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PPG Industries, Inc. (PPG)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Emily and I'll be your conference operator today. At this time, I would like to welcome everyone to the Fourth Quarter PPG Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you. I would now like to turn the conference over to John Bruno, Vice President of Investor Relations. Please go ahead, sir.

John A. Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Emily, 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 2022 financial results conference call.

Joining me on the call from PPG are Tim Knavish, President and Chief Executive Officer; and Vince Morales, Senior Vice President and Chief Financial Officer. Our comments relate to the financial information released after US equity markets closed on Thursday, January 19, 2023.

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 to provide additional support to the brief opening comments Tim 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's President and CEO, Tim Knavish.

Timothy M. Knavish

President, Chief Executive Officer & Director, PPG Industries, Inc.

Thank you, John and good morning everyone. I'd like to welcome you to our fourth quarter 2022 earnings call and my first earnings call as CEO. I'll keep my comments brief, provide a few highlights on the recent quarter, the year 2022, and our outcome.

Let me start with the fourth quarter. Our fourth quarter sales of $4.2 billion were near the record levels achieved in 2021 despite significant unfavorable foreign currency translation.

Sales were aided by our strong US automotive refinish volume growth as supply chain disruptions started to moderate, and our order books remain robust. In 2022, our automotive refinish coatings business delivered over

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2,000 net new body shop wins as customers continue to value the product technology and industry-leading services and capabilities that this business delivers every day, including what we believe the best-in-class body shop full repair process.

Also aiding our sales were record results in our PPG Comex business in Mexico as our team continued their strong execution and delivered another record quarter of sales and earnings. PPG Comex sales are now more than $1 billion on annual sales basis, another record year for this business.

Our aerospace business continued to recover, delivering organic sales growth of more than 20% on a year-over-year basis, even with continued supply chain challenges. With an initial reopening in China, strong global order book, increased military related growth and PPG's advantaged technology products we expect this business to continue to grow in 2023 and beyond.

Our adjusted earnings per diluted share from continuing operations were $1.22, above the midpoint of $1.13 from the guidance we provided in October. This included more than 20% year-over-year segment earnings improvement driven by selling price realization and strong cost management. On a two-year stack, selling prices were up about 19%.

We achieved this segment earnings improvement despite the significant and unpredictable shutdowns in China from COVID-19 that were worse than what we had anticipated going into the quarter, and these have continued into the first quarter.

In Europe, despite demand remaining soft, earnings were similar to prior year due to strong selling price realization and cost management. We also continue to execute our previously announced restructuring programs and realization of acquisition synergies and delivered about $20 million of savings in the quarter.

Now a few comments on the full year 2022. The challenges were many, including unprecedented cost inflation, unexpected geopolitical issues in Europe, disruptive and unpredictable shutdowns in China, strong appreciation of the US dollar and rapid escalation in interest rates in the United States.

Though all of these factors impacted our sales and margin performance, the PPG team responded to these challenges, including rapidly implementing real-time selling price increases that, by early 2023 will offset all cumulative cost inflation incurred since early 2021. Given the more difficult macro backdrop, we also announced, and are quickly executing new cost savings initiatives with particular focus on Europe.

In 2022, we also made good progress on key strategic initiatives, including strengthening our relationship with the Home Depot, as evidenced by the launch of our new US architectural Pro program, and winning more shelf space with our Glidden Max-Flex spray paint. In addition, we were honored to be awarded Home Depot's 2022 Overall Innovation Award, which was the first time that a paint supplier has achieved this distinction.

Our partnership with The Home Depot continues to be a great opportunity for significant growth in the coming years. The PPG team continued the integration of our recent acquisitions, including timely execution of acquisition-related synergies. These businesses are all executing well and provide the company with increased organic growth prospects in the next few years.

We made some smaller but strategically important powder coating acquisitions which adds needed manufacturing capacity and greatly aids our technological capabilities in this fast-growing product category.

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In 2022, we once again lowered our SG&A as a percent of sales, decreasing by about 100 basis points, including the delivery of about $65 million in restructuring savings in the year. While working capital remains higher than we would like, we made solid progress in the second half 2022 to lower our inventories on a sequential basis. We expect cash conversion to return to our historical levels in 2023 and have exited 2022 with a strong and flexible balance sheet.

Throughout 2022, we took actions to bolster our ESG program, including announcing our commitment to the Science Based Targets initiative, issuing our first ever diversity report, and finally obtaining shareholder approval to declassify our board and remove supermajority voting requirements. In 2023, I expect our team to continue their strong progress by introducing additional sustainable products for our customers and unveiling our new 2030 sustainability goals.

In summary, for 2022, we did not meet our own earnings expectations. But through the resiliency of the global PPG team, we did deliver record sales of $17.7 billion and set the foundation for many accretive growth initiatives.

Now moving to our outlook. As we outlined in our press release, we expect the Q1 demand environment to remain similar to the fourth quarter. However, as the year progresses, we are more confident that we have several catalysts that will enable PPG to drive earnings growth, including improvements in the supply chain, which will further moderate raw material costs, and we expect to see this flow through our P&L more prominently starting in the second quarter, also, our strong position in China that will benefit us as the COVID reopening progresses.

With respect to Europe, we expect coatings demand stabilization beginning in the second – resulting in higher year-over-year earnings. In the US, we will benefit from the continued recovery of the aerospace and automotive refinish businesses and the current strength of our order books in both of those businesses. Also in the US, our recent share gains in the architectural business will help buffer lower demand from a softer US housing market. As a reminder, our overall exposure to the US new home construction market is relatively small, only about 1% of our global revenues.

As we said last quarter, we believe our global portfolio mix will prove more resilient in the coming quarters if we experience a broader global economic decline. As normal course of business, we will be highly focused on controlling the controllables, including managing our costs and optimizing working capital.

In summary, while economic conditions are challenging in the near-term, I expect segment margin recovery to continue in the first quarter and remain confident about the future earnings capabilities of PPG, and we certainly see a path to return to prior peak operating margins with opportunities to exceed it.

As I begin my tenure as CEO, the PPG team is laser focused on delivering improved financial results, including recovering our historical margin profile, and executing on all levers to return our portfolio to mid to high-teen percentage segment margins.

At a high level, you can expect me and the PPG team to elevate our collaboration with our customers, bringing them innovative, sustainable and differentiated products and solutions, which will enable our customers to improve their productivity and growth and allow us to improve our own organic growth performance.

We'll simplify and optimize our manufacturing and supply chain efficiencies to reduce complexity and deliver productivity for both PPG and our customers. And we will preserve our legacy of prudent management of our

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balance sheet, continuing to prioritize cash deployment for shareholder value creation. I plan to share more details on our key initiatives as the year progresses.

In closing, I am looking forward to leading this great team of 50,000 employees around the world, as we continue to partner with our customers to create mutual value. This year marks PPG's 140th year anniversary, and I strongly believe that our best days are ahead, thanks to our people, industry-leading products, innovative technologies and great customers.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question today comes from David Begleiter with Deutsche Bank. Please go ahead, David.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Good morning. Tim, for the full year, consensus was around $7 per share, which would imply a pretty big ramp up from the Q1 levels. Is that a number that you think you can – that can be achieved or get close to as the year progresses?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah. Right now, David, just because of all the uncertainty in many different avenues of our business, we're focused on Q1. And clearly, Q1 has some hangover elements from Q4, particularly around China. We do believe, as I said in my comments, that there are the shopping list of multiple potential earnings growth catalysts for 2023, including China, including aero, including refinish, including Comex, EVs, THD, literally a shopping list of potential earnings catalysts. But we'll get through this hangover of Q1 and then reassess and communicate more as we move forward.

Operator: Our next question comes from Michael Sison with Wells Fargo. Michael, please go ahead.

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Hey, guys. Good morning. Tim, I think your outlook for the first quarter is down mid-single-digits for volumes. Can you walk us through what the volume outlook is from your less cyclical markets and your more cyclical markets to give us a gauge of kind of where those are at for the first quarter?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Sure, Mike. I mean the biggest impact is, again, China. Typically, in China, March is a very big month for us, okay? And our assumption for China in Q1 is that they'll see a second wave to some degree after Chinese New Year. And so, our base case is that we won't really see significant China recovery until starting in Q2.

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Additionally, on the architectural side, particularly in Europe, we would normally, in Q1, see a fairly robust stock up ahead of paint season. And because of everything that's happening in Europe that we see some buildup, but not nearly what we would see in a normal year.

And then, finally, one of our top performing businesses, PPG Comex, typically has a very strong Q4, and it had an even stronger than expected Q4 in 2022. So there's a little bit of just timing there, even though we expect another great year from that business, there's a timing issue with Q1. So those are the three main factors, I would say.

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

A

Mike, this is Vince. Just to [indiscernible] (00:17:00) other businesses. We're not seeing any tone change in the businesses sequentially. Again, good strong pace of recovery in aerospace, a solid, consistent growth in refinish, auto OEM, consistent – generally consistent quarter-over-quarter, starting to recover in Europe. So, again, we're not seeing any significant changes in some of the other key businesses either.

Operator: Our next question comes from the line of Christopher Parkinson with Mizuho. Christopher, please, go ahead.

Christopher Parkinson
Analyst, Mizuho Securities USA LLC

Q

Great. Thank you so much. Just a real quick question on pricing. Can you just comment on the current pricing environment, just given the macro movement in, let's say, raw materials and then also several management changes across the sector. Are you still seeing the ability to sustain price throughout the year? Just any commentary would be incredibly helpful. Thank you, so much.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah. Sure. Thanks. Thanks for the question, Chris. You saw on the print that we put up 11% for Q4, 19% on a two year stack, sequentially it was 18% on a two year stack in Q3. So we still have pricing momentum. We will have additional price in Q1 targeted by business. We've got some carryover impact in Q1 as well.

As for what's happening out there in the world besides PPG, all the coatings companies are facing the same inflation inputs that we are, be it raw materials, which we focus a lot on, but there's also significant inflation outside of raw materials that we are also – all experiencing.

So, we see a continuation of positive pricing as we enter the year. And beyond that, a lot of it depends, what happens on the inflationary environment, but that's our view at this point in the year, Chris.

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

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

Q

Hey, guys, good morning. As it relates to the US architectural, I mean, obviously, there's bifurcation so far between yourself and some of the professional markets, how do you sort of see that evolving over time as the year unfolds?

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And then, for European architectural, just given the extent of the volume weakness in the markets, can you just give us a sense as to how competitive the pricing backdrop is in the industry, just given the volume weakness? Thanks.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Sure. Thanks, Ghansham. So let me start with the US environment. I'll start at a high level from a macro standpoint. Clearly, DIY is down partly because of what's happening with consumer confidence, but also a bit a holdover from the COVID piece of DIY. And clearly, new housing construction going down, again, only 1% of our sales. But those two segments are down.

Fortunately, for us, we're much stronger in commercial and maintenance. And there, we still see backlogs with our customers. I think you know we do a survey every quarter with our professional customers here in the United States. And their backlogs are still floating in that 12 to 13-week range. So we still see some good demand there.

And then as we move forward, we expect to continue to see growth from our Home Depot Pro program moving forward. Now going over to Europe, the volume started to really deteriorate after the invasion last Q1, and was down double digits throughout all of 2022, the professional painter business down, not nearly as much more in the single digits.

But as we enter 2022, we'll see particularly for Q1 – I'm sorry, 2023. For Q1, we've got a little bit of a comp issue where we're still comping part of the quarter to the pre-war era. But then once we get to Q2, we start to have, frankly, some positive comps because our total business in Q2 in Europe was down about 10% double digits, low double digits. So, we do see it more or less kind of bouncing off the bottom, if you will, as we end Q1 and then comping better as we get into Q2.

Operator: Our next question comes from John McNulty with BMO. John, please go ahead.

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah, good morning. Thanks for taking my question. Tim, you spoke in your prepared remarks about the target of mid to high teens margins for PPG going forward. Is it a function of just raw materials getting back to normal and kind of having that catch-up kind of finally been made? Or do you see a lot of manufacturing efficiency improvements that may have uncovered themselves through some of the supply chain problems, what have you? And if so, if it's the latter, can you help us to understand what some of those levers might be?

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

A

Hey John, this is Vince. I'm going to start, and I'll let Tim add some color here, but really three levers. One, we've been chasing, which is the raw material price, or total inflation price gap, which, again, we think will be caught up on that in early 2023. We call it weeks not even months. But the second, which I think is important is, and you hit on it, John, we haven't had a strong manufacturing couple of years here, due to disruptions, due to supply disruptions, due to customer disruptions, COVID disruptions, due to churn in the workforce that many companies are seeing. So we do – that is not a significant number for us from a manufacturing perspective.

But the third, which is very important, though, is we're still down about 10% versus pre-COVID levels in terms of volumes spread throughout our portfolio. So, those are the three big levers and Tim can add color here.

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Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah, you really hit the Phase 3, but particularly to the volume, we've got aero still down significantly. We've got auto, auto has been at recession levels for three years now. There's pent-up demand across the planet for cars. Refinish is still down 10%-ish from 2019.

In addition to what Vince mentioned, we have done a good bit of cost out during this period as well and restructuring. So we'll get levered from that. We're not completely finished with our acquisition synergy realization. So, as I said, I used the term shopping list. We've got a shopping list of items that are contribute to our margin recovery.

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

Steve Byrne
Analyst, BofA Securities, Inc.

Q

Yes. Thank you. Tim, you made a comment a few minutes ago about inflation outside of raws. And I just wanted to drill into this near-term outlook of yours of low single-digit inflation in the first quarter. Is that a comment on broadly cost of goods? Or is it just raws? And are you also seeing it in labor and freight and so forth? And maybe just on the raws side of that, for first quarter, when would you say that flowing through cost of goods is based on? What month would be the midpoint of your purchases that would flow through cost of goods in the first quarter versus your purchases of those raws today, what would you say that would reflect in terms of maybe second quarter raw material costs?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Sure, Steve. I think the numbers you were quoting at the beginning of your question were raw material, okay? So in Q4, we were up mid single-digits year-over-year, down low single-digits sequentially. In Q1, we expect to see modest down year-over-year and another sequential step down. The reality of flow through is, we're really flowing through inventory that we have on hand now pretty much. And that will flow through throughout Q1. So we're expecting the positive benefits of that on the P&L to really not show itself significantly until Q2, okay.

And then on the other inflation, that's going to be, at least for now, that's going to be pretty constant as we move from Q1 into Q2 around labor inflation and some of the other inflation.

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

A

Yeah. And, Steve, just going back to what Tim said earlier in the call. That's why we're doing targeted pricing in – across our portfolio to compensate for this other inflation that's going to be higher year-over-year, primarily labor. I'm not seeing as much freight as you pointed out. It's not been an inflationary factor the last couple of quarters.

Operator: Our next question comes from Duffy Fischer of Goldman Sachs. Please go ahead, Duffy.

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

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Yeah. Good morning guys. Question just around price. So as you ended last year, if you just anniversary the price that you had at that point how much would that move up price this year just from an accounting standpoint as we roll through? And two, I'd imagine you've gone out with a lot of your price increases already. So if you average that across the company, kind of what's the ask on price that you've sent out to customers so far this year?

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

A

Yeah. Duffy, I'll handle the first part of the question on the carryover pricing. We do have every quarter, our price off of our sales base so that you can do the math. And you come up with several hundreds of millions of dollars of price carryover in 2023 from our 2022 pricing initiatives. Again, if you just do the math, you can easily come up with that. It's certainly north of $300 million and will be carried over.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah. And, Duffy, thanks for the question. It's Tim here. On the new pricing, if you will, it will be more targeted just based on where each of the segments are on their catch-up and on offsetting total inflation and new inflation. We've already gone out for additional price in a couple of businesses. We're having discussions with customers in a few other businesses. And we'll prefer to have those discussions with the customers first and – but we'll have more visibility on that as we move forward. But we will have positive price when you net all of that here as we move through 2023.

Operator: Our next question comes from Laurent Favre with Exane BNP Paribas. Please go ahead.

Laurent Favre
Analyst, Exane BNP Paribas

Q

Yes. Good morning. Tim, in your focus areas, you mentioned simplification and optimization of supply chain and manufacturing. I was wondering if you could talk a little bit about this and maybe size the opportunity on costs and working capital, and are there areas where you think you need to rationalize the footprint based on a structurally lower demand environment, for instance, in Europe? Thank you.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah. Thanks, Laurent. If you look at our journey over the last decade and a half, we've got a lot of acquisitions, we've acquired a lot of manufacturing [ph] assets (00:29:41). We've also acquired a lot of product portfolios, and we've captured a lot of synergies along the way. As we look at where we are today and some of the things we've learned through some of the supply shortages, et cetera, of the crisis, we believe there's fairly significant opportunities for us to really simplify, not only our footprint, but our processes, simplify and standardize some of what we've acquired, simplify some of the portfolios that we've required or required – or acquired.

So we do believe that there's some significant upside for us there as we move forward. And as you can imagine, that's not as quick a realization as, say, procurement synergies when you first close the deal, but we feel pretty confident that in the medium and long-term that we can deliver value there.

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

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Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Yes. Good morning. Tim, a question on your US architectural business. If we look at most of the macro indicators for housing and construction, they're slowing markedly in recent months. On the other hand, you have some company-specific tailwinds in the form of a ramp of your Pro paint program at Home Depot. I think you also referenced increased shelf space at Glidden. So can you frame that out in terms of what you're anticipating maybe volumetrically as 2023 progresses in that vertical?

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

A

Yeah, Kevin, this is Vince. Let me just start on the macro. Again, what we're seeing, which I think's been pretty chronicled, is new housing starts and leading indicators are certainly pointing down. We really have to bifurcate that. Single-family housing starts are significantly down. Multifamily, we expect to turn down, and they're starting to turn down. But there's still going to be growth with multifamily completions, again, paints at the end of the cycle here. There's still completions that will carry us well into the year.

As Tim mentioned earlier on the commercial side, commercial new build, again [ph] starting (00:32:06) for the first half of the year should be constant, if not longer. Again, commercial repaint is solid right now. And there's a backlog on that. So those are the macro signs and we do have some PPG specific items that Tim's going to talk about.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah, Kevin. The PPG specifics, you know well about the THD – Home Depot Pro program, and we expect double digits from that program again this year after strong double digits last year. The other one, we've got a nice additional retail win. Our customer is going to announce it first, but you should hear in weeks, possibly months here of what that is, that will help offset some of the other things that Vince mentioned.

And then the spray paint win for us with that innovation award at The Home Depot is – we're excited about opportunity to not only leverage that specific product, but expand that offering [ph] even (00:33:14) further. But when you put it all together, Kevin, we are expecting, net-net, for volumes in that space to be down. But of course, sales to be up with the price offsetting the difference.

Operator: Our next question comes from Frank Mitsch with Fermium Research. Please go ahead, Frank.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Thank you and good morning, all. First, I want to extend my sympathies to the PPG family on the passing of Bill Hernandez. He really was a great, great guy. Hey, Tim, I appreciate your answer on the full year EPS question, for sure, given all the uncertainties. But you already indicated that you expect European earnings will be up year-over-year in the second quarter. And you also mentioned that your folks on the ground in China are expecting China to really pick up come April.

And so I'm wondering, is part of your calculus that we will likely see higher year-over-year EPS in the second quarter?

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Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Well, again, Frank, first of all, thanks for the call out to Bill Hernandez, a loved PPG – partnered here for many years and just a world-class CFO and great human being, and a tragic and sudden loss this past weekend. So thank you for calling that out.

Frank, at the end of the day, the uncertainty at this point with what's happening with China and when, and what's happening with Europe and to what degree, and what's happening to raw material pricing, and the specificity of that raw material pricing, as you know, can change our earnings profile fairly significantly, we're just not in a position right now to put out a statement on Q2 EPS. That said, as I said earlier, I believe we've got a hangover in Q1, but a number of those, let's call them, earnings levers start to come due in Q2.

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

A

Yeah, Frank, this is Vince. We do give this up. If you look at our profile of countries, China is one of our largest countries for sure. So, there's still uncertainty, there as we pointed out, and Tim pointed out in the opening remarks about the timing of the opening. Right now, we certainly hope March is a strong month. Definitely too hard to predict April, which is Q2 is typically a very big quarter in China. So [ph] not in a (00:35:59) position at this point to provide any [ph] broad line (00:36:02) on that, at this point.

Operator: Our next question comes from Josh Spector of UBS. Please go ahead, Josh.

Joshua Spector
Analyst, UBS Securities LLC

Q

Yeah. Hi. Thanks for taking my question. I just have a couple of follow-ups here. First, do you think you can achieve the low end of your margin targets this year in 2023 on average? And second, if you could comment on your ability to hold prices across the businesses as we move through this year? And any comments there versus why this might be different versus prior cycles? Thanks.

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

A

Yeah. Hey, Josh, [ph] one lever (00:36:39) to help us improve earnings, again, we're not trying to give full year guidance on margins, and that's even harder pass through than top line. So we'll defer that till a little bit later into the year. Your question on pricing, I'm going to let Tim answer it.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah, Josh, I'm confident in our team's ability to hold price similar to prior cycles. And with this cycle, possibly even more because of other inflation that is more persistent than we've had in other cycles. So that's – we're confident in that.

Operator: Our next question comes from Vincent Andrews of Morgan Stanley. Please go ahead, Vincent.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

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Thank you. I think you commented in the prepared remarks that you've got auto builds flat in 1Q, and I think the consultants are still calling for it to be up about [ph] 2.25% (00:37:38). So is that just something you're seeing in your own book? Or are you anticipating those consultant numbers to come lower? And just, in addition to that, could you talk about how you anticipate the mix of auto builds this year? Is there going to be any different than last year? And would that be a plus or minus for you?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah. Thanks, Vincent. Well, first of all, historically, I don't want to brag, but historically, we've actually nailed it pretty well compared to some of the external consultants on the builds, because we got so many people in the plants every day. We have visibility to operating schedules, and we talk to those folks. So the difference for us in Q1 specifically is China. Because our base case is that, there will be, to some degree, a second wave after Chinese New Year of infections, and we saw what that did on the first wave to assembly plants and other suppliers.

So that's our base case, and that may explain the difference between us and some of the consulting houses out there. But beyond that, we're expecting modest growth for the year, low single digits. And that's an area where there potentially could be upside, but our base case is low single digits. Yeah, just to give you some examples specifically of what happened on the ground in China, and why we are a bit cautious on the post-Chinese New Year.

When things opened up in mid-December in China, we've got 19 PPG manufacturing sites across the country. And we went from near zero absenteeism very quickly to above 50% absenteeism across that whole network. And that had it returned very rapidly to near zero in a period of about two and a half to three weeks. And we saw that same in some of our other suppliers, assembly plants, you name it. So we've lived it. We've seen the data.

And we believe that as people travel to the families that more travel than the last three years across China for Chinese New Year, as they travel to some of the more remote villages to visit their families and return, we do believe there will be a short but acute second wave. And so that's why we're a bit more cautious. And as Vince mentioned, March is a huge month normally for our China business.

Operator: Our next question comes from Aleksey Yefremov with KeyBanc. Please go ahead, Aleksey.

Aleksey Yefremov
Analyst, KeyBanc Capital Markets, Inc.

Q

Thank you, good morning everyone. I just wanted to clarify your raw materials commentary from earlier. It sounds like you are currently de-stocking sort of earlier raw materials purchases and will begin to purchase more perhaps in the second quarter. So there could be more of a step down in the cost. Is that the right way to think about it?

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

A

Yeah. Aleksey, let me provide some – maybe some clarity here. So we did see, as Tim mentioned, some modest sequential raw material inflation in Q3 to Q4. We expect a further incremental inflation in Q4 to Q1.

We were still up, Q4 year-over-year. And we have to work that inflation through our inventory, which will take us likely through the first quarter before we see that impact on our P&L. And so that's I think what we were trying to articulate.

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We do have – as Tim mentioned, we do have efforts underway to optimize our working capital, primarily our inventory. We ended July or June with seemingly high inventory levels. We worked in the second half of the year to work those down.

And we're still working those down as we get into the first quarter of 2023. So they're still above what we want to be our target range. So we're still going through various de-stocking depending on the region, depending on the product. So we will have crimped raw material purchases in Q1 and likely some crimped raw material purchases in Q2 as well.

Operator: Our next question comes from John Roberts of Credit Suisse. Please go ahead, John.

John Roberts
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you and morning Tim, Vince and John. I just wanted to ask a question about auto refinish. You won 2,000 new body shops in 2022. Was that concentrated anywhere regionally? Or was there something else common to those shops that switched?

And when you talk about 15% higher productivity, is that relative to the prior supplier to those shops? Or how are you defining that since you're leading competitors also talking about having productivity higher than the competition?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yeah. Thanks, John. To your first question, our net wins on body shops are positive in all the major regions, US, Canada, Europe, Australia, New Zealand and China. It's just proportionate to our business [indiscernible] (00:43:24) the vast majority of those are in the US and Europe.

Relative to the whole productivity question, the way we look at it is change is only as strong as its weakest link. And so every link on the refinish body shop throughput has to be strong in order to really drive what's most important to the body shop owner, and that's what they call key-to-key time. From the time you take the vehicle owner's keys until the time you hand those keys back to the vehicle owner. That is the one and only metric that is [ph] present (00:44:09).

So if you are incrementally faster in one of those steps, but slower in several others such that your key-to-key time is 15% slower than you're simply not as productive in the eyes of that – in that body shop owner. And so we focus on that end-to-end with things like the digitized color match, our [ph] linked (00:44:39) digital system that really encompasses the whole body shop, the visualizer, optimized, mixing to improve speed, eliminate waste.

And another thing that's really important to the body shop owners right now that PPG's value proposition delivers and some of our competitors don't, is you're actually simplifying some of those steps with things like MoonWalk and the visualizer, so that the constrained flavor of the professional painter doesn't always have to be the one to do that. You open it up to other labor that can do that and that adds additional productivity of the body shops. So again, the most important thing is that key-to-key time, and that's where we have the 15% advantage.

Operator: Our next question comes from P.J. Juvekar with Citigroup. Please go ahead P.J.

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

Q

Yes, good morning. Tim, clearly, the housing market is slowing down, whether you look at new homes or existing home sales. Have you seen a slowdown in the contractor business? The contractor business was robust. Last couple of summers, they had a huge backlog that they were working from COVID. As that backlog is worked down, do you expect some slowing in the contractor business? Thank you.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Yes, P.J. Yes, we have already seen a slowdown in contractors that are primarily focused on new housing. That's a brutal reality that we all have to face. But again, that's a small portion of our business. Our backlogs for where we're strong, which is commercial and maintenance, literally have moved only incrementally, 13 weeks average backlog in Q3 to 12 weeks average backlog in Q4. So that's what's been the margin of error of our survey. So that's holding up much better than the new build.

I believe part of that, if you think about a lot of commercial work and maintenance work and light industrial work, a lot of that work was near zero during COVID, while DIY and res repaint was offsetting it. So there's still a lot of pent-up demand there. So I don't want – as I said earlier, the total volume is still going to be incrementally down. So I don't want to oversell that. But that's why some of our Pro business is holding up better.

Operator: Our next question comes from Michael Leithead of Barclays. Please go ahead, Michael.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning, guys. I just had a bit of a follow-up on the raw material basket. Can you just help us with how you think about that evolving broadly over the course of this year? I guess, with 1Q demand being pretty benign or restock volume was down 5-ish-percent or so, why do you think input costs aren't coming down faster? And if China does recover in 2Q and beyond pretty quickly, how do you think about what that does to your raw material costs?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

So, Mike, I'll start and I will – Vince will fill in some color. I think there were actual artificial demand in the second half of 2022 that has maybe delayed some of the basic supply-demand economics. Because you'll recall that for most of 2021 and the first half of 2022, raw material availability was our number one issue and a lot of our coatings peers' number one issue. So as that availability improves, we all stocked up and got safety stock and, at the same time, demand started to collapse.

So things were kind of go on – when I say collapse, I mean, particularly on the DIY and deco side, but big driver to the overall raw material change. So I think a lot of companies, and you've seen that what companies have said, ended the year with more inventory than they would like. So there was a bit of artificial demand that delayed what would be a normal supply-demand curve.

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

A

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Yeah, Mike, let me just add some color here. So as we enter 2023, again, we're destocking. We know from a public commentary, a lot of our peers have excess inventory and are destocking. I do think there is this type of war with the supplier base typically Q1 and Q2 are peak volume quarters for coatings raw material purchases. I don't think that's going to materialize in the same manner this year. So we'll have a lower buy – PPG will have a lower buy in Q1. We have suppliers in virtually every week or every day for the past couple of weeks, indicating to us they have excess supply to give to us. And so we're going to maximize that to the benefit of our shareholders. And we'll negotiate our Q1 and Q2 pricing accordingly. We do believe, as we said over the last couple of quarters, there's ample supply in our supply base.

Operator: Our next question comes from [ph] Silica Cook (00:50:14) with JPMorgan Chase. Please go ahead.

Q

Good morning. This is [ph] Silica (00:50:23) for Jeff. I was wondering whether you can discuss your volumes and your price in your US architectural stores. And secondly, I was wondering whether you can talk about what's happening in the packaging business?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

Sure. So the stores pricing, we've raised price there multiple times, and we've held that price throughout the year. And 2023, it will depend on what happens from an inflation standpoint, but that's one of the businesses where we moved fairly quickly to keep up with cost inputs.

On packaging, we did have strong margin recovery in that business throughout 2022, and we expect that to continue in 2023. We do see some softness there in pockets around the world, driven by – in China, it's the lockdowns. And in Europe, it's just consumer confidence in beverage spending. So we have seen some softness in volume, but strong margin recovery. And we also continue to convert to our Innovel PRO BPA-free content material. And we've got some nice wins in that beverage space, it will be launched as we move through this year. But overall, at a high level, good margin recovery, some softness in demand around the world.

Operator: Our next question comes from Arun Viswanathan with RBC. Please go ahead, Arun.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Great, thanks for taking my question. Good morning. I guess, my question is about some framework you've provided in the past. If we go back maybe a year, year and a half ago, you were discussing maybe $9 of earnings for 2023.

Do you see that as still maybe a possibility a couple of years out, that would imply another $400 million, $500 million of EBIT on top of where you are? So what's the framework to get back there? Is it kind of that high-teens EBIT margin and maybe the recovery of the 10% volume, or would you need more than that to get back? And is that still maybe again available in a couple of years' time? Thanks.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.

A

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Yeah. Hi Arun, I've said before, I believe that the $9 EPS is when, not if, and I stand behind that. And that's because the fundamentals are there. We have a portfolio that has earnings power that has yet to be released. And I won't give you my entire 10-point plan that will get us there, but you've still got recovery in some of our better businesses, aerospace, auto, refinish.

Let me just talk about auto for a second without going too far off topic here. But if you take a six-year run rate of global builds before COVID, compared to the 2020, 2021, 2022, there's 40 million fewer cars that were built during that three-year period compared to the six year [ph] before (00:53:59). So everybody has their guess as to how much of that 40 million will be made up over time, but it's not zero.

And so that business has a lot of volume recovery to go. We've got some price/cost momentum. You've heard about our restructuring, acquisition synergies, some of the technology innovation, productivity, sustainable products that will drive share growth, and then just broader volume recover, we feel confident that the $9 is a when not if.

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

And just – Arun, it's Vince. Just a couple of comments, [ph] this is actually a (00:54:41) little more near-term. So if you look at 2022, we have to remind – Tim mentioned this earlier, but it's a good reminder. We really saw Europe fall really the back half of March. So we're going to come up against some recession type volumes here in a couple weeks.

We remind everybody that, in Q2, China was shut down, industrial-wise, for almost two months. So again, we don't think 2022 was representative in China of a traditional – even a compressed run rate on GDP growth. So those two outside of aerospace, outside of refinish, we think have some opportunities to contribute. And again, as Tim mentioned earlier, we expect very good leverage – above historical average leverage as volumes return in any business.

Operator: Our next question comes from Laurence Alexander with Jefferies. Please go ahead, Laurence.

Daniel Rizzo
Analyst, Jefferies LLC
Q

Good morning. It's Dan Rizzo on for Laurence. Thanks for fitting me in. Just in terms of the backlog you mentioned, I think you said commercial backlog was 13 to 14 weeks. And then I think in the comments, you said a $200 million backlog in aerospace. I was – just for comparison purposes, what does that mean versus what, I guess, historically it's been?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.
A

Yeah, Dan, historically, that 12, 13 week for US Pro painters is actually still high. So that will offset some of the negative volume in some of the other segments. I can tell you that in my short 35.5 years with PPG, I don't remember the aerospace backlogs ever being this strong. And that will take us – that's pent-up demand for the foreseeable future.

Refinish, our refinish backlogs are still, particularly here in the US, probably five times what they were pre-COVID. And it's not only a matter of us getting product out or getting raw materials in, our refinish customers' backlogs are high. I hope you haven't had any minor fender benders lately, but if you have and you've taken a car to a body

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shop, they're likely to tell you it's six to eight weeks before you're going to get that car serviced and taken care of. So the backlogs across all of those spaces are high, and in some cases, historically high.

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

Yeah. I'll add some color, Dan, to the aerospace figures here. And so we said before, aerospace is circa $1 billion business for us. This $200 million backlog is typically a small fraction of that. So this is almost another two months of activity. If we can get it done this year, we're still facing some supply challenges that are governing what we can do in a particular month, quarter, but it is a significant backlog relative to historic terms.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.
A

Yeah. And I'm going to grab that back for one more comment. The demand in aerospace is actually growing as we progress through the months and quarters. So you've got kind of the underlying demand is growing, which means that $200 million backlog is going to be there even longer. And recall that China, international travel only opened on January 8, so that's going to be another stimulus for aerospace demand.

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

Michael J. Harrison
Analyst, Seaport Research Partners
Q

Hi, good morning. In the auto OEM business, a question on electric vehicles that hit 10% of global car sales last year. I was hoping that you could give us an update on some of the key products that you're providing for electric vehicles. Any recent wins or other metrics you can share on that portion of the auto OEM business?

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.
A

Yeah, Mike, we're really excited about EV because we are winning where the EVs are winning, okay? We're winning where the EVs are gaining the most and that's China. You probably saw the journal article here not that long ago. It's something like 65% or so of the EVs sold last year were in China, and that's where we're having the most success. In fact, we're growing significantly with the largest EV producer in China.

The way we're approaching is, it's not only about new technologies, it's about picking the winners on the EVs and selling, let's say, more conventional corrosion protection and beautification products to those customers. So, it's a combined effort of selling our new and differentiated products like our battery fire protection, and our dielectric coatings products to those customers, but also targeting and winning with the EV winners in the market.

Operator: Our final question today comes from Jaideep Pandya with On Field Research. Please go ahead.

Jaideep Pandya
Analyst, On Field Investment Research LLP
Q

[audio gap] (01:00:49-01:01:01) partly because of the crazy raw material inflation you've seen. Now as raw materials tail off, are you not getting pushed back from your customers when you're trying to do these targeted pricing, especially in a demand environment, which has at least changed and has slowed? That's my first question.

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And the second question really is on protective. Could you just tell us like what is the backlog in marine and protective these days? Thank you.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.
A

Hey Jaideep, I'm sorry. The beginning of your first question cut out, if you – I apologize, but if maybe you could repeat your first question for us, please.

Jaideep Pandya
Analyst, On Field Investment Research LLP
Q

Yeah, sure. Sure. So my first question is just on the pricing. So...

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.
A

Yes. I got the first question.

Jaideep Pandya
Analyst, On Field Investment Research LLP
Q

Hello. Yeah. It's just on – yeah.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.
A

So, Jaideep, I'll take it and then Vince, you can jump in. On pricing, you got to remember that the pricing that we've achieved over the last couple of years was to offset what's happened in inflation in the last couple of years. And our customers have visibility to what's happened to our net margins, and so they have optics on where we are on a margin recovery standpoint and they also know when we have these discussions with them that we're not back to peak margins. And so it's not like we're going, in most cases, above and beyond that. So as we move forward, we'll continue to be competitive, and we'll continue to price to offset non-raw material inflation.

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

Before Tim answers the protective question, Jaideep, I think we have discussions with our customers in almost every business. And they want us to be a healthy supplier that continues to innovate and they understand that and again, get paid a fair price for innovative technology that typically helps them. And we're coming into a period of time, given the inflation and base and salary where our customers really value functional attributes of our coatings products.

And, again, they're pushing us – not so much on products, they're pushing us to help them with their productivity right now, which is a much bigger cost pull for them, cost opportunity for them than the price on coatings. So, again, we're in a lot of discussions with our customers about how to improve their productivity, which again is a key attribute for them.

Timothy M. Knavish
President, Chief Executive Officer & Director, PPG Industries, Inc.
A

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Yeah. On your protective question, our protective and marine business actually had a very strong year last year. Even though there was volume degradation in Q4, that volume degradation was China, because whether it's marine new builds or large petrochemical protective projects, a lot of those are done in China.

So that will – some of that will follow the China closing and then reopening curve. But beyond that, a couple of things are happening in protective. There is significant investment in LNG, all aspects of LNG, and that area uses a lot of our advantaged protective products.

There's an infrastructure investment certainly coming in the US and other countries that leads to future growth for the protective business. And then, finally, on a PPG-specific protective opportunity, we had a fantastic distribution network in Mexico, over 5,000 store locations that has historically been very heavily architectural and deco focused.

Well, we're now leveraging more and more of that network to grow our protective business, which is how we're successful in that business in other countries like the US and Canada. So that's a really great growth opportunity in the protective area that differentiates PPG.

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

John A. Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Emily. We appreciate your interest in PPG. This concludes our fourth quarter earnings call. Have a good day.

Operator: Thank you, everyone, for joining us today. This concludes our conference call. You may now disconnect.

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