16-Apr-2021

PPG Industries, Inc. (PPG)

Q1 2021 Earnings Call

Copyright © 2001-2021 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

John Bruno
Vice President-Investor Relations, PPG Industries, Inc.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

OTHER PARTICIPANTS

John P. McNulty
Analyst, BMO Capital Markets Corp.

Ghansham Panjabi
Analyst, Robert W. Baird & Co., Inc.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Steve Byrne
Analyst, BofA Securities, Inc.

Frank J. Mitsch
Analyst, Fermium Research LLC

John Roberts
Analyst, UBS Securities LLC

Laurent Favre
Analyst, Exane BNP Paribas

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

David I. Begleiter
Analyst, Deutsche Bank Securities, Inc.

Michael Sison
Analyst, Wells Fargo Securities LLC

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Duffy Fischer
Analyst, Barclays Capital, Inc.

Jaideep Pandya
Analyst, On Field Investment Research

Laurence Alexander
Analyst, Jefferies LLC

Michael J. Harrison
Analyst, Seaport Global Securities LLC

Copyright © 2001-2021 FactSet CallStreet, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Jerome, and I will be your conference operator today. At this time, I would like to welcome everyone to the PPG Industries' First Quarter 2021 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

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

John Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Jerome and good morning everyone. Once again this is John Bruno, we appreciate your continued interest in PPG and welcome you to our first quarter 2021 financial results conference call.

Joining me on a 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 after US equity markets closed on Thursday, April 15, 2021. We posted detailed commentary and accompanying 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 brief opening comments Michael will make shortly. Following management'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 the 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 H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

Thank you, John. Good morning everyone. I would like to welcome everyone to our first quarter 2021 earnings call, most importantly I hope you and your loved ones are remaining safe and healthy. Now let me provide some comments to supplement the detailed financial results we released last evening.

For the first quarter, our net sales were a record and were about $3.9 billion, and our adjusted earnings per diluted share from continuing operations were also a record at $1.88. Our adjusted EPS was significantly higher than the first quarter of 2020, partially due to last year's first quarter being impacted by various pandemic related impacts. We'll also be comparing various financial metrics versus pre-pandemic results. And this comparison was nearly equally impressive with adjusted EPS 27% higher than the pre-COVID first quarter results of 2019.

Copyright © 2001-2021 FactSet CallStreet, LLC

This excellent operating performance was driven by strong year-over-year sales growth in our industrial coatings reporting segment with the automotive OEM, general industrial and packaging coatings businesses, all delivering double-digit percentage year-over-year sales growth. Our global architecture coatings business continued their strong sales growth trends. And automotive refinish had a strong quarter as activity in that end-use market is beginning to recover, and we were partially aided by some customer restocking in the US.

First quarter segment margins were at a multiyear high as we benefited from strong operating margin leverage on higher year-over-year net sales growth. The significant amount of cost savings we have achieved in the past two years from our restructuring programs is a primary factor contributing to us realizing this increased leverage. We delivered these outstanding results despite sales volumes not fully returning to pre-pandemic levels, including in several key PPG businesses such as aerospace.

In addition, we experienced a significant acceleration of raw material and logistics cost inflation during the quarter. Coming into the year, we were expecting an inflationary environment and had prioritized selling price increases across all of our businesses. This has helped us achieve solid price increases year-to-date. With a higher inflation backdrop, we have already secured further selling price increases and are in the process of executing additional ones during the second quarter.

As a reminder, the first quarter of 2021 was our 16th consecutive quarter of higher selling prices. We also continued to execute on our cost savings programs, realizing an incremental $35 million of structural savings and maintain our target of $125 million of total savings for the full year 2021. In addition, we retained about $30 million of interim cost savings during the quarter and remain confident that we'll be able to make at least $80 million of these interim cost savings permanent for the full year 2021.

We ended the first quarter with about $1.9 billion of cash and cash equivalents. This is a grossed up cash balance as we are preparing for the closing of the Tikkurila and Wörwag acquisitions. Contributing to this strong cash balance is a 200 basis point year-over-year improvement in our operating working capital in the first quarter, which drove better operating cash generation than a typical first quarter.

Our new traffic solutions business, which is the Ennis-Flint acquisition, performed to our expectations in the quarter despite significant challenges with weather and raw material availability. The business has a strong order book heading into the second quarter. In the first quarter, we also completed the VersaFlex acquisition, and the Tikkurila and Wörwag acquisitions are expected to be completed in the second quarter. In the accompanying presentation to our earnings material, we included several slides to provide further information and perspective on our four recent acquisitions and our performance for a number of acquisitions.

Some items that I'd like to highlight. Each of the four acquisitions bring incremental strategic benefits to PPG, such as product line extensions and geographic expansions. We've continued to deliver strong synergy capture from our past acquisitions and believe our global breadth, regional participation in all coating verticals, best-in-class procurement and mature back-office centers of excellence in low-cost areas allow us to deliver higher synergy capabilities than our competitors.

For our recently announced acquisitions, we expect to realize synergies of high-single-digit of sales, higher than historical industry synergy capture. We also provided an update to our acquisition performance we last shared in May 2019. We included our 10 most recent acquisitions that have been closed for at least 24 months. In most acquisitions and in aggregate, we have achieved higher synergy capture than our initial estimates, averaging about 50 basis points higher.

Copyright © 2001-2021 FactSet CallStreet, LLC

All of these acquisitions will help drive shareholder value creation. The post-synergy multiples for each of these acquisitions is below PPG's five-year average multiple. And for eight of the acquisitions, the post-synergy multiple is below 10. All four of the recently announced acquisitions provide earnings accretion from their historical base business and synergy realization.

By the end of 2022, we expect cumulative synergies to total about $75 million and will be at an annual run rate of $135 million once they are all fully integrated. As with many of our initial synergy projections, these initial targets only include a modest benefit from sales synergies, although these acquisitions are well suited for us to drive further top line growth.

We expect the Tikkurila acquisition to be completed in the second quarter. We recently extended the tender offer period until May 11 to finalize customary regulatory approvals. Tikkurila is a highly strategic acquisition, with leading architecture coatings positions across various countries.

As I said in January, I see many similar characteristics to our previous Comex acquisition. We'll have significant opportunities to cross-sell complementary products through our legacy channels to further grow sales and earnings. Our Comex acquisition has well exceeded our initial acquisition economics.

Moving to our current outlook. We are continuing to see very robust and broad-based demand globally, including in many industrial and OEM end-use markets and continued architectural coatings activity. Many of our customers have indicated they have strong order books, and we anticipate this global – strong global demand pattern to continue well into the second half of 2021 at a minimum. In addition, we expect an eventual restocking of inventory to occur in many of our selling channels as the year progresses.

One important item to note is some of our customers are experiencing input or component shortages, so their production capabilities and schedules remain choppy, and we are experiencing a few spot outages of direct coatings raw materials.

As a result, we expect some unfavorable sales impacts from both our direct supply chain disruptions and these production curtailments at some of our customers. Our best current estimate is that sales are expected to be impacted by about $70 million to $90 million in the second quarter due to these issues. We expect these sales to be deferred in the second half of 2021, and thus, this impact is already included in our second quarter 2021 financial guidance.

Also, as I mentioned previously, we're experiencing commodity inflation that occurred quickly due to the weather event named Uri. As a result of this rapid inflation increase in both raw materials and logistics, we have fully mobilized our commercial teams and are successfully securing additional selling price increases. We have a very good head start on this inflation cycle, and we expect to fully offset raw material cost inflation in the second half of 2021.

Finally, as you've come to expect from PPG, we remain committed to strong and real-time cost management, which will provide continued strong operating leverage of sales growth. These current disruptions are temporary. And we maintain a positive view on the overall global coatings demand growth, which continues to be robust and broad-based across most of the end-use markets that we supply.

This is expected to continue throughout 2021. The strong demand conditions, along with our leading technology advantaged products, provides us with many organic growth opportunities in 2021 and beyond.

Copyright © 2001-2021 FactSet CallStreet, LLC

For the company, aggregate sales volumes are projected to be up by low-teen percentage in the second quarter on a sequential basis, compared to the first quarter 2021, with differences by business and region. Adjusted earnings excluding amortization expense is expected to be between $2.15 to $2.20, continuing a strong earnings momentum.

As a reminder, this guidance does not include any EPS impact from either the Tikkurila or Wörwag acquisitions. Our near-term cash deployment priority will be to complete the acquisitions we have announced, which we anticipate to be funded by a combination of cash on hand and debt by the end of the second quarter.

In closing, I want to thank and recognize our global PPG team. The character of our employees has never shone brighter than it has during these times of adversity. Our people have shown great resiliency, continuing to serve our customers, our communities and drive a common purpose to protect and beautify the world.

Thank you for your continued confidence in PPG. This concludes our prepared remarks.

And now, Jerome, would you please open the line for questions?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of [ph] Caleb Dume (13:08) with BMO. Your line is open.

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Hi. This is John McNulty. So a question on the raw material front. It seems like there's still a little bit of supply chain issues. Have you seen raw material pricing? Have you've seen it peak yet? Or are there still some pockets where you're still continuing to see that rising pressure? And then can you speak to the level of price increases that you need to offset some of that raw material pressure that you've been speaking about?

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

John, this is Michael. I would tell you that most prices have peaked. There probably could be a few nits and nats here that could increase further. But what we see is that raw material availability is getting better. It's not great, but it's getting better on a daily basis. Our teams are working hard on that. And we had 1.7% positive price in Q1, and we expect to have more positive price in Q2. So it's probably a little bit early to say how much we need to get, but we're working hard at it. And what I'm most encouraged by is that every coatings business in PPG had positive price, including our automotive business, and we're on track for every coatings business to have positive price in Q2.

Operator: Your next question comes from the line of Ghansham Panjabi with Baird. Your line is open.

Ghansham Panjabi
Analyst, Robert W. Baird & Co., Inc.

Q

Thank you, and good morning, everybody. I guess on the strong second quarter guidance despite what we're obviously seeing with massive raw material cost inflation, can you just take us through the mechanics of how

Copyright © 2001-2021 FactSet CallStreet, LLC

you're approaching pricing now versus previous cost inflation cycles? And related to that, I read a new paradigm for the coatings industry, whereby pricing will more quickly align with raw material cost volatility, including when costs start to decline at some point? I guess, I'm asking because historically, the industry has been very good about maintaining pricing even as raw material costs have moderated post previous peaks. Thanks so much.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Ghansham, what I would tell you is that, we anticipated raw material inflation coming into the year. And so we had put our teams on high alert to get pricing early in the year. And the second thing is, we're trying to do a better job of surgical price increases as well as value selling. So as we roll out new products to capture that additional value. And we're doing a better job, I think, on services. During the pandemic, it was clear how much our customers valued our ability to help them get their lines up and running. And I think we're doing a better job of capturing value for those services.

So I think each of those things is important. Clearly, as the freeze happened, it wasn't any shock to anybody at PPG that this was going to lead to additional raw material inflation. And so we immediately – as we saw Texas going into a deep freeze, put all our sales teams on high alert that they need to start talking to their customers immediately about raw material inflation. I think one of the things that's different, if you remember 2017 and 2018, there are – some of our competitors were distracted.

You had the Valspar acquisition being completed. Valspar wasn't raising price. And Akzo is under a lot of pressure. They were not doing anything that were going after value. This is so clear and obvious that I think everybody is more on top of this. Hopefully, this will be a trend to be on top of raw material inflation as a regular ongoing business practice. So I would just tell you, I'm confident that our teams are proactively addressing this.

Operator: Your next question comes from the line of Bob Koort with Goldman Sachs. Your line is open.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning. And I appreciate the increased transparency around all the deals and sub-segment trends, that was very helpful in the slide deck. I wanted to ask on Tikkurila, when is the peak paint season in Northern Europe? So is there some risk of maybe missing the best part of the year if you can't close that more efficiently?

And then secondly, on Ennis-Flint, I noticed that you didn't check off the geographic expansion. It was one of the opportunities or key attributes there. And I guess I recall you guys talking about maybe getting more aggressive internationally there. So – did I misunderstand that in the past? Thanks.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

No, Bob, Ennis-Flint does have some regional aspects. It is – got a little bit of share in Mexico, has a little bit of share in Argentina, has a little bit in Australia and a little bit in Europe. We are digesting all that information right now looking at a strategy that will help us accelerate that. It will be a prime focus for us.

We have already made some headway, as you can imagine, in Mexico. Our strong PPG-Comex team is all over this, and that's the area that will leverage the quickest. Probably the next area, that will be Europe. So I think these are all positives. So it's a small piece of it, but it will get bigger over time.

Copyright © 2001-2021 FactSet CallStreet, LLC

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

And before Michael answers, Bob, the Tikkurila question, the geographic expansion on that slide was really for PPG, not necessarily for the acquired company. So Tikkurila definitely gives us significant geographic expansion in Scandinavia, where we have very minor presence. So that line item on that chart was really around PPG's benefit.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

And then the paint season in Nordic and Russia, as you can imagine is more compressed than a typical one. And the best months are April through August and September. It definitely slows down in the fourth quarter. And so clearly, we'd like to get this thing closed sooner rather than later.

Operator: Your next question comes from the line of Stephen Byrne with Bank of America Securities. Your line is open.

Steve Byrne
Analyst, BofA Securities, Inc.

Q

You have these EBITDA synergy percentages for these four acquisitions, just curious as to whether in those metrics and then also on the slide where you show pre and post-synergy multiple impacts, do you include in there the revenue benefit from either cross-selling into your other businesses or your ability to accelerate the sales growth, do you include that in these post-synergy metrics?

And perhaps if you do, could you comment on, say, the relative split between them? I would assume that it would depend on the business. Like Ennis-Flint, I would imagine your ability to cut costs with your supply chain could be meaningful. But this VersaFlex, I'm glad you made that comment, Vince, to Bob's question, I would assume that VersaFlex is the technology is one that you could really expand globally.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

Yes. Steve, this is Vince. Typically, in most of these deals, the ones we've completed as well as the ones that we have here as pending, most of these deals have very – as Michael said in his opening comments, have very minor top line synergies included. So, our metrics on a traditional project – acquisition project are typically based on cost synergies primarily.

There are a few in the ones completed. Michael mentioned Comex where we do have further top line synergies than traditional. But I think for us and most people in this space, most of the synergies come from the cost side. I think what's also important is some of these come day one. So, these day one synergies certainly help us in terms of the project economics. And you're spot on again, as we look at this chart, all of these acquisitions provide expansion of the acquired companies' products across PPG's footprint. But again, that's typically not the big driver in these synergy buckets.

Operator: Your next question comes from the line of Frank Mitsch with Fermium Research. Your line is open.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Copyright © 2001-2021 FactSet CallStreet, LLC

Thank you and good morning. I'd be remiss if I didn't pass along that a client told me that your result was like Matsuyama on Saturday, so congrats on that.

Michael, you indicated that the first quarter volumes were 2% below 2019 levels. And I'm curious what is embedded, relative to 2Q 2019, in your 2.15% to 2.20% guidance, where you stand relative to the pre-pandemic period? And if you could give a discussion as to how much of that volume is related to restock because I believe you mentioned in a couple areas that you are seeing some restock take place versus underlying demand.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Yeah. Frank, I would say that there's very little anticipated restock in 2Q. The restock that we saw in the US refinish market really had more to do with the fact that we had a more normal winter. And so the guys didn't want to get caught if we had a return to work situation. So, they've done, I think, whatever restocking they're going to do.

So, from that standpoint, I would say the volumes that we're projecting for 2Q are still at or slightly below the 2Q of 2019, and that's primarily driven by aerospace. So, what I'm encouraged about, Frank, to be honest, is that January and February for aerospace was still pretty mediocre. But March was pretty encouraging. And we know that the aerospace guys have completely depleted inventory. I mean they have virtually nothing in the chain.

So, at some point, as things get better, they're going to start ordering and that will start to be a positive. We haven't seen that yet. We do track it on a very regular basis, as you can imagine. But I was encouraged by March, and the MRO sales have continued to tick up in April here. Now we expect OEM aerospace to be flat, because that's not going to change anytime soon. But the MRO side will be better. So we have military still doing well. MRO is starting to improve. So you should regard that as a real positive.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

And couple other channels that are light inventory. We know the automotive market globally is exceptionally light in terms of their historical inventory trends. We think the US, for example, is somewhere in the mid-40s days of inventory, which is typically 70% or 80%. We know the US car rental agencies are very light inventory. They didn't buy much in the past 12 months. So again, we think auto production, once it's available, to run full out will be a good tailwind.

The other industries and many industrial markets are light inventory, some of those due to the chip shortages. And we are, as a company, light inventory; we weren't able to produce as much inventory in Q1 as we wanted for the 2Q architectural season. So we do feel there's an inventory replenishment across many of the end markets that we supply.

Operator: Your next question comes from the line of John Roberts with UBS. Your line is open.

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. Versus the 2019 pre-pandemic, overall volumes down 1% and looks like second quarter will be maybe up a couple percent. Can you talk about some of the businesses that are well above pre-pandemic levels like DIY architectural, how far above 2019 is that? And are we above or below pre-pandemic in refinish? Kind of, hard to tell since it's been moving around a lot.

Copyright © 2001-2021 FactSet CallStreet, LLC

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Yeah. We're still below in refinish. We're below in every place but China. So Australia is low. Europe is definitely low. US will remain down. I mean, claims even last reported one was down 8%. So that's going to continue to be under. I think we put a slide in there as far as by each of the businesses. I hope – well, we'll get into it. So I think the one that's most negative to think about is aerospace. But then the rest of them should be – automotive OEMs should be marginally down. That's really due to chips. Industrial should be up. Packaging should be up. And all the other ones will be down.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

Yeah. But John, I just want to – we are expecting volumes slightly below – in Q2, slightly below 2019 levels. So we do – again, there's still recovery outstanding in most of these end markets.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

In architectural, we don't see a slowdown yet, even April continue to be very strong. So the architectural side, globally, in every market we participate in around the world, continues to be quite strong.

Operator: Your next question comes from the line of Laurent Favre with Exane BNP. Your line is open.

Laurent Favre
Analyst, Exane BNP Paribas

Q

Yes, good morning all. It's actually a follow-up to that question on DIY versus do-it-for-me. I was wondering if you could give us a little bit of at least directional color on what you're seeing in North America and in Europe, especially on do-it-for-me? Thank you.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Well, the DIY, Laurent, continues to be quite strong, double digits plus. We were up more than double digits plus in Europe, same thing in the US, same thing in Australia. So for us, this is – and Mexico has been – it's not much of a DIY market, but it continues to be strong. So we're not seeing any change in that trend. And of course, with the continued lockdown, as you are well aware, in Europe, we anticipate this will continue throughout the summer.

Operator: Your next question comes from the line of Vincent Andrews with Morgan Stanley. Your line is open.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you very much. I just wanted to make sure I understood your comments on raw materials for the back half of the year. I believe you said that you expect pricing to offset raws in 2H. But I just want to clarify whether that means by the end of 2H or for the entirety of 2H?

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

Copyright © 2001-2021 FactSet CallStreet, LLC

Hey Vincent, this is Vince. Our view of raw materials as they are, we hope, at the high watermark at this point, that will carry somewhat into Q3. We are seeing in some spot outages that we expect will continue through part of April and into May. Then seasonally, we expect these raw materials to have normal seasonal patterns. And our pricing in different businesses by segment will differ. But certainly, in the second half and its entirety, we'll definitely offset raw materials is our expectation.

Operator: Your next question comes from the line of David Begleiter with Deutsche Bank. You may now ask your question.

David I. Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Michael, just on the cost savings. On the temporary costs they're becoming permanent, can you give a little more color as to what they are and where they are and how you accomplish that? And just on Tikkurila, I believe you need Russian approval. If that approval was delayed, could you still close on the rest of the company without that approval in hand?

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

So the Tikkurila one is easy. We're going to wait for Russian approval and close all at once. That's what we're expecting to do. As far as your first question, I would tell you that I feel confident that the businesses are well prepared. And Vince, I don't know if you want to...

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

Yeah. I think on the cost, David, we've – couple of things. Obviously, travel is down considerably. We have other discrete cost items that we expect to stay out. We've had head count freezes on in certain parts of the world in certain businesses. We've learned to operate without some of the head count. We have done some work in terms of consolidation of warehouses given our lower inventory levels. And given our lower inventory level overall, we don't expect to bring back some of those warehouses that we've exited.

And the other piece that we've talked about is in terms of digital, we're finding different ways of working that are reducing our cost footprint in different parts of the world. In Europe, for example, which is our highest architectural digital portion, we are looking at our overall footprint in terms of architectural bricks and mortar. So it's really spread out. Every business is in a high alert with respect to these costs. And you could see the benefit in our leverage of earnings. Our volumes were up 7%. That came at around a 40% leverage. So every business sees the value of that, and we're being very mindful of every cost line item on our income statement.

Operator: Your next question comes from the line of Michael Sison with Wells Fargo. Your line is open.

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Hey guys. Nice start to the year. In terms of your outlook for sales growth in 2Q versus 1Q, I think you said low double digits. How much of that increase sequentially is going to be price and volume? And then – and I'm just curious, how much – what exactly is the inflation delta that you have to uncover, maybe either in dollars or gross margin percentages for the year?

Copyright © 2001-2021 FactSet CallStreet, LLC

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.
A

Hey, Mike, thanks. I'll start and then Michael can certainly add some more color. But we do expect pricing to be higher than Q1 on a percentage basis year-over-year. The volumes are still a bit mixed by business and segment, again, due to the shortages, both in our inventory as well as customers and ability to run. But, again, we gave you the composite number. So, hopefully, you can vet out what you expect to be from a volume perspective.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.
A

And I would say, Michael, just to be consistent, the primary drivers of the higher volume are going to be on the industrial segment side. As you remember, April and May last year, the automotive companies were completely shut down. Packaging remains strong and many segments in our industrial business are doing quite well.

Michael Sison
Analyst, Wells Fargo Securities LLC
Q

Fair enough.

John Bruno
Vice President-Investor Relations, PPG Industries, Inc.
A

And, Mike, maybe just to add one more thing. We would have probably had a little bit more sales in 2Q, if it wasn't for the supply disruptions that we noted, that Michael noted of $70 million to $90 million in his opening comments.

Operator: Your next question comes from the line of Jeff Zekauskas with JPMorgan. Your line is open.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC
Q

Thanks very much. Your EBITDA margins were 17% in 2020. And I think in the first quarter, they were about 18%. You've got all kinds of raw material inflation. Your volumes are not really back to where you want them to be. You've made some acquisitions. Once you get your price increases and businesses back to normal, what's the EBITDA margin? Should it be roughly 20%? Can you do better than that? What's your long-term goal? And what is the profitability of PPG look like on a normal basis?

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.
A

Well, I think, Jeff, one of the PPG Way tenets is that we do better today than yesterday, every day. So, right now, our current target is to well exceed our 2016 peak margin. So if you want to go back and look at that, you'll see one data point.

We're well above that in our performance coatings segment. We're not there on our industrial side. So we have more work to do. But overall, I think what you should do is anticipate that we're going to continue to drive these margins higher.

I think you hit on all the right aspects. We have better leverage. We're going to be able to retain pricing once we get it in place. And we have new products that are coming out. So I think we're doing quite well. I mean we're excited that we had a record quarter. We're forecasting a record second quarter. And that's three quarters in a row of record adjusted EBIT. So we're happy about that.

Copyright © 2001-2021 FactSet CallStreet, LLC

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

And if I could just add, I think part of the equation here, and Jeff, you've hit on this a couple of times in our prior conference calls, as part of the equation is the fixed cost elimination that we've done on a multiyear stack. That's a significant contributor to our margin profile.

We still have – as you asked, I think, in the fourth quarter, we still have more restructuring activities to go, specifically this year and early next year. And the last thing I'd say on this is, we are bringing these acquisitions in. They typically come in at below our company margin. So that will temper some of the average margin benefits until we're able to extract the synergies from these acquisitions.

Operator: Your next question comes from the line of Kevin McCarthy with VRS (sic) [VRP]. Your line is open.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Good morning. Michael, I was wondering if you might expand on some of the supply chain disruption issues that you're seeing from both an internal and an external perspective? In other words, on the internal side, what is it that PPG buys that is in short supply? And has it impacted your production rates? Then externally, we hear a lot about the semi-chip shortages. Is that really the lion's share of the issue for PPG? Or are you seeing customers that are impacted in other industries as well?

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

So on the internal side, Kevin, I mean, epoxies, VAM, methyl acrylate, MMA, specialty isocyanate, those are all challenged supply chains right now, and we're operating hand-to-mouth. There's some real minor nits and nats of chemicals you wouldn't really understand – or maybe I shouldn't use the word understand, but very small things that we need to make certain batches of paint, especially in our packaging business. So we are shuffling raw materials around between the plants to make sure everybody has everything they need.

So I would say that the primary issue is on our side, except for the automotive guys. They do have the chip shortages. The automotive guys also have plastic shortages. They had seat shortages. So they are really struggling right now. But we expect it to loosen up and get better. We do see every day. We're getting more emulsions every day. Epoxy is not great, but it's getting better. So we're anticipating that as we get raw materials, we'll be able to better service our customers.

But the good news is we're pretty sure we're doing better than our competitors in many of these spaces, especially our smaller competitors, which they're struggling to get raw materials. So we're taking good care of our customers and our suppliers are doing a good job of taking care of us.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

And I'll just add one comment. From our internal shortages, it's primarily in our architectural businesses. We do have some internal shortages that may affect traffic solutions. And we expect these to be transitory. They're baked into our guidance for Q2. But that's where we're seeing from a business perspective, the shortages.

Operator: Your next question comes from the line of P.J. Juvekar with Citi. Your line is open.

Copyright © 2001-2021 FactSet CallStreet, LLC

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Yes. Hi. Good morning, Michael and Vince. In your chart on M&A, which was quite helpful, you showed that Tikkurila's multiple was at the high end of the historical range. Can you talk about Tikkurila's exposure in Eastern Europe and Russia? And how do margins compare in those regions and returns compare in those regions to Western Europe? And what are the risks in Russia? And you already have operations there in industrial. Can you just talk about any risks in Russia with respect to FX and all that? Thank you.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Well, we're certainly – we'll look at the FX much like any of our foreign currencies. We do have a fairly sizable presence in Russia right now. We're number one in automotive. We're number one in the premium refinish. We're number one in packaging, number one in aerospace. So we have a pretty sizable presence. We're used to doing business in Russia.

Because we're still competitors, we can't talk about what their specific margins are until such time as we close. But what I would tell you is, if you look at their overall margins, they're below our margins in Europe. So that's going to be an opportunity for us to bring those up to PPG levels. And we also think that in some of the countries, there's an opportunity to go beyond that because of the synergies with the warehousing, the raw materials. They're struggling right now with raw materials and so I anticipate that we'll be able to improve their business pretty quickly once we close.

Operator: Your next question comes from the line of Arun Viswanathan with RBC Capital Markets. Your line is open.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Great. Thanks. Good morning. Congrats on the great results. Just wanted to get your thoughts on the margin. So, obviously, some pretty strong performance. Is there a way you could kind of help us understand what portion of the upside came from, say, volume leverage versus some of the selling price increases versus temp cost reductions in the quarter? And maybe looking ahead, if you expect those buckets to kind of remain similar, or how we should kind of characterize that? Thanks.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

Yeah. Arun, great to hear from you. Look, the majority of our benefit year-over-year and versus 2019 came from the volume leverage. We had 7% volume leverage. We've been talking for quite some time about all the costs we've taken out. So that had a significant, I said, 40-plus-percent dropping to the bottom line. If you do the math just on that, you could see the remainder of the gap was modest.

So again, as we continue to have this volume recovery, especially in some of our key businesses like aerospace, we do expect consistent performance in subsequent quarters. Again, I would profess that our teams are doing very well in terms of discrete cost management. But we also have the structural cost management, the multi-year stack I talked about earlier that's going to provide us benefit here into the future, and we still have more of that to execute against.

Copyright © 2001-2021 FactSet CallStreet, LLC

Operator: Your next question comes from the line of Duffy Fischer with Barclays. Your line is open.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Yeah. Good morning fellas. If you go back and look 2014 through 2019, each first half versus second half was either 50% or 51% of your revenue for that year. This year, with that $70 million, $90 million hole you talked about in Q2, just kind of the rebound, it looks like second half should be meaningfully better than the first half maybe for the first time in that period. So can you kind of help us walk through, excluding the acquisitions, what might the second half look like with your view on things today versus the first half on a top line basis?

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

So Duffy, I would tell you that we're confident that our momentum is going to continue. So if you think about – if you walk through some of the businesses, right, so automotive, inventories are exceptionally low. I think Vince covered that in detail earlier on the call. So we're going to have a better second half than normal for automotive.

Our industrial segment, so you think whether that's coil or heavy-duty equipment or any of these other segments in there, they continue to do very well as also. Packaging, we see no slowdown in the packaging momentum. In fact, if you look at the number of new packaging plants, can plants that come in, in the second half of the year that should be all good as well.

Again, I talked about it earlier, architectural, we've seen no slowdown in the DIY. And we do anticipate – we're not really seeing a lot of it yet, but we do anticipate the professional side will get better. Certainly commercial and industrial and that market is still quite like, but that should get better.

Aerospace will get better. It's not a matter, if it's just a matter of when. And then I'm kind of excited by the fact that I see a little bit of the big oil guys starting to spend some capital. So, if they get serious about spending capital, our protective business will start to get better. So, quite honestly, when I look at the various segments that we have, I think we should have a good back half of the year from a volume perspective.

Operator: Your next question comes from the line of Jaideep Pandya with On Field Research. Your line is open.

Jaideep Pandya
Analyst, On Field Investment Research

Q

Thank you. Just on the aerospace, could you just tell us, so much of the fleet has been sort of grounded. So, when this fleet goes back up flying, can you just explain us what do you expect in terms of a pickup in MRO because this probably had never happened for a long, long time that such so much percentage of fleet has been grounded.

And then what do you expect in terms of recovery in 2022, 2023 with regards to sort of new-build and on the military side? And then just sort of on a similar note, protective and marine, on the infra bill in the US, what do you expect has an impact on the protective side. If you can just remind us what is PPG's exposure on the infra and how would that benefit the protective business? Thanks a lot.

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Copyright © 2001-2021 FactSet CallStreet, LLC

Okay. I'll try to capture all these questions here. So, let's do the easy one first. Military, we see no slowdown in the military side. That's, let's call it, 35% of our aerospace business. Our most important program is the F-35. The builds continue along. We're gaining more share. We have more share on the transparency. We have more share on the winglet transparencies. So, we feel good about that.

From the commercial side, to be quite honest, our visibility is quite limited because we've never had planes sit on the ground for a year. And so the MRO, how they were put into storage and how they come out of storage is still somewhat of an unknown. What checks they're going to do before they put them into storage is still somewhat of an unknown. So, what we do see is that the MRO activity for our aerospace business is picking up.

We are getting – what's interesting is when they put – when some of the planes are giving back to the lease source, they have to paint them white. So, we have been getting some of those white paint sales. And of course, when they come back out of the lease source, they're going to be re-branded again, so they'll be repainted again. So as that happens, that will be a positive for us.

Your question on infrastructure, I would tell you that we touch a lot of things in the infrastructure, whether that's the road markings that will be needed, whether that's the bridges that will need to be painted. If they support the building and trades industry, that will require protective coatings. So, I would say for PPG, any infrastructure bill will be regarded as a positive.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

And I'll just add some color on the aerospace. If you think about the drivers of volume, we expect it to return in waves. The first wave, I think Michael alluded to in his prepared remarks, which is the domestic flights, we're seeing that certainly in the US. We're seeing significant upticks still below pre-pandemic levels. But we care about takeoffs and landings. That's what drives the aftermarket. So, the more takeoff and landings in the US and in other countries, internal takeoff and landings is very important to us.

The second wave we see is a return of business travel. And then the third wave, which we don't expect until later this year at the earliest, would be international travel. So we do feel there's a couple opportunities for step-ups in the aerospace industry on the MRO side.

Operator: Your next question comes from the line of Laurence Alexander with Jefferies. Your line is open.

Laurence Alexander
Analyst, Jefferies LLC

Q

Good morning. What's your expectation for labor cost inflation for this year, and how do you expect pressure to be building into next year? And secondly, in prior kind of inflationary environments, there was a lot of thrifting driven by a shift in the innovation cycle. What can you do this time? What are you seeing from the customers, and will that translate into share gains in 2022, 2023?

Michael H. McGarry
Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Well, let's talk about the labor piece first. Labor for PPG is not a huge piece of our business. What I would put into your model is traditional 2% to 3% kind of number. That's typical of what we're seeing. But our goal always is to offset that through productivity. Our manufacturing teams are always a challenge to drive additional productivity

Copyright © 2001-2021 FactSet CallStreet, LLC

year-over-year. They have to come forward in their plan to offset that. So that would be the first thing I would think about from a productivity standpoint.

Operator: Your next question comes from the line of Mike Harrison with Seaport Global Securities. Your line is open.

Michael J. Harrison
Analyst, Seaport Global Securities LLC

Q

Hi, good morning. Within the industrial business, if we look at that sequentially, sales were down $30 million, operating income was down more like $35 million. What caused that sequential decline in operating income? Is this discretionary cost that are coming back? Is this the impact of disruption? Maybe just some thoughts on how we should think about industrial margin trajectory over the rest of the year as demand recovers and you get some pricing against raws? Thanks.

John Bruno
Vice President-Investor Relations, PPG Industries, Inc.

A

Yeah. Mike, this is John. I would highlight two things. We saw the chip issue in the auto OEM side, still robust demand. But that was an impact on the top-line. And then we saw raw material inflation sequentially. So that would be the other part that I would call out.

Vincent J. Morales
Chief Financial Officer & Senior Vice President, PPG Industries, Inc.

A

Yeah. And if I could just add just a tidbit there. We did see raw material inflation, and it was very rapid, obviously, following the weather events we chronicled earlier. Typically, we don't see that much inflation mid-quarter. But we did see some items, especially around the oil side, spike up mid-quarter. So again, we started to put in pricing, as Michael alluded to earlier. But we weren't able to offset that fully in Q1.

I do want to go back to, Laurence – Laurence asked two questions. We didn't get to the second one, which was thrifting. Right now, we're not seeing in our architectural business anywhere in the world any significant impacts from thrifting. We're really – again, we're really light inventory. We think some of our customers are light inventory. So most of our customers as well as customers buying from us are selling what they have on the shelves. So we don't expect for that to be a big event in Q2 just because of product availability.

Operator: All right. There are no further questions at this time. Mr. Bruno, I'll turn the call back over to you.

John Bruno
Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Jerome, and I'd like to thank everyone who participated on our call today and for your continued interest in PPG. If you have any further questions please contact me and the Investor Relations Department. This concludes our first quarter earnings call.

Operator: This concludes today's conference call. You may now disconnect.

Copyright © 2001-2021 FactSet CallStreet, LLC

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2021 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.

Copyright © 2001-2021 FactSet CallStreet, LLC