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PPG Industries, Inc.

First Quarter PPG Earnings Conference Call

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PRESENTATION

Operator

Welcome, everyone, to the First Quarter PPG Earnings Conference Call. Thank you.

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

John Bruno

Thank you, Sam, and good morning, everyone. Once again, this is John Bruno.

We appreciate your continued interest in PPG and welcome you to our first quarter 2022 financial results conference call.

Joining me on the call from PPG are Michael McGarry, Chairman and Chief Executive Officer; Tim Knavish, Chief Operating Officer; and Vince Morales, Senior Vice President and Chief Financial Officer.

Our comments relate to the financial information released after U.S. equity markets closed on Thursday, April 21, 2022.

We have posted detailed commentary and accompanying presentation slides on the Investor site of our website, ppg.com. The slides are also available on the webcast site for this call and provide additional support to the brief opening comments Michael will make shortly.

Following management's perspective on the Company's results for the quarter, we will move to a Q&A session. Both the prepared commentary and discussion during the call may contain forward-looking statements reflecting the Company's current view of future events and their potential effect on PPG's operating and financial performance. These statements involve uncertainties and risks which may cause actual results to differ. The Company is under no obligation to provide subsequent updates to these forward-looking statements.

This presentation also contains certain non-GAAP financial measures the Company has provided in the appendix of the presentation materials, which are available on our website, reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures.

For more information, please refer to PPG's filings with the SEC.

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

Michael McGarry

Thank you, John, and good morning, everyone.

I'd like to welcome everyone to our first quarter 2022 earnings call. I hope you and your loved ones are remaining safe and healthy. To say that these have been difficult and challenging times for so many would be a massive understatement. Since the beginning of the war in Ukraine, we have been focused on protecting the health and safety of our employees and their families from Ukraine as well as our employees in Russia.

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PPG and the PPG Foundation have also committed more than $800,000 to humanitarian relief as well as longer-term recovery support. In addition, PPG employees have also been providing direct support to those in need, including taking refugee families into their homes.

The war has also made it necessary to scale back and now wind down our operations in Russia. As a result, we have recorded a pre-tax charge of $290 million for impairment of substantially all of our Company assets related to our Russian operations. For context, net sales in Russia represented approximately 1% of total PPG net sales for the year ending December 31, 2021.

We will continue to closely monitor developments in the region.

Before I provide the regular quarterly review of our results, I'd like to provide a concise summary of the key issues impacting our business in the quarter as we look ahead.

During the first quarter, we had two major events: the Ukraine-Russia crisis and increased COVID-19 restrictions in China which have created some new uncertainties about overall regional demand and possible global carry-on effects.

You will see, due to these increased uncertainties, we have widened our earnings guidance range we provided for the second quarter. Notwithstanding these two major events are other longer-standing global impacts which have affected our financial results for several quarters, and which are abating or rateably improving.

Specifically, we continue to experience improvements in our supply chain and our raw material availability. Additionally, outside of China, COVID restrictions have continued to decrease in many parts of the world.

As a Company, we have continued to improve our pricing realization in both pace and cadence. This has been necessary to battle the persistence and breadth of inflation. Our price capture this cycle is much faster and we are now pricing in the second quarter for second quarter inflation impacts, so we are basically pricing in real time. We continue to deliver good earnings leverage when we have improving volumes.

While many of our businesses and regions have not fully recovered from the pandemic, as a matter of fact, we are still down about 5% in aggregate. However, when a business does deliver volume improvement, we are realizing good bottom-line gains. This reflects the hard work from our teams on managing our operating costs and SG&A.

Finally, we had a very solid month of March from a financial returns perspective. We have stated many times that March is the most important month in the first quarter given the seasonality of our businesses. Our month of March financial returns are the best return since the second quarter of 2021.

I will now move to provide some comments to supplement the detailed financial results we released last evening.

For the first quarter, we delivered record net sales of $4.3 billion and our adjusted earnings per diluted share from continuing operations were $1.37. To quickly summarize the quarter, our sales performance was better than our January guidance despite unexpected impacts from the crisis in Europe, COVID-related disruption in China and continuing logistics bottlenecks. More than offsetting these unexpected macro issues was stronger than expected demand across many of our businesses as regional economies and end-use markets continue to recover from the pandemic impacts. Above market sales volumes were

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achieved in several of our end-use markets, including our PPG-Comex business, which during the quarter opened their five-thousandth concessionaire location in Mexico.

First quarter sales in Latin America were a record. In addition, our automotive refinish business performed well with strong sales volumes in the U.S. and Europe. Also, our aerospace business benefited from year-over-year initial improvements in the market, and we expect further industry demand growth, as we are still well below pre-pandemic levels.

Our adjusted earnings were significantly above the upper end of our January financial guide as we delivered strong earnings leverage on the higher-than-expected sales volumes. This leverage was a result of improving manufacturing performance as COVID-related absenteeism subsided significantly as we progressed through the quarter, and we experienced increasing raw material availability.

In addition, our selling price increases increased 10% year-over-year, marking the twentieth consecutive quarter of higher selling prices. Our selling prices are up over 12% on a two-year stack basis versus the first quarter of 2020, reflecting our continued actions to offset generationally high inflation.

Our recent acquisitions also performed well, including the realization of targeted synergies. The Tikkurila business delivered year-over-year sales growth of more than 10%, excluding our Russian operations. Our Traffic Solutions business also achieved greater than 10% sales growth and our first quarter sales were a record and the business continued to have a large order backlog as we entered the second quarter.

During the quarter, we also launched a significant expanded pro painter initiative with The Home Depot, and despite continuing raw material constraints restricting our ability to fully load inventory, we now have our full PRO Product assortment available in about 60% of their stores. We expect to have all The Home Depot stores loaded in the coming months. We are excited about the growth opportunities that this initiative provides and have already recognized some significant new professional painter business gains.

Our earnings and margins continue to be impacted by elevated levels of inflation and supply disruptions. In the first quarter, our selling prices did offset year-over-year raw material inflation but did not offset inflation from other sources including logistics, energy, and labor, and we did not fully recover prior year inflation. Sequentially, versus the fourth quarter 2021, our overall margins improved by more than 200 basis points.

We are targeting continued quarterly sequential margin improvement in the second quarter as well despite further increases in raw material and logistics inflation.

We have continued to optimize our commercial processes the last two years and, as mentioned, are now closer to real-time pricing relative to inflation. Due to higher crude oil and energy prices, we are implementing incremental selling price increases in the second quarter and expect that we will exit the second quarter offsetting all inflation categories on a run-rate basis. This drives our expectations for operating margins to sequentially improve further as the year progresses.

In several businesses, we continue to face certain raw material shortages, resulting in our overall sales backlog growing to about $180 million exiting the quarter. The order backlogs are the highest in our aerospace and automotive refinish businesses. Additionally, these are two of our many industries we supply where inventory levels are extremely low all the way to the end consumer.

We have continued to control our controllables and once again lowered our SG&A as a percentage of sales, decreasing by about 40 basis points compared to the first quarter 2021. This included delivery of an additional $15 million in cost savings from recent restructuring programs and acquisition synergies.

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This is also despite expanding our multiyear investment in our advanced digital capabilities and we are experiencing growing digital adoption from our customers, most notably in the architectural coatings business.

In the first quarter, our net debt increased mainly due to the higher dollar value of inventory reflecting inflationary effects. The seasonal working capital increase in the quarter was consistent with pre-pandemic years.

We expect our cash flow generation to match prior year end trends, which is to consume cash early in the year and generate strong cash flow as we progress through the end of the year. Strategically, on April 1, we completed the acquisition of Arsonsisi's Powder Coatings business, continuing our focus on growing our powder coatings manufacturing capabilities.

In addition, we divested some architectural coatings businesses in Africa as we continue with our legacy evaluating all regional businesses and product lines to ensure that they continue to have strategic value and meet our financial hurdles.

In the first quarter, we continued to take additional measurable steps to further advance our ESG program by issuing our inaugural DE&I report. While I am proud of what we have achieved, we know that there is more work to do and additional areas of opportunity to focus on. If you have not already done so, I would encourage you to read our report and learn more about what we have done and our aspirational goals for the future which are outlined in our presentation materials.

Looking ahead, while underlying demand continues to be solid in most of our end-use markets and regions, second quarter economic activity, in particular in Europe, has started to soften as consumers remain cautious based on the current geopolitical issues in the region.

In addition, manufacturing supply chains have been recently impacted in China due to severe restrictions from rising COVID cases. In the last few weeks, up to five of our smaller manufacturing sites have been mandated to shut down due to restrictions, plus our Principal Protective & Marine Coatings production facility.

We are working in both of these regions to manage our operations and costs are reflective of these current macro challenges. We are also assessing impacts both positive and negative these challenges may have on raw material supply and costs. As mentioned earlier, we expect further sequential inflationary pressures on raw materials, logistics and energy. Our two-year stacked raw materials inflation expected to exceed 35%, but only up low to mid-single digits sequentially versus the first quarter.

We are implementing further selling price increases in all of our businesses and expect a quicker offset versus historical lags. Due to the heightened levels of uncertainty, our earnings guidance considers a wider range of outcomes for the second quarter. More generally, our guidance assumes that restrictions in China ease somewhat in May and that geopolitical issues do not expand beyond the current Russia-Ukraine boundaries.

While the current environment remains difficult to predict, I expect that as 2022 progresses we will begin to experience an easing in supply chain disruptions, general inventory rebuilding across many end-use markets and still a healthy consumer willing to spend, especially in North America.

The future PPG earnings catalysts that I referenced on the January earnings call remain intact, and we certainly see a path to return to prior peak operating margins with opportunities to exceed them. This includes continued recovery in the automotive refinish, OEM and aerospace coatings businesses.

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Normalization of commodity raw material costs, which should moderate over time given supply dislocations, are improving and there is a softening in certain regional economies.

As demonstrated this past quarter and supported by our lower cost structure, strong operating leverage on any sales volume's growth, accretive earnings growth from our recent acquisitions from both their historical base earnings and further synergy capture, above market organic growth driven by our advantage and leading brands, technologies and services.

In closing, as we look ahead, I remain confident about the Company's future. I strongly believe in our team of 50,000 employees as we work to do better today than yesterday every day. The way our employees have dealt with the pandemic and our helping during the Ukraine humanitarian crisis and are navigating through a very challenging business environment are a prime example of how the team is making it happen.

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

Now, Sam, would you please open the line for questions?

Operator

Absolutely. Your first question comes from the line of Christopher Parkinson with Mizuho.

Christopher, you can proceed with your question.

Christopher Parkinson

Great. Thank you so much.

Can you quickly give us more granular update on the various inputs as it pertains to, I would say, 2Q and the second half inflation outlooks and as well as the persistence—excuse me, of certain input shortages on a quarter-to-quarter basis? Thank you.

Michael McGarry

Chris, what I would tell you is that our input shortages remain consistent with what we have seen previously. Motions tend to be at the top of the list. We have had some intermittent, because of manufacturing issues with TiO2. Those issues have all been resolved. Force majeures, when we had the last call, they were over 100. We are down to about 50 now. We have seen improved reliability in Europe. We have seen improved reliability, exclusive of the Shanghai area for Asia. We are still seeing some challenging with trucking here in the U.S. But sequentially, we do see the pace of inflation coming down. And what's most important is that our pricing is accelerating and is in a much more real-time basis.

Operator

The next question comes from the line of Ghansham Panjabi of Baird.

Ghansham, please proceed.

Ghansham Panjabi

Thank you. Good morning, everybody.

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Could you just give us a bit more color on a real-time basis in terms of what you are seeing both in Europe and China, both from a demand and supply chain standpoint, and in particular which businesses are being most impacted?

Then related to that, just given all the complexity in the world and your strong capital position, how are you now thinking about share buybacks at this point in context of, obviously, the moves in the stock and your peers this year, any changes to that versus acquisitions? Thanks.

Michael McGarry

Okay. Ghansham, let's start with the share buyback question first. We are always going to look to optimize shareholder value. Our pipeline of acquisitions remains active. But obviously, at the share price, we are going to balance what's most accretive to the shareholders, and so we are looking at both.

In regards to China and Europe, what I would tell you is the car situation in China is being impacted probably a little bit more than some of the other markets. We do regard that as transitory. We're fully expecting, as we've seen in other incidences, people are going to be much more interested in driving themselves versus taking math transit. We do expect car recovery in Europe, and it's the largest car market in the world. They're also shifting from internal combustion engines to electric vehicles faster than some of the other markets, and of course, as you know, we have more content on electric vehicles and we do internal combustion engines. So, we feel optimistic about that.

Clearly, we're concerned about the rising number of COVID cases. It has plateaued in the last two or three days. We have gotten all but two of our plants back up and operating. We expect to get the other two plants up and operating in the next three to five days, I would say, if we're being a little bit optimistic here.

But overall demand in China remains good. I don't think the Chinese economy can afford to have GDP in the low single digits. That's not good for them. I do expect the government to be aggressive in providing a business-friendly environment coming out of this most recent COVID situation.

Then in regards to Europe, clearly, the most concerning area for Europe is DIY. We predicted this. This is consistent with what we have told. We continue to have a strong pro painter backlog. But DIY and traffic through the big-box stores in Europe is the one indicator that we're watching out.

Vince Morales

Ghansham, this is Vince.

I think if we think more broadly as we put together our Q2 forecast, we do expect China to—some of the COVID restrictions to ease in the early part of May and continue to ease through the balance of the quarter, but they are certainly restrictive right now. We know there'll be some carry-on effects with respect to logistics and transportation and port availability well into May. So that's baked into our guidance. In Europe, again, we're concerned about—maybe overly concerned, but we're concerned about the effect on consumer of energy prices and just the overall environment.

Our forecast has baked some of that passiveness, consumer passiveness, into Q2. We hope we're being a bit bearish, but that's what we've forecasted, and we will see how the cards fall as we go through the quarter.

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Thank you, Ghansham.

The next question is from the line of David Begleiter of Deutsche Bank.

David, please proceed.

David Begleiter

Thank you. Good morning, Michael and Vince. Guys, just on U.S. architectural, are you seeing any discounting by your competitors? And if so, how are you responding to this more competitive pricing environment potentially? Thank you.

Michael McGarry

Okay. David, we have Tim here. I'm going to let Tim handle that question.

Tim Knavish

Hi, David. Tim Knavish here.

Look, in our architectural U.S. business, in fact, our architectural business is around the world, we continue to get increasing sequential pricing. And that pricing, while never easy to get, is being accepted by our customers. And our customers have to remain competitive every day. So, we can assume that we're seeing that same kind of behavior from others in the market.

We have not seen what you call discounting in the market. I think the industry realizes what's going on upstream of us and acting accordingly.

Operator

Thank you, David.

The next question is from John McNulty of BMO.

John, please proceed.

John McNulty

Yes. Thanks for taking my question.

On the pricing front, Michael, you kind of indicated you're almost at a point where it's real-time pricing. I guess, what are the mechanisms in place that you've put so that we can actually see that real-time pricing? And I guess to that also, when the raw materials eventually or hopefully subside, do you give back some of that pricing in real time, or is that something where we may see the more traditional lag or even stability when it comes to price? I guess, how should we be thinking about that?

Michael McGarry

Well, John, first of all, we're not going to be giving this pricing back. As you know, we are still lagging, if you look at this on a 2.5-year stack. So, there is plenty of recovery. The reason that we're able to get more real-time pricing than ever before is it's impossible for our customers to argue with what's going on, right. They fully see the same things that we're seeing. They are seeing energy prices go up. They see

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raw materials that we buy, they can see it in their own systems going up. They can see transportation going up, they are paying for transportation. And they also cannot argue that our competitors are not pricing.

From that standpoint, most of the bullets that they usually try to fire at us, that our salespeople try to avoid, that's not happening. And now it's not a matter of can we take a price increase. Now it's about how much of a price increase are you going to take. And the other thing that we've done much more aggressively than we ever have is withhold shipments.

We're telling people, this is the new price. And if you don't like it, please don't place purchase orders. And if the purchase orders come in without the new price on it, we're sending those purchase orders back. And that has gotten the attention of our customers, and they understand that we need relief and we need relief now. And so you could see that there is a palpable energy in the air to get price increases, as we're doing it.

When you see oil at $107, our customers are getting priced like that. So, I'm really pleased our sales teams have gotten much better at pricing than ever in the history of the Company.

Operator

Thank you, John.

The next question is with Stephen Byrne of Bank of America.

Stephen, please proceed.

Stephen Byrne

Yes. Thanks.

I'd like to drill in a little more on this relationship with Home Depot. Michael, you mentioned the 60% level of a particular metric. I didn't catch what that was. But I'm sure there is many, many steps involved in the rollout of that relationship. And a couple I wanted to ask you about was how many of those 2,300 Home Depot stores—does PPG actually have a distribution center available in the vicinity to fulfill orders? And then maybe another one would be how many of those stores have your reps already started to reach out to contractors that are buying materials in The Home Depot, but not paint, as identified by those respective pro desks at those respective Home Depots?

Michael McGarry

Okay. Stephen, I'm going to just tell you, the 60% referred to, we've only been able to stock 60% of their 2,300 stores, and I'll let Tim add additional color to it.

Tim Knavish

Yes, Stephen. Look, the program, while it's in 60% of the stores, will continue to ramp up as we move throughout the next several months as supply situation improves and we continue to build inventory. We've got our full pro-trade workforce engaged across what's now an omni-channel between our own network and the THD network. And we're beginning to see customer conversions already.

That will continue to grow as we learn, as The Home Depot associates learn, and as the supply continues to build, and we will pivot as necessary. But we expect this to continue to grow throughout the year

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through a combination of load-in and conversion of contractors. And then we expect this to be a long-term, multiyear growth initiative for both us and The Home Depot in the Pro category.

Vince Morales

And Steve, again, just more broadly, and we talked about this on our January earnings call. We think this relationship, and this extended partnership really gives us a considerably higher market access. Again, we're really targeting availability for the professional painter on a daily basis. And as Tim mentioned, that omni-channel approach, they can come to our stores, they can go to our dealers, or they can go to Home Depot, and that's all within a close proximity of their job site.

Michael McGarry

And Stephen, this is Michael.

The last thing I would add is, look, at the beginning of the day, every time we go into a new market with Home Depot, we get substantial new wins right out the gate. And what that does is it builds excitement among The Home Depot team. And their confidence level grows, because what they do is they start creating these winning stories across each of the different markets. And that's the most exciting thing about it.

Operator

Thank you for the question, Stephen.

Your next question is from Vincent Andrews of Morgan Stanley.

Vincent, please proceed.

Vincent Andrews

Thank you very much.

Michael, I'd be curious to get your updated thoughts on sort of the home improvement market, just given since our last call there has been a big move in interest rates and housing market seems tight still. So how do you—do you think the rising interest rates matters at all in terms of architectural paint demand and renovation? Or how should we be thinking about the evolving housing market?

Michael McGarry

Okay, Vincent, I'll let Tim comment on this.

Tim Knavish

Yes. Look, right now, there is such a strong backlog, particularly on the residential side. There is so many walls to be painted yet, but certainly not any near-term concern for ours. And even, obviously, rising interest rates, there is going to be some mortgage and affordability impact there, but there is such a shortage of overall housing in multiunit housing. Multiunit housing continues to climb despite the interest rate rises. Residential permits continue to climb here in the U.S. despite the interest rate rises. So absolutely, it's something that we're watching. But we're certainly bullish on that for at least the rest of this year, and we will see beyond that.

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Michael McGarry

And Vincent, this is Michael.

The one thing I would add to that is that we do a pro painter survey, and that pro painter survey continues to show a very strong backlog of our professional painters. So, we're very concerned about affordability more than interest rates. But at the end of the day, our pro painters still show pretty good backlog.

Tim Knavish

Yes, in fact, our last pro painter survey, which we just wrapped up, 75% of the painters had a backlog that was at least as big or higher than what they had 90 days and a year ago, so certainly no impact on the short to medium term.

Operator

Thank you, Vincent.

Your next question is with Josh Spector of UBS.

Josh, please proceed.

Josh Spector

Yes. Hi, guys. Thanks for taking my question.

A lot of investors are focused on your comment last call about EPS in 2023 perhaps greater than $9 per share. You didn't necessarily reiterate that today. Just curious, based on what you're seeing from a price cost dynamic, but also a demand environment, is that something that's still achievable? And is that achievable in a scenario that you lay out where China lockdown impact perhaps fade over the next couple of quarters, but Europe perhaps enters into a minor recession.

Michael McGarry

Yes. Josh, I would tell you that the dynamics for $9 remain valid. So, we're going to have an improving refinish market. That's a great business for us. Miles driven, we're actually almost back to 2019 levels in the U.S. We see miles driven improvement in Europe as well. From that dynamic, refinish is in solid shape. You see the numbers for aerospace. TSA bookings are all up. Aerospaces continue to get stronger. You probably noticed yesterday, Boeing said they were going to start rebuilding or building 787s again. That's a positive. There is a strong backlog of planes. Our share with Airbus has continued to grow.

I think that's excellent. We are only producing probably about 80 million cars this year. And so, when you think about what the run rate of car should be, we're still very bullish that car builds in the U.S. have been muted because of lack of chips, lack of parts. So, this is going to get better. So overall, I would tell you that we're in good shape.

Our synergies are going to be continuing to come in, productivity is continuing to improve. So, I feel very good, I feel very comfortable around $9. And the price raws, we're going to be past that in the second quarter. We're going to be pricing past all of it. And then we're going to be catching up on the early 2021 kind of inflation. So, we're on the right track.

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Operator

Thank you. Next question is from Michael Sison of Wells Fargo.

Michael, please proceed.

Michael Sison

Hi, guys. Nice start to the year. Historically, third quarter tends to sort of seasonally decline from 2Q, but it sounds like the pricing raws is going to get better as you noted.

Is this year going to be a little bit different where you should continue to see EPS improvement? I understand it's kind of tough to guide beyond one quarter. But kind of given so the potential for improving volumes and your sort of pricing mechanism, is that something that likely happens this year versus historical patterns?

Vince Morales

Yes, Mike. This is Vince.

Probably one of the most important metrics we're watching is sequential margin improvement. And I think from Q4 to Q1, you saw our margins move up 200 to 300 basis points, depending on the segment. We think that's the true indicator of how well we're doing, how well the industry is doing. It's really hard year-over-year at this point to compare.

Again, we're looking sequentially. And again, we're very proud with our performance Q4 to Q1. We do expect—again, there is a lot of noise in 2021. There'll be additional noise this year. So, we do expect, as you've heard Michael in the opening, some improvement in demand as we go through the year, especially as China comes back.

We are seeing refinish, aerospace, etc. But it's really going to be hard to compare versus historical patterns. And again, we're just looking sequentially. Our margin's getting better Q4 to Q1, Q1 to Q2 versus historical patterns, and that's really our marker.

Operator

The next question is with Frank Mitsch of Fermium Research.

Frank, please proceed with.

Frank Mitsch

Yes. Good morning. I need to give props to John on Slide 5. It tells a very helpful story as to what you're facing.

Obviously, a lot of questions already on price. Michael, I was just curious what the absolute number you're expecting in 2Q would be versus that 10% in 1Q. And then I noted in the comments that your Tikkurila sales were up low teens, excluding Russia. I'm curious how much of that was volume.

Michael McGarry

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Yes. Frank, first of all, we try to give you a guide on that second quarter. So, if you take John's little dotted line on that chart, you're going to dot a line up to around 12%. So that's probably a pretty good number. We certainly are internally pushing the team for more than that, but I think that's a realistic outcome.

I think the Tikkurila volume was in the low single digits if I remember correctly. But the beauty about what we're seeing with the Tikkurila team is that we're teaching them how to price. And that is something that they historically have not done a lot of. And so, this has been a wonderful thing for us. As we have talked about before, we think Tikkurila can look just like what Comex has.

We get more growth in the local markets, and we get better value for what we are selling, and that leads to an ever-improving return on our investment that we invested in buying Tikkurila.

Vince Morales

Since we brought up Tikkurila, one of the other businesses that performed really well in Q1 was our Traffic Solutions business, the prior Ennis-Flint acquisition. We saw around 25% organic growth year-over-year in that business, and with a seasonally light quarter. But again, we still ended that—ended the quarter with a very strong backlog, and now we are going into a very strong quarter.

Tim Knavish

Yes. Hi, Frank. It's Tim.

Just to add one more thing on that other large acquisition for us. Vince mentioned 25% top line growth, all-time record quarter for that business. And much like what Michael described with Tikkurila, the prior Ennis-Flint business pricing discipline was very different than how we executed PPG. And we also achieved double-digit price increase in that business for Q1. So really, really pleased with both of the large acquisitions and how they perform for us.

Operator

Thank you, Frank.

The next question is from Arun Viswanathan of RBC.

Arun, please proceed.

Arun Viswanathan

Hi. Thanks for taking my questions.

I just wanted to, again, drill into some of the drivers of maybe Q3 and Q4, understanding that your visibility is relatively dynamic. But when you think about the raw material inflation that you saw in Q1 and Q2 or are seeing now, are your current price increases sufficient to carry you into Q3, or will you be raising prices even more? And if you do have to raise prices even more, could you also comment on the availability of raws and if that has improved greatly from last year? Thanks.

Vince Morales

Yes, Arun, this is Vince.

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Honestly, our visibilities in terms of all the dynamics that play into inflation is probably 60 days to 90 days. So going out to Q3 or Q4 is difficult. And what we could tell you is we are seeing better supply in Europe, certainly. Better supply in the U.S. China is obviously—we are going through a transitory period due to the restrictions. But we do expect supply to normalize for the balance of the year. And as we said many times, we do feel there is enough structural supplier capacity to easily satisfy global coatings demand.

We have a lot of other noise going on right now. But at some point, we will normalize across supply-demand based on historical patterns, just too hard to predict Q3, Q4 right now. We do have enough—we do have good pricing going in, as Michael said, in Q2, which is enough to compensate for the sequential increase in raw materials. If we see more raw materials in the back half of the year, we will put in that real-time pricing engine again.

Operator

Thank you, Arun.

Next question is with Jeff Zekauskas of JPMorgan.

Jeff, please proceed.

Jeff Zekauskas

Thanks very much.

It seems that your packaging coatings business has slowed down. When we look at beverage can demand globally, it seems pretty strong. What's the dynamic that's going on there?

And in auto refinish, what were the volumes in the quarter year-over-year?

Michael McGarry

Yes. First of all, let me touch on the packaging. Look, we have picked up new share at, I would say, 70% of the new beverage can plants. We are in very good shape from that going forward.

Second, when you look at the packaging numbers, you have to remember we had phenomenal comps last year, and that will make it more difficult. But our packaging overall growth this year is going to be quite good. I feel very good about our position in our packaging coatings business. I would also tell you that when I think about that business, it's not just the volume, it's also the price that we are realizing as well.

John Bruno

Jeff, this is John. I will just comment on refinish.

If you look at the U.S. and Europe, on a year-over-year basis, volumes were up about mid-single digit, and that's off of a tough comp from last first quarter.

It was a good quarter, especially in the U.S. Asia was off a little bit, mainly driven by when we talked about the Winter Olympics slowed activity down and there was obviously some restrictions in March.

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Thank you, Jeff.

Your next question is from Kevin McCarthy with Vertical Research Partners.

Kevin, please proceed.

Kevin McCarthy

Good morning, everyone. Two questions on manufacturing variance and Capex.

First, on the manufacturing side, back in January, I think you talked about a $0.20 EPS drag in the fourth quarter. And I would like to know if that number declined in the first quarter, and if so, how much and what your crystal ball might say for the second quarter.

And then on the Capex side, if I read the numbers right, it looked like your first quarter spend was $194 million versus $80 million last year. And just was wondering if there is anything unusual in that in terms of cadence or any change in your annual range of $475 million to $525 million for Capex this year?

Michael McGarry

Yes. So, we will take the easy one first, Capex. We had Capex spending in December that we don't pay for until January. So, the January number was probably a little bit inflated, but our overall spend for the year is not going to change. And we are still looking at that 3%, $500 million kind of range. So, we feel good about that. As you know, a little bit of that is catch-up from the under-spending in '20 and a little bit of early 2021.

From a manufacturing standpoint, we had about $0.20 in Q4. We probably had about half of that in Q1. And the problem is it's not that we are having challenges making things, it's we are having challenges scheduling things because of raw materials predictability, what comes in. And if you are missing one item, you can't make the paint. So that's a bigger issue. And of course, some of it is also unexpected additional inflation on energy at the plant. As you can imagine, going into Q1, we had a certain natural gas number for Europe. And we are well in excess of that once the war broke out.

I would tell you, overall, the manufacturing is getting better. And I would say for Q2, you should anticipate another 50% improvement in that number.

Operator

Thank you, Kevin.

Next question, PJ Juvekar of Citi.

PJ, please proceed.

PJ Juvekar

Yes. Good morning.

Michael, I know you have been back integrating into risen capacity in the past. Just kind of how did that help you during this crazy period of energy inflation and all that?

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And then second question for Vince. Vince, you mentioned sequential margin improvement. But given your sort of first quarter that you reported, the second quarter guidance, first half is going to be down year-over-year. If you continue to improve margins sequentially, do you think you can grow earnings this year? Thank you.

Michael McGarry

Okay. PJ, I will take the emulsions question. We, as part of our Traffic Solutions or Ennis-Flint acquisition, it came with a small resin plant. We are making more emulsions there. We think we can increase the size of that facility. The team is working to do that as well. Not only we are going to use the asset, it was running five days a week, one shift, now it's running 24 hours a day, seven days a week. We are going to improve the size of that. We are able to get B A (phon) and some of these other raw materials that go into making the emulsion. The availability is better there.

And so, we feel comfortable that we are going to continue to improve the utilization of that facility.

Vince Morales

Yes. And PJ, on the margins, I am glad you brought that issue back up, because I do feel it's really the measurement stick because of all the noise last year. Our first quarter last year was very strong, the first quarter of 2021 benefited by some pandemic recovery. And then as we got through the balance of the year, our second half of '21 was very, very weak.

We are not going to give full year guidance on the call here today. But again, the trajectory of margins sequentially for each of these quarters I think is the true marker for our industry. We do expect, again, from some of the reasons Michael mentioned, abating supply shortages, improvement in our manufacturing and catch-up on pricing, we do expect our margins to improve sequentially versus historical patterns for the foreseeable future.

Operator

Thank you. The next question, Laurence Alexander with Jefferies.

Laurence, please go ahead.

Kevin Asberg

Hi. Good morning. This is Kevin Asberg on for Laurence Alexander.

I just had a quick question about the credit market. I guess given the moves and also the Fed's tightening cycle, I guess I was wondering if there has been any shift in how you think about financial leverage, and I guess how much you plan or expect that you could flex your balance sheet going forward?

Vince Morales

Yes. Our financial—our long-term financial discipline hasn't changed. We are kind of in the mid-2s in terms of debt to EBITDA. We do expect to pay down some debt this year. If we see anything strategically, we want to execute on, we will act accordingly. But we are not going to shift our strategies.

Again, if you look at our interest rate and blended interest rate, it's the best-in-class of our space, or close to the best-in-class, so again, no change in our strategy or outlook in the near term.

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Operator

Thank you. Next question, Mike Harrison of Seaport Research Partners.

Mike, please go ahead.

Mike Harrison

Hi. Good morning. A couple of questions on the auto OEM business.

First of all, you have been dealing with some operational inefficiencies there. Has that improved either in terms of customer behavior or your ability to manage what's going on in that space?

And then maybe an update on electric vehicle application wins with some of your innovative offerings. Have you seen some wins come through? And are you concerned at all about battery shortages impacting EV growth this year?

Michael McGarry

Okay. Let's start with manufacturing. I would say the auto guys have gotten better at knowing what chips are coming in and when they are coming in. So, they are much better. They are having much less scheduled—or unscheduled downtime is how it should be phrased. Our manufacturing has gotten better because their predictability of running has gotten better. And the one question nobody asked, so I am going to throw the answer out there and make sure you know it is our automotive team has priced higher than Company average. I feel really good about that, where we are in that space.

And then from an EV standpoint, we don't see battery shortages this year. It's certainly a longer-term trend that we are going to be paying close attention to. But right now, when I think about where we are winning in that space, our protective coatings that go into the battery has been a huge win for us. We just picked up two world-class customers this quarter. Dielectric powders, is another area that we are winning in. And so, I feel very comfortable about that. So one of the top five guys, we are also running a long-term cathode binder study with, that's more like a three- to five-year program, but the fact that they came to us to do that is really a good sign about how they see us playing in this space long term.

I am very comfortable with the pace that EVs are growing and our ability to service that market.

Vince Morales

And Mike, I just want to—I am glad you brought the question up again because I do want to talk a little bit more broadly about auto build. Michael mentioned, targets from third-party consultants this year is around 80 million builds. Again, we think the market, on a run rate basis, is typically over 90. So, there is at least, let's call it, a 10% to 12%, 15% catch-up that will occur in the next, you pick the number of quarters or months, 12 months to 18 months.

On top of that, we think there is a fleet rebuild that has to occur for things like car rental fleets. We peg that as another 3% to 4% of the market. On top of that, there is an inventory replenishment cycle in the U.S., for example, dealer lots, so, a very long runway. They are certainly getting better chip availability and more consistency. And there is more chips to come in the back half of the year and early 2023.

Very instrumental in our recovery, and we feel very strong about the underlying demand that supports that.

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Operator

Thanks, Mike.

Next question is from Jaideep Pandya of On Field Research.

Jaideep, please go ahead.

Jaideep Pandya

Thanks. The first question really is around your protective and marine business. Appreciate you guys are bigger in China these days. But how do you see your backlogs evolving now that oil prices are high, gas prices are high and also some of the marine end markets are doing extremely well in terms of cash generation? So, do you think that next two years we should see a material improvement in this area?

And then the second question really is around the auto business of yours. Appreciate Vince what you just said. But like if we go by the theory that there is cannibalization where EVs are eating into the ICEs, just want to understand your fixed cost structure. In the sense, in the next five years, if we have 90 million cars, but 25 million or 20 million of them are EVs, can you actually reduce your fixed costs in your traditional ICE-based auto OEMs? And on the other hand, obviously, when in EVs. And then are you looking at any bolt-on acquisitions, for instance in EV-related coatings for batteries, or do you have already exposure there? Thanks a lot.

Michael McGarry

Okay. Jaideep, we will start with the new builds. Our marine business is up substantially, and it's going to continue to grow. New builds are up 20% year-over-year, and it's up strongest in China, which is where we are strongest. This is a good market for us.

The oil and gas assets that are going to be built because of the Russia war on Ukraine are also going to increase. So that's really good for us. LNG tankers are really good for us. This is an area where pool fires lead to a product that we sell that are best-in-class. I have high hopes for our teams, our Protective/Marine business over time that is continuing to do well.

When you talk about the auto business, fixed costs, we actually paint EV cars just like you paint an internal combustion cars. We are going to still have all that business and pleasure you sell additional paint for the battery box. So, actually, your fixed—your cost structure improves as the volume goes through. So, the transition from internal combustion engines to batteries is actually a good trend for us. And we are leading in the space in this area. So, we are doing—I would say, we are doing better than our typical market share on internal combustion engines.

Now, will we look at acquisitions in that space, we are always looking for things that add shareholder value. I would tell you that we are always interested. It is a highly competitive space right now. There is a number of people playing in it, whether it's the protective coatings, whether it's films, whether it's powders, whether it's thermal gap fillers, there is a variety of different applications on how you win in that space, but we feel very good about this.

Operator

Thank you, Jaideep.

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There are no further questions waiting at this time. So I would like to hand the call back over to John Bruno.

John Bruno

Thank you, Sam.

Before we wrap up the call today, I wanted to let everyone know that Mary Anne Bendzsuk will be retiring in the second quarter, and this will be her last quarterly earnings call. I think a lot of people on the call had dealt with Mary Anne, and she has been a valued team member here at PPG for many years and provided excellent support to the investment community, supporting Investor Relations for more than 20 years. We want to thank Mary Anne and wish her and her family all the best in retirement.

That concludes today's call. If anybody has any other questions, please give us a call. Thank you very much.

Operator

That concludes the PPG Q1 2022 earnings call. Thank you all for your participation.

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