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PPG Industries, Inc. (PPG)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Rocco, and I will be your conference operator today. At this time, I would like to welcome everyone to the Fourth Quarter and Full Year 2021 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. And as a reminder, ladies and gentlemen, today's conference call is being recorded.

I'd now like to turn the conference over to John Bruno. Please go ahead, sir.

John A. Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Rocco. And good morning, everyone. Once again, this is John Bruno. We appreciate your continued interest in PPG, and welcome you to our fourth quarter and full year 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 markets closed on Thursday, January 20, 2022.

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 that 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 risks, which may cause actual results to differ. The company is under no obligation to provide subsequent updates to these forward-looking statements.

This presentation also contains certain non-GAAP financial measures. The company has provided in the appendix of the presentation materials, which are available on our website, reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures. For additional information, please refer to PPG's filings with the SEC.

Now let me introduce PPG Chairman and CEO, Michael McGarry.

Michael H. McGarry

Chairman & Chief Executive Officer, PPG Industries, Inc.

Thank you, John. And good morning, everyone. I would like to welcome everyone to our fourth quarter 2021 earnings call. I hope you and your loved ones are remaining safe and healthy. I will provide some comments to supplement the detailed financial results we released last evening.

For the fourth quarter, we achieved record net sales of about $4.2 billion and our adjusted earnings per diluted share from continuing operations were $1.26. To quickly summarize the quarter, we had favorable sales versus

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our forecast, but incurred significant manufacturing challenges due to COVID-related staffing shortages, intermittent customer order patterns and raw material supply challenges.

Our adjusted earnings were aided by a lower-than-expected tax rate in the fourth quarter, as we recognized more favorable discrete items. Excluding the favorable impact from the tax rate, our adjusted EPS was about 10% below the financial guidance we provided in October.

Our sales performance for the fourth quarter was solid, as we achieved higher than [audio gap] (00:03:35) sales than our guidance, primarily due to better-than-expected automotive OEM global production, higher selling price realization and strong above-market sales volumes in several of our end-use markets. Overall, demand remains robust.

Our PPG-Comex business delivered yet again another excellent quarter and finished with 10% organic sales growth for the full year of 2021. This business had record sales and earnings growth for 2021, and continued to expand its concessionaire network, and in January, we will have 5,000 concessionaire locations in our network and we recently added our Traffic Solutions products to its portfolio.

The Protective and Marine business continued its trend of strong top line results, this time led by improvements in the Marine Coatings where industry builds are expected to grow for the next several years. We also continue to grow our share in automotive refinish for our full suite of advantaged products and services differences PPG from our competition. And in automotive OEM, we were awarded new 2022 business based upon our expanded mobility product offering. And finally, we realized higher increased selling prices globally.

Lastly, the recently acquired Tikkurila business delivered record sales and earnings for a new fourth quarter despite the difficult operating environment. As I mentioned, overall sales would have been better, but we experienced continuing supply chain disruptions and a significant increase in COVID cases that hampered our ability to fully and consistently operate and prevented us from fully meeting our strong customer order books.

Recently, some of our manufacturing facilities have had up to 40% of their workforce out. In several businesses, we continue to face certain raw material shortages with the biggest impacts in US Architectural Coatings and Traffic Solutions. Overall, our sales backlog grew, and in total was about $150 million exiting the quarter, most notably in our aerospace and automotive refinish and general industrial businesses.

Our segment earnings did not meet our expectations. While we benefited from higher sales and increased selling prices, it was not sufficient to offset significant inflation, supply disruptions and operational inefficiencies caused by the rapid increase in COVID cases within our employee base, and those at our customers and suppliers. Raw material cost inflation was up approximately 30% compared to prior year and transportation costs spiked due to shortages of available trucks and drivers.

In addition, operating costs were progressively higher during the quarter due to manufacturing, interruptions at both our facilities and our customers' operations stemming from COVID. These increased operating costs impacted the quarter by $0.20 per share and COVID-related absenteeism has continued in January. Once we see some normalization, we are confident that we will quickly be able to return our legacy of strong manufacturing performance.

We've been taking actions to further diversify our supplier base and increase our internal resin manufacturing capability. PPG has in-house large-scale resin manufacturing in each major region, and we are expanding our

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capability in 2022 to mitigate future risks. As one example, PPG-Comex sources a high percentage of its resins internally, which has resulted in minimal disruptions.

In addition to the historically high-level of commodity raw material prices, we're also experiencing rising costs in other areas such as labor and utilities. We expect to continue to proactively work with our customers to implement additional selling price increases in the first quarter. In aggregate, our selling price realization in the fourth quarter was about 8%, with a higher price realization in our Industrial reporting segment. Our price capture remains broad, with good traction in all businesses and all regions, and the pace of price – excuse me, the pace of price capture is much faster than the pace of prior inflationary cycles.

Reflecting back to 2021, we achieved all-time record sales of $16.8 billion, led by strategic acquisitions and strong organic growth of 10% despite the various ongoing supply chain challenges we incurred. In addition, we delivered record EPS growth of more than 10% even with raw material cost inflation of about 20% for the full year, the highest level of coatings industry inflation in recent memory.

We once again lowered our SG&A as a percentage of sales decreasing by about 200 basis points, aided by delivering $135 million in restructuring savings in 2021. We also advanced our digital capabilities in many businesses, most notably the Architectural Coatings business where sales transaction on a digital platform increased by 20% compared to 2020 as we see our customers' digital patterns become more ingrained.

In 2021, we had strong accretive cash deployment, including the funding of our acquisitions, share repurchases made in the fourth quarter and increase in our quarterly dividend for the 50th consecutive year. We're among a small number of companies that have achieved this milestone, along with even fewer companies paying a dividend for more than 120 consecutive years. Our working capital as a percent of sales remain at historically low levels and comparable to last year, even though we purchased more raw material than typical in the fourth quarter.

Finally, we have lowered our net debt by about $350 million since funding Tikkurila in June and exited 2021 with a strong balance sheet and optionality for future accretive cash deployment.

Throughout 2021, we took actions to bolster our ESG program. As an example, in the fourth quarter, we further strengthened our overall ESG corporate governance structure. We defined accountability and oversight for all major elements of our ESG efforts under respective Board committees. We've also redefined and renamed our Technology and Environmental Committee to the Sustainability and Innovation Committee, with a key focus on tracking our sustainability and progress and defining climate-related risks and opportunities. A slide reflecting the changes is included in our presentation materials.

Looking ahead, demand continues to be robust in most of our end-use markets. Tightened supply and COVID-related disruptions evidenced in the fourth quarter are expected to continue into the first quarter of 2022, impacting our ability to manufacture and deliver product. We expect economic activity to be soft in China during the first quarter as more severe operating restrictions have recently been imposed due to COVID and during the Winter Olympics. We anticipate more favorable economic conditions in the second quarter.

We plan to implement further selling price increases in all our businesses as raw materials and other cost inflation remain at elevated levels and are increasing further in certain areas. We will continue to aggressively manage all aspects of our cost structure and are managing to minimize the cost impacts of the current supply challenge.

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The first quarter EPS guidance that we provided has a wider range than normal. As is typical, the month of March will be the largest component to our quarterly sales. Our current visibility to the second half of the quarter is limited due to uncertainties around the supply chain disruptions and the various impacts of Omicron globally. While the current environment remains difficult to predict, I expect that as 2022 progresses, we will start to experience more economic re-openings and an easing of supply chain problems, general inventory rebuilding across many end-use markets and a healthy consumer willing to spend.

I remain very optimistic about future earnings capability of our company and see many catalysts to return to prior peak operating margins with opportunities to exceed them. This includes, first, continued recovery in the automotive refinish, OEM and aerospace coatings businesses, which collectively account for about 40% of our pre-pandemic sales and where we have broad global businesses supported by advantaged technologies. The volume for these businesses remain about 15% below pre-pandemic levels, and we're already experiencing improving order flow that is being crimped by supply availability.

Second, normalization of commodity raw material costs, which should moderate over time as supply dislocations improve. Third, higher operating leverage on sales volumes supported by our lower cost structure. Fourth, the year-over-year earnings growth in 2022 and 2023 due to further synergy capture from our recent acquisitions, including a 15% increase to our original synergy target. And finally, above market organic growth driven by our advantaged and leading brands technology and services.

An example of the key organic growth opportunity is the recent announcement on our expanded relationship with The Home Depot and HD Supply with the launch of Pro Paint Assortment at all US locations. This initiative strongly supports our asset-light strategy by adding more than 2,000 distribution locations. Together with The Home Depot, we are positioned to outgrow the Pro market in the US. Considering all of these catalysts, I believe we have a path to at least $9 of EPS in 2023.

In closing, I want to express my thanks and appreciation to our more than 50,000 employees around the world for their dedication to serving our customers and supporting the many communities where we operate. Every day their hard work and commitment to delivering on our company's purpose to protect and beautify the world are reasons why we are well-positioned today and in the future. Thank you for your continued confidence in PPG. This concludes our prepared remarks.

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

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QUESTION AND ANSWER SECTION

Operator: Yes sir. [Operator Instructions] And today's first question comes from David Begleiter with Deutsche Bank. Please go ahead.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Michael, just on the Q1 guidance, can you parse out a little bit more of the details around the US manufacturing disruptions and what's happening in China, and how it's impacting the Q1 earnings guidance?

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

A

Well, I think, David, right now we're not seeing a whole lot of difference between what we experienced in the fourth quarter. So we had about $0.20 of manufacturing negative deviation. If you think about October, November, we have had in December and January four times the amount of people out with Omicron. And that includes not just people who are sick with Omicron, but also people that we have to quarantine because they had a close exposure. And what we're really worried about is if Omicron gets to China.

So if you think about China, they have this zero COVID policy, and our largest plant in PPG is in Tianjin, and just recently they had a small outbreak there. And in two days, they tested 14 million people. So if Omicron were to get to China and they continue with their zero COVID policy, that could have a pretty disruptive effect. So we're being very careful in how we look at this. And right now, I just – I think Omicron has peaked in the US, but it hasn't started to come down yet.

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

A

Yeah David, and if you think about our Q1 guide in addition to the production concerns or limitations we've had, we do know that China will be limited somewhat due to the Olympics. We are also experiencing significant logistics issues in the US and in other parts of the world. We expect those logistics issues to continue into Q1, especially in March when the overall economy starts to improve seasonally. And for us, the month of March is our biggest month by far in the first quarter as is traditional. And we have more muted visibility on March than we typically would, given the issues we've seen over the past six to eight weeks.

Operator: Thank you. And our second question today comes from Bob Koort with Goldman Sachs. Please go ahead.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Thank you very much. Good morning. Michael, the guide you gave in the first quarter seems to suggest maybe the raw material inflation aspect is starting to hit a crest, obviously availability and production issues compounding problems. Do you see any stability in those raws? Have you seen any come down? Are the ones that caused you such trouble in the past the same ones as availability improved? Can you give us any inspiration outside of Omicron that maybe the inflation bubble is hitting a ceiling?

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

A

Yeah, actually Bob, I think our guide for the first quarter looks at two factors. One, raw materials have leveled off. Obviously we're watching the recent pop in oil, up to the mid to high-80s. So that could have an impact on solvents. But right now, we've modeled 20% to 25% raw material inflation.

For the first quarter, we were also modeling that our price is going to be at the same level as raw material inflation. So I think that's going to be a good number for us. We are seeing logistics. And I think I misspoke, I think its 25% to 30% for Q1. But anyway, so price will equal raw material inflation in Q1. And obviously, we're watching logistics costs but we are feeling pretty good. We're projecting price to be up between 9% and 10%.

Operator: Thank you. And our next question today comes from Chris Parkinson at Mizuho. Please go ahead.

Christopher Parkinson
Analyst, Mizuho Securities USA LLC

Q

Thank you. Good morning. Michael, it seems that the goalposts keep on moving on both the costs and the procurement front. But it really appears that it's really the raw material shortages, freight as you highlighted, electricity rates in varying capacities depending on geography, and to – I guess to a slightly lesser extent, labor. I know you've already [ph] said you (00:18:43) have been talking about it and getting and achieving price, but can you quickly comment on those other cost variables 1Q? Just hit on it a little bit, how we should be thinking about those heading through the balance of the first half of 2022. So it's a short-term question. The second thing is just are there any other strategic actions that you and your team can take to potentially alleviate these challenges in the future? Thank you very much.

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

A

Well, what I would tell you freight is the single biggest challenge we have right now, truck drivers not showing up. So you don't get the contract price that you have negotiated, then you end up having to buy spot loads. That's one. We are seeing labor inflation. That's another one. I would tell you that we anticipate warehousing inflation, although we always try to do those as a long-term contract but any that roll off this year, we'll be looking for an increase in that space.

Overall, I would tell you though those are all been anticipated, so there's nothing that we haven't anticipated in regards to that inflation. Our team is well-versed that we're not looking to get just raw material inflation, but raw material and total inflation from our customers, and we've been very explicit in those discussions with our customers as well. So I think that would be the first part. I don't know Vince, if there's anything you want to add.

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

A

Yeah. Chris, just to stratify the total cost pools here. Again, raw materials remain significant, they're 60%, 70% of our cost of goods sold. If you look at labor, it's a mid-single digit percent of our sales, a little higher. Obviously, in architectural given the stores and the feet on the Street, a little lower in some of our OEM businesses, and logistics cost is probably mid-to-high single digits as a percent of sales. Again, the distribution businesses like architectural, we finish a little higher, the OEM business is a little lower. So these labor and logistics costs, while they're going up, and we're covering them with price, they're much smaller cost components for the company.

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Operator: Thank you. And our next question today comes from Ghansham Panjabi with Baird. Please go ahead.

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

Q

Thank you. Good morning, everybody. Just high level, given all the disruptions on the customer side and incremental impact from Omicron, will first half 2022 the way you see it at this point, be more pressured than the back half of last year or do you think there'll be an easing on the bottlenecks as the first half unfolds? I guess I'm asking because you have massive labor issues at the homebuilder level, rolling shutdowns in auto OEM and various degrees of logistical constraints? How should we think about that?

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

A

Ghansham, I think that the single biggest thing about Omicron; let me just give you an example about how difficult it is to be a plant manager. The toughest job in PPG right now is a plant manager. They wake up in the morning; check their phone to see how many people call off sick. Then they get to work, they go through the dock area to see how many trucks didn't get picked up, and then they go to the receiving areas and find out what didn't come in that was supposed to. And then they move into the plant and the supply chain people are telling me that they're going to have to make smaller batches because of lack of raw materials. And then the sales team is telling them, oh, my God, if we don't get paint out the door, here's how many customers we're going to impact.

So by the time they get to their desk, and before they even have a morning meeting, they've had to overcome a number of issues. But the contrary to that is when I think about your first quarter to second quarter question, what do I see improving? I see automotive OEM definitely improving. The chip shortage is going to continue to get marginally better. They're getting better at handling it. So that is going to get better. Refinish, clearly this winter that we're having right now is a positive, and so refinish is going to get better first quarter to second quarter.

At some point, China is going to approve the 737 MAX. And when they fully approve that, that is going to be a positive for our aerospace business, because Boeing we anticipate will increase build rates. Also, we are seeing and you've heard the CEOs of the airlines talk about how people are already booking post-Omicron. So, we expect the MRO of our aerospace business to continue to improve first quarter to second quarter.

Our packaging business, we could continue to see a strong push for sustainability. There are a number of new packaging plants that will be opening up in 2022. And so to transition from plastic to metal packaging, away from single-use plastic is continuing, and that is going to be a positive. So that – those are the positives that I see coming up. Now clearly, the Marine new builds in China are going to be significant, but we don't anticipate that to be a first quarter to second quarter event. I think that's more of a back half of the year.

Operator: Thank you. And our next question today comes from John Roberts with UBS. Please go ahead.

John Roberts
Analyst, UBS Securities LLC

Q

Thanks. Michael, I think Comex, when you bought it, had 80% of their own resin in plastic pail production. You're obviously a lot lower in the other regions. What's the right level of pack integration for PPG?

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

A

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Well, I would tell you that that's not a precise answer because you have to balance the capital that you put in to build additional resin capacity into the cost of buying it. And so for us, we're actually getting more capacity in Mexico, we're adding a little bit more capacity in the US. We don't see the need to do that in Europe because the supply availability is pretty good in Europe. And from Asia, it is certainly not a priority for us. So it is a balance. So I would tell you that we'll be higher in internally sourced resins in 2022 and 2023 than we are today.

Operator: Thank you. And our next question today comes from Michael Sison with Wells Fargo. Please go ahead.

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Hey, guys. Good morning. Michael, just curious if you could help us sort of bridge the gap to the $9 that I suspect a good portion of that will be closing that pricing raw material gap. But any help in sort of how much of the walk gets us there on that, and then volume, cost savings and such? Thanks.

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

A

Yeah, Mike, this is Vince. I'll start and Michael can add some color. The biggest issue that we've talked about for the last couple of quarters is just a return of normalcy on some of our biggest businesses, auto OEM, refinish, aerospace. Michael gave you some color a few minutes ago around how we see that just from 1Q to 2Q, but those businesses are down 10% to 15% or more in the case of aerospace versus 2019 levels. We do see strong demand patterns in those businesses. And to get to the $9, we need those businesses to get closer to 2019.

One of the other benefits we expect is we had negative price raw exposure all of 2021. As Michael said, we're cresting on raws; prices are getting close to raws or exceeding them, depending on the business. So we expect some year-over-year recovery there. And then if you look over the past couple of years, Mike, we've taken about $250 million of structural cost out via restructuring. We've taken out about another $100 million to $125 million of overhead cost out. So as volume returns, we expect a higher incremental margin than we've had historically. So those are three of the bigger pillars that will get us to the $9. Again, a return to normalcy is the biggest one of those.

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

A

And Mike, I would just add that when you think about the volume, you can use some external sources like Orr & Boss and then you could think about how a bigger return in our impacted businesses will be a positive for us. And finally, productivity; productivity is one item that we're very good at, and this obviously wasn't there in the 2021 time period.

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

A

Yeah. And Michael, I'll add one more, our synergies that we've taken up in this quarter, we're now targeting $150 million in total. So that will also provide some assistance in getting to that $9.

Operator: Thank you. And our next question today comes from John McNulty with BMO. Please go ahead.

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John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Thanks for taking my question. Michael, maybe you can help us to think about the big Home Depot win that you had. Can you help us to maybe scale the opportunity there? Also maybe give us a little bit of color in terms of how big the initial fill is and how much incremental help you might get from that? Thanks very much.

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

A

So John, the way I would think about it is, first of all, we had a very extensive test. So we started out in Tampa, Denver, Albany, so we had about 80-plus stores in that market. That went exceptionally well.

And then we expanded that to Indy, New Orleans and Detroit. We added about another 80 stores. So that's, let's call it, 160 stores. And they were very pleased. We were able to share internal data between the companies about who comes into Home Depot, who buys a number of paint sundry items but do not buy paint. We were also able to pinpoint who comes in the store and buys what type of paint products that if they optimize their purchase, they'd be able to do a better job in productivity.

And as a result of that, we are able to target not winning in Home Depot, but winning externally. And that is the number one thing that Home Depot and PPG want to do is win externally. And so this is going to be a significant win for us. We will be outpacing the Pro growth for many years to come with the support of Home Depot. So we've basically taken our 800 stores, they're 2,000-plus stores and formed a network. And this will allow them to significantly grow their share in the Pro Paint market.

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

A

And if I could add, this is Vince, a couple of things for us strategically. This is consistent with our heavy distribution model in an asset-light format using existing brick-and-mortar. This is also consistent with our digital strategy, where we're able to use digital platforms for both us and our big customers.

And probably one of the more exciting things that Michael alluded to is as we compared CRMs or customer data, we do know that painters of all size go into The Home Depot. As Michael alluded to, they're not always buying paint today, but painters of all size – all Pro Painters of all size are going into Home Depot for something. So this will, we hope, alleviate their need to visit two different or three different retail outlets to get their full needs.

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

A

Which will drive productivity for the Pro Painter, that's what this is all about. So they can spend more time painting and less time driving to stores.

Operator: Thank you. And our next question today comes from Stephen Byrne at Bank of America Securities. Please go ahead.

Steve Byrne
Analyst, BofA Securities, Inc.

Q

Yeah. I'd like to continue this discussion on this Home Depot relationship. Some of these really large paint contractors benefit from free delivery to the job site and five-gallon containers features that you may provide from

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your stores, but Home Depot doesn't. Is that going to change? And if so, will that service be provided from your stores or will Home Depot provide that? Does it depend on whose digital app is involved in this?

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

Yeah. Actually, we will have fives in the store. So if you go into a Home Depot right now, you'll see PPG five gallon containers already in the store. We will be coordinating with Home Depot on delivery as appropriate. And we also have service level agreements with our own stores to provide a fast turnaround to our people that are ordering digitally. And of course, Home Depot already has this on their digital apps as well. So this will continue to be a new dynamic in how paint is delivered to our major Pro Painters.

Operator: Thank you. And our next question today comes from Laurent Favre with BNP Exane. Please go ahead.

Laurent Favre
Analyst, Exane SA (United Kingdom)
Q

Yes. Good morning. Michael, in the slides, you highlighted two businesses where Q1 is expected to be better than Q4; auto OEM and architectural EMEA. You've talked quite a bit about auto OEM. Could you say a little bit more about the architectural EMEA line?

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

Sure, Laurent. And what you are starting to see in Europe is a continued growth in the Pro Painter in Europe. And it's – DIY is kind of normalized, but Pro is picking up. And even though there have been a small amount of lockdowns in Europe, that has not really impacted the order pattern so far in the European market. Plus we have the growth that we are expecting to see in Tikkurila. So we have a pretty good line of sight to their – what they call their pre-selling season, and that has worked out pretty well. And so we're expecting to have a pretty good first quarter, second quarter in European architectural.

Operator: Thank you. And our next question today comes from Frank Mitsch with Fermium Research. Please go ahead.

Frank J. Mitsch
Analyst, Fermium Research LLC
Q

Good morning gentlemen. And let me give a quick shout out to Mr. Knavish. Congrats, if you're listening. Michael, you outlined why the last couple of quarters we've seen margin compression. And in the release, you mentioned that you see a path to returning to prior peak operating margins and also exceeding them. I was wondering if you could offer a kind of a glide path or a timeline that you see the margin improvement over the next couple of years?

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

Well, I think what you should think about, Frank, is that every quarter from this point out, we should start to see improvement in the margins. So we're anticipating raw materials are flattening out right now. Our price increases will continue. So we've had 19 quarters in a row of positive price. So we'll be stacking 2021 out there as well. And so that's going to be the start of it.

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We'll be getting the manufacturing behind us. Those issues will be behind us as well. So that will be a positive. And then we have a number of productivity programs, capital that we want to put into the business to drive more productivity, so you take less – need less labor to get the paint out the door. So that will also be a positive. So we've talked about being over $9. I don't know why we wouldn't be there in 2023.

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

But I think, Frank, just – again, the challenges we faced of the past three or four quarters, we've been playing significant catch-up on pricing. Again, that's – we think we're normalizing there to closer to parity this quarter. In successive quarters, we hope to get some recapture. So that headwind should turn into at least a neutral, if not a catch-up tailwind. The manufacturing, again, we expect to normalize at some point we hope in late Q1, early Q2.

But the real driver for us is that volume. And again, we're down significantly. We're down probably 6 – 5%, 6% versus 2019 still with several of our big businesses, as I alluded to earlier, and those are going to come back at nice incrementals. And then as John Bruno mentioned, we'll have the synergy capture latter part of this year heading into next year. So these will be stacked sequentially in that manner.

Operator: Thank you. And our next question today comes from Kevin McCarthy at Vertical Research Partners. Please go ahead.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC
Q

Yes. Good morning. Michael, just to follow-up on pricing, you're making some good progress there. I think you mentioned 9% to 10% as an outlook for the first quarter on pricing. So two parts. Where are you most happy with the realizations and where do you think you might have more work to do? And then as we think about that 9% to 10% level for the first quarter, how do you think that might trend as 2022 progresses? Would you expect that level to be sustained, move higher or regress in a scenario where the raw pressure might cool off?

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

Kevin, this is Vince. Let me start. The 9% to 10% on the Q1, if you look at it on a two-year stack, it's closer to 11% to 12%. So I think when we talk about pricing from here going forward, we're going to have to look at it on a two-year stack because we did get pricing traction early in 2021. So we'll be lapping that as we go throughout the year. So again, that two-year stack is probably a better marker on a go-forward basis. And that again 11% to 12% is what we're expecting on a two-year stack beginning in Q1. And I'll let Michael talk about the different businesses.

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

Yes. I would say, Kevin, the businesses are probably pretty much what you would expect, right. So, we've been working proactively in our refinish business, and we're able to consistently get price in refinish. PMC, we've done a really good job in PMC except in China. China has been a challenge for us with people chasing volume. So that would be the one area I'd say we need to do a better job in.

And then when you think about architectural, we've consistently done a good job on that around the world. I have no concerns in that regard. I would tell you that we've gotten traction in automotive OEM. And so automotive OEM

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was very close to the company average in the fourth quarter, and they expect to be at the company average in the second quarter. So that's been an improvement.

I would say on the packaging side, we need to do a little bit better. We have more inflation in packaging because it has a higher epoxy component. And I've been pleased with the Industrial side. But around the world way of thinking about this is China has always been the most challenging on the automotive OEM side. We have a number of competitors that are still chasing volume instead of pushing price. So we see that, and so we're conscious of what's going on over there.

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

A

Yeah. If I could just add on some of the auto businesses. For us, our mission is to ensure we're getting good value for our products. If we don't see value, we're going to shed some of the customer businesses. We know some of the competition, especially in China is not doing that. Our marker is to remain a good, solid, profitable Automotive business.

Operator: Thank you. Our next question today comes from Vincent Andrews with Morgan Stanley. Please go ahead.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you, and good morning. A couple of things on your acquisitions. One, the businesses you've already brought into the fold, how are you doing there in terms of getting the price cost relationship to the company level? And then just on capital allocation, I think the last time or last quarter, it seems like M&A was less likely this year versus last year just given maybe where the bid-ask spread was, but any update there as well, please?

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

A

Okay. Let's do these by the acquisitions. So we'll start with the little ones. So VersaFlex well ahead, been exceptionally pleased with that team. The two in Germany is Cetelon and Wörwag. Unfortunately, the prior management before our time had made commitments for 2021. So the good news is 2021 is behind us. 2022 price increases will be significant and is already in place. So I'm pleased with where we are starting, not pleased obviously that we had to wait a number of months to make that happen.

Traffic Solutions, that's the old Ennis-Flint. They've done a really good job on that. They've really have changed the way the industry thinks about getting value for paint. And I think that has really helped out a lot. And then finally, Tikkurila, we're doing very well there as well. I've been pleased with the team. And we had a good pricing realization in the fourth quarter, and we're starting out Q1 in good shape as well. So net-net, slow on a couple of businesses due to prior management commitments. But overall, for 2022, I feel very good about it.

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

A

Yeah. And just on cash deployment, first of all, we're still reviewing what I would call an active acquisition pipeline. That remains if available and at the proper price priority for us. We'll continue to vet those and use the remainder as a flywheel. We'll certainly look to mop up dilution this year as we've tried to do in prior years, at least on a cumulative basis. We have some debt to service, so we'll do that as well. But right now, we have a strong balance sheet, and we'll use that for shareholder accretion as we go throughout the year.

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Operator: Thank you. And our next question today comes from Arun Viswanathan with RBC Capital Markets. Please go ahead.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Hi, guys. Thanks for taking my question. Just curious, I guess on refinish, have you guys seen a noticeable drop off in the last couple of months because of Omicron? And similarly for aerospace, has that happened as well? And if so, I guess, could you offer any thoughts on when would that reverse, I guess?

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

A

No. Actually, Arun, on both those businesses, we have substantial backlogs. We finished the year in refinish, especially in Europe and the US with substantial backlogs. Inventories are low. Winter has been helpful to us, especially here in the US, so we're anticipating a good start to our refinish business in 2022. And we finished with a very substantial backlog in aerospace. The challenge in aerospace has been the airlines have been ordering MROs, especially transparencies and coatings. And coatings we're able to mostly keep up, but on transparencies, we're having a challenge of hiring enough people. And it takes a lot longer to train people to build transparencies. And so I would tell you that pretty substantial backlog, and that's only going to get bigger in the first half of the year, and we anticipate both of those businesses doing better in 2022 than they did in 2021.

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

A

Hey Arun, and this is Vince again. If you think about one of the things Michael alluded to in the opening comments, the inventory channels in almost every one of our end markets is very depleted. The most visible economically is in the Automotive business, where dealer lots are void of cars. We know refinish is extremely light in terms of inventory, not only to complete the current mix of cars that are in need of repair, but also to replenish with a very low distribution inventory level.

Michael talked about aerospace MRO, a very light inventory that needs to be replenished with safety stock. The architectural businesses, no matter where you are in the world, the inventory at market is very light. And so, in general industrial markets, some of those have very low safety stock, if any at all. So we're very comfortable if we could make product, we could sell product. And we do feel, hopefully that some of the supply chain issues will resolve in the back half of Q1, early Q2 and allow us to begin shipping. We certainly need to get the labor availability back. But inventory, replenishment is a big story for 2022.

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

A

Yeah. And the other thing I would tell you, Arun, that maybe people don't recognize is with used car prices so high, people are repainting cars that get in accidents that might have previously been totaled. And so we're seeing a number of used cars get painted. And historically, where that might have been what I'd call a value paint, a lot of people are now coming in and demanding premium paint. So, the refinish business is in really good shape.

Operator: Thank you. And our next question today comes from Duffy Fischer of Barclays. Please go ahead.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

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Yes, good morning. Question around the foregone volumes. So, your volumes were negative 4%. I think everybody would argue if you didn't have – or the industry didn't have issues, that number would have been positive. So, maybe there was 5%, 6%, 7% foregone volume. But my question is, what's the mix in that volume? Were you able to push those scarce resources into higher-margin products, or maybe that foregone volume carries a lower margin, or maybe just help us understand the margin that that volume would have carried versus the corporate average and how the mix is different in that than what you're actually selling?

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

A

Duffy, the first thing is I'd probably take a little bit of an exception to that minus 4% going to a plus. I don't think that's likely. I think a minus 4% would have probably been minus 1% or – at best because there's a number of other issues going on in the market right now.

To the extent that we can get raw materials, we are shipping product. And from that standpoint, most of our businesses have had challenged getting product out the door. We have significant demand out there. And I don't think it would have been any different mix, to be honest. Clearly, if we'd have been able to get more transparencies and more refinish out the door, that would have been a better mix for us. But I'm not sure that we have really substantially diluted ourselves or accreted ourselves by what we shipped in the fourth quarter.

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

A

Yeah, Duffy. And I'll add here, the minus 4% is versus a very strong comp in the prior year. We saw in the fourth quarter of 2020, the partial recovery from COVID in our Automotive businesses and our Industrial businesses. So we had very strong performance in Q4 of 2020 that we were comping against in 2021. If you compare to 2019, we're still down more than 4%. And again it's in the heavy technology laced businesses; refinish, OEM, aerospace [ph] that (00:47:37) typically would favor the mix that you're referring to.

Operator: And the next question today comes from P.J. Juvekar with Citi. Please go ahead.

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

Q

Yes. Good morning. A couple of questions, Michael. Emerging markets seem to have slowed down. It seems like Chinese industrial activity is down, but that could be due to dual control and the Olympics. Latin America seems to be down as well, maybe because of COVID. Can you just parse out and tell us what you think is happening underlying in emerging markets?

And then secondly, you were talking about OEM just recently – just now. I was not sure why your OEM sales were down or underperformed the industry, because I think you have good EV exposure, so that should have helped you. Thank you.

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

A

Yeah. We'll start with the OEM. I would tell you that we were slightly below because when you look at some of our business in China, we decided that we wanted price, and we were willing to walk away. And that business will come back to us. So I'm not worried at all about that.

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We are definitely gaining share in the mobility section. In fact, we started up a brand new battery fire protection plant in China, and that's 100% for batteries, and that is going exceptionally well. And we will be doing similar expansions in Europe to support the European growth as well. So I feel very confident about that, but we are committed at getting price up in OEM. And if that means that some of these smaller customers move their business elsewhere, that's fine.

From an emerging market standpoint, let's talk about this in several different factors. Okay, China is right now a little bit soft, but that just means they're not growing as fast as they used to grow. They're still growing, right. And we're expecting global production in China to be up 4%, 5% in 2022. Second, I would tell you that India is doing exceptionally well. We're expecting them to be up 8% or 9% this year. And actually, when you look at our Eastern European business in the past six months, it was up high single-digits. So we're pretty pleased with that as well.

And what I'm most excited about long term, it won't be a major win in 2022, but with our Tikkurila acquisition, we are now the largest coatings company in Russia. And our architectural business is substantially bigger than the number two guy, and I think this is going to be an opportunity for us to grow share in Russia through advantaged products. And that's going to be a win for us, long term, in Russia.

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

And Michael mentioned earlier, P.J., Mexico for us, we have big businesses there obviously in architectural, which has done exceptionally well once again. The Automotive and Industrial businesses we have there were somewhat tempered by the lower automotive builds on a year-over-year basis. We do expect those to return as the chip shortages alleviate as we pass through the year here.

Operator: And the next question today comes from Mike Harrison at Seaport Research Partners. Please go ahead.

Michael J. Harrison
Analyst, Seaport Research Partners
Q

Hi. Good morning. I had a question on the auto OEM business. You noted that production was a little bit better than you were anticipating coming into the quarter, but that it was intermittent. Can you help explain why this intermittent production led to operational challenges and higher operating costs for PPG?

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

Sure, Mike. I mean the issue that you have is the suppliers don't have great visibility on when they do or don't get chips. So they provide us an order schedule. And in the old days, a 90-day advance order schedule would give us; let's call it, 85% to 90% confidence. And then at 30 days, it was 100% confidence. Well nowadays, even at a week out, we only have 80% confidence. And so we're having to make smaller batches, and we're having to shipped basis what they get in from a chip standpoint, what we might have to make, and those lead to inefficiencies in our operations.

But what I would tell you looking forward, the industry produced about 75 million cars this year. And we're looking at that being closer to 82 to 84 million cars next year. So this is still down from its peak and that is a substantial opportunity for us long-term because at the peak, it was 95 million cars. So there is still more runway in the automotive OEM space.

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

A

Yeah. And at the peak, the 95 million cars Michael mentioned, doesn't include the fact that we have to replenish the dealer lots. We think that's up to 2 million to 3 million vehicles in 2022 alone, if they can make them as well as the rental car fleets in the US are fairly depleted and those need replenished. And then in Europe, there's a lot of company-owned cars that have been not replenished over the past couple of years. So in addition to the normal demand, the normal consumption from consumers, there's other elements in the automotive market that we believe will allow us to remain an elevated production capability, willing – elevated production for multiple years.

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

A

And Mike, I assume you've also put in the OEM model of growth in the mobility space. So when we do get back at higher levels, there will be more content per vehicle for PPG.

Operator: Thank you. And our next question today comes from Edlain Rodriguez with Jefferies. Please go ahead.

Edlain Rodriguez
Analyst, Jefferies LLC

Q

Thank you. Good morning guys. Michael, again apology if you already addressed that, in terms of capital allocation, you have more than $1 billion left on the current share buyback program. What should we be thinking in terms of pace and timing? Is this a 2022 event or will it take longer?

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

A

Yeah, Edlain, this is Vince. We did, just a few questions ago, answer that. Again, we're going to look at acquisitions, primarily still active pipeline, likely smaller transactions in the past 12 to 15 months. And we'll mop up dilution for sure this year at a minimum. And we'll do some debt servicing, and then we'll continue to assess as we go through the year where to deploy any excess cash.

Operator: Thank you. And ladies and gentlemen, this concludes the question-and-answer session. I'd like to turn the conference back over to the management team for any final remarks.

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

Great. Thank you, Rocco. We'd like to thank everyone for your time and interest in PPG. This concludes our fourth quarter earnings call. Have a good day.

Operator: Thank you, sir. Today's conference has now concluded. And you may all disconnect your lines. And have a wonderful day.

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