

SHERWIN WILLIAMS CO

Form 10-Q

October 22, 2008

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

(Mark One)

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

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the transition period from _____ to _____**

Commission file number **1-04851**

THE SHERWIN-WILLIAMS COMPANY

(Exact name of registrant as specified in its charter)

OHIO

34-0526850

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

101 Prospect Avenue, N.W., Cleveland, Ohio

44115-1075

(Address of principal executive offices)

(Zip Code)

(216) 566-2000

(Registrant's telephone number including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common Stock, \$1.00 Par Value 116,902,299 shares as of September 30, 2008.

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STATEMENTS OF CONSOLIDATED INCOME (UNAUDITED)**

Thousands of dollars, except per share data

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

See notes to condensed consolidated financial statements.

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

Thousands of dollars

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

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

See notes to condensed consolidated financial statements.

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CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS (UNAUDITED)**

Thousands of dollars

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

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

See notes to condensed consolidated financial statements.

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

Periods ended September 30, 2008 and 2007

Note A BASIS OF PRESENTATION

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

The Company uses the last-in, first-out (LIFO) method of valuing inventory. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management's estimates of expected year-end inventory levels and costs are subject to the final year-end LIFO inventory valuation. In addition, interim inventory levels include management's estimates of annual inventory losses due to shrinkage and other factors. The final year-end valuation of inventory is based on an annual physical inventory count performed during the fourth quarter. For further information on inventory valuations and other matters, refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the year ended December 31, 2007.

The consolidated results for the three months and nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the year ending December 31, 2008.

Note B IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

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

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

In April 2008, the FASB issued FSP FAS No. 142-3, which amends the factors that must be considered in developing renewal or extension assumptions used to determine the useful life over which to amortize the cost of a recognized intangible asset under FAS No. 142, "Goodwill and Other Intangible Assets." The FSP requires an entity to consider its own assumptions about renewal or extension of the term of the arrangement, consistent with its expected use of the asset, and is an attempt to improve consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141,

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

In March 2008, the FASB issued FAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," an amendment of FASB Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities." FAS No. 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under FAS No. 133, and how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. The statement is effective for financial statements issues for fiscal years and interim periods beginning after November 15, 2008, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

In December 2007, the FASB issued FAS No. 141(R), "Applying the Acquisition Method." FAS No. 141(R) provides guidance for the recognition of the fair values of the assets acquired upon initially obtaining control, including the elimination of the step acquisition model. The standard is effective for acquisitions made in fiscal years beginning after December 15, 2008, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

In December 2007, the FASB issued FAS No. 160, "Accounting for Noncontrolling Interests." FAS No. 160 clarifies the classification of noncontrolling interests in consolidated statements of financial position and the accounting for and reporting of transactions between the reporting entity and holders of such noncontrolling interests. Under the standard, noncontrolling interests are considered equity and should be reported as an element of consolidated equity, and net income will encompass the total income of all consolidated subsidiaries and there will be separate disclosure on the face of the income statement of the attribution of that income between the controlling and noncontrolling interests. FAS No. 160 is effective prospectively for fiscal years beginning after December 15, 2008, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

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

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

The Company also adopted EITF Issue No. 06-11, Accounting for Income Tax Benefits on Dividends on Share-Based Payment Awards as of January 1, 2008. This EITF indicates that tax benefits of dividends on unvested restricted stock are to be recognized in equity as an increase in the pool of excess tax benefits. Should the related awards forfeit or no longer become expected to vest, the benefits are to be reclassified from equity to the income statement. The adoption of this EITF does not have a significant impact on the Company's results of operations, financial condition or liquidity.

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements. FAS No. 157 provides guidance for using fair value to measure assets and liabilities and only applies when other standards require or permit the fair value measurement of assets and liabilities. It does not expand the use of fair value measurements. FAS No. 157, as issued, is effective for fiscal years beginning after November 15, 2007. FASB Staff Position (FSP) FAS No. 157-2 was issued in February 2008 and deferred the effective date of FAS No. 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities. Accordingly, as of January 1, 2008, the Company adopted FAS No. 157 for financial assets and liabilities only. The Company is still in the process of evaluating the impact that FAS No. 157 will have on its pension related financial assets and its nonfinancial assets and liabilities.

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

| (Thousands of dollars) | Fair Value at September 30, 2008 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|--|---|---|--|
| Assets: | | | | |
| Deferred compensation plan asset ^(A) | \$ 15,180 | \$ 15,180 | | |
| Net currency derivative asset ^(B) | 23 | | \$ 23 | |
| Total assets at fair value | \$ 15,203 | \$ 15,180 | \$ 23 | |
| Liabilities: | | | | |
| Deferred compensation plan liability ^(C) | \$ 20,733 | \$ 20,733 | | |
| | \$ 20,733 | \$ 20,733 | | |

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

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

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

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

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

Note C DIVIDENDS

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

Table of Contents**Note D COMPREHENSIVE INCOME**

Comprehensive income is summarized as follows:

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

Note E PRODUCT WARRANTIES

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

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

For further details on the Company's accrual for product warranty claims, see Note 1 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

Note F EXIT OR DISPOSAL ACTIVITIES

Liabilities associated with exit or disposal activities are recognized as incurred in accordance with FAS No. 146,

Accounting for Costs Associated with Exit or Disposal Activities. Qualified exit costs primarily include post-closure rent expenses, incremental post-closure costs

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and costs of employee terminations. Adjustments may be made to liabilities accrued for qualified exit costs if information becomes available upon which more accurate amounts can be reasonably estimated. Concurrently, property, plant and equipment is tested for impairment in accordance with FAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, and, if impairment exists, the carrying value of the related assets is reduced to estimated fair value. Additional impairment may be recorded for subsequent revisions in estimated fair value.

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

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

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

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(Thousands of dollars)

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

Note G HEALTH CARE, PENSION AND OTHER BENEFITS

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

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

For further details on the Company's health care, pension and other benefits, see Note 6 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

NOTE H OTHER LONG-TERM LIABILITIES

The Company initially provides for estimated costs of environmental-related activities relating to its past operations and third-party sites for which commitments or clean-up plans have been developed and when such costs can be reasonably estimated based on industry standards and professional judgment. These estimated costs are determined based on currently available facts regarding each site. If the best estimate of costs can only be identified as a range and no specific amount within that range can be determined more likely than any other amount within the range, the minimum of the range is provided. At September 30, 2008, the unaccrued maximum of the estimated range of possible outcomes is \$119.8 million higher than the minimum.

The Company continuously assesses its potential liability for investigation and remediation-related activities and adjusts its environmental-related accruals as information becomes available

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upon which more accurate costs can be reasonably estimated and as additional accounting guidelines are issued. Actual costs incurred may vary from these estimates due to the inherent uncertainties involved including, among others, the number and financial condition of parties involved with respect to any given site, the volumetric contribution which may be attributed to the Company relative to that attributed to other parties, the nature and magnitude of the wastes involved, the various technologies that can be used for remediation and the determination of acceptable remediation with respect to a particular site.

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

Five of the Company's currently and formerly owned manufacturing sites account for the majority of the accrual for environmental-related activities and the unaccrued maximum of the estimated range of possible outcomes at September 30, 2008. At September 30, 2008, \$138.7 million, or 75.2 percent of the total accrual, related directly to these five sites. In the aggregate unaccrued maximum of \$119.8 million at September 30, 2008, \$76.8 million, or 64.1 percent, related to the five manufacturing sites. While environmental investigations and remedial actions are in different stages at these sites, additional investigations, remedial actions and monitoring will likely be required at each site.

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

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

For further details on the Company's Other long-term liabilities, see Note 8 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

Table of Contents**Note I LITIGATION**

In the course of its business, the Company is subject to a variety of claims and lawsuits, including litigation relating to product liability and warranty, personal injury, environmental, intellectual property, commercial, contractual and antitrust claims that are inherently subject to many uncertainties regarding the possibility of a loss to the Company. These uncertainties will ultimately be resolved when one or more future events occur or fail to occur confirming the incurrance of a liability or the reduction of a liability. In accordance with Statement of Financial Accounting Standards (FAS) No. 5, *Accounting for Contingencies*, the Company accrues for these contingencies by a charge to income when it is both probable that one or more future events will occur confirming the fact of a loss and the amount of the loss can be reasonably estimated. In the event that the Company's loss contingency is ultimately determined to be significantly higher than currently accrued, the recording of the additional liability may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such additional liability is accrued. In those cases where no accrual is recorded because it is not probable that a liability has been incurred and cannot be reasonably estimated, any potential liability ultimately determined to be attributable to the Company may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued. In those cases where no accrual is recorded or exposure to loss exists in excess of the amount accrued, FAS No. 5 requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred if even the possibility may be remote.

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

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Notwithstanding the Company's views on the merits, litigation is inherently subject to many uncertainties and the Company ultimately may not prevail. Adverse court rulings, such as the jury verdict against the Company and other defendants in the State of Rhode Island action and the Wisconsin State Supreme Court's July 2005 determination that Wisconsin's risk contribution theory may apply in the lead pigment litigation (both discussed in more detail below), or determinations of liability, among other factors, could affect the lead pigment and lead-based paint litigation against the Company and encourage an increase in the number and nature of future claims and proceedings. (The jury verdict in the State of Rhode Island action was subsequently reversed by the Rhode Island Supreme Court. See Rhode Island lead pigment litigation below.) In addition, from time to time, various legislation and administrative regulations have been enacted, promulgated or proposed to impose obligations on present and former manufacturers of lead pigments and lead-based paints respecting asserted health concerns associated with such products or to overturn the effect of court decisions in which the Company and other manufacturers have been successful.

Due to the uncertainties involved, management is unable to predict the outcome of the lead pigment and lead-based paint litigation, the number or nature of possible future claims and proceedings, or the effect that any legislation and/or administrative regulations may have on the litigation or against the Company. In addition, management cannot reasonably determine the scope or amount of the potential costs and liabilities related to such litigation, or resulting from any such legislation and regulations. The Company has not accrued any amounts for such litigation. Any potential liability that may result from such litigation or such legislation and regulations cannot reasonably be estimated. In the event any significant liability is determined to be attributable to the Company relating to such litigation, the recording of the liability may result in a material impact on net income for the annual or interim period during which such liability is accrued. Additionally, due to the uncertainties associated with the amount of any such liability and/or the nature of any other remedy which may be imposed in such litigation, any potential liability determined to be attributable to the Company arising out of such litigation may have a material adverse effect on the Company's results of operations, liquidity or financial condition. An estimate of the potential impact on the Company's results of operations, liquidity or financial condition cannot be made due to the aforementioned uncertainties.

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

The State of Rhode Island retried the case and on February 22, 2006, the jury returned a verdict, finding that (i) the cumulative presence of lead pigment in paints and coatings on buildings in the State of Rhode Island constitutes a public nuisance, (ii) the Company, along with two other defendants, caused or substantially contributed to the creation of the public nuisance, and (iii) the Company and two other defendants should be ordered to abate the public nuisance. On February 28, 2006, the Court granted the defendants' motion to dismiss the punitive damages claim, finding insufficient evidence to support the State's request for punitive damages. Final judgment was entered against the Company and two other defendants on March 16, 2007. The

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Company and two other defendants appealed the final judgment to the Rhode Island Supreme Court and, on July 1, 2008, the Rhode Island Supreme Court, among other determinations, reversed the judgment of abatement with respect to the Company and two other defendants. This decision reverses the public nuisance liability judgment against the Company on the basis that the complaint failed to state a public nuisance claim as a matter of law and concludes the case in favor of the Company and the other defendants.

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

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

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

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

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

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

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

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

Litigation seeking damages from alleged personal injury. The Company and other companies are defendants in a number of legal proceedings seeking monetary damages and other relief from alleged personal injuries. These proceedings include claims by children allegedly injured from ingestion of lead pigment or lead-containing paint, claims for damages allegedly incurred by the children's parents or guardians, and claims for damages allegedly incurred by professional painting contractors. These proceedings generally seek compensatory and punitive damages, and seek other relief including medical monitoring costs. These proceedings include purported claims by individuals, groups of individuals and class actions.

The plaintiff in *Thomas v. Lead Industries Association, et al.*, initiated an action against the Company, other alleged former lead pigment manufacturers and the Lead Industries Association in September 1999. The claims against the Company and the other defendants include strict liability, negligence, negligent misrepresentation and omissions, fraudulent misrepresentation and omissions, concert of action, civil conspiracy and enterprise liability. Implicit within these claims is the theory of risk contribution liability (Wisconsin's theory which is similar to market share liability) due to the plaintiff's inability to identify the manufacturer of any product that allegedly injured the plaintiff. Following various pre-trial proceedings during which certain of the plaintiff's claims were dismissed by the court, on March 10, 2003, the trial court granted the defendants' motion for summary judgment, dismissing the case with prejudice and awarding costs to each defendant. The plaintiff appealed and on June 14, 2004, the Wisconsin Court of Appeals affirmed the trial court's decision. On July 15, 2005, the Wisconsin Supreme Court reversed in part the trial court's decision and decided, assuming all of plaintiff's facts in the summary judgment record to be true, that the risk contribution theory could then apply to excuse the plaintiff's lack of evidence identifying any of the Company's or the other defendant's products as the cause of the alleged injury. The case was remanded to the trial court for further proceedings and a trial commenced on October 1, 2007. On November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain

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

Wisconsin is the first jurisdiction to apply a theory of liability with respect to alleged personal injury (i.e.: risk contribution/market share liability) which does not require the plaintiff to identify the manufacturer of the product that allegedly injured the plaintiff in the lead pigment and lead-based paint litigation.

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

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

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

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

Provisions for environmental matters net represent site-specific increases or decreases to environmental-related accruals as information becomes available upon which more accurate costs can be reasonably estimated and as additional accounting guidelines are issued. Environmental-related accruals are not recorded net of insurance proceeds in accordance with FASB Interpretation (FIN) No. 39, Offsetting of Amounts Related to Certain Contracts an Interpretation of APB Opinion No. 10 and FASB Statement No. 105. See Note H for further details on the Company's environmental-related activities.

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

Other (income) expense net

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

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

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

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

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

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

Note K INCOME TAXES

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

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

At December 31, 2007, the Company had \$39.4 million in unrecognized tax benefits, the recognition of which would have an affect of \$34.2 million on the current provision for income taxes. Included in the balance of unrecognized tax benefits at December 31, 2007, was \$4.8 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. This amount represents a decrease in unrecognized tax benefits comprised of items related to assessed state income tax audits, state settlement negotiations currently in progress and expiring statutes in foreign jurisdictions.

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

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

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

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

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

Note M REPORTABLE SEGMENT INFORMATION

The Company reports segment information in the same way that management internally organizes its business for assessing performance and making decisions regarding allocation of resources in accordance with FAS No. 131, Disclosures about Segments of an Enterprise and Related Information.

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

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

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

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

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

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

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

Net external sales and segment profit of all consolidated foreign subsidiaries were \$299.7 million and \$22.6 million, respectively, for the third quarter of 2008, and \$245.8 million and \$22.7 million, respectively, for the third quarter of 2007. Net external sales and segment profits of these subsidiaries were \$867.8 million and \$70.8 million for the first nine months of 2008, and \$694.5 million and \$57.1 million, respectively, for the first nine months of 2007. Long-lived assets of these subsidiaries totaled \$234.3 million and \$220.1 million at September 30, 2008 and September 30, 2007, respectively. Domestic operations accounted for the remaining net external sales, segment profits and long-lived assets. The Administrative segment did not include any significant foreign operations. No single geographic area outside the United States was significant relative to consolidated net external sales, income before taxes, or consolidated long-lived assets.

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

NOTE N ACQUISITIONS

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

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

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

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

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

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

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Note O DEBT

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

On July 11, 2008, the Company terminated its \$500 million accounts receivable securitization borrowing facility. The facility was entered into effective February 1, 2006 pursuant to a Purchase and Contribution Agreement between Sherwin-Williams and SWC Receivables Funding LLC (SWC) and a Loan and Servicing Agreement between SWC and a third-party program agent. The facility enabled SWC to borrow up to \$500 million secured by the granting of a security interest in certain eligible accounts receivable and related security. The facility had a scheduled commitment termination date of February 20, 2009. There were no outstanding borrowings under the facility at the time it was terminated. Sherwin-Williams incurred no early termination penalties as a result of the termination. Effective September 3, 2008 SWC was dissolved.

During the second quarter of 2008, the Company amended the five-year revolving credit facility to extend the maturity date from July 20, 2009 to July 20, 2010. The amendment also reduces the letter of credit subfacility from \$500 million to \$300 million effective May 30, 2008 and reduces the aggregate amount of lender commitments from \$910 million to \$845 million effective July 20, 2009.

Note P GOODWILL, INTANGIBLE AND OTHER LONG-LIVED ASSETS

During the second quarter of 2008, the Company performed an interim impairment review of its goodwill and indefinite-lived intangible assets in accordance with FAS No. 142, Goodwill and Intangible Assets. Soft domestic architectural paint sales in the new residential, residential repaint, DIY and commercial markets indicated that certain domestic indefinite-lived intangible assets, namely trademarks, might be impaired. In addition, continued low cash flow projections in one foreign business unit indicated that further goodwill impairment might be possible. The interim impairment review resulted in reductions in the carrying values of certain trademarks with indefinite lives of \$23.1 million. The trademark impairments were charged to the Paint Stores Group (\$20.4 million) and the Consumer Group (\$2.7 million). The additional goodwill impairment of a foreign business unit, initially impaired in 2007, aggregated \$0.8 million and was charged to the Global Finishes Group. The total trademark and goodwill impairments of \$23.9 million are reported as a separate line item in the Statements of Consolidated Income for the nine months ended September 30, 2008. No additional impairment was recorded in the third quarter. During the fourth quarter, the Company will perform its annual impairment review as of October 1, 2008.

For further details on the Company's goodwill, intangible and long-lived assets, see Note 3 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

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

OVERVIEW

Consolidated net sales increased \$71.6 million, or 3.3 percent, to \$2.269 billion in the third quarter and \$128.5 million, or 2.1 percent, to \$6.280 billion in the first nine months of 2008 compared to the same periods in 2007. The net sales increases were due primarily to acquisitions and favorable foreign currency translation rate changes. Seven acquisitions completed at various times throughout 2007 and two completed in 2008 increased consolidated net sales 1.7 percent in the quarter and 2.3 percent in the first nine months. Favorable currency translation rate changes increased consolidated net sales 0.9 percent in the quarter and 1.3 percent in the first nine months. Diluted net income per common share decreased 3.2 percent in the quarter to \$1.50 per share from \$1.55 per share in 2007 and decreased 8.0 percent in the first nine months, including second quarter 2008 asset impairment charges of approximately \$.12 per share, to \$3.57 per share from \$3.88 per share last year. In the quarter, accretive acquisition results and favorable currency translation rate changes had a combined impact on diluted net income per common share of approximately \$.04 per share. In the first nine months, acquisitions had an unfavorable impact on diluted net income per common share that was offset by favorable currency translation rate changes resulting in a net increase of approximately \$.05 per share in diluted net income per common share.

Due to recent market events that have adversely affected all industries and the economy as a whole, management has placed increased emphasis on monitoring the risks associated with the current environment, particularly the collectibility of receivables, the fair value of assets, and the Company's liquidity. At this point in time, there has not been a material impact on the Company's assets and liquidity. Management will continue to monitor the risks associated with the current environment and their impact on the Company's results.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements and accompanying footnotes included in this report have been prepared in accordance with U.S. generally accepted accounting principles and contain certain amounts that were based upon management's best estimates, judgments and assumptions that were believed to be reasonable under the circumstances. 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 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, 2007. A comprehensive discussion of the Company's critical

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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, 2007.

FINANCIAL CONDITION, LIQUIDITY AND CASH FLOW

Cash and cash equivalents increased \$13.6 million during the first nine months of 2008. Cash requirements of \$595.9 million for capital expenditures (\$91.8 million), payments of cash dividends (\$124.2 million) and treasury stock purchases (\$379.9 million) were funded primarily by net operating cash of \$592.6 million.

Short-term borrowings related to the Company's domestic commercial paper program outstanding were \$168.5 million at an average rate of 3.04 percent at September 30, 2008. The Company had unused maximum borrowing availability of \$741.5 million at September 30, 2008 under the commercial paper program that is backed by the Company's revolving credit agreement. Short-term borrowings under certain revolving and letter of credit agreements were \$500 million at an average rate of 2.80 percent at September 30, 2008. Short-term borrowings outstanding under various foreign programs at September 30, 2008 were \$47.4 million with a weighted average interest rate of 9.42 percent.

Since September 30, 2007, net operating cash of \$903.4 million and net increased short-term borrowings of \$57.7 million were used primarily to increase cash and cash equivalents by \$19.7 million and for investment in acquisitions of \$82.7 million, capital expenditures of \$140.5 million, treasury stock purchases of \$562.8 million and payments of cash dividends of \$163.3 million.

Capital expenditures during the first nine months of 2008 primarily represented expenditures associated with improvements in manufacturing facilities in the Consumer Group, new store openings and normal equipment replacement in the Paint Stores Group and new branch openings in the Global Finishes Group.

During the third quarter of 2008, the Company purchased 793,135 shares of its common stock for treasury purposes through open market purchases. The Company acquires shares of its common stock for general corporate purposes and, depending upon its cash position, financial flexibility requirements and market conditions, the Company may acquire additional shares of its common stock in the future. The Company had remaining authorization at September 30, 2008 to purchase 20.0 million shares of its common stock.

At September 30, 2008, the Company's current ratio was .94, a decrease from the current ratio of .97 at December 31, 2007. The reduction in the current ratio was due primarily to increased short-term borrowings, accounts payable and accrued taxes that more than offset an increase in accounts receivable and cash and cash equivalents.

During the third quarter of 2008, the Company completed the acquisition of the liquid coatings subsidiaries of Inchem Holdings International Limited (Inchem). Inchem produces coatings applied to wood and plastic products in Asia. These waterborne, solvent-based, and ultraviolet

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curable coatings are applied to furniture, cabinets, flooring, and electronic. The coatings are made and sold in China, Vietnam and Malaysia, and distributed to 15 other Asian countries. During the first quarter of 2008, the Company acquired Becker Powder Coatings, Inc., a subsidiary of Sweden-based AB Wilh. Headquartered in Columbus, Ohio, Becker produces powder coatings applied to appliances, metal furniture, fixtures, equipment and electronic products manufactured throughout North America.

Contingent Liabilities

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 U.S. generally accepted accounting principles. In addition, the Company may be subject to potential liabilities, as described in the following, for which a loss was not deemed probable at this time and a fair value was not available or an amount could not be reasonably estimated due to uncertainties involved.

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

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

Management of the Company has reviewed the potential increased liabilities associated with Life Shield's systems and determined that potential liabilities arising from an Act of Terrorism that could ultimately affect the Company will be appropriately insured or limited by current regulations. However, due to the uncertainties involved in the future development, usage and application of Life Shield's systems, the number or nature of possible future claims and legal proceedings, or the affect that any change in legislation and/or administrative regulations may have on the limitations of potential liabilities, management cannot reasonably determine the

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scope or amount of any potential costs and liabilities for the Company related to Life Shield or to Life Shield's systems. Any potential liability for the Company that may result from Life Shield or Life Shield's systems cannot reasonably be estimated. However, based upon, among other things, the limitation of liability under the SAFETY Act in the event of an Act of Terrorism, management does not currently believe that the costs or potential liability ultimately determined to be attributable to the Company through its ownership of Life Shield, as a supplier to Life Shield or as a distributor of Life Shield's systems arising from the use of Life Shield's systems will have a material adverse effect on the Company's results of operations, liquidity or financial conditions.

Litigation

In the course of its business, the Company is subject to a variety of claims and lawsuits, including litigation relating to product liability and warranty, personal injury, environmental, intellectual property, commercial, contractual and antitrust claims that are inherently subject to many uncertainties regarding the possibility of a loss to the Company. These uncertainties will ultimately be resolved when one or more future events occur or fail to occur confirming the incurrence of a liability or the reduction of a liability. In accordance with Statement of Financial Accounting Standards (FAS) No. 5, Accounting for Contingencies, the Company accrues for these contingencies by a charge to income when it is both probable that one or more future events will occur confirming the fact of a loss and the amount of the loss can be reasonably estimated. In the event that the Company's loss contingency is ultimately determined to be significantly higher than currently accrued, the recording of the additional liability may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such additional liability is accrued. In those cases where no accrual is recorded because it is not probable that a liability has been incurred and cannot be reasonably estimated, any potential liability ultimately determined to be attributable to the Company may result in a material impact on the Company's results of operations, liquidity or financial condition for the annual or interim period during which such liability is accrued. In those cases where no accrual is recorded or exposure to loss exists in excess of the amount accrued, FAS No. 5 requires disclosure of the contingency when there is a reasonable possibility that a loss or additional loss may have been incurred if even the possibility may be remote.

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

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Company is also a defendant in legal proceedings arising from the manufacture and sale of non-lead-based paints which seek recovery based upon various legal theories, including the failure to adequately warn of potential exposure to lead during surface preparation when using non-lead-based paint on surfaces previously painted with lead-based paint. The Company believes that the litigation brought to date is without merit or subject to meritorious defenses and is vigorously defending such litigation. The Company expects that additional lead pigment and lead-based paint litigation may be filed against the Company in the future asserting similar or different legal theories and seeking similar or different types of damages and relief.

Notwithstanding the Company's views on the merits, litigation is inherently subject to many uncertainties and the Company ultimately may not prevail. Adverse court rulings, such as the jury verdict against the Company and other defendants in the State of Rhode Island action and the Wisconsin State Supreme Court's July 2005 determination that Wisconsin's risk contribution theory may apply in the lead pigment litigation (both discussed in more detail below), or determinations of liability, among other factors, could affect the lead pigment and lead-based paint litigation against the Company and encourage an increase in the number and nature of future claims and proceedings. (The jury verdict in the State of Rhode Island action was subsequently reversed by the Rhode Island Supreme Court. See Rhode Island lead pigment litigation below.) In addition, from time to time, various legislation and administrative regulations have been enacted, promulgated or proposed to impose obligations on present and former manufacturers of lead pigments and lead-based paints respecting asserted health concerns associated with such products or to overturn the effect of court decisions in which the Company and other manufacturers have been successful.

Due to the uncertainties involved, management is unable to predict the outcome of the lead pigment and lead-based paint litigation, the number or nature of possible future claims and proceedings, or the effect that any legislation and/or administrative regulations may have on the litigation or against the Company. In addition, management cannot reasonably determine the scope or amount of the potential costs and liabilities related to such litigation, or resulting from any such legislation and regulations. The Company has not accrued any amounts for such litigation. Any potential liability that may result from such litigation or such legislation and regulations cannot reasonably be estimated. In the event any significant liability is determined to be attributable to the Company relating to such litigation, the recording of the liability may result in a material impact on net income for the annual or interim period during which such liability is accrued. Additionally, due to the uncertainties associated with the amount of any such liability and/or the nature of any other remedy which may be imposed in such litigation, any potential liability determined to be attributable to the Company arising out of such litigation may have a material adverse effect on the Company's results of operations, liquidity or financial condition. An estimate of the potential impact on the Company's results of operations, liquidity or financial condition cannot be made due to the aforementioned uncertainties.

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

The State of Rhode Island retried the case and on February 22, 2006, the jury returned a verdict, finding that (i) the cumulative presence of lead pigment in paints and coatings on buildings in the State of Rhode Island constitutes a public nuisance, (ii) the Company, along with two other defendants, caused or substantially contributed to the creation of the public nuisance, and (iii) the Company and two other defendants should be ordered to abate the public nuisance. On February 28, 2006, the Court granted the defendants' motion to dismiss the punitive damages claim, finding insufficient evidence to support the State's request for punitive damages. Final judgment was entered against the Company and two other defendants on March 16, 2007. The Company and two other defendants appealed the final judgment to the Rhode Island Supreme Court and, on July 1, 2008, the Rhode Island Supreme Court, among other determinations, reversed the judgment of abatement with respect to the Company and two other defendants. This decision reverses the public nuisance liability judgment against the Company on the basis that the complaint failed to state a public nuisance claim as a matter of law and concludes the case in favor of the Company and the other defendants.

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

The Santa Clara County, California proceeding was initiated in March 2000. The named plaintiffs are the County of Santa Clara, County of Santa Cruz, County of Solano, County of Alameda, County of Kern, City and County of San Francisco, San Francisco Housing Authority, San Francisco Unified School District, City of Oakland, Oakland Housing Authority, Oakland Redevelopment Agency and the Oakland Unified School District. The proceeding purports to be a class action on behalf of all public entities in the State of California except the State and its agencies. The plaintiffs' second amended complaint asserted claims for fraud and concealment, strict product liability/failure to warn, strict product liability/design defect, negligence, negligent breach of a special duty, public nuisance, private nuisance and violations of California's Business and Professions Code, and the third amended complaint alleges similar claims including a claim for public nuisance. Various asserted claims were resolved in favor of the defendants through pre-trial demurrers and motions to strike. In October 2003, the trial court granted the defendants' motion for summary judgment against the remaining counts on statute of limitation grounds. The plaintiffs appealed the trial court's decision and on March 3, 2006, the Court of Appeal, Sixth Appellate District, reversed in part the demurrers and summary judgment entered in favor of the Company and the other defendants. The Court of Appeal reversed the dismissal of the public nuisance claim for abatement brought by the cities of Santa Clara and Oakland and the City and

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County of San Francisco, and reversed summary judgment on all of the plaintiffs' fraud claim to the extent that the plaintiffs alleged that the defendants had made fraudulent statements or omissions minimizing the risks of low-level exposure to lead. The Court of Appeal further vacated the summary judgment holding that the statute of limitations barred the plaintiffs' strict liability and negligence claims, and held that those claims had not yet accrued because physical injury to the plaintiffs' property had not been alleged. The Court of Appeal affirmed the dismissal of the public nuisance claim for damages to the plaintiffs' properties, most aspects of the fraud claim, the trespass claim and the unfair business practice claim. The plaintiffs have filed a motion for leave to file a fourth amended complaint. On April 4, 2007, the trial court entered an order granting the defendants' motion to bar payment of contingent fees to private attorneys. The plaintiffs appealed the trial court's order and on April 8, 2008 the California Court of Appeal reversed the trial court's order. The defendants filed a petition for review with the California Supreme Court requesting the Supreme Court to review the decision of the Court of Appeal.

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

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

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

In 2006 and 2007, a number of cities in Ohio individually initiated proceedings in state court against the Company and other companies asserting claims for public nuisance, concert of action, unjust enrichment, indemnity and punitive damages. Also in September 2006, the Company initiated proceedings in the United States District Court, Southern District of Ohio, against certain of the Ohio cities which initiated the state court proceedings referred to in the preceding sentence and John Doe cities and public officials. The Company's proceeding sought declaratory and injunctive relief to prevent the violation of the Company's federal constitutional rights in relation to such state court proceedings. All of these Ohio cities' actions have been voluntarily dismissed by the plaintiff cities. Accordingly, on August 28, 2008, the Court granted, with prejudice, the Company's motion to dismiss the remaining proceedings in the United States District Court, Southern District of Ohio.

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

Litigation seeking damages from alleged personal injury. The Company and other companies are defendants in a number of legal proceedings seeking monetary damages and other relief from alleged personal injuries. These proceedings include claims by children allegedly injured from ingestion of lead pigment or lead-containing paint, claims for damages allegedly incurred by the children's parents or guardians, and claims for damages allegedly incurred by professional painting contractors. These proceedings generally seek compensatory and punitive damages, and seek other relief including medical monitoring costs. These proceedings include purported claims by individuals, groups of individuals and class actions.

The plaintiff in *Thomas v. Lead Industries Association, et al.*, initiated an action against the Company, other alleged former lead pigment manufacturers and the Lead Industries Association

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in September 1999. The claims against the Company and the other defendants include strict liability, negligence, negligent misrepresentation and omissions, fraudulent misrepresentation and omissions, concert of action, civil conspiracy and enterprise liability. Implicit within these claims is the theory of risk contribution liability (Wisconsin's theory which is similar to market share liability) due to the plaintiff's inability to identify the manufacturer of any product that allegedly injured the plaintiff. Following various pre-trial proceedings during which certain of the plaintiff's claims were dismissed by the court, on March 10, 2003, the trial court granted the defendants' motion for summary judgment, dismissing the case with prejudice and awarding costs to each defendant. The plaintiff appealed and on June 14, 2004, the Wisconsin Court of Appeals affirmed the trial court's decision. On July 15, 2005, the Wisconsin Supreme Court reversed in part the trial court's decision and decided, assuming all of plaintiff's facts in the summary judgment record to be true, that the risk contribution theory could then apply to excuse the plaintiff's lack of evidence identifying any of the Company's or the other defendant's products as the cause of the alleged injury. The case was remanded to the trial court for further proceedings and a trial commenced on October 1, 2007. On November 5, 2007, the jury returned a defense verdict, finding that the plaintiff had ingested white lead carbonate, but was not brain damaged or injured as a result. The plaintiff filed post-trial motions for a new trial which were denied by the trial court. On March 4, 2008, final judgment was entered in favor of the Company and other defendants. The plaintiff has filed an appeal of the final judgment.

Wisconsin is the first jurisdiction to apply a theory of liability with respect to alleged personal injury (i.e.: risk contribution/market share liability) which does not require the plaintiff to identify the manufacturer of the product that allegedly injured the plaintiff in the lead pigment and lead-based paint litigation.

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

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Environmental-Related Liabilities.

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

Depreciation of capital expenditures and other expenses related to ongoing environmental compliance measures were included in the normal operating expenses of conducting business. The Company's capital expenditures, depreciation and other expenses related to ongoing environmental compliance measures were not material to the Company's financial condition, liquidity, cash flow or results of operations during the first nine months of 2008. 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 2008.

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 September 30, 2008 and 2007, the Company had accruals for environmental-related activities of \$184.5 million and \$190.0 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

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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 \$119.8 million higher than the accruals at September 30, 2008.

Five of the Company's currently and formerly owned 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 September 30, 2008. At September 30, 2008, \$138.7 million, or 75.2 percent, related directly to these five sites. Of the aggregate unaccrued exposure at September 30, 2008, \$76.8 million, or 64.1 percent, related to the five sites. While environmental investigations and remedial actions are in different stages at these sites, additional investigations, remedial actions and/or monitoring will likely be required at each site.

Two of the five sites are formerly owned manufacturing facilities in New Jersey that are in the early investigative stage of the environmental-related process. Although contamination exists at the sites and adjacent areas, the extent and magnitude of the contamination has not yet been fully quantified. It is reasonably likely that further extensive investigations may be required and that extensive remedial actions may be necessary not only at the formerly owned sites but along adjacent waterways. Depending on the extent of the additional investigations and remedial actions necessary, the ultimate liability for these sites may exceed the amounts currently accrued and the maximum of the ranges of reasonably possible outcomes currently estimated by management.

Two additional sites are a currently owned operating facility located in Illinois and a currently owned contiguous vacant property. The environmental issues at these sites have been determined to be associated with historical operations of the Company. The majority of the investigative activities have been completed at these sites and some remedial measures have been taken. Agreement has been obtained from the appropriate governmental agency on a proposed remedial action plan for the currently owned operating site and further development of that plan is underway. A proposed remedial action plan has been formulated for the currently owned contiguous vacant property but no clean up goals have been approved by the lead governmental agency. Due to the uncertainties of the scope and magnitude of contamination and the degree of remediation that may be necessary relating to this vacant site, it is reasonably likely that further investigations may be required and that extensive remedial actions may be necessary. The fifth site is a currently owned former manufacturing site located in California. The environmental issues at this site have been determined to be associated with historical manufacturing operations of the Company. The majority of the investigative activities have been completed at this site, some interim 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. Due to the uncertainties of the scope and magnitude of contamination and the degree of remediation that may be required relating to this site, it is reasonably likely that extensive remedial actions may be necessary.

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

In accordance with FIN No. 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143, 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 and Commercial Commitments

Short-term borrowings increased \$58.9 million to \$716.0 million at September 30, 2008 from \$657.1 million at December 31, 2007. Total long-term debt increased \$2.5 million to \$310.9 at September 30, 2008 from \$308.4 million at December 31, 2007. See the Financial Condition, Liquidity and Cash Flow section of this report for more information. There have been no other significant changes in the first nine months of 2008 to the Company's contractual obligations and commercial commitments 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, 2007.

Changes to the Company's accrual for product warranty claims in the first nine months of 2008 are disclosed in Note E.

Table of Contents**RESULTS OF OPERATIONS**

Shown below are net sales and the percentage change for the third quarter and first nine months by segment for 2008 and 2007:

| <i>(thousands of dollars)</i> | 2008 | Change | 2007 |
|---|---------------------|--------|--------------|
| Three months ended September 30: | | | |
| Paint Stores Group | \$ 1,410,461 | 0.7% | \$ 1,400,937 |
| Consumer Group | 355,669 | 1.8% | 349,442 |
| Global Finishes Group | 500,772 | 12.5% | 444,947 |
| Administrative | 1,756 | 2.3% | 1,716 |
| Total net sales | \$ 2,268,658 | 3.3% | \$ 2,197,042 |
| | | | |
| Nine months ended September 30: | | | |
| Paint Stores Group | \$ 3,796,645 | -0.5% | \$ 3,817,283 |
| Consumer Group | 1,026,483 | -2.0% | 1,047,295 |
| Global Finishes Group | 1,451,545 | 13.3% | 1,281,454 |
| Administrative | 5,212 | -3.1% | 5,376 |
| Total net sales | \$ 6,279,885 | 2.1% | \$ 6,151,408 |

Consolidated net sales increased \$71.6 million in the third quarter and \$128.5 million in the first nine months of 2008 compared to the same periods in 2007. The net sales increases were due primarily to acquisitions and favorable foreign currency translation rate changes. Seven acquisitions completed at various times in 2007 and two completed in 2008 increased consolidated net sales 1.7 percent in the quarter and 2.3 percent in the first nine months. Favorable currency translation rate changes increased consolidated net sales 0.9 percent in the quarter and 1.3 percent in the first nine months.

Net sales of all consolidated foreign subsidiaries increased 21.9 percent to \$299.7 million for the third quarter and 25.0 percent to \$867.8 million for the first nine months compared to \$245.8 million and \$694.5 million for the respective comparative periods last year. Domestic operations accounted for the remaining net sales. Favorable foreign currency exchange rates increased net sales of foreign subsidiaries during the quarter and first nine months by 8.3 percent and 10.9 percent, respectively. Acquisitions increased net sales of foreign subsidiaries during the quarter and first nine months by 4.1 percent and 5.2 percent, respectively. Net sales of all operations other than consolidated foreign subsidiaries increased 0.9 percent to \$1.969 billion for the quarter and decreased 0.8 percent to \$5.412 billion for the first nine months compared to \$1.951 billion and \$5.457 billion for the respective comparative periods last year.

Net sales in the Paint Stores Group increased \$9.5 million in the third quarter and decreased \$20.6 million in the first nine months. The sales increase in the quarter was due primarily to increased sales from acquisitions of 1.5 percent and selling price increases that were partly offset

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by paint sales volume reduction. In the first nine months, the decreased sales resulted primarily from soft domestic architectural paint sales in the new residential, residential repaint, DIY and commercial markets and weak sales in non-paint categories that more than offset an increase in net sales of 2.4 percent from acquisitions. In the quarter, net sales from stores open for more than twelve calendar months decreased 1.4 percent over the same quarter last year and decreased 3.9 percent over the first nine months last year. Total paint sales volume percentage decreases were in the mid-to-high single digits in the quarter and first nine months of 2008 as compared to the same periods last year. Sales of non-paint products decreased approximately 4.6 percent in the quarter and 6.6 percent in the first nine months of the year compared to last year. 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 increased \$6.2 million in the third quarter and decreased \$20.8 million in the first nine months. The sales increase in the quarter was due primarily to an increase in selling price increases and an increase in sales of 0.4 percent related to a 2007 acquisition. The sales decline in the first nine months was due primarily to soft DIY demand at most of this Group's retail customers partially offset by a 0.3 percent increase in sales due to the acquisition. Percentage changes in external paint sales volume, a portion of total consumer Group sales, increased slightly in the quarter and decreased in the low single digits in the first nine months. Unit volumes in applicators, aerosols, caulk and other non-paint categories were down similarly.

The Global Finishes Group's net sales stated in U.S. dollars increased \$55.8 million in the third quarter and \$170.1 million in the first nine months of 2008 due primarily to favorable currency translation rate changes, acquisitions, volume gains outside the U.S. and selling price increases. Favorable currency translation rate changes increased net sales of this Group by 4.5 percent in the quarter and 5.7 percent for the first nine months. Acquisitions increased this Group's net sales in U.S. dollars by 3.1 percent in the quarter and 3.5 percent in the first nine months. A discussion of changes in volume versus pricing for sales of products in the Global Finishes Group is not meaningful due to the wide assortment of paint, coatings and general merchandise sold in many different countries.

The table below shows segment profit and the percent change for the three and nine months ended September 30, 2008 and 2007:

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| <i>(thousands of dollars)</i> | 2008 | Change | 2007 |
|---|------------|--------|------------|
| Three months ended September 30: | | | |
| Paint Stores Group | \$ 240,999 | -3.0% | \$ 248,377 |
| Consumer Group | 26,320 | -59.0% | 64,147 |
| Global Finishes Group | 45,337 | -5.6% | 48,020 |
| Administrative | (46,514) | -29.8% | (66,227) |
| Income before income taxes | \$ 266,142 | -9.6% | \$ 294,317 |
| Nine months ended September 30: | | | |
| Paint Stores Group | \$ 534,736 | -12.2% | \$ 608,911 |
| Consumer Group | 127,929 | -36.9% | 202,823 |
| Global Finishes Group | 136,438 | 3.1% | 132,296 |
| Administrative | (163,760) | -10.5% | (183,050) |
| Income before income taxes | \$ 635,343 | -16.5% | \$ 760,980 |

Consolidated segment profit (Income before income taxes) was negatively impacted by a decrease in gross profit of \$27.9 million and \$52.4 million in the third quarter and first nine months of 2008, respectively, compared to comparable periods in 2007. As a percent of sales, consolidated gross profit decreased to 42.3 percent in the quarter from 45.0 percent in 2007 and to 43.2 percent for the first nine months from 45.0 percent in the comparable period last year. The decrease in the consolidated gross profit percentage was primarily related to increasing raw material costs, lower domestic production volumes and pricing pressures. Consolidated selling, general and administrative expenses (SG&A) increased \$10.9 million in the quarter and \$55.0 million in the first nine months of 2008 from the same periods last year due to the impact related to acquisitions. Acquisitions increased SG&A in the quarter by \$12.7 million and in the first nine months by \$54.4 million. SG&A declined as a percentage of net sales to 30.0 percent in the quarter compared to 30.5 percent last year. For the first nine months, SG&A remains slightly higher as a percentage of net sales at 32.0 percent versus 31.8 percent in the same period last year.

The Paint Stores Group's gross profit for the third quarter was essentially flat with last year and decreased \$12.7 million in the first nine months. The Group's gross profit in the quarter was favorably affected by acquisition sales offset by lower sales and higher product and freight costs in comparable business units. The year-to-date reduction in Paint Stores Group gross profit was primarily due to lower sales volume and higher product and freight costs that could only be partly offset by selling price increases and acquisition gross profit. The Consumer Group's gross profit for the quarter and first nine months decreased from last year by \$40.0 million and \$83.6 million, respectively, due to lower volume throughput in the manufacturing and distribution facilities, increasing raw material costs and lower sales in the first half of the year. The Global Finishes Group's gross profit for the quarter and first nine months increased \$10.0 million and \$46.5 million, respectively, over last year due primarily to acquisitions and favorable currency translation rate changes. Acquisitions and exchange fluctuations increased the Group's gross profit by \$10.9 million and \$38.7 million in the quarter and first nine months, respectively. Increased volume sales of foreign operations and higher selling prices in the Global Finishes Group were primarily offset by higher raw material costs and lower domestic sales.

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In the Paint Stores Group, SG&A increased \$1.4 million in the third quarter and \$30.5 million for the first nine months of 2008 due to acquisition SG&A of \$6.7 million and \$38.2 million in the quarter and nine months, respectively, partially offset by SG&A reductions associated with good expense control and closed stores. The Consumer Group's SG&A decreased \$3.2 million in the quarter and \$12.8 million in the first nine months due primarily to tight spending control. The Global Finishes Group's SG&A increased by \$19.0 million in the quarter and \$50.0 million in the first nine months due primarily to combined acquisition-related SG&A and exchange rate fluctuations of \$10.0 million in the quarter and \$32.5 million in the first nine months and increased spending related to additional sales activity.

Administrative expenses in the third quarter and first nine months of 2008 decreased \$6.4 million and \$12.7 million, respectively, versus 2007. The reductions in administrative expenses were due to administrative expense control and decreased compensation and benefit related expenses not directly allocable to the Reportable Operating Segments of approximately \$3.6 million in the quarter and \$13.6 million in the first nine months. Partially offsetting these reductions in the first nine months was increased interest expense net of investment income of \$8.8 million.

Consolidated income before income taxes decreased \$28.2 million, or 9.6 percent, during the third quarter and \$125.6 million, or 16.5 percent, during the first nine months of 2008 due primarily to the lower segment profits of the Reportable Operating Segments.

The effective tax rates for the third quarter and first nine months of 2008 were 33.5 percent and 32.8 percent, respectively, compared to 31.9 percent and 32.4 percent, respectively, in 2007.

Net income in the third quarter of 2008 decreased \$23.3 million, or 11.6 percent, to \$177.1 million from \$200.3 million in 2007. Net income in the first nine months of 2008 decreased \$88.0 million, or 17.1 percent, to \$426.7 million from \$514.8 million in 2007. Diluted net income per common share in the quarter decreased 3.2 percent to \$1.50 per share from \$1.55 per share in the third quarter of 2007, and 8.0 percent to \$3.57 per share from \$3.88 per share in the first nine months of 2007 as lower net income more than offset the reduction of 11.4 million shares in the diluted average shares and equivalents outstanding from the third quarter 2007 and 12.9 million shares from the first nine months of 2007.

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

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in the Statements of Consolidated Income and Statements of Consolidated Cash Flows. EBITDA as used by management is calculated as follows:

| <i>(thousands of dollars)</i> | Three months ended September 30, | | Nine months ended September 30, | |
|-------------------------------|-------------------------------------|------------|------------------------------------|------------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$ 177,081 | \$ 200,349 | \$ 426,710 | \$ 514,758 |
| Interest expense | 15,200 | 17,048 | 51,006 | 52,415 |
| Income taxes | 89,061 | 93,968 | 208,633 | 246,222 |
| Depreciation | 36,182 | 35,453 | 107,330 | 100,964 |
| Amortization | 6,213 | 5,962 | 16,887 | 17,311 |
| EBITDA | \$ 323,737 | \$ 352,780 | \$ 810,566 | \$ 931,670 |

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

These risks, uncertainties and other factors include such things as: (a) 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 and energy supplies and pricing; (d) changes in the Company's relationships with customers and suppliers; (e) the Company's ability to attain cost savings from productivity initiatives; (f) the Company's ability to successfully integrate past and future acquisitions into its existing operations, as well as the performance of the businesses acquired; (g) risks and uncertainties associated with the Company's ownership of Life Shield Engineered Systems LLC; (h) changes in general domestic economic conditions such as inflation rates, interest rates, tax rates, unemployment rates, higher labor and healthcare costs, recessions, and changing governmental policies, laws and regulations; (i) risks and uncertainties associated with the Company's expansion into and its operations in China, India, South America and other foreign markets, including general economic conditions, inflation rates, recessions, foreign

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currency exchange rates, foreign investment and repatriation restrictions, legal and regulatory constraints, civil unrest and other external economic and political factors; (j) the achievement of growth in developing markets, such as China, India, Mexico and South America; (k) increasingly stringent domestic and foreign governmental regulations including those affecting the environment; (l) inherent uncertainties involved in assessing the Company's potential liability for environmental-related activities; (m) 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); (n) 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 (o) 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 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, 2007.

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Item 4. CONTROLS AND PROCEDURES

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

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

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

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

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

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| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Number of Shares Purchased as Part of Publicly Announced Plan | Number of Shares That May Yet Be Purchased Under the Plan |
|---|--|--|---|---|
| July 1 - July 31 | | | | |
| Share repurchase program ⁽¹⁾ | 231,168 | \$ 45.48 | 231,168 | 20,561,967 |
| Employee transactions | | | | NA |
| August 1 - August 31 | | | | |
| Share repurchase program ⁽¹⁾ | 500,000 | \$ 57.24 | 500,000 | 20,061,967 |
| Employee transactions | | | | NA |
| September 1 - September 30 | | | | |
| Share repurchase program ⁽¹⁾ | 61,967 | \$ 59.06 | 61,967 | 20,000,000 |
| Employee transactions | | | | NA |
| Total | | | | |
| Share repurchase program ⁽¹⁾ | 793,135 | \$ 53.96 | 793,135 | 20,000,000 |
| Employee transactions | | | | N/A |

(1) All shares were purchased through the Company's publicly announced share repurchased program. On October 19, 2007, the Board of Directors of the Company authorized the Company to purchase, in the aggregate, 30.0 million shares of its common stock and rescinded the previous authorization limit. The

Company had remaining authorization at September 30, 2008 to purchase 20,000,000 shares. There is no expiration date specified for the program. The Company intends to repurchase stock under the program in the future.

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Item 6. Exhibits.

- 10(a) Schedule of Executive Officers who are Parties to the Severance Agreements in the forms filed as Exhibit 10(b) to Sherwin-Williams Current Report on Form 8-K dated February 21, 2007 (filed herewith).
- 10(b) Schedule of Executive Officers who are Parties to the Individual Grantor Trust Participation Agreements in the form filed 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).

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SIGNATURES

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

THE SHERWIN-WILLIAMS COMPANY

October 22, 2008

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

October 22, 2008

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

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INDEX TO EXHIBITS

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