PPG

Second Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

John Bruno – *Director of Investor Relations*

Michael McGarry – *Chairman, and Chief executive Officer*

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

PRESENTATION

Operator
Good afternoon, everyone. Welcome to the PPG Industries Second Quarter 2018 Earnings Conference call. My name is Jamey, 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 then one using a telephone keypad. To withdraw your questions, 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 of Investor Relations. Sir, please go ahead.

John Bruno
Thank you Jamey, 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 Second 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, July 19, 2018. I will remind everyone that we have posted detailed commentary and associated presentation slides on the investor 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 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 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 Chairman, and CEO Michael McGarry.

Michael McGarry
Thank you, John, and good afternoon, everyone. Let me start by reminding everyone that we communicated on June 28th that PPG's audit committee had completed its investigation into allegations of violations of PPG's accounting policies and procedures. We have filed for restated financial statements for the fiscal years 2016 and 2017, and certain quarterly periods within those fiscal years in order to correct PPG's previously issued financial statements. The restated financial statements, additional details regarding these restatements, and the findings of the investigation are contained in PPG's Form 10-KA and Form 10-Q that were filed on June 28, 2018.

As you all know, PPG has been in existence for 135 years and has earned a reputation as a highly ethical and credible organization. I am disappointed that there was a need to restate our financial statements. Our audit committee and I are participating in the oversight of the remediation plan.

As I said in our press release, we are 100% committed to take actions that are consistent with our ethics and values and fully meet the expectations of both internal and external stakeholders. Unwavering adherence to our core standards of financial integrity and honesty remains a top priority and a focus for all PPG employees. To date, we have made good progress addressing the corrective actions identified during the audit committee investigation.

I am personally committed to ensuring that PPG will have a robust controlled environment and look forward to reinstating our reputation. As we have disclosed, we have proactively communicated with the SEC on this matter. It is PPG's policy not to discuss matters that are being reviewed by regulatory bodies. Finally, I want to share my appreciation with all our stakeholders for your patience as we have worked our way through this investigation.

Now, I will move on to our second quarter results. Today, we reported second quarter 2018 financial results. For the second quarter, our net sales were approximately $4.1 billion and our adjusted earnings per diluted share from continued operations were $1.90. This represents an adjusted EPS growth rate of nearly 6% for the quarter which included benefits from a lower tax rate year-over-year. The earnings growth we achieved was despite elevated raw material inflation and higher logistic costs during the quarter which we partially offset with selling price improvements and strong cost management. In addition, we continue to benefit from our ongoing cash deployment focused on earnings accretion.

For the second quarter our reported net sales were up almost 9% while our sales in local currencies increased by about 6%. Supporting the higher local currency sales were volume growth of more than 3% with balanced contributions from both of our reporting segments. For the first half in aggregate, volumes grew nearly 2%.

Selling prices increased more than 2% in the second quarter marking the fifth consecutive quarter of improvement over the previous sequential quarter. While modest in overall magnitude, in certain business units we continued to decline some volume as we pursue higher selling prices and prioritized margin recovery.

Foreign currency translation was still favorable year-over-year but by a lower amount in comparison to the first quarter as the US dollar strengthened during the quarter against several key currencies. Sales were favorably impacted by approximately $90 million from currency translations and pre-tax income favorably impacted by about $15 million. We expect foreign currency translation to turn to a headwind in the third quarter based on current exchange rates.

Looking at some of our business trends in the second quarter, in the performance coatings segment aerospace coatings delivered an excellent quarter with slightly more than 10% volume growth led by above-industry performance in the US and Asia-Pacific. Automotive refinish continued to grow organic sales by mid-single-digit percentage supported by above-market performance in all regions.

Architectural coatings' EMEA sales volumes were down slightly in the quarter as consumer demand continued to be subdued and we are prioritizing selling price initiatives. Sales volumes in architectural coatings Americas and Asia-Pacific grew at low-single-digit percentage aided by continued strong organic sales growth in the US and Canada company-owned stores.

Volume in our DIY business in US and Canada were slightly higher as sales to Lowes continued albeit at a lower rates than the prior year. Also we benefitted from the successful launch of our award-winning PPG Olympic Stain products at the Home Depot. Sales volumes also grew at our Mexican PPG Comex business including the benefit of opening an additional 52 stores in the second quarter.

Protective and Marine coating sales volume increased with continued strong protective coating sales in Asia. The PMC business has stabilized at a low base and is expected to gain more traction in 2019. Our industrial coating segment delivered solid organic sales growth of approximately 3% which included continued improvement in selling price from the previous quarter.

Sales volume in packaging coatings were up mid-single-digit percentage as the adoption to our INNOVEL interior can coatings products continued. Selling price increases were also achieved.

Automotive OEM coating sales volumes increased at low-single-digit percentage and were similar to global industry automotive builds [ph]. This business outperformed the market in Europe and Latin America. As expected, in China our sales volume increased by high-single-digit percentage matching the improved industry build rates for the quarter. We also continued to grow sales volumes in our general industrial business with above market growth rates in Europe and Latin American regions. In addition, our general industrial selling prices continued to gain traction in the quarter.

From a regional perspective, for the company overall, sales volume growth was the highest in the emerging regions. Sales in the Asia-Pacific region were driven by strong growth in our aerospace, automotive refinish, and protective coatings business. Sales in both China and India grew at low-teen percentage. Our China business met our expectations of a strong quarter after a softer first quarter. Going forward, we anticipate sales growth in China to be more uneven as recent uncertainties around trade policies and tariffs potentially impact economic activity in the country.

Sales grew at a high-single-digit percentage in Latin America supported by continuing outperformance by the business's in industrial coating segment and strong automotive refinish and architectural coatings sales volumes growth. Sales volumes were higher year-over-year in Europe. A mid-single-digit percentage increase in the industrial coating segment was offset by slightly lower sales in architectural coatings EMEA. We anticipate that the industrial coatings business will continue to deliver growth in the third quarter as regional industrial production remains favorable for a broader continued economic recovery.

Sales volumes were also higher in the US and Canada in the second quarter supported by strong sales volumes in our packaging and aerospace coatings business along with solid sales growth in automotive refinish business. From an earnings perspective, our second quarter adjusted earnings per diluted share of $1.90 was nearly 6% improvement versus the prior year quarter.

Our earnings were impacted by elevated raw material and logistics cost inflation in the quarter including the impact from elevated oil prices. In aggregate, raw material inflation was about a mid-single-digit percentage increase year-over-year and inflation rates similar to what we experienced in the first quarter. Our logistics costs, which were impacted by higher costs and availability of transportation equipment, were also higher the second quarter of 2017. We expect both these costs to remain elevated during the third quarter.

In the second quarter, we continued to make progress in our selling price initiatives. Prices increased by more than 2% on a year-over-year basis as both of our reporting segments realized higher selling prices. We have secured further price increases for the third quarter and will continue to prioritize collaborating with our customers on further selling price initiatives.

In addition to selling price initiatives, we are making good progress with our efforts on raw material efficiency. As one example, we now expect to further reduce our TO2 requirements by more than 1% this year. We also remain focused on aggressive cost management.

Our December 2016 restructuring program is tracking to our targeted savings and in the second quarter we initiated a new restructuring program to help mitigate the previously announced architectural customer assortment change and to further offset the inflation we are experiencing. This new program will result in annualized savings of about $85 billion dollars upon full implementation. In aggregate, we expect these restructuring efforts to deliver between $45 million and $50 million of savings in the second half of 2018.

In addition, earnings per share benefitted from our on-going cash deployment actions. This includes the impact of our repurchase of more than $450 million of PPG stock in the second quarter. In the quarter, average diluted shares outstanding were 5% lower versus the second quarter 2017.

Our effective tax trade was 22% in the second quarter which is lower than the 24% rate for the second quarter 2017. The reduction is related to recognizing certain discrete tax items in the second quarter and the tax reform legislation that was implemented at the start of 2018. We still anticipate a full-year tax rate between 23% and 24%.

As we look ahead, we still expect continued positive momentum and overall global economic growth. Our third quarter sales are typically lower than the second quarter due to traditional seasonal trends and we anticipate normal seasonal patterns this year. The heightened uncertainty around certain recent trade policies could create uneven growth by region and industries in the second half of 2018. In particular, we are closely monitoring our business in China for any possible impacts.

Currently the new tariffs are starting to add some modest cost to our raw materials. Based on the strength in the US dollar in the second quarter, we expect foreign currency exchange rates to have an unfavorable impact to our sales in the third quarter. Based on current rates, the unfavorable impact is expected to be between $60 million and $80 million for the third quarter.

Specific to our businesses, we expect housing starts in the US to continue to improve in the second half of 2018. We believe that US regional automotive industry builds in the second half of 2018 should be higher than 2017 due to the natural disasters that last year impacted automotive production. In Latin America, we anticipate similar economic expansion as we experienced in the first half of 2018.

Growth rates in Asia are expected to modestly decline in the second half mostly driven by uncertainties in China. We expect automotive build growth rates in China to grow in the third quarter but at lower levels than those realized in the second quarter. We expect economic expansion to continue in India after a very strong first half.

Economic growth in Europe is expected to continue in the second half at a similar rate that we saw in the second quarter. Favorable in-use market trends are expected to continue driven by positive growth in industrial production in automotive builds. For PPG, this regional growth will be tempered by subdued architectural coatings demand.

We will continue to manage all elements of our business within our control to ensure that we remain competitive regardless of economic conditions. Based on the current cost environment we anticipate that our selling price and cost management initiatives will drive improvement in our industrial coating segment margins by the fourth quarter 2018. As previously communicated, our sales of PPG Olympic products in Duluth have stopped at the end of the second quarter.

As I mentioned earlier, our launch of PPG Olympic stain products into the Home Depot has met our early targets and we are pleased to be working more closely with the outstanding team at Home Depot. We expect that the net impact for these customer assortment changes will result in reduced third quarter

performance coating segment sales of between 200 and 250 basis points, and that's PPG's total sales of between 100 and 150 basis points for the remainder of 2018.

With the actions we have already taken, and plan to take in the coming months, we fully expect to offset the margin impact to this net sales loss in the year 2019. We continue to invest in growth initiatives including targeting certain growth spending in the third quarter with plans to spend up to an additional $5 million similar to the second quarter.

Finally, we ended the second quarter with about $1.1 billion of cash in short-term investments which continues to provide 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.

The acquisition pipeline in our industry remains active. We continue to be highly interested in participating in our industry's consolidation, but will remain disciplined in our approach. We plan to continue to repurchase shares in the third quarter.

This concludes our prepared remarks. Once again, we appreciate your interest in PPG.

Now, Jamey, 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 using a touchtone phone. 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 the star then two. Once again that is star and then one to ask a question. We'll pause momentarily to assemble the roster.

Our first question today comes from Christopher Parkinson from Credit Suisse. Please go ahead with your question.

Christopher Parkinson
Thank you. Can you just give us a little color on the breakdown of the raw material basket, what you're currently seeing as well as your general outlook for the second half into '19 and also just how you're assessing the potential to further raise prices in order to recover your margins? Thank you.

Michael McGarry
Well, let's start with the easy one first. We have price increases announced in the second quarter we're evaluating and we'll be announcing further increases as we speak. That's the easy one.

The pressure on raw materials, think about propylene as a significant driver of that. You have emulsions up. That's a significant one. Of course, you have acrylates up. Then, you have the pressure coming from the higher oil prices that's impacting solvents. Then you have packaging costs are also up and then my favorite of course is epoxy. So, those are all ones that we're feeling the pressure on.

The good news is for a number of these things we're taking action, so whether it's a TiO2 where we're trying to optimize the formulas, and I mentioned earlier 1% lower consumption, packaging where we're looking at how we optimize our packages, that one as well. So, I would say, those are the primary pinch points, Christopher.

Christopher Parkinson
Thank you. Then, also, I think we all understand why the focus remains on architectural volumes given the recent developments, but can you talk about what you're seeing on a sequential basis and your general outlook for general industrial coil packaging in aero? How should we think about growth there and also, the margin contribution in the short- and long-term? Thank you.

Michael McGarry
Okay**, l**et me see if I get all the businesses you mentioned. We'll start with aerospace, fantastic business. Terrific performance. I mentioned on the call that we're going to be up 10%, and we were up 10% in the second quarter.

Strong performance across all the different platforms whether it's sealants, packaging, transparencies, coatings, all of them doing well. Military is strong. Commercial is strong, and we see general aviation coming back, so a very solid team performing at a very high level in that regard.

General industrial, the places that I would say are on the upper end of the range, so automotive parts are continuing to do well. Electronic Materials probably low-single digits, wood kind of flattish, coil doing well. As you can imagine that's a strong commercial market, Transco doing well. Appliance we started to see a little slowdown in appliance. You have the trade uncertainty, the tariffs. So I think our appliance guys are going to be looking at this a little cautiously. I don't see demand change, but I do see inventory in the system work in progress change. Of course, heavy duty equipment remains very, very strong. So Christopher, did I catch—

Vincent Morales
The last one is packaging, Christopher. I'll tell you this is Vince. Packaging business for us as I know you know has been a good performer as we introduce our BPA-NI technologies further. We continue to outperform the market up mid-single digits this quarter, in a market that's low-single digits. We expect that to continue. We're in the middle innings of the BPA conversion process, so we still feel there's good runway left.

Christopher Parkinson
Thank you, both.

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

David Begleiter
Michael on the U.S. and Canada company-owned stores, strong performance in Q2 also strong performance in Q1. What did the market grow either in Q2 or Q1 and/or combined, and how are you out growing the market as it appears you are?

Michael McGarry
First of all, I don't know that we are growing anything but at the market rate. I think if you look in our presentation where we have the heat chart you will see that where we color coded ourselves at market for U.S. So that would be my first comment.

I think this trend of strong performance in the stores, as you know, this has been a multiyear effort to close the gap in that area. The team has worked really hard to close that gap and we're getting price. The market is strong. Of course, the shift from DIY to do-it-for me is what's really driving why the trade business is outperforming the DIY business.

David Begleiter
Very good, and Michael and Vince, just on the $85 million of cost, can you break down between how much was allocated to Lowe's and how much is in this designed to offset the other cost inflation you highlighted?

Vincent Morales
Yes, David this is Vince. Walking around numbers certainly more than half, close to two-thirds would have been allocated to support what I would call not only our customer assortment change, but look at geographically our U.S. business and the remainder would be rest-of-world. We won't break it any finer than that.

We are battling, as you know, David, raw material inflation everywhere. So rest-of-world we're trying to offset that with pricing and the lever obviously is with efficiency and cost. Then again, the portion for the U.S. would be split between our architecture business and other businesses.

David Begleiter
Got it. Thank you very much.

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

John Roberts
Solvents usually follow oil more closely than other raws. You mentioned propylene as well. The industrial segment I think probably has more exposure to petroleum based raws. Is that the biggest difference of the different margin performance we had between the two segments this quarter?

Michael McGarry
I would say that is certainly one significant factor. You have the epoxies that are in there as well, and so when you look at the raw material basket. And of course, the other factor is it's much more difficult to get price with our global large OEM customers. Although, we are starting to get it, it lags the other businesses. You can see how we in performance coatings side that gap has closed much quicker than the gap on the Industrial Coatings segment.

Vincent Morales
That said, John, I'll just reiterate what Michael said. We're out with selling price increases to our customers in Q3. Certainly, a portion of those are pointed at our Industrial segment and the businesses within that segment. Then we're comfortable, we'll get traction with some of those and certainly increases.

John Roberts
Michael, I think you mentioned the new tariffs were having a modest impact on your Chinese raw material costs. What would be the raw material most sensitive to the tariffs that have gone in?

Vincent Morales
John, for us probably the more sensitive and direct one is what we call tinplate. So you can imagine a lot of tin goes into paint cans, so that's the one that we're watching most closely with respect to the tariffs that are announced.

John Roberts
All right, thank you.

Operator
Our next question comes from Ghansham Panjabi from R.W. Baird. Please go ahead with your question.

Ghansham Panjabi
Thank you. Good afternoon, guys. First off, on auto refinish and your expectation of moderating growth in North America, I think you called out lower collision claims and miles driven in the second quarter. Do you view that as part of the normal shift in the market during the course of a year, or is there something more secular that concerns you?

Michael McGarry
Well, the miles driven is only up like 0.2%. Typically miles driven is more driven by the economy and employment? So this is a clear sign that people Ubering around and taking shared vehicles and public transportation and that as having a slightly, I would say, very modest impact on miles driven.

Collision claims, I would say, is much more cyclical, so you should have less accidents during the summer than you will have during the winter. Of course, we will start to see the impact to some of my favorite activity, which is hail, which doesn't hurt anybody but yet leads to a lot of opportunities for our refinish business. That would be something that you'll have some offsetting that's a positive during the August/September timeframe.

Ghansham Panjabi
Got it. Then on packaging in Asia and the share loss that you experienced as part of your price increase initiatives, this business, in theory, has high switching costs. I guess, were you surprised at the share loss or was it sort of the coatings on the outside of the cans? Thank you.

Michael McGarry
Well, I would tell you that our Asian customers are willing to send messages much more frequently than our U.S. and European customers. So even though there are switching costs, sometimes they'll want to punish you. As you know, we've had five quarters in a row of price increases. One of the reasons why our volume was up this quarter is people have stopped punishing us, but in Asia some of that behavior still exists.

Ghansham Panjabi
Got it. Thank you, Michael.

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

Bob Koort
Thank you very much. Maybe extending from that a bit, Michael, you had obviously very good volumes this quarter, two out of the last three. I think you had suggested maybe in the past that the underlying demand was better but there was some blowback from the price hikes. It seems like your competitors now are playing ball or at least talking of the same more aggressive moves on pricing. So should we expect that we can see this more GDP type volume growth in the future? Or, is it still too early to call?

Michael McGarry
Well, first, I think it's too early to call because we're going to continue to prioritize margin recovery. Second, I think, we're going to be a little bit hampered as we tried to explain in the prepared commentary that the impact of the customer assortment change at Lowe’s.

By and large, we do see more customers taking price. We see more of the market talking the same need, have margin recovery. So there should be less opportunity for people to shift volumes around to take advantage of, what I would call, salespeople who aren't paying attention.

Bob Koort
Could I ask on Europe, it seems like architectural trends there have been pretty uninspired for quite a long time. I guess I always envisioned the paint market has been fairly constant, maybe low growth, but reasonably sustained growth. Why can't you guys get better volumes out of the European markets in architectural?

Michael McGarry
Well, again, I would say that's a little bit choppy. We've done exceptionally well. If you go back the last three, four, five years in the U.K., we had a little bit of a setback in the Benelux when the people that were not maintaining, there's a large rental market in the Benelux and they've kind of prioritize cash recovery for a while. Now they're back painting. So we do see fairly decent growth there.

Eastern Europe, I would say, is slightly better. The big challenge is, France is our biggest market by far, Bob. Retail is soft. The one thing I would tell you is, I was just over there a month or so ago and I saw more cranes over in Paris than I've seen in a long time. Consumer sentiment is up. I've been joking with my friends over there, the French One, the World Cup, hopefully that will take them to spend a little more money, but we do have to recognize that there is some portion of our business that people have a choice at where to spend their discretionary dollars and right now they're much more focus on experiences than they are in home improvement, unlike in the U.S. where you're getting a pretty significant return on your investment when you put your money in your house.

I haven't given up, so if your question is, have I given up? The answer is absolutely not. The good news is we're doing pretty well earnings wise. We just need to continue to capture our fair share.

Bob Koort
Great. Thanks for the help.

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

Frank Mitsch
Good afternoon, gentlemen, and Michael that World Cup cuts both ways. I'd imagine that productivity was probably a little bit lighter over there over the past several weeks.

Michael McGarry
I don't accept that excuse from my team.

Frank Mitsch
I certainly I could understand that it would not be applicable to a company based in Pittsburgh. I want to come at the pricing question just a little bit differently. You have a string of positive year-over-year prices. I think it was like 0.1% 3Q, 2017, 1% in 4Q, 1.6% in 1Q, 2.2% in 2Q and you have got pricing initiatives in place, so should we think about the order of magnitude of price as kind of accelerating here and we're going to be approaching that 3% mark? How do we think about the overall magnitude of price?

Michael McGarry
Well I do think price is accelerating and I think that's a reasonable assumption to make. I do think that there's more to be asked for and gotten in this marketplace. When we think about the logistics, now we've stacked logistics cost on top of raw material costs. So our sales teams are heavily focused on that capture**.**

Frank Mitsch
Got you, and then also going back on looking at the lovely heat map, seems to be a fair amount more green on the screen now relative to last few quarters and a little bit less red. I think you were saying that you're expecting end use market activity comparable to the second quarter. So understanding that seasonality takes it down from 2Q, but on a year-over-year basis it seems like absent the issue with Lowe's that you're still calling for a pretty good volume quarter. Is that correct?

Michael McGarry
Well, I certainly would like to see that. I'm confident the team recognizes the importance of getting price first. So I would say your conclusions are probably accurate.

Vincent Morales
And Frank, I think as Michael said in the prepared remarks we generally feel the economies around the world are pretty healthy and we think there will be—so in Q3 obviously, depending upon global trade discussions. So right now we're running at a fairly good clip in most of our end use markets.

Frank Mitsch
Got it. Thanks so much.

Michael McGarry
Thanks, Frank.

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

Jeff Zekauskas
Thanks very much. It looks like your cash flow from operations was down by about $250 million year-over-year for the first half. Is that roughly right? And are you going to be able to generate the same amount of cash you did last year in 2018 or because of higher raw material costs, that's too high a bar to reach?

Vincent Morales
Yes, Jeff. I think your numbers are fair. The biggest cash issues we have for the first six months of the year—even though our working capital as a percentage of sales is even with last year, our sales are up, so we actually have more working capital in terms of dollars and that's—by far that's the biggest use of cash year-over-year. But your numbers are accurate.

Jeff Zekauskas
So PPG used to generate much more cash than it did net income and your cash conversion over time has really come down, where it's more or less equal to your net income. Do you have any targets or plans as to what your cash conversion should look like over a longer period of time?

Vincent Morales
Yes. As I think you're aware, Jeff, the last three years we've shaved roughly 100 basis points off of our working capital as a percent of sales. And in some of those years we were growing sales. So the big

contributor was the 100 basis point reduction. That's still our target this year and again I think that will be—that will allow us to grow our operating cash flow higher than our earnings, to your point.

Jeff Zekauskas
Okay, great. Thank you so much.

Vincent Morales
Thank you.

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

Kevin McCarthy
Yes, good afternoon. Your corporate line under operating profit looks like expense declined materially in the second quarter on a year-over-year basis and that was the case in the first quarter as well. Would you comment on what's driving that and what your outlook is for future quarters there?

Vincent Morales
Yes, I'll comment on the difference and John's probably going to comment on the outlook. So, Kevin, we made a significant amount of effort over the past couple of years in some of our cost pools such as pension and OPEC [ph] costs. Those have driven that corporate expense line down. In addition, the past—this year and the past year the incentive comp number for the corporation has also been lower.

And finally, we did have in the first half of the year positive inter-company foreign currency. This would be assets and liabilities between our foreign affiliates and our domestic—obviously our headquarter parent company. When currencies move, we have to take those inter-company balances and true them up to dollars, and in the first half of the year for both quarters that was a positive. We do expect some of that to reverse as the currencies have flipped and, John, do you have the forecast for—

John Bruno
Yes. Kevin, this is John, so for the second half of the year we would be looking at between $75 million and $90 million for both quarters. And I think as you go into next year, I think the run rates will come down from 16. So a lot of people have been looking at the 16 run rate and through a lot of efforts, a lot of different actions, whether it's benefits and pensions or through workforce reductions, we have a lower base now, so I expect our run rate going forward to be lower as well.

Vincent Morales
Just for clarity, the $75 million to $90 million is total for both quarters.

Kevin McCarthy
Understood. That's helpful color. And then second question if I may relates to your new restructuring program of $85 million. What are the sources of those savings? And then I think you made a comment that you expect $45 million to $50 million in the back half of '18, but I think that included your old program from December '16. So maybe you can help us understand the flow-through on the new $85 million and how much will be this year versus next.

John Bruno
Yes, Kevin, John again. So let's talk about the '16 program. Most of those actions are done, so now we're realizing the benefits and that's working out to be a $13 million to $15 million a quarter of benefit. Per quarter, that should sustain itself into Q1 of next year.

The new program has started. We're going as fast as we can with the program—probably be at a full run rate early '19, but really a significant contribution as we get into Q4 on that program as well.

Kevin McCarthy
Okay. Thank you very much.

Operator
Our next question comes from Patrick Lambert from Raymond James. Please go ahead with your question.

Patrick Lambert
Hi. Good afternoon. Is the reception okay?

Vince Morales
I can hear you, Patrick.

Patrick Lambert
Good. Yes, it's pretty far away from you guys. A few questions—the first one. I think your comments on EMEA decor volumes that you somehow let go, if I heard correctly during the comments, where do you think these volumes have gone, if I may ask? First question. Maybe I'll ask a question later, following your answers.

Vincent Morales
Yes, Patrick, this is Vince. You know, as Michael said we're prioritizing selling prices in the region over volume. There is a marginal volume going to folks who are not following the same philosophy as us. And as you know, in particular because you live in the region that there are several much smaller players in the region than you would find versus the US market, so there are folks who are willing to take substandard profitability business.

Patrick Lambert
So mostly [indiscernible].

Vincent Morales
Correct.

Patrick Lambert
The second question regards the—again, sorry, I could not understand completely the Lowe's impact in H2. How to model the top line of the lack of contracts there.

Vincent Morales
Yes. So—

Patrick Lambert
H2 '18.

John Bruno
Right, Patrick, this is John. So the 120 to 150 range represents the net impact so it would be the loss at Lowe's and the gains at Home Depot. And it would be off of our expected revenue, total revenue for the company.

Patrick Lambert
Okay. And the last one, last question. In this year margin I think there's a good 400 basis points year-on-year difference of EBIT margin. OEM is likely to be the largest contributor to that, but is there any big discrepancies between the other and sub-segment in this field? I can explain that de-cap [ph].

Vincent Morales
Yes, Patrick, we typically don't provide our business unit details below the reporting segment. Again, as Michael alluded to, we have very large customers in that segment, global customers. They're typically good at deferring price increases. We're starting to get traction as you see in the numbers now. We expect that to continue.

Patrick Lambert
And so we expect the prices acceleration also in this field, actually maybe more pronounced in this field than in that.

Vincent Morales
We expect further pricing in both reporting segments, correct.

Patrick Lambert
Thank you.

Vincent Morales
Thank you, Patrick.

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

Don Carson
Thank you. Michael, you mentioned that you thought industrial margins could be better year-over-year by Q4. Are you expecting gross margins for the overall company to be better year-over-year by Q4, or is part of that improvement in industrial also some of your cost-cutting?

Vincent Morales
Okay, Don, I'm going to take this. For us, we're looking at the reporting segment margins which is what Michael was alluding to. That would include pricing actions, but also the cost actions that John mentioned. So it would be a cumulative of both of those to get us on a reporting segment basis, on the flat year-over-year.

Don Carson
So, said another way, overall you don't think you're going to get improvement in gross margin year-over-year until you get into calendar '19 for the overall company?

Vincent Morales
Too early to call '19, Don. We're tracking the Q4 reporting segment margins flat and that would include some benefit from items below gross margin.

Don Carson
Okay. And then a follow-up, I guess—

Michael McGarry
We are totally focused on the second half of the year and getting this margin recovery

Don Carson
And a follow-up on US Architectural. Two questions. One, do you need more price there given that emulsions continue to go up and solvents and packaging costs are going up as well, so do you have a third price increase on the table? And secondly, you've been getting such good volume growth in your company stores. Is there any thought to accelerate your expansion plans on the company store front in the US?

Michael McGarry
So, there's no question that there's a raw material pressure in Architectural US in its year. The other one is logistics costs and that's not just from our DCs to our customers, but also from our plants to our DCs. So you've got two levels of logistics costs in there. So, we are actively evaluating the appropriate timing for that. We're not at a position that we can talk about that, but that is under active evaluation.

As far as the store expansions, we are selective in that, so we've added in the markets that we're best in. So, think about the Texas market, that's an area that we've continued to invest in, but we're selective on where we're doing that and we will do that on an as-needed basis. Obviously, we're more aggressive in Canada where we're the market leader and we're less aggressive in certain segments where we're far away from the market leader.

Don Carson
Thank you.

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

Duffy Fischer
Yes, good morning, or good afternoon. First one just on Michael's comment on FX being negative $60 million to $80 million in Q3. Was that a sequential or a year-over-year number?

John Bruno
Duffy, this is John. That's a year-over-year number.

Vincent Morales
That's a sales number, Duffy.

Duffy Fischer
Yes, okay. And then could you parse out the big buckets of raw materials? We've talked around a lot of different pieces and parts, but epoxies, solvents, TiO2, which do you see moderating in the back half and which do you see continued pressure upwards and do you get any relief in the next year in any of those buckets?

Michael McGarry
Well, I think we talked about TiO2 moderating, so I think that one we see supply increasing in TiO2. So I think that we're pretty consistent on that. The propylene one though is a bit of a concern for us. If you look at it, propylene in the US is up 28% year-over-year in the US and 30% year-over-year in Asia. So there's still more pricing pressure likely to come through in anything that touches propylene.

Vincent Morales
In oil and solvent derivatives, your guess is as good as ours, Duffy.

Michael McGarry
Yes, but WTI's up 40% year-over-year and rents up like 50% year-over-year.

Duffy Fischer
Fair enough. Great. Thank you, fellows.

Vincent Morales
Thanks, Duffy.

Michael McGarry
Thanks, Duffy.

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

Steven Byrne
Is there anything that kept you from being a little more aggressive about share repurchases in the second quarter? Just looking at the share price, thought you might have been more aggressive, but perhaps it's a reflection of what you're looking at in your M&A pipeline.

Michael McGarry
Yes. I think you answered your own question. So we're always trying to keep our powder dry so that we can do acquisitions and we're always looking at the pipeline. We would prefer to do acquisitions; that's number one in our target list. But if we can't do it, we're not going to let the cash sit on the balance sheet, so we're going to put it to work. So I think that's how we're looking at it.

Vincent Morales
Yes, Steven, we've been all quarter with a very active pipeline in the coating space. There's certainly in our mind going to be deals done this year whether we're the one who tracks the deals or not, that remains to be seen. We're going to remain disciplined but it's an active pipeline right now.

Steven Byrne
Very, very good. And on the inflationary cost pressures, we've talked a fair bit about the raws, but on the logistics side would you say that that shift between those two is becoming a little more problematic on the logistics and transportation side? And do you have the power to push price because of an awareness of logistics costs? Is it as challenging as it is with higher raw material costs or does it give you a little more support on pushing price?

Michael McGarry
Well, it's certainly not the magnitude of the raw material increases, right, but it's an adder. So if you think about high jumping it's adding another foot to the high jump bar. And all our customers are impacted by that. Some of them can argue, "Well, we don't buy oil, we don't buy this, and you should offset the raw materials." Well, I can assure you there's no customer that isn't impacted by logistics increases. So that makes some of the selling argument that we have out there easier to sell because they can't deny that.

Steven Byrne
Very good. Thank you.

Vincent Morales
Thank you, Steve.

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

John McNulty
Yes. Thanks for taking my question. With regard to the logistics, can you give us a rough idea of what that nugget is for you in terms of percent of your either cost or sales, just so we have a clue, and then how to think about how much it's up year-over-year?

Vincent Morales
Well, it's a number we typically don't like to give out, John. It's certainly in the single digits to mid-single digits as a percent of sales. We kind of give you some kind of guardrails. Right now it's up a double-digit percent as most companies are seeing.

John McNulty
Okay, fair enough. And then I guess if I think about the costs or the raw materials, I guess, and price, I understand it doesn't necessarily work on the margin percentages, but if I'm doing the math right on mid-single digit cost inflation and at 2% plus price, it looks like the two kind of net each other out. Are we thinking about that right? And then if that's the case, when you think about bucketing where some of the other headwinds are, how should we think about the bigger buckets and what the real pressures were this quarter?

Vincent Morales
Well, if the two netted out, I think we'd be having a different dialogue right now, John. We're still climbing the hill to get our raw materials back with price. As you pointed out, we made good progress, good traction, but we've still got more to do and then as Michael mentioned we're stacking now on top of that freight. Some of that freight goes in the gross profit line, so that might be another element for you to consider. But we have more work to do.

John McNulty
Okay, great. Thanks for the color.

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

P.J. Juvekar
Yes. Thank you. So, Michael, I think you mentioned that you have reduced your TiO2 requirement by 1%. Is that correct? And if it's true, then is that permanent? And just tell us how did you achieve that and how much savings can you get from that?

Michael McGarry
Yes. So the first question is, it is permanent and it is how you formulate the paint. So unless you're a paint chemist I'm not sure you'd fully understand the way we're doing it, but it is the spacing of the TiO2 within the formulation. So if you want more chemistry lesson, I'll get you in here with our chief technology officer, but the bottom line is, it is permanent and this is something that we're working on. We have a number of suppliers that supply us other raw material ingredients that are dedicated to helping us work on the TiO2 spacing. And you add the hiding as well and so they're also working on the hiding, so these are all things that the team is working actively on.

P.J. Juvekar
Well, that's good. Yes, I would like to talk to your scientist to understand that better. And then secondly, one of your competitors started TiO2 pass throughs. Have you thought about doing pass-throughs of TiO2 or any other raw material which would reduce volatility in your business and maybe allow you to focus more on innovation?

Michael McGarry
Yes, I guess, P.J., we have not seen that initiative. Any of these single raw material initiatives have not really been successful. What's more successful is if you tie a basket where all the basket goes up or all the basket goes down, and the netting of that basket. And so we have a number of different pricing mechanisms with our customers and they're all unique to the marketplace, so that we try to work collaboratively with our customers to get the price and some customers want it in fashion A and some want it in fashion B and some want it in C and D. So we try to be unique with our customers, but this single thing of, like a single TiO2 doesn't typically work, whereas a freight surcharge might be something that might be beneficial, but that's generally not the way we do it.

P. J. Juvekar
Okay. I just have a clarification question on your comment earlier. You mentioned that you expect uneven growth in China. Is that more of a slowdown in China? Have you seen that so far or is that an expectation? Thank you.

Michael McGarry
No, we have not seen it and it's all going to be tariff-related. Right now through the first whatever it is, 18 days of the sales reports that I've seen for China, they're having a July very similar to the second quarter. And so we're just on the lookout for that.

P.J. Juvekar
Okay. Thank you.

Michael McGarry
Thanks, P.J.

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

Vincent Andrews
Thanks. So just two quick ones. Could you help quantify the extra shipping day from a volume perspective, how much did that help in the quarter?

John Bruno
Yes, Vince, this is John. It was mostly related to Mexico and the US, so it's specific to those businesses and probably total revenue, 50 basis points or less.

Vincent Andrews
Okay. And just as a clarifying question. I think the comment earlier was that you expect TiO2 to moderate in the second half? I just want to make sure you, are you saying the pace of the increase is going to be less year-over-year, or you're actually expecting the price to go down? Thanks.

Michael McGarry
I would say it should be very moderate increases, if at all.

Vincent Andrews
Okay. Thanks very much.

Michael McGarry
Thanks, Vincent

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

Laurence Alexander
Hello. One quick clarification and then one larger picture question. Can you just clarify when you commented on the sequential trends will reflect normal seasonality, is that remark about the segment trends intended to be before or after the Lowe's adjustment that you then break out?

And secondly, a bigger picture question about the balance between pricing and productivity and innovation as ways to offset the raw material pressure. Are there other opportunities to do a similar kind of blitz as what you've done on TiO2 on some of the other raw materials that you use, to materially change your input? And can we expect the same split between productivity and price as a way to get margin back, to be sustainable over time, or is it going to get tougher to keep finding new sources of restructuring opportunities?

Vincent Morales
So Laurence, I'll answer the first one and Michael will take the second one. The numbers we gave you with respect to the customer assortment change in seasonality, you should take the seasonality effect first and then take the map on the customer assortment change after that.

Michael McGarry
Yes. And just to make sure you're clear on that, so the second quarter you had the big boxes building inventory and in advance of the paint season. So now they had their inventory, they're going to work through their inventory to see how the year goes, so they're ordering less as the quarter goes on.

In regards to the formulations, every one of our scientists that's working on formulations are encouraged to look at the total cost of the formulation. And so whether that's optimized in the TiO2, the solvent blend, the resin, or how do they get more solids in a coating versus the alternative, all those things—packaging, how can they deliver more active ingredients in a package versus less, so there's multiple different ways to look at it and we don't mandate only TiO2. We're looking at the total cost of the formulation.

Vincent Morales
Laurence, just to your question on overall innovation, I think it dovetails—we have formulators who do this. That's cannibalization of an existing product. We prefer to be in a certainly much more amiable raw material environment and we could shift their resources to creating new to world type products. So this is cannibalizing from our ability to spend as much R&D as we would on innovation. We also have process or process innovation teams who try to allow us to produce this in a more efficient manner. So from a manufacturing perspective, they work on that as well.

Laurence Andrews
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. Quick question. On volume, what would you say are the buckets that give you the most concern as to why you wouldn't keep this 3% plus clip going. Would it be Europe, Asia, or Latin America, or maybe by business line, but any areas you're specifically worried about?

Michael McGarry
Well the first one is retail Europe would be the highest one. The next one would be Brexit. The next one would probably be I would say the uncertainty around China. You know we're not seeing that yet, so it's probably a guesstimate at this point in time.

But when I look at the other businesses, PMC [ph] is at a cyclical low and so that's probably not going to get anything but better from this point on. Aerospace continues to perform well. Refinish continues to perform well. Surprisingly, the OEM automotive had a good first half of the year, slightly better than expectations and we see no reason why the second half won't continue. The only negative there, of course, is whether or not people were trying to buy ahead of the tariffs, right? So we won't know that just yet. But we still see more transitions to our packaging of Innovel products so there's still more gains to be had there, and our industrial business continues to perform well. So I guess the main ones are China, retail, and Brexit.

Arun Viswanathan
Great, thanks. That's helpful. And then just had a question on price versus raws. If we look back, this industry has done a pretty good job of recapturing raw material inflation and sometimes even pricing over raws. It looks like now there was maybe an exacerbated lag, maybe due to the M&A activity last year. But is there anything else that has changed structurally as to why it's either taking longer for you guys to achieve price or to offset inflation or is it that the volume picture is just weaker, that your customers are pushing back more? Any thoughts on if there's been any larger scale changes here?

Michael McGarry
There's been no industry change. Clearly there's probably more people focused on cash right now, and because of that they're making certain decisions. For us, we're going to be in this business for a long, long time, and so we're prioritizing the margin recovery. I don't think there's been any change though.

Arun Viswanathan
And then lastly, on M&A, you discussed that there was likely to be activity this year. Is there any heightened kind of aggressiveness on your part to be involved in that? Would there—private equity folks, are they dropping their return requirements in valuations? What would it take for us to see more deals from you guys this year?

Michael McGarry
Well now, private equity is really not a factor in this space. They can't match the synergies that the strategics can bring to the table. So, we do get outbid at times and that's a fact of life. We're going to remain disciplined. But we do know what's in our pipeline and we are certainly actively engaged with a number of people. The biggest challenge is what I talked about on the first quarter where the bid and the ask had widened because of raw material inflation, so they're not getting their margins back and they want to get paid on let's call it their best 12 months in the last 36, as opposed to we want to pay on the current performance. So that's what the bid and the ask differential is.

Arun Viswanathan
All right. Okay. Thanks a lot.

Operator
And our next question comes from James Sheehan from SunTrust Robinson Humphrey. Please go ahead with your question.

James Sheehan
Thank you. On your auto OEM performance, looks like in most regions you were performing at or above the market, but in Asia Pacific you're below the market and I'm not used to seeing that. Can you provide some more color on Asia Pacific auto OEM?

Michael McGarry
Yes, there's two primary factors that drove that. One is we still have in our numbers Australia, where there was still an operating plant a year ago, and then the other one is our share in Korea. As you know, the Korean business is significantly impacted and so that's it. If we drew our box around India and China, we're doing very, very well and I have absolutely no concerns. So it's really those two factors that are driving that.

James Sheehan
Thank you. And on the accounting investigation, you wrapped up your own probe, but then I think there's also an SEC probe. Can you talk about the expected timing of that investigation?

Michael McGarry
We have absolutely no idea what the SEC timing will be. And we won't be able to share anything with it until it was finalized anyway, so we'll be totally transparent whenever we can be, but right now we have no insight into what they're thinking.

James Sheehan
Thank you.

Michael McGarry
Thanks, James.

CONCLUSION

Operator
And at this time I'm showing no additional questions. I'd like to turn the conference call back over to management for any closing remarks.

John Bruno
Thanks, Jamie. I'd like to thank everyone for your time and interest in PPG. If you have any further questions, please contact industrial relations. This concludes our second quarter earnings call.

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