PPG

Second Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

John Bruno – *Director Investor Relations*

Michael McGarry – *Chairman and Chief Executive Officer*

Vince Morales – *Senior Vice President and Chief Financial Officer*

PRESENTATION

Operator
Good afternoon and welcome to the PPG Industries Second Quarter 2017 Earnings Conference Call. My name is Gary and I will be your conference specialist today. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to John Bruno, Director of Investor Relations. Please go ahead.

John Bruno
Good afternoon, this is John Bruno, Director of Investor Relations. We appreciate your interest in PPG and welcome you to our second quarter 2017 financial results conference call. Joining me on the line from PPG are Michael McGarry, Chairman and Chief Executive Officer, and Vince Morales, Senior Vice President and Chief Financial Officer.

Our comments relate to the financial information released on Thursday, July 20, 2017. In accordance with generally accepted accounting principles, both current and prior year PPG financial figures presented today will recast/reflect our former glass segment as discontinued operations. As a reminder, in the second half of 2016, we sold our flat glass and European fiberglass business along with divesting our two Asian fiberglass joint ventures.

Our North American fiberglass businesses is pending sale, and we expect that sale to be completed in the second half of 2017. About one hour ago, we posted detailed commentary and accompanied presentation slides on the Investor Center of our website, www.PPG.com. The slides are also available on the webcast site for this call and provide additional support to the opening comments Michael will make momentarily.

Following Michael's perspective on the company's quarterly results, we will move to a Q&A session. Both the prepared commentary and discussion during this call may contain forward-looking statements, reflecting the company's current view of future events and their potential effect on PPG's operating and financial performance. These statements involve uncertainties and risks which may cause actual results to differ. The company is under no obligation to provide subsequent updates to these forward-looking statements.

This presentation also contains certain non-GAAP financial measures. The company has provided, in the appendix of the presentation materials, which are available on our website, reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures. For additional information, please refer to PPG's filings with the FCC.

Now, let me introduce PPG's Chairman and CEO, Michael McGarry.

Michael McGarry
Thank you, John, and good afternoon, everyone. Today, we reported second quarter and year-to-date 2017 financial results. Our net sales for the second quarter were $3.8 billion, and adjusted earnings per diluted share from continued operations were $1.83, up 6% year-over-year. Our overall sales were up

less than 1% in the quarter, with benefits from acquisition-related sales partly offset by unfavorable currency translation.

As a US-headquartered global company, currency and translation has been a headwind on sales and earnings for more than a year; however, given the US dollar weakening during the second quarter, and assuming those current exchange rates hold, we expect only a modest currency translation affecting our sales and earnings in the third quarter.

For the second quarter, our selling prices were only up slightly versus the prior year; however, this marked an improvement sequentially versus the past few quarters. This improvement is important as it is the result of our initial efforts to offset significant raw material costs inflation that the coatings industry has experienced. Our overall company volumes are flat in the second quarter. Industrial coatings volume improved by about 3%, while performance coating volumes declined by about 2%.

One factor impacting our second quarter volumes was the effect of our efforts to raise prices resulting in us turning away certain business. We expect to sell customers our products at fair prices that allow us to make a reasonable return on the tremendous amount of service and value we provide to these customers. We have additional pricing actions that are being initiated and implemented in all businesses and all regions in the third quarter to further offset raw material inflation, and we'll continue to work collaboratively with our customers on an individual basis.

Also, modestly affecting our second quarter volume growth was a shift in the timing of the Easter holiday. Easter was in the first quarter of 2016 and the second quarter of 2017. This holiday shift impact is more prominent in the performance coating segment due to the retail and distribution nature of our business in that area and has a much less significant effect in our industrial coatings segment.

However, while this shift had a modest, unfavorable impact in the second quarter, it aided first quarter volume comparisons and had no impact on our year-to-date volume growth, which came in about 1%, which is well below our target. We continue to work on a variety of actions to improve our organic volume growth rate and are delivering results on various initiatives.

Some highlights include the industrial coatings segment where volumes grew at well above industry rates, including our general industrial coatings business where our growth exceeded global, industrial production growth by a factor of two to one. We've delivered this level of growth in this business several quarters in a row now. Also, our automotive OEM coatings business is once again outpacing global automotive build rates.

In the second quarter, our volumes were up over 1% versus the decline of about 1% in the global industry auto builds. A few of the key factors of our outperformance are our innovative products, the excellent technical service we deliver to our customers, and the decision investments we made a few years ago back to emphasize and shift our regional mix of businesses toward higher growth regions.

Another solid growth trend for us has been our US company-owned architectural stores. While we have some more work to do here, we have posted six consecutive quarters of improved same-store sales. Over the past several years, we have made significant structural improvements to the business we acquired, and we have made certain targeted brand investments. We are now beginning to yield benefits from these initiatives.

We're also realizing continued benefits from various innovative products in refinish and aerospace among others. However, given our overall performance year-to-date, volume growth remains a key focus for the company, and we continue to work on a variety of initiatives to address this issue and accelerate our

growth rate. From an earnings perspective, while our adjusted EPS grew by 6%, we experienced compression in our overall gross margin and also in the return on sales in both our reporting segments.

The largest driver was significant raw material cost inflation, and we expect the second quarter to be our most difficult comparison for this cost category. We will continue to experience year-over-year raw material inflation in the third quarter. As I mentioned, we will be implementing additional selling price increases in the coming quarters, and we are entering a seasonally-slower period, which will decrease the overall demand for the commodities we buy.

Additionally, we have expanded our research work team focus on raw material efficiency and innovation, and they are working on projects to decrease or expand the supply base for certain raw materials we purchase. Also, we were able to mitigate some margin compression with overall productivity improvements due to our aggressive manufacturing overhead cost management. In addition, we accelerated some actions from our restructuring program we announced in 2016. We will continue our similar efforts in the coming quarters.

Our cash deployment also provides some benefit to our earnings per share growth. This included several acquisitions we completed over the past 12 months, along with the synergies we have captured to date. Additionally, year-over-year, we have reduced our overall share count by about 4%.

Looking ahead, we expect to remain in a consistent but modest overall global economic growth environment. Our highest growth rates continue to be in emerging regions, although these economies have moderated in recent quarters. However, we expect solid growth to continue in China, India, and certain Latin American countries. Notable, and specific to PPG, is that we will reach the anniversary of the significant declines and marine new-build, which has had an unfavorable impact in our organic growth rate in Asia and, specifically, Korea the past two years.

We have seen evidence of broadening, early economic cycle activity in Europe. Although we are a few steps down the chains, the backdrop for this regional economy appears favorable. This continues to be an opportunity for PPG. As we have said many times in the past, our best incremental margins are in Europe given the lack of a broad recovery-to-date coupled with the latent capacity we have there.

In the US and Canada, growth has become more industry-specific. The overall construction market remains solid, as does general industrial activity; however, automotive builds have moved past mid-cycle, and we have still not evidence of meaningful improvement in business investment or return of large scale energy investment. As a result of the various puts and takes in the global economy, and specifically in the coatings industry, we will continue to manage our overall cost structure, including delivering on our targeted $40 million to $50 million in restructuring savings this year.

Also, we ended the quarter with a very strong balance sheet, including approximately $1.6 billion of cash. We expect a higher level of earnings accretive cash deployment in the second half of 2017 versus the first half. We previously communicated an intent to deploy $2.5 billion to $3.5 billion of cash on acquisitions and share repurchases in 2017 and 2018 and are now targeting the upper end of that range at a minimum.

This deployment will likely include both acquisitions and share repurchases. Our acquisition pipeline remains solid, and we're resuming share repurchases in the third quarter and have approximately $1.7 billion remaining under its current share repurchase authorization.

To summarize our results, we had a solid quarter against a backdrop of raw material cost inflation and modest global economic growth. We delivered excellent performance in several of our businesses, and,

overall, we worked to successfully counter the effects of inflation, and we achieved a 6% EPS growth.

Going forward, we have further work to do on organic growth, and I believe we are up to the task based on the traction we have delivered to date on various initiatives. Also, we expect continued earnings accretive benefits from a higher level of cash deployment in the second half of 2017. This concludes our prepared remarks. Once again, thank you for your interest in PPG.

Gary, would you please open the line for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. [Operator Instructions]. Our first question comes from David Begleiter with Deutsche Bank. Please go ahead.

David Begleiter
Thank you. Good afternoon, Mike and Vince. Mike, on the raws versus selling price increases, do you expect to catch up in Q3 or Q4, and I guess we would still expect some margin compression in Q3 year-over-year?

Michael McGarry
I think, in Q3, we're still going to have some margin compression, but we are working hard on the price increases, and, I think, Q4 you'll start to see a meaningful improvement in that regard.

David Begleiter
And, Mike, just on the lost business when you tried to raise prices, in what businesses and what regions did it occur, and how concerned are you about lack of discipline in the industry on pricing?

Michael McGarry
I'm not concerned at all, David. I mean, historically, you know, because such a large percentage of our cost is raw materials, our coatings peers we'll need to be managing their margins, and I think that's important. You have one of our competitors, who was obviously going through a significant change as they were being acquired Sherwin, so maybe there was some lack of focus there, I don't know. We'll wait and see.

Then, you have another one that has additional challenges where they're focused highly on growth, organic growth, and volume. They specifically listed that. So, I think there's some divergence out here, but that's not going to continue. I think the coatings industry has had a history of pricing, and our customers know that this is a significant issue for us. We work collaboratively with our customers, and we would expect to do so in the third and fourth quarters as well.

Vince Morales
And, David, if you look at our history as an industry and certainly as a company, we've said for a long period of time, it typically takes six to nine months to offset inflationary effects, and we're really in the three, four, five month category, so we do expect additional pricing from our sales in the back half of the year, consistent with past practice.

David Begleiter
Very good. Thank you.

Vince Morales
Thanks, David.

Operator
The next question comes from Ghansham Panjabi with Robert W. Baird. Please go ahead.

Ghansham Panjabi
Hi, guys. Good afternoon. I guess, Michael, just given some of your macro comments in your press release, and based on flat volume growth during Q2 on top of a flat volume quarter a year ago, how are you thinking about volumes in aggregate for the second half? Do you expect volumes to grow on a year-over-year basis during the back half?

Michael McGarry
Well, I do expect volumes to grow. We have had a lot of traction in a number of our businesses. I will point to one area that's been a significant drag and that's marine. We've had 18 quarters in a row of volume declines in Korea. We had a nice uptick in our order book in the second quarter. Now, don't forget, we paint ships 12 to 18 months after, but we saw deliveries getting, I would say, at the bottom, and we expect deliveries of ships in the fourth quarter to be up. That would be the first one. So, I think that's a nice one. And, also, when I think about our packaging business, we reported basically zero in packaging for the second quarter, but they were comping [ph] versus plus 9%. So I think we still have more upward ability in that business.

Miles driven continued to be a positive for refinish. Aerospace deliveries were weak, and, if you look at what their goals for the big aerospace companies are, their second half of the year has to be stronger if they're going to meet their targets. I think I see a number of things that are positive, so I'm optimistic.

Ghansham Panjabi
Okay, that's helpful. And, on the capital allocation side, I have been assuming only a portion of your $3.5 billion plus of capital allocation goes toward share buybacks. That's still a very large number that can influence quarterly earnings. How should we think about layering in buybacks as we work through our remodels, realizing you'd want to be optimistic depending on the stock price? Thanks.

Vince Morales
Thanks, Ghansham. What I would tell you is we don't give out our cadence on share repurchases. If you look at the economics for us, the acquisitions have typically been able to drive incremental value above a share repurchase just because the synergy value of the acquisitions are at a good pricing. So, if there's an opportunity to do a value-creating acquisition that still remains a preference, assuming again the returns are better than a share repo. If we're unable to find those transactions or unable to close them, then we do share repurchases, but, again, historically, we've not given our cadence about what we're going to do by quarter with share repurchases.

Ghansham Panjabi
Okay. Thanks so much.

Operator
The next question comes from Bob Koort with Goldman Sachs. Please go ahead.

Bob Koort
Thank you very much. I was wondering, Michael, if you might be able to help us figure out what the heck is going on in the paint stores versus the DIY markets, why there seems to be such a divergent trend lately?

Michael McGarry
Well, I think you have several factors going on there. First of all, the biggest trend is the do it for me. So, you have the aging baby boomers, cash in the pocket, they'd rather have somebody else go out and do it. They were the big users of DIY, so that's one.

You have the millennials, who have not yet moved into the housing formation market because of college debt or a number of factors, so I think that's another one. And, I think, some of the home centers have complicated their category, if you will, and made it more difficult for consumers when they come in to initiate a paint purchase. So, we've been in a lot of discussion with our DIY customers for the need to simplify their category so that people can come in and move the decision cycle from, say, 100 days down to 60 days, and I think that's a huge one.

So, I think there are a number of factors, but, certainly, you saw the strength in our own company stores. It's outperforming the DIY segment. But, we have a huge vested interest in our customers to be successful in DIY, so we're trying to talk to them about that.

Bob Koort
Alright. And, can you talk a little bit about, maybe Vince, the corporate reporting segment? Obviously, there was a marked improvement there. What were the buckets that led to that improvement, and what's the sustainability or run-rate of that expense line?

Vince Morales
Hi, Bob. The biggest impact on our corporate line was simply incentive-based compensation. As you can tell, we're running below our 10% EPS target and our volume growth is below our targets, as well, so we're reflecting that. And, our margins are compressed, so we're reflecting that in our incentive-based comp. I would say that line item for the back half of the year, we took two quarters' worth in this quarter, and we took the first quarter and second quarter adjustments cumulatively in the second quarter, but for the back half of the year, I would expect that corporate line to be slightly lower than last year but not much so.

Bob Koort
Got it. Thank you very much.

Vince Morales
Thanks, Bob.

Operator
The next question comes from Kevin McCarthy with Vertical Research Partners. Please go ahead.

Kevin McCarthy
Yes, good afternoon. Vince, would you comment on where you think you're tracking for capital expenditures this year, and do you have any preliminary view on the trajectory for 2018 there?

Vince Morales
Yes, Kevin. So, historically, we've been somewhere between 2.5% to 3% of sales on capital spending. In both '15 and '16, we were slightly above that number, because we were doing some cost localization projects, primarily in emerging regions.

Vince Morales
You may have seen in the quarter that we opened a new plant in Russia as well. Now we're expecting,

for 2017, an aggregate to be right around that 3% of sales figure. I would say, in 2018, we're going to stick right around our depreciation level might be slightly above.

Kevin McCarthy
Okay. And then to come back to the notion that you exerted discipline on price and may have lost some volume in industrial, Michael, would you say that that effect was fully captured, or evident in your 2Q financials, or is there, in effect, a spillover into the back half? Perhaps you could provide a little color on which individual businesses within the segment felt that the most?

Michael McGarry
So, in regards to the first question, our paying customers typically make a decision, and then they don't flip-flop people back and forth. So, any share that we lost in 2Q in some of our businesses will likely continue. But, as our competitors feel the same raw material inflation that we have, should they make their own independent decisions, then they may be impacted by customers. Our customers could say, "Okay, well, we see it coming now, so we'll make adjustments differently." That's something we can't predict, but what I will tell you is the raw material inflation is not new to the coatings business. When it happens everybody needs to react, and so we'll be continuing to work in this area. I would say the areas that were impacted the most are the areas that have, I would say, more ability to switch than others, so that means that they're likely to switch back as well. I'm not sure I want to get into the individual businesses, but, if you think the big, global guys have less flexibility and the smaller guys have more flexibility; that may be one way to think about it.

Kevin
Thanks very much.

Operator
The next question comes from the Frank Mitsch, with Wells Fargo. Please go ahead.

Frank Mitsch
Good morning, gentlemen, and congrats, John, on your new position. Michael, you mentioned that Europe is the area where you have the highest incremental margins. As I'm looking at the handy-dandy heat map by geography, I'm looking at Europe a little bit sequentially worse than it was in Q1. But, yet, in Q3 of '16, Europe was relatively weak. How should we think about what's going to happen in Europe in the back half of the year?

Michael McGarry
Well, I think, the positive news about Europe is—if you look at automotive, you still have more latent demand in automotive. I think Eastern Europe has had a nicer recovery, and I think that's going to help. I think maybe the order book in France will start to get healthier now with the change in administration. Certainly UK/Ireland continues to be a strong market for us. I think, a number of things I see from that regard has positive momentum, so that's how I would think about that, Frank.

Vince Morales
Frank, we're not pleased with the volume growth, but I would tell you that one of our bigger businesses there, which is architectural, was down modestly in Q2, but they had two less selling days and their sales per selling day were actually up over 2%. So, again, I think there's been a caveat there with respect to one of our bigger businesses in the Q2 period.

Frank Mitsch
All right, so are more pronounced Easter effect taking place over there? I think we also saw, from some competitor, that the Nordic region had poorer weather, so that might recover. Then, just a follow up on

a comment on the packaging side, which has obviously been a very strong part for the company, and, as you mentioned, a very difficult comp, growth was zero in Q2. From the commentary, it sounds like you expect that to continue. In terms of the shift to BPA and non-intent, what inning are we in? You've made a lot of progress there. Is there still a lot more to go? How should we think about that change in technology playing out?

Michael McGarry
No, we're still in the early innings, Frank. I think right now we have between 50 and 70 trials and conversions still ongoing around the world, so there are a number of activities. Part of that, unfortunately, is the fact that the new coatings, they are multiple coatings, so you don't use just one coating and have to roll it out everywhere. We have multiple coatings, and none of our packaging customers—they have different line configurations, different oven configurations, different airflow configurations, so, I would say, the conversions are not progressing quite as fast as anybody would like. The good news is when we get it they are very happy with it. We still have a lot more conversion to go, but the good news is when we get it right the customers are ecstatic.

Frank Mitsch
Very helpful, thank you gentlemen.

Michael McGarry
Thank you, Frank.

Operator
The next question comes from Vincent Andrews, with Morgan Stanley. Please go ahead.

Vincent Andrews
Thanks. I just wanted to get back to the capital allocation discussion. The subtlety I saw was at least the upper end or the upper end at a minimum. I just wanted to know whether that was a comment on your M&A pipeline, or what you see there, or if it was indicating a willingness to ultimately be more aggressive with the size of the buyback, or both, I suppose?

Vince Morales
Well again, if you look at our balance sheet, we have a very strong balance sheet. We are committed to growing the company or returning the money to the shareholders. We do, I think as evidenced in the quarter, if there's an opportunity to create value for our shareholders, we'll certainly try to take advantage of it. But, it's really a reflection of two things, Vincent: One, our strong cash and our strong balance sheet; and, secondly, our need to be creative and value creative for our shareholders with that asset.

Michael McGarry
And Vincent—this is Michael—the other thing I would say is that, in the beginning of the year, we thought we would be selling fiberglass, but we didn't have a deal. Obviously, now we have a deal, and we have a sightline on when that deal is going to close. So, there's more certainty on the cash flow from that. So, that's a positive. As you see today, the announcement of the Crown Coating Services, we're going to continue to put our money to work in acquisitions.

Vincent Andrews
Okay. Thanks, very much, guys.

Michael McGarry
Thank you.

Operator
The next question comes from Christopher Parkinson, with Credit Suisse. Please go ahead.

Christopher Parkinson
Perfect. Thank you. Can you sum out anything else you could potentially do to improve the performance in US Architectural? It appears that, in the context of obviously of a flux market, that Paramount and Diamond have done relatively well in their respective homes. Also, over the past two seasons, you've made efforts to improve branding, quality, etc., but is there anything else your team is specifically targeting to do in the back half of the year, even into next season? Thank you.

Michael McGarry
Yes. Christopher, I would tell you that we continue to work proactively with our retail partners. One of them launched—Home Depot to be specific—launched PPG Timeless Stain. It has been a little bit of a difficult stain year, given the amount of rain, and so it has impacted exterior paint as well as exterior stain. So, that's a positive. We also have pitched other new ideas to our customers, and they are proactively evaluating them. We won't know until they roll it out in the store, but those are all positives for us. Diamond has been a significant success, Assure at Lowe's has done very well, and Paramount has done well, so, I think, we have a number of success stories. I think our customers are comfortable with the fact that we can play at the good, better, best range, and that's been a positive force.

But, it is an evolution. When we bought the Glidden business, they had underinvested in the brand, they'd underinvested in the resources, so we have brought all that up to speed, and we're just now starting to see that. As you can tell, we have the same thing going on in our PPG-owned stores, which have had significant improvement in sales on a quarter-over-quarter basis.

Christopher Parkinson
Just as a follow up, you have done well on a relative basis in global auto OEM, despite moderation or just flat-out slowing in key regions. Can you comment on your position in the Asian market, specifically, given your exposure with multi-nationals versus some of the domestic producers who appear to potentially be poised to gain share? Just any long-term comments there? Thank you.

Michael McGarry
Yes, so we're a strong number one in OEM in Asia, and we're a strong number one in both the global OEMs, as well as the domestics in China, and we're a very solid performer in India, which is also growing. So, I would say we've been happy. We significantly outpaced industry rates in Asia by multiple points in our OEM business, and, specifically, in China, we were well above what happened in the industry. The industry was flat, and we were up high single digits. So, our platform in Asia is really strong.

Christopher Parkinson
That's great color, thank you.

Vince Morales
Chris, the basis of our performance really goes back a couple of years. We've made some significant investments. We talked earlier about the capex we've done in Asia. We've made some significant bets with some customers, and so it's been planned full, and executable by our team over there.

Christopher Parkinson
Thank you.

Operator
The next question comes from Jeff Zekauskas, with JP Morgan. Please go ahead.

Jeff Zekauskas
Thanks very much. I'd like to go back to the capital expenditure question in that in your earnings brief you say that you expect your capex to be about 3.0% of sales. So, if your sales are roughly $8.7 billion, that would be $262 million, or call it $265 million. Is that the number you expect for capex this year, or that's not correct?

Michael McGarry
We typically, Jeff, if you look at our cadence of capital spending, because our businesses are very busy in the beginning of the year operationally, we typically do a greater amount of capital spending in the back half of the year. If you look at our sales on a full year basis, I don't know what your model has, but I would use your sales on a full year basis times around 3% to get our capital spending figure.

Jeff Zekauskas
Okay, can you, as my follow up, talk about what's going on in the do-it-yourself market, and why the results in general, or the volumes, seem so weak? Do you think that there is a shift downward, and either pricing or complexity of the paint product that's leading to a lower mix?

Vince Morales
Well, Michael mentioned this a little earlier about some of the factors that may be affecting the different channels in architectural. I'll add to what he said earlier when he talked earlier about Baby Boomers and Millennials and different preferences. But, in addition to that, we've typically seen the do-it-for-me category go up, and when you have low unemployment, and unemployment in the US, as you know is at a ten-year low—I would tell you, we've also seen, in the repair market, bigger repairs being done. Paint is a very cost-effective and small dollar repair, and we're typically seeing bigger repairs being done, such as kitchens and baths, that don't use much paint. So, those are the two other contributing factors to what Michael mentioned earlier.

Jeff Zekauskas
Okay, good. Thank you very much.

Vince Morales
Thank you, Jeff.

Operator
The next question comes from PJ Juvekar, with Citi. Please go ahead.

PJ Juvekar
Yes, good afternoon, Michael, Vince.

Michael McGarry
PJ.

Vince Morales
PJ.

PJ Juvekar
You know, the independent channel has been struggling for quite a few years. What's your strategy for that channel? Do you want to be there? And, then, if you compare your pricing across your three

channels, in with this qualitative that we're talking about, where are you seeing the most pressure and where do you see the best pricing?

Michael McGarry
So PJ, the dealer channel continues to be a very good channel for us. The beauty about that channel, even though it's moderating, it's moderating at a very slow rate. It's highly predictable. We're able to manage our cost structure along with the moderation and demand, so the profitability of that segment remains quite good. From our standpoint, we want to be in all three. We want to be in the company-owned stores, we want to be with the dealers, and we want to be with the IOI, so we want to play across them all.

Probably the biggest thing that we probably haven't talked about is in the DIY segment. Because, Vince talked about the bigger projects being done, and if you look at some of the large retailers, they have a lot of big ticket growth. What we want to encourage them to do is make sure when somebody walks in and wants a $25 gallon of paint that we're not chasing them out because we're trying to upsell everybody. So, that's an area of focus is to make sure that we do that. But, I would tell you, all three segments are attractive to us, and we're going to continue to focus on all of them.

PJ Juvekar
Thank you. If I look at your comments on pricing, you guys seem unusually aggressive on pricing. Correct me if I'm wrong, but you let your customers walk away in certain channels. When I look at your raw materials, yes, I'll give you that [indiscernible] is going up, but oil is down and propylene is down. So, you should see some benefit on the hydrocarbon side. Can you talk about this pricing strategy in an environment where the hydrocarbons are lower and the global growth is also quite slow?

Michael McGarry
Well, first of all, I would tell you that I don't think we're pricing any differently than we have historically. That would be my first comment. Second, I would urge you to look at propylene and ethylene on a global basis, because if you look at some of those on a global basis you'll find that propylene in Asia is up year-over-year. You'll find that ethylene in Asia is similar. European ethylene is up year-over-year. So, it's not quite the same overall. This period last year you had oil at about $35 or so, $40, and now you have it at $50. We are seeing oil derivatives. They typically are, again, two or three steps down the value chain, so you don't get the immediate decrease that you see in oil. So, solvents, yes, but for some of the other key commodities, it doesn't happen overnight. I would just tell you we still see raw material inflation, and TI2 is certainly going to be still marginally up in 3Q.

PJ Juvekar
Do you think TI2 continues to go up in second half in a slow season of the year? Thank you

Michael McGarry
Well, historically it doesn't go up in the fourth quarter. As you know, we produce the vast majority of our paint through the first seven or eight months of the year. It tapers off. A number of them have historically come to us and tried to quietly move some volume to incentivize us to make some production ahead of the next year's paint schedule. Whether or not they will do that, it's too early to tell, this is only July, but that is not unusual behavior. I would tell you we should just wait and see how they respond.

PJ Juvekar
Thank you.

Vincent Morales

Thanks, PJ.

Operator
The next question comes from Duffy Fischer, with Barclays. Please go ahead.

Duffy Fischer
Yes, good afternoon, fellas. Just wanted to go to your Slide 5. It's a little hard to tease everything out, but on there it looks like you have 4 categories that you say you're below market and 11 that you're above. Would you say, globally, across all your markets, you're still outgrowing those markets?

Vincent Morales
Duffy, I'll take a stab at it, and let Michael add some color here. We're fairly confident in our industrial businesses. We're outgrowing, or well outgrowing, the markets on a global basis. There may be some discrepancies below or above that comment within each of the individual regions. But, we've had very good volume growth in our general industrial business, mid-single digits. We know in automotive, because we get a report card every month, and, as Michael said, even though in packaging our volumes were flat that's really a factor of the prior year comparable. We're comfortable in our performance segment with our European architectural business and certainly in our architectural businesses in emerging regions. In the US, we don't have all the data yet to make a determination, but in refinish we're above market. There's certainly some work we have to do, but we're not losing share in many of these key markets, and, in many cases, we're well outperforming the market. Michael, I don't know if you want to add.

Michael McGarry
No, I think that's a good summary, Vincent.

Duffy Fischer
Yes, and I guess that's the way I would read it. But, then, the corollary, and help me square this, is, if you guys are growing at least a little bit above market, you are at zero volumes, that would mean the market globally is down. And, to get to that raw material question of, if volumes globally are down in coatings—help me square the pressure on some of the raw material costs. You think, actually, they may be moving the other direction if volumes for the industry are down year-over-year.

Michael McGarry
Well, part of the raw material challenge we're having right now is some of the force majeures on some of the larger items. You did have the challenging environment in Europe, where one of the TI2 plants is still down. You have the environmental issues in China, where they're trying to radically reduce the emission levels, so the TI2 costs are going up there. Then, if you look at some of the things like epoxies, epoxies are up, emulsions are up, and so those are all having that kind of impact. I think on balance, we're not happy. Obviously, we're paying more, but we don't think we're paying anything different than our competitors. We also think that, after the fourth quarter, it's going to be moderating, and, on a year-over-year basis, the first quarter will probably be flat. But right now, it's maybe a little too early to tell that.

Duffy Patrick
Great, thanks, fellas.

Michael McGarry
Thanks.

Operator

The next question comes from Don Carson, with SIG. Please go ahead.

Don Carson
Yes, two questions on volume, Michael, you mentioned some organic initiatives to try and get volume going. You've talked about architectural. Can you talk about your other businesses and what impact you think these overall initiatives can have on volume growth? Secondly, Vince, on the acquisition side, what's the pipeline look like, and are you seeing multiples go up, or at least people's price expectations go up, as they look at some of these big deals that have been done?

Michael McGarry
So, Don, on the specific businesses, we still are going to be launching a new commercial transport product in our refinish business in the back half of this year. Refinish, historically has been a very good business for us. We've consistently grown that business. We think that will be the next catalyst in that.

If you look at our aerospace business, we just launched what we call Aerocron; it's e-coat for the aerospace business. We have commercial customers up. Now, this is an industry, unfortunately, that thinks in terms of decades and not in terms of years, so some of our bigger customers will take several years to grow into that process. But they're all doing testing, and they're all excited about the way that the e-coat can reduce the weight of the parts in the plane. So, that's another technology we're bringing to the market.

If you think about it, in the marine protective side we have a number of new products, vantage products, which go into our passive fire protection. So, that's a positive for us. I would tell you from general industrial we have developed some new products for light weighting in that area as well. So, when you think about the major things, sustainability, and light weighting, and those areas, that has all been a positive for us. But, I would tell you, a lot of our customers move at a little bit slower pace than we'd like them to.

Vincent Morales
And Don, relative to your second question, I think the evidence is certainly out there. Over the past 18 months, if you look retroactively, there's been a significant amount of continued consolidation in the coatings space. We said at the beginning of not this year but last year, there's a very active pipeline. We're sitting in the same place today. We think there's a very active pipeline of small to mid-sized deals out there. We announced one today. I think we're proud to say that we've remained disciplined with respect to multiples, and we intend to do so going forward. But, there is certainly a series of active discussion underway with us and other potential targets in the space.

Don Carson
Thank you.

Operator
The next question comes from Arun Viswanathan, with RBC Capital Markets. Please go ahead.

Arun Viswanathan
Great, thanks. I guess I had a question, again, on the volume growth. If I look at the two heat maps from Q1 to Q2, there were some changes, but Q4 and Q1 you saw positive volume growth across the portfolio in the 1% to 2% range and now you went to flat. Maybe you can just characterize what happened. Did you see some weakness in some of your bigger categories? Then, similarly, going forward do you need to see those big categories really turn around, or is there something internally you can do to drive more of your categories into the above market section?

Vincent Morales
Hi, Arun, this is Vincent again. So, again, I think we provide the heat map, we try to be as transparent as possible. This does include, by region and by end market, our projections of what the market's doing, but I think we provide the most granular level detail of anybody of our expectations on how we're performing for you guys. I would say, if you look at Q1 to Q2, in Q1 versus Q2, we did see a higher level of auto build growth rate. In Q2, the build growth rate is slightly negative globally and was slightly positive in Q1. That is a bigger business for us.

We talked about packaging, the differences there, and we talked about architectural enough. Those are probably the three biggest differences if you look quarter-over-quarter. We do expect auto to reaccelerate, as we said in our prepared comments. We expect that business to grow globally in Q3. And, as Michael said about architectural, we expect some improvement there, especially in Europe.

Arun Viswanathan
Okay, and the auto OEM share loss in the US, when does that run its course? Again, do you think that the current initiatives that you have in place will get you back to positive volume growth for the year?

Vincent Morales
We measure auto OEM on a global basis, because these are global customers and there are decisions you make to move around the world based on your competencies and your technology. We could pick on one region, but I would tell you that we're well above market in the Asian region, which is the biggest market in the world. As I said earlier, that was orchestrated. We're also well above market in Latin America, which predominantly is Mexico, which is the fastest growing region in the world right now. So again, we've made very significant and planful decisions in the past that are allowing us to outperform globally, and we expect to continue to do so in the second half of the year.

Michael McGarry
I guess I'd add to that a little bit. The reason why we gained so much share in Asia was because of our compact process, where you put down multiple layers of paint at once. That was easier to sell that benefit in Asia when they were building new plants. Now that they see how well that is working, now they're thinking about brownfield conversions, and you'll see that happen in Europe before you'll see it in the US, because obviously energy costs are higher in Europe than they are in the US. But we're starting to see a number of our global customers thinking about this, and, as this trend accelerates, obviously, that is a good benefit for us, because we have the best technology in that regard.

Arun Viswanathan
Great, thanks.

Operator
The next question comes from Stephen Byrne, with Bank of America Merrill Lynch. Please go ahead.

Stephen Byrne
Yes, thank you. Just wanted to drill into this higher raws expectation, particularly TIO2 in this third quarter. You made a comment, Michael, about some research efforts, and I think you said expanding the supply base. Can you comment about whether you see more opportunities to either reformulate less into the coating, or maybe blend more lower quality ingredients into the mix just to lower raws? Do you have any more bandwidth there?

Michael McGarry
Sure. We started on this initiative probably five years ago, and we've made a significant improvement in that regard. Depending upon the formulation, anywhere from 7% to 10% less PO2. The next generation

of that was either the substitute or the total conversation of chloride to sulfate. Now, I would say, it's the optimization of the formulations that we're working on now. We're also working on whether or not there's more TIO2 sulfate guys in China that can reach the level of quality that we need. So, we're working with a broader set of suppliers in Asia to bring them up to the level, and we have number of trials ongoing in that regard, so that is still to be played out. Then, of course, we have the formula optimization that we need to do as we get more cross-fertilization across the businesses and across the world. I think that still has many more innings to play out in that respect. This is an ongoing area of focus for the company. We spend $500 million on R&D, and a portion of our R&D effort is raw material and formula optimization.

Stephen Byrne
Then, more broadly on cost given your outlook for higher raws and your sales are kind of flattish, are you looking at some new productivity initiatives or ways to maybe accelerate or pull forward some of your existing cost reduction efforts?

Michael McGarry
This is PPG, so productivity is a mandate. This isn't optional. No businesses, no matter how good they are, get out of this. They all have their productivity goals for the year, and I would say the vast majority of our businesses are delivering in that regard. Our manufacturing teams are doing a very good job of driving productivity. I think we are ahead of the restructuring initiative that we set. I think we gave you a target of $40 million to $50 million for the year, and we're well on our way to achieving that target. I think we're on track in that regard, and I always have higher expectations for the team. They know that, and I think they're all focused to deliver more in the second half of the year.

Stephen Byrne
Thank you.

Operator
The next question comes from Dmitry Silversteyn with Longbow Research. Please go ahead.

Dmitry Silversteyn
Good afternoon, guys. Thanks for taking my question. A couple of follow ups, if I may, as a lot of my questions have been answered. Specifically, on the Latin American and Mexican business for architectural paint, after some pretty good quarters and after you completed the Comex acquisition, I see that, in this quarter, you identify that business is growing with the market. Is that just a question of anniversary-en some of the initiatives and expansions that you undertook when you first bought the business, or is the competitive dynamic in the region changing in any way that's making it more difficult to grow above market?

Vincent Morales
No, Dmitry, it's the former. As you know, we posted a couple of really good strong growth years there. We're comping against those. We're confident in the Comex business model, and the business remains very successful.

Dmitry Silversteyn
Okay, but going forward, Vince, if I understood what you said correctly, we should expect more in line with the market type of growth in that business?

Vincent Morales
It's the middle of that market, and it certainly can go above market depending on how many stores we open, etc.

Dmitry Silversteyn
Gotcha, fair enough.

Michael McGarry
Dmitry, this is Michael. I would tell you that, in Mexico, we opened 52 stores in the second quarter, and we also opened a number of stores in Central America. Last year, in Central America, I think we grew 29%, so we had to overcome that. I would tell you that the expectation for the team is to continue to perform at least two times GDP. We are not walking away from that target.

Dmitry Silversteyn
Okay, fair enough. On the packaging side of the business, obviously you had a zero growth against a very tough comp in the second quarter, but, as you get into the back end of the year, should we expect a return to low single-digit, market-like growth, or do you expect to outgrow the market with continuing share gains or benefits of ramp up with existing customers?

Michael McGarry
No, I think we should continue to marginally pick up share. We do, though, expect it to be in the low single-digit range, as opposed to prior years when it was growing high single-digits.

Dmitry Silversteyn
Right, right. And, then, my final question in the DIY channel in the North America paint business. I understand the dynamics that are driving lower performance there versus the contractor business, but are you seeing significant difference in the cadence of revenues you get from your various channel partners in the DIY market, whether it's big box versus mass merchant or mass merchant versus Ace or True Value hardware store channels? Is there any channel that's doing reasonably better in this environment or a lot worse in this environment that we can focus on?

Vincent Morales
No. Again, there's still more data to come out for the quarter, Dmitry, so it's hard for us to speak. Can we have some projections about the industry? Hard for us to speak holistically, but, if you look at most of our national customers, we're seeing generally similar trends. There's always a little bit of difference in delta and that, but I'd say there's not a wide disparity. In the dealer channel, as Michael talked about earlier, that's a channel that has very small, incremental erosion on a year-over-year basis that we can very well manage. That's typically a very sticky channel in terms of customer relationships, so I would say we're not seeing anything unique by the different customer sets.

Dmitry Silversteyn
Okay, so it's not like mass merchant is losing share to big box, or picking up share form hardware stores, it's kind of across the board, and the various channels are fairly close to each other in terms of performance.

Vincent Morales
Yes. I think the difference between the channels, trace versus DIY, we've been in this situation for well over a year, so it's not any different than prior quarters. It's not accelerating or decelerating.

Dmitry Silversteyn
Great, okay. Thanks.

Operator
The next question comes from Michael Sison, with Key Bank. Please go ahead.

Michael Sison
Hi, guys. Thinking about the second half of '17, you talked about volumes returning to more positive territory or going to deploy more capital and maybe catch up at raw materials a little bit. Should EPS growth in the second half be better in terms of year-over-year X fiberglass than the first half?

Vincent Morales
Well, as Michael said earlier, Mike, we hope to minimize somewhat the margin compression we saw in Q2. For that factor alone, we would hope to see improved operating earnings. Again, we're going to work on our cash deployment, and again we're not going to give a cadence there, but I think you hit on all the key elements to look at for the second half of the year in terms earnings leverage.

Michael Sison
Then in terms of M&A, aside from smaller bolt-on acquisitions, are there opportunities for bigger type of transactions?

Vincent Morales
Well, we've always said that there's no transaction that we wouldn't' look at, but we're always going to remain disciplined in that regard. We're going to look at it whether it's accretive to our shareholders, and I would tell you that the vast majority of the ones we're looking at tend to be bolt-on types. We still have an active pipeline, and we're still going to manage that appropriately.

Michael Sison
Great, thank you.

Operator
The next question comes from John Roberts, with UBS. Please go ahead.

John Roberts
Afternoon, guys. I don't understand the European DIY paint business as well as I should here. Is that relatively small for you? And, is there a different dynamic in the European market between DIY like we're talking about here with the US?

Vincent Morales
No. It's a big segment. It's our second biggest segment after the US and Canada. You know, we're bigger in trade in Europe than we are in retail. So, you know, we're doing fairly well in most of our markets, but, you know, the retail segment over there is more challenging than it is in the US because there's more private label in Europe than there is in the US. They will tend to switch people out faster than they will here in the US where, you know, you might lose a price point here or a price point there, but, there, you see a lot more action from that regard.

But, overall, I would tell you, you know, France is our biggest market, and, when you look at trade France, it's been flat to marginally down. And, since that's our biggest market, it has more impact. But, the good news is, in the UK/Ireland, we've been significantly growing share and that's getting to be a bigger market. The Benelux has been a very good market for us. I would say, the positive in Eastern Europe is we saw a nice little turnaround. Now, the key is whether it's sustainable, because we'll have to wait and see. But, that's a good thing.

John Roberts
It doesn't sound like it's underperforming the pro-apply paint market to the extent we're seeing in the US The divergence doesn't sound as big, at least to me, in the discussion here. Then, it doesn't sound like we have this issue of maybe having priced too high, or having your customers priced to high, in Europe

like they may have done in some of the big box retail locations here in the US.

Vincent Morales
Yes, I would agree with that. You know, they don't have as much super-premium paint in Europe as we do in the States, because of its more private label, and the US market has done a really good job driving the premium paints. So, I think that is one key difference. The other thing, you don't have the full employment over there that you do have here, so the DIY segment and the do-it-for me hasn't diverged as much as it has here.

John Roberts
Got it. Thank you.

Michael McGarry
Thanks, John.

Operator
The next question comes from Laurence Alexander with Jeffries. Please go ahead.

Laurence Alexander
Hello. Just quickly, on the M&A tailwind for Q3, does the acquisition announced today offset Medicoat in size or is one noticeably different in size than the other?

Vincent Morales
I'll let Michael give the size, Laurence, but I will remind you that Medicoat, which we bought last year, their anniversary is July 1, so that would not be considered acquisition-related on a go-forward basis. And, I'll let Michael talk about the operation today.

Michael McGarry
Yes, so for Crown, it has sales between 125 and 150. We've essentially paid, you know, $1 dollar for a dollar of sales. It's a nice acquisition. The segmentation of it is, I think, in the sweet spot. It has a high majority of trucks, SUVs, and a nice exposure to heavy-duty equipment. As you know, the heavy-duty equipment market is recovering at a nice rate. Then, for the trucks and SUVs, that's by far the strongest part of the automotive markets. I think it's segmented appropriately, and, now that we have more density, the big, big OEM guys and the big heavy-duty equipment guys are going to be anxious to push more share, I think, our way long-term, because we'll be able to supply them over a broader portfolio, a product as well as the broader portfolio locations.

Vincent Morales
And, Laurence, with respect to trading off dollar for dollar in terms of impact on us, we haven't closed the transaction yet. So, until we close the transaction, we won't see any effect of the acquisition.

Laurence Alexander
Yes, got it. Okay, thank you.

Operator
The next question comes from Mike Harrison with Seaport Global Securities. Please go ahead.

Mike Harrison
Hi, good afternoon. Michael, I think it was you who referenced the confusing offering at one of your key big box retailers. Can you talk a little bit about what potentially could be done to address all the different brands and price points that are available and maybe share your view on how that plays out going

forward?

Michael McGarry
Well, I could, but maybe our retail partners would not be happy, because we don't make the decisions in their aisles. But, we have encouraged them to think about how they can simplify the number of price points, simplify the number of choices, make the color decision faster and easier, and provide, I would tell you, less competition in the aisle and more conversion in the aisle. I think that's the key. We all want to make sure that everybody that goes in the store to buy paint buys somebody's paint. That's the real key is to make sure they walk out the door with paint, and anything we can do to help them understand what impact in their conversion is intelligence that we're sharing with them.

Mike Harrison
Alright. And then, I was also just curious, with respect to the AXO deal, were you prohibited from doing share repurchases while that proposal was in place? And, also, the management change at AXO recently, what does that mean for your interest in that asset going forward?

Michael McGarry
Well, we did not purchase shares during that period of time. Obviously, we felt like we had inside information, so we were prohibited from buying shares. In regards to the management change, we will not comment on it. I think you should call them and find out. But, we have put AXO in the rear view mirror and we're looking forward to growing our business.

Mike Harrison
Thank you very much.

Vincent Morales
Thank you, Mike.

Operator
[Operator Instructions] The next question comes from Jim Sheehan with SunTrust. Please go ahead.

Jim Sheehan
Thanks. A question on TIO2: How are your relationships with your suppliers this cycle compared to the last up-cycle in TIO2 around 2011? Do you expect the price inflation this time around to be more manageable than it was in the past?

Vincent Morales
Well, I certainly do. I think if you look at some of their own commentary, I think they've taken an approach that is, you know, appropriate. I think they recognize the last time they chased away, permanently, TIO2 volume, which was not in their best long-term interest. As far as relationships with them, I would tell you that we always try to keep good relationships with our suppliers. It's important, because, you know, the good times will turn into bad times. You know, most of our product raw materials are cyclical, and, so, it's important for us to work collaboratively with them the same way we work with our own customers in a collaborative manner.

Jim Sheehan
Great. And then, architectural coatings in the US, did you see any seasonal effects or unusual unseasonable patterns as the quarter progressed? One of your competitors has mentioned sales slowing in the second half of June and maybe an acceleration in July. Are you seeing that trend in your order book, as well?

Michael McGarry
Well, I would tell you that there was certainly rain that impacted—you know, exterior paint is awfully difficult to do to begin with, and then the rain makes it impossible. We do have a good, strong start to July for our stores, but it's also relatively consistent with what we saw in the first two quarters. As you know, we've had good company-owned store sales in Q1 and Q2, and we're pleased with the performance of the team. And then we see similar patterns in July.

Jim Sheehan
Is your volume weakness in that business causing any fixed-class absorption issues for you?

Vincent Morales
No, Jim. If you look again, our US architectural business in the stores' network is up 5%, so our cost absorption is actually better.

Jim Sheehan
Thank you.

Vincent Morales
Sure. Thank you.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Vincent Morales for any closing remarks.

Vincent Morales
I just wanted to once again thank everybody for their time on the call today. We will be taking investor calls. Please look at the presentation materials for the call-in information to schedule a call. And, again, appreciate your time and interest in PPG. Thank you.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.