PPG Industries, Inc.

First Quarter 2018 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, and welcome to the PPG Industries First Quarter 2018 Earnings Conference Call. My name is Jamie and I will be your conference specialist today. 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. To ask a question, you may press star and then one. To withdraw your question, you may press star and two. Please also note today's event is being recorded.

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

John Bruno
Thank you, Jamie. Good afternoon, everyone. We appreciate your continued interest in PPG and welcome you to our First Quarter 2018 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 on Thursday, April 19, 2018.

I will remind everyone that we have posted detailed commentary and Company presentation slides on the Investors Center of 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 shortly. Following Michael's perspective on the Company's results for the quarter, we will move to a Q&A session.

Both the prepared commentary and discussions during this call may contain forward-looking statements reflecting the Company's current view of future events and their potential effects 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 Chairman and CEO, Michael McGarry.

Michael McGarry
Thank you, John, and good afternoon, everyone. Today, we reported first quarter 2018 financial results. For the first quarter, our net sales were approximately $3.8 billion and our adjusted earnings per diluted share from continuing operations were $1.39. This represents an EPS growth rate of nearly 4% for the quarter. The earnings growth we achieved was despite continuing and elevated raw materials inflation during the quarter, which we partially countered with selling price improvements and strong cost management. In addition, we continue to benefit from our ongoing cash deployment focus on our earnings accretion.

For the first quarter, our reported net sales were up almost 9%, while our sales in local currencies increased about 3%. Supporting the higher local currency sales were increased selling prices of nearly 2%, marking the fourth straight quarter of improvement over the prior sequential quarter. Total sales volumes increased modestly, but were negatively impacted by

fewer shipping days in the first quarter 2017, lower European architectural coatings volumes due to harsh winter weather that caused several days of store closures during the quarter, and lower U.S. architectural DIY coatings sales volume. In addition, we passed on some business this quarter as we pursued higher selling prices and have prioritized margin recovery.

Foreign currency translation was favorable as several key currencies strengthened against the dollar, with sales favorably impacted by approximately $200 million and pre-tax income favorably impacted by about $25 million. We expect a slightly less favorable impact in the second quarter.

Looking at some of the business trends in the first quarter, our Industrial Coatings segment delivered solid organic sales growth of about 2%, which included a 200-basis-point improvement in selling price from the previous quarter. Organic sales volumes in packaging coatings were up by a mid-single-digit percentage, as the adoption of our INNOVEL® interior can coating products continues, and selling price increases were achieved. We also continued to grow sales volume in general industrial and specialty coatings material, delivering our ninth consecutive quarter of above market growth rate, driven by strong sales growth in the Europe and Latin America regions. In addition, the general industrial selling prices gained notable traction in the quarter.

Automotive OEM Coatings sales volumes were flat, consistent with the global industry automotive builds. We continue to outperform the market in Latin America due to new business we received in prior years. In China, our sales volumes were modestly lower and in line with the overall industry, which was expected following the December expiration of the tax subsidy that was previously available in the country. We anticipate China automotive build growth both for the industry and PPG to improve in the second quarter.

In the Performance Coatings segment, aerospace coatings had high-single-digit percentage volume growth, led by above industry performance in the U.S. and Asia-Pacific regions.

Automotive refinish grew organic sales by mid-single-digit percentage, supported by above market performance in Europe.

Architectural EMEA sales volumes were down in the quarter, as I mentioned, impacted by fewer shipping days and harsh winter weather. This business has progressed selling price initiatives working to counter raw material inflation during the quarter. Sales grew a solid mid-single-digit in Latin America, with contributions from our Mexican PPG Comex business, Brazil and Central America. During the quarter, we opened an additional 45 stores in Mexico and Central America. Sales volumes in architectural coatings in Americas and Asia-Pacific were flat and sales organic growth in the U.S. and Canada company-owned stores were offset by lower DIY and independent dealer network sales volume. Our company-owned stores delivered their strongest quarterly growth in over four years on an adjusted day basis. Our PPG TIMELESS® products continue to be added to more Home Depot stores and had good end consumer pull through the quarter.

Protective and marine coatings sales volumes were flat, compared to last year, with solid protective coatings sales driven by Asia, offset by moderating weakness in our aggregate marine coatings sales volume. Shipbuilding orders in Asia continue to increase, boosting the prospects of a recovery in marine coatings in early 2019. This will begin to aid paint sales volumes later this year.

From a regional perspective, sales volumes growth was the highest in Latin America, driven by our market outperformance in the Industrial Coatings segment and strong architectural coatings sales volume.

Sales volumes were slightly lower year-over-year in Europe. A solid mid-single-digit percentage increase in the Industrial Coatings segment was offset by lower sales in the architectural coatings EMEA segment. We anticipate that the Industrial business will continue to deliver growth in the second quarter, as regional industrial production continues to remain favorable for a broader continued economic recovery.

Sales volumes were flat in U.S. and Canada in the first quarter. Strong sales volumes in our aerospace coatings business and solid organic sales growth in automotive refinish, general industrial and packaging coatings were offset by lower automotive OEM sales volumes, including the decline in regional industry automotive production.

Sales in the Asia-Pacific region were flat with prior year as we experienced softer demand in China, as our customers had a longer shutdown after the Chinese New Year. We expect stronger sales in China during the second quarter, led by higher automotive OEM demand. Sales volumes in India grew by low-teen-digit percentage, with broad-based contributions across many businesses.

From an earnings perspective, our first quarter adjusted earnings per diluted share of $1.39 was more than a 4% improvement versus the prior year. Our earnings were impacted by elevated raw material inflation in the first quarter, and while impacting most of our businesses, had a heightened impact on the business in our Industrial Coatings segment. In the first part of the quarter, epoxy resin, which is a key input for automotive OEM and packaging coatings, increased by more than 40% due to production curtailments in China. In addition, elevated oil prices impacted solvent-based raw materials and logistics costs. In aggregate, raw material inflation was about a mid-single-digit percentage increase in the quarter, which is on top of raw material inflation we incurred in the first quarter of 2017. We expect raw material inflation to continue in the second quarter of 2018, but expect increases to current inflation levels to moderate.

During the first quarter, selling price initiatives gained momentum, with our most significant improvement since the current cycle of raw material inflation started a year ago. Noteworthy are the gains realized in our Industrial Coatings segment, which achieved 200 basis points of sequential improvement. We are continuing to work with our customers on further selling price initiatives focused on offsetting this persistent raw material inflation. In addition, we are making more progress in our efforts on raw material efficiency, with more expected as we progress through the year.

In addition to selling price initiatives, we are partially mitigating raw material inflation through continuing cost management. We reduced selling, general and administrative costs by about 140 basis points, compared to last year, including good progress from our business restructuring actions. We have raised our target of restructuring savings now to between $50 million to $55 million in 2018 from our prior guidance.

In addition, earnings per share benefited from our ongoing cash deployment actions. This includes the impact of our repurchase of $600 million of PPG stock in the first quarter. In the quarter, average diluted shares outstanding were 3% lower versus the quarter of 2017.

Our effective tax rate was 23.5% in the first quarter, which is lower than the 24.9% rate in the first quarter of 2017. The reduction mostly relates to the tax reform legislation that was implemented at the start of 2018. We are still anticipating a full year tax rate between 23% and 24%.

As we look ahead, we still expect continued positive momentum in overall global economic growth. We are closely monitoring and evaluating the possibility and ramifications of new tariffs. Currently, we do not see a significant direct impact to our Company, but any disturbance to free trade would be concerning.

Specific to our business, we still expect better growth in housing starts in the U.S. during 2018. We believe the U.S. regional automotive industry builds will be relatively flat year-over-year. In Latin America, we anticipate continued economic expansion in South America, in particular for Brazil. Growth rates in Asia are expected to remain generally consistent with 2017, with continued industrial production growth in China. We expect stronger automotive build growth rates in the second quarter, based on lower inventory levels and easier prior year comparisons. We expect economic expansion to continue in India after a strong first quarter. Economic growth in Europe is expected to continue, but remains varied by sub-region and country. Favorable end use market trends are expected to continue, particularly in automotive OEM coatings, as industry build growth rates are expected to remain positive. We will continue to manage all elements of our business within our control to ensure that we remain competitive regardless of economic conditions. We will continue to execute our 2016 restructuring program, focused on reducing our overall cost structure.

As we announced this morning, we will be launching our highly rated Olympic® stain products in the Home Depot during the second quarter. Olympic® has been America's most trusted stain brand since 1938. We are very excited to expand our relationship with the leading do-it-for-yourself retailer in the world. We will work closely with the Home Depot to optimize its success.

As mentioned in our earnings press release, based on the change in customer assortment that we experienced in the first quarter, we are further evaluating our cost structure and will be diligent to and execute on any opportunities to reduce costs, which is what you expect from PPG. While we do this, we will not forego our efforts and investments to continue our growth initiatives, including targeting certain growth spending in the second quarter, with plans to spend an additional $5 million.

Finally, we remain in a position of strength as we ended the first quarter with over $1.4 billion in cash and short-term investments, which provides us with significant financial flexibility. We remain committed to deploy a minimum of $2.4 billion of cash in 2018 on acquisitions and share repurchases as part of our previously communicated target to deploy a minimum of $3.5 billion in 2017 and 2018, combined. Our acquisition pipeline remains active. We plan to continue to repurchase shares in the second quarter.

This concludes our prepared remarks. Once again, we appreciate your interest in PPG, and now, Jamie, would you please open the line for questions?

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time, we will begin the question and answer session. To ask a

question, you may press star and then one. If you are using a speakerphone, we do 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 from R.W. Baird. Please go ahead with your question.

Ghansham Panjabi
Hey, guys, good afternoon.

Michael McGarry
Hi, Ghansham.

Ghansham Panjabi
I guess the first question is on North American paint stores and the mid-single-digit increase during the first quarter. How does that parse out between volumes and price, and just given the ongoing weakness in the independent dealer channel and the share shift in the home improvement channel, how are you thinking about your store footprint, I guess, more broadly, in terms of incremental investments there?

Michael McGarry
Well, we had nice volume and we had positive price, is the way I would describe that. We opened seven new stores in the first quarter, and that was despite, as you know, weather in the north continued to be exceptionally challenging as we closed the month of March. So, I was quite pleased with our store performance.

Ghansham Panjabi
Okay, and I guess the second question, as it relates to your comments on raw materials, I think you said mid-single-digit increase in the first quarter and some level of moderation as the year unfolds, but crude oil prices are up quite a bit, the curtailments in China have been in place. I guess, what's giving you confidence that you will start to see that moderation as the year unfolds on the cost side? Thanks so much.

Michael McGarry
We still anticipate mid-single-digit increases. We will have increases in the second quarter and continuing. I think what we see—first of all, certainly, oil is up significantly year-over-year, so that's not going to change. Propylene is up in all the three regions, and that's up sequentially, as well. Ethylene is the one thing that is down. So, I guess I'm trying to put it in perspective that Q4 was a very large number, Q1 was a very large number, and we're going to continue to see significant numbers, but maybe not to the exact same significant increase that we saw in Q4 and Q1.

Ghansham Panjabi
Got it. Thanks so much.

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

Christopher Parkinson

Thank you. When we think about the Industrial Coatings segment, specifically volumes, can you just take us a quick walkthrough to your comments on general industrial, packaging versus your expectation for auto, not in the first quarter, but how you see ’18 evolving into ’19; and then, also, just what’s the best way for all of us to think about your ability to achieve price in the segment once again by end market versus last year? Thank you.

Michael McGarry
Well, let’s start with price, because I think that’s a really positive story. We have price in every single one of our businesses, without exception. We also see price coming in the second quarter, as well, in every single one of our businesses. So, the traction has improved significantly. As we have said, we’re prioritizing price over volume, and that message clearly received by the entire team in PPG.

When you break it down into the various sub-segments of Industrials—I’ll take the Industrial Coatings first. Heavy duty equipment continues to perform well. Electronic materials is a positive. Coil is a positive. Transportation is a positive. Our Coatings Services business, because of all the wins they had in Mexico, they’re doing well. The one area negative, of course, is wood. China is shifting from people painting in the houses to painting in the factories and that has a change in where it’s happening in the marketplace as far as the channel that the product is being sold. That’s the one negative.

When you look at packaging, that’s been a continued success story for us. Our new INNOVEL® technology has been positively received and we’re really pleased about that.

OEM coatings, again, you have to break that down into regions. So, the U.S., we went into the year thinking the U.S. volumes would be slightly down. As you saw, March was very strong, about $17.5 million. The one caveat would be Europe. Even though we see Europe being up, registrations in Europe were modestly down. Year to date, they’re flat. So, we still are very optimistic, we think it’ll be up probably 3% in Europe.

Latin America will be strong, as you know, plus our share gain in Mexico.

Then, I was pleased when I looked at China for March. Inventories are in very good shape there. Dealer inventory in the lots are in good shape. OEM inventories are in good shape. March sales were actually up 3%, so I think that’s going to be good, and of course India had an outstanding month.

Vincent Morales
If I could add, Chris, the expectations in China for the first quarter were modest. As Michael mentioned in the prepared remarks, we were coming off a tax incentive, that we believe pulled some business into 2017, so we were again pleased with March stepping up after, again, a brief pause.

Christopher Parkinson
That’s helpful. Can you also do a quick walkthrough of your EMEA architectural business; specifically, a walkthrough in Europe? I’m assuming France is still weak, but what about the Benelux, U.K. and Central Eastern Europe on a sequential basis? Just any comments on growth and the competitive landscape would be helpful. Thank you.

Michal McGarry
The Benelux did pretty well. You’ve got to remember, Benelux is a market that has a lot of

exterior painting, so the fact that we've had such tough weather in March is part of what dragged that down, but when you look at the underlying backlog of our customers, it's still quite good. Retail Europe is by far the biggest concern. Retail Europe is down high-single-digits. I'm sure you've seen some of the reports from some of the folks in that space. We did get a little cautious on the U.K., we saw some early signs of Brexit, but it's hard to parse out the Brexit versus the fact that they had snow in England, which never happens, so I think that's part of our concern. When you look at some of the Eastern European countries, doing pretty—well, I'd say in hanging in there. They were more impacted by weather than anybody else. Then, you come back to France as a country, our trade business did very well, actually, in the first quarter, but it was offset by the weakness in retail. So, no recovery yet for France as a country, but we are in pretty good shape as far as the business.

Christopher Parkinson
Thank you.

Operator
Our next question comes from John McNulty from BMO Capital Markets. Please go ahead with your question.

John McNulty
Great. Thanks for taking my question. With regard to the volumes, you had indicated there was some pressure around pricing, where you were walking away when they weren't taking the pricing. I guess, could you articulate how much of the volume impact that was in the quarter?

Vincent Morales
Hey, John, this is Vince. Again, in several of our businesses, we saw marginal volume that we had—we thought we had booked or had booked. That, with the lower price, went to somebody else. It's not quantifiable, but we definitely anecdotally and qualitatively saw that happen in several of our businesses.

John McNulty
Got it. Then, just as a follow-up, your corporate and legacy line, I think the original guide had been for 220 to 240 kind of an expense this year, and I guess you've revised it 175 to 190. I guess, what are the major takeaways on that, that's getting as low as it is? I know you had been working on cost cutting all along, so I would imagine that was partially in the original guide, so I guess what's the big change there?

Vincent Morales
The two biggest things that have lowered that number since we provided guidance, number one, we did receive revised actuarial information from our pension plan. I think, as you know, John, we've done a lot of work over the past three or four years to help immunize our pension plan, and that actuarial information, which we do receive periodically, but we received it after our original guidance, was a big factor; and also we made some structural changes to our retiree healthcare programs that are rolling through. That's a pay-as-you-go process.

John McNulty
Great. Thanks very much for the color.

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

John Roberts
Thank you. Could you talk about the range of price increases that you achieved sequentially? I'm guessing packaging coatings was up the most given the epoxy situation, and perhaps the increases were minimal in weaker areas, like Europe deco or U.S. DIY.

Vincent Morales
Yes, John, we typically don't get into details by business. We just provide in the prepared materials the information by segment, which is our traditional reporting protocol, so I'd ask you to just refer to that.

John Roberts
Then, I thought last quarter was a record quarterly repurchase rate for the Company and now this quarter is 50% higher. How do we think about the pace of buyback as you complete the cash deployment target?

Vincent Morales
Well, as I think we've said many times in the past, we don't provide our pace or type of cash deployment from quarter to quarter. We use a multitude of factors to determine what we're going to do with our cash and those include our acquisition pipeline. We still are committed to the $2.4 billion for this year on both acquisitions and share repurchases, and we'll honor that, but we won't give the cadence by quarter or type.

John Roberts
Thank you.

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

Dan Jester
Hey, guys, it's Dan Jester on for P.J. If I look at the heat map in your slide deck, it seems like there's a couple more end markets which you logged below market growth in this quarter, packaging in Asia-Pacific and a couple businesses in EMEA. Is that related to some of the business that you walked away from because of margins or is there something else going on in those markets that we should be aware of?

Michael McGarry
You hit the nail right on the head. As you can imagine, epoxy prices were up significantly and we were raising price and we wanted to get value for the market-leading technology we provide, and we didn't get it. We were aggressive and saying, "Then, see if you can find your coatings needs from somewhere else."

Dan Jester
Okay. Then, logistics cost is something that's come up a bit, not just for yourself, but for other players in the industry. I'm wondering, is there anything that you can do with regards to your own production plans to help to optimize or limit your logistics cost, or is that just another line item that eventually you need to pass on to your customers and get them to pay for? Thank you.

Michael McGarry
We are always looking at our manufacturing footprint, that's a constant item, and so we are looking how we can continue to optimize that, but as you know, especially here in the U.S., and it's not just a U.S. problem, but there is less trucking availability, and availability of trucks on a

short notice is also challenged, if you need something short, you need to pay more or you don't get it, so that's the challenge for us, but, as you know, that's not nearly as big a problem as what we have with epoxy, emulsions, TiO2, and some others.

Vincent Morales
But we are working with our customers on both of these categories with respect to selling price.

Dan Jester
Great. Thank you very much.

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

Kevin McCarthy
Yes, good afternoon, and thank you. Would you comment on the timing of the roll-out of Olympic® stain across the 2,000 stores at Home Depot and perhaps characterize the size of that win as you work to backfill a lot of foregone sales at Lowe's?

Michael McGarry
Yes, Kevin, I think it's up to Home Depot to tell you when it gets in their stores. What we did put in the release is that we are shipping and it will be a second quarter event, so that's a real positive. The other thing is how quickly they responded. Within two days of the announcement from the other big box retailer, we were in Atlanta mapping out plans jointly, and that was a brand that they've valued for a long time and jointly we're going to work very hard to make this a success. I think the way to think about the overall sales dollars, though, is you think about any big box paint, it's always bigger than stain, and Home Depot is always bigger than Lowe's, so I'll let you kind of do that. Now, what you have to remember is there was product already in Home Depot, and so they'll have to work their way through that product and work their into ours, so there is some of that timing issue that you'll have to factor in. So, our sales in 2019 will be significantly bigger than 2018 in the Home Depot.

Kevin McCarthy
Okay, thank you for that, and then as a second question, I wanted to come back to your price contributions. You've seen some nice acceleration there over the last couple of quarters. Michael, as you look at the balance of the year, do you think you can sustain this level of price contribution for the overall Company, accelerate from here, does it tail off at some point because you get to harder comps? How should we think about the cadence of those contributions this year?

Michael McGarry
No, the traction is getting better, and we will have more to come. You have to remember, you know, we typically like to be six to nine months behind the raw materials. We're a little bit later than that now, so we have more to catch up. Even with the nice traction, we still have to do a better job in this area. You can expect to hear us talk more about price gain in the next quarter, as well.

Vincent Morales
Kevin, you're right. The back half of the year of 2017, we did see some modest price traction, that went back to year-over-year numbers, but on an absolute basis, we're continuing to pursue higher pricing.

Kevin McCarthy
Thank you very much.

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

Frank Mitsch
Hey, good afternoon, gentlemen. Let me ask Kevin's question a different way. Where do we stand right now, second quarter to date, in terms of price increases that you've been able to achieve relative to Q1?

Vincent Morales
Frank, our expectation is that's going to be higher year-over-year than we saw in Q1. Again, we saw in Q1 a 1.6% selling price increase, and, again, every one of our businesses, we think we'll be tracking higher in Q2. We're not going to quantify that, but, again, it should be higher than we saw in Q1 on a year-over-year basis.

Frank Mitsch
All right, terrific, that's helpful. Then, I did notice your net debt to EBITDA went up to 1.5 times at the end of Q1. Where's your comfort level? Where should we be thinking about your targeted leverage ratios?

Vincent Morales
Yes, Frank, Vince again. Yes, we did borrow approximately $1 billion in Q1. We liked the interest rate at the time when we borrowed that. All in, it was about a 3.6% interest rate. We certainly have a lot of financial flexibility and a lot of balance sheet capacity. As an industry and as a company, the coatings industry can support a much higher leverage ratio than we have today. We're not going to put a quantification on that, but if we find opportunities, we will certainly exercise the balance sheet, within reason. Our only biggest criteria would be to remain investment grade.

Frank Mitsch
Thank you so much.

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

David Begleiter
Thank you. Michael and Vince, when will selling price increases fully catch up to higher raw material costs, which quarter, is it Q2, is it Q3?

Michael McGarry
I think the back half of the year, David, is probably the most likely scenario. As you know, this is not a perfect science. Every day every sales rep in the world for PPG is talking about price and has their own deliverables on that. But, I would definitely say the second half, the last half of the year is it.

David Begleiter
Very good, and, Michael, just on volume, after the soft numbers in Q1, for a variety of reasons,

could we get back to, let's say, 2% volume growth in Q2 year-over-year, do you think?

Michael McGarry
As I told you on the fourth quarter call, the 3%, we don't want to draw a line, using one data point. We saw the one less selling day in the first quarter, so we were trying to be a little cautious. We obviously did not predict the tough weather. April hasn't started out very well from a weather standpoint in the U.S., so that will have some moderation on it, but the customers all have strong backlogs. When we talk to our big contracting customers, they really are bullish on the year. So, I would say that we should be closer to your number than our first quarter number.

David Begleiter
Very good. Thank you.

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

Chris Evans
Good afternoon. This is Chris Evans on for Bob. I just wanted to check in and see if you're seeing in different product categories that your peers are as committed as PPG has been to pricing, any specific product categories, or maybe you're not seeing the same discipline that you guys are expressing?

Michael McGarry
Well, I think the only way to answer that question is our comment where we said that we've walked away from some business. Every company has to make their own independent decisions. PPG has made their decisions. You are probably better off asking our peers about their own independent decisions.

Chris Evans
Great, and then maybe just talk a little bit about the product line rearrangement that happened earlier in the year, maybe if you can just deconstruct what happened there. It seemed like that came as a bit of a surprise. Then, I'd be curious to hear opportunities where you might be able to shift those architectural gallons that we haven't seen yet, and then, lastly, as part of that, do you expect the Home Depot new product launch to be EPS positive in this year or are there any additional costs associated with that?

Vincent Morales
Yes, Chris, Vince, I'll take the first part of that question. With respect to the customer assortment change, I'd simply classify that as the customer made a decision that we certainly were disappointed with, but it's certainly any customer's decision to like our product or like somebody else's product. If you need any more information, you certainly would need to inquire with that customer.

I think your last question—Michael's going to answer the middle one. I think your last question on Home Depot is it's certainly our attention for that to be accretive in Q2 and in succeeding quarters. As you know, Q4 is a light quarter, especially for stain, so that one, we'll have to see what the customer pull-through is, as we will in Q2 and Q3, but given the volumes in queue we expect, hopefully, to achieve in Q2 and Q3, we would expect that to be accretive.

Michael McGarry

Yes, I think as far as the volume, I think I covered that earlier. Home Depot is 100% behind this and you'll see, when they start to put it in the store, the type of assortment and type of highlighting of the product, but, again, that's really for them to comment on.

Chris Evans
Thanks, guys.

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

Jeff Zekauskas
Thanks very much. The was a $15 million other income net benefit in the quarter, what was that?

Vincent Morales
Jeff, we had about a $7 million charge last year for one of our legacy items, for a plant we no longer operate, and haven't operated for quite some time, and we had an equity investment that started in Q2 of last year, or it may have been early Q3, that had equity income. Those two items combined comprise the delta.

Jeff Zekauskas
Okay. Second, you've been trying to raise prices in the Industrial area for roughly a year and you're now up 1%, and you have rising raw material costs, they're rising much faster than 1%. Can you diagnose what happened in Industrial Coatings that's really led to the slowness in successful price realization?

Michael McGarry
Jeff, I think that really boils down to several factors. The first one is people have got to see that it's sustainable raw materials and maybe last year they weren't thinking that it was quite as sustainable, so that may have affected how some people are thinking about that. The second thing I would say is we had some of our peers who had publicly stated that they were going after volume, so that naturally impacts the ability to get price. Then, third, our Industrial customers are very large and very sophisticated, and it has historically worked this way, every time we to get to price in Industrial after we get price in the Performance Coatings segment. The good news is we're starting to get it in every business, and that includes automotive, and that also includes the very large OEM Industrial customers, as well. I'm disappointed it's taken this long, but the pace at which it's coming is apparent and the teams are doing a much better job.

Jeff Zekauskas
Thanks very much.

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

Dmitry Silversteyn
Good afternoon, and thank you for taking my questions. Just revisiting the European situation, in particular, with respect to paint, if you sort of exclude the impact of weather, and obviously it's been a big problem for the region in the first quarter, how would you sort of characterize the overall market fundamentals with respect to construction spending and remodeling activity,

anything going on there that the weather elements have hit in the first quarter that should become more apparent as we get into the meat of the painting season.

Vincent Morales
Hey, Dmitry, Vince. Again, I think you classified it properly. Our visibility on a lot of that is fairly opaque given the weather situation. I think the one trend Michael called out, which was visible throughout the quarter, was lower retail sales, especially in the home centers throughout the region, so that's the one item we can say we have some comfort is a trend. We also did see just some generally lower—in the U.K., not paint-specific, we saw some generally lower retail overall sales, which, again, may be the early or middle effects of Brexit. But, beyond that, it's really hard to decipher what's going to occur throughout the paint season.

Dmitry Silversteyn
Okay. In terms of the Olympic® product that you're getting into Home Depot, it's good to see that you guys are able to benefit quickly from a fill-in in the second quarter. One of the businesses that Home Depot lost on was interior paint, interior stains, as well. Are there sort of future announcements possibly coming from you and Home Depot on that? Do you have a drop-in product or is that something that you're working on? Can you give us some visibility or perhaps something that we can look forward to?

Michael McGarry
Well, I can't give you any visibility on that. Obviously, Home Depot is very interested in having competitive products. They were, and continue to be, the largest seller of interior stain and they fully expect to be in the future the largest seller of interior stain. So, they've set that objective, and how that plays out in the future, when we have that clarity, we will be happy to share it with you.

Dmitry Silversteyn
Got it, and then final question just on the overall automotive OEM market. It sounds like we're getting a little bit better results out of China, and the U.S. sales, as you mentioned, were perhaps a little bit stronger than expected, and Europe is expected to grow. As you look at the business right now for the balance of the year versus how you looked at it at the beginning of the year, would you say that your overall sort of impression of what the industry growth would be has gotten a little bit better or is it still fairly kind of low to no growth environment?

Michael McGarry
No, I would say I'm marginally more positive, but whether you're going to be able to pick that up and whether that can be material or not is not known, but I would tell you it's put a nice solid floor on anything that may happen, so I would say I'm marginally more positive.

Vincent Morales
Dmitry, just as Michael mentioned earlier, we're pleased with the inventory positions in the U.S., the industry inventory positions in the U.S. and China, coming into what is the typically the highest selling season in the U.S.

Dmitry Silversteyn
Got it, got. Okay, thank you, Vince, thank you, Mike.

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

Duffy Fischer
Yes, good morning. The first one is, can you just shed a little bit of light on the accounting issue and your comfort level at kind of ring-fencing it at that small $5 million level?

Michael McGarry
Okay, Duffy. So, first of all, I'm so thankful that this was brought forward as we are finalizing our earnings report. As you know, at PPG, we hold ourselves to a very high standard of business and professional conduct. Our reputation for being an ethical and respectful company is a competitive advantage. We believe it is our responsibility and commitment to ensure the long-term success of our Company, and that benefits all of our stakeholders, whether it's customers, shareholders, employees, suppliers or neighbors. We take this matter very seriously. We're conducting an investigation concerning these potential violations. The Audit Committee is comprised of independent directors of the Company's Board of Directors and they're overseeing it, with the assistance of outside counsel. We're not able to predict the timing or the outcome. All I'm saying is that the investigation is ongoing. I'm sorry I can't provide any additional information at this time.

Duffy Fischer
No, fair enough. Okay, thank you. Then, the second one, the Ford City judgement that hit a couple papers yesterday, is that meaningful, and if it is, what's kind of the timeline of how that will play out?

Michael McGarry
Well, first of all, the Judge said that the other party was not responsible, so that's the first thing, that's what the court case was about. Second, we have been working with the Pennsylvania Department of Environmental Protection on this issue for 10-plus years. We are in very good shape with them. We have a very good remediation and we have—I would say, as far as you and as an investor is concerned, this will not be a meaningful issue.

Duffy Fischer
Okay, perfect. Thank you, guys.

Michael McGarry
The other thing I would say, our current actions are protective of the human health and environment, so everybody is clear.

Duffy Fischer
Perfect. Thanks, guys.

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

Laurence Alexander
Good afternoon. I have two quick ones. First, on the general industrial and packaging outlook comments, where you say it's similar to Q1 in terms of the year-over-year volume growth, if Q1 had the tough comparisons in Asia, what is the comparable offset that makes Q2 similar to Q1? Secondly, in terms of productivity, where do you still see areas for significant productivity gains, given how many years you've been pushing back on that?

Vincent Morales

Yes, Laurence, I'll take the first one and I think Mike will probably take the second one. I think I heard your question with China, our comp in China in Q1. I think it was actually coming out of Q4, we expected softness because of a buy-ahead, as the tax incentive expired. I would say Q2 last year was a traditional quarter. Q4 of 2017 was the one we thought there would be a buy-ahead. So, again, I would say the comps for Q2 in automotive China will be normal.

Michael McGarry
Laurence, with regards to your question about costs, as you know, this is a never-ending quest for PPG to get more efficient, and so we're always looking at our manufacturing footprint. As you know, we have done other acquisitions in the past 12 months, and so that means that there's other labs that are overlapping, other plants that are overlapping, so we'll be working hard to get those things out. I don't think that we're ever going to stop in this area. Plus, I think we'll be looking at how we reposition our architectural U.S. business, with the announcement of the customer assortment change that was detailed earlier in the quarter.

Laurence Alexander
Thank you.

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

Vincent Andrews
Thanks, and good afternoon. Maybe you could just give us an update on what you're seeing out there in the M&A environment. I know you guys have your eyes on a variety of things over the years. Has anything changed about the conversations with those targets? I'm going to assume, based on the size of your repo in the first quarter that you're not close on anything material, so just thoughts on where all that sits would be helpful.

Michael McGarry
The biggest challenge we have right now, Vincent, is the fact that, you know, when you're trying to buy somebody whose earnings are going down, they want to look backwards to what they were doing 12 months ago and we want to look at either what they're doing today or what they're going to do the next quarter. They want to get paid on what their business used to be and of course we're going to be the ones that will be improving it. So, I would say the conversations right now are a little bit more challenging. We have a very healthy number of people we're talking to. In fact, we had a new one fly in last week. So, I would tell you that the pipeline is still there, but, as you can see by our Q1 response, we're going to moderate our purchases of shares based on our pipeline, and we've always preferred acquisitions over share repurchases, and so we're going to continue to look hard at acquisitions, but if we can't do them, then we'll buy back stock.

Vincent Andrews
Okay, and just to follow up on the logistics cost comments from earlier, I might have missed this, if you commented on this before, but is trucking part of the issue of what's going on with driver hours, and things like that, or is it just fuel expense?

Michael McGarry
No, it's trucking; (a) it's availability and (b) when they don't show up and sometimes you have to shift the LTL to keep your customer going, because we have so many of our customers that run just-in-time, so that ratchets up the cost to serve that customer during that period of time

because of the lack of availability. So, you have two factors going on.

Vincent Andrews
Okay. Thank you very much, guys.

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

Michael Sison
Hey, guys. EPS growth was up in the first quarter and it sounds like your general economic outlook is positive, pricing has started to take some play. So, when you think about EPS growth going forward, does it get better in Q2, and to what degree? I'm trying to gauge your confidence in generating better EPS growth this year versus last year, in total.

Vincent Morales
You know, Mike, we don't give guidance, it's a longstanding practice of ours. I would tell you that the elements to look out for as we go into Q2, we try to give you some anecdotal information on, which is we're still seeing raw material inflation. We have to offset a little more of that with price. Volumes in architectural, as Michael mentioned, early in April, are more reminiscent of March than they would be of a better weather season. Other than that, emerging region growth looks good. So, I think we're hoping for a higher volume number, as we said earlier, higher price number, but we're still battling with inflation.

Michael Sison
Got it. Then, it sounds like you may still have to walk away from some volume in Q2 to get some of the pricing, is that the case, and what would the impact be on volumes if you do have to continue to do that?

Vincent Morales
I'll reiterate what Michael said, that our priority is margin recovery. I would say there will be no more incremental impact than we saw in Q1 in the second quarter, as we continue to work with our customers on pricing. Again, I think we'll see the same situation where certain customers will move to a lower price without us.

Michael Sison
Great. Thank you.

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

Arun Viswanathan
Great, thanks. Good afternoon. Just a question, if I could, on—the same question, asked a little differently. Do you expect to be kind of caught up to margins in Industrial in Q3 or Q4, or are you still going to be lagging year-over-year?

Michael McGarry
I think it'll be hard to get there in Q4, but that's currently our target.

Arun Viswanathan

Okay. Then, in the past, I guess you had mentioned that a potential inflection could be improvements in Europe, and that would be maybe the best opportunity for you guys to start growing again. Maybe you can just help us understand if that's still the case and any other kind of signposts that we should be looking for as to seeing an improvement or anticipated improvement in your businesses?

Michael McGarry
Well, I think when I walked around the world with some of my commentary, Mexico, even with the challenges with the election, is still going to be a good market for us. We saw Brazil getting better, so Latin America is going to continue to grow. You saw that China's GDP number was 6.8%, if I remember right, was a good solid number, so that's a positive. I talked about India being up basically double-digits. Another positive, obviously, would be if we could get this weather behind us. Look at our Industrial business, as well, in Europe, we dropped 30% or 40% of any sales growth in Europe down to the bottom line. I would say that Europe still has a very positive outlook and we're well positioned with our customers. The team is performing well in a solid environment.

Vincent Morales
I'll just append to that, Arun, that we did continue to see in Q1, even despite some harsh weather conditions, very solid growth in our Industrial segment in Europe. As we've said many times in the past, it's typically a segment that leads a region into growth, so we still remain optimistic that's the potential outcome in the near future.

Arun Viswanathan
Great, thanks, and just last one, if I could. Just on the M&A side, understanding that the businesses want to get paid for potentially depressed earnings, do you think that could change, and if not, why not get more aggressive with price on some of these deals if M&A is the preference, because it would seem that, from a long-term perspective, M&A still probably is a higher return on capital use of that than buybacks?

Michael McGarry
You're exactly right, Arun. We will be as aggressive on price as the outcome of the return dictates. We want to be prudent with our acquisitions. We are preferential on them when they have a good return and we're not preferential on them when they don't. So, again, we're going to be prudent, but I do think you hit the nail on the head with what respect to what we're looking at, which is what's the return on the potential acquisition itself, which would certainly be dictated by the purchase price.

Arun Viswanathan
All right, thanks.

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

Don Carson
Yes, thank you. A question on architectural. Last year, TiO2 was you raw material that went up the most, this year it's shifted more to the Industrial side, but maybe you still see TiO2 going up this year as much as your mid-single-digit overall raw material basket increase projection; and two, if you look at TiO2 and emulsions, is there a need for a third price increase in your U.S. company stores to keep margins growing?

Michael McGarry
Let's take the TiO2 question first. Supply and demand is what drives TiO2 pricing. I would say that clearly, when people report all their earnings across Europe and other places, you'll see that demand will be weak, in our opinion, and so we're going to be fighting for roll-over type pricing in TiO2, because we think that's reflective of supply and demand. So, we'll wait and see exactly how that all that turns out, but as you know, we'll fight to the last day on any price taking and any price increase.

But, as far as emulsions, that's driven by a number of factors, propylene being the biggest one, and sequentially, we see that it's likely to be heading south in this regard, which should lead us to an opportunity to try to get some lower pricing in that regard. It's too early to speak that way, but that's certainly our expectation.

As far as needing more price, I will tell you that we're aggressively capturing price within that segment now. We haven't gotten everything we want to date, so let me focus on getting that done first.

Don Carson
Then, Vince, a housekeeping follow-up. You mentioned an accounting change on the last call that would hurt gross margins by 50 to 100 basis points. Did that turn out to be the case and would you expect that to be recurring for the full year.

Vincent Morales
Yes, we adapted the new guidelines with respect to revenue recognition. Those numbers are still valid, Don, and, again, adapting the new guidelines.

Don Carson
Thank you.

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

Ian Bennett
Thanks. This is Ian Bennett on for Steve. Do you expect SG&A expense to decline or increase in 2018?

Vincent Morales
In our first quarter, we were down 140 basis points in SG&A. We continue to be very active in controlling our costs. As Michael alluded to earlier, we're assessing the situation with the customer assortment loss and we'll react to that, as well. So, I think our projection would be for that to continue to be lower. I won't give you a specific number, but we're definitely working on productivity initiatives, as Michael alluded to earlier.

Ian Bennett
Okay, thanks, and just a follow-up on the gross margin. Did I hear that correctly, that gross margin, the expectation is for not positive year-over-year growth until the fourth quarter or 2019?

Vincent Morales
I think the question that Michael answered was around the Industrial segment margins and

those are the ones that would be challenged until certainly the latter part of the year. If you look on the gross margin basis, I think we're down around 300 basis points. Our goal is to get that up closer to neutral as we go into the earlier part of the back half of the year. The Performance Coatings business, where we were able to achieve pricing earlier, would help prop that up faster than the Industrial Coatings segment.

Ian Bennett
Thank you very much.

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

Mike Harrison
Hi, good afternoon. You saw really pretty good growth in company-owned stores in North America during the first quarter. Can you give a little bit of color on what's been driving that, and maybe address if company-owned stores become a little greater focus in light of the change that you've seen in the customer base with the big box retailers?

Michael McGarry
This continued improvement in our company-owned stores is multiple factors. The biggest one, though, is the fact that there are more do-it-for-me people, you know, the baby boomers are aging and, therefore, they're asking people to do the work, and then you have a lot of the younger folks who never learned how to do it, so they're getting it done for them. So, that's the biggest trend. The company-owned stores are winning in that space. The second one, of course, is we've done a lot of improvement in our stores. When you think about the rebranding initiatives, the customer initiatives, those have all been a positive. Our ability to deliver on a more timely basis, that's been a positive. So, there's a lot of underlying activities in that regard, and we did open up seven new stores in Q1, so they will continue to be a focus area for us.

Mike Harrison
Then, you announced a price increase for auto OEM customers in the Americas in mid-March. I was wondering if you can just give us some color on how those negotiations are progressing with customers and how you guys are seeing the competitive environment in auto OEM right now.

Michael McGarry
Well, I've never seen a time when the competitive environment in auto OEM was anything but fierce. We have super-sophisticated customers. The benefit is they clearly see the inflation. There's no denying the inflation is there. We've worked ourselves through a number of gates, if you will, with these folks, and so we are getting traction. What I'll tell you is it's been good for us to get additional price increases out there in the marketplace and we are getting price, so you should expect to see more in the future.

Mike Harrison
Thanks very much.

Operator
Our last question today comes from James Sheehan from SunTrust Robinson Humphrey. Please go ahead with your question.

James Sheehan
Mike, as you evaluate your efforts to reaccelerate organic growth, how effective has your rebranding and other initiatives been?

Michael McGarry
Well, the rebranding has been very positive. As you can see, again, this quarter was the best quarter we've had in our stores in more than four years. That's been doing really well. Also, the branding that we've done overall in PPG has helped us in a number of areas, so I'm pleased with that. The clarity on which brands in which markets has helped, as well. So, overall, I would say I'm pleased.

James Sheehan
Raw materials, you gave some color on several of the different raw materials. I'm just wondering, on epoxy reasons, in particular, do you think those prices have peaked yet?

Michael McGarry
Well, I'd like to say the answer is yes. A lot of that will depend upon some of the plants that were forced down in China in Q1, how quickly they can get up and running, are they able to run the rest of the year, or will China be diligent. I think China will continue to be diligent in their enforcement action, and so I think we're going to have a period here where we're in pretty good shape, but then I think as we move into winter, you'll see China again continue to very aggressively enforce the environmental laws.

James Sheehan
Great, and what's your read on the U.S. paint season thus far?

Michael McGarry
Well, disappointing. I wish I had a magic wand that could get rid of all the snow. Even in Pittsburgh, we've had two snow days this week and it's April 19. But, our customers' underlying book of business is strong. Every painter I talk to would like to have three more people painting for him. The housing market is good, all the underlying demand is good., they want to be painting, so it should be a good year, and you can see the stores, even in spite of this weather, did quite well. So, I would tell you I'm still optimistic.

James Sheehan
Thank you.

Operator
Ladies and gentlemen, at this time, that will conclude our question and answer session. I'd like to turn the conference back over to Management for any closing remarks.

John Bruno
Thanks, Jamie. This is John Bruno. I'd like to thank everyone for their time and interest in PPG. If you have any further questions, please contact us in the Investors Relations Department. This concludes our first quarter earnings call.

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