21-Oct-2021

PPG Industries, Inc. (PPG)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Jason and I'll be your conference operator today. At this time, I would like to welcome everyone to the PPG Third 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]

I would now like to turn the conference over to John Bruno. You may begin your conference.

John Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Jason, and good morning, everyone. We appreciate your continued interest in PPG and welcome you to our third 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 Wednesday, October 20, 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 you to our third quarter 2021 earnings call. I will provide some comments to supplement the detailed financial results we released last evening.

For the third quarter, we achieved record net sales of nearly $4.4 billion and our adjusted earnings per diluted share from continuing operations were $1.69. As we communicated in early September, our sales and adjusted EPS were significantly impacted by worsening supply chain disruptions and increasing raw material cost inflation. Our raw material costs in the quarter inflated by about 25% year-over-year. For context, this is about three times higher than any previous coatings raw material inflation peak in recent history.

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We're also experiencing elevated logistics costs and are incurring increased manufacturing costs due to the sporadic nature of these outages. Commercially, we have taken significant mitigation efforts due to the high level inflation through rapid implementation of structural selling price increases.

In aggregate, our selling price realization is about 6%, with more than 6% price realization in our Industrial reporting segment. Our price capture pace is much faster than previous inflationary cycles and we have further pricing initiatives underway.

Coming into the quarter, we expect that the supply chain and customer production disruptions would impact our sales by about $150 million. However, this actual impact was more than $350 million. Additionally, this prevented us from completely fulfilling our strong order books and further depleted retail inventory in many of our end-use markets. We expect much of this demand will be deferred into 2022 and in particular, these current conditions will elongate the global automotive OEM recovery.

To put the automotive OEM situation in perspective, US dealer inventories are at record historical lows in the mid-20 day range. And in 2021, global production in this industry is expected to be about 20% below prior peak levels. Despite the current challenges, several of our businesses, including our automotive refinish, protective and marine, and packaging coatings delivered strong above-market performance, driven by our strong service capabilities and advantaged technology.

Our PPG Comex business achieved record third quarter sales with year-over-year organic sales growth of more than 10%. In addition, our US architectural coatings business delivered about 10% same-store sales growth as we continue to expand our customer base with many new wins and increase our digital sales as a percentage of our total sales base. More generally, we continue to experience improving trade painter demand globally and architectural DIY coatings sales returned closer to 2019 levels after notable growth last year, driven by the stay-at-home impacts.

We remain focused on cost management, which is evidenced by our SG&A as a percent of sales being 100 basis points lower than the third quarter 2020. This is being supported by our ongoing execution on our structural cost savings programs as we delivered an incremental $35 million of savings in the third quarter. We continue to target and on track for our full year 2021 savings of about $135 million.

In the quarter, we also continued to make good progress integrating our five recent acquisitions, contributing to our overall earnings for the quarter. Our two larger acquisitions, Tikkurila and Ennis-Flint, delivered good top line results despite the challenging supply constraints. We continue to expect them to deliver an aggregate of $25 million of synergies for the full year of 2021.

We once again delivered strong operating cash flow during the quarter and had about $1.3 billion of cash and cash equivalents at the quarter end, including sequential reduction of our net debt by about $400 million. This was supported by our continuing strong working capital management as we maintain our positive step change improvement achieved last year and are at multi-year lows on a percentage of sales basis. While we will continue to evaluate accretive deals in our M&A pipeline, we are initiating stock repurchases in the fourth quarter, and we'll continue to focus on debt reduction. As a reminder, based on the seasonality of our businesses, the fourth quarter is typically our strongest cash generation quarter of the year.

Also during the quarter, in support of further enhancing our ESG program, we were happy to announce an agreement with Constellation Energy to power our Carrollton, Texas manufacturing facility with 100% renewable

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solar energy. We are also working on our very first ever diversity report and developing science-based climate targets, both of which we will communicate in 2022. Equally important is PPG's market-leading sustainable products continue to enable our customers to meet their respective sustainability goals. We will continue to provide updates on these initiatives on subsequent quarters.

In addition, I'm extremely pleased to announce that yesterday, PPG earned three R&D 100 Awards for 2021. The R&D World Magazine honors the 100 most innovative technologies and services over the past year with the R&D 100 Awards. Even more importantly, two of the three innovations that we were recognized are growth initiatives in electric vehicles, including BFP-SE Battery Fire Protection coating, which protects the vehicle occupants from fire and mitigate thermal runaway events plus Envirocron Extreme Protection thermally conductive dielectric powder for battery packs, providing dielectric protection and thermal conductivity.

Our dielectric powder has already been commercialized by a leading EV maker and our battery fire protection product will launch in 2022 by one of the world's largest car makers.

Moving to our outlook, we are continuing to evidence solid demand in aggregate. Many of our customers continue to indicate that their order books are at high levels and have lower-than-normal inventory levels. In the near-term, we anticipate only modest improvements to the supply disruptions that we've been experiencing.

Our estimate is that our sales are expected to be unfavorably impacted by about $250 million to $300 million in the fourth quarter, both from the semiconductor chip shortage issue and chronic supplier operational capabilities. Recent production curtailments in China may add incremental pressures to availability and inflation, and we expect our inflation to approach 30% compared to the fourth quarter of 2020.

As a result, all our businesses are securing additional selling price increases, and now we expect to fully offset raw material cost inflation in the early part of 2022. We continue to strongly believe there is sufficient capacity available in our supply chain as operating conditions continue to normalize. Absent any further disruption, we expect supply chains to operate more normally by year's end, supported by normal seasonality trends.

To provide further assistance and assurance of more consistent supply going forward, we are rapidly qualifying additional regional and global commodity suppliers across a variety of our key raw material procurement groupings. We expect these increases in product availability, coupled with continued improvement in the existing supply chain will provide ample supply beginning early in 2022.

While the current environment remains difficult to predict, I remain very optimistic about our specific growth catalyst for 2022. Specifically, we expect continued recovery in automotive refinish, OEM and aerospace coatings, which collectively account for about 40% of our pre-pandemic sales where we have broad global businesses supported by advantaged technologies. We expect a measurable rebuild of inventories in many of our end-use markets. Specific to PPG is year-over-year earnings growth in 2022 due to further synergy capture from our recent acquisitions.

In closing, these continue to be dynamic times, but thanks to our more than 50,000 employees around the world, we are well positioned today and in the future. Their dedication and commitment to make it happen are reasons why our customers, our communities and our many stakeholders can count on us to protect and beautify the world. Thank you for your continued confidence in PPG. This concludes our prepared remarks.

Now, Jason, would you please open the line for questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Chris Parkinson from Mizuho. Please go ahead.

Christopher Parkinson
Analyst, Mizuho Americas LLC

Q

Great. Thank you very much. Michael, obviously, there's been a lot going on in the industry both in terms of raw material inflation as well as input shortages. If we start there, particularly on the shortages aspect of it, can you just offer your general views as we approach 2022, what's changed in the past 12 months, what offers confidence? And then also, are there any differences on how these variables are affecting results at the segment level? So anything would be greatly appreciated. Thank you.

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

A

Well, Chris, I would say, starting with the segment levels, the most impacted, of course, are architectural, our traffic solutions business, our automotive OEM and, quite surprisingly, our Industrial Coatings, because there are a lot more chips than people realize in some of these things like appliances and other electronic materials, heavy-duty equipment, things like that. So those were the businesses most impacted.

What I see though is, obviously, it's in our suppliers' best interest to continue to sort out their supply chains. And seasonally weak fourth quarter should give them adequate time to do that. Now the flip side is we have an extremely large backlog of demand right now. So anything that they can make in the fourth quarter, we're going to ship. So we feel very good about that.

As you know, we've been a little bit more pessimistic and probably right about the supply chain issues. And so, we have put in, like we said on the call, an expectation of further challenges in the fourth quarter.

Christopher Parkinson
Analyst, Mizuho Americas LLC

Q

That's very helpful. And just kind of staying on the topic, it seems demand is fairly strong and kind of building into 2022 and the supply chain disruptions, obviously, are creating a lot of noise in the second half. When you take a step back, look at your own order books, your own customers' outlook, can you just quickly touch on just how you're thinking about 2022 and maybe even perhaps on the longevity into 2023 in terms of the volume recovery aspects for auto refinish and aero? And then also perhaps touch on the sustainability of momentum in both general industrial and packaging. Thank you very much.

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

A

Okay. Well, that's a mouthful. Let's start with auto OEM. Clearly, if you look at the inventory in the US, we're down about 1.5 million cars from where typical is. Inventories in China are less than one month as well. They're probably in the 25-day range. So that's 15 days less than they typically have. Europe has not been able to supplement what they need. And when you think about fleets, not just rental fleets, but fleets in general, they're short as well. So there's significant OEM demand out there.

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I would also tell you, from the refinish side, we can always tell when the lockdown's in, in every country, because driving comes up and collisions come up and demand comes up. And there's very little inventory in the chain from that standpoint. And so, we see that also being a strong positive.

And then, I guess, finally, I would tell you from aerospace, we see strong order books on the small plane. So A320s and 737 builds are going to come up. Once you start to see some international travel, then I expect Airbus and Boeing will get back to building the bigger planes.

MRO is improving monthly. And now that Europe is getting a little bit more open, we expect MRO to improve even better. So our catalysts for 2022 are strong and if you then start building 787s on top of that, then our catalysts for 2023 get even better.

Operator: The next question comes from Ghansham Panjabi from Baird. Please go ahead.

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

Q

Thank you. Good morning everybody. I guess, sort of stepping back, China was first in, first out from COVID, also led the global economic recovery over the past year. Subsequently, the macro headlines and some of the recent data out of China are confirming quite a bit of a slowdown. So, first off, what are you seeing in the region on a real-time basis occurred?

Second, how do you see China evolving over the next couple of quarters? And I guess, just more broadly, Michael, how are you thinking about the current inflation cycle impacting your expected recovery over the next couple of years given that consumers will ultimately have to bear all these massive cost increases? Thank you.

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

A

Well, Ghansham, let's start with China first. So, maybe I think you're aware of this, but maybe some of the other folks on the call aren't. Our plants typically in China are running two shifts today, most of them, not all of them run three. And so the dual control issue that's happening in China where they're trying to reduce the amount of energy consumed as well as the energy per unit, we're in a very good position to be able to run off hours and consume the cheaper energy off hours. So that helps us from that standpoint.

Industrial demand is down in China right now, but it's as much from lack of raw materials as it is from demand. As you know, we're not very big, in fact, I would say, almost negligible in the project market for architectural. So, the challenges in that market are really not going to hurt us from that standpoint.

But our kitchen and industrial bakeware business, our electronic materials business, our automotive business are all in good shape over there. Our packaging business, double-digit kind of demand. So, I feel good about China, both short-term and long-term, and I think we have the team that can help us manage through the challenges that are over there.

When I think about the higher prices today, I start first with, let's say, oil is $80. Well, $80 historically is not a high number. It would be a – what I would say is, if you say $70 has been the average, it's only marginally higher. So, from a structural cost perspective, I think our consumers are going to be able to continue to have strong demand. So, I'm not worried about that.

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

John Roberts
Analyst, UBS Securities LLC

Q

Thank you. Because the price increases are so large and happening so quickly, we're getting a bigger divergence than normal between the year-over-year price changes reported by the different companies. Maybe comment a little bit on where the differences are, maybe between you and some of your key peers by region or application or is it just timing differences, Michael, that's resulting in these different prices?

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

A

Yeah. John, let me just start with the basic way it works. We report peer price and we report it for all our businesses. And so when you look at the business mix, that's one thing to take into account. The other thing is the mix by geography. So, if you have a large percentage in a geography that has hyperinflation, then that's going to impact you.

But more importantly for us, we are on our 18th quarter in a row of price increases. So, we're stacking increases on top of increases. So, one way you might think about this is whether or not somebody might be trying to catch up to where we are and I think that's probably the most important thing.

And the other thing I would say is make sure you look at inflation reported as well as margins. And for us, the ultimate end goal is margins. And I think our procurement team is doing a great job. We have hired people to help us qualify additional raw materials from that standpoint. And so we're in a pretty good shape, I think, from a competition wise.

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

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Thanks, Michael. I'm curious, you mentioned that the supply chain issues could moderate as you go through the quarter, but obviously, still some elevation in run rate on the cost side. So are you starting to see some force majeures lessened? Or what is it that you're seeing that gives you some hope that maybe it improves through the quarters? Is there some tangible anecdotes you're already seeing?

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

A

Well, Bob, the way I would answer that question is, in Q1, we had 95 force majeures that was all eerie, right? And then we only had two in quarter two. And then we have 13 new ones added in the quarter three due to all the Ida issues. And there's been only one added in the fourth quarter. So the pace of force majeures has improved. And at these commodity levels, I know our suppliers, and I've talked to a number of them, are focused on smoothing out the supply chain.

And what I would tell you is they know we can sell, they know we're going to continue to consolidate the industry, they know we're going to win. And so they've been out there protecting PPG as much as they can within the limits of the force majeures. So I see these force majeures starting to decline in the fourth quarter. And so I think we're going to be in a much, much better place starting early 2022.

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

A

And Bob, this is Vince. Michael mentioned in the opening comments. Seasonally, we see a significant downturn in demand for commodity raw materials. So this will allow them to do some catch-up in terms of maintenance, in terms of rebuilding inventory. So we do feel that has a tangible benefit as well entering 2022.

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

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Hey, guys. When I add up the revenue impacts on supply disruptions, it looks like it's nearing $1 billion. And so just curious, how do you think you'll get that back over time? And how long do you think it will take to sort of get the raw materials in place to do that and curious how confident you are about Halloween?

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

A

Was that a Cleveland Browns reference? Is that what you're...

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

A

Mike, it's Vince. I think your math is accurate. Two big components here one, and as Michael mentioned, the semiconductor chip really impacting our automotive and to a lesser degree, our industrial business. We expect that to continue to rectify over the next couple of quarters. So really, we would hope in the back half of – improvement now through the first half of 2022 and then more normalcy in the back half of 2022.

The other side of the equation is the commodity supplier force majeures that Michael just alluded to. We're expecting that to largely rectify in the beginning part of 2022. We will be able to supply our customers and more importantly, rebuild inventories, which is a piece of the equation that's missing here. So those shortages we're seeing in 2021 will go back into our customer inventories throughout the year of 2022. So we're confident the demand is there and runability issues and supply constraints around chips should be resolved in the coming quarters.

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

A

And I guess, Mike, I'd finish by saying that it won't surprise us to see you in a black and gold jersey once again after Halloween.

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

Stephen Byrne
Analyst, Bank of America Merrill Lynch

Q

Yes. Thank you. So about a decade ago, you had a string of four or five quarters with mid-single digit price increases. And here you just put up a 6% or you have some – quite a different situation here than you did a decade ago. And I just would like to hear your view on whether something of that same trend might be repeatable with a string of mid-single digit price increases? Or could they potentially be higher than that given the raws you're

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talking about going from a 25% year-over-year hit to 30% in this fourth. And you're talking about being able to offset it in early 2022, does that seem like a reasonable assumption on our end that those price increases are going to get pushed even higher?

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

A

So, Stephen, we tried to convey that in the slides that we published last night. We're expecting to have a higher increase in the fourth quarter than we did in the third quarter. And I would say that is essentially already in place. So, it's just a matter of what it rounds to, but it's going to be higher than the 6% that we posted in 3Q.

And in the first quarter, there will be additional price increases as well. So the magnitude of the increases are historic, but so is the amount of inflation. Our teams feel very good about this. Our customers are well aware of what's going on. They also need product. They're also facing logistics challenges. They're also facing raw material challenges, and they buy a number of the things that we buy, maybe not to the level that we do, but they understand it.

And so I feel very confident that we're going to continue to put up historical price increase numbers that will help us when raw materials moderate. This will be a significant catalyst for continued earnings growth going forward.

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

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Thank you for taking my question. Maybe just another one on the price versus raws dynamics. So you're looking to kind of catch up in early 2022. Is that all on the premise of pricing? Or do you expect some raw material relief as you start to get into the first quarter or so of 2022? And I guess, somewhat related to that, you've got about $500 million worth of sales tied to M&A in the third quarter. I guess, sometimes, it takes a little bit of time to get the pricing wheel of an acquired asset working. So, I guess, can you speak to the pricing that you're seeing in the businesses that you acquired and if there's maybe a catch-up phase of that as we look to 2022? Thanks a lot.

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

A

Yeah. John, I'll take the first part of the question, I'll let Michael handle the second part on acquisitions. We're in a position now where we believe the inflation levels are cresting. We have 30% targeted inflation in Q4. The supply constraints, as we alluded to earlier, we think, are going to abate somewhat.

And so, again, our goal is to get pricing up to offset this high level of inflation. And some of this will moderate, and we are starting to see some signs of moderation. But, again, given the tightness of the supply chain right now, it's not coming through in absolute percentages, but we are starting to see in certain raw materials, some abating.

For us, though, I think what's most important is we've gone after structural price increases. The vast majority of the pricing that Michael alluded to, the 6% in Q3, almost all of that is structural in nature. So we're changing unit pricing as opposed to surcharges. We think that's appropriate to do. So those structural price increases will remain as we head into 2022 and throughout the duration of 2022.

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

A

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And John, with regard to the acquisitions, Ennis-Flint, the highest they'd ever achieved price prior to our acquisition was 2%. And they did not have, what I would call, a structured program to analyze what was going on and a structured program to get price increases out in a real-time basis. We have significantly improved that, and we have a PPG legacy leader running that business now, and we are really excited about what that future holds.

Myself and Tim Knavish were in Europe, like within days when Tikkurila closed. That was the first thing on the agenda, was pricing. We were much further ahead in the price increase. We've already done our second price increase in architectural Europe. Prior to us acquiring Tikkurila, they were on their first increase. They are now catching up. They have put in place new processes that will allow them to better process not just raw material inflation, but also the value creation that we bring to the market with our new technology. And I feel very comfortable that we're on top of that, and we are in a good position, not only with the increases we've announced for the fourth quarter with the legacy Tikkurila products, but also the first quarter increases that are to come.

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

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Good morning. Given all of the dislocations in the external environment that we've been discussing, it struck me that your fourth quarter EPS range was quite narrow at plus or minus $0.03. And so in that context, I was wondering if you could talk about material upside or downside risks if it turns out that you did materially better or worse when we see the results in January. What do you think the potential drivers of those variances could be, based on what you see today?

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

A

Hey, Kevin, this is Vince. We're typically announcing earnings a week or so earlier, but due to the way the calendar fell this year, we're 20 days, three weeks into the quarter. October is a very large month for most coatings companies in the fourth quarter just due to seasonality. We've got a good read on October. We've got a good read on the next couple of weeks, at least, of demand and our ability to supply.

So just given the size of the first month plus as it waits on the quarter, we have some level of confidence. That being said, things that could push it up or down, again, as Michael alluded to earlier, everything we can make today we could sell. So, if we do get more raw materials, we are able to manufacture more, that would be a positive for the fourth quarter.

As you alluded to, Kevin, there still could be some things out there that could suppress the ability to get raw materials like logistics and that would be a negative. But we think all the other variables, we have a fairly good handle on.

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

Laurent Favre
Analyst, Exane BNP Paribas

Q

Yes, good morning. I've got a question on capital allocation. Nippon just announced the Cromology deal this week. Michael, I think you just talked about resuming buybacks in Q4. So, I was wondering can you assume that the M&A pipeline is getting thin. And can you give us a sense of the overall envelope for the buyback you've got in mind for the next 12 months?

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

A

Yeah, Laurent. So, first of all, I would not say the M&A pipeline has slowed down. In fact, I would tell you that, that has picked up because of the high prices that have been paid, so there's more interest out there.

What we said about the buyback is, first, we think PPG is a structurally sound company. We think the current price on PPG is undervalued and so we're going to buy some shares back. So, that's the first thing.

The second thing is we also generate a lot of cash in the fourth quarter. That's our strongest quarter for cash. So, we're going to pay down debt as well as buy back stock. And we're in good shape as we look at the pipeline for acquisitions. So, I don't think it's any more complicated than that, so.

Operator: The next question comes from Aziza Gazieva from Fermium Research. Please go ahead.

Aziza Gazieva
Analyst, Fermium Research LLC

Q

Hi guys. So, you're calling for 30% inflation in the fourth quarter. But could you put an estimate on your current read for inflation for 2022 versus 2021? Vince mentioned that some of the raws are abating, but which products are still a particular concern into 2022? Thank you.

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

A

Yeah. I'll handle the macro, and I'll let Michael talk about some specifics. But again, when we look at the raw material basket in aggregate, we do feel it's cresting. We'll have some year-over-year inflation in Q1 just because we didn't have the level of inflation in Q1 this year. So, there'll be some year-over-year comparisons. But the absolute prices on raws, we feel, will hold as we go into 2022. And Michael, you can talk some specifics, please?

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

A

Yeah. Aziza, I would tell you that the three items that I'm paying particular attention to are epoxies, emulsions, and isocyanates. Emulsions, in particular, have been elevated purely due to the inability of the suppliers to run their plants. It was impacted by Ida as well because a couple of raw material suppliers there were impacted down more than a month due to that. And so once they're back to normal rates, some of the stress on pricing, I think, will start to come back down, so that's one.

The epoxy, especially in China, I'm anticipating that they will moderate the pricing demand as we get into the fourth quarter with seasonality, and that will provide some relief.

And from an isocyanates, we did have some force majeures in that area. That will be coming off, I think, in the very near-term. So, those are the ones I'm paying attention to.

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

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

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Great. Thanks for taking my question. Just a two-part question here. So first on margins, just wondering, obviously, there's a lot of volatility, and it's going to depend on price capture versus raws. But how should we think about margin recovery next year? Is there anything special that you have as far as cost reduction buckets or anything that would be specific that you could call out?

And then secondly, I was just curious on your comments on EVs and beverage cans, two areas that have been robust. Have those been impacted? I know that you called out some supply chain disruptions there, but have those been disrupted from a structural standpoint on demand? Or is it just transitory? Thanks.

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

A

Yeah. Arun, I'll handle the margin question, and I'll let Michael do the commercial side here. If you look at – we're projecting – we'll give obviously more numbers out in January on our fourth quarter earnings call. But we do have an active restructuring program. We're part of the way through that program.

2021 savings on that are in the $130 million range. We would expect additional savings in 2022, as we continue to execute against the actions that we have previously outlined for that. And again, we'll give a number on that in January. More importantly and idiosyncratic for PPG, we do have synergy capture next year, typically 12 to 15 months after an acquisition, we start to realize additional structural synergies. Again, we'll give a number out in January. But those are two elements to the margin expansion opportunities on the cost base.

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

A

And then, Arun, I'd tell you, on EVs, obviously, you saw how Tesla performed last night when they reported. And I would tell you there's virtually all of the global guys are very dead serious about improving their EV at a faster rate than what the current projections are. I don't know if you saw it yesterday, one of the largest EV producers in China, even though the government says they want a 20% by 2025, this particular company said they expect it to be 35% by 2025. So the momentum in EV continues to build.

From the beverages, that is going to continue to be strong. We're up double-digits in beverage, and there's – I've actually lost count of the number of plants. I think there's either 13 or 14 new plants that are in the process of being built. And those new plants will need a lot of coatings. And we are winning more than our fair share in that beverage space. So I anticipate beverage to continue to be strong as people shift away from single-use plastic into recyclable beverage containers. So I'm looking for that to be a long-term sustainable play.

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

David Huang
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. This is David Huang here for Dave. Can you talk about why you're below the IHS auto build forecast in Q4? And how much of an EPS impact is from that lower forecast? Thanks.

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

A

Yeah, thanks. This is John Bruno. So I remind everybody, going into 2Q and 3Q, PPG has been below the IHS forecast, and I think we've come out ahead in terms of accuracy. We do see things improving. We just don't see

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the velocity of improvement that IHS is forecasting for the fourth quarter. We see more of a gradual recovery into 2022.

Operator: The next question comes from Kevin Hocevar from Northcoast Research. Please go ahead.

Kevin Hocevar
Analyst, Northcoast Research Partners LLC

Q

Hey, good morning, everybody. You mentioned DIY paint demand being back to 2019 type levels. So, do you think that the underlying demand is back to 2019 for DIY paint? So do you think that the supply chain issues are what's holding that back? Or, yeah, I mean, has there been – is there just been, because things were so robust, the pull forward of demand? And, yeah, I'm curious of your thoughts there and how do you see it going forward.

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

A

Yeah. Kevin, it's moving back toward 2019. It's still above it. But actually, if you go into a Home Depot, you'll see how bare the shelves are. I mean, there's just not enough paint out there and that is a challenge for our partners. Menards certainly would like to have a lot more paint than they're getting right now. So, we're working hard to try to meet our big box customer needs. So, I actually do think that there's more upward potential there as the supply chain normalizes.

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

Michael J. Harrison
Analyst, Seaport Research Partners

Q

Hi, good morning. I was wondering if you could give us an update on the competitive environment within the auto OEM space. All of you and suppliers are hurting, the customers are hurting. Do you see any share shift going on in this environment? And can you maybe talk about industry pricing discipline into that auto OEM coatings market? Thanks.

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

A

Yeah. So, Mike, I would tell you that the discipline is better in Europe, in the US, in Latin America, and it's still a little bit challenged in Asia. That doesn't surprise us. China is historically a difficult place, plus there's more than 80 car guys in Asia. So, there's all the global plus all the locals and so there's a little bit more competitive attention.

But what I would tell you is, for us, any time that we might lose some share, get punished for raising price, we get it back very quickly as they roll out new programs because they have to put the finest technology out there on the newest programs to compete in that market because it's hyper-competitive from an appearance and performance standpoint. So, I'm not worried too much about that. We've been pushing the teams to continue to raise price appropriately and that's what we're doing.

Operator: The next question comes from Steven Haynes from Morgan Stanley. Please go ahead.

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Steven K. Haynes
Analyst, Morgan Stanley & Co. LLC

Q

Hey, thanks for taking my question. I was wondering if you could go into a bit more detail on your pricing in the Industrial segment by end market. It seems like packaging was potentially pretty strong, maybe double-digits. So, just any additional color there would be helpful.

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

A

I'm not sure I want to get into that level of detail, Steven. What I would tell you is we've posted more than 6% in the Industrial. We had strong positive price in automotive, Industrial as well as packaging. And these conversations with our customers are one-on-one, and I think that's the way it should remain.

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

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Yeah. Good morning, guys. Maybe three questions, if I can sneak it in. On your one chart that you showed, the acquisitions, you show the seasonality of the revenue. Can you talk about the seasonality of the margins off that chart and what that would look like? Then on your chart 6, where you break out kind of the 60% PPG, 40% PPG that has struggled volumetrically, what is the difference in margins between those two buckets? And the 40% that's been lower on volumes, has it been harder to get price in those businesses because of the lower volumes?

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

A

Let me start just, Duffy, with the first question. Well, I'll start with the 60/40 question, because I think that's more relevant right now. If you look at the 60/40 question, the businesses that are down – the 40% of the businesses that are down, let's call it, low teens in terms of volume versus 2019, these are very technology-rich businesses.

They typically command the value for the technology. We've seen good pricing as evidenced by the segment pricing. Two of these businesses fall in performance. Performance pricing was up 6%. They're very big businesses. So they're going to have an impact on the segment.

The automotive business is our biggest business in Industrial. So it's going to have, again, an outsized impact on the aggregate pricing. So, again, we're capturing pricing collectively across the portfolio, and it's not differential based on the 60/40.

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

A

Yeah. And I would say, Duffy, listen, the fact that they're down has not prevented us from getting price. So as you know, in refinish, we were historically an annual price. This year, we've had more than one price increase in refinish. So that has not prevented it.

Automotive clearly has not prevented it. The automotive guys would like every kilo of coating that we can provide to them, they would – definitely would like to get more. And then from the aerospace side, as you know, it's a very technology-driven business and it's a very spec-driven business and so our ability to get price on the MRO side is

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actually pretty good. So that has not been impacted either. So, when I look at the catalysts for 2022, these businesses are certainly going to be a strong contributor to the increase in earnings for next year.

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

A

In terms of the seasonality from the acquisitions, we did put in the appendix of the materials we distributed last evening, the sales seasonality. You would expect and it's accurate that the earnings seasonality is even more pronounced. These are businesses that have a fixed cost base, especially architectural. So you do get more leverage – there's more leverage on the peak sales quarters. And there's certainly less leverage on the sales quarters on either end of the peak. So definitely more pronounced earnings impact in Q1 and Q4. And we'll see the reciprocal of that, Duffy, in Q2 next year. We didn't have Tikkurila for the vast portion of Q2 2021. And in Q2 2022, we'll see that positive leverage.

Operator: 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. I have two questions. Firstly, on growth, actually, when you think about the European business in deco and compare it to some of the other periphery businesses like the adhesives industry or construction sort of building materials, light building materials industry, and think in the context of the green wave and the renovation wave that will kick into Europe, as we speak for the next few years. Do you think that paint and sort of adhesives building materials volume growth is sort of similar in trajectory? Or do you think that paint actually will slightly undergrow because of the higher penetration for a lot of these materials in the sort of increased insulation demand? That's my first question.

And the second question is really around raw materials. So, if you take a step back, I guess, you guys have lost probably 15% to 20% of supply because of Ida and Uri and all the other issues across your basket this year.

Fundamentally speaking, do you think your suppliers have invested enough in things like epoxy, acrylic acid to support the growth that your industry is seeing? In other words, do you think that even if supply normalizes, utilization in these products will remain high and, therefore, you will always remain a bit susceptible to a storm or two? Thanks a lot.

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

A

Hey Jaideep, this is Michael. I'll take the first one, which is the suppliers. I think they're clearly hampered this year because I think in the pandemic, they did not do the required maintenance. They postponed some things, and they got caught short by the recovery. And so as a postponed maintenance are underspent, that has impacted their ability to deliver what we wanted.

So, I would tell you that, that, obviously, they're all making very good money right now and they're all interested in getting their reliability up at or above where they were pre-2019. So, I anticipate this to get better.

I'll let Vince cover the adhesives and sealants versus paint for Europe questions.

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

A

Yes, I think when we just think about ESG, which I think was the heart of your question, typically, these products like adhesive, sealants, like coatings, act as an enabler to provide better ESG capabilities, longer term, longer lasting. And the aftermarkets typically provide the same opportunities to reduce people's environmental footprint.

So, the coatings industry, the adhesives industry, every time there's been a technology change, we're seeing it in EVs. We typically get more content and we typically are able to provide the functionality needed in order for them to make technology improvements to cover whatever that technology change is. In this case, it's better environmental performance.

Operator: The next question comes from Edlain Rodriguez from Jefferies. Please go ahead.

Edlain Rodriguez
Analyst, Jefferies LLC

Q

Thank you. Good morning, guys. Just one quick question on raw materials and, again, apologies if you already addressed that. Like in terms of the raw materials availability issues you've seen this quarter, like was it mostly concentrated in the US because of the hurricanes or was it broad based in all the different regions?

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

A

Yeah. So, Edlain, what I'd tell you is the worst was in the US, okay? So, that was obviously challenged with Hurricane Ida. The next most impacted over the quarter was Europe, because they do buy some things from the US. So, that has impacted, especially our architectural business over there.

And then the one that got impacted last, but somewhat meaningful was the dual control issue in China that started late in September because there were a lot of government edicts, people were supposed to meet their quarterly goals, and they were not on track to meet the quarterly goals.

So, starting about mid-September, there was a lot of pressure to get the dual control initiatives underway and on target. And in China, when they set targets, you can almost rest assured they're going to hit those targets. So that's the way – there was no real material challenges in Latin America. They came out of the US, but we were able to manage through most of those.

Edlain Rodriguez
Analyst, Jefferies LLC

Q

Yeah. Thank you.

Operator: [Operator Instructions] The next question is from Eric Petrie from Citi. Please go ahead.

Eric B. Petrie
Analyst, Citigroup Global Markets, Inc.

Q

Hi, good morning, guys. I've been reading about potential for magnesium shortages, which goes into producing aluminum alloys for auto, aerospace, construction end markets. So are you worried there at all with China still in control and low inventory levels in Europe?

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

A

Yeah. Eric, I would tell you that none of our big aerospace guys have right now put out any concerns about magnesium nor have our EV customers. So, right now, that is not currently on the radar screen. We're always trying to look around the corner, but that is one that so far has not raised its head.

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.

Thank you, Jason, and we'd like to thank everyone for joining the call today, for your time and interest in PPG. This concludes our third quarter earnings call.

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

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