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PPG Industries, Inc. (PPG)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Jason, and I will be your conference operator today. At this time, I would like to welcome everyone to the PPG's Second 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, Vice President of Investor Relations. You may begin your conference.

John Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Jason, and good morning, everyone. Once again, this is John Bruno. We appreciate your continued interest in PPG and welcome you to our second quarter 2021 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 after US equity markets closed on Monday, July 19, 2021. We have 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 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 risk, 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, and good morning, everyone. I would like to welcome everyone to our second 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 second quarter, our net sales were a record and nearly \$4.4 billion and our adjusted earnings per diluted share from continuing operations were \$1.94. Our adjusted EPS was significantly higher than the second quarter of 2020, partially due to last year's second quarter, including various pandemic-related impacts.

Looking back to pre-pandemic results, our adjusted EPS was similar to the second quarter 2019, despite sales volumes being 6% lower than that period and we are dealing with historical high levels of raw material inflation in the current period. Our strong year-over-year sales reflect a partial recovery from the unfavorable pandemic effects of last year, but also include a better-than-market performance across many of our businesses for this quarter. We achieved these higher sales levels despite significant supply and component disruptions, including ones that reduced the overall manufacturing capability of our customers.

Coming into the quarter, we expect that these disruptions would have an estimated impact of \$70 million to \$90 million. However, the actual impact was much more severe and closer to \$200 million. Our adjusted EPS in the second quarter, while near all-time record levels, was below our April forecast. Three main factors impacted the difference.

Due to supply disruptions, we experienced unprecedented levels of raw material and transportation costs that continually elevated as the quarter progressed. This drove raw material inflation to be up a mid- to high-teen percentage on a year-over-year basis versus our original estimate of a high single-digit percentage increase.

Our automotive OEM business was impacted most significantly from supply disruptions as we estimate that more than 2 million less cars were built than initially expected during the quarter. This impacted our sales by about \$100 million or higher than – \$40 million more than we expected in April.

Finally, as we expected, the supply disruptions led to shortages of certain raw materials. We had anticipated an impact of \$30 million to \$50 million, but the actual impact was closer to \$100 million. We are highly confident that the sales related to these production disruptions will be deferred to later quarters and this will elongate the global automotive OEM recovery.

As I mentioned in April, coming into the year, we were expecting an inflationary environment and had prioritized selling price increases across all our businesses. This helped us achieve solid price increases year-to-date, and our pace of price realization is well ahead of the most recent raw material inflation cycle in 2017 and 2018.

Clearly, this inflation cycle is much higher than anyone anticipated, and we're continuing on a business-by-business basis, working to secure further selling price increases. This includes executing additional pricing actions during the third quarter. As a reminder, the second quarter of 2021 was our 17th consecutive quarter of higher selling prices.

We're also continuing our strong cost management, evidenced by our SG&A as a percentage of sales being 130 basis points lower than the second quarter 2019. This is being supported by our ongoing execution on our structural cost savings programs, realizing an incremental \$40 million of savings in the second quarter. We have increased our targeted full year 2021 savings by about 10% to \$135 million.

In the second quarter, we finalized three acquisitions; Tikkurila, Wörlag and Cetelon. We funded the acquisitions through a combination of cash and external financing, which came in at a very attractive borrowing rate. We had yet another strong operating cash performance during the quarter and ended the quarter with about \$1.3 billion of cash and cash equivalents, giving us continued flexibility to do additional accretive cash deployment in the upcoming quarters.

In regards to our other two recently completed acquisitions, our new traffic solutions business, which is comprised of the Ennis-Flint acquisition, performed to our expectations in the quarter despite significant challenges with raw material availability and its order book is at historical highs entering the third quarter. Our VersaFlex acquisition,

while smaller, is performing well and it's already helped us win significant protected coatings project in Central America due to the advantaged technologies that we acquired.

Another notable accomplishment during the second quarter was the appointment of our company's first-ever Vice President of Global Sustainability. PPG has been a clear ESG leader in the coatings industry through our market-leading sustainable products and we have plans to further improve our overall ESG program. We will provide updates on these initiatives in subsequent quarters.

Moving to our current outlook, most important is that we are continuing to see very robust and broad-based demand globally, including in many industrial and OEM end-use markets and strong architectural coatings trade activity in the US. Many of our customers have indicated that their order books were at high levels exiting the second quarter. We anticipate this strong global demand pattern to continue. In addition, we expect an eventual restocking of inventory to occur in many of our selling channels, either later this year or in 2022.

In the near term, we expect some of our customers will continue to be challenged with input or component shortages, so their production capabilities and schedules likely to remain choppy throughout the third quarter. PPG is also experiencing the continuation of spot outages of direct coatings raw materials. As a result, we expect some unfavorable sales impacts from both our direct supply chain disruptions and the production curtailments of some of our customers in the third quarter.

Our current best estimate is that our sales are expected to be unfavorably impacted by about \$150 million in the third quarter due to these issues. We expect these sales will be largely deferred to subsequent quarters. We also expect raw material costs to remain at elevated levels in the third quarter. Our current best estimate is that they will be inflated by as much as 20% compared to the third quarter of 2020, with businesses in our Industrial Coatings segment experiencing the largest increases due to the raw material mix of those types of coatings.

As a result, all our businesses are securing additional selling price increases. Due to the significant increases we experienced in the second quarter and anticipate in the third quarter, we now fully expect to offset raw material cost inflation in the fourth quarter on 2021 on a run rate basis.

As I have said previously, these current disruptions are temporary and we strongly believe there is sufficient capacity available in our supply chain once operating conditions normalize. I'm very pleased that we completed five recent acquisitions since December 2020. In the third quarter, these acquisitions will add about \$500 million of incremental sales to our company. As we continue to integrate these acquisitions, we will start to realize meaningful synergies that will be a strong earnings catalyst.

We're also witnessing domestic flight activity picking up all over the world. This will begin to benefit our commercial aftermarket business in aerospace in the second half of 2021. In the information we posted on our website yesterday evening, we're projecting aggregate sales volumes to be up a low single-digit percentage in the third quarter compared to the prior year quarter. With differences by business and region, including our acquisitions, we expect overall sales growth to be over 20% compared to the third quarter of 2020.

In addition, full year 2021 adjusted earnings, excluding amortization expense and other non-recurring items, is expected to be \$7.40 to \$7.60, which, at the midpoint, would be about 13% higher than the adjusted EPS we realized in 2019, despite the significant raw material inflationary pressures we are dealing with this year and the fact that sales volumes are still not fully recovered from the pandemic when compared to 2019.

Finally, I'm very pleased that our board recently approved a dividend increase of about 10%. Our September payment, coupled with the anticipated payment of a similar quarterly dividend in December, will mark 50 consecutive years of annual per share increases in the company's dividend. This is another testament of our company's legacy of consistently rewarding our shareholders and the confidence that the board and I have in our ability to continue to generate and grow our operating cash flow.

In closing, I could not be more proud of our now 50,000 employees around the world who serve our customers, our communities and our many stakeholders. Their dedication and commitment to doing better today than yesterday every day helps assure that PPG continues to protect and beautify the world.

Thank you for your continued confidence in PPG. This concludes our prepared remarks. And now, Jason, would you please open the line for questions?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Ghansham Panjabi from Baird. Please go ahead.

Ghansham Panjabi

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

Hey, guys. Good morning.

Q

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

Good morning.

A

Ghansham Panjabi

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

Yeah. So, I guess, Michael, what do you think is the realistic timeline for the recovery in auto OEM production? I mean, between 2Q and 3Q, that looks to be about \$200 million in total. Is this a deferral of a couple quarters? Or is it longer than that just based on what you see at this point? And then just also more broadly, there's been some concern in the market about slowdown in China. Can you just sort of give us a real-time pulse as to what you're seeing in the region? Thanks so much.

Q

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

Well, Ghansham, first of all, I would say that the auto industry continues to have significant demand in all places around the world, except for Europe. And we do anticipate Europe recovering, but probably at a little bit slower rate because of the pace of vaccines over there.

A

But I would tell you overall we're anticipating that there's going to be about 1 million cars less built in the third quarter than we had originally anticipated, because of the chip shortage. And right now, if you look at the overall pace of car builds, they're still below peak levels, but demand is recovering.

So, I anticipate that we're going to have a very strong back half of 2021 and a very good 2022. So, from that standpoint, inventories across the lots, whether they're in the US or China, are still at quite low levels. And so, I can still remain very optimistic.

From a China standpoint, specifically, inventories are probably in that 40 to 45-day range, which is below average slightly. Demand remains strong. And what's most encouraging to me is that the pace of EVs continues to pick up. And as you know, our positioning on EVs are very strong. And so, we anticipate continuing to be above industry build rates in content.

Vincent J. Morales

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

A

And, Ghansham, this is Vince. Just to dovetail Michael's comments, if you look at the automotive OEM, particularly in the US, one other benefit we expect to occur later this year or early next year, as chips become available, is the rental car fleets.

The rental car fleets, there's a sparse inventory in those fleets. And so, we know those typically account for 10% to 15% of auto builds annually, and we know that 10% to 15% will be higher going forward until they replenish those fleets.

More broadly in China, while we're seeing a lower growth rate, we're still seeing good growth across many of our end markets. So, I think the anecdotal information you referenced is accurate. The growth has come off what was very high rates. But it's still a solid growth rate going forward.

Operator: The next question comes from John McNulty from BMO. Please go ahead.

John P. McNulty

Analyst, BMO Capital Markets Corp.

Q

Yeah, thanks for taking my question. With regard to the raw material catch-up and where you catch up with price, and I think you're looking for, I think you said in the fourth quarter or toward the end of the year. Is that exclusively on price getting high enough to catch up or do you have any assumptions baked in for raw materials actually coming off from these levels? And then I guess tied to that, anything about the raw material environment right now that's making you think about possible changes to your supply chain and how you might be thinking about that going forward?

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Hi, John. This is Michael. First, I'd say there's no change on how we're approaching raw material. We think this is a temporary dislocation. We've actually been very surprised at the recovery rate in this period. Typically, even if you go back and look at the most severe hurricanes, our suppliers have been able to get online and get back up to full rates pretty quickly this time. They've been significantly challenged and it's been compounded by the lack of transportation equipment; not just equipment, but more importantly drivers.

So, we've had a number of situations where we had to go out and buy spot material and it was challenging to get trucks to be able to deliver that because of the inability of some of our suppliers. So, if you ask me if there's any change we might do, there could be some additional suppliers brought into the mix to provide us some additional flexibility.

But other than that, I don't think there'll be any major changes. But overall, I would say raw materials, the only one that we're currently forecasting to be moderating is oil. And as you saw, oil in the past week has started to decline. So, solvents would parallel the oil price changes. So, that's the only one we have right now in our model.

John Bruno

Vice President-Investor Relations, PPG Industries, Inc.

A

And, John, your first question on our assumptions on raws in the fourth quarter, we would be assuming that on a sequential basis, the third quarter or the fourth quarter, the raws would stay at a similar level. That's our current assumption.

Operator: The next question comes from David Begleiter from Deutsche Bank. Please go ahead.

David Begleiter

Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Michael, Vince, can you quantify how much worse price versus raws will be in Q3 versus Q2? And how much better you think they'll be in Q4 versus Q3? Thank you.

Vincent J. Morales

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

A

Okay, David. This is Vince. I think it's similar to the question John just asked. Again, we gave guidance out, 20% raw material inflation, give or take, in Q3. We did include in the slide packet that was posted last night to our website our initial views of pricing. Those views will be somewhere between 4% and 5% in terms of our price capture. That's still well short of what we need. We typically need 40% to 50% of the inflation to recover fully. So, we're still looking at additional pricing actions throughout 3Q across all of our businesses, all of our regions.

In 4Q, to John Bruno's comment a minute ago, while we expect inflation to remain high, we do expect to remove some of the spot buys that we're doing currently. Those are typically coming at a large premium to traditional pricing or list pricing. And we're still looking at additional price capture or a full realization of the 3Q price capture in 4Q. So, again, on a run rate basis, our target is to get fully offset in 4Q.

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

John Roberts

Analyst, UBS Securities LLC

Q

Thanks. The raw material and logistic comments all seem to be North American-centric. Could you give us maybe a more global view on what you're seeing in the raw material outlook in Europe and Asia?

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Yeah, John, this is Michael. I would actually say that the Chinese raw material inflation was actually higher. That was driven primarily by epoxies, isocyanates. And so, those were the most challenging thing in China, the rapidity or the significant increases that we saw in China have kind of leveled off at this point in time.

I would say in Europe, they are also coming up, but not quite at the same rate as China. Availability in Europe is better than availability in the US, but still not great. Availability in China is there if you're willing to pay for it or spot. So, we've been really pushing our customers hard.

If they want to buy more than contract, that they need to pay extra for that additional volume. And so, from that standpoint, we've been working closely with our customers on this additional raw material inflation. And I would say for Latin America, it kind of mirrors the US market.

Vincent J. Morales

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

A

And, John, if I could just add, we are seeing with oceangoing freight, some of that has been significantly delayed. So, even though if there's availability and it's a product that's being ported around, it's not showing up in time. So, again, that's exasperating some of the issues.

We expect, again, a lot of these logistical issues to begin to self-correct in the third quarter. Q2, we have to remind everybody, Q2 is typically the peak quarter for a lot of companies, lot of industries. Q3, things start to moderate in terms of overall global economic demand from a seasonal perspective. So, again, we expect some of this to self-correct.

John Roberts

Analyst, UBS Securities LLC

Q

Thank you.

Operator: The next question comes from Stephen Byrne from Bank of America. Please go ahead.

Stephen Byrne

Analyst, BofA Securities, Inc.

Q

Yes. Thank you. Wanted to drill in a little bit about the MoonWalk rollout in Europe. You mentioned 750 installations. Can you put that into perspective? Like, how many auto body shops are there in Europe? Is 750 just scratching the surface? Or is this meaningful? And with respect to the 20% that's new customers, are you primarily targeting new accounts and share gains with this technology? And any comments on the outlook for share gains would be helpful here.

Vincent J. Morales

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

A

Yeah, Steve, this is Vince. If you look across Europe and the US, there's thousands upon thousands of body shops. So, this is a small percent relative to the total universe. I think, for us, what's most exciting is every one of these we can make and get to market is immediately sold. We have a backorder – significant backorders in Europe. We're moving this now to the US.

We are certainly providing our existing customers who value the speed that this provides for their paint shops, who value that productivity, we're providing them with the opportunity to purchase this first, but we do have an allotment of these that are really focused on new customer wins. And I think as we roll out kind of this 80-20 strategy, we're going to continue to see customer wins around this body shop productivity, which the premium shops, the MSOs prefer. That's their business model. So, still early innings here, but we're exceptionally pleased with the traction this is getting. And we'll continue to update you and continue to roll out more MoonWalk devices as we go forward.

Operator: The next question comes from Mike Sison from Wells Fargo. Please go ahead.

Michael Sison

Analyst, Wells Fargo Securities LLC

Q

Hi guys. Good morning. In terms of the raw material pricing gap, any thought between each of the segments? Are there some segments a little bit better off in terms of getting pricing and closing that gap? Are there other segments that are doing – might take a little bit more time to close the gap?

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Yeah, Mike, this is Michael. So, I mean it's a traditional PPG model here. So, the gap is the largest in automotive for two reasons. One, they had the biggest inflationary gap. And the second is, it's most difficult to get price increases with the automotive guys. But I am very pleased to announce that we have gotten positive price in every automotive region in the world.

So, we are making good progress there and well ahead of where we were in 2017, 2018. I would say the next inflationary would be in our Industrial Coatings business. They also buy a lot of epoxies, isocyanate. So, they would have been hit second most difficult. The business that's impacted the least is aerospace due to the raw material mix we have there.

The place that we probably have closed the gap the most is architectural. We're working also hard on traffic solutions. This is a business that historically price was a secondary thought. We've elevated that in this business, and we've been very pleased at the pace of recovery in our traffic solutions business.

So, I don't think it's any different than what we've seen in years past. And I think we're going to continue to push hard to close that gap with our automotive customers. And that's – I'm really pleased when you think about where we are in this cycle versus where we were in the last cycle, it's light years apart.

Operator: The next question comes from Jeff Zekauskas from JPMorgan. Please go ahead.

Jeffrey J. Zekauskas

Analyst, JPMorgan Securities LLC

Q

Thanks very much. I think at the end of the last quarter, you thought that you would earn between \$2.15 to \$2.20 a share. When did you realize that you wouldn't be able to do that? Was it something that happened at the very end of the quarter or in the middle of the quarter?

And in the misassessment of how much you might earn in the second quarter, what were the real sources of that? Was it an information issue? Or did it turn out that raw materials really rose very, very quickly in June? Can you talk about the history of the way you assessed the quarter over the past couple of months?

Vincent J. Morales

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

A

Yeah, Jeff, this is Vince. So, if you look, we came out early in April, we were one of the early reporters in April. It was directly after the weather event in Texas. At that point in time, we were hearing from our suppliers and, as Michael alluded to earlier, that this would be a multi-week startup or restart-up.

As we progressed through the quarter and especially in June, we continued to see outages and escalation of raw materials, specifically in the June time period, which is why we're seeing Q3 higher than Q2 in terms of our raw

material estimates. We continued to see outages, particularly around transportation. Those outages continued to worsen, especially in June. And our customers continued to have spot production curtailments from their perspective.

So, as we were in June, we continued to see the automotive market be heavily impacted by chip shortages and a lot of customers in that particular industry who had earmarked Q3 for some downtime actually took it in Q2. So, as we went through the quarter, we saw the difficulties continue to grow. So, that really was the timeline. And again, as you look at our guidance for Q3, you could see some of these things are going to certainly carry forward into the third quarter that we were not anticipating. We were anticipating them being rectified some point in mid Q2, certainly not even before late Q2.

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

And, Jeff, this is Michael. I would say we're disappointed that the raw material inflation [ph] continuing its (28:40) high level throughout the quarter. And it just seemed to get worse. And when you bank on your suppliers saying they're going to get you 20 trucks and they get you 10, that doesn't help you. So, we own up to this raw material inflation miss, and that's our accountability.

Operator: The next question comes from Prashant Juvekar from Citi. Please go ahead.

Prashant Juvekar

Analyst, Citigroup Global Markets, Inc.

Q

Yes. Hi, good morning. Michael, given the shortage of raw materials, are you able to make enough paint product? And where do paint inventories stand in the supply chain in your stores, for example, or in the MSOs and refinish? And if paint inventories are below normal, could there be sort of paint restocking cycle some time in second half or next year? Can you talk about that?

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

So, P.J., I tried to cover that in our opening remarks. Inventory levels in all our businesses are at exceptionally low levels. You saw that in our working capital numbers. I've actually asked our businesses to share with me the amount of product they made in April, May, June and versus how much of that went out the door, and virtually everything we made went out the door. So, inventories have gone backwards for us.

We see very low inventories in the chain, in many of our customers as well. So, if you look at our architectural guys, they typically don't carry a lot, but they have even less. If you look at our industrial customers, I've had more calls from customers directly to me in the past quarter than I've had in the past probably three or four years.

So, customers have low inventories as well. I do think [ph] that it will (30:34) be a restocking. Of course, as you know, in aerospace, inventories, I would say, are at rock bottom because they couldn't afford to buy anything previously. And so, they're trying to stock up now ahead of what they anticipate as increased demand. So, I can't really think of a single one of our businesses that have any kind of a material inventory either on the shelf or at our customers.

Vincent J. Morales

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

A

And, P.J., this is Vince. If you look ahead, we do think again there's very good underlying demand in many of the markets that we supply, automotive being a proxy, as we talked about earlier. There's several steps where we see automotive sales continuing for multiple quarters. There's a restock that will take place just to get back to normal safety stock levels in our customers' inventory. So, we feel good for the next several quarters about the ability to sell product or our customers' ability to sell product, more so than we have for quite some time because of this very strong underlying demand around the world.

Operator: The next question comes from Frank Mitsch from Fermium Research. Please go ahead.

Frank J. Mitsch

Analyst, Fermium Research LLC

Q

Hey, good morning, folks. Michael, you mentioned during this call that you maintain enough flexibility to do accretive cash deployment. And so, as I'm listening, there's a number of comments in the release and the transcript on this call today that says, you guys are very constructive on your outlook. So, I was just curious as to what extent might you be able to be opportunistic on buybacks.

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Well, Frank, as you know, we always prefer the acquisitions over the buybacks. Clearly, we take a look at this on a monthly basis. You saw that we finished the quarter with about \$1.2 billion to \$1.3 billion of cash. We're coming into our very strong cash period, where we generate a lot of cash in the back half of the year.

I think our current ratio is 2.1. So, from that standpoint and with cash coming in, we're in a good position. There have been a number of the top-30 coatings company have been taken off the board in the last couple of – let's call it, last three or four quarters. So, the availability of targets is probably not as good as it was six months ago.

So, right now, we're going to keep an open mind for that. And we're going to remain balanced in how we deploy cash. You saw that we increased our dividend. We think that was important. Certainly 50 years of dividend increase is a significant milestone. And right now, I would say that I like our acquisition order logbook, if you will, where we stand but pipeline. But overall, I would say, we're going to remain balanced on this viewpoint.

Operator: The next question comes from Laurent Favre from Exane BNPP. Please go ahead.

Laurent Favre

Analyst, Exane BNP Paribas

Q

Yes. Good morning, all. My question is on architectural and the guidance on Q3, with volumes down in both the Americas and Europe. I was wondering if you could talk about, I guess, the different buckets of what's driving that. Is it underlying demand? Is it share loss due to pricing, availability of raw materials, DIY comp, destocking, et cetera? Thank you.

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Laurent, I would say from an architectural standpoint, there's certainly been no share loss. We've been really pleased with how we're performing in architectural. You saw the numbers we reported in both Europe and the US, strong numbers.

So, from that standpoint, what we're looking at is a shift, as we anticipated, would eventually happen of people moving from DIY to trade as people start to go on vacation and start to spend their money, they're going to hire professionals that come in and do that. We see our trade order book increasing to offset the weakness in DIY.

But what I would point out is DIY is still well above 2019 levels. And so, when you combine the two, we're pleased with the outlook on where we stand. And I think the outlook we gave for the third quarter for architectural is quite strong, and we are pleased with the performance of the business.

Vincent J. Morales

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

A

Yeah, Laurent. This is Vince. I would add, we are still in the third quarter expecting to experience shortfalls for coatings raw material supply. So, it is moderating our ability to supply some of our key products, especially on the US side, so trade and DIY. So, that is one of the limiters we do have in terms of our sales outlook.

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

Vincent Stephen Andrews

Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much. Just wondering, we're halfway through 2021, maybe you could give us an assessment of the cost that came out with COVID, the cost that you're able to avoid, as we're now halfway through the year. Could you give any better sense of how much of that's going to come back and when?

John Bruno

Vice President-Investor Relations, PPG Industries, Inc.

A

Yeah, Vincent, this is John. So, we think we're kind of at parity now. There might be some travel and entertainment, just some modest stuff that comes back as things continue to open up. But we felt that on an annualized basis that we could bank – we set on a quarterly basis, \$25 million to \$30 million of temp savings.

We had another \$30 million benefit in the second quarter. So, I think this is something we probably won't talk much more about because at this stage, I think we've made some of these costs permanent reductions and now will just ebb and flow more with our volume and demand activity.

Vincent Stephen Andrews

Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much.

Vincent J. Morales

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

A

And, Vincent, this is Vince. I do think when you look at our multiyear selling, general, administrative cost as a percent of sales, you could not only see the interim savings, as we call these, dropping to the bottom line, but you could also see more importantly the structural savings that we've introduced for a couple years now and those are also benefiting us.

And then on top of that, just to dovetail from Michael on the acquisitions, we do have a significant amount of synergy savings targeted for the five acquisitions. We gave out a target earlier in the year. We're on target for that, although some of these have just closed. So, a lot of those savings will be visible or more visible in 2022.

Operator: Our next question comes from Kevin McCarthy from Vertical Research Partners. Please go ahead.

Kevin W. McCarthy

Analyst, Vertical Research Partners LLC

Yes, good morning. Michael, there's been a lot of focus on automotive as a source of the negative variances. I'm curious, if we put automotive on the side for the moment, would you care to call out other businesses that would have disappointed relative to your prior expectations? And if so, was that more driven by a demand variance or price/cost spread that was spread across many of your businesses?

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

Yeah, Kevin, so the two businesses that were impacted besides automotive the most was architectural due to emulsions and traffic solutions, the same thing. So, we had a hard time getting emulsions and resins from our suppliers. You can't make paint without that. And so, we were hand to mouth on those kind of things despite having significant demand.

If you go into any of our stores or go into any of the big boxes or ask any of the [ph] DOTs (38:56), they would all tell you that all the suppliers are struggling to put paint on the shelves. So, I think that was the most material things. But it is interesting, we didn't track it because I didn't think it would become a material number, but the number of other places that chips show up, whether it's appliances or other heavy-duty equipment, so everybody is being impacted somewhat, but it didn't – it really didn't turn out to be enough of a number to call out. But I would say the two biggest ones are architectural and traffic solutions.

Vincent J. Morales

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

Yeah. And, Kevin, I'll just add, in many of our businesses, automotive obviously, the two Michael mentioned, traffic solutions, architectural, we can even get into aerospace, some of our industrial businesses, refinish, we have a higher order book exiting Q2 that we just could not fulfill. So, our order book, as we alluded to earlier, is very strong. We just got to be able to fulfill that with product availability.

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

Arun Viswanathan

Analyst, RBC Capital Markets LLC

Great. Thanks for taking my questions. So, I guess I just wanted to go back to the last question a little bit and understand, I guess, potentially some of the bridge items for 2022 versus 2021. So, you'll have a full year of accretion on many of the deals, you'll have kind of a normalization in some of your volumes. And hopefully, you will have caught up on price/cost.

So, I think you made the comment that your 2021 EPS is going to be double-digit growth from 2019 levels. Is that a fair starting point when you think about 2022? Just given what you've seen on the cost side, is there opportunities to continue to grow margins as you recover that price/cost spread in 2022 as well? Thanks.

Vincent J. Morales

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

Yeah, Arun, this is Vince. A little bit longer look than we want to do at this point in time. There's still a lot of fluidity just in the economies out there. I think we tried to lay out today some of the positive things we think are in store, not only for us, but the industry, good demand.

We do think PPG-specific, these acquisitions, along with the synergies that come with them, we hope we get to a normal price/cost environment. But it's a little too early to make that call for what the supply chain looks like going into 2022. Right now, we think it will normalize. But it's just early to make all these calls at this point in time of the year.

We certainly feel very optimistic about next year, just given the overall demand outlook. Typically, when you have strong demand, that parlays into positive results, better cost spread on a bigger sales base, et cetera.

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

Duffy Fischer

Analyst, Barclays Capital, Inc.

Q

Yeah, good morning folks. Just wanted to drill down on volume, particularly in Q3, if we can. Vince, you talked about 4%, 4.5% price rolling through. And relative to your low single-digit growth, I mean that's kind of all the growth then that would be in both segments as price, which will mean the volumes kind of flat to maybe down.

And Michael called out \$150 million of kind of foregone sales because of issues, which might add another 4% to that. So, what that would say is kind of the run rate volume growth, looks like it's 3-ish percent in Q3, which feels pretty light given how early we are in the cycle. So, can you just talk about what you think the underlying volume growth is in your businesses kind of Q3? And then how has that set the table then for continued volume growth the rest of this year into next year?

Vincent J. Morales

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

A

Yeah, Duffy, I'll try to give this a shot, a lot of numbers there. Look, when you look by business, we're still constrained, as Michael alluded to, on our ability to fully satisfy our order book. We expect that to continue well into Q2, if not fully through Q3. Some of our customers are still well-constrained on their ability to produce. So, again, we gave out the guidance of low single-digit organic growth. And we think there's a lot of moving pieces in there.

What, again, I'll just pass through to you is our confidence level that we're not going to be able as an industry to supply the demand that's out there even by the end of Q3. So, how these pieces come together Q3 versus Q4, we'll still see how that's determined. But very strong underlying demand, recovery demand occurring in aerospace, starting to occur in aerospace, some demand in refinish as traffic miles pick up. So, we're just confident there's underlying demand there, and we just got to be able to fulfill it.

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

Robert Koort

Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning. Michael, Vince, I think you guys talked about having to go into the spot market for procurement. How tolerant are your customers going to be of that as a basis for price hikes and sustaining price hikes then into next year as some of those spot markets start to normalize a bit? What gives you the confidence

you can retain those price hikes? And is there any scope for you to use the force majeure impacts that you suffer to somehow pass those along on your own terms of your customers? Or is that just something that doesn't happen? Thank you.

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

No, Bob, this is Michael. We have been aggressive in trying to get our customers pay for the additional freight charges that are, if they want to move up orders, if they want us to buy from spot people in order to keep them running, we have gone to them and asked them to pay for that. But that's a portion of the overall raw material increase. Even without the spot, we would have still been 15% to 17%. So, these are real increases. They're seeing them in their own cost structure as well. So, they're not able to debate whether or not we're having these things.

So, as Vince alluded to earlier, we need to get about 50% of the overall increase. And so, we've been out there with some very significant increases. And I think we're making a lot of progress in that regard. Clearly, we'd like to have moved faster. But when I look back on 2017, 2018, we're well ahead of that. So, I think the customers are very understanding of this. And what it takes is the whole market to move to capture it. And we've been out early and often, and we'll have to continue to do that in 3Q and 4Q.

Vincent J. Morales

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

A

And, Bob, I'll just add, most of our customers are facing similar issues beyond just coatings, and they're trying to supply their customers and they're short of product as well. So, this is a pervasive issue that's well-known across the materials and industrial spaces. And our customers are seeing inflationary pressures from a variety of different industries. We're one of those industries, of course. And so, again, the acceptance level, as Michael alluded to, is higher today than it certainly was in past cycles.

Operator: The next question comes from Mike Harrison from Seaport Research Partners. Please go ahead.

Michael J. Harrison

Analyst, Seaport Global Securities LLC

Q

Hi, good morning. I had a question on the aerospace business. Within the aftermarket business, do you have situations where some of these aircraft have been mothballed for several months and they need significant maintenance or even repainting before they return to service? Maybe just talk a little bit about how that aftermarket business' recovery is playing out.

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Yeah. So, the easy one is on the repaint side. They don't need repainting per se. But if a customer had returned planes to the lessor, those planes may be returned in a white format. So, we have been painting a lot of planes white during the pandemic. Now, we're not painting any white right now because they're going to be returned to service. So, there will be a pickup of that. Also, what we historically find is after events like this, you will see some rebranding being done. So, we're anticipating that will also happen maybe in 2023, 2024.

But overall, right now, when you take a plane out of storage, if it was properly stored, there is some maintenance they need to do on it before it goes back into service. But then they don't have to do the big heavy checks that they do at the big maintenance cycles. But overall, inventories are exceptionally low.

Our order book in – or I should say our book-to-bill ratio has improved significantly in aerospace. Our backlog has increased. And so, right now, the biggest challenge we have in our aerospace business is labor, making sure we get enough qualified labor to work in the plants to be able to get the product out the door.

So, we're feeling very good about aerospace on the MRO side. We're not there yet, obviously, on the OEM side. Builds are picking up slightly on the 737. They're picking up slightly on the A321. But for the bigger birds, they're not picking up at all and we don't anticipate seeing that range pick up until 2023 time period because of a lack of international flights.

Operator: [Operator Instructions] The next question comes from Jaideep Pandya from On Field Investment Research. Please go ahead.

Jaideep Pandya

Analyst, On Field Investment Research LLP

Q

Thanks a lot. Just a question really around the logistics. So, obviously, there's a significant increase in container rates out of China. So, as and when the container rate or rather logistics situation sort of normalizes, do you expect a sharp reversal in some of your raw material basket?

Because if I think about oil, it has only gone up, let's say, call it, circa 20% in the last quarter, but some of your raw materials have more than doubled. And literally volumes that are coming out of China into Europe and US are – gone down a lot in all the raw materials. So, once the container rate situation normalizes, do you see a sharp reversal of raw material dynamics? Thanks a lot.

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

Jaideep, this is Michael. I would say the container rate is only a portion of the overall raw material spend. The bigger challenge overall has been the supply/demand issue for the base raw materials. Certainly, we're not happy with the container prices. It has escalated significantly. But if we could get the overall base supply/demand balance back in balance, if you will, in our supply chain, I think prices would start to normalize somewhat.

We don't see that happening in 2021. So, right now, we're still anticipating significant inflation, when we said it's 20% in Q3 and we'll have significant inflation in Q4. So, for as far as we can currently look out, we're still looking at a pretty inflationary cycle.

Vincent J. Morales

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

A

Yeah. Again, this is Vince, if I could just add. So, what we've seen is a compounding of events here. One was, obviously, the shock in March to the chemical supply chain. That was then compounded by the logistics – the logistics systems got out of sequence, which was then compounded by some of the international logistics, not only got out of sequence, but were higher priced.

So, these kind of chain events is what really pushed these raw materials up. Some of that will unwind as we get out of the season. As I've said earlier, Q2 is the peak season. But we do expect these raw material costs to remain elevated for the balance of the year.

Operator: The next question comes from [ph] Edlain Rodriguez (51:46) from Jefferies. Please go ahead.

Q

Thank you. Good morning, guys. Michael, quick questions. I mean, one quick one about medium-term volumes. So, when you look at the couple of businesses that are still below pre-pandemic level, do you have a sense of when they catch up? I mean, essentially, given the pace of activity you're seeing, do you get there in 2022? Or is it more like 2023 or so?

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

A

The only business that will not be recovered by 2022, in my opinion, is aerospace OEM. So, aerospace MRO will probably be 90%. In fact, certainly, the military is already back. Refinish, we saw last year when – when Europe opened up, we saw the refinish miles in Europe come back very strongly. So, we're anticipating the same thing as they get the vaccines out, that we anticipate the back half of 2021 will recover significantly. And by hopefully all of 2022, Europe will be back to normal.

We see in the US already, we're at 90-plus percent recovered in refinish. And actually, what you're seeing is a little shift from traffic from the cities into the suburbs. So, collisions are actually improving every month here in the US. And, of course, in China, it's all the way back to normal. And we see a snapback in India whenever we see the folks get allowed to travel again. So, most places, it is vaccine-related. And so, we're pretty confident.

And if you go through the rest of our businesses, we're already back in industrial. We're mostly back in automotive. Our packaging business is well ahead. The demand in aluminum packaging is very strong. So, our packaging business is going to have another record year this year and next year.

If you look at our PMC business, protective, now that oil prices have recovered, I expect protective to continue to recover as well, as they start to protect these high-value assets in the oilfields. So, I'm very comfortable that we're going to have a strong back half of the demand for 2021 and a continued demand recovery in 2022.

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

John Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Yeah. Thank you, Jason. I'd like to thank everyone for their time and interest in PPG. This concludes our second quarter earnings call.

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

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