PPG Industries, Inc.

Third Quarter 2017 Earnings

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CORPORATE PARTICIPANTS

John Bruno - *Director, Investor Relations*

Michael McGarry - *Chairman and Chief Executive Officer*

Vincent Morales - *Senior Vice President and Chief Financial Officer*

Operator
Good afternoon, ladies and gentlemen, and welcome to the PPG Third Quarter 2017 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key, followed by zero. After today's presentation, there will be an opportunity to ask questions. Please also note today's event is being recorded.

At this time, I would like to turn the conference call over to Mr. John Bruno. Sir, please go ahead.

John Bruno
Thank you, Jamie, and good afternoon, everyone. Once again, this is John Bruno, Director of Investor Relations. We appreciate your continued interest in PPG and welcome you to our Third Quarter 2017 Financial Results Conference Call. Joining me on the call 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 today, Thursday, October 19. In accordance with Generally Accepted Accounting Principles, all periods present the former Glass segment as discontinued operations. About one hour ago, we posted detailed commentary and accompanying presentation slides on the Investors Center of our website, 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 SEC.

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

Michael McGarry
Thank you, John, and good afternoon, everyone. Today, we reported third quarter and year-to-date 2017 financial results. Our net sales for the third quarter were approximately $3.8 billion, up more than 3% year-over-year, and our reported earnings per diluted share from continuing operations were $1.52.

This quarter was filled with a lot of emotion and many operational challenges due to the number of severity of natural disasters that many experienced. I would first like to thank our employees for their commitment and support they provided and continue to provide. We will continue to support our impacted employees, their families and their communities as they continue to rebuild.

Turning more specifically to our results in the quarter, our sales growth of more than 3% was

driven by improving sales volumes and favorable currency translation. Currency translation, which has been unfavorable for quite some period of time, reverted to favorable in the third quarter, and is expected to be so in the fourth quarter, based on current exchange rates.

Regarding our sales volumes, I'm encouraged by the pace of growth in July and August, before the hurricanes and earthquakes, and by our order book in the first few weeks of October. Our overall year-over-year company sales volumes were up nearly 1% in the third quarter, including about $25 million of unfavorable sales volume impacts from natural disasters.

Industrial Coatings segment volumes improved by about 3%, while our Performance Coatings segment volumes declined by about 1%. The Performance segment realized most of the unfavorable sales impact from the natural disasters. Before the natural disasters, we were tracking about 1.5% of sales volume growth in the quarter, higher than our volume performance in the first half of 2017.

Let me quickly discuss a few specific business unit performance trends where we are tracking both above and below the market.

In the third quarter, general Industrial Coatings business growth again exceeded the rate of global industrial production, continuing a multi-quarter trend. Also, volumes returned to mid-single-digit percentage growth in our Packaging Coatings business, stemming from increased customer conversions to our new technologies. Our U.S. company-owned Architectural stores once again grew same-store sales at mid-single-digits, despite the natural disasters, marking seven consecutive quarters of sequential volume improvement.

Of note, during the quarter, we are pleased to have launched PPG Timeless, a new premium stain and new interior paint brand into the Home Depot, and we will work to drive customer adoption of this new product. This includes some additional growth-related marketing spend in the fourth quarter. That being said, demand in the overall U.S. DIY paint market has remained soft throughout the year.

During the quarter, our sales volume in Architectural Coatings in EMEA were below market. While certain parts of our business remained solid, such as the U.K., where we continue to outperform the market, demand in certain other important countries to PPG, such as France, remains weak. Also, we turned away certain business in the region due to either low profitability or lack of customer acceptance of selling price increases.

As I previously said, volume growth remains one of our key focus areas for the Company. While I'm pleased with some of the measureable progress we have made, we continue to work on a variety of initiatives to accelerate our growth rate.

From an earnings perspective, our reported EPS was consistent with our prior year adjusted EPS. The recent natural disasters reduced our third quarter EPS results by about $0.05. This was the result of raw material inflation, higher transitory logistics costs, and impact to reduced sales volume.

In the third quarter, we made initial progress to begin to recover our margin. Our contribution margin compression was lower year-over-year in the third quarter than it was in the second quarter. Specifically, in the third quarter, our contribution margin was 160 basis points lower than last year's third quarter, and would have been 130 basis points lower excluding the natural disaster impacts. Higher than expected raw material cost inflation was the largest driver of

margin compression. Our basket of raw materials were up mid-single-digit percentage year-over-year, pacing much higher versus our expectations at the beginning of the year. The main causes continue to be various supplier force majeure issues in Europe and additional supply-driven production curtailments in China.

Selling prices were up modestly versus the prior year, with additional pricing secured for the upcoming fourth and first quarters. We continue to work with our customers on additional selling price initiatives focused on further offsetting the persistent inflation. We now expect the current level of raw material inflation to last through the fourth quarter and anticipate inflation to continue, but at a lower rate, in the early part of 2018. We are working with our suppliers to mitigate the increases and have also expanded our research, resources and efforts on another wave of raw material efficiency projects. We were able to mitigate some margin compression with overall productivity improvements due to aggressive manufacturing and overhead cost management. Due to the acceleration of some of our actions from our restructuring program we announced in 2016, I now expect restructuring will benefit us by more than $45 million in 2017, which is toward the upper end of our initial target range.

In the third quarter, we completed the sale of the North American Fiber Glass business. This is a transformation milestone for the Company, as it completes the culmination of our multi-year strategic shift in our business portfolio. The gross sales proceeds were about $540 million, with the net after-tax gain recorded in discontinued operations.

In the third quarter, we purchased about $250 million of stock, and on October 2, we finalized the acquisition of The Crown Group, a coatings services company. Including the Crown acquisition, year to date we have spent about $725 million toward our multi-year target of $3.5 billion to be deployed on acquisitions and share repurchases.

Looking ahead, we expect to remain in a modest overall global economic growth environment. Demand in the fourth quarter is seasonally lower historically and we anticipate normal seasonal trends this year. We expect recent favorable end-use market trends to continue in Refinish and Aerospace. Additionally, we expect our General Industrial growth to continue to outperform solid global industrial production, and similar results in the packaging coatings industry. Architectural Coatings volumes in the U.S. are expected to remain mixed by distribution channel. Protective and Marine Coatings volumes are expected to be positive globally, aided by growth in protective coatings and very modest declines in marine volumes. Our U.S. Automotive OEM Coatings business is expected to return to at-market performance in the fourth quarter, coupled with continued PPG outperformance in the other major auto-producing regions. We expect our Architectural EMEA sales volumes to remain mixed sequentially, with improved quarterly results in Northern Europe, adjusted for seasonal trends, but offset by continued subdued end-use market conditions in certain countries, including France, Italy and Spain. Finally, the Automotive OEM and General Industrial Coatings business in Asia have a difficult fourth quarter comparison, as sales volumes grew at a low-double-digit percentage pace in 2016.

One unknown entering the fourth quarter relates to the China tax subsidiary on certain small engine vehicles. Last year, the subsidy was originally scheduled to expire at the end of 2016, but was extended at a lower subsidy rate. This subsidy is now slated to expire at the end of 2017, but any change in this could impact fourth quarter demand in a favorable or unfavorable fashion.

As always, we’ve included additional segment and regional details in our presentation materials.

Also, for the fourth quarter, we expect additional transitory impacts stemming from natural disasters; specifically, raw material cost inflation and modest unfavorable sales impact, mostly from anticipated lower Mexican and Puerto Rico demand. We expect these to have an unfavorable impact to our fourth quarter EPS of about $0.05.

Finally, we will maintain our aggressive focus on cost management, and we have also reduced our projected capital spending target for 2017 to be approximately 2.5% of sales to reflect the subdued growth environment.

To summarize our results, we delivered solid business results despite a variety of external factors which impacted our sales, operations and supply chain. We are now beginning to deliver on margin recovery. We delivered excellent performance in many of our businesses, including continuation of an improvement in volume growth on a pre-natural disaster basis. Going forward, we remain focused, first, on increasing prices in a collaborative manner with our customers to recover our margins, and, second, on improving our sales volume growth trends, including continued focus on deploying technology and our technology-advantaged products. We entered the third quarter with $2.3 billion in cash, our acquisition pipeline remains healthy, and we will continue to repurchase shares in the fourth quarter. Just as a reminder, we remain committed to deploying a minimum of $3.5 billion on acquisitions and repurchases in 2017 and 2018, combined. As a result, we intend to deploy an additional $2.8 billion of cash by the end of 2018.

This concludes our prepared remarks. Once again, thank you for your interest in PPG. Now, Jamie, would you please open the line for questions?

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time, we'll begin the question and answer session. To ask a question, you may press star and then one using your touchtone telephone. If you are using a speakerphone, we ask that you please pick up your handset before pressing the keys to ensure the best sound quality. To withdraw your question, you may press star and two. Once again, that is star and then one to ask a question.

Our first question today comes from Ghansham Panjabi. Please go ahead with your question.

Ghansham Panjabi
Hey, guys, good afternoon.

Michael McGarry
Hi, Ghansham.

Ghansham Panjabi
Hey, Michael, you gave us some good insight into the fourth quarter in terms of trend line, but as we cycle into '018, I guess, how are you thinking about the overall macro, first off, and then the related outlook for some of your major end markets?

Michael McGarry
Ghansham, I think 2018 will be somewhat of a repeat of 2017, volumes modest up in the majority of the markets. If you start with Automotive, you know, the biggest wild card there is China, but I think China is going to grow 2% or 3%. That'll take up the global market in that 1%,

2% range. I think the U.S. will be the one market that'll be under pressure. Industrial production should be relatively decent. Obviously, you're going to have heavy-duty equipment improving at a faster rate, so that's always good for us. Then, you know, we're going to continue to have good adoption of our Packaging business, so I think that's a real positive. I think from the—you know, Refinish is steady-eddy. You're going to have Aerospace slightly up. Again, Boeing and Airbus have great backlogs. I just wish they'd figure out how to make a few more planes each month. Then, I would say Architectural, we've been pleased with the pace in Architectural. We see that growing 2% or 3% next year. So, that's kind of a walk around the various businesses.

Ghansham Panjabi
That's very helpful, and then maybe a question for Vince on the fourth quarter, just in terms of operating income year-over-year. Should we expect an improvement there year-over-year or will that be difficult just given some of the higher raw material costs, and also the residual disruptions from the hurricanes and earthquake? Thanks so much.

Vincent Morales
Hi, Ghansham. As you know, we typically don't give guidance. I think, for us, we've worked to try to close the margin gap. I think you'll see additional margin recovery in Q4 on a year-over-year basis, similar to what we saw in Q3 versus Q2. The key factors there, again, would be additional pricing, still stubbornly persistent raw materials, but probably ticking down seasonally a little bit, and then, again, we'll see normal seasonal trends in most of our businesses.

Ghansham Panjabi
Thank you so much.

Operator
Our next question comes from Duffy Fischer. Please go ahead with your question.

Duffy Fischer
Good afternoon. Michael, I guess a question for you. On the raw materials side, it seems like a couple of quarters in a row that we've gotten a lot more dispersion geographically in the direction that raw materials have moved. Is that something that will normalize over the next couple of quarters? Is it just kind of opening up some of your own transportation lines to move stuff around geographically, or should we think about that as being more structural going forward?

Michael McGarry
Well, I do think there is some structural piece of that, especially in China. If you notice, in the last couple of months in China, they have been exceptionally focused on enforcing environmental rules, which is really positive not just for the environment, but also positive for us. With our water-based technologies, that's a great place for us to be, and the fact that they're cracking down on dangerous goods warehouses, they're cracking on plants that are in non-industrial parks or not in chemical zones, we think that's a positive for us. So, there'll be more upward raw material inflation in China. We've had a lot of force majeures in Europe. Europe has historically been a place that operates very well, so I don't think—I think that's more of a transitory impact, I don't view that as long term. Obviously, the hurricanes in the U.S., this is the first major hurricane that's hit the U.S. in 10 years, so—I'm not a weather forecaster, I'm not going to predict anything, but historically, you know, I view that also as transitory. So, the only real place I see as structural is China.

Duffy Fischer

Great. Then, on the back of the comment on China, does that mean if your raw materials are going up because some of the competitors are getting squeezed out or shut down, will your prices go up meaningfully more in China than they will other parts of the world, because, again, some of your competitors may not be able to sell products or people might have to mix shift up to your higher quality water-based products?

Michael McGarry
Well, I would describe it this way, Duffy. We would always expect our—and we currently have margins in Asia consistent with our margins in the rest of the world, and so if we have additional raw material inflation in China, we would have to have additional raw material recovery in China. So, I would not expect a material impact. Obviously, as you know, we lag getting price, but I would not expect that to be a long-term issue. For us, I would focus more on the fact that if they continue to enforce the rules, there'll be more water-based products, and that technology is with a limited subset of suppliers and that will be good for us.

Duffy Fischer
Great. Thank you.

Operator
Our next question comes from David Begleiter from Deutsche Bank. Please go ahead with your question.

David Begleiter
Thank you. Michael, you've had very good success this year in U.S. Refinish. Can you remind us again what the drivers are of that success and from whom you're taking business from?

Michael McGarry
The main drivers in Refinish, first and foremost, is miles driven. So, year to date, miles driven are up 1.5%. The next is collision, or think about it as accidents, and higher employment leads to more miles driven, leads to more congestion, more congestion leads to more accidents, and of course, the real phenomena we see now is distracted driving. This is a market that historically was flattish, but we are doing well in this area. I would just say that given our strong technology base and our strong customer base, we're probably nibbling and getting a little bit of share from everybody, but overall, I would say, you know, it's more driven by technology. Our water is the best-in-class.

Vincent Morales
David, if I could just add, we think this is a—this has historically been a very modest growth market in the developed regions, and that's continued. We haven't seen any changes in pattern with our customer base and we haven't seen any changes in pattern in terms of the industry itself.

David Begleiter
That was part of my next question. Michael, is there still real pricing power left in Refinish, and, again, no change, from your view, in terms of distributors exerting more pricing pressure or MSOs exerting more pricing pressure? Thank you.

Michael McGarry
No, Duffy, I would tell you it's still a highly fragmented market. I mean, if you drew out this MSO consolidation over a 20-year period, you might could extract something, but there is so—I would say it's not material in any near-term pattern, so it's not something we're worried about. We

have positive price in Refinish this year and we would expect to have positive price in the business next year, as well.

David Begleiter
Thank you very much.

Vincent Morales
Thanks, David.

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

Bob Koort
Thanks very much. Good afternoon, guys. I was going to ask around the raw materials side. I guess some of us thought Ti02 was going to go up throughout the year, so I'm guessing that hasn't surprised you. Can you talk about which specific raw materials have seen that unexpected inflation, so that we might take a guess on what can give you some relief next year?

Michael McGarry
Yes, I would say the first one that was most unexpected was the emulsions. So, you think about VAM, that has been a problem. Outside of the U.S., ethylene is down in the U.S., but everywhere else in the world it's up. I would say that was probably not on my radar screen, given the significant ethylene expansions in the U.S. Obviously, there's more coming on, so hopefully there'll be some relief there. I would tell you Ti02 is up more than we expected. I've cautioned some of the Ti02 suppliers, you know, don't forget 2011, where there was demand destruction. So, that has been my focus on that. The other thing that I would say is a little bit of a surprise is packaging. If you think tinplate and steel, I think those things were probably a little bit higher than I would expect it. So, we had low-single-digits in our plan and we're in the solid mid-single-digits now. So, those would be the ones that I would focus on.

Bob Koort
Michael, could I ask you, on the Architectural markets, looking at both the U.S. and in Europe, in the U.S., this deviation between do-it-for-me and do-it-yourself seems pretty pronounced. Is there historic precedent for that different direction to persist, and if not, which do you think happens? Does the do-it-for-me in your stores, numbers come in, or does the DIY market finally get some lift, and then maybe a similar question in Europe? I generally think of paint as being a very consistent end market, and yet it sounds like either the market is not doing well or maybe you've got some competitors that tolerate some pressured margins, which doesn't seem sustainable. So, maybe just an appraisal of the markets and what you expect. I think you said volumes would be get next year, but what you expect maybe on the price or margin side going forward?

Michael McGarry
Well, Bob, we normally allow only two questions and that's like seven, so I'll do my best.

Bob Koort
It was all about Architectural. That doesn't count as one?

Michael McGarry
I'd say the big driver in the U.S. is two factors. One is unemployment. So, you have low

unemployment, and so people would rather pay somebody to get it done, and the second one is baby boomers are getting older and the millennials aren't painting as much as their parents. They're not a DIY group as much as anybody else. So, I would say that's the U.S. I think that's going to continue. We see real strength. I mean, even our October order book in Architectural has started out really well, so I think that's going to continue. I don't see a change in the unemployment situation, so we're all good there.

I think the difference between Europe and the U.S. now is the U.S. is very much a branded market and Europe has way too much private label. I think the European big boxes have really erred in the way they've gone to market. If you look at the average price of the paint in Europe versus the average price of the paint in the big boxes in the U.S., it's clear that the U.S. big boxes have a different strategy, they're executing it very well. In Europe, there's not been a trend to branded, and that brings in significantly more competition. It also brings in, on a regional basis, a lot more folks. So, I think that's the big disconnect.

I do think there are people out there still chasing volume. We're not going to chase it at this point in the cycle. We see people trying to trade down. We'll let them trade down. We're trying to recover margins, and that's been our focus. If you look back, 2007, 2011, the last two raw material inflations cycles, we were first to get margins back. We think we're going to be in that top quartile again. We can't control what other people, how they make their own independent decisions on how to price.

Bob Koort
Great. Thanks for your patience. I'll be tighter next time.

Vincent Morales
Thanks, Bob.

Operator
Our next question comes from Christopher Parkinson from Credit Suisse. Please go ahead with your question.

Christopher Parkinson
Great, thanks, guys. Can you just talk a little bit about pricing trends across your various Industrial platforms, such as Auto, General Industrial and Packaging, and just give us any broad expectations you have regarding the timelines to recapture price costs, or maybe even achieve net price real longer term, if that's still a theme? I think most of us understand that there's probably differences in contractual nature and COGS distribution between the various inputs, but just any broad comments would be really appreciated. Thank you.

Michael McGarry
Well, I think the broad comment is, you know, we have very sophisticated customers in Automotive, as well as in the Large Industrial segment, and these guys not only are sophisticated, but they have set up what I would call choice in their distribution or paint networks, and that allows them to move people in and out in some small segments, to allow them to put pressure on their suppliers, and what you need to do is have faith that your technology makes it difficult for them to do that. I would say it takes us longer to get price in those segments, but we do recover it. We already have pricing in those segments today. It will start to pick up a little momentum late in the fourth quarter, early in the first quarter.

I would tell you, in the Packaging area, probably the bigger driver on the pace of getting it in

Packaging is that there was consolidation in the major packaging players, and so they were focused on trying to get their synergies, so you had that trend going on at the same time as new technologies. So, we were pushing the new technologies and there might have been some other folks that didn't have the new technologies that were trying to hang onto volume using price, and that's probably the biggest differentiator in the Packaging that's different than normal. Historically, in the past, everybody was pushing the same technology. Now, you have some certain players that are very strong on the BPA non-intent and some of the others that maybe don't bring that same new technology to the table.

Christopher Parkinson
Can you talk a little bit about some of your comments on EMEA Architectural, specifically, how you expect the volume headwinds to persist and whether or not your price comments pertain to the lack of acceptance among your customer base or is it more a functionality of bad behavior among some of your regional competitors? Thank you.

Michael McGarry
I hate to throw our friends under the bus, so I won't do that. I think everybody makes their own independent decisions. In this regard, we are very much focused on delivering margin recovery. It's margin first, volume second. We have some very good markets. We're growing share in the U.K. We're hanging in there in the Benelux. French retail has been a very challenging environment. We're doing well in Scandinavia, growing share up there. I would say Eastern Europe is more of a free-for-all. We have been actively pushing price aggressively in our African stores and African countries. So, it provides that mixed bag, if you will. But, right now, bottom line is we've yielded a little bit of share in order to drive profitability. I regard these as transitory. If I look back in history, we've done this in the past, and once this transitory period is over, we will not have lost any share in that regard, and good, strong performing products always win in the marketplace long term, and we feel good with our product portfolio.

Christopher Parkinson
Great. Thank you.

Operator
Our next question comes from Frank Mitsch from Wells Fargo Securities. Please go ahead with your question.

Frank Mitsch
Good afternoon, gentlemen. Michael, for the first of my seven questions, I was wondering—you know, you're clearly making progress on reducing the margin compression year-over-year. You said it was 210 bps in the second quarter, 160 bps in Q3, or would have been 130 ex the hurricane. At what point do you believe you're going to stop talking about year-over-year margin compression and start talking about year-over-year margin expansion?

Michael McGarry
I think, Frank, if I look at history, we're probably first quarter, second quarter next year. I'd like to say it's first quarter, but I don't want to set unrealistic expectations. The fact of the matter is this is top of mind. We have a very experienced Coatings Leadership Team with deep experience in this area. Many of our leaders have been around through multiple cycles. I think that's what really allows me to sleep well at night, is the strong leadership of the Company. I think that would be the focused area.

Frank Mitsch

All right, so—

Michael McGarry
So, your next six?

Frank Mitsch
Yes, for my next six. So, look, I'm not going to ask the M&A question, but you did say, "Look, I've got $2.8 billion to spend on M&A and share buyback over the next 15 months," but your company-owned store is doing extremely well here in the U.S., certainly, relative to your other channels, so I'm just curious what your plans are for growth in terms of opening up new stores, how should we think about that, and is that also a focus area for the M&A part of your capital allocation?

Michael McGarry
Well, it's certainly—as you know, the dealers, any time they want to sell, if they don't have a succession plan in place, we are always the first choice, and we are happy to do that. We stay close to the big dealers. So, we'll continue to look at that. We're not adverse to spending in that area. We are adding stores in the U.S., as well, that's top of mind, but we're also looking at not just the U.S. I mean, if you look in Canada, we're adding stores at a faster rate than anybody else in Canada. Of course, in Mexico, we added 53 stores alone in the third quarter in Mexico. We add stores in Europe, as well. So, it's not just a U.S. play for us.

As far as the acquisition pipeline, the question you didn't ask that you wanted to ask, the pipeline remains solid. We do continue to look at a lot of stuff. We continue to remain disciplined. When we have something, we'll let you know, but we are actively engaged with a number of parties, talking to them about what the next steps might be.

Frank Mitsch
Thank you so much.

Michael McGarry
Thanks, Frank.

Operator
Our next question comes from Jeff Zekauskas from JP Morgan. Please go ahead with your question.

Jeff Zekauskas
Thanks very much. Over the last three years, you've averaged about $330 million annually in acquisition spending, and you have a very large target in deploying your cash. So, if you spend again at a $330 million acquisition level, in order to hit your $3.5 billion number next year you'd have to buy something like $1.7 billion in shares. Are you willing to do that, in that, historically, you never seemed to buy back more than $1 billion annually in shares?

Vincent Morales
Yes, Jeff, this is Vince. Again, as you know, acquisitions are episodic, both in number and in size. As Michael just mentioned, we do have a fairly active pipeline that we're vetting, along with potential sellers. We certainly would hope that that's our primary use of cash for the next 15 months, and beyond that, but I would tell you we don't have certainty, you never do around acquisitions. What we are committing to is $2.8 billion of deployment, effectively, from this month until the end of '18. We don't know how that's going to fall, acquisition versus share

repurchase, but the $2.8 billion will be spent. So, if we have to deploy all that in share repo as opposed to acquisition, because the targets are not willing or not at the right price, we will do so, but I think, as Michael mentioned, our preference would be earnings accretive acquisitions.

Jeff Zekauskas
Okay. Then, for my follow-up, when you look at raw material cost inflation across the globe, which are the areas that have the most inflation and which are the areas that have the least, or is it mostly all the same?

Vincent Morales
Yes, it's a great question, Jeff, because there are big differences in inflation by region. Michael touched on it a little earlier. For different reasons, the regions have moved in a different direction. Our highest inflation region is actually Europe, really predicated on all the force majeure activity that has taken place this year, and then we're seeing inflation in Asia, primarily China, again, because of the supply curtailments that are being enforced there. The U.S., Canada and Mexico would be a third in terms of pace of inflation.

Just to remind everybody what Michael said earlier, we are expecting low-single-digit inflation coming into the year. We're now solidly at mid-single-digit inflation. So, inflation has certainly has been higher this year than our preliminary expectations.

Jeff Zekauskas
Okay, great. Thank you so much.

Operator
Our next question comes from P.J. Juvekar from Citi. Please go ahead with your question.

P.J. Juvekar
Yes, hi, good afternoon. Vince, your working capital was up by $300 million, not a huge amount, but it was still up. What are the different pieces in that? Is it raw materials related or is it due to slower growth that led to higher working capital?

Vincent Morales
Yes, P.J., we're a seasonal business, so I think you're right, our working capital versus the end of the year was up, as it typically is this time of year. If you look on a year-over-year basis, our working capital as a percent of sales is actually down about 50 basis points. We've been targeting 100 basis points of decline, which we think we'll achieve by the end of the year. We'll work through the—as we get through this lower season, work through some of the inventory, as we typically do, to achieve that goal. So, I would look at our working capital versus the same quarter prior year.

P.J. Juvekar
Thank you. Michael, you had lower selling prices in Industrial Coatings, despite what you described as pretty decent volume growth. One of your competitors gave pricing concessions to Automotive OEM customers. I was wondering if you're seeing an impact from such competitive actions.

Michael McGarry
Well, you know, everybody makes their own independent decisions. I would tell you that we already have gained price increases in some parts of our Industrial segment and we expect to get further increases in Q1. From my standpoint, we have a lot of areas that are growing above

the market and we're quite pleased with the pace of that, and I think that the price will come in that area, so I'm not worried about it. I guess we'll just continue to push the team to get the price up and that's what they're working on.

P.J. Juvekar
Thank you.

Operator
Our next question comes from Vincent Andrews from Morgan Stanley. Please go ahead with your question.

Vincent Andrews
Thank you very much. You mentioned some new raw material efficiency programs. I'm just wondering are you specifically talking about Ti02 or the balance of the basket, and what, if anything, are you working on that's new and interesting.

Michael McGarry
No, we really target the whole thing. I mean, even things like antibacterial things. The team was briefing us on—you know, if you think about all the various things that go into paint, every aspect of it has a material cost impact. Now, Ti02 is certainly at the top of the list. Resins are top of the list. Some of the other pigments that are in there are all key. We're driving simplification in some of our raw materials, which allows us to bundle a larger spend, and that helps us, as well. So, I would say we're focused on this on several different levels, not just Ti02.

Vincent Andrews
Okay. Then, you also mentioned that you were paring back growth capex for this year. Are there particular projects that you're focused on not doing and are these just going to get pushed into '18, or is this stuff that you just think does not make any sense anymore just given the overall environment?

Vincent Morales
Well, I think, Vince, as you've followed us over the years, I think you'll find we try to be aggressive on all fronts and try to make sure what we're doing, whether it be growth-related expenses or growth-related cap spending, matches what's happening in the external environment. As Michael started the call out, we see a low growth environment, so we are not pushing on some growth projects that could be delayed or deferred till a later time. Again, I think that's just our typical management style.

Vincent Andrews
Okay. Thanks very much, guys.

Operator
Our next question comes from Kevin McCarthy from VRP. Please go ahead with your question.

Kevin McCarthy
Good afternoon. As you put together your business plans for 2018, what sort of uplift, if any, do you anticipate from end-use markets, like autos and construction, in the wake of the natural disasters? Put differently, if we think about the nickel drag in EPS for 4Q, how do you think that might trend into the first quarter of '18?

Michael McGarry

Well, first of all, I don't think there'll be any drag in the first quarter '18, Kevin, so I think we can put that behind us. I would not have anticipated much in the fourth quarter this year, but the damage in Mexico and Puerto Rico—I mean, we went two weeks without a single store being open in Puerto Rico, and even now we only have 50% of them open. I think, when you look at having to rebuild stores completely in Mexico, that's going to have an impact, but not into the first quarter.

I would say, as far as looking at 2018, as I said in my very first question from Duffy, I think Automotive, we're going to be down a little bit in the U.S., up a little bit in Europe, and up a little bit in Asia, primarily driven by China. So, overall, I would say the market's going to be up 1% to 2%. Industrial production, I see a moderate improvement in that area. I think housing around the world is going to be solid, but not any barn-burner, and the biggest barn-burner has historically been the U.S. Housing prices are up a lot in the U.S. The amount of new permits, I would say, should be higher, could be higher, but it hasn't shown that. We're projecting 2% to 3% growth in the total Architectural market in the U.S., higher in the do-it-for-me market than do-it-yourself market.

Kevin McCarthy
Okay, and then a second question, if I may, for Vince. You've flexed your capital expenditures down slightly this year. Would you expect to be able to maintain the pace of 2.5% of sales next year in '18?

Vincent Morales
Okay, Kevin, the same thing as I answered the last question with, it depends on our growth outlook. If we see a more robust growth environment, we'll step up cap spending. If we don't, we're going to toe the line. We hope to start the year a little more optimistic outlook and see what happens as the year develops. For us, we're fortunate, because we're a capital-light industry, so 2%, 2.5% of sales, relative to other industries, is very favorable from a shareholder perspective, but, again, we're not going to spend if we don't see the growth trajectory established.

Kevin McCarthy
Very good. Thanks a lot.

Vincent Morales
Thank you.

Operator
Our next question comes from Don Carson from Susquehanna Financial. Please go ahead with your question.

Don Carson
Two questions. Michael, it seems overall you're expecting '18 to look like '17, so is that kind of sort of a 1% to 2% volume growth for the Company overall, and how much can you leverage that with new internal initiatives?

Michael McGarry
I would say 2-plus. I don't see the 1 to 2, because I think some of the things that we've seen this year won't repeat. So, I think I would be erring on the 2-plus side. We are always driving productivity, so we're not going to walk away from productivity initiatives. I think that's at the top of the list. We're going to continue to deploy our capital, and then we're going to continue to look

for ways to improve efficiencies in the plants, as well. So, I think we've had a historical preference to grow EPS 10% and I don't think we're walking away from that.

Don Carson
Okay, and then a follow-up on Architectural pricing. What kind of price increases have you been able to get at your company stores, have you matched the two price increases of your competitor over the last 12 months, and are you able to get any price in the big box channels?

Michael McGarry
Well, I think the answer to the first question is we have announced two price increases, we are getting two price increases. Typically, I always say that we get, you know, 50% to 75% of any increase we announce. The last one, dependent upon product, it—you know, you can't just draw a line around it. It's anywhere from 3% to 6%, depending upon the product in the market. In the big boxes, the answer is, yes, we do get it. It's never as fast or as easy as we like, but they do recognize raw material inflation, they do understand that we have to be profitable, and we also are very sensitive to the fact that they have a business they also need to run, so we collaborate very well in that regard.

Don Carson
Okay. Thank you.

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

Stephen Byrne
Michael, you were just mentioning here a minute ago about this 2% to 3% outlook for U.S. Architectural business. How would you assess that in terms of where we are in the remodeling cycle in the U.S. with respect to the average household use of paint? Are we at that prior peak, or if not, why not, and what would it take to get there?

Michael McGarry
Well, we're certainly not at the prior peak. As far as what it takes to get there, is—the last peak, if you remember, there was what, 2 million housing starts, so we're a long way away from that, but we do have a lot more remodeling going on, there's a lot of value in the houses, so there is still more upward potential in that regard, but you don't see the feeding frenzy on loans that you saw the last time. I think we're in a more sustainable place now. So, I think that's a positive.

Vincent Morales
Steve, this is Vince. If you look over a long period of time and you take out the peaks and valleys surrounding the last financial crisis, which was, again, part driven by homes, this is a 2% to 3%, or 4% growth market and that's the value of the market. From an equity investor perspective, is it's stability. So, I think we've gone back to what I would call a more stable growth rate over a longer period of time.

Stephen Byrne
Then, with respect to this new brand that you're introducing in Home Depot, can that channel handle a new brand, and is it entering at a new price point or quality point?

Michael McGarry
Yes. So, the PPG Timeless stain is a premium stain and it has started out very well. I think the

Home Depot associates are pleased with that. The PPG Timeless paint has also entered at a premium point, which we're excited about, it's the first time we've had what I would call a premium product in the Home Depot stores. It has also started out well. I think it certainly support it. I think we have very sophisticated customers who make good decisions and I think in this regard we'll have to wait and see how it pans out, but we're pleased with it. We're going to put advertising money, you know, support behind the brand at Home Depot, as well as externally, and so we're obviously happy with that.

Stephen Byrne
Thank you.

Vince Morales
Thanks, Stephen.

Operator
Our next question comes from John Roberts from UBS. Please go ahead with your question.

John Roberts
Thanks. Mike, on your earlier response to the question on environmentally regulation driven closures in China, your answer was directed towards hydrocarbons and solvents. Does that mean you're really not seeing anything more on the Ti02 side? We had a number of closures, I think, of suppliers there, but Ti02 prices, I think, in China actually went down during the quarter.

Michael McGarry
Ti02 prices went up in the quarter in China, and they did have some of the suppliers get shut down for emissions, and some were shut down because they were too close to where the party is doing certain activities. Like, today, in Beijing, starting actually about a week-and-a-half ago, they shut down all the body shops in Beijing, and they're told to be shut down all the way through the end of October. So, it's not just the hydrocarbons, but that is a much bigger portion of it. But, I would say anybody whose making dangerous goods is under pressure if they're not in a chemical zone, first and foremost, or if you have a bad historical record of performance. Those are the two places that they're going to first to enact regulatory enforcement.

Vincent Morales
John, this is Vince. Again, I think, just to echo what we said earlier, for a company like PPG, that has compliant coatings products, we think if this trend continues longer term, it's favorable for us. We know we have some local competition there that does not currently have compliant water-based products, so the continual move toward more high-technology coatings, I think, favors the multinationals.

John Roberts
Okay, and then a second question. The initial dilution on Crown, is that due to a temporary step-up in the inventory valuations, or are they just a lower margin business because they're more service-oriented and then you've got to take costs out to get the margins back to your corporate average?

Vincent Morales
John, it's definitely more the latter. We typically bring in these small acquisitions at margins below ours and then we're able to extract synergies and get them at or closer to our margins. The Crown acquisition, the first quarter will be in this quarter, fourth quarter, so, again, it's coming in at a lower level and we'll start working on synergies—or we already have started

working on synergy capture.

John Roberts
Thank you.

Vincent Morales
Thank you.

Operator
Our next question comes from Dimitry Silversteyn from Longbow Research. Please go ahead with your question.

Dimitry Silversteyn
Good morning, gentlemen, and thanks for taking my question. A couple of follow-ups, if I may. First of all, on the Protective and Marine business, you've put up a flat volume quarter-over-quarter in the third quarter here, which I think is the first time in five quarters that you haven't had a pretty big downturn in volumes there. How should we think about this business going forward? Is this an apparition or have we truly sort of reached the bottom and we can look forward to, you know, maybe more benign, if not necessarily positive, comps as we get out into 2018?

Michael McGarry
Yes, Dimitry, I think it's actually been seven quarters, if I remember right, so it's been—

Dimitry Silversteyn
Seven quarters, okay.

Michael McGarry
Yes, and that's memory. I can have John follow up and give you the exact number. The first answer is, you know, with the decline in Marine, your Protective business gets larger, and the Protective business is not as volatile as the Marine side. That's the first thing. So, the mix is now such that Protective is really significant. Second, Marine is at a bottom. If you look, the first time in two years, there's been a net increase in ship orders that were placed in the third quarter, so that's a positive, and I think that we're going to start to see continued growth in ship orders. Don't forget that we paint, typically 18 months after the orders are placed. So, I think we're at the bottom. It's always hard to tell, you know, calling the bottom, so I won't be 100% sure on this, but when I look at the order book, I see that—I also see that China has picked up share. Korea and Japan have both lost share in this enterprise downturn. For us, that's good for us from a mix standpoint, because we, obviously, are not winning as much in Japan as we win in China. So, that's a positive trend for us, as well. Overall, we're projecting a slight improvement quarter-over-quarter in the fourth quarter, as well. So, I would say that, you know, for the short term, we're, in our own business, seeing an upturn, and I think the market will also start to mirror that shortly.

Dimitry Silversteyn
Okay, that's helpful, thank you. Then, just to get a little bit more granular on the North American paint market, I understand that you guys talk about your own store volumes and you don't really discuss much what's happening in the DIY, in the independent dealer channel, but if you look at—I'm assuming you have those numbers internally. So, if you look at sort of the pace of declines year-over-year, is it changing? Can we talk about maybe inventory reductions that took place in DIY over the last couple of years maybe have played out? Any dynamics changing in

terms of demand destruction in the independent channel, or, really, we have not seen much change from, let's say, the last four to six quarters, that at least the DIY business has been suffering.

Vincent Morales
Yes, Dimitry, this is Vince, I'll the question here. If you look at those two channels, the independent dealer channel has been a perennial modest share loss channel for multiple years. It's a channel that requires very little maintenance. It's a very good channel for PPG and the other parties involved. But, the fact is it's a modestly shrinking channel. It'll be here for quite some time, but it'll continue to shrink, and that has not changed in terms of its trajectory. The big box channel, as Michael alluded to earlier, we think the DIY market is being primarily affected by low unemployment. We, PPG, this year, we personally have not seen much inventory destocking or restocking. That does happen from year to year to different products, so it's certainly plausible in the space. If you remember, Dimitry, we had some destocking last year. So, it just depends what products are selling versus which products are not. But, the fact of the matter is it's down low to mid-single-digit percentages, and that has not changed, again, from the beginning of the year.

Dimitry Silversteyn
Okay. So, basically, we can continue to see similar trends we saw over the past several quarters. Okay. Thank you.

Vincent Morales
Thank you, Dimitry.

Operator
Our next question comes from Michael Sison from KeyBanc. Please go ahead with your question.

Michael Sison
Hey, guys, how you doing? In terms of the capital deployment, you have a little over $2 billion in cash to date, and I would imagine you'd generate a good amount of free cash flow again in '18. Is there potential to do even a lot more than the $2.8 billion as you head into '18?

Vincent Morales
Yes, Mike, as you followed us over the years, we like to put a like put a cash deployment target out there at a minimum. We like to meet that target. We rate the target in July to the minimum of $3.5 billion, and if there's something that earnings accretive above that, we would certainly have the balance sheet firepower to do that and would be—and you should expect us to act upon that.

Michael Sison
Okay. Then, when you think about—I know it's a little bit early to talk specifics on '18, but volumes sound like they could be a little bit better, you'll recoup some margin from higher raw materials, you've got capital deployment, and you sort of noted 10% is kind of the annual goal, but given all that, wouldn't EPS growth be—I don't know what the right descript would be, but stronger than 10%?

Vincent Morales
Well, again, I think when you look across the Industrial basket of companies, you know, 10% EPS growth in a low growth environment, like we're talking about, is admirable. It depends on a

lot of factors. We do think there'll be slight inflation heading into next year. We're still going to be working on getting our pricing up. The one you didn't mention is currency right now would be a slight tailwind, that would be of benefit to us, as well. But, I do think all the levers that you talked about are ones we see, as well.

Michael Sison
Great. Thank you.

Vincent Morales
Thank you.

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

Mike Harrison
Hi, good afternoon. Michael, going back to the Architectural EMEA commentary, you talked about that being a fragmented market with all the private label that's out there. Does that suggest that there are additional consolidation opportunities where you could take out some of that private label business, potentially, or is it a situation where you would need to work with those customers if you wanted to figure out a way to reduce the amount of shelf space that some of those private labels have?

Michael McGarry
Well, there's always consolidation opportunities both ways. First, a customer, if they want to consolidate shelf space, they know where we live, so that's the easy one. We're always going in and doing aggressive product line reviews. But, probably, the more realistic opportunity is the fact that some of these private-owned paint companies are not getting recovery on the raw materials, and even those these are good cash flow positive businesses, even in this environment, it may an appropriate time for them to look at whether or not this is the time to monetize, or whether they have family situations, that it maybe appropriate for them to look at selling. So, we try to stay close to all the large families in Europe, so that they know if they're in a position, that they're ready to sell, that the first person to call is PPG. So, we stay close to that.

Mike Harrison
Then, I wanted to just ask on the Industrial segment, overall. That margin looks like it was, as far as I can tell, the lowest since 2013, despite some volume growth there, so I was wondering if you can just walk us through how much of that year-on-year margin pressure is coming from pricing versus raws, is there some mix components factored in there? Obviously, the natural disasters had some impact on logistics costs? What other factors are in there? Again, maybe a year-over-year basis makes the most sense. I'm just trying to understand what that margin could look like next quarter and into next year?

Vincent Morales
Mike, this is Vince. I think the answer is very simple. We've got, as Michael mentioned, a very large amount of sophisticated customers. It takes us further, in terms of time, to price with those customers. We're still seeing very high inflation rates on raw materials. So, that's the gap. We've got to continue to push pricing in order to recover the margins. All the other things you mentioned, I think are certainly a piece of the puzzle, but the bigger piece is for us to get price to offset raws.

Mike Harrison
All right. Thanks very much.

Vincent Morales
Thank you.

Operator
Our next question comes from Laurence Alexander from Jefferies. Please go ahead with your questions.

Laurence Alexander
Hi, I have two questions, might be very quick ones. First, most of the leverage we've talked about have been either end markets or consolidation. Is there anything on the technology or R&D side that you can do over the next couple of years, that if you're still in a slow growth environment at the end of the decade, your growth algorithm relative to that environment changes? Secondly, I guess this summer there was some noise around the European Union debating sort of labeling risks on Ti02 as an ingredient and that possibly affecting packaging. Has there been any update on that, and if there has been movement, what opportunities would that create for you?

Michael McGarry
Well, if you start with the Ti02 question, there was an original push by France to label that product as a probable carcinogen, if I get my facts right, and that's been downgraded to possible. We're in complete disagreement with the science. They're looking at one old report. We have billions of man hours of safely handling Ti02 in our plants. Of course, Ti02 suppliers have the same thing. But, given the fact that it's embedded in a liquid matrix, there's no concern in the paint product. We've even done testing, you know, sanding cars, and things like that. So, there's no push to impact paint. If there were—if we were to eventually "lose" this argument with the authorities in Europe, it would lead to us having to put more safeguarding in dispensing the Ti02 into the paint. That is not—we already protect our employees, our employees feel very comfortable handling Ti02, but we'll do whatever is necessary to continue that. So, we don't feel like that's in any way a threat to the business, but the fact of the matter is we think the science is flawed. When you try to stick a ton of Ti02 powder into a rat, I'm not sure that replicates what happens to a human, but so be it.

In regards to technology, though, we are strongly focused on R&D. We spend nearly $500 million a year on this. We spend more than any other coatings company. We've led the—if you look at the BPA non-intent, you look at the water-borne for Refinish, a compact process for Automotive, what we've done as far as some of the advantaged products, passive fire protection in our PMC business, we have a number of success stories in that regard, and we would expect to continue to drive innovation, which should allow us to grow faster in the market, which has been our historical stance, so I don't see a lot of difference going forward. I'm excited about our R&D pipeline. I have a quarterly meeting with these guys and they are really good at what they do.

Laurence Alexander
Thank you.

Vincent Morales
Thanks, Laurence.

Operator
Our next question comes from Arun Viswanathan from RBC Capital Markets. Please go ahead with your question.

Arun Viswanathan
Great. Thanks, guys. I've got two questions, one on margins and one on M&A. First, on the margins, Industrial was down a couple hundred basis points year-on-year, Performance also down. Is there a specific target that you have on recovery of those margins, and if you do, maybe you can just help us understand how much of that you will get through price or cost reductions.

Vincent Morales
Arun, this is Vince. We're working all levers to recover the margins. We've got some self-help activities, obviously, that Michael talked about in the opening comments. We're pushing price with all of our different segments of customers. Our target, as Michael said, is to get margins back to flat in the first half of next year, hopefully earlier in that first half as opposed to later, and I think we're on path now to do that. We're, as Michael again mentioned earlier, six or maybe seven months behind where we would like to have been, if you look at past situations, but we're comfortable we'll work back to margin parity.

Arun Viswanathan
Do you actually need raws to come down for that to happen, or is it price should get you most of the way there?

Vincent Morales
No, I think with our pricing actions, predominantly, as well as some productivity, those would be sufficient to recover the raws inflation.

Arun Viswanathan
Just real quickly, if I may, on M&A, you know, Crown was in the coatings services area. You've talked about doing adjacencies before, adhesives, and so on. Is that sill an area of focus or are you kind of more focused on coatings producers? Thanks.

Michael McGarry
No, I would tell you that we are very comfortable in adhesives and sealants area. We did do one, I think it was last—early last year when we did the acquisition of LJF in France on the sealant side. That's been a huge win for us. We bought 60% of it. Our partner, Total, is very happy that we bought it. They're a lot more profitable at owning 40% than they were at 100%, so they've been pleased with what we brought to them. So, we're very comfortable in that space. Adhesives are certainly an area. We have the specialty coatings and material business, that would be another area that we would stick in. Obviously, coatings is our bread-and-butter. So, those are the focus areas. Our Aerospace business is a good business in a number of areas. So, I think you're can expect us to stay in the businesses that we're most focused now and the near—what I call the near adjacencies. So, if it touches paint or touches the adhesives or touches a sealant, that would be the areas we'd be focusing on.

Arun Viswanathan
Thanks.

Vincent Morales
Thank you, Arun.

Operator
Our next question comes from Jim Sheehan from SunTrust Robinson Humphrey. Please go ahead with your question.

Jim Sheehan
Thanks. On the subject of AkzoNobel, there's been some deterioration in their results, management changes, activists are still clamoring for changes. Is this a situation you might revisit in the future, when you're able to?

Michael McGarry
Jim, I think we were very clear. We withdrew our offer June 1. We have moved on. Our shareholders expect us to continue to create value today, and we're not paid to wait around. So, we're going to continue to do that. We're happy with our acquisition pipeline. Our goal is to improve our business every single day. You saw that in these results. We've closed the gap on the margin deterioration. You can expect us to close that gap again the next quarter, as well. So, I'm pleased.

I guess the last comment I would say is I want to thank all our employees. We had all these hurricanes and earthquakes and our employees did a phenomenal job of supporting each other and supporting the Company, and I just want to thank them in that regard. So, maybe that answers your question, Jim.

Jim Sheehan
Thank you very much, Mike.

Vincent Morales
Thank you, Jim.

Operator
Ladies and gentlemen, that will conclude today's question and answer session. At this time, I'd like to turn the conference call back over to John Bruno for any closing remarks.

John Bruno
Thanks, Jamie. Once again, I'd like to thank everybody for their time and interest in PPG. If you have any further questions, please contact me at the Investor Relations area. This concludes our Third Quarter 2017 Earnings Call. Have a good day.

Operator
Ladies and gentlemen, the call has now concluded. We do thank you for attending today's presentation. You may now disconnect.