013, the Federal Competition Commission of Mexico (FCCM) informed the Company that the acquisition was not authorized by the FCCM by a 3-2 vote of its members. The Company is preparing a response to address the Commission's concerns.

The completed acquisitions below have been accounted for as purchases and their results of operations have been included in the consolidated financial statements since the date of acquisition. Both acquisitions resulted in the recognition of goodwill and intangible assets.

Effective December 18, 2012, the Company acquired Jiangsu Pulanna Coating Co., Ltd. (Pulanna). Headquartered in Changzhou, China, Pulanna is a leading automotive refinishes coatings manufacturer in China. The acquisition strengthens the Global Finishes Group's established presence in China and its ability to serve automotive customers around the world.

Effective June 1, 2012, the Company acquired Geocel Holdings Corporation. Geocel manufactures innovative caulks, sealants, and adhesives specially designed for tough construction and repair applications in commercial, residential, industrial and transport non-automotive markets. Geocel has operations in both the United States and United Kingdom. The acquisition strengthens the Consumer Group's sealant and adhesive market position.

The following unaudited pro-forma summary presents consolidated financial information as if Pulanna and Geocel 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, 2012 or of future results of operations of Pulanna and Geocel under ownership and operation of the Company.

(Thousands of dollars except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Net sales	\$2,713,889	\$2,597,205	\$4,881,057	\$4,754,057
Net income	257,287	231,181	373,472	334,407
Net income per common share:				
Basic	\$2.51	\$2.26	\$3.65	\$3.26
Diluted	\$2.46	\$2.20	\$3.57	\$3.19

#### 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 second quarter. The following table presents the Company's financial assets and liabilities that are measured at fair value on a recurring basis, categorized using the fair value hierarchy:

(Thousands of dollars)

	Fair Value at June 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Deferred compensation plan asset <sup>(1)</sup>	\$20,770	\$6,349	\$14,421	
Liabilities:				
Deferred compensation plan liability <sup>(2)</sup>	\$24,785	\$24,785		

(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 \$20,399.

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

#### NOTE 16—DEBT

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 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. The Company's publicly traded debt and non-traded debt are classified as level 1 and level 2, respectively, in the fair value hierarchy.

(Thousands of dollars)	June 30, 2013		June 30, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Publicly traded debt	\$1,630,197	\$1,637,505	\$632,448	\$694,626
Non-traded debt	4,386	4,245	7,387	7,120

On March 18, 2013, Sherwin-Williams Canada, Inc., a wholly owned subsidiary of the Company, increased the aggregate amount of its existing credit facility to CAD 150 million. The credit facility is being used for general corporate purposes, including refinancing indebtedness and for acquisitions.

#### 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 \$236.5 million and \$250.5 million at June 30, 2013 and 2012, respectively. The liability for estimated future capital contributions to the investments was \$205.8 million and \$233.7 million at June 30, 2013 and 2012, respectively.

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 four reportable segments—Paint Stores Group, Consumer Group, Global Finishes Group and Latin America Coatings Group (collectively, the "Reportable 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 15 and Note 18, on pages 74 through 76, in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 for more information concerning the Reportable Segments.

The Company's financial condition, liquidity and cash flow continued to be strong in the second quarter of 2013 primarily due to higher paint sales volume in our Paint Stores Group. Net working capital increased \$1.283 billion at June 30, 2013 compared to the end of the second quarter of 2012 due to an increase in cash and cash equivalents and a decrease in short-term borrowings, which was primarily due to the \$700.0 million of 1.35% Senior Notes due 2017 and \$300.0 million of 4.00% Senior Notes due 2042 issued on December 4, 2012. The Company has been able to arrange sufficient short-term borrowing capacity at reasonable rates, and the Company has sufficient total available borrowing capacity to fund its current operating needs. Net operating cash improved \$100.0 million in the first six months of 2013 to a cash source of \$302.1 million from a cash source of \$202.1 million in 2012 primarily due to an increase in net income of \$45.4 million, improved working capital management, and a payment to the IRS for the 2011 ESOP settlement of \$59.1 million in the first quarter of 2012 partially offset by a payment to the ESOP for the 2012 DOL settlement of \$80.0 million in the first quarter of 2013.

Consolidated net sales increased 5.5 percent in the second quarter of 2013 to \$2.714 billion from \$2.573 billion in the second quarter of 2012, and increased 3.6 percent in the first six months of 2013 to \$4.881 billion from \$4.709 billion in the first six months of 2012 due primarily to higher paint sales volume in our Paint Stores Group. Consolidated gross profit as a percent of consolidated net sales increased in the second quarter to 45.5 percent from 44.7 percent in 2012 and increased to 45.0 percent from 43.8 percent in the first six months due primarily to increased paint volume, improved operating efficiency and selling price increases. Selling, general and administrative expenses (SG&A) decreased as a percent of consolidated net sales to 30.8 percent from 31.5 percent in the second quarter of 2012 and decreased to 33.1 percent from 33.3 percent in the first six months due primarily to increased sales partially offset by new store openings and acquisitions. Interest expense increased \$4.8 million in the second quarter and \$9.8 million in the first six months of 2013 due to increased long-term debt balances. The effective income tax rate for the second quarter of 2013 was 32.5 percent compared to 30.5 percent in 2012, and the rate for the first six months of 2013 was 32.0 percent compared to 30.2 percent in 2012. Diluted net income per common share increased to \$2.46 per share for the second quarter of 2013 from \$2.17 per share a year ago and increased to \$3.57 per share from \$3.13 per share in the first six months.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation and fair presentation of the consolidated unaudited interim financial statements and accompanying notes included in this report are the responsibility of management. The financial statements and footnotes have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and contain certain amounts that were based upon management's best estimates, judgments and assumptions that were believed to be reasonable under the circumstances. Management considered the impact of the 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 48 through 51, in the Company's Annual

Report on Form 10-K for the year ended December 31, 2012. There have been no significant changes in critical accounting policies, management estimates or accounting policies followed since the year ended December 31, 2012. FINANCIAL CONDITION, LIQUIDITY AND CASH FLOW

#### Overview

The Company's financial condition, liquidity and cash flow continued to be strong through the first six months of 2013 primarily due to improving domestic architectural paint demand. Net working capital increased \$1.283 billion at June 30, 2013 compared to the end of the second quarter of 2012 due to an increase in cash and cash equivalents and a decrease in short-term borrowings. Cash and cash equivalents increased \$694.5 million, accounts receivable increased \$61.8 million, inventories decreased \$46.6 million and all other current assets increased \$8.8 million. Short-term borrowings decreased \$554.3 million while accounts payable increased \$15.3 million and all other current liabilities decreased \$25.3 million from June 30, 2012. Net working capital increases were impacted primarily by cash proceeds of long-term debt acquired during the fourth quarter of 2012, increased sales, and decreased short-term borrowing needs. The Company continues to maintain sufficient short-term borrowing capacity at reasonable rates, and the Company has sufficient cash on hand and total available borrowing capacity to fund its current operating needs. In the first six months of 2013, accounts receivable and inventories increased \$331.7 million when normal seasonal trends typically require significant growth in these categories. Accounts payable increased \$194.5 million, primarily due to the seasonal increase in need for working capital, while short-term borrowings decreased \$18.4 million and all other current liabilities decreased \$85.0 million, primarily due to a payment to the ESOP for the 2012 DOL settlement of \$80.0 million and timing of accrued expense payments. The Company's current ratio was 1.70 at June 30, 2013 compared to 1.04 at June 30, 2012 and 1.68 at December 31, 2012. Total debt at June 30, 2013 increased \$440.4 million to \$1.685 billion from \$1.245 billion at June 30, 2012 and increased as a percentage of total capitalization to 47.4 percent from 44.7 percent at the end of the second quarter last year. Total debt decreased \$19.6 million from December 31, 2012 and decreased as a percentage of total capitalization from 48.8 percent. At June 30, 2013, the Company had remaining borrowing ability of \$2.277 billion. Net operating cash improved \$100.0 million in the first six months of 2013 to a cash source of \$302.1 million from a cash source of \$202.1 million in 2012. In the twelve month period from July 1, 2012 through June 30, 2013, the Company generated net operating cash of \$987.8 million, including a payment to the ESOP for the 2012 DOL settlement of \$80.0 million in the first quarter of 2013, used \$379.7 million in investing activities, and generated \$85.8 million in financing activities. In that same period, the Company invested \$159.3 million in capital additions and improvements, invested \$60.2 million in acquisitions, had net proceeds from total debt of \$432.6 million, purchased \$427.7 million in treasury stock and paid \$183.8 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 \$121.5 million during the first six months of 2013. Cash and cash equivalents on hand funded cash requirements for increased sales and normal seasonal increases in working capital, capital expenditures of \$72.1 million, payments of cash dividends of \$103.3 million, treasury stock purchases of \$232.5 million, and net payments made on long-term debt of \$0.9 million. At June 30, 2013, the Company's current ratio was 1.70 compared to 1.68 at December 31, 2012 and 1.04 a year ago. The increase from a year ago was primarily due to a significant increase in cash and cash equivalents resulting from proceeds received from issuance of long-term debt during the fourth quarter of 2012 and a decrease in short-term borrowings.

Goodwill and intangible assets decreased \$20.1 million from December 31, 2012 and increased \$46.3 million from June 30, 2012. The net decrease during the first six months of 2013 was due primarily to amortization of \$14.1 million. The net increase over the twelve month period from June 30, 2012 resulted from acquisitions of \$64.0 million, capitalization of software of \$4.7 million and foreign currency translation of \$9.8 million partially offset by amortization of \$28.1 million and impairments of \$4.1 million. See Note 4, on pages 52 to 53, in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 for more information concerning goodwill and intangible assets.

Deferred pension assets increased \$1.1 million during the first six months of 2013 and increased \$18.4 million from June 30, 2012. The increase in the last twelve months was due primarily to increases in the fair market value of equity securities held by the Company's defined benefit pension plans. See Note 6, on pages 56 to 62, in the Company's

Annual Report on Form 10-K for the year ended December 31, 2012 for more information concerning the Company's benefit plan assets.

Other assets at June 30, 2013 increased \$13.3 million in the first six months of 2013, due primarily to increased investments in affordable housing and historic renovation real estate properties along with increases in various other investments, and decreased \$14.8 million from a year ago due primarily to decreases in investments in affordable housing and historic renovation real estate properties.



Net property, plant and equipment decreased \$13.7 million in the first six months of 2013 and increased \$13.8 million in the twelve months since June 30, 2012. The decrease in the first six months was primarily due to depreciation expense of \$78.3 million, sale or disposition of fixed assets of \$1.4 million and changes in currency translation rates of \$7.5 million partially offset by capital expenditures of \$72.1 million. Since June 30, 2012, capital expenditures of \$159.3 million, acquisitions of \$7.7 million and changes in currency translation rates of \$7.4 million were partially offset by depreciation expense of \$155.0 million and dispositions or sale of assets with remaining net book value of \$5.5 million. Capital expenditures during the first six months of 2013 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.

There were no borrowings under the Company's domestic commercial paper program outstanding nor certain other short-term revolving and letter of credit agreements at June 30, 2013. Short-term borrowings outstanding under various foreign programs at June 30, 2013 were \$50.7 million with a weighted average interest rate of 2.6 percent. The Company had unused capacity of \$1.050 billion at June 30, 2013 under the commercial paper program that is backed by the Company's revolving credit agreement. On March 18, 2013, Sherwin-Williams Canada, Inc., a wholly owned subsidiary of the Company, increased the aggregate amount of its existing credit facility to CAD 150 million. The credit facility is being used for general corporate purposes, including refinancing indebtedness and for acquisitions. There were no significant changes in long-term debt during the second quarter of 2013. See Note 7, on pages 62 through 63, in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 for more information concerning the Company's debt.

Long-term liabilities for postretirement benefits other than pensions did not change significantly from December 31, 2012 and increased \$21.4 million from June 30, 2012. The increase in the liability was due to the increase in the actuarially determined postretirement benefit obligation resulting from changes in actuarial assumptions and unfavorable claims experience. See Note 6, on pages 56 to 62, in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 for more information concerning the Company's benefit plan obligations.

Other long-term liabilities at June 30, 2013 increased \$7.2 million in the first six months of 2013 and increased \$0.4 million from a year ago primarily due to acquisitions.

#### 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 six months of 2013. 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 2013.

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

The Company accrues for estimated costs of investigation and remediation activities at its currently and formerly owned sites and third party sites for which commitments or clean-up plans have been developed and when such costs can be reasonably estimated based on industry standards and professional judgment. These estimated costs are based

on currently available facts regarding each site. The Company accrues a specific estimated amount when such an amount and a time frame in which the costs will be incurred can be reasonably determined. If the best estimate of costs can only be identified as a range and no specific amount within that range can be determined more likely than any other amount within the range, the minimum of the range is accrued by the Company in accordance with applicable accounting rules and interpretations. The Company continuously assesses its potential liability for investigation and remediation activities and adjusts its environmental-related

accruals as information becomes available upon which more accurate costs can be reasonably estimated. At June 30, 2013 and 2012, the Company had accruals for environmental-related activities of \$110.9 million and \$126.8 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 \$85.6 million higher than the accruals at June 30, 2013.

Two 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 June 30, 2013. At June 30, 2013, \$58.5 million, or 52.8 percent, related directly to these two sites. Of the aggregate unaccrued exposure at June 30, 2013, \$56.6 million, or 66.1 percent, related to the two 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 two 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, 2012. There have been no significant changes in the investigative or remedial status of the two sites since December 31, 2012.

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

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 decreased \$18.4 million to \$50.7 million at June 30, 2013 from \$69.0 million at December 31, 2012. Total long-term debt decreased \$1.3 million to \$1.635 billion at June 30, 2013 from \$1.636 billion at December 31, 2012 and increased \$994.7 million from \$639.8 million at June 30, 2012. 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 second quarter or the first six months of 2013 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, 2012.

Changes to the Company's accrual for product warranty claims in the first six months of 2013 are disclosed in Note 5.

### Contingent Liabilities

Life Shield Engineered Systems, LLC (Life Shield), a wholly-owned subsidiary of the Company, ceased operations in 2012. Life Shield developed and manufactured 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 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, but not limited to, litigation relating to product liability and warranty, personal injury, environmental, intellectual property, commercial, contractual and antitrust claims that are inherently subject to many uncertainties regarding the possibility of a loss to the Company. These uncertainties will ultimately be resolved when one or more future events occur or fail to occur confirming the incurrence of a liability or the reduction of a liability. In accordance with the Contingencies Topic of the ASC, the Company accrues for these contingencies by a charge to income when it is both probable that one or more future events will occur confirming the fact of a loss and the amount of the loss can be reasonably estimated. In the event that the Company's loss contingency is ultimately determined to be significantly higher than currently accrued, the recording of the additional liability may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such additional liability is accrued. In those cases where no accrual is recorded because it is not probable that a liability has been incurred and the amount of any such loss cannot be reasonably estimated, any potential liability ultimately determined to be attributable to the Company may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued. In those cases where no accrual is recorded or exposure to loss exists in excess of the amount accrued, the Contingencies Topic of the ASC requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred.

Lead pigment and lead-based paint litigation. The Company's past operations included the manufacture and sale of lead pigments and lead-based paints. The Company, along with other companies, is and has been a defendant in a number of legal proceedings, including individual personal injury actions, purported class actions, and actions brought

by various counties, cities, school districts and other government-related entities, arising from the manufacture and sale of lead pigments and lead-based paints. The plaintiffs' claims have been based upon various legal theories, including negligence, strict liability, breach of warranty, negligent misrepresentations and omissions, fraudulent misrepresentations and omissions, concert of action, civil conspiracy, violations of unfair trade practice and consumer protection laws, enterprise liability, market share liability, public nuisance, unjust enrichment and other theories. The plaintiffs seek various damages and relief, including personal injury and property damage, costs relating to the detection and abatement of lead-based paint from buildings, costs associated with a public education campaign, medical monitoring costs and others. The Company 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 City of Chicago, Illinois, the City of Milwaukee, Wisconsin and the County of Santa Clara, California and other public entities in the State of California. Except for the Santa Clara County, California proceeding, all of these legal proceedings have been concluded in favor of the Company and other defendants at various stages in the proceedings.

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

The Santa Clara County, California proceeding was initiated in March 2000 in the Superior Court of the State of California, County of Santa Clara. In the original complaint, the plaintiffs asserted various claims including fraud and concealment, strict product liability/failure to warn, strict product liability/design defect, negligence, negligent breach of a special duty, public nuisance, private nuisance, and violations of California's Business and Professions Code. A number of the asserted claims were resolved in favor of the defendants through pre-trial proceedings. The named plaintiffs in the Fourth Amended Complaint, filed on March 16, 2011, are the Counties of Santa Clara, Alameda, Los

Angeles, Monterey, San Mateo, Solano and Ventura, 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. A trial commenced on July 15, 2013.

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 included strict liability, negligence, negligent misrepresentation and omissions, fraudulent misrepresentation and omissions, concert of action, civil conspiracy and enterprise liability. Implicit within these claims is the theory of “risk contribution” liability (Wisconsin’s theory which is similar to market share liability) due to the plaintiff’s inability to identify the manufacturer of any product that allegedly injured the plaintiff. The case ultimately proceeded to trial and, on November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain damaged or injured as a result. The plaintiff appealed and, on December 16, 2010, the Wisconsin Court of Appeals affirmed the final judgment in favor of the Company and other defendants.

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

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

Department of Labor (DOL) leveraged ESOP settlement. As previously disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012, on February 20, 2013, the Company reached a settlement with the DOL of the DOL’s investigation of transactions related to the Company’s ESOP that were implemented on August 1, 2006 and August 27, 2003. The DOL had notified the Company, among others, of potential enforcement claims asserting breaches of fiduciary obligations and sought compensatory and equitable remedies. The Company resolved all ESOP related claims with the DOL by agreeing, in part, to make a one-time payment of \$80.0 million to the ESOP, resulting in a \$49.2 million after tax charge to earnings in the fourth quarter of 2012. The Company made this required \$80.0 million payment to the ESOP during the first quarter of 2013.

Import duty assessment settlement. During the second quarter of 2013, the Company recorded a charge of \$11.8 million to Cost of goods sold due to an assessment as a result of audits brought by the Brazilian government related to the handling of import duties on products brought into the country for the years 2006 through 2008, resulting in an

after-tax charge of \$8.4 million. The Company elected to accept a voluntary amnesty program offered by the government to resolve this issue rather than incur significant legal expenses to contest the assessment in court. The Company's import duty processes were changed beginning in 2009, however, years subsequent to 2008 remain open to audit. No additional accruals for potential assessments have been recorded.

### Shareholders' Equity

Shareholders' equity increased \$75.7 million to \$1.868 billion at June 30, 2013 from \$1.792 billion at December 31, 2012 and increased \$328.3 million from \$1.539 billion at June 30, 2012. The increase in Shareholders' equity for the first six months of 2013 resulted primarily from net income of \$373.5 million and an increase in Other capital of \$99.3 million, resulting primarily from stock option exercises, partially offset by purchases of treasury stock of \$232.5 million, cash dividends paid on common stock of \$103.3 million, and an increase in Cumulative other comprehensive loss of \$42.6 million. Since June 30, 2012, net income of \$676.5 million and an increase in Other capital of \$343.9 million more than offset purchases of treasury stock for \$427.7 million, cash dividends paid on common stock of \$183.8 million and an increase in Cumulative other comprehensive loss of \$63.7 million in twelve months. During the first six months of 2013, the Company purchased 1.30 million shares of its common stock for treasury purposes through open market purchases. The Company purchased 2.60 million shares of its common stock since June 30, 2012 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 June 30, 2013 to purchase 15.15 million shares of its common stock. At a meeting held on February 13, 2013, the Board of Directors increased the quarterly cash dividend from \$.39 per common share to \$.50 per common share. This quarterly dividend will result in an annual dividend for 2013 of \$2.00 per common share or a 33.2 percent payout of 2012 diluted net income per common share.

### Cash Flow

Net operating cash improved \$100.0 million in the first six months of 2013 to a cash source of \$302.1 million from a cash source of \$202.1 million in 2012 primarily due to an increase in net income of \$45.4 million, improved working capital management, and a payment to the IRS for the 2011 ESOP settlement of \$59.1 million in the first quarter of 2012 partially offset by a payment to the ESOP for the 2012 DOL settlement of \$80.0 million in the first quarter of 2013. Net investing cash usage increased \$37.3 million in the first six months of 2013 to a usage of \$127.4 million from a usage of \$90.1 million in 2012 primarily due to increased cash used in other investments. Net financing cash decreased \$200.8 million to a usage of \$296.8 million in the first six months of 2013 from a usage of \$95.9 million in 2012 primarily due to net decreases in short-term borrowings of \$277.6 million and decreased proceeds from stock options exercised of \$47.6 million in the first six months of 2013 partially offset by decreases in treasury stock purchases of \$130.1 million. In the twelve month period from July 1, 2012 through June 30, 2013, the Company generated net operating cash of \$987.8 million, including a payment to the ESOP for the 2012 DOL settlement of \$80.0 million in the first quarter of 2013, used \$379.7 million in investing activities, and generated \$85.8 million in financing activities. In that same period, the Company invested \$159.3 million in capital additions and improvements, invested \$60.2 million in acquisitions, made net payments on total debt of \$432.6 million, purchased \$427.7 million in treasury stock and paid \$183.8 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 six months of 2013, 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 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 for that facility 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 twelve month period ended on the same date. Refer to the "Results of Operations" caption below for a reconciliation of EBITDA to Net income. At

June 30, 2013, 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 7, on page 62 and 63, in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 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 second quarter and first six months:

(Thousands of dollars)	Three Months Ended			Six Months Ended				
	June 30, 2013	2012	Change	June 30, 2013	2012	Change		
Net Sales:								
Paint Stores Group	\$ 1,606,509	\$ 1,488,109	8.0	% \$ 2,774,446	\$ 2,611,187	6.3	%	
Consumer Group	393,660	397,749	-1.0	% 702,240	718,122	-2.2	%	
Global Finishes Group	513,524	498,693	3.0	% 1,000,342	981,768	1.9	%	
Latin America Coatings Group	198,991	187,281	6.3	% 401,627	395,874	1.5	%	
Administrative	1,205	1,190	1.3	% 2,402	2,415	-0.5	%	
Total	\$ 2,713,889	\$ 2,573,022	5.5	% \$ 4,881,057	\$ 4,709,366	3.6	%	

(Thousands of dollars)	Three Months Ended			Six Months Ended				
	June 30, 2013	2012	Change	June 30, 2013	2012	Change		
Income Before Income Taxes:								
Paint Stores Group	\$ 332,972	\$ 266,982	24.7	% \$ 462,685	\$ 379,694	21.9	%	
Consumer Group	79,042	80,757	-2.1	% 133,014	136,063	-2.2	%	
Global Finishes Group	54,462	48,032	13.4	% 88,393	76,669	15.3	%	
Latin America Coatings Group	856	9,281	-90.8	% 21,695	29,168	-25.6	%	
Administrative	(86,448 )	(77,249 )	-11.9	% (156,519 )	(151,476 )	-3.3	%	
Total	\$ 380,884	\$ 327,803	16.2	% \$ 549,268	\$ 470,118	16.8	%	

Consolidated net sales increased in the second quarter and first six months of 2013 due primarily to higher paint sales volume in our Paint Stores Group.

Net sales of all consolidated foreign subsidiaries were up 8.1 percent to \$531.6 million in the quarter and up 5.5 percent to \$1.048 billion in the first six months versus \$491.9 million and \$993.8 million in the same periods last year. The increase in net sales for all consolidated foreign subsidiaries in the quarter was due primarily to acquisitions, which increased net sales 3.8 percent in the quarter, and selling price increases partially offset by a 1.2 percent negative impact of foreign currency translation rate changes. The increase in the first six months was due primarily to acquisitions, which increased net sales 4.0 percent in the first six months, and selling price increases partially offset by a 2.5 percent negative impact of foreign currency translation rate changes. Net sales of all operations other than consolidated foreign subsidiaries were up 4.9 percent to \$2.182 billion in the quarter and up 3.1 percent to \$3.833 billion in the first six months as compared to \$2.081 billion and \$3.716 billion in the same periods last year. Net sales in the Paint Stores Group increased in the second quarter and first six months due primarily to higher architectural paint sales volume. Net sales from stores open for more than twelve calendar months increased 7.0 percent in the quarter and increased 5.4 percent in the first six months compared to last year's comparable periods. Total paint sales volume percentage increases exceeded 10.0 percent for the quarter and first six months as compared to last year's comparable periods. Sales of non-paint products increased by 10.4 percent over last year's second quarter and increased by 8.2 percent over last year's first six months. A discussion of changes in volume versus pricing for sales of products other than paint is not pertinent due to the wide assortment of general merchandise sold. Net sales of the Consumer Group decreased in the second quarter and first six months, due primarily to lower volume sales to most of the Group's retail customers and the previously disclosed elimination of a portion of a paint program with a large retail customer partially offset by acquisitions. Net sales in the Global Finishes Group stated in U.S. dollars increased in the second quarter and first six months, due primarily to selling price increases and acquisitions. Acquisitions increased net sales in U.S. dollars by 1.2 percent and 1.1 percent for the second quarter and first six months, respectively, which offset the impact of unfavorable currency translation rate changes in the quarter and first six months. Net sales in the Latin America Coatings Group stated in U.S. dollars increased in the second quarter and first six months, which can primarily be attributed to selling price increases and higher paint sales volume partially offset

by unfavorable currency translation rate changes. Currency translation rate changes decreased net sales by 2.8 percent in the quarter and 4.8 percent in the first six 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, were essentially flat in the second quarter and first six months.

Consolidated gross profit increased \$83.0 million in the second quarter and increased \$136.0 million in the first six months of 2013 compared to the same periods in 2012. As a percent of sales, consolidated gross profit increased to 45.5 percent in the quarter from 44.7 percent in the second quarter of 2012 and improved to 45.0 percent in the first six months of 2013 from 43.8 percent last year. The percent to sales and dollar increases were primarily due to increased paint sales volume and selling price increases.

The Paint Stores Group's gross profit was higher than last year by \$83.0 million in the second quarter and was higher than last year by \$120.6 million in the first six months due to increased paint sales volume. The Paint Stores Group's gross profit margins were higher in the quarter and first six months compared to the same periods last year. The Consumer Group's gross profit decreased by \$0.4 million in the quarter and increased by \$2.5 million in the first six months and gross profit margins increased as a percent of sales for the second quarter and first six months compared to the same periods last year primarily due to improved operating efficiencies. The Global Finishes Group's gross profit increased \$8.6 million in the second quarter and increased \$22.3 million in the first six months compared to the same periods last year, when stated in U.S. dollars, due primarily to selling price increases, acquisitions and improved operating efficiencies partially offset by unfavorable currency translation rate changes. The Global Finishes Group's gross profit margins were up as a percent of sales in the quarter and first six months compared to last year primarily due to selling price increases and improved operating efficiencies. The Latin America Coatings Group's gross profit decreased by \$9.2 million in the second quarter and \$10.0 million in the first six months from the same periods in the prior year, when stated in U.S. dollars, primarily due to a government import duty assessment related to our Brazilian operations and unfavorable currency translation rate changes partially offset by selling price increases. Charges of \$11.8 million were recorded to cost of goods sold due to an assessment brought by the Brazilian government related to the handling of import duties on products brought into the country for the years 2006 through 2008. The Company elected to accept a voluntary amnesty program offered by the government to resolve this issue rather than incur significant legal expenses to contest it in the courts. The Latin America Coatings Group's gross profit margins were down as a percent of sales for the second quarter and first six months as compared to the same periods last year for these same reasons. The Administrative segment's gross profit increased by an insignificant amount in the second quarter and first six months compared to the same periods last year.

Selling, general and administrative expenses (SG&A) increased \$26.9 million in the second quarter and increased \$47.9 million in the first six months of 2013 versus last year due primarily to increased expenses to support higher sales levels and net new store openings. As a percent of sales, consolidated SG&A decreased to 30.8 percent in the quarter and decreased to 33.1 percent in the first six months from 31.5 percent in the second quarter and 33.3 percent in the first six months of 2012 due to higher sales levels and good expense control.

The Paint Stores Group's SG&A increased \$16.7 million in the second quarter and increased \$36.4 million in the first six months due primarily to net new store openings and general comparable store expenses to support higher sales levels. The Consumer Group's SG&A was up \$1.1 million in the quarter and increased \$5.1 million in the first six months compared to the same periods last year primarily due to acquisitions. The Global Finishes Group's SG&A decreased \$1.2 million in the quarter due to good expense control, and increased \$1.1 million in the first six months primarily due to acquisitions. The Latin America Coatings Group's SG&A increased \$3.4 million in the second quarter and increased \$0.3 million in the first six months primarily due to currency translation rate changes. The Administrative segment's SG&A increased by \$6.9 million in the second quarter and increased \$5.0 million in the first six months primarily due to acquisition due diligence efforts and information systems costs.

Other general expense—net decreased \$2.6 million in the second quarter and decreased by \$3.7 million in the first six months. The decrease in the quarter was primarily due to decreased provisions for environmental expenses in the Administrative segment. The decrease in the first six months was primarily due to decreased provisions for environmental expenses and a current period loss on disposal of assets versus prior period gain on disposal of assets both in the Administrative segment.

Other income—net decreased \$0.8 million in the second quarter and decreased \$3.1 million in the first six months primarily due to increased foreign currency losses partially offset by increased miscellaneous income both primarily

impacting the Global Finishes and Latin America Coatings Groups.

Consolidated income before income taxes increased \$53.1 million in the second quarter and increased \$79.2 million in the first six months of 2013 due to higher segment profits in Paint Stores and Global Finishes Groups partially offset by lower segment profits in the Consumer and Latin America Coatings Groups and increased expenses in the Administrative segment.

The effective income tax rate of 32.5 percent for the second quarter of 2013 was higher than the 30.5 percent effective income tax rate for the second quarter of 2012 due primarily to the timing of discrete items. The effective income tax rate of 32.0



percent for the first six months of 2013 was higher than the 30.2 percent effective income tax rate for the first six months of 2012 due primarily to the timing of discrete items.

Net income for the quarter increased \$29.5 million to \$257.3 million from \$227.8 million in the second quarter of 2012 and increased \$45.4 million to \$373.5 million from \$328.0 million in the first six months of 2012. Diluted net income per common share increased 13.4 percent from \$2.17 per share in the second quarter of 2012 to \$2.46 per share in the second quarter of 2013, including second quarter charges of \$.08 per share resulting from the government import duty assessment related to our Brazilian operations. Diluted net income per common share increased percent from \$3.13 in the first six months of 2012 to \$3.57 in the first six months of 2013, including second quarter charges of \$.08 per share resulting from the government import duty assessment related to our Brazilian operations.

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

(Thousands of dollars)	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Net income	\$257,287	\$227,813	\$373,472	\$328,029
Interest expense	15,069	10,230	30,380	20,567
Income taxes	123,597	99,990	175,796	142,089
Depreciation	39,409	37,623	78,301	75,507
Amortization	6,463	6,364	14,127	12,963
EBITDA	\$441,825	\$382,020	\$672,076	\$579,155

## 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 likely 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 planned acquisition of Comex and the recent acquisitions of Leighs Paints, Geocel and Jiangsu Pulanna, 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 government 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.

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.

**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, 2012.

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.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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.

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## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

A summary of the repurchase activity for the Company's second 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
April 1 - April 30				
Share repurchase program <sup>(1)</sup>				15,950,000
May 1 - May 31				
Share repurchase program <sup>(1)</sup>	750,000	\$ 189.71	750,000	15,200,000
Employee transactions <sup>(2)</sup>	289	183.23		NA
June 1 - June 30				
Share repurchase program <sup>(1)</sup>	50,000	\$ 176.06	50,000	15,150,000
Total				
Share repurchase program <sup>(1)</sup>	800,000	\$ 188.85	800,000	15,150,000
Employee transactions <sup>(2)</sup>	289	183.23		NA

All shares were purchased through the Company's publicly announced share repurchase program. The Company <sup>(1)</sup> had remaining authorization at June 30, 2013 to purchase 15,150,000 shares. There is no expiration date specified for the program. The Company intends to repurchase stock under the program in the future.

<sup>(2)</sup> All shares were delivered to satisfy the exercise price and/or tax withholding obligations by employees who exercised stock options or had shares of restricted stock vest.

Item 5. Other Information.

During the fiscal quarter ended June 30, 2013, 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 tax and tax compliance services and international tax compliance.

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Item 6. Exhibits.

- 10 Amendment No. 1 to Stock Purchase Agreement, dated June 24, 2013, by and among Avisep, S.A. de C.V., Sherwin-Williams (Caribbean) N.V. and the Company (filed herewith).
- 31(a) Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer (filed herewith).
- 31(b) Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer (filed herewith).
- 32(a) Section 1350 Certification of Chief Executive Officer (filed herewith).
- 32(b) Section 1350 Certification of Chief Financial Officer (filed herewith).
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

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Signatures

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

THE SHERWIN-WILLIAMS COMPANY

July 24, 2013

By:

/s/ Allen J. Mistysyn  
Allen J. Mistysyn  
Vice President-Corporate Controller

July 24, 2013

By:

/s/ Catherine M. Kilbane  
Catherine M. Kilbane  
Senior Vice President, General  
Counsel and Secretary

INDEX TO EXHIBITS

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