SHERWIN WILLIAMS CO
Form 10-Q
August 08, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q
(Mark One)

þ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the Period Ended June 30, 2005
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the transition period from__________ to __________
Commission file number 1-04851

THE SHERWIN-WILLIAMS COMPANY

(Exact name of registrant as specified in its charter)

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

(216) 566-2000

(Registrant s telephone number including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

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 138,827,667 shares as of June 30, 2005.

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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 June 30,		Six months ended June 30,	
	2005	2004	**2005**	2004
Net sales	**$1,965,358**	$1,617,955	**$3,503,903**	$2,937,476
Cost of goods sold	**1,127,192**	896,538	**2,004,963**	1,644,433
Gross profit	**838,166**	721,417	**1,498,940**	1,293,043
Percent to net sales	***42.6%***	*44.6%*	***42.8%***	*44.0%*
Selling, general and administrative expenses	**593,063**	514,403	**1,134,660**	998,949
Percent to net sales	***30.2%***	*31.8%*	***32.4%***	*34.0%*
Interest expense	**13,556**	9,365	**25,520**	18,752
Interest and net investment income	**(662)**	(1,231)	**(1,761)**	(2,541)
Other expense net	**12,641**	3,706	**13,310**	3,527
Income before income taxes and minority interest	**219,568**	195,174	**327,211**	274,356
Income taxes	**65,647**	68,311	**89,756**	96,025
Minority interest	**700**	425	**940**	425
Net income	**$ 153,221**	$ 126,438	**$ 236,515**	$ 177,906
Net income per share:				
Basic	**$ 1.12**	$ 0.89	**$ 1.71**	$ 1.26
Diluted	**$ 1.08**	$ 0.87	**$ 1.66**	$ 1.22

See notes to condensed consolidated financial statements.

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

	June 30, 2005	December 31, 2004	June 30, 2004
ASSETS			
Current assets:			
Cash and cash equivalents	**$ 12,520**	$ 45,932	$ 233,549
Accounts receivable, less allowance	**982,968**	724,385	775,292
Inventories:			
Finished goods	**747,361**	651,095	588,135
Work in process and raw materials	**116,883**	121,757	96,685
	864,244	772,852	684,820
Deferred income taxes	**89,409**	88,985	86,641
Other current assets	**141,119**	149,774	148,036
Total current assets	**2,090,260**	1,781,928	1,928,338
Goodwill	**913,064**	900,444	570,755
Intangible assets	**299,820**	307,900	179,687
Deferred pension assets	**431,363**	430,238	423,778
Other assets	**146,030**	133,281	152,865
Property, plant and equipment	**1,817,838**	1,751,628	1,639,323
Less allowances for depreciation	**1,084,147**	1,031,268	984,011
	733,691	720,360	655,312
Total assets	**$ 4,614,228**	$ 4,274,151	$ 3,910,735
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Short-term borrowings	**$ 403,212**	$ 238,815	
Accounts payable	**739,028**	650,977	$ 705,638
Compensation and taxes withheld	**167,193**	195,739	148,533
Accrued taxes	**122,467**	95,558	167,853
Current portion of long-term debt	**10,493**	11,214	11,288
Other accruals	**332,839**	327,834	313,161
Total current liabilities	**1,775,232**	1,520,137	1,346,473
Long-term debt	**487,598**	488,239	501,190
Postretirement benefits other than pensions	**224,746**	221,975	218,891
Other long-term liabilities	**411,650**	392,849	337,990
Minority interest	**4,645**	3,705	2,851

Shareholders equity:			
Common stock $1.00 par value:			
138,827,667, 140,777,115 and 142,362,519 shares outstanding at June 30, 2005, December 31, 2004 and June 30, 2004, respectively	**218,236**	216,396	214,729
Preferred stock convertible, participating, no par value:			
97,356, 171,819 and 235,985 shares outstanding at June 30, 2005, December 31, 2004 and June 30, 2004, respectively	**97,356**	171,819	235,985
Unearned ESOP compensation	**(97,356)**	(171,819)	(235,985)
Other capital	**517,158**	474,594	392,698
Retained earnings	**2,874,496**	2,695,193	2,527,876
Treasury stock, at cost	**(1,698,376)**	(1,529,355)	(1,394,206)
Cumulative other comprehensive loss	**(201,157)**	(209,582)	(237,757)
Total shareholders equity	**1,710,357**	1,647,246	1,503,340
Total liabilities and shareholders equity	**$ 4,614,228**	$ 4,274,151	$ 3,910,735

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, 2005	2004
OPERATING ACTIVITIES		
Net income	**$ 236,515**	$ 177,906
Adjustments to reconcile net income to net operating cash:		
Depreciation	**58,934**	50,874
Amortization of intangibles and other assets	**12,126**	6,531
Provisions for qualified exit costs		2,700
Provisions for environmental - related matters	**12,279**	2,000
Defined benefit pension plans net credit	**(2,403)**	(1,848)
Net increase in postretirement liability	**2,771**	2,038
Other	**3,920**	6,395
Change in working capital accounts net	**(235,015)**	(92,918)
Costs incurred for environmental - related matters	**(2,355)**	(4,251)
Costs incurred for qualified exit costs	**(149)**	(455)
Other	**12,225**	(4,844)
Net operating cash	**98,848**	144,128
INVESTING ACTIVITIES		
Capital expenditures	**(69,493)**	(52,982)
Acquisitions of businesses	**(26,455)**	(6,799)
Increase in other investments	**(15,877)**	(16,622)
Other	**2,372**	(7,967)
Net investing cash	**(109,453)**	(84,370)
FINANCING ACTIVITIES		
Net increase in short-term borrowings	**164,396**	
Payments of long-term debt	**(1,217)**	(375)
Payments of cash dividends	**(57,212)**	(48,884)
Proceeds from stock options exercised	**40,711**	48,286
Treasury stock purchased	**(165,253)**	(122,778)
Other	**(3,918)**	(7,301)
Net financing cash	**(22,493)**	(131,052)
Effect of exchange rate changes on cash	**(314)**	2,030
Net decrease in cash and cash equivalents	**(33,412)**	(69,264)

Cash and cash equivalents at beginning of year	**45,932**	302,813
Cash and cash equivalents at end of period	**$ 12,520**	$ 233,549
Income taxes paid	**$ 57,287**	$ 28,931
Interest paid	**25,394**	18,570

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, 2005 and 2004

Note A BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Form 10-K for the fiscal year ended December 31, 2004. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The consolidated results for the second quarter and six months ended June 30, 2005 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2005.

Minority interest reflects the minority shareholder s interest in the net income and equity of Sherwin-Williams Kinlita Co., Ltd (Kinlita).

Note B STOCK BASED COMPENSATION

At June 30, 2005, the Company had two stock-based compensation plans accounted for under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, as more fully described in Note 1 and Note 12 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2004. Pro-forma information regarding the impact of stock-based compensation on net income and earnings per share is required by Statement of Financial Accounting Standard (SFAS) No. 123, Accounting for Stock-Based Compensation. Such pro-forma information, determined as if the Company had accounted for its employee stock options under the fair value method of that Statement, is illustrated in the following table:

(Thousands of dollars except per share data)	Three months ended June 30,		Six months ended June 30,	
	2005	2004	**2005**	2004
Net income, as reported	**$153,221**	$126,438	**$236,515**	$177,906
Add: Total stock - based compensation expense included in the determination of net income as reported, net of related tax effects	**990**	1,416	**2,589**	3,932
Less: Total stock - based compensation expense determined under fair value based method for all awards, net of related tax effects	**(2,115)**	(3,832)	**(5,415)**	(7,068)
Pro forma net income	**$152,096**	$124,022	**$233,689**	$174,770
Net income per share:				
Basic as reported	$ 1.12	$ .89	$ 1.71	$ 1.26
Basic pro-forma	$ 1.11	$ .88	$ 1.69	$ 1.23
Diluted as reported	$ 1.08	$ .87	$ 1.66	$ 1.22
Diluted pro-forma	$ 1.07	$ .85	$ 1.64	$ 1.20

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Note C ACQUISITIONS

During the first quarter of 2005, the Company acquired substantially all of the assets and business of KST Coatings Manufacturing, Inc., KST Coatings LLC and Uniflex LLC (collectively, KST) for $23.1 million paid in cash. KST, included in the Consumer Segment, provides roof coatings and roof, deck and wall sealants to professional paint contractors and do-it-yourself users in the United States under the Kool Seal® and the Snow Roof Systems® brands. The acquisition was accounted for as a purchase, with results of operations included in the consolidated financial statements beginning with the month of January 2005. The KST acquisition resulted in the recognition of goodwill of $13.5 million and identifiable intangible assets of $2.8 million and was completed primarily to assist with the implementation of the Company s growth strategy of supplying high quality products and services to professional paint contractors and do-it-yourself users through various channels of distribution.

During the second quarter of 2004, the Company acquired a majority interest in Kinlita for $7.0 million paid in cash. Kinlita, included in the Automotive Finishes Segment, supplies coatings to original equipment truck and bus manufacturers in the Peoples Republic of China. The acquisition was accounted for as a purchase, with results of operations included in the consolidated financial statements beginning with the month of April 2004.

During the third quarter of 2004, the Company completed its acquisitions of 100% of the stock of Duron, Inc. (Duron) and Paint Sundry Brands Corporation (PSB) for an aggregate consideration of $640.0 million, and the assumption of certain financial obligations. Both acquisitions were financed through the use of cash, liquidated short-term investments and $350.0 million in proceeds from the sale of commercial paper under the Company s existing commercial paper program. Both acquisitions were accounted for as purchases, with results of operations included in the consolidated financial statements beginning with the month of September 2004.

The following unaudited pro-forma summary presents consolidated financial information as if KST, Kinlita, Duron and PSB had been acquired at 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, 2004 or of future results of operations of the combined companies under ownership and operation of the Company.

(Thousands of dollars except per share data)	Three months ended June 30,		Six months ended June 30,	
	2005	2004	**2005**	2004
Net sales	**$1,965,358**	$1,757,258	**$3,503,903**	$3,199,990
Net income	**153,221**	139,616	**236,515**	193,278
Net income per common share:				
Basic	**$ 1.12**	$ 0.99	**$ 1.71**	$ 1.36
Diluted	**$ 1.08**	$ 0.96	**$ 1.66**	$ 1.33

For further details on the Company s 2004 acquisitions, see Note 2 and Note 4 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

Note D DIVIDENDS

Dividends paid on common stock during each of the first two quarters of 2005 and 2004 were $.205 per common share and $.17 per common share, respectively.

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Note E OTHER EXPENSE NET

Items included in Other expense net are as follows:

(Thousands of dollars)	Three months ended June 30, 2005	2004	Six months ended June 30, 2005	2004
Dividend and royalty income	**$ (780)**	$ (616)	**$ (1,542)**	$(1,210)
Net expense from financing and investing activities	**327**	477	**1,847**	1,602
Foreign currency related losses	**621**	1,942	**871**	1,483
Provisions for environmental matters	**12,279**	2,000	**12,279**	2,000
Other income	**(1,062)**	(1,125)	**(2,126)**	(1,713)
Other expense	**1,256**	1,028	**1,981**	1,365

The net expense from financing and investing activities represents the realized gains or losses associated with the disposal of fixed assets, the net gain or loss relating to the change in the Company s investment in certain long-term asset funds and financing fees.

The provisions for environmental matters recorded during the three months ended June 30, 2005 were for clean-up plans at several of the Company s sites. See Note L for further details on the Company s environmental-related activities.

Other income and other expense include miscellaneous items that are not related to the primary business purpose of the Company.

Note F EXIT OR DISPOSAL ACTIVITIES

The Company recognizes liabilities associated with exit or disposal activities as incurred in accordance with SFAS No. 146, Accounting for Costs Asssociated with Exit or Disposal Activities. Qualifying exit costs primarily include post-closure rent expenses, incremental post-closure costs and costs of employee terminations. Adjustments may be made to prior provisions 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 SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, and, if impairment exists, the carrying value of the related assets is reduced to estimated fair value. Additional impairment may be recorded for subsequent revisions in estimated fair value. No significant revisions occurred during the first two quarters of 2005.

The following table summarizes the remaining liabilities associated with qualified exit costs at June 30, 2005 and the activity for the six month period then ended:

(Thousands of dollars) Exit Plan	Balance at December 31, 2004	Provisions in Cost of goods sold	Actual expenditures charged to accrual	Balance at June 30, 2005
Automotive Finishes distribution facility:				
Other qualified exit costs	$ 316		$ (265)	$ 51
Qualified exit costs initiated prior to 2003	13,819		116	13,935
Totals	$ 14,135	$	$ (149)	$ 13,986

For further details on the Company s exit or disposal activities, see Note 6 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

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Note G PRODUCT WARRANTIES

Changes in the Company s accrual for product warranty claims during the first six months of 2005 and 2004, including customer satisfaction settlements during the year, were as follows:

(Thousands of dollars)	**2005**	2004
Balance at January 1	**$18,098**	$ 16,555
Charges to expense	**11,032**	16,190
Settlements	**(9,833)**	(13,151)
Balance at June 30	**$19,297**	$ 19,594

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, 2004.

Note H COMPREHENSIVE INCOME

Comprehensive income is summarized as follows:

(Thousands of dollars)	Three months ended June 30,		Six months ended June 30,	
	2005	2004	**2005**	2004
Net income	**$153,221**	$126,438	**$236,515**	$177,906
Foreign currency translation adjustments	**13,745**	(7,659)	**8,434**	(8,489)
Marketable equity securities adjustments	**94**		**(9)**	
Comprehensive income	**$167,060**	$118,779	**$244,940**	$169,417

Note I INCOME PER COMMON SHARE

(Thousands of dollars except per share data)	Three months ended June 30, **2005**	Three months ended June 30, 2004	Six months ended June 30, **2005**	Six months ended June 30, 2004
Basic				
Average common shares outstanding	**137,263,048**	141,540,368	**137,972,218**	141,669,734
Net income	**$ 153,221**	$ 126,438	**$ 236,515**	$ 177,906
Net income per common share	**$ 1.12**	$ 0.89	**$ 1.71**	$ 1.26
Diluted				
Average common shares outstanding	**137,263,048**	141,540,368	**137,972,218**	141,669,734
Non-vested restricted stock grants	**926,342**	897,000	**1,014,438**	848,000
Stock options and other contingently issuable shares	**3,300,846**	3,467,524	**3,461,177**	3,032,905
Average common shares assuming dilution	**141,490,236**	145,904,892	**142,447,833**	145,550,639

Net income	**$**	**153,221**	$	126,438	**$**	**236,515**	$	177,906
Net income per common share	**$**	**1.08**	$	0.87	**$**	**1.66**	$	1.22

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Note J 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 SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information.

Net External Sales/Operating Profit

	2005		2004	
(Thousands of dollars)	**Net External Sales**	**Segment Operating Profit**	Net External Sales	Segment Operating Profit
Three months ended June 30:				
Paint Stores	**$1,310,771**	**$187,383**	$1,036,708	$143,814
Consumer	**415,884**	**65,025**	371,747	69,956
Automotive Finishes	**143,576**	**17,496**	131,468	16,256
International Coatings	**93,257**	**3,319**	76,122	1,271
Administrative	**1,870**	**(53,655)**	1,910	(36,123)
Consolidated totals	**$1,965,358**	**$219,568**	$1,617,955	$195,174
Six months ended June 30:				
Paint Stores	**$2,298,358**	**$265,627**	$1,840,423	$196,335
Consumer	**743,661**	**116,028**	688,949	119,139
Automotive Finishes	**273,490**	**32,479**	251,812	28,220
International Coatings	**184,672**	**7,286**	152,483	6,004
Administrative	**3,722**	**(94,209)**	3,809	(75,342)
Consolidated totals	**$3,503,903**	**$327,211**	$2,937,476	$274,356

Intersegment Transfers

	Three months ended June 30,		Six months ended June 30,	
(Thousands of dollars)	**2005**	2004	**2005**	2004
Paint Stores	**$ 218**	$ 169	**$ 392**	$ 333
Consumer	**433,747**	314,012	**706,674**	546,284
Automotive Finishes	**16,556**	13,406	**31,866**	26,597
International Coatings	**143**	104	**277**	788
Administrative	**1,445**	1,187	**2,646**	2,321
Segment totals	**$ 452,109**	$ 328,878	**$741,855**	$576,323

Segment operating profit is total revenue, including intersegment transfers, less operating costs and expenses. Domestic intersegment transfers are accounted for at the approximate fully absorbed manufactured cost plus distribution costs. International intersegment transfers are accounted for at values comparable to normal unaffiliated customer sales. The Administrative Segment s expenses include interest which is unrelated to certain financing activities of the Operating Segments, certain foreign currency transaction losses related to dollar-denominated debt and other financing activities, and other adjustments.

Net external sales and operating profits of all consolidated foreign subsidiaries were $184.0 million and $8.0 million, respectively, for the second quarter of 2005, and $155.2 million and $5.6 million, respectively, for the second quarter of 2004. Net external sales and operating profits of these subsidiaries were $352.0 million and $17.0 million, respectively, for the first six months of 2005, and $303.3 million and $13.2 million, respectively, for the first six months of 2004. Long-lived assets of these subsidiaries totaled $130.3 million and $120.3 million at June 30, 2005 and 2004, respectively. Domestic operations account for the remaining net external sales, operating profits and long-lived assets. The Administrative Segment s expenses do not include any significant foreign operations. No single geographic area outside the United States was significant relative to consolidated net external sales or consolidated long-lived assets.

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

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Note K HEALTH CARE, PENSION AND OTHER BENEFITS

Shown below are the components of the Company s net periodic benefit (credit) 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	
	2005	2004	**2005**	2004	**2005**	2004
Three months ended June 30:						
Net periodic benefit (credit) cost:						
Service cost	**$ 4,315**	$ 3,049	**$ 521**	$ 497	**$ 1,111**	$ 1,092
Interest cost	**3,407**	3,178	**597**	677	**4,345**	4,344
Expected return on assets	**(11,003)**	(9,726)	**(441)**	(530)		
Recognition of:						
Unrecognized prior service cost	**155**	197	**15**	34	**(1,112)**	(1,112)
Unrecognized actuarial loss	**782**	1,631	**265**	267	**1,265**	1,112
Net periodic benefit (credit) cost	**$ (2,344)**	$ (1,671)	**$ 957**	$ 945	**$ 5,609**	$ 5,436
Six months ended June 30:						
Net periodic benefit (credit) cost:						
Service cost	**$ 8,630**	$ 5,872	**$ 1,249**	$ 880	**$ 2,222**	$ 2,184
Interest cost	**6,814**	6,355	**1,424**	1,263	**8,690**	8,688
Expected return on assets	**(22,006)**	(19,451)	**(1,051)**	(1,011)		
Recognition of:						
Unrecognized prior service cost	**310**	394	**38**	50	**(2,224)**	(2,224)
Unrecognized actuarial loss	**1,564**	3,263	**625**	537	**2,530**	2,224
Net periodic benefit (credit) cost	**$ (4,688)**	$ (3,567)	**$ 2,285**	$ 1,719	**$11,218**	$10,872

For further details on the Company s health care, pension and other benefits, see Note 7 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

NOTE L 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 historical experience. 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. The unaccrued maximum of the estimated range of possible outcomes is $132.1 million higher than the accrued amount at June 30, 2005. 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, 2005 and 2004 were accruals for extended environmental-related activities of $126.5 million and $107.6 million, respectively. Estimated costs of current investigation and remediation activities of $24.9 million and $25.7 million are included in Other accruals at June 30, 2005 and 2004, respectively.

Four of the Company s current and former 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, 2005. Included in the accruals of $151.4 million at June 30, 2005 is $97.5 million related directly to these four sites. Of the aggregate unaccrued exposure of $132.1 million at June 30, 2005, $74.0 million relates to the four manufacturing sites. While environmental investigations and

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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 potential loss contingencies related to these four 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 governmental agency approval, as necessary, with respect to investigation and remediation activities, and the indefinite amount of time necessary to conduct remediation activities.

For further details on the Company s Other long-term liabilities, see Note 9 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

Note M IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R, Share-Based Payment, that addresses the accounting transactions in which a company exchanges its equity instruments for goods or services. It also addresses transactions in which a company incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments. SFAS No. 123R eliminates the ability to account for share-based compensation transactions using APBO No. 25 and requires instead that such transactions be accounted for using a fair-value-based method. SFAS No. 123R requires the tax benefit associated with these share based payments to be classified as financing activities in the statement of cash flows. In April 2005, the Securities and Exchange Commission adopted a rule that amends the compliance date of SFAS No. 123R to fiscal years beginning after June 15, 2005. The Company will adopt this statement as required, and management is currently assessing the effect SFAS No. 123R will have on the Company s results of operations, financial condition or liquidity.

In December 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, which requires that abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) be recognized as current-period charges. In addition, the statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company will adopt this statement as required, and management does not believe the adoption will have a material effect on the Company s results of operations, financial condition or liquidity.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The statement defines a nonmonetary exchange with commercial substance as one in which the future cash flows of an entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for fiscal years beginning after June 15, 2005. The Company will adopt this statement as required, and management does not believe the adoption will have a material effect on the Company s results of operations, financial condition or liquidity.

In December 2004, the FASB issued FSP FAS No. 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, for the Tax Deduction Provided to U.S. Based Manufacturers by the American Jobs Creation Act of 2004. This statement requires the qualified production activities deduction as defined in the American Jobs Creation Act of 2004 (the Jobs Act) to be accounted for as a special deduction in accordance with SFAS No. 109, Accounting for Income Taxes. The statement also requires that the special deduction should be considered in measuring deferred taxes when graduated tax rates are a significant factor and when assessing whether a valuation allowance is necessary. FSP FAS No. 109-1 was effective upon

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issuance. Management has determined that this statement will have a slightly favorable effect on the Company s 2005 annual effective tax rate.

In March 2005, the FASB issued Interpretation No. 47 (FIN 47), Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143. FIN 47 requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. FIN 47 states that a conditional asset retirement obligation is a legal obligation to perform an asset retirement activity in which the timing or method of settlement are conditional upon a future event that may or may not be within control of the entity. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. Retrospective application for the interim financial information is permitted but not required. Early adoption of FIN 47 is encouraged. The Company will adopt this statement as required, and management is currently assessing the effect FIN 47 will have on the Company s results of operations, financial condition or liquidity.

Note N INCOME TAXES

The effective tax rates were 29.9 percent and 27.4 percent for the second quarter and first six months of 2005, respectively, and 35.0 percent for both the second quarter and first six months of 2004. The reduction in the tax rate in 2005 was due to various favorable factors including the impact of the settlement of federal and state audit issues and tax benefits related to foreign operations.

Note O RECLASSIFICATION

Certain amounts in the 2004 financial statements have been reclassified to conform with the 2005 presentation.

Note P SUBSEQUENT EVENT

Effective July 20, 2005, the Company s five-year senior unsecured revolving credit agreement was amended to increase the aggregate maximum borrowing capacity to $910.0 million. There were no borrowings outstanding under the revolving credit agreement at June 30, 2005.

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

OVERVIEW

Consolidated net sales increased 21.5 percent to $1.97 billion in the second quarter of 2005 and 19.3 percent to $3.50 billion in the first six months of 2005 versus 2004. Diluted net income per common share increased 24.1 percent in the second quarter to $1.08 per share from $.87 per share in 2004 and 36.1 percent in the first six months of 2005 to $1.66 per share from $1.22 per share a year ago.

Consolidated net sales increased in both the quarter and first six months of 2005 due primarily to strong sales performances by stores open for more than twelve calendar months, acquisitions in the Paint Stores and Consumer Segments and improvement in the Automotive Finishes and International Coatings Segments. Acquisitions completed since the comparable periods of 2004, including Duron, Inc. and Paint Sundry Brands Corporation acquired in September 2004 added $144.1 million, or 8.9 percent, to net sales in the second quarter and $265.0 million, or 9.0 percent, to net sales in the first six months of 2005.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements and accompanying footnotes included in this report have been prepared in accordance with accounting principles generally accepted in the United States with certain amounts based on management s best estimates and judgments. To determine appropriate carrying values of assets and liabilities that are not readily available from other sources, management uses assumptions based on historical results and other factors that they believe are reasonable. Actual results could differ from those estimates. Also, materially different amounts may result under materially different conditions or from using materially different assumptions. However, management currently believes that any materially different amounts resulting from materially different conditions or material changes in facts or circumstances are unlikely.

There have been no significant changes in critical accounting policies or management estimates since the year ended December 31, 2004. Changes in the Company s accruals for environmental remediation-related activities since the year ended December 31, 2004 are disclosed in Note L. Changes in the Company s accruals for qualified exit or disposal costs since the year ended December 31, 2004 are disclosed in Note F. A comprehensive discussion of the Company s critical accounting policies and management estimates 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, 2004.

FINANCIAL CONDITION

Cash and cash equivalents decreased $33.4 million during the first six months of 2005 related primarily to treasury stock purchases of $165.3 million, cash dividends of $57.2 million and capital expenditures of $69.5 million, which were offset by net cash from operations and an

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increase in short-term borrowings of $164.4 million. Net cash from operations included cash proceeds of $13.0 million relating to the liquidation of umbrella insurance coverage with a group of insurance carriers for certain past product liability claims. A gain resulting from the receipt of such proceeds was primarily offset by an accrual for the minimum estimated loss contingency related to future settlement of such past claims. Short-term borrowings related to the Company s commercial paper program outstanding at June 30, 2005 were $385.5 million. The Company had unused maximum borrowing availability of $264.5 million at June 30, 2005 under the commercial paper program that is backed by the Company s revolving credit agreement. At June 30, 2005, the Company s current ratio was 1.18, a slight increase from 1.17 at December 31, 2004.

Since June 30, 2004, a cash balance of $233.5 million, cash generated by operations of $499.4 million and the net increase in short-term borrowings of $403.2 million were used primarily for acquisitions of businesses of $574.1 million, treasury stock purchases of $309.8 million and ongoing financing and investing activities.

Capital expenditures during the first six months of 2005 primarily represented expenditures associated with 28 new store openings and normal equipment replacement in the Paint Stores Segment and capacity and service improvements in the Consumer Segment.

During the second quarter of 2005, the Company purchased 1,000,100 shares of its common stock for treasury purposes through open market purchases, which brings the total number of shares purchased in 2005 to 3,700,100. The Company acquires shares of its common stock for general corporate purposes and, depending upon its cash position and market conditions, the Company may acquire additional shares of its common stock in the future. The Company had remaining authorization at June 30, 2005 to purchase 6,722,900 shares of its common stock.

Management believes that it properly valued the Company s assets and recorded all known liabilities that existed as of the balance sheet date for which a value was available or an amount could be reasonably estimated in accordance with all present accounting principles generally accepted in the United States. In addition, the Company may be subject to potential liabilities, as described in the following, which cannot be reasonably estimated due to the uncertainties involved.

The Company s past operations included the manufacture and sale of lead pigments and lead-based paints. The Company, along with other companies, is a defendant in a number of legal proceedings, including purported class actions, separate actions brought by the State of Rhode Island, and actions brought by various counties, cities, school districts and other government-related entities, arising from the manufacture and sale of lead pigments and lead-based paints. The plaintiffs are seeking recovery based upon various legal theories, including negligence, strict liability, breach of warranty, negligent misrepresentations and omissions, fraudulent misrepresentations and omissions, concert of action, civil conspiracy, violations of unfair trade practices and consumer protection laws, enterprise liability, market share liability, nuisance, unjust enrichment and other theories. The plaintiffs seek various damages and relief, including personal injury and property damage, costs relating to the detection and abatement of lead-based paint from buildings, costs associated with a public education campaign, medical monitoring costs and others. The Company is also a defendant in legal proceedings arising from the manufacture and sale of non-lead-based paints which seek recovery based upon various legal theories, including the failure to adequately warn of potential exposure to lead during surface preparation when using non-lead-based paint on surfaces previously painted with lead-based paint. The Company believes that the litigation is without merit and is vigorously defending such litigation. The Company expects that additional lead pigment and lead-based paint litigation may be filed against the Company in the future asserting similar or different legal theories and seeking similar or different types of damages and relief.

During September 2002, a jury trial commenced in the first phase of the action brought by the State of Rhode Island against the Company and the other defendants. The sole issue before the court in this first phase was whether lead pigment in paint constituted a public nuisance under Rhode Island law. This first phase did not consider the issues of liability or damages, if any, related to the public nuisance claim. In October 2002, the court declared a mistrial as the jury, which was split four to two in favor of the defendants, was unable to reach a unanimous decision. This was the first legal proceeding against the Company to go to trial relating to the Company s lead pigment and lead-based paint litigation. The State of Rhode Island has decided to retry the case and the new trial will decide all issues, including liability and damages. The trial is scheduled for September 2005. The Company believes it is possible that additional legal proceedings could be scheduled for trial in subsequent years in other jurisdictions.

Litigation is inherently subject to many uncertainties. 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 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 and to overturn 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 affect 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 any such legislation and regulations. The Company has not accrued any amounts for such litigation. Any potential liability that may result from such litigation or such legislation and regulations cannot reasonably be estimated. Based upon, among other things, the outcome of such litigation to date, management believes that the Company will ultimately be successful on the merits of such litigation. However, 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.

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 2005. 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 2005.

The Company is involved with environmental investigation and remediation activities at some of its current and former 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 current, former 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, 2005 and 2004, the Company had accruals for environmental-related activities of $151.4 million and $133.3 million, respectively.

Due to the uncertainties surrounding environmental investigation and remediation activities, the Company s 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 $132.1 million higher than the accruals at June 30, 2005.

Four of the Company s current and former manufacturing sites, described below, 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, 2005. Included in the accruals of $151.4 million at June 30, 2005 was $97.5 million related directly to these four sites. Of the aggregate unaccrued exposure of $132.1 million at June 30, 2005, $74.0 million related to the four manufacturing sites. While environmental investigations and remedial actions are in different stages at these sites, additional investigations, remedial actions and monitoring will likely be required at each site.

The first of the four sites is a former manufacturing facility in New Jersey that is in the early investigative stage of the environmental-related process. Although contamination exists at the site and adjacent areas, the extent and magnitude of the contamination has not yet been fully quantified. Due to the uncertainties of the scope and magnitude of contamination and the degree of remediation that may be necessary relating to this site, it is reasonably likely that further extensive investigation may be required and that extensive remedial actions may be necessary not only at the former manufacturing site but along an adjacent waterway. Depending on the extent of the additional investigation and remedial actions necessary, the ultimate liability for this site may exceed the amount currently accrued and the maximum of the range of reasonably possible outcomes currently estimated by management.

Two additional sites relate to a current manufacturing facility located in Illinois and a contiguous property. The environmental issues at these sites have been determined to be associated with historical operations of the Company. While the majority of the investigative work has been completed at these sites and some remedial actions taken, agreement on a proposed remedial action plan has not been obtained from the appropriate governmental agency.

The fourth site is a current manufacturing facility in California. Similar to the Illinois sites noted above, the environmental issues at this site have been determined to be associated with historical operations. The majority of the investigative activities have been completed at this site, some remedial actions have been taken and a proposed remedial action plan has been formulated but currently no clean up goals have been approved by the lead governmental agency. In both the Illinois and California sites, the potential liabilities relate to clean-up goals that have not yet been established and the degree of remedial actions that may be necessary to achieve these goals.

Management cannot presently estimate the potential loss contingencies related to these four 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 governmental agency approval, as necessary, with respect to investigation and remediation activities, and the indefinite amount of time necessary to conduct remediation activities.

There have been no significant changes to the Company s contractual obligations and commercial commitments in the first six months of 2005 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, 2004.

Changes to the Company s accrual for product warranty claims in the first six months of 2005 are disclosed in Note G.

RESULTS OF OPERATIONS

Shown below are net sales and the percentage change for the second quarter and first six months by reportable segment for 2005 and 2004:

(thousands of dollars)	**2005**	Change	2004
Three months ended June 30:			
Paint Stores	**$1,310,771**	26.4%	$1,036,708
Consumer	**415,884**	11.9%	371,747
Automotive Finishes	**143,576**	9.2%	131,468
International Coatings	**93,257**	22.5%	76,122
Administrative	**1,870**	-2.1%	1,910
	$1,965,358	21.5%	$1,617,955
Six months ended June 30:			
Paint Stores	**$2,298,358**	24.9%	$1,840,423
Consumer	**743,661**	7.9%	688,949
Automotive Finishes	**273,490**	8.6%	251,812
International Coatings	**184,672**	21.1%	152,483
Administrative	**3,722**	-2.3%	3,809
	$3,503,903	19.3%	$2,937,476

Consolidated net sales increased in both the quarter and first six months of 2005 due primarily to strong sales performances by stores open for more than twelve calendar months, acquisitions in the Paint Stores and Consumer Segments and improvement in the Automotive Finishes and International Coatings Segments. Acquisitions completed since the comparable periods of 2004, including Duron, Inc. and Paint Sundry Brands Corporation acquired in September 2004 added $144.1 million, or 8.9 percent, to net sales in the second quarter and $265.0 million, or 9.0 percent, to net sales in the first six months of 2005. In the Paint Stores Segment, the acquisition of Duron, Inc. added approximately 10.2% to this Segment s net sales in the quarter and 10.5% in the first half. Net sales from stores open for more than twelve calendar months increased 14.5% in the quarter and 12.7% in the first six months over last year. Net sales of the Consumer Segment increased in the quarter and the first six months compared to last year were due

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primarily to acquisitions completed since the comparable periods of 2004 that added approximately 9.7 percent to net sales in the quarter and approximately 9.6 percent to net sales in the first six months. In addition, sales increases associated with new product introductions, increased paint sales volume and selling price increases were more than offset by the elimination of a paint program with a customer and sluggish sales at some of the Segment s large retail customers.

The Automotive Finishes Segment s net sales in the second quarter and first six months increased due primarily to the impact of favorable currency exchange rates and selling price increases. The impact of favorable currency exchange rates increased net sales of this Segment by 3.1 percent in the quarter and 2.2 percent in the first half. The April 2004 acquisition of a majority interest in an automotive coatings company in China added 2.4 percent to net sales in the first half. In the International Coatings Segment, net sales increases in local currencies of 9.7 percent in the quarter and 11.7 percent in the first six months were enhanced by the impact of favorable currency exchange rates that further increased sales in U.S. dollars. The sales increases in local currencies were due primarily to volume gains in South America and selling price increases.

Shown below are operating profit and the percent change for the second quarter and first six months by reportable segment for 2005 and 2004:

(thousands of dollars)	**2005**	Change	2004
Three months ended June 30:			
Paint Stores	**$187,383**	30.3%	$143,814
Consumer	**65,025**	-7.0%	69,956
Automotive Finishes	**17,496**	7.6%	16,256
International Coatings	**3,319**	161.1%	1,271
Administrative	**(53,655)**	-48.5%	(36,123)
	$219,568	12.5%	$195,174
Six months ended June 30:			
Paint Stores	**$265,627**	35.3%	$196,335
Consumer	**116,028**	-2.6%	119,139
Automotive Finishes	**32,479**	15.1%	28,220
International Coatings	**7,286**	21.4%	6,004
Administrative	**(94,209)**	-25.0%	(75,342)
	$327,211	19.3%	$274,356

Consolidated operating profit increased due to the change in gross profit, which increased $116.7 million and $205.9 million in the second quarter and first six months of 2005, respectively. Consolidated gross profit as a percent to net sales declined to 42.6 percent in the quarter from 44.6 percent in the second quarter of 2004 and to 42.8 percent from 44.0 percent in the first half of 2004 due primarily to raw material cost increases partially offset by price increases and better factory utilization resulting from higher volume.

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The Paint Stores Segment s gross profit for the second quarter and first six months of 2005 increased $113.9 million and $198.7 million, respectively, due primarily to increased sales volume from strong domestic architectural paint sales and improved industrial maintenance and product finishes sales that partially offset increased raw material costs. The Consumer Segment s gross profit for the second quarter and six months of 2005 decreased due to significant raw material cost increases that were only partially offset by selling price increases and better factory utilization resulting from higher volume through the Paint Stores Segment. The Automotive Finishes Segment s gross profit percentage decreased slightly during the quarter and first six months of 2005 due to significant increases in raw material costs that could not be entirely offset by the favorable net sales gains. The International Coatings Segment s gross profit for the second quarter and first six months of 2005 increased by $4.9 million and $5.9 million, respectively, as a result of increased sales, favorable currency exchange rates and improved operating efficiencies related to additional manufacturing volume which were partially offset by significant cost increases of many raw materials.

Consolidated operating profit was also influenced by selling, general and administrative expenses, which as a percent of sales decreased to 30.2 percent in the second quarter of 2005 from 31.8 percent in the second quarter of 2004 and decreased to 32.4 percent in the first six months of 2005 from 34.0 percent in the six months of 2004. In the Paint Stores Segment, the SG&A ratio decreased in both the second quarter and first six months of 2005 due to increased sales volume and effective SG&A expense control. The Consumer Segment s SG&A ratio was favorable to last year in the second quarter and first six months of 2005 due primarily to continued tight expense control. The Automotive Finishes and International Coatings Segment s SG&A expense as a percent of sales decreased for both the second quarter and first six months of 2005 due to increased sales volumes and effective expense control.

The effective tax rates were 29.9 percent and 27.4 percent for the second quarter and first six months of 2005, respectively, and 35.0 percent for both the second quarter and first six months of 2004. The reduction in the tax rate in 2005 was due to various favorable factors including the impact of the settlement of federal and state audit issues and tax benefits related to foreign operations.

Net income increased $26.8 million, or 21.2 percent, in the second quarter of 2005 and increased $58.6 million, or 32.9 percent, for the first six months of 2005. The increase in diluted net income per common share of $.21 in the quarter resulted from approximately $.10 per share due to improved operating performance, $.06 per share due to acquisitions, $.08 per share due to a lower effective tax rate resulting primarily from favorable tax rulings and $.03 per share due to a reduction in the number of average diluted common shares outstanding partially offset by a reduction of $.06 per share due to provisions for environmental remediation-related activities. The increase in diluted net income per common share of $.44 in the first six months resulted from approximately $.19 per share due to improved operating performance, $.10 per share due to acquisitions, $.17 per share due to a lower effective tax rate resulting primarily from favorable tax rulings and $.04 per share due to a reduction in the number of average diluted common shares outstanding partially offset by the second quarter environmental charges of $.06 per share.

Management considers a measurement that is not in accordance with accounting principles generally accepted in the United States 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

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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 accounting principles generally accepted in the United States 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 June 30,		Six months ended June 30,	
	2005	2004	**2005**	2004
Net income	**$ 153,221**	$ 126,438	**$ 236,515**	$ 177,906
Interest expense	**13,556**	9,365	**25,520**	18,752
Income taxes	**65,647**	68,311	**89,756**	96,025
Depreciation	**29,367**	25,547	**58,934**	50,874
Amortization	**6,063**	3,326	**12,126**	6,531
EBITDA	**$ 267,854**	$ 232,987	**$ 422,851**	$ 350,088

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements contained in Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based upon management s current expectations, estimates, assumptions and beliefs concerning future events and conditions and may discuss, among other things, anticipated future performance (including sales and earnings), expected growth, future business plans and the costs and potential liability for environmental-related matters and the lead pigment and lead-based paint litigation. Any statement that is not historical in nature is a forward-looking statement and may be identified by the use of words and phrases such as expects, anticipates, believes, will, will l 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) general business conditions, strengths of retail and manufacturing economies and the growth in the coatings industry; (b) competitive factors, including pricing pressures and product innovation and quality; (c) changes in raw material availability and pricing; (d) changes in the Company s relationships with customers and suppliers; (e) the ability of the Company to attain cost savings from productivity initiatives; (f) the ability of the Company to successfully integrate past and future acquisitions into its existing operations, as well as the performance of the businesses acquired, including the acquisitions of Duron, Inc. and Paint Sundry Brands Corporation; (g) changes in general domestic economic conditions such as inflation rates, interest rates and tax rates; (h) risks and uncertainties associated with the Company s expansion into and its operations in China, South America and other foreign markets, including inflation rates, recessions, foreign currency exchange rates, foreign investment and repatriation restrictions, unrest and other external economic and political factors; (i) the achievement of growth in developing markets, such as China, Mexico and South America; (j) increasingly stringent domestic and foreign governmental regulations including those affecting the environment; (k) inherent uncertainties involved in assessing the Company s potential liability for environmental remediation-related activities; (l) 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); (m) 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 affect of any legislation and administrative regulations relating thereto; and (n) 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.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk associated with interest rates and value changes in foreign currencies. The Company 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 has partially hedged risks associated with fixed interest rate debt by entering into various interest rate swap agreements. The Company does not believe that any potential loss related to interest rate exposure would have a material adverse effect on the Company s financial condition, results of operations or cash flows. The Company enters into foreign currency option and forward contracts to hedge against value changes in foreign currency. The Company believes it may experience continuing losses from foreign currency translation. However, the Company does not expect currency translation, transaction 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, 2004.

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Item 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chairman, President 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. Based upon that evaluation, our Chairman, President and Chief Executive Officer and our Senior Vice President Finance and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be disclosed by us in our periodic SEC reports. There were no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 2. Unregistered Sales of 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	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plan
April 1 April 30				
Share repurchase program (1)	327,200	$ 43.56	327,200	7,395,800
Employee transactions (2)	72,662	$ 44.73		N/A
May 1 May 31				
Share repurchase program (1)	672,900	$ 43.14	672,900	6,722,900
Employee transactions (2)	2,312	$ 43.99		N/A
June 1 June 30				
Share repurchase program (1)				6,722,900
Employee transactions (2)				N/A
Total				
Share repurchase program (1)	1,000,100	$ 43.28	1,000,100	6,722,900
Employee transactions (2)	74,974	$ 44.71		N/A

(1) All shares were purchased through the Company s 20.0 million share repurchase program publicly announced on October 24, 2003. There is no expiration date specified for the program. The Company intends to repurchase stock under the program in the future.

(2) All shares were delivered to satisfy the exercise price and/or tax withholding obligations by employees who exercised stock options.

Item 6. Exhibits.

(a) Exhibits.

(10)(a) Schedule of Certain Executive Officers who are Parties to the Severance Pay Agreements in the forms attached as Exhibit 10(b) to Sherwin-Williams Quarterly Report on Form 10-Q for the period ended June 30, 1997 (filed herewith).

(10)(b) Schedule of Certain Executive Officers who are Parties to the Individual Grantor Trust Participation Agreements in the form attached as Exhibit 10(a) to Sherwin-Williams Quarterly Report on Form 10-Q for the period ended September 30, 2003 (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).

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

August 8, 2005 By: /s/ J. L. Ault

J. L. Ault
Vice President Corporate Controller

August 8, 2005 By: /s/ L. E. Stellato

L. E. Stellato
Vice President, General Counsel and Secretary

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