SHERWIN WILLIAMS CO
Form 10-Q
July 23, 2007

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

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the Period Ended June 30, 2007

or

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

Commission file number 1-04851
THE SHERWIN-WILLIAMS COMPANY
(Exact name of registrant as specified in its charter)

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

(216) 566-2000

(Registrant s telephone number including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes þ 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 130,815,549 shares as of June 30, 2007.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
THE SHERWIN-WILLIAMS COMPANY AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME (UNAUDITED)
Thousands of dollars, except per share data

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	**2007**	2006
Net sales	**$ 2,198,188**	$ 2,129,970	**$ 3,954,366**	$ 3,898,498
Cost of goods sold	**1,211,618**	1,193,382	**2,176,429**	2,190,499
Gross profit	**986,570**	936,588	**1,777,937**	1,707,999
Percent to net sales	***44.9%***	*44.0%*	***45.0%***	*43.8%*
Selling, general and administrative expenses	**666,899**	641,562	**1,284,640**	1,239,147
Percent to net sales	***30.3%***	*30.1%*	***32.5%***	*31.8%*
Other general expense net	**7,789**	12,501	**7,024**	15,266
Interest expense	**16,786**	16,837	**35,367**	34,187
Interest and net investment income	**(3,683)**	(5,856)	**(10,783)**	(11,693)
Other (income) expense net	**(4,366)**	2,419	**(4,974)**	56
Income before income taxes	**303,145**	269,125	**466,663**	431,036
Income taxes	**100,538**	84,533	**152,254**	132,773
Net income	**$ 202,607**	$ 184,592	**$ 314,409**	$ 298,263
Net income per common share:				
Basic	**$ 1.56**	$ 1.37	**$ 2.41**	$ 2.22
Diluted	**$ 1.52**	$ 1.33	**$ 2.34**	$ 2.16
Average shares outstanding basic	**129,647,874**	134,436,954	**130,351,224**	134,484,223
Average shares and equivalents outstanding diluted	**133,286,728**	138,441,559	**134,146,842**	138,359,486

See notes to condensed consolidated financial statements.

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

	June 30, 2007	December 31, 2006	June 30, 2006
ASSETS			
Current assets:			
Cash and cash equivalents	**$ 57,542**	$ 469,170	$ 248,644
Short-term investments		21,200	
Accounts receivable, less allowance	**1,093,345**	864,972	1,040,647
Inventories:			
Finished goods	**783,533**	707,196	761,884
Work in process and raw materials	**114,516**	117,983	102,988
	898,049	825,179	864,872
Deferred income taxes	**122,647**	120,101	109,799
Other current assets	**168,691**	149,659	153,092
Total current assets	**2,340,274**	2,450,281	2,417,054
Goodwill	**979,419**	916,464	886,573
Intangible assets	**322,952**	285,922	284,713
Deferred pension assets	**395,912**	387,668	415,005
Other assets	**136,083**	125,971	153,262
Property, plant and equipment	**2,153,826**	2,049,772	1,962,672
Less allowances for depreciation	**1,275,586**	1,220,991	1,184,052
	878,240	828,781	778,620
Total assets	**$ 5,052,880**	$ 4,995,087	$ 4,935,227
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Short-term borrowings	**$ 454,977**	$ 369,778	$ 279,005
Accounts payable	**885,187**	779,369	849,934
Compensation and taxes withheld	**198,016**	236,930	183,822
Accrued taxes	**154,073**	61,246	146,585
Current portion of long-term debt	**10,210**	212,853	209,072
Other accruals	**396,463**	414,639	390,670
Total current liabilities	**2,098,926**	2,074,815	2,059,088
Long-term debt	**292,059**	291,876	300,950
Postretirement benefits other than pensions	**304,274**	301,408	229,465

Other long-term liabilities	**342,388**	334,628	375,828
Shareholders equity:			
Common stock $1.00 par value:			
130,815,549, 133,565,287 and 135,766,303 shares outstanding at June 30, 2007, December 31, 2006 and June 30, 2006, respectively	**225,026**	222,985	220,824
Preferred stock convertible, no par value:			
377,012 and 433,215 shares outstanding at June 30, 2007 and December 31, 2006, respectively	**377,012**	433,215	
Unearned ESOP compensation	**(377,012)**	(433,215)	
Other capital	**843,733**	748,523	633,860
Retained earnings	**3,713,667**	3,485,564	3,275,017
Treasury stock, at cost	**(2,520,664)**	(2,202,248)	(1,952,966)
Cumulative other comprehensive loss	**(246,529)**	(262,464)	(206,839)
Total shareholders equity	**2,015,233**	1,992,360	1,969,896
Total liabilities and shareholders equity	**$ 5,052,880**	$ 4,995,087	$ 4,935,227

See notes to condensed consolidated financial statements.

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

	Six months ended June 30,	
	2007	2006
OPERATING ACTIVITIES		
Net income	**$ 314,409**	$ 298,263
Adjustments to reconcile net income to net operating cash:		
Depreciation	**65,510**	59,839
Amortization of intangibles and other assets	**11,349**	11,259
Stock-based compensation expense	**15,811**	11,417
Provisions for environmental-related matters	**7,717**	15,446
Defined benefit pension plans net credit	**(4,098)**	(780)
Net increase in postretirement liability	**4,237**	2,939
Other	**(3,350)**	4,276
Change in working capital accounts net	**(132,712)**	(156,900)
Costs incurred for environmental related matters	**(3,016)**	(5,145)
Costs incurred for qualified exit costs	**(628)**	(1,056)
Other	**(4,539)**	(6,540)
Net operating cash	**270,690**	233,018
INVESTING ACTIVITIES		
Capital expenditures	**(83,331)**	(94,431)
Acquisitions of businesses, net of cash acquired	**(149,316)**	
Proceeds from sale of short-term investments	**21,200**	
Increase in other investments	**(21,049)**	(19,100)
Proceeds from sale of assets	**2,823**	3,215
Other	**3,383**	(775)
Net investing cash	**(226,290)**	(111,091)
FINANCING ACTIVITIES		
Net increase in short-term borrowings	**73,039**	154,552
Net (decrease) increase in long-term debt	**(202,779)**	12,424
Payments of cash dividends	**(82,951)**	(68,107)
Proceeds from stock options exercised	**53,883**	41,437
Income tax effect of stock-based compensation	**28,343**	12,500
Treasury stock purchased	**(309,586)**	(62,348)
Other	**(9,518)**	(487)
Net financing cash	**(449,569)**	89,971
Effect of exchange rate changes on cash	**(6,459)**	705

Net (decrease) increase in cash and cash equivalents	**(411,628)**	212,603
Cash and cash equivalents at beginning of year	**469,170**	36,041
Cash and cash equivalents at end of period	**$ 57,542**	$ 248,644
Income taxes paid	**$ 54,018**	$ 71,250
Interest paid	**40,812**	33,598

See notes to condensed consolidated financial statements.

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

Periods ended June 30, 2007 and 2006

Note A BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. 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 fiscal year ended December 31, 2006.

The consolidated results for the three months and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2007.

Note B IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2007, the Financial Accounting Standards Board (FASB) ratified the Emerging Issues Task Force (EITF) consensus on EITF Issue No. 06-11, Accounting for Income Tax Benefits on Dividends on Share-Based Payment Awards. 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 EITF is effective for fiscal years beginning after December 15, 2007. The Company will adopt the EITF as required and management does not expect it to have a significant impact on the Company s results of operations, financial condition or liquidity.

In March 2007, the FASB ratified the EITF consensus on EITF Issue No. 06-10, Accounting for Collateral Assignment Split Dollar Life Insurance. This EITF indicates that an employer should recognize a liability for postretirement benefits related to collateral assignment split-dollar life

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insurance arrangements. In addition, the EITF provides guidance for the recognition of an asset related to a collateral assignment split-dollar life insurance arrangement. The EITF is effective for fiscal years beginning after December 15, 2007. The Company will adopt the EITF as required and management does not expect it to have any impact on the Company s results of operations, financial condition and liquidity.

In February 2007, the FASB issued Statement of Financial Accounting Standards (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. This standard is not expected to have any impact on the Company s results of operations, financial condition and 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 measurement. FAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company will adopt this standard as required and adoption is not expected to have a significant impact on the Company s results of operations, financial condition and liquidity.

In September 2006, the FASB ratified the EITF consensus on EITF Issue No. 06-4, Accounting for Deferred Comp./Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. This EITF indicates that an employer should recognize a liability for future post-employment benefits based on the substantive agreement with the employee. The EITF is effective for fiscal years beginning after December 15, 2007. The Company will adopt the EITF as required and management does not expect it to have any impact on the Company s results of operations, financial condition and liquidity.

Note C DIVIDENDS

Dividends paid on common stock during each of the first two quarters of 2007 and 2006 were $.315 per common share and $.25 per common share, respectively.

Note D COMPREHENSIVE INCOME

Comprehensive income is summarized as follows:

	Three months ended June 30,		Six months ended June 30,	
(Thousands of dollars)	**2007**	2006	**2007**	2006
Net income	**$ 202,607**	$ 184,592	**$ 314,409**	$ 298,263
Foreign currency translation adjustments	**7,835**	1,749	**12,247**	6,408
Amortization of net prior service costs and actuarial losses, net of taxes	**842**		**2,612**	
Adjustments of marketable equity securities and derivative instruments used in cash flow hedges, net of taxes	**423**	57	**1,076**	293
Comprehensive income	**$ 211,707**	$ 186,398	**$ 330,344**	$ 304,964

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Note E PRODUCT WARRANTIES

Changes in the Company s accrual for product warranty claims during the first six months of 2007 and 2006, including customer satisfaction settlements, were as follows:

(Thousands of dollars)	**2007**	2006
Balance at January 1	**$ 25,226**	$ 23,003
Charges to expense	**13,584**	12,682
Settlements	**(14,643)**	(11,077)
Balance at June 30	**$ 24,167**	$ 24,608

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, 2006.

Note F EXIT OR DISPOSAL ACTIVITIES

The Company recognizes liabilities associated with exit or disposal activities as incurred in accordance with FAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. Qualifying exit costs primarily include post-closure rent expenses, incremental post-closure costs and costs of employee terminations. Adjustments may be made to prior provisions for qualified exit costs if information becomes available upon which more accurate amounts can be reasonably estimated. Concurrently, property, plant and equipment is tested for impairment in accordance with 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. No significant revisions occurred during the first six months of 2007.

The following table summarizes the remaining liabilities associated with qualified exit costs at June 30, 2007 and the activity for the six-month period then ended:

(Thousands of dollars) Exit Plan	Balance at December 31, 2006	Actual expenditures charged to accrual	Balance at June 30, 2007
Consumer Group manufacturing facilities shutdown in 2005:			
Other qualified exit costs	$ 947	$ (189)	$ 758
Consumer Group manufacturing facility shutdown in 2004:			
Other qualified exit costs	130	(27)	103
Qualified exit costs initiated prior to 2003	12,110	(412)	11,698
Totals	$ 13,187	$ (628)	$ 12,559

For further details on the Company s exit or disposal activities, see Note 5 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

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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 pension plans, foreign defined benefit pension plans and postretirement benefits other than pensions:

(Thousands of dollars)	Domestic Defined Benefit Pension Plans		Foreign Defined Benefit Pension Plans		Postretirement Benefits Other than Pensions	
	2007	2006	**2007**	2006	**2007**	2006
Three months ended June 30:						
Net periodic benefit (credit) cost:						
Service cost	**$ 4,610**	$ 4,722	**$ 702**	$ 652	**$ 1,177**	$ 1,146
Interest cost	**4,030**	3,697	**910**	740	**4,231**	4,020
Expected return on assets	**(12,648)**	(11,335)	**(610)**	(584)		
Recognition of:						
Unrecognized prior service cost	**305**	151	**15**	15	**(159)**	(158)
Unrecognized actuarial loss	**342**	1,244	**308**	336	**1,282**	860
Net periodic benefit (credit) cost	**$ (3,361)**	$ (1,521)	**$ 1,325**	$ 1,159	**$ 6,531**	$ 5,868
Six months ended June 30:						
Net periodic benefit (credit) cost:						
Service cost	**$ 9,220**	$ 9,444	**$ 1,390**	$ 1,274	**$ 2,354**	$ 2,292
Interest cost	**8,060**	7,394	**1,802**	1,444	**8,462**	8,040
Expected return on assets	**(25,296)**	(22,670)	**(1,208)**	(1,138)		
Recognition of:						
Unrecognized prior service cost	**610**	302	**30**	30	**(318)**	(316)
Unrecognized actuarial loss	**684**	2,488	**610**	652	**2,564**	1,720
Net periodic benefit (credit) cost	**$ (6,722)**	$ (3,042)	**$ 2,624**	$ 2,262	**$ 13,062**	$ 11,736

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, 2006.

NOTE H OTHER LONG-TERM LIABILITIES

The Company initially provides for estimated costs of investigation and remediation activities at its currently or formerly owned sites and third-party sites for which commitments or clean-up plans have been developed and when such costs can be reasonably estimated based on industry standards and historical experience. These estimated costs are determined based on currently available facts regarding each site. If the best estimate of costs can only be identified as a range and no specific amount within that range can be determined more likely than any other amount within the range, the minimum of the range is provided. The unaccrued maximum of the estimated range of possible outcomes is $141.9 million higher than the accrued amount at June 30, 2007. 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 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.

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Included in Other long-term liabilities at June 30, 2007 and 2006 were accruals for extended environmental-related activities of $139.5 million and $135.7 million, respectively. Estimated costs of current investigation and remediation activities of $39.5 million and $33.5 million are included in Other accruals at June 30, 2007 and 2006, respectively. Five of the Company s currently or formerly owned manufacturing sites account for the majority of the accrual for environmental-related activities and the unaccrued maximum of the estimated range of possible outcomes at June 30, 2007. At June 30, 2007, $126.7 million, or 70.9 percent of the total accrual, related directly to these five sites. In the aggregate unaccrued exposure of $141.9 million at June 30, 2007, $99.1 million, or 69.8 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 activities take 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, 2006.

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. The Company accrues for these contingencies when it is 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. However, because litigation is inherently subject to many uncertainties and the ultimate result of any present or future litigation is unpredictable, the Company s ultimate liability may result in costs that are significantly higher than currently accrued. In the event that the Company s loss contingency is ultimately determined to be significantly higher than currently accrued, 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 involved, 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.

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 Rhode Island and 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.

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 judgment 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. 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. On February 26, 2007, the Court issued a decision on the post-trial motions and other matters pending before the Court. Specifically, the Court (i) denied the defendant s post-trial motions for judgment as a matter of law and for a new trial, (ii) decided to enter a judgment of abatement in favor of the State against the Company and two other defendants, and (iii) decided to appoint a special master for the purpose of assisting the Court in its consideration of a remedial order to implement the judgment of abatement, and if necessary, any monitoring of the implementation of that order. On March 16, 2007, final judgment was entered against the Company and two other defendants. Also on March 16, 2007, the Company filed its notice of appeal to the Rhode Island Supreme Court.

This was the first legal proceeding against the Company to go to trial relating to the Company s lead pigment and lead-based paint litigation. The Company cannot reasonably determine the impact that the State of Rhode Island decision and determination of liability will have on the number or nature of present or future claims and proceedings against the Company or estimate the amount or range of ultimate loss that it may incur.

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Other public nuisance claim litigation

The Company and other companies are 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 the California Court of Appeal has decided to review the decision.

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

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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.
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 seeks declaratory and injunctive relief to prevent the violation of the Company s federal constitutional rights in relation to such state court proceedings.
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

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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.

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 is scheduled for October 1, 2007.

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

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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 would be unavailable under the policies at issue to mitigate any ultimate abatement related costs and liabilities in Rhode Island and that insurance proceeds could be unavailable under the policies at issue to mitigate any ultimate abatement related costs and liabilities in other jurisdictions.

For further details on the Company s litigation, see Note 9 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

Note J OTHER (INCOME) EXPENSE

Other general expense net

The Company added the caption Other general expense net to its Statements of Consolidated Income and reclassified certain amounts that were previously included in Other expense net to conform with the 2007 presentation. Included in Other general expense net were the following:

	Three months ended June 30,		Six months ended June 30,	
(Thousands of dollars)	**2007**	2006	**2007**	2006
Provisions for environmental matters-net	**$ 7,658**	$ 12,371	$ **7,717**	$ 15,446
Loss (Gain) on disposition of assets	**131**	130	**(693)**	(180)
Total expense	**$ 7,789**	$ 12,501	$ **7,024**	$ 15,266

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

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Other (income) expense net

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

(Thousands of dollars)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Dividend and royalty income	**$ (623)**	$ (721)	**$ (1,938)**	$ (1,775)
Net expense (income) from financing and investing activities	**1,460**	1,391	**2,902**	(172)
Foreign currency related (gains) losses	**(4,128)**	2,068	**(3,151)**	2,815
Other income	**(2,358)**	(1,074)	**(5,215)**	(2,550)
Other expense	**1,283**	755	**2,428**	1,738
Total (income) expense	**$ (4,366)**	$ 2,419	**$ (4,974)**	$ 56

The net expense (income) 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 (gains) 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 June 30, 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 June 30, 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.

Note K INCOME TAXES

The effective tax rates were 33.2 percent and 32.6 percent for the second quarter and first six months of 2007, respectively, and 31.4 percent and 30.8 percent for the second quarter and first six months of 2006, respectively. The lower tax rates in 2006 were due to numerous favorable audit settlements and reserve releases.

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.

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At January 1, 2007, the Company had $37.8 million in unrecognized tax benefits, the recognition of which would have an affect of $32.2 million on the effective tax rate. Included in the balance of unrecognized tax benefits at January 1, 2007, is $5.2 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 recognizes accrued interest and penalties related to unrecognized tax benefits in Income tax expense. At January 1, 2007, the Company had accrued $11.8 million and $3.4 million for the potential payment of interest and penalties, respectively.

As of January 1, 2007, the Company is subject to U.S. Federal income tax examinations for the tax years 2004 through 2006, and to non-U.S. income tax examinations for the tax years of 2000 through 2006. In addition, the Company is subject to state and local income tax examinations for the tax years 1992 through 2006.

There were no significant changes to any of these amounts during the first six months of 2007.

Note L NET INCOME PER COMMON SHARE

	Three months ended June 30,		Six months ended June 30,	
(Thousands of dollars except per share data)	**2007**	2006	**2007**	2006
Basic				
Average common shares outstanding	**129,647,874**	134,436,954	**130,351,224**	134,484,223
Net income	**$ 202,607**	$ 184,592	**$ 314,409**	$ 298,263
Net income per common share	**$ 1.56**	$ 1.37	**$ 2.41**	$ 2.22
Diluted				
Average common shares outstanding	**129,647,874**	134,436,954	**130,351,224**	134,484,223
Non-vested restricted stock grants	**1,143,860**	1,181,100	**1,161,723**	1,130,528
Stock options and other contingently issuable shares	**2,494,994**	2,823,505	**2,633,895**	2,744,735
Average common shares assuming dilution	**133,286,728**	138,441,559	**134,146,842**	138,359,486
Net income	**$ 202,607**	$ 184,592	**$ 314,409**	$ 298,263
Net income per common share	**$ 1.52**	$ 1.33	**$ 2.34**	$ 2.16

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.

(Thousands of dollars)	Three months ended June 30, 2007				
	Paint Stores Group	Consumer Group	Global Group	Administrative	Consolidated Totals
Net external sales	**$ 1,365,423**	**$ 396,647**	**$ 434,293**	**$ 1,825**	**$ 2,198,188**
Intersegment transfers		**471,329**	**30,384**	**(501,713)**	
Total net sales and intersegment transfers	**$ 1,365,423**	**$ 867,976**	**$ 464,677**	**$ (499,888)**	**$ 2,198,188**
Segment profit	**$ 238,161**	**$ 82,613**	**$ 48,880**		**$ 369,654**
Interest expense				**$ (16,786)**	**(16,786)**
Administrative expenses and other				**(49,723)**	**(49,723)**
Income before income taxes	**$ 238,161**	**$ 82,613***	**$ 48,880**	**$ (66,509)**	**$ 303,145**

	Three months ended June 30, 2006				
	Paint Stores Group	Consumer Group	Global Group	Administrative	Consolidated Totals
Net external sales	$ 1,328,322	$ 400,906	$ 398,778	$ 1,964	$ 2,129,970
Intersegment transfers		467,160	36,232	(503,392)	
Total net sales and intersegment transfers	$ 1,328,322	$ 868,066	$ 435,010	$ (501,428)	$ 2,129,970
Segment profit	$ 217,167	$ 76,317	$ 34,033		$ 327,517
Interest expense				$ (16,837)	(16,837)
Administrative expenses and other				(41,555)	(41,555)
Income before income taxes	$ 217,167	$ 76,317*	$ 34,033	$ (58,392)	$ 269,125

* Segment profit includes $7,586 and $7,518 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores Group during the second quarters of 2007 and 2006, respectively.

(Thousands of dollars)	Six months ended June 30, 2007				
	Paint Stores Group	Consumer Group	Global Group	Administrative	Consolidated Totals
Net external sales	**$ 2,416,346**	**$ 697,853**	**$ 836,507**	**$ 3,660**	**$ 3,954,366**
Intersegment transfers		**815,396**	**67,265**	**(882,661)**	
Total net sales and intersegment transfers	**$ 2,416,346**	**$ 1,513,249**	**$ 903,772**	**$ (879,001)**	**$ 3,954,366**
Segment profit	**$ 360,534**	**$ 138,676**	**$ 84,276**		**$ 583,486**
Interest expense				**$ (35,367)**	**(35,367)**
Administrative expenses and other				**(81,456)**	**(81,456)**
Income before income taxes	**$ 360,534**	**$ 138,676***	**$ 84,276**	**$ (116,823)**	**$ 466,663**

	Six months ended June 30, 2006				
	Paint Stores Group	Consumer Group	Global Group	Administrative	Consolidated Totals
Net external sales	$ 2,384,408	$ 730,847	$ 779,353	$ 3,890	$ 3,898,498
Intersegment transfers		829,683	69,700	(899,383)	
Total net sales and intersegment transfers	$ 2,384,408	$ 1,560,530	$ 849,053	$ (895,493)	$ 3,898,498
Segment profit	$ 330,486	$ 132,997	$ 66,505		$ 529,988
Interest expense				$ (34,187)	(34,187)
Administrative expenses and other				(64,765)	(64,765)
Income before income taxes	$ 330,486	$ 132,997*	$ 66,505	$ (98,952)	$ 431,036

* Segment profit includes $12,513 and $12,659 of mark-up on intersegment transfers realized as a result of external sales by the Paint Stores Group during the first six months of 2007 and 2006, respectively.

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 segment loss included administrative expenses of the Company s corporate headquarters, interest expense which was unrelated to retail real estate leasing activities, investment income, certain foreign currency transaction 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 financing activities, stock-based compensation expense and other expenses not directly associated with any Reportable Operating Segment.

Net external sales and segment profits of all consolidated foreign subsidiaries were $236.9 million and $24.0 million, respectively, for the second quarter of 2007, and $203.0 million and $13.7 million, respectively, for the second quarter of 2006. Net external sales and segment profits of these subsidiaries were $446.7 million and $39.5 million, respectively, for the first six months of 2007, and $397.1 million and $29.3 million, respectively, for the first six months of 2006. Long-lived assets of these subsidiaries totaled $176.1 million and $121.7 million at June 30, 2007 and 2006, respectively. Domestic operations account for the remaining net external sales, segment profits and long-lived assets. The Administrative segment does not include any significant foreign operations. No single geographic area outside the United States was significant relative to consolidated net external sales or consolidated long-lived assets.

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

Note N 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, 2006 for a complete description of the Company s borrowing arrangements.

During the second quarter of 2007, the Company extended its accounts receivable securitization borrowing facility to January 27, 2010 from January 28, 2009. There were no borrowings outstanding under this facility at the end of the second quarter.

On April 26, 2007, the Company entered into an additional five-year credit agreement. This additional credit agreement gives the Company the right to borrow and to obtain the issuance, renewal, extension and increase of a letter of credit up to an aggregate availability of $250.0 million. At June 30, 2007, there were no borrowings outstanding under the agreement.

NOTE O ACQUISITIONS

During the second quarter of 2007, the Company completed its acquisitions of 100 percent of the stock of M. A. Bruder & Sons Incorporated (MAB) and substantially all of the assets and business of Nitco Paints Private Limited (Nitco) for an aggregate consideration of $149.3 million, net of cash acquired, including costs of acquisition and the assumption of certain financial obligations. The acquisitions were financed through the use of cash and Short-term borrowings. Both acquisitions were accounted for as purchases, with results of operations included in the consolidated financial statements beginning with the month of April for Nitco and June for MAB.

MAB, included in the Paint Stores Group, is a leading manufacturer and distributor of paints and coatings in the eastern and southeastern portions of the United States. MAB services the

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professional painting contractor, builder and do-it-yourself markets through 131 company-operated stores. MAB was acquired to contribute to the Company s domestic controlled-distribution growth strategy. Nitco, included in the Global Group, is a leading manufacturer and distributor especially in western India of exterior paints and coatings used in the construction of office buildings, high rise apartments, shopping malls, hospitals and schools. Nitco was acquired to support the Company s international growth strategy.

Goodwill recognized in the acquisitions amounted to $50.1 million in the Paint Stores Group and $11.6 million in the Global Group. Identifiable intangible assets valued in the acquisitions amounted to $30.8 million in the Paint Stores Group and $11.8 million in the Global Group. The allocations of the purchase prices to specific assets and liabilities during the second quarter of 2007 were based on preliminary independent appraisals and internal estimates. The final allocations are not expected to differ significantly from the preliminary amounts allocated.

In October 2006, the Company acquired substantially all of the assets and business of Susannah Dobbs Company LLC (Dobco) for $51.2 million paid in cash. Dobco, included in the Consumer Group, manufactures, distributes and sells thermoplastic pavement marking and related products. Dobco was acquired to contribute to the Company s growth strategy by expanding its existing product base. The acquisition was accounted for as a purchase, with results of operations included in the consolidated financial statements since the date of acquisition. The Dobco acquisition resulted in the recognition of goodwill of $29.0 million and identifiable intangible assets of $11.0 million.

The following unaudited pro-forma summary presents consolidated financial information as if MAB, Nitco and Dobco had been acquired at the beginning of each period presented. The pro-forma consolidated financial information does not necessarily reflect the actual results that would have occurred had the acquisitions taken place on January 1, 2006 or of future results of operations of the combined companies under ownership and operation of the Company.

	Three months ended June 30,		Six months ended June 30,	
(Thousands of dollars except per share data)	**2007**	2006	**2007**	2006
Net sales	**$2,225,825**	$2,185,369	**$4,012,136**	$3,995,406
Net income	**203,353**	188,571	**313,992**	303,574
Net income per common share:				
Basic	**1.57**	1.40	**2.41**	2.26
Diluted	**1.53**	1.36	**2.34**	2.19

Note P RECLASSIFICATION

Certain amounts in the 2006 financial statements have been reclassified to conform with the 2007 presentation.

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

OVERVIEW

Consolidated net sales increased by 3.2 percent to $2.20 billion in the second quarter of 2007 and 1.4 percent to $3.95 billion in the first six months of 2007 versus comparable periods in 2006. The net sales increase was due primarily to improving domestic and strong international paint sales. Consolidated net income increased 9.8 percent to $202.6 million in the second quarter of 2007 and 5.4 percent to $314.4 million in the first six months of 2007 versus comparable periods in 2006. Consolidated net income improved as a percent to net sales to 8.0 percent from 7.7 percent in the first six months of 2007 versus the comparable period in 2006. Diluted net income per common share increased 14.3 percent in the second quarter to $1.52 per common share from $1.33 per common share in 2006 and 8.3 percent in the first six months of 2007 to $2.34 per common share from $2.16 per common share a year ago.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Effective January 1, 2007, the Company adopted FIN No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN No. 48 provides guidance for the recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. 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. See Note K for more information on income taxes.

Except for the adoption of FIN No. 48, there have been no significant changes in critical accounting policies or management estimates since the year ended December 31, 2006. A comprehensive discussion of the Company s critical accounting policies and management estimates is included in Management s Discussion and Analysis of Financial Condition and Results of Operations in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

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FINANCIAL CONDITION, LIQUIDITY AND CASH FLOW

Cash and cash equivalents and short-term investments decreased $432.8 million during the first six months of 2007 due primarily to the maturity and payment of long-term debt and funding of acquisitions. Cash requirements for normal seasonal increases in working capital, capital expenditures of $83.3 million, payments of cash dividends of $83.0 million and treasury stock purchases of $310.0 million were funded primarily by net cash from operations, a net increase in short-term borrowings of $85.2 million and proceeds from the exercise of stock options of $53.9 million. Short-term borrowings related to the Company s domestic commercial paper program outstanding were $378.7 million at an average rate of 5.4 percent at June 30, 2007. The Company had unused maximum borrowing availability of $530.5 million at June 30, 2007 under the commercial paper program that is backed by the Company s revolving credit agreement. Short-term borrowings outstanding under various foreign programs at June 30, 2007 were $76.3 million with a weighted average interest rate of 10.4 percent.

Since June 30, 2006, cash generated by operations of $853.5 million and other financing sources was used primarily for acquisitions of $200.5 million, capital expenditures of $198.8 million, treasury stock purchases of $558.4 million, payments of cash dividends of $150.2 million and payment of long-term debt of $200.0 million.

Capital expenditures during the first six months of 2007 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 Group.

During the second quarter of 2007, the Company purchased 1,300,000 shares of its common stock for treasury purposes through open market purchases, which brings the total number of shares purchased in 2007 to 4,650,000. 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 June 30, 2007 to purchase 8,171,070 shares of its common stock.

At June 30, 2007, the Company s current ratio was 1.11, a decrease from the current ratio of 1.18 at December 31, 2006. The decrease in the current ratio was primarily due to the increase in working capital items needed to meet increased demand during the third quarter and the funding of acquisitions with cash.

During the second quarter of 2007, the Company completed its acquisitions of 100 percent of the stock of M. A. Bruder & Sons Incorporated (MAB) and substantially all of the assets and business of Nitco Paints Private Limited (Nitco), located in India, for aggregate consideration of $149.3 million, net of cash acquired, including costs of acquisition and the assumption of certain financial obligations. The acquisitions were financed through the use of cash and Short-term borrowings.

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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 accounting principles generally accepted in the United States. In addition, the Company may be subject to potential liabilities, as described in the following, which cannot be reasonably estimated due to the uncertainties involved.

In October 2005, an indirect wholly-owned subsidiary of the Company acquired a 25 percent interest in Life Shield Engineered Systems, LLC (Life Shield) and became obligated to acquire an additional 24 percent interest in Life Shield in October 2007. Life Shield is a start-up company that 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 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

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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. The Company accrues for these contingencies when it is 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. However, because litigation is inherently subject to many uncertainties and the ultimate result of any present or future litigation is unpredictable, the Company s ultimate liability may result in costs that are significantly higher than currently accrued. In the event that the Company s loss contingency is ultimately determined to be significantly higher than currently accrued, 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 involved, 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.

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 Rhode Island and 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.

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 judgment 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. 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. On February 26, 2007, the Court issued a decision on the post-trial motions and other matters pending before the Court. Specifically, the Court (i) denied the defendant s post-trial motions for judgment as a matter of law and for a new trial, (ii) decided to enter a judgment of abatement in favor of the State against the Company and two other defendants, and (iii) decided to appoint a special master for the purpose of assisting the Court in its consideration of a remedial order to implement the judgment of abatement, and if necessary, any monitoring of the implementation of that order. On March 16, 2007, final judgment was entered against the Company and two other defendants. Also on March 16, 2007, the Company filed its notice of appeal to the Rhode Island Supreme Court.

This was the first legal proceeding against the Company to go to trial relating to the Company s lead pigment and lead-based paint litigation. The Company cannot reasonably determine the impact that the State of Rhode Island decision and determination of liability will have on the number or nature of present or future claims and proceedings against the Company or estimate the amount or range of ultimate loss that it may incur.

Other public nuisance claim litigation

The Company and other companies are 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 the California Court of Appeal has decided to review the decision.

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.

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

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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 seeks declaratory and injunctive relief to prevent the violation of the Company s federal constitutional rights in relation to such state court proceedings.

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.

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 is scheduled for October 1, 2007.

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 would be unavailable under the policies at issue to mitigate any ultimate abatement related costs and liabilities in Rhode Island and that insurance proceeds could be unavailable under the policies at issue to mitigate any ultimate abatement related costs and liabilities in other jurisdictions.

Environmental-Related Liabilities

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

Depreciation of capital expenditures and other expenses related to ongoing environmental compliance measures were included in the normal operating expenses of conducting business. The Company s capital expenditures, depreciation and other expenses related to ongoing environmental compliance measures were not material to the Company s financial condition, liquidity, cash flow or results of operations during the first six months of 2007. 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 2007.

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

The Company accrues for estimated costs of investigation and remediation activities at its currently or formerly owned sites and third party sites for which commitments or clean-up plans have been developed and when such costs can be reasonably estimated based on industry standards and professional judgment. These estimated costs are based on currently available facts regarding each site. The Company accrues a specific estimated amount when such an amount and a time frame in which the costs will be incurred can be reasonably determined. If the best estimate of costs can only be identified as a range and no specific amount within that range can be determined more likely than any other amount within the range, the minimum of the range is accrued by the Company in accordance with applicable accounting rules and interpretations. The Company continuously assesses its potential liability for investigation and remediation activities and adjusts its environmental-related accruals as information becomes available upon which more accurate costs can be reasonably estimated. At June 30, 2007 and 2006, the Company had accruals for environmental-related activities of $179.0 million and $169.2 million, respectively.

Due to the uncertainties of the scope and magnitude of contamination and the degree of investigation and remediation activities that may be necessary at certain currently or formerly owned sites and third party sites, it is reasonably likely that further extensive investigations may be required and that extensive remedial actions may be necessary not only on such sites but on adjacent properties. Depending on the extent of the additional investigations and remedial actions necessary, the Company s ultimate liability may result in costs that are significantly higher than currently accrued. If the Company s future loss contingency is ultimately determined to be at the maximum of the range of possible outcomes for every site for which costs can be reasonably estimated, the Company s aggregate accruals for environmental-related activities would be $141.9 million higher than the accruals at June 30, 2007.

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 June 30, 2007. At June 30, 2007, $126.7 million or 70.9 percent, related directly to these five sites. Of the aggregate unaccrued exposure of $141.9 million at June 30, 2007, $99.1 million or 69.8 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 stages of the environmental-related process. Although contamination exists at

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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 former sites but along adjacent waterways. Depending on the extent of the additional investigations and remedial actions necessary, the ultimate liabilities 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 facility located in Illinois and a contiguous owned vacant property. The environmental issues at these sites have been determined to be associated with historical manufacturing 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 and further development of that plan is currently underway. The majority of the investigative activities have been completed for the contiguous former property, some remedial actions have been taken and a proposed remedial action plan has been formulated but currently no clean up goals have been approved by the lead governmental agency. Due to the uncertainties of the scope and magnitude of contamination and the degree of remediation that may be necessary relating to this former site, it is reasonably likely that further investigations may be required and that extensive remedial actions may be necessary at this former facility.

The fifth site is a currently owned idle facility 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.

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 investigation at the sites is completed and remedial action plans are fully 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

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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 $85.2 million to $455.0 million at June 30, 2007 from $369.8 million at December 31, 2006. Total long-term debt decreased $202.4 million to $302.3 at June 30, 2007 from $504.7 million at December 31, 2006. See the Financial Condition, Liquidity and Cash Flow section of this report for more information. There have been no other significant changes to the Company s contractual obligations and commercial commitments in the first six months of 2007 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, 2006. Changes to the Company s accrual for product warranty claims in the first six months of 2007 are disclosed in Note E.

RESULTS OF OPERATIONS

Shown below are net sales and the percentage change for the third quarter and first six months by segment for 2007 and 2006:

(thousands of dollars)	**2007**	Change	2006
Three months ended June 30:			
Paint Stores Group	**$ 1,365,423**	2.8%	$ 1,328,322
Consumer Group	**396,647**	-1.1%	400,906
Global Group	**434,293**	8.9%	398,778
Administrative	**1,825**	-7.1%	1,964
	$ 2,198,188	3.2%	$ 2,129,970
Six months ended June 30:			
Paint Stores Group	**$ 2,416,346**	1.3%	$ 2,384,408
Consumer Group	**697,853**	-4.5%	730,847
Global Group	**836,507**	7.3%	779,353
Administrative	**3,660**	-5.9%	3,890
	$ 3,954,366	1.4%	$ 3,898,498

Consolidated net sales increased in the second quarter and first six months of 2007 due primarily to improving domestic and strong international paint sales. The acquisitions of MAB and Nitco increased consolidated net sales by 0.7 percent in the quarter and by 0.4 percent in the first six months of 2007.

Net sales of all consolidated foreign subsidiaries were up 16.7 percent to $236.9 million for the second quarter and up 12.5 percent to $446.7 million for the first six months of 2007 versus

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$203.0 million and $397.1 million for the respective comparative periods in 2006. Of the increase in net sales for foreign subsidiaries during the second quarter and first six months of 2007, 6.4 percent and 4.1 percent, respectively, related to favorable foreign currency exchange rates. Net sales of all operations other than consolidated foreign subsidiaries were up 1.8 percent to $1,961.3 million for the second quarter and up 0.2 percent to $3,507.7 million for the first six months as compared to $1,927.0 million and $3,501.4 million for the respective comparative periods in 2006.

Net sales in the Paint Stores Group during the first six months increased due primarily to the MAB acquisition and increasing domestic architectural paint sales to do-it-yourself (DIY) customers and commercial and residential repaint contractors and to improved industrial maintenance product sales. Net sales from stores open for more than twelve calendar months was flat for the quarter and down 1.0 percent in the first six months over last year s comparable periods. The acquisition of MAB, effective May 31, 2007, added 131 new stores and increased net sales by 1.0 percent in the quarter and 0.5 percent for the first six months of 2007. Total paint sales volume percentage decreases were in the low-single digits for the second quarter and the first six months of 2007 as compared to the same period last year. Sales of products other than paint were flat for the quarter and the first six months of 2007 over last year s comparable periods. A discussion of changes in volume versus pricing for sales of products other than paint is not pertinent due to the wide assortment of general merchandise sold.

Net sales of the Consumer Group decreased due primarily to soft DIY demand at most of the segment s retail customers and, during the first quarter of 2007, the final period in the elimination of a portion of a paint program with a large retail customer. The decline in sales for the second quarter and the first six months of 2007 was caused by a general softness in sales of paint and products other than paint.

The Global Group s first quarter and first six months of 2007 net sales increased due primarily to a new product introduction in the U.K., architectural and automotive paint volume gains in South America, and improved product finishes sales. Favorable currency exchange rates also increased net sales of this Segment by 3.6 percent in the quarter and 2.2 percent for the first six months of 2007 over 2006. The acquisition of Nitco accounted for no significant increase in net sales in the quarter or first six months of 2007.

Shown below are segment profit and the percent change for the second quarter and first six months by segment for 2007 and 2006:

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(thousands of dollars)	**2007**	Change	2006
Three months ended June 30:			
Paint Stores Group	**$ 238,161**	9.7%	$ 217,167
Consumer Group	**82,613**	8.2%	76,317
Global Group	**48,880**	43.6%	34,033
Administrative	**(66,509)**	-13.9%	(58,392)
	$ 303,145	12.6%	$ 269,125
Six months ended June 30:			
Paint Stores Group	**$ 360,534**	9.1%	$ 330,486
Consumer Group	**138,676**	4.3%	132,997
Global Group	**84,276**	26.7%	66,505
Administrative	**(116,823)**	-18.1%	(98,952)
	$ 466,663	8.3%	$ 431,036

Consolidated segment profit was favorably impacted by a change in gross profit, which increased $50.0 million and $69.9 million in the second quarter and first six months of 2007, respectively, as compared to comparable periods in 2006. As a percent of sales, consolidated gross profit increased to 44.9 percent in the quarter from 44.0 percent in the second quarter of 2006 and to 45.0 percent from 43.8 percent in the first six months of 2006. The increase in the consolidated gross profit percentage is primarily related to better factory utilization, product sales mix and foreign selling price increases. Negatively impacting consolidated segment profit was an increase in selling, general and administrative expenses (SG&A) of $25.3 million in the second quarter and $45.5 million in the first six months of 2007 as compared to last year. As a percent of sales, consolidated SG&A increased slightly to 30.3 percent in the quarter from 30.1 percent in the second quarter of 2006 and to 32.5 percent in the first six months from 31.8 percent in the first six months of 2006. The increase in SG&A for the first six months over last year was mitigated by an additional reduction of $7.3 million in the first quarter in the estimated incentive compensation expense accrued at December 31, 2006. The acquisitions of MAB and Nitco did not have a significant impact on consolidated segment profit or segment profit for the Paint Stores Group or the Global Group.

The Paint Stores Group s gross profit for the second quarter and for the first six months of 2007 increased $32.2 million and $50.0 million, respectively, due primarily to higher selling prices implemented in 2006 that helped return gross profit to a more normal percentage of sales. The Consumer Group s gross profit for the second quarter increased from last year by $2.6 million and decreased for the first six months by $1.6 million due to lower sales that could not be offset by tight spending control and better factory utilization. The Global Group s gross profit for the second quarter and first six months of 2007 increased $13.7 million and $21.9 million, respectively, due to increased sales volume and prices in South America and improved operating efficiencies related to additional manufacturing volume. Foreign exchange fluctuations increased the Global Group s gross profit by $4.0 million and $5.0 million in the second quarter and first six months of 2007, respectively.

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In the Paint Stores Group, SG&A increased $11.2 million for the quarter and $20.3 million for the first six months of 2007 due primarily to increased expenses associated with new stores that were partially offset in the first quarter by the additional reduction of $5.2 million in a prior accrual related to incentive compensation expense. The Consumer Group s SG&A decreased $4.0 million for the quarter and $8.3 million for the first six months of 2007 due primarily to tight spending control and decreased sales volume. The Global Group s SG&A increased by $6.4 million for the quarter and $9.5 million for the first six months of 2007 relating primarily to sales volume gains, more branch openings and exchange rate fluctuations of $2.8 million for the quarter and $3.5 million for the first six months of 2007.

Administrative expenses for the second quarter and first six months of 2007 included increased compensation and benefit related expenses not directly allocable to the Reportable Operating Segments of approximately $10.2 million and $16.5 million, respectively. Included in these increases were $1.7 million for the quarter and $4.4 for the first six months of 2007 of increased stock-based compensation expense, and other increased administrative expenses. Also included in administrative expenses for the first six months of 2007 were increases of $3.0 million in the net expense of financing and investing activities. Reduced environmental-related expenses partially offset these increases in the second quarter and first six months of 2007.

Consolidated income before income taxes improved $34.0 million, or 12.6 percent, during the second quarter and improved $35.6 million, or 8.3 percent, during the first six months of 2007 due to improved segment profits of the Reportable Operating Segments that more than offset the year-over-year increases in administrative expenses.

The effective tax rates were 33.2 percent and 32.6 percent, for the second quarter and first six months of 2007, respectively, and 31.4 percent and 30.8 percent for the second quarter and first six months of 2006, respectively. The lower tax rate in 2006 was due to numerous favorable audit settlements and reserve releases.

Net income increased $18.0 million, or 9.8 percent, in the second quarter of 2007 and $16.1 million, or 5.4 percent, for the first six months of 2007. Diluted net income per common share increased 14.3 percent to $1.52 per share from $1.33 per share in the second quarter of 2007 and 8.3 percent to $2.34 per share from $2.16 per share for the first six months of 2007 as the diluted average shares and equivalents outstanding declined 4.2 million shares from 2006.

Management considers a measurement that is not in accordance with accounting principles generally accepted in the United States a useful measurement of the operational profitability of the Company. Some investment professionals also utilize such a measurement as an indicator of the value of profits and cash that are generated strictly from operating activities, putting aside 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

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operating activities in accordance with accounting principles generally accepted in the United States disclosed in the Statements of Consolidated Income and the Condensed Statements of Consolidated Cash Flows. EBITDA as used by management is calculated as follows:

	Three months ended June 30,		Six months ended June 30,	
(thousands of dollars)	**2007**	2006	**2007**	2006
Net income	**$ 202,607**	$ 184,592	**$ 314,409**	$ 298,263
Interest expense	**16,786**	16,837	**35,367**	34,187
Income taxes	**100,538**	84,533	**152,254**	132,773
Depreciation	**33,272**	30,160	**65,510**	59,839
Amortization	**5,897**	5,622	**11,349**	11,259
EBITDA	**$ 359,100**	$ 321,744	**$ 578,889**	$ 536,321

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements contained in Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based upon management s current expectations, estimates, assumptions and beliefs concerning future events and conditions and may discuss, among other things, anticipated future performance (including sales and earnings), expected growth, future business plans and the costs and potential liability for environmental-related matters and the lead pigment and lead-based paint litigation. Any statement that is not historical in nature is a forward-looking statement and may be identified by the use of words and phrases such as expects, anticipates, believes, will, will l result, will continue, plans to and similar expressions.

Readers are cautioned not to place undue reliance on any forward-looking statements. Forward-looking statements are necessarily subject to risks, uncertainties and other factors, many of which are outside the control of the Company, that could cause actual results to differ materially from such statements and from the Company s historical results and experience.

These risks, uncertainties and other factors include such things as: (a) general business conditions, strengths of retail and manufacturing economies and the growth in the coatings industry; (b) competitive factors, including pricing pressures and product innovation and quality; (c) changes in raw material and energy supplies and pricing; (d) changes in the Company s relationships with customers and suppliers; (e) the ability of the Company to attain cost savings from productivity initiatives; (f) the ability of the Company to successfully integrate past and future acquisitions into its existing operations, as well as the performance of the businesses acquired; (g) 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; (h) risks and uncertainties associated with the

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Company s expansion into and its operations in China, India, South America and other foreign markets, including general economic conditions, inflation rates, recessions, foreign currency exchange rates, foreign investment and repatriation restrictions, legal and regulatory constraints, civil unrest and other external economic and political factors; (i) the achievement of growth in developing markets, such as China, India, Mexico and South America; (j) increasingly stringent domestic and foreign governmental regulations including those affecting the environment; (k) inherent uncertainties involved in assessing the Company s potential liability for environmental-related activities; (l) other changes in governmental policies, laws and regulations, including changes in accounting policies and standards and taxation requirements (such as new tax laws and new or revised tax law interpretations); (m) the nature, cost, quantity and outcome of pending and future litigation and other claims, including the lead pigment and lead-based paint litigation, and the effect of any legislation and administrative regulations relating thereto; and (n) unusual weather conditions.

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

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk associated with interest rates, foreign currency and commodity fluctuations. The Company utilizes derivative instruments as part of its overall financial risk management policy, but does not use derivative instruments for speculative or trading purposes. The Company enters into foreign currency option and forward 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, 2006.

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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.

During the first quarter of 2007, we upgraded a portion of our financial information systems to a more technologically current and flexible financial system. When fully implemented, this upgrade in financial software will enhance our common financial platform worldwide and will create additional efficiencies to support our continued growth. We plan to complete our domestic implementation of such software by the third quarter of 2007. In connection with the upgrade in its financial software, we have modified or replaced the design and documentation of certain internal control processes and procedures.

Except as described above, there were no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

For information with respect to certain environmental-related matters and legal proceedings, see the information included under the captions entitled Environmental-Related Liabilities and Litigation of Management s Discussion and Analysis of Financial Condition and Results of Operations and Notes 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 second quarter is as follows:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plan
April 1 - April 30				
Share repurchase program (1)	195,779	$ 65.25	195,779	9,275,291
Employee transactions (2)	1,766	$ 66.20		N/A
May 1 - May 31				
Share repurchase program (1)	679,000	$ 66.33	679,000	8,596,291
Employee transactions (2)	2,183	$ 67.50		N/A
June 1 - June 30				
Share repurchase program (1)	425,221	$ 65.94	425,221	8,171,070
Employee transactions (2)		$		N/A
Total				
Share repurchase program (1)	1,300,000	$ 66.04	1,300,000	8,171,070
Employee transactions (2)	3,949	$ 66.92		N/A

(1) All shares were purchased through the Company s publicly announced share repurchase program. On October 21, 2005, the Board of Directors of the Company authorized the Company to purchase, in the aggregate,

20.0 million shares of its common stock and rescinded the previous authorization limit. The Company had remaining authorization at June 30, 2007 to purchase 8,171,070 shares. There is no expiration date specified for the program. The Company intends to repurchase stock under the program in the future.

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

Item 5. Other Information.

During the fiscal quarter ended June 30, 2007, the Audit Committee of the Board of Directors of the Company approved additional audit services and non-audit services to be performed by Ernst & Young LLP, the Company s independent registered public accounting firm. The non-audit services were approved within categories related to domestic advisory and compliance services and foreign tax consulting and advisory services.

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Item 6. Exhibits.

4(a) Five Year Credit Agreement, dated as of April 26, 2007, by and among Sherwin-Williams, Citicorp USA, Inc., as administrative agent and issuing bank, the Lenders from time to time party thereto, and The Bank of New York, as paying agent, filed as Exhibit 4.1 to Sherwin-Williams Current Report on Form 8-K dated April 26, 2007, and incorporated herein by reference.

4(b) Agreement for Letter of Credit, dated as of April 26, 2007, by and between The Sherwin-Williams Company and Citibank, N.A. , filed as Exhibit 4.2 to Sherwin-Williams Current Report on Form 8-K dated April 26, 2007, and incorporated herein by reference.

4(c) Amendment No. 1 to Loan and Servicing Agreement, dated as of May 29, 2006, among SWC Receivables Funding LLC, Sherwin-Williams, CIESCO, LLC, Citibank N.A., and Citicorp North America, Inc. (filed herewith).

4(d) Amendment No. 2 to Loan and Servicing Agreement, dated as of January 31, 2007, among SWC Receivables Funding LLC, Sherwin-Williams, CIESCO, LLC, Citibank N.A., and Citicorp North America, Inc. (filed herewith).

4(e) Amendment No. 3 to Loan and Servicing Agreement, dated as of June 6, 2007, among SWC Receivables Funding LLC, Sherwin-Williams, CIESCO, LLC, Citibank N.A., and Citicorp North America, Inc. (filed herewith).

10(a) Summary of Adjusted Base Salaries for Named Executive Officers (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
July 23, 2007	By: /s/ J.L. Ault J.L. Ault Vice President-Corporate Controller
July 23, 2007	By: /s/ L.E. Stellato L.E. Stellato Vice President, General Counsel and Secretary

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