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PPG Industries, Inc. (PPG)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Elliott and I'll be your conference operator today. At this time, I would like to welcome everyone to the First 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'd 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, Elliott and good morning everyone. Once again, this is John Bruno. We appreciate your continued interest in PPG and welcome you to our first quarter 2023 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, April 20, 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 first quarter 2023 earnings call. I will keep my comments brief, providing a few highlights on our first quarter financial performance and on our outlook.

First quarter sales were a record \$4.4 billion and were achieved despite the backdrop of macro challenges including soft global industrial activity, elevated cost inflation, continued geopolitical issues and weakening demand in US construction-related end-use markets. We delivered adjusted earnings per diluted share from continuing operations of \$1.82 which is 33% higher than the first quarter of 2022.

Our operating segment margin recovery accelerated, improving 380 basis points compared to the first quarter of 2022 as we work back toward our historical profile. The first quarter was aided by incremental 2023 selling price increases in the Performance Coatings reporting segment and in total company-wide. We have now fully offset all cumulative cost inflation incurred since early 2021.

As I highlight some of the key drivers that drove the strong first quarter performance, an overriding theme is around the benefits we are deriving from our diverse portfolio. For example, PPG has the largest and most diversified aerospace business in the coatings industry. We are well positioned to serve our customers in the aerospace aftermarket and our backlogs expanded once again this quarter following the reopening in China as customers need to replenish their stock with PPG's technologically advantaged products, including sealants and transparencies. We expect this business to continue to grow for the remainder of 2023 and beyond.

Also, PPG has the largest architectural coatings business in Mexico where current economic conditions remain robust and among the best in the world. The PPG Comex business continued their strong execution and delivered an 11th consecutive quarter of record sales. We are laser-focused on driving organic growth. During the quarter, we benefited from several customer wins that included becoming the primary paint supplier at Walmart's 3,800 locations that carry paint products.

The expansion of our well-recognized Glidden DIY brand at Walmart and in our independent dealer channel will support further growth opportunities. The automotive refinish business has now installed 1,400 global Moonwalk machines, recently gaining traction in the US with additional rollouts planned globally, about a third of these installations are new body shop wins.

While overall demand conditions in Europe remain difficult, our leading position in automotive OEM in the region allowed us to support our customers during a sharp rise in automotive builds in the region, albeit off a historically low base.

Our OEM sales volumes in the region were up mid-teen percentage for the quarter and we expect additional growth throughout 2023. The first quarter is typically a negative cash generation quarter due to our business seasonality. However, our strong earnings contributed to us generating positive operating cash flow in the first quarter for the first time in seven years.

As our operating cash generated was about \$400 million higher than the first quarter 2022. Our financial results were better than our preliminary first quarter update on April 3. This was mostly attributable to stronger sales at the end of the month, a richer sales mix and lower costs than we predicted.

A quick update to our very important ESG initiatives. We are prioritizing and delivering sustainably advantaged products and services to our customers and view this as a key lever for organic growth. Last year, we increased our sales from sustainably advantaged products to 39% of our total sales and continue to better define our product sustainability priorities to enable the sustainability ambitions of our customers.

We look forward to sharing our new 2030 targets once our emissions reduction goals are validated by the science-based targets initiative. We will also be launching our 2022 ESG report in late May, which will include our progress against current environmental goals as well as our previously communicated diversity, equity and inclusion targets.

Moving to our outlook. It is evident that challenges remain to the demand environment and in some cases, such as US housing and construction, they're weakening. Despite these anticipated headwinds, we remain confident

that our margin recovery momentum will continue. We are executing against the shopping list of opportunities, which we expect to contribute to strong year-over-year earnings growth in the second quarter and for the rest of 2023.

This includes supporting our aerospace customers as they fulfill their strong order books, and we expect a second straight quarter of more than 10% sales volume growth year-over-year in this business. Also, as availability of raw materials returns to pre-pandemic levels, we expect our earnings to start benefiting from moderate deflation from recent historic inflation highs. As a reminder, aggregate raw material inflation since early 2021 remains at historically high levels.

Additionally, our manufacturing is beginning to improve for multiyear production disruptions and we expect this will generate efficiencies that will provide another earnings growth lever in the coming quarters. With respect to Europe, we are seeing coatings demand stabilize, albeit at lower levels which will enable further year-over-year earnings growth, aided by the actioning against our restructuring program.

PPG has leading architectural coatings positions in several countries in Europe, once the economy begins to improve, this will provide an additional earnings growth lever. I'm also pleased with the growth prospects for our auto refinish, protective coatings and traffic solutions businesses. These end-use markets have proven to be more demand resilient than in prior economic downturns, and a couple of these are positioned for further growth to support infrastructure investment in the United States.

In China, we expect moderate and continuous sequential quarterly improvement in domestic demand as the year progresses. This will be more evident on a year-over-year basis given the pandemic-related restrictions in China last year during the second and fourth quarters. In summary, for the past few quarters, we have been conveying our strong conviction that various earnings growth catalysts would be activated.

I am pleased that we have reached this inflection point and continued to have strong conviction as reflected in our full year earnings guidance, the year-over-year earnings growth will continue 2023. In addition, in this challenging macroeconomic period, you can also count on PPG's legacy of being highly focused on controlling the controllables, including managing our entire cost structure and optimizing our working capital.

As I've begun my new role as CEO, I've challenged our team to focus on our advantages, prioritizing investments that will differentiate us and move the needle for our customers and our business. This includes advancing our digital capabilities throughout our businesses to improve our customers' productivity and further enhance our internal efficiencies.

Our team is committed to accelerating earnings growth while preserving the strengths of PPG's legacy. Thank you for your continued confidence in PPG. This concludes our prepared remarks. And Elliott, would you please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question today comes from Duffy Fischer from Goldman Sachs. Your line is open.

Duffy Fischer

Analyst, Goldman Sachs & Co. LLC

Q

Yeah, good morning guys and congrats on a nice quarter. My question is mostly around the sequential EPS and how that relates to history. So if you stripped out 2020 and 2021 and looked at the six years before that and last year, Q1 to Q2 has averaged up about \$0.48 with all of those years being above \$0.40. And at the midpoint of your guide, you're only up \$0.28 this year. So how do you match those two?

And then a similar question for first half versus second half, if you just use the midpoint of your guide, your second half was down \$0.80 versus the first half but in those same seven years, if you look historically, it's averaged down about \$0.30. So could be conservatism could be something different in the seasonality, maybe something around the loading of Walmart. Can you just kind of walk through why we should expect a lower – or why we shouldn't expect kind of a higher number of history [ph] that (00:12:16) to prevail?

Timothy M. Knavish

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

A

Sure, Duffy. Good to hear from you. First of all, let me give a few high-level comments, and I'll let Vince fill in the gaps. On the Q1 to Q2 step up, we definitely had some one-timers in Q1, notably, the Walmart load-in. We had some insurance settlements related to past storms. We have a promotion for Comex Easter sales every year, more of those sales were pulled into Q1 than normal.

And that's a big piece of the Q1 to Q2, and I'm sure Vince can give you more details. As for the rest of the year, we are cautious on volume for a number of reasons. Slower China opening of manufacturing cautious on US housing for the second half of the year, we're cautious on global industrial. So those are some of the few high levels. And Vince, do you want to add a few details.

Vincent J. Morales

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

A

No, I think we quantified the Walmart business. The load-in for us in Q1 was about \$40 million. Again, just a little more color. The Comex business has a very large Easter campaign. The Easter campaign was split last year between Q1 and Q2 this year, most of the load [ph] earned (00:13:43) in Q1. So we're not going to have that traditional step up. We did see really good activity in Europe auto. And again, our prediction is, well, that's still going to be a very strong business. Q1 was a very strong European auto.

Operator: Our next question comes from Ghansham Panjabi from Baird. Your line is open.

Ghansham Panjabi

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

Q

Yeah. Thanks. Good morning guys, and congrats on all the progress to start the year. I guess, first off, on auto refinish and your outlook for directional improvement in 2Q. Is that just a function of comparability from the year-ago period and the China reopening, and also going back to some of the volume weakness in Europe and North

America for auto refinish in the first quarter? Can you just give us some more color on the customer order pattern timing that you called out? Thanks.

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

A

Sure. Thanks for the question, Ghansham. Let me start off by saying I have full confidence, high confidence in our auto refinish business globally going forward as well as over the last several quarters because our key to key value proposition is best-in-class. What you see in refinish, if you look at Q4 then to Q1, then what we're saying for Q2, this business, because of the two-step distribution, you really need to look at it over a multi-quarter basis just because it's hard sometimes to project the order pattern of our independent distribution.

So I would look at Q1 in that light and rather look at instead of an individual quarter, look at it over multiple quarters. But we have strong backlogs across the body shops, and it's really driven by two things other than paint. It's driven by parts shortages, and it's driven by labor shortages. So those backlogs remain. And so, this actual sellout to the collision industry remains strong. There's just some fluctuation in independent distribution ordering patterns.

Operator: Our next question comes from Stephen Byrne from Bank of America Merrill Lynch. Your line is open.

Stephen Byrne*Analyst, BofA Securities, Inc.*

Q

Yes. Thank you. I'd like to drill in a little bit on your commercial strategy in US architectural. It seems like you have a similar offering now at the independent hardware stores and Walmart with this Glidden platform. And between those in The Home Depot arrangement, in your own stores, it seems like it could be nearly 10,000 locations. My question for you is how would you split your sales in architectural paint in the US between those various buckets? And where do you think that could go in the next few years? And could this cannibalize sales in your own stores?

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

A

Thanks, Steve. Great question. So we don't expect cannibalization. Let me explain a little bit about what we're doing. Glidden is by far, our strongest and best known DIY brand in the US. And historically, despite that strong brand strength, we've lacked distribution. So obviously, we partnered with The Home Depot with Glidden. We're now partnering with Walmart with Glidden. And we've always partnered with our independent dealers with Glidden. One of your points, typically, we don't carry Glidden at our own company stores.

So think about it as big box home improvement, plus Walmart, plus private dealers. The type of customer that buys paint at Walmart is very different than the type of customer that buys paint at The Home Depot. And so what we're really doing with these recent moves is expanding distribution and providing access to a strong DIY brand across multiple different types of consumers, multiple different price points of consumers and expanded geography. So that's really what we're doing here. And there's very little conflict between those three pieces and certainly very little cannibalism.

Operator: Our next question comes from John McNulty from BMO. Your line is open.

John McNulty*Analyst, BMO Capital Markets Corp.*

Q

Yeah. Thanks for taking my question. Tim, your first quarter margins, I don't think we've seen them this high other than maybe twice in the last 15 years, and that's even with adding traffic solutions, which I think should be dragging it down in 1Q. So I guess, one, where can we see margins go this year for PPG? And then what are some of the big factors? Is it all price versus raws? How should we think about mix, some of the efficiency measures you were speaking to? I guess can you help us to frame that a bit?

Timothy M. Knavish

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

A

Well, we're on – as you've heard me say, John, we are on a margin recovery journey. And as happy as we are with the 380 basis point improvement, we're pleased with that progress, but we are not satisfied with where we are. We are not back to historical levels. We've still got more work to do, and we're confident that we will continue to see improvement. This frankly, is our second straight quarter of year-over-year margin improvement. We expect 2Q to be the third straight quarter year-over-year margin improvement. But we've got more work to do here. And it's both on the value capture side and getting paid for the products and services that we deliver. It's mix driven. And certainly, we've begun to see some moderation on the cost side.

Vincent J. Morales

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

A

Hey, John, this is Vince. Just to get some more numeric guidance here. We're down still 150, 200 basis points versus our prior high watermarks, which we hit several times in the past 10 years and in the first quarter. So we have other levers. Tim mentioned one in the opening comments. We're still not back to where we want to be on manufacturing. Our volumes on a multiyear basis are still down. And again, cost control, which is a legacy here, we feel we could do better. So we still have multiple levers to get back to prior high watermarks and then eventually hoping to exceed those.

Operator: Our next question comes from Christopher Parkinson from Mizuho. Your line is open.

Christopher Parkinson

Analyst, Mizuho Securities USA LLC

Q

Great. Thank you so much. Can you just offer a little bit more color about what's embedded in both your aerospace and refinish guidance levels? Just how you're thinking about for the year? Does aerospace include Boeing's further build rates? 737 MAX in China, wide-body, some color on that.

And then on the refinish side, just any color about how you think the body shop world, specifically in the US is still dealing with labor constraints and so on and so forth. You had some pretty optimistic or actually, bullish comments for the second quarter. It'd just be great to know what's underscoring that in particular versus 2019 levels. Thank you so much.

Timothy M. Knavish

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

A

Sure. Thanks, Chris. So on the aero side, you mentioned a number of things there, and the answer would be yes, to all of them. We have a number of positive catalysts there. The China reopening, even though China – international China wide-body is still well below 2019 levels.

Domestic travel alone drives a lot of MRO activity for us. So, that we expect to continue to grow. You mentioned one of our big OEM customers. You've seen their 2023 output so far is much better. So that certainly helps.

We've got – the backlog continues to grow on both OEM and aftermarket, particularly on the MRO side – I'm sorry – on the transparency side. So we've got some catch-up of that backlog built into our planning. And the Military segment remains very strong.

So a lot of what we've got built in is the underlying demand strength but also our ability to continue to increase our output because right now, in many parts of our business in aerospace, we can sell whatever we can produce.

On the refinish side, again, you have to take out these quarter-to-quarter fluctuations. Fundamentally, the collision business is still very strong. And so if the body shops are able to get more cars through because they're able to improve supply on parts, improve labor, we're in a much better supply situation because most of our supply dynamics are behind us.

So we're really poised to capture whatever throughput increase, they're able to achieve, which they're highly motivated to do because their backlogs are so strong.

Vincent J. Morales

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

A

Just to put some numbers to the chart. This is Vince. Just to put some numbers to the China aerospace opportunity, international flights to and from China are down about 70% versus pre-pandemic still. Domestic travel in China is down about 20% versus pre-pandemic. Obviously big market for all the aerospace players and again, for us, that's all opportunity in both OEM and our aftermarket business.

Operator: Our next question comes from David Begleiter from Deutsche Bank. Your line is open.

David Begleiter

Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Tim, just on raw materials. What's embedded in your second half guidance in terms of declines year-over-year? And just on pricing, where are you still implementing price increases?

Timothy M. Knavish

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

A

Sure. Thanks, David. On raw materials, well, let's start with – the high-level statement is we expect to continue to see moderation as we move through the year. And what we actually realized in Q1 was essentially flat on a year-over-year basis. We expect Q2 to be about low-single-digits down on a year-over-year basis. And beyond that, we expect continued further moderation, but hard to quantify the scale of that at this point because there's still so many moving parts. But that's what I would say on the raw materials side.

On the pricing side, we did achieve more pricing in Q1. We were up 8% in total. About 70% of that is carryover. We were able to achieve some additional pricing in the quarter on an incremental basis. The vast majority of that being in the Performance Coatings segment. So I think as we move forward on price, we'll start to comp higher increases as we move through the year from last year. So the increments will be smaller but we are highly confident that for Q2, Q3, Q4, we will print positive price numbers.

Vincent J. Morales

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

A

And just a reminder, we're still at a 40-year high inflation rates in our sector, even with this moderation.

Operator: Our next question comes from Jeff Zekauskas from JPMorgan. Your line is open.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much. Two-part question. So first, when you look at your auto OEM prices in the quarter, were they comparable to the Industrial segment in general, that is industrial was up, I don't know, maybe 8%? Is that what auto OEM prices did? Or were they higher or were they lower? Can you calibrate that? And second...

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

A

Jeff, they were certainly in line. Sorry, go ahead.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yeah. Okay. Yeah.

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

A

Go ahead, Jeff.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yeah. I'm puzzled that your raw materials were flat year-over-year in that oil was \$100 a barrel in the first quarter of 2022, and propylene was \$0.60 a pound. And I believe that maybe your raw materials probably peaked in the second quarter of 2022 and then came down. So like where is the inflation coming from? Or there must be something – it seems to be unusual about your raw material basket and that it should be lower than where it was in the first quarter of last year, at least from an outside perspective.

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

A

Hey, Jeff, I'm going to take the auto question. So yes, auto OEM was consistent with segment pricing, which was about that 8%. And again, I want to remind you, the vast majority of that is carryover, especially in that business. And the new pricing there, much of that was actually negotiated last year. And part of the process in negotiations with auto OEMs is magnitude and timing of implementation. So that's the answers to your first question. Vince, do you want to take raws?

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

A

Yeah. Jeff, I think when you look at our raw materials, one of the things we've talked about the last several quarters was pulling that through our inventory. And if you look, we ended the year – we talked about this in the back half of last year, we ended Q3 and Q4 with abnormally high inventory balances. We were buying raw materials when we can get them. So we have to work that inventory down.

If you look at our inventory balance actually in Q1, it's still elevated relative to what our expectations are. So it's really a matter of how we're pulling those prior purchases through our inventory and into our cost of sales. We still

have some, again, inventory to work down as we get into the peak season here in Q2. And we'll see some more realized benefit once we are able to work through that inventory.

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

A

Yeah. Jeff, to your basket question, our raw material basket is largely what it's always been. But there are parts of that raw material basket that we're still seeing year-over-year inflation in. Pigments, additives, extenders, inorganics, a number of items where we're still seeing year-over-year increase.

Operator: Our next question comes from Vincent Andrews from Morgan Stanley. Your line is open.

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

Q

Thank you. Thank you very much. I'm wondering if you could just help us better understand how March went. It sounds like, obviously, it was stronger than you expected, particularly in the back half of the quarter. In which particular areas of your business that strength came in? And if there was any particular driving force for it and whether it's continued into April so far to the extent you have data you can share?

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

A

Sure. Sure, Vincent. The parts of our business that were very strong as we move through March, I would say, our aerospace business, our auto business, particularly Europe auto. And as Vince alluded to earlier, our Comex business was stronger than we had expected as we saw more pull forward of the Easter campaign.

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

A

And just a reminder, when we said this in January, March is typically 40%, 50% of the quarter in terms of the size of the quarter, financially. So again, when we have a strong March, it's very helpful.

Operator: Our next question comes from Josh Spector from UBS. Your line is open.

Joshua Spector*Analyst, UBS Securities LLC*

Q

Yeah, hi. Thanks for taking my question. So I just want to poke on the guidance again for the year. So if I think about some of the one-timers in 1Q, if I say they're maybe \$0.20 in EPS seasonally adjust first half implies the year's kind of at the midpoint of your guidance for the year about [ph] \$710 million (00:30:52). No incremental benefit from raw materials. And where the areas where you talk about volume weakness, China housing industrial, maybe we're talking about 20%, 25% of your sales, but you're optimistic on auto OEM, refinish, aero, which more than offsets that. So I mean, is it a fair take to look at this and say, there's really minimal benefit of raw materials in the second half, similar benefit of pricing and you're just like pushing on where volumes are today? Or is that an entirely wrong way to look at it?

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

A

Well, on our second half guide, first thing I'll say is it's still 10% EPS growth Y-o-Y in an extremely challenging environment. And so I just want to lead with that. And most of the concern for second half is more volume

focused. We're – continued slowdown, US housing. We've got uncertainty on the general industrial side. And really, uncertainty on the pace of recovery of industrial/manufacturing in China. So those are really the key drivers to the second half.

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

A

Yeah, this is Vince. I'll just add. Again, it's still cloudy when we look at the economy. We do know that those countries are raising interest rates. There's typically a delay between interest rate increases and consumer effect. We're seeing that in different parts of our portfolio around the world. So we just remain somewhat cautious on the delayed effect on that interest rate increase environment.

As Tim mentioned, I'll echo, we're not sure about the pace of recovery in China. We do feel it's going to be – our guide includes a moderate recovery continuing, elongated recovery. That's beneficial from our perspective because we don't see that creating more commodity inflation, but that – the pace of that recovery is still uncertain at this time.

Operator: Our next question comes from Aleksey Yefremov from KeyCorp. Your line is open.

Aleksey Yefremov*Analyst, KeyBanc Capital Markets, Inc.*

Q

Thanks and good morning, everyone. In architectural in the US, can you share any data or sentiment from Pro paint contractors? How is the backlog changing here?

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

A

Yeah. Backlogs have remained surprisingly robust despite everything you see in the news and despite what's happening in construction, driven by labor shortages primarily. So the backlogs remain strong. And for our Pro business, the omni-channel of our Pro business was up almost 10% for the quarter. So we are seeing continued good activity in the Pro space in architectural in United States.

Operator: Our next question comes from Michael Sison from Wells Fargo. Your line is open.

Michael Sison*Analyst, Wells Fargo Securities LLC*

Q

Hey, guys. Nice start to the year. Tim, just curious, in terms of the second half with the 10% EPS growth, I apologize on this is, but what do you expect for volumes? What's sort of the range of outcomes for the company? Is it down, flat, maybe even up on easy comps? Just curious. Thank you.

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

A

Hey, Mike, this is John. I'll take that one. So as Tim pointed, there's a few factors that we're considering in the volumes forecast that's in the guide. I would say that it's down slightly in our second half guidance, Mike, overall, based on all the feedback that Tim provided.

Operator: Our next question comes from Peter Clark from Société Générale. Your line is open.

Peter Clark

Analyst, Société Générale SA (UK)

Q

Yes. Good morning, everyone. Just looking at your number one priority of getting your margin back and particularly on the industrial coatings because obviously, you were peaking at over 18%. I know there's been mix changes. You bought in lower margin acquisitions that you're working on. But if I play with your full year guidance, you're sort of inferring this margin recovering to about 14%, ex-amortization. So you're still 400 basis points of drift. I understand it's challenging. Volumes are still not great. But is there anything structurally that stops you getting back to that sort of level in the next few years that you were achieving back in 2016 and 2017 level? Thank you.

Timothy M. Knavish

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

A

Yeah. Thanks for the question. There's nothing structurally preventing us from getting back to those levels. The big driver for us, I would say two things. Number one, volume. Volume is still down significantly from the time periods that you referenced. And so just the leverage from that.

And then the other one is operating efficiencies. All of the supply chain disruptions that we've had over the last couple of years, our manufacturing costs have not been at benchmark. And you heard that we did see some improvement in that in Q1, and we're expecting further improvement as we move forward. So there's nothing structurally preventing us from getting back to peak margins in that segment.

Operator: Our next question comes from Arun Viswanathan from RBC. Your line is open.

Arun Viswanathan

Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question. Just a couple of questions around margins. It looks like your margins were up at around 13% level for EBIT in the first quarter. Do you see continued growth there? And what kind of volume growth would you expect to get that back into the mid-teens to high-teens level? Thanks.

Timothy M. Knavish

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

A

Well, we absolutely expect to see continued margin growth, Arun, as I mentioned earlier, we're confident that the next couple of quarters will show continued year-over-year margin improvement. The volume question, as John mentioned, we're going to have volume challenges likely potentials for upside, but our base case is that it will be a tougher volume second half.

Vincent J. Morales

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

A

Yeah, Arun, this is Vince. If you look at some of the nearer term levers we have, the rich mix we benefited from in Q1, we expect to continue against some of our key technology businesses, aerospace, automotive. Tim mentioned about the strength of the Mexican economy. We have leading positions in Mexico and several of our businesses, including Comex.

And as Tim mentioned, we're starting to see early signs of manufacturing optimization. Still a long – we still have a long way to go there, but that's something internally we're managing. And as I mentioned earlier, we have laser

focus on our costs, especially with the volume outlook and the concern around consumer spending that I talked about earlier.

Operator: Our next question comes from Kevin McCarthy from VRP. Your line is open.

Kevin W. McCarthy

Analyst, Vertical Research Partners LLC

Q

Yes, good morning. A few questions on your auto OEM coatings business. What are you baking in for global builds in terms of your annual EPS guide? And would you also comment on any meaningful share shifts by region and how the EV penetration is playing out for PPG?

Timothy M. Knavish

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

A

Sure. Thanks, Kevin. Our base case on auto OEM for the year on builds is low-single-digits with potential for upside depending what happens with a whole number of things around affordability in China. But our base case is low-single-digits. We have not seen a huge amount of share shift. We did see some in China as we were executing our margin recovery strategy. We did lose some of the lower-margin business, but what's historically happened there, Kevin, is they ultimately come back for a number of reasons.

And third part of your question was around EVs. What I could say on EVs is we're extremely pleased with our progress there. We're winning on EVs where EVs are winning, which is China. So we're doing well with the number one China EV player, and they're doing well.

If you look at builds now of EVs, they were up over 10% of global builds now are EVs. And in China, which is where we're having most of our success, over 20% now of all vehicles sold in China are EVs. So we like what we're seeing from a penetration standpoint and we're pleased with our progress, but still a lot more to do there.

Vincent J. Morales

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

A

Just to add, again, we came into the year with a low to mid-single-digit projection on global builds for the year. Q1 was – for the industry was 5%. So Q1 outperformed the initial projections for the industry.

Operator: Our next question comes from Michael Leithead with Barclays. Your line is open.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

Perfect. Thanks. Good morning, guys. Real briefly, just on North American architectural, there's obviously a few moving pieces with all the wins you flagged. So I guess, high level, what do you assume or you think the industry is growing at this year versus what do you think PPG is going to be able to grow at?

Timothy M. Knavish

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

A

I think it's – the reality is the industry, in totality, is going to be soft, driven by what's happened on two fronts. Number one, housing, and number two, you still have some post-COVID hangover from the DIY side due to what everybody did, painting their houses during that period. So industry-wide, that's what we're seeing.

For PPG, we've got a number of programs, as you say, with obviously our Walmart win, the launch of The Home Depot Pro program. Our mix, we're not as big on new build as we are on construction and maintenance. So we're thinking about it a little bit better than the rest of the industry. But driven by housing and driven by DIY, we expect this overall to be a challenging year in architectural US.

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

A

Yeah. And Mike, just another reminder here. We're – paint is typically the last part of the cycle. So as housing starts have come down past several quarters, we're still working off those backlogs from a paint perspective.

If you look at the mixture of housing starts, roughly 60% are single-family. Those have come down already. I'm not sure if they bottomed yet or not. There's some positive signs that they at least flattened.

If you look at multifamily, multifamily is at still a very high record. And those will be delivered late this year or maybe early next year. And we do think there's an air pocket after that due to credit, liquidity, et cetera. Again, 60% single-family, 40% multifamily, so we haven't seen the negative effects at multifamily.

Operator: Our next question comes from Laurence Alexander with Jefferies. Your line is open.

Laurence Alexander*Analyst, Jefferies LLC*

Q

Good morning. Could you just briefly flesh out your outlook for US infrastructure, and particularly kind of, sort of, your assumptions for the back half of the year and the landscape for – or the pipeline for potential bolt-on M&A and particularly like how do you think about opportunities in the emerging markets?

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

A

Yeah. Sure, Laurence. The outlook for infrastructure, we're quite positive on that as the infrastructure spending is starting and there's a lot more projects in the queue. And we have a number of portfolio positions that should help us there.

Our protective coatings business, some of our industrial coatings business, and certainly, our traffic solutions business, so we're positive on that ramping up as we move through not only this year but into the future.

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

A

Yeah, Laurence, on the M&A, environment, yeah, I'd still say it's somewhat active, not consistent. Historically, it's been more active. There's, certainly some deals or some files that are percolating of the small kind of vintage.

So, there's still an issue if you're a buyer or a seller, coming up with a price based on the past 12-month financials. Again, we said many times, we would expect a few deals to get done in our space each year. And that's our same expectation this year.

Operator: Our next question comes from Laurent Favre from Exane BNP Paribas. Your line is open.

Laurent Favre

Analyst, Exane SA (United Kingdom)

Q

Yes. Hi. Good morning. Two very quick questions, please. The first one is on manufacturing. Can you size that opportunity for us? And is it just about China where you see the COVID issues in the early part of Q1?

Or do you also see an opportunity in Europe and US? And the second question was just on marine and protective. It sounds like that was a bit surprise for you in Q1. You thought it would be down, was up. I'm just wondering if you can share a few thoughts there. Thank you.

John A. Bruno

Vice President-Investor Relations, PPG Industries, Inc.

A

Hello Laurent, this is John. I'll start with the manufacturing one, and Tim will take the second part. So if you go back to January of 2022, we talked about significant manufacturing challenges we had due to supply disruptions in the fourth quarter of 2021.

And we quoted about a \$0.20 EPS impact. That was the height of the impacts. And every quarter since, we've had some type of negativity. Now this quarter, the first quarter of 2023, we were close to being breakeven on a year-over-year basis, and we expect that to get better as we go forward. So the objective is for us to claw back all of the inefficiencies that we've had in the last five quarters.

Timothy M. Knavish

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

A

Yeah. I'll take the protective and marine side. The way I think about this business right now is it's well positioned for infrastructure, near-shoring, energy, a lot of the investments that are happening around those areas and also in marine, where we have really pivoted our focus to marine aftermarket, which is doing well.

So when you add those all together, we were up high-single-digits in Q1 and we expect to be up mid-single-digits again in Q2. So that's one of the businesses that we're pretty bullish on.

Operator: Our next question comes from Frank Mitsch from Fermium Research. Your line is open.

Frank J. Mitsch

Analyst, Fermium Research LLC

Q

Good morning, gentlemen. Congrats on the start to the year. Vince, you took a \$144 million charge due to the pension benefit obligation. I'm curious, as to what sort of future cost benefit might we expect from that action?

And Tim, obviously, very impressive progress on price and your expectation is that you're going to have positive price for the balance of the year. But as we see deflation from record raws, any concerns on potential price give backs in any of your businesses? Thank you.

Vincent J. Morales

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

A

Thanks, Frank. This is Vince. Yeah, just a reminder, we do have a step up in 2023, a non-cash step up as it relates to pension expense. Fairly significant, \$10 million to \$15 million a quarter. We did annuitized a portion of our pension plan. The benefit from that from an expense perspective is fairly minimal. It's about \$1 million or \$2 million a quarter. So nothing sizable relative to the step up we've had coming into the year.

Timothy M. Knavish

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

A

Yes. And Frank, on price, so on protective, we expect very little, if any, any price give back as we – I'm sorry, I said protective, I meant performance. On performance, in total, we expect very little give back as we move through the year. On industrial, I'll remind, about 30% of our Industrial segment business, the pricing is based on index arrangements. So if there is raw material deflation, those indexes will kick in, but there's a delay of multiple quarters depending on the contract. So that's more of a 2024 issue for us.

And beyond that, more generally, I'd say, obviously, we watch this very closely every day. And churn would be our primary indicator if there's something we need to act upon. Our competitors are facing the same basic cost structure and cost inputs that we are. And we watch our churn. And to-date, we've seen very little churn, as I mentioned earlier, other than a little bit in Asia.

Operator: Our next question comes from John Roberts from Credit Suisse. Your line is open.

John Roberts

Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. Where within the Performance segment were you able to get additional price? Or was that mix with the aerospace business just improving in the mix?

Timothy M. Knavish

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

A

Well, there were both factors. The mix element, part of it was our aerospace business, no doubt. As the first part on where we're able to get price, we got incremental price in almost all parts of our Performance segment. So architectural, refinish. And I'd just remind that while we are seeing moderation and some raw material inflation, we're still seeing inflation in wages and indirects and some raw material categories. So I'd say that incremental price was largely in response to incremental inflation.

Vincent J. Morales

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

A

John, this is Vince. Just for clarity, as we break out these numbers for you guys externally, we have price separate. We put in business mix, regional mix, product mix. We combine that with volume. And if you look at both our original guide and our updated guide or updated final numbers, again we benefited from incremental pricing, standalone pricing, so invoice pricing.

Secondarily and separately, we benefited from regional mix. Tim mentioned some of our business, including Latin America were higher than our expectations. We benefited from business mix. Some of our higher technology businesses were higher than our expectation as we called out in both of our releases. And we benefited within business from product mix. So we hit, I think, three big categories for us.

Operator: Our final question today comes from Jaideep Pandya from On Field Research. Your line is open.

Jaideep Pandya

Analyst, On Field Investment Research LLP

Q

Thanks. First, I want to go back to the EV point. Could you just give us some color on what is the content per vehicle for ICE versus EV? And in your top EV customers, are they all sort of the top five Chinese companies? That's my first question.

And the second question is on the industrial coatings, where you alluded to weakness in the US. Have you seen sort of the destocking coming to an end in Q1? Or are you expecting further destocking or weaker volumes from the coil, extrusion categories in the US, especially in Q2 and Q3? Thank you.

Timothy M. Knavish

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

A

Thanks, Jaideep. I'm going to be backwards with how you asked them. Just destocking, our Industrial segment businesses, there's not a tremendous amount of inventory held at our customers. And so any significant destocking, whether it's – frankly, whether it's Industrial or Performance is largely behind us.

But the softening that we mentioned in general industrial and in particular here in the US is across a couple of key segments. One of them you already mentioned, and that's coil because that's largely tied to construction. But we've also seen softness in some consumer-facing areas, electronic materials, kitchen and bakeware appliance. Fortunately, there's some positives offsetting some of that as well on HD – heavy-duty equipment, transportation, powder. But in general, those were the segments that were a bit soft.

On your EV question, so the content per vehicle, unfortunately, there's not a simple one number answer to do that because it depends upon the different technologies that are adopted by each of the OEMs. But what I will tell you is that the potential content per vehicle for functional and specialty protective coatings is significant and in the same scale as the content per vehicle of conventional layering systems, which can – that can range between \$90 to \$125 a vehicle.

You had a question embedded in there about who are we working with. Who are we successful with in China? Generally speaking, we're working with all of the OEMs, whether it's Chinese or non-Chinese but we have had most of our commercial success thus far with the number one player in EVs in China.

Vincent J. Morales

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

A

Yeah, Jaideep, this is Vince. I want to go back to your industrial question and maybe broaden it a little bit. If you think about PPG, 2022 was a difficult year. We had significant exposure in Europe, where we saw the geopolitical items really affect our volumes.

As everybody is fully aware, China had multiple months of shutdowns in 2022. And the US was one of our most stable businesses. And Mexico and Latin America continued to grow. If you fast forward into 2023, we feel Europe stabilized, and we're able to then put our cost stewardship on that. We feel China and Asia is going to grow. So two big pieces of our portfolio pointing in the right direction as it compared to last year. And we still feel very strong about Latin America and grow, and we're seeing some softness in the US in industrial, certainly in the construction markets, but we're offsetting the majority of that with aerospace and automotive, protective, as Tim mentioned. So again, I think for us, we had a difficult 2022, and we're lapping some of that in 2023. The only thing we see softening is really those pockets in the US.

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

John A. Bruno

Vice President-Investor Relations, PPG Industries, Inc.

Thank you, Elliott. We appreciate everyone's continued interest and confidence in PPG. This concludes our first quarter earnings call.

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

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