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# PPG Industries, Inc. (PPG)

Q3 2023 Earnings Call

## CORPORATE PARTICIPANTS

**John A. Bruno**

*Vice President-Investor Relations*

**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

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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 Third 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 John Bruno, Vice President of Investor Relations. Please go ahead, sir.

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**John A. Bruno**

*Vice President-Investor Relations*

Thank you, Emily, and good morning, everyone. We appreciate your continued interest in PPG, and welcome you to our third quarter 2023 financial results conference call. Joining me on the call from PPG are Tim Knavish, Chairman and Chief Executive Officer; and Vince Morales, Senior Vice President and Chief Financial Officer.

Our comments relate to the financial information released after US equity markets closed on Wednesday, October 18, 2023. We have posted detailed commentary and accompanying presentation slides on the Investor Center of our website, [ppg.com](http://ppg.com). The slides are also available on the webcast site for this call and provide additional support to the 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 the discussion during this call may contain forward-looking statements, reflecting the company's current view of the 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. The presentation also contains certain non-GAAP financial measures. The company has provided in the appendix of the presentation materials, which are available on our website, reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures. For additional information, please refer to PPG's filings with the SEC.

Now let me introduce PPG Chairman and CEO, Tim Knavish.

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**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

Thank you, John, and good morning, everyone. Welcome to our third quarter 2023 earnings call. I'd like to start by providing a few highlights on our third quarter record financial performance, and then I'll move to our outlook.

In the third quarter, the PPG team continued to deliver strong financial results, including sales of \$4.6 billion and adjusted earnings per diluted share of \$2.07, both records for our third quarter. Our year-to-date cash generation is over \$1.5 billion, which is also a record on a year-to-date basis.

Our adjusted EPS of \$2.07 was 25% higher year-over-year. We benefited from several non-recurring favorable discrete income tax items, which added \$0.10 on versus our beginning of quarter guidance. Excluding this favorable tax benefit this year, our EPS was still about 20% higher than the third quarter of 2022. We're on pace to finish 2023 with all-time record adjusted earnings per share.

As we communicated at the beginning of the year, we had a high degree of conviction that our global business portfolio mix would prove resilient this year and as we had anticipated a challenging economic environment that has clearly played out through the first 9 months of the year.

Our results were supported by good growth trends and strong execution in several of our leading and technology advantaged businesses, which resulted in record third quarter sales in the aerospace, automotive OEM, automotive refinish and PPG Comex Coatings businesses. Our third quarter sales volumes were impacted by soft global industrial production, which worsened in many countries during the quarter and also by cautious consumer buying patterns in Europe, China and other parts of the world.

The selling price increases we implemented earlier this year, primarily in the Performance Coatings segment drove a solid 3% increase for the quarter. We expect selling prices to remain positive in the fourth quarter of 2023, albeit a little lower sequentially, as we continue to see prior price increases reach their anniversaries.

Throughout 2023, a key priority for our team has been restoring our margin profile. The third quarter marked the fourth consecutive quarter of year-over-year operating segment margin improvement with aggregate segment margins up 260 basis points. This led to both of our operating segments delivering at least 25% earnings growth in the third quarter with the Industrial Coatings segment also delivering higher sequential margins.

Another key focus remains strong cash generation. Throughout the first three quarters of the year, the \$1.5 billion operating cash generation that we delivered is up more than \$1.1 billion over a year -- on a year-over-year basis. In addition to our strong earnings performance, we significantly reduced working capital in total by about \$300 million, mainly driven by lower inventories, contributing to the robust operating cash flow generation.

We use part of this cash to reduce our higher variable cost debt during the quarter and despite significant increases in market interest rates, our net interest expense declined year-over-year. As we look to continue our momentum into the fourth quarter, we are laser-focused on achieving top line sales and earnings growth in 2024 and beyond. I'd like to highlight a few items that we expect will support growth in 2024.

First, as I communicated at our CEO investor briefing in May, we are working on a number of commercial growth opportunities and several of these initiatives have been launched and are now gaining momentum.

For example, we are pleased with the progress being made supporting our customers' rapid growth of electric vehicles in China with PPG technology advantage products and services. We are well positioned with the leading electric vehicle producers and continue to gain share as the production rate increases each quarter, including strong EV export activity out of China.

In the past few years, we've invested to enhance our manufacturing and technology capabilities around powder coatings products with prudent capacity additions. This year, we're realizing the benefit of these investments as our powder coating related sales have increased about 15% compared to last year. We're winning new business every quarter and supporting our customers' sustainability and productivity objectives and we expect powder to outgrow the market for a number of years to come.

Another commercial growth initiative supporting our growth in 2024 and beyond involves expanding the breadth of products being sold through the PPG Comex distribution network. Our world-class network of over 5,100 concessionaire locations in Mexico has consistently outgrown the regional architectural market and provides customers with their preferred paint brand and products in Mexico.

We are very excited about the opportunity to now leverage this distribution network to support customer needs for protective, refinish, traffic and light industrial products. So, these focus areas are part of a larger basket of commercial initiatives that will support our previously communicated organic sales growth targets. I will provide periodic updates on these initiatives in subsequent quarters.

A legacy of PPG and another catalyst for earnings growth going forward is strong cash generation and value creating capital deployment. I plan to continue to abide by our hallmark of prudent balance sheet management and financial flexibility supported by strong free cash flow of our business portfolio. Year-to-date we have delivered record cash flow from operations and we have utilized this to deliver on our prior commitment to repay some variable rate debt, driving down our interest expense.

In the fourth quarter, we will likely incorporate some additional debt repayment, but will also likely complete some share repurchases reflecting our strong cash position and seasonality of our cash flows. In addition to the sales and earnings growth initiatives, one other strategic initiative that we've been actioning relates to some selective pruning of our business portfolio.

As a reminder, we've recently divested a number of smaller assets, including most of our coating businesses in Africa, a non-core business that we acquired with the Ennis-Flint acquisition and have exited certain product categories in some businesses. In addition, this week we announced the divestiture of certain international operations in our Traffic Solutions business.

These actions allow us to channel our growth bandwidth in areas that are meaningful and where we have winning advantages, including technology, brands, and customer relationships. We will continue to actively assess each of our businesses and product lines to ensure they're consistent with our growth objectives and that they meet our financial objectives and they earn the right to remain in the portfolio.

Now, I'll comment on our fourth quarter outlook. We expect several of the businesses in our Performance Coatings segment to deliver organic growth, including continued solid growth in our PPG Comex and aerospace businesses. We do expect slowing in US architectural coating's demand, stemming from multi-decade highs in interest rates and lowering housing turnover.

While we expect our automotive OEM business to grow in the fourth quarter in most regions, other portions of our industrial coating segment will be challenged due to sluggish overall global industrial production. While there are many variables in uncertain timing, we have prudently included an estimated financial impact of the UAW strikes of a few cents of EPS in our fourth quarter financial guidance.

As we have communicated in the past, our regional sales to the OEMs impacted by the strike are low single-digit percentage of our total company sales. Also, we sell to other OEM customers in the region not impacted by the strikes. And given the historically low dealer inventory levels, we expect any lost volume will be made up in subsequent quarters.

Certain other sales volume headwinds are beginning to abate as we expect China is at or approaching trough levels. Also, we do not expect destocking to be a significant issue in our packaging coatings and use market in 2024.

With regard to commodity raw materials, supply has normalized to pre-pandemic levels and we expect to continue to realize benefits from moderating input costs. We will maintain emphasis on diligently managing our costs and expect to make more progress on our previously announced restructuring initiatives.

In addition, we are beginning to deliver manufacturing and productivity gains which are supported by a more stable supply chain and customer order pattern. Despite the challenging environment, we've raised our full year earnings guidance and expect fourth quarter aggregate segment margins will be higher on a year-over-year basis for the fifth consecutive quarter.

Lastly, I'd like to thank our team members around the world, who live our purpose every day to protect and beautify the world. Thanks to their hard work and dedication, we're able to support our customers and help them solve their biggest challenges. I remain confident in our team's ability to make it happen.

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

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## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Your first question today comes from the line of John McNulty with BMO. John, please go ahead. Your line is now open.

**John McNulty**

Q

Yeah. Good morning. Thanks for taking my call and congrats on a solid set of results. I wanted to ask on the raw material environment. We've seen a decent jump up in oil recently.

I guess can you speak to how we should be thinking about raws moving from 3Q to 4Q and if you expect those to be down? And how much on a sequential basis, do you expect them to be down? And then, I guess, how should we thinking about that as it rolls through into 2024?

**Timothy Knavish**

A

Hey John, thanks for the question. So let me talk about oil first. Obviously, oil is going to produce some impact on solvents for us. But really, our raw material basket is much more dependent upon supply-demand where several steps removed from oil with the exception of solvents.

So that's a much bigger impact for us. And then the total impact for Q4, we saw high single-digit deflation in Q3. We expect high-single digits in Q4, and we expect further deflation as we move into 2024 on a broader basis.

Vincent Morales

A

Yeah, John, this is Vince. Let me just add a little bit to what Tim was saying. So the supply-demand environment, as we pointed out, I think, in our prepared remarks and the press release, we have seen sufficient -- more than sufficient supply.

That's typically a bigger driver of our input costs than just the feedstocks. And right now and heading into a seasonally lower fourth quarter, we expect that to continue. So I would expect the increase in rise in oil to have no impact other than solvents on our fourth quarter.

And as we head into next year, start negotiating with suppliers in Q4 -- late-Q4, and the tone from our suppliers has been more volume-driven, as opposed to price-driven.

**Operator:** Your next question comes from the line of Duffy Fischer with Goldman Sachs. Duffy, please go ahead. Your line is now open.

Duffy Fischer

Q

Yeah. Good morning guys. Just a question around the delta between industrial and Performance. So Industrial margins were up 300bps year-over-year and performance was a little under 2.5%.

But industrial trailed on volumes by 4% and trailed on dollar pricing 3%. So it doesn't look like there were any leverage from price and volume on the margin spread. So what's underlying that gap? And why was industrial able to do better than performance even though it didn't on price or volume?

Vincent Morales

A

Yeah. Duffy, this is Vince. Let me start on and Tim add some color, obviously. But if you look at Q3 alone, the improvement year-over-year in Industrial is larger but the Performance segment improved quicker. So we got pricing, we typically have pricing and performance quicker. So we had price injected into our businesses quicker in performance. We lagged that with industrial, and we were still getting price in industrial and certainly in 2022 in the back half. So on a year-over-year delta, you're correct, the industrial segment looks better, but performance just recovered earlier. Tim, do you want to add?

Tim Knavish

A

Yeah. I think it's spot on and I think both segments will see continued year-over-year margin improvement, depending upon the addition of manufacturing productivity improvements that I mentioned in my opening comments. And course, as we get into seasonality, more volume will help that step change in margins as well.

**Operator:** Your next question comes from the line of Ghansham Panjabi with Baird. Ghansham, please go ahead. Your line is now open.

Ghansham Panjabi

Q

Thank you, operator. Good morning, everybody. As we kind of think about 2023, two of your higher-margin verticals, including aerospace and Comex had delivered on outsized growth and obviously, margin conversion as well. How should we think about the sustainability of these growth verticals into 2024? And just more broadly, what is your base case for volumes for each of the two operating segments next year?

Tim Knavish

A

Yeah. Ghansham, thanks for the question. Aerospace, you should expect that to continue not only for 2024, but multiple years going forward. We have just such a unique technology advantaged position in that industry across commercial, commercial new build, commercial aftermarket, general aviation, military. And all of those are strong and projected to be strong for the foreseeable future. We've got a tremendous backlog. Everything we make, we can sell. So that you should feel very good about we do for coming quarters and years.

Likewise, with PPG Comex. I think this was the 13th quarter in a row of record performance. There's nothing to say we won't have 14th, 15th and beyond. In my opening comments, I mentioned and back in May at the CEO briefing, I mentioned that while we will continue to gain share in the conventional architectural business. We're now focused on kind of our next chapter of accelerated growth in PPG Comex and that's using our world-class distribution network to sell refinish coatings, traffic, industrial protective and those are all up and running.

So, you should feel really good about those two businesses continuing record-breaking performance, and we certainly do. On an overall volume basis, I'm confident that we're going to swing to overall positive volume in 2024, based on a number of green shoots that we're seeing throughout our portfolio.

Vince Morales

A

Yeah. And Ghansham, if I could add just to those green shoots. We are seeing Europe, in our opinion, is troughing especially for our business mix. We were essentially flat in Q3 in European volume across our portfolio. We do expect growth to resume in China, albeit at a lower level. Those are two pieces of our -- two big pieces of our portfolio geographically.

And as Tim mentioned, Mexico, we expect to have outsized growth relative to other regions. And then the business, as Tim mentioned, I would agree with, but I would also add that we do -- we are picking up share in our Refinish business based on some of the technologies that we talked about in May.

**Operator:** Your next question comes from the line of Christopher Parkinson with Mizuho. Christopher, please go ahead. Your line is now open.

Christopher Parkinson

Q

Thank you so much. Good morning. Tim, you've spoken a lot about kind of refocusing on R&D and just further positioning PPG to outgrow some of its respected end markets. New products, new technologies has been literally just mentioned one. Once we're through this macro mayhem [ph], how you want to characterize it?

What's your level and degree of confidence that you will, in fact, be able to outgrow certain end markets? And where are you ultimately the most enthusiastic? Thank you.

Tim Knavish

A

Yes. Hey, Chris, thanks for the question. I like how you described the macro. The way I'm thinking about the broader, kind of, sequential that you should expect to see from us. You know, most of 2023, you heard me say many times, laser-focused on market recovery. We've made progress there. I think the next phase, I would call mostly focused on recovery growth in some of our stronger portfolio segments. But while all of that is happening, we have been shifting those focus in investment areas that you alluded to in. I would say innovation areas, not just classic R&D because some of that innovation is inside the can and some of that innovation is outside the can.

And we're starting to see progress in a number of those areas, which is some of the green shoots and confidence that I have on go forward. From a sustainability standpoint, I look at our marine M&R business. We're up 20% this year. And a lot of that is driven by sustainable products for reducing friction on the hall of ships, and we're getting tremendous pull and we expect that to grow significantly in 2024 and beyond.

I'm sorry, Vince mentioned in Chancey Hagerty's business, some of the digital innovations that we've invested in and continue to invest in are really starting to gain not only momentum with our existing customers, but share winning momentum. By the end of this year, we'll have 2,000 moonwalks in place. About one-third of those are share gain.

You'll recall back in May, Chancy and his team demonstrated the broader PPG Link digital ecosystem to help body shops be more productive. Even though we're only nine months in, we've got 7,000 shops lined up for PPG link paying their subscriptions and starting to improve their own shops and we're still very early days. And share gain momentum on PPG Link is starting to pick up.

EVs, 25% every car produced in China now is EV. We are winning share with the EV producers and we are growing content per vehicle on EVs. So a lot of the things we talked about are starting. They're moving from incubation phase to implementation and execution phase. So I'm highly confident, Chris, that the things that we've picked as needle-moving investments for our future are going to do just that and move the needle in a positive direction.

**Operator:** Your next question comes from the line of Michael Leithead of Barclays. Michael, please go ahead. Your line is now open.

Michael Leithead

Q

Great. Thanks. Good morning, guys. Question for Vince on cash flow. It's been quite strong this year. You've talked a bit about 4Q deployment opportunities. But just what's the early read for the best opportunities to deploy cash in 2024? And just how should we think about pick backup potentially in buyback sort of factoring into the into the EPS growth algorithm next year? Thanks.

Vincent Morales

A

Yeah. Thanks Mike. Good morning. Yeah, again, look just to reiterate, again, record Q3 year-to-date cash flow, about \$1.5 billion. If you look at our net debt, we're down \$700 million, \$800 million year-over-year or versus the end of the year.

Tim mentioned that, we have some more debt coming due in 2024. We're going to pay some of that early to get the interest rate carry our EPS. But we have \$600 million of debt coming due over next 12 years -- 12 months, excuse me.

And again, some of that's -- we have -- we can prepay early, which we'll take advantage of. And we are going to do some level of share repo in Q4. And we're not going to itemize that in terms of size, but we'll look at our cash position and we'll look at the cash flow and typically our strongest quarter of the year. We'll give more guidance on 2024 in January.

Again, we do have expect -- again continue strong cash flow in 2024. Our earnings growth, supporting that as well as we're still carrying several hundred million dollars of excess inventory, as we continue to -- we make good progress and working that down in Q2 and Q3, but we still have a couple \$100 million we want to work down, over the next six months or so. So that will help our cash flow next year, but we'll get more cash and financial guidance in January.

**Operator:** Your next question comes from the line of Vincent Andrews with Morgan Stanley. Vincent, please go ahead. Your line is now open.

**Vincent Andrews**

Q

Thank you. Good morning, everyone. I believe there were some comments in the prepared remarks in US refinish about some negative volume. It's a function of some customer issues. Could you just give a little more detail on those? And whether they're going to persist into the fourth quarter? Or it was just unique to the third quarter?

**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

A

Yeah. Hey Vincent, it's Tim. Thanks for the question. So to the earlier point, we are winning share in US refinish. We are winning share largely driven by our Digital Ecosystem technology. So -- and we're laser-focused on the body shop level because that's ultimately the end customer. That's where our products get consumed.

Because of the two-step distribution in this business, the actual sales we book or to the distributors. And they -- especially in a high-interest rate environment, they fluctuate their inventories up and down. So we look at it over a multi-quarter basis. But we're confident, based on our net body shop wins that the volume and growth in this business will be a good story for us.

**Vincent Morales**

A

Yeah. And Vincent, just at the market level, the body shops are still very active. They still have a backlog. They're working through that backlog. So sell-in certainly matters for us, but the ultimate judge of how the business and how the market is performing or the body shop metrics and the body shop business remains very solid as we sit here today, and we don't see that changing in the near-term.

**Operator:** Your next question comes from the line of Stephen V. Byrne with Bank of America Merrill Lynch. Stephen, please go ahead. Your line is open.

Stephen Byrne

Q

Thanks, Tim. I'd like to ask you about your view on -- among all of your growth potential, where would you rank cross-selling you highlighted growth opportunities in businesses, but -- and you highlighted Comex as an opportunity to drive a few other businesses. But do you see potential to do that in other regions? And which of your businesses do you think you have the most potential to drive geographic share gain?

Tim Knavish

A

Yeah. Hey, Steve. Thanks for the question. Comex is example. Two areas that top of mind, we talk about often as far as cross-selling, if you look at protective coatings, we are -- as part of our PMC business, we sell protective coatings today across the distribution networks that are kind of owned and operated by our architectural business.

We look at from a customer standpoint, the near-shoring, the construction of battery plants, for example, or the near shoring of factories into Mexico or Vietnam and other places, those are cross-business selling opportunities where we would be selling protective coatings, architectural coatings and light industrial coatings.

So we have those cross-selling opportunities around the world, and we leverage those and see good opportunities for further growth going forward. PPG Mexico, I point out, because I would argue it's the strongest distribution network in the coating space globally. But we have similar opportunities to different scales around the world.

Vince Morales

A

Yeah. And Steve, I just want to expand on the battery factory comment, Tim made. So if you look at the battery factory construction, we typically have multiple angles to prosecute that. We may go in first with protective coatings as they're building the infrastructure for factory.

We certainly could do architectural coatings. We then have an entrée into the actual products being made in those factories, both on a light industrial or heavy industrial coatings as well as an OEM basis. So, that I think battery factors are prime examples of where we are able to cross pollinate with the customers.

**Operator:** Your next question comes from the line of Jeff Zekauskas with JPMorgan. Jeff, please go ahead. Your line is now open.

Jeff Zekauskas

Q

Hi. Thanks very much. You said that you're on FIFO and that your raw materials on that basis were down at a high-single-digit rate. If you were on LIFO, how much would they be down? I know that they would be down more, but my question is by what percentage?

And secondly, it seems that your volumes in your domestic architectural paint stores business increased in the third quarter. Is that true? And do you think they're capable of increasing in the fourth quarter?

Vince Morales

A

Hey, Jeff. This is Vince. Great to hear from you. Let me take the first question on inventory and Tim will take the architectural question. I think the best way we could describe that -- it's a complicated question, as you pointed out, but a great question. I think the best way we've been describing that is if you look on a realized basis, we're realizing mid to high-single-digit deflation in our financial -- in our P&L in Q2, Q3.

We think that would be high-single-digit or even low-double-digit depending on the commodity, if we were able to move to a LIFO, for the 80% of our business that's on FIFO. So that gap is probably 200 to 300 basis points of deflation capture. So hope that's understood. Tim?

Tim Knavish

A

Hey, Jeff. On your architectural US question, the way we look at it with our new business model is -- our stores are part of our professional omnichannel, which is company-owned stores plus the Pro at Home Depot plus our independent dealers. That business, despite all the challenges macro-wise, that omnichannel delivered low single-digit growth in Q3. And we would expect that or better as we move forward. So yes, I think the omnichannel is delivering what we've expected some help from macros would make that even better.

John Bruno

A

And Jeff, this is John. Just one other point to Tim's feedback that growth was driven more by volume than price in the third quarter.

**Operator:** Our next question comes from the line of Josh Spector with UBS. Josh, please go ahead. Your line is now open.

Josh Spector

Q

Yes. Hi. Thanks for taking my question. So I wanted to ask on margins, and I'll ask it on industrial, but I think the same logic should apply on performance since you remove some of the seasonality. So if we look at where margins are now in industrial, you're in the high 13% range. You were there in the first quarter of this year. When you weren't getting benefits on raw materials, you're there now where you are getting benefit, sales are roughly similar. So I guess, first, is why aren't we seeing the flow through on margin? Is there something on cost or any price hitting back impacting that? And then second, when we look at next year, if volumes are, say, flattish or maybe slightly up is there anything in your control to get margins up higher than where they are today, be it cost or otherwise? Or is this the level we kind of normalize that and it's more volume growth? Thanks.

Tim Knavish

A

Hey, Josh. So Industrial segment, 39, as you said, that is 300 basis points up from year in Q3. And the real driver -- it's not part -- we have not seen any significant, if any, price give back on the impact there in industrial. The big

impact is volume. That – volume as recovers, moving forward, you'll see margin in Industrial Coatings improve. So within our control, the operational improvements that we've talked about and we said in our prepared remarks that we're starting to see those impacts come through on a productivity basis. That's another big driver to Industrial segment margin continued improvement.

**Operator:** Your next question comes from the line of David Begleiter with Deutsche Bank. David, please go ahead. Your line is now open.

**David Begleiter**

Q

Thank you. Good morning. Tim and Vince, just on the Q4 guidance, can you give a little more color on your assumptions for the auto strike, how long it continues? And does it expand? And also, what are you seeing in terms of professional contracted backlogs heading into Q4 here? Thank you.

**Tim Knavish**

A

Yes. Hey, David, on UAW, I said in my prepared remarks a few cents. I'll be a little more specific. We've assumed \$0.03 for Q4. It was much less than that in Q3, almost negligible because just the mix of where the strikes hit from UAW, but we have made some assumptions that this will go on and will likely spread to a couple of plants. But as you know, David, we're trying to guess as much as anybody to, what tactics are going to be deployed. But we've got about \$0.03 built into our Q4 guide. And the second question again was...

**John A. Bruno**

*Vice President-Investor Relations*

Yeah, the backlogs in the US architectural side.

Q

**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

Yeah. Thanks. Sorry. Sorry, I forgot the second question. Backlogs in architectural from a DIY standpoint of course no backlogs to download from an overall sales and volume standpoint, but the PRO backlogs are actually holding up pretty well despite everything that's happening out there on housing.

You'll recall that a lot of our PRO business is commercial and maintenance that's holding up well despite the macros. And some of it is based on a backlog of jobs still coming out of prior quarters and prior years.

And some of that backlog is holding up because skilled labor availability, that our customers are seeing. So backlogs remain strong. I think the average backlog for us and our customers only dropped by about a week from average of 14 weeks to 13 weeks. So still pretty solid there.

**Operator:** Your next question comes from the line of Kevin McCarthy with VRP. Kevin, please go ahead. Your line is now open.

**Kevin McCarthy**

Q

Yes. Good morning. Portfolio question for you, Tim, you've done a fair amount of pruning, including most recently, the Australia, New Zealand portion of Traffic Solutions. Can you just put that into context, where are you in that process? How much more might there be to go?

And then, on the flip side of the coin, I'd appreciate any updated thoughts on potential for an increase in bolt-on acquisitions. With interest rates having increased, are you starting to see asking prices come down in the private market? And how would you characterize that versus, say, repurchases or just ongoing deleveraging for next year?

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**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

A

Yeah. Thanks Kevin. Good morning. To your pruning question, I would say we're in early innings, frankly. What we've done so far is, I'd say some of the more obvious ones around the edges.

But businesses are on notice my team knows that every business has to earn their right to stay in the portfolio. And that's small or medium or large even. But we did the obvious ones first, and we're working through a number of other things. It's a bit early to give any specifics, but early days there.

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**Vincent Morales**

A

And Kevin let me just add there. I think this goes back to the May, CEO briefing, the focus for us is to make sure that we're spending our energies, our bandwidth on organic growth. And if a business is not performing or too small to contribute meaningfully, then we're going to shift that bandwidth to organic growth initiatives. So that's, again, one of the critical focus is here as well as the financial returns, obviously.

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**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

A

Yeah. And the word is focused. I said that many times back in May, and I'd say it's daily within the company. We're going to focus on the areas that we have the best right to win for the future and that are going to drive the best financial and growth performance for the future.

To your second question, we are still -- still a core part of our strategy is value creation, shareholder value accretive acquisitions because we still see many opportunities out there in the coatings space.

But it's been a little slower than historical just given the financing costs and also performance of some companies during these macro-challenged environment. Sellers, of course, sellers want to sell it to peak EBITDA.

So I think there's a little bit of a pause in closing deals, but we have a number in our pipeline. We're talking to potential sellers daily, weekly, monthly. So it's still a core part of our strategy. And frankly, because these acquisitions add long-term earnings and long-term cash generation, it's still our preferred -- one of our preferred deployment opportunities. But as you heard us in our opening remarks, if those don't happen we will put that surplus cash to work in other ways, including repo.

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**Operator:** Your next question comes from Aleksey Yefremov with KeyBanc. Aleksey, please go ahead. Your line is now open.

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Aleksey Yefremov

Q

Thanks and good morning, everyone. Did you outperform in the pro paint market in the US this year, and if so, by what magnitude? And how do you think you could do relative to the market in the segment next year?

Tim Knavish

A

Well, we're in -- again, architectural, we really run three very different architectural businesses depending on where you are in the world, right? So we talk a lot about our strength in Mexico, in Europe. We're number one in 10 countries with a very strong position with the existing business model. And that business, we're actually starting to see flat volumes despite everything that's happening in Europe. So we see that the flat volumes, we see as a positive, given what's happened over the last couple of years with the potential that Europe has stabilized.

In the US specifically, it's a very different business model where we are actually in the mode of building a business model for the future. And so it's early days in that journey where we're building a model that's brick-and-mortar like omnichannel model across our three channels, and we're converting paint customers one-by-one-by-one. You heard me say in the past that for that model to prove success, it needs to grow high-single-digits, low-double-digits every quarter, and it will take many quarters to get significant scale there.

Q3, you heard the earlier question, we did grow both volume and sales by low-single-digits, a little lower than where I'd like. But given the macros in housing, I'd say that was to expect it. How we're doing versus the market and peers? We'll see as other people release their results. But our architectural US business, we are building a business model for the future. And it's a marathon, not a sprint. So we're looking at it on a long-term business model foundation.

**Operator:** Your next question comes from the line of Michael Sison with Wells Fargo. Michael, please go ahead. Your line is now open.

Michael Sison

Q

Hey, guys. Nice quarter. In terms of the fourth quarter, your outlook is for plus low-single-digit sales growth to minus. I guess that implies some pricing, right? So the outlook for volume would be kind of like flattish to down mid-single-digits. So can you maybe talk about what drives sort of the flattish or drive sort of the down? And then given where the interest rate environment is, do you think US architectural demand next year could be up, down, flat? Thank you.

John A. Bruno

*Vice President-Investor Relations*

A

Yes. Mike, this is John. Let me start, and I'll have Tim and Vince add on here. So in terms of the fourth quarter outlook and volume, the Performance segment, we expect volume to be positive. We're still going to see good growth in aerospace and Comex as two key drivers there. The industrial segment, we are expecting volumes to be lower, and that includes the assumption that Tim made earlier about the UAW impact. So if you -- if we didn't have a UAW impact, we must be much closer to being flat in volume in the Industrial Coatings segment.

Tim Knavish

A

Yes. For Architectural Coatings US next year, I feel good about the Pro based on two things, Mike. The continued growth an acceleration of the omnichannel that we're building plus the backlogs that our customers continue to experience. DIY, it's a big part of the business. And if it stays at the current low level, that would actually be a positive for us as opposed to declining further. If there is just a little uptick in consumer spending and consumer remodeling, and I will remind everybody that paint remodeling is the lowest-cost home remodeling project you can do. So it will be the first one to start to recover. A little bit of volume recovery there would really help the total business in aggregate. So net-net, I'm positive on the pro. I'm still questioning what's going to happen on DIY for next year.

A

And Mike, just one more thing on the DIY is we do know many of the large DIY retailers have destocked in 2023. So we certainly haven't had detailed conversations about their plans for 2024, but there was a pretty aggressive destock in 2023. So the sellout was much greater than the sell-in in 2023. And if that just normalizes on a year-over-year basis, that will assist the pain producers.

**Operator:** Your next question comes from the line of Frank Mitsch with Fermium Research. Frank, please go ahead. Your line is open.

Frank Mitsch

Q

Thank you and congrats, John, on the promotion of VP Finance, reading a lot about wage inflation and higher accruals at PPG. So I assume it's because you've been doing double duty for the last 2.5 months, so congrats on that. You commented that volumes in the fourth quarter, it seemed like we might finally get that to be positive if it wasn't for the UAW strike. I'm curious as to given the nine quarters in a row of negative volumes, Tim, what your expectations are as you have an early read into 2024 in terms of volume growth at PPG?

A

Yes. Frank, I do appreciate you congratulating John on his promotion. Very easy decision for us, well-deserved, but it didn't affect our wage inflation because John loves his job so much, he does it for free. But going into next year, I'm confident based on what we know today, based on what we see today, that we will swing to positive volume as a total enterprise in 2024.

Q4 will be close, but again, UAW is a big unknown, what it will – depending on how that goes and which plants and which ones we supply, customer mix wise, it's still a bit of an unknown. But I do feel positive that we will swing to positive volume in 2024.

We've got Europe and China, two of our biggest regions that sequentially -- sequentially, we believe China is going to recover to a slower speed than historical, to a slower speed than what we thought a couple of quarters ago, but sequentially, we will see improvement in China.

Europe, as I said earlier, we're actually pleased to see flat volume across some of our larger businesses like Deco in Europe, because we really believe it is bouncing off the bottom. So we've got demand stability and any incremental increases in Europe will drive really good leverage for us.

I mentioned the aerospace backlog, more we make, the more we sell and that will go on for many quarters. And we're focused very heavily on productivity and getting more out the door, which will drive growth for us.

Automotive, I believe, will have sequential improvement, sequential build increases moving into 2024. So when exactly? Which month? We will have some macro dependency. But overall, I'm confident in the swing to positive volume in 2024.

**Operator:** Your next question comes from the line of Laurence Alexander with Jefferies. Please go ahead. Your line is now open.

**Laurence Alexander**

Q

Good morning. Congrats on strong quarters. I just want to pin down one point. With respect to the incremental price actions and productivity, do you think you'll be able to keep that ahead of wage inflation in Q4 in next year? Or how should we think about the bridge there?

**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

A

Yeah. Hey Laurence thanks for the question. The short answer is, yes, we'll stay ahead of wage inflation with a combination of price and productivity. We do expect, if you look at, let's call it, salary inflation in the established markets a little higher than normal, call it, 3%, frontline workers is very country specific.

So it will be higher than that in some countries. But we're also confident, given our pricing track record that through a combination of price and productivity, we'll be able to offset the wage inflation that we'll see.

And I'll also point out -- remember that with our mix of businesses, with the exception of company-owned stores, we have a very low people intensity structure, because most of our businesses are direct -- or direct to somebody else's distribution channel. So with the exception of company-owned stores, we have a pretty low human capital intensity frontline business.

**Operator:** Your next question comes from the line of Aron Ceccarelli with Berenberg. Please go ahead, Aron. Your line is now open.

**Aron Ceccarelli**

Q

Hi. Good morning. Thanks for taking my question. I have one on pricing. With the heavy lift on pricing initiatives now behind us and the supply of raw materials back to normal condition, how should we be thinking about pricing across the two segments for 2024? And how do you feel about the potential scenario where pricing could turn negative next year? Thank you.

**Timothy M. Knavish**

*President, Chief Executive Officer & Director*

A

Yeah. Hey Aron, thank you for the question. Pricing, we will, in the Performance segment, we will get incremental targeted pricing as we move into 2024, because of the structure and the value-add that we deliver relative to the total cost of production that our customers have. So in other words, the small amount of paint consumption, a small amount of price is more than offset by the total production cost that we impact and the value that we add to our customers from a productivity standpoint. So we will get more targeted price in performance next year.

In Industrial segment, we have not seen price give back to this point. We do have some structural contracts about 30% of our Industrial segment that is tied to some form of an index contract. So depending on what happens to that total basket of raws, there is a time lag built into where there would be some structural price changes. But again, that's less than half of our business. Beyond that, let's -- to the prior question, let's recall that there's a lot of other inflation out there, so the discussions we'll have with our customers and continue to have with our customers is that, that other inflation we also need to talk about when it comes the price of our products and services.

**Operator:** Your next question comes from the line of Mike Harrison with Seaport Research Partners. Mike, please go ahead. Your line is now open.

**Mike Harrison**

Q

Hi. Good morning. I wanted to ask a question about the growth that you're seeing in powder coatings. Is this mostly share gain where you're seeing the growth or is there a lot of conversion happening with existing customers such that we should view it more as cannibalization? And I guess what does the margin profile look like for powder coatings compared to liquid for a similar application? Thank you.

**Tim Knavish**

A

Yeah, Mike, great question. Thank you. What you see in powder growth for PPG is share gain, okay? Very little, if any, conversion of existing PPG customers from liquid to powder because there's two factors there. One, frankly, we're starting at a fairly low market position in powder. So we're specifically targeting share gain and conversion of an existing customer from liquid to powder takes a capital investment by that customer in their paint job. So it's not an overnight flip. So what you're seeing is sharing.

Now from a margin standpoint, if you look at our US powder business, for example, on a net margin standpoint, it's one of our more profitable segments across general industrial. And the reason is we target specifically the higher end of the powder portfolio. There's liquid-like appearance, there's metallic powders, those types of things that command a higher margin because they're more technology advanced from a formulation standpoint. So we're specifically targeting the higher end of the segment.

Longer term, one of reasons we are investing in powder for the future is, it is the more sustainable solution for our customers. So you've got the short-term focus that where we're driving share gain by targeting the higher-end segments of margin for powder. Longer term, you will see more and more customers converting from liquid to powder because of the sustainable solution that it provides.

**Operator:** Our final question today comes from the line of Arun Viswanathan with RBC. Arun, please go ahead. Your line is open.

Arun Viswanathan

Q

Great. Thanks for taking my questions. I just wanted to understand, it sounds like you may be looking at consolidated positive volume growth for 2024? Given that scenario and the operating leverage and the incremental margins that you, kind of, envisioned, do you expect to get to that \$9 EPS level or what's the path to getting back to that that level you put out a couple of years ago? Thanks.

A

Yes. Thanks, Arun, for the question. I've said many times, and I'll continue to say it that \$9 for PPG is a question of when not if, okay? We will get there. I just fully confident in our new enterprise growth strategy and leveraging the portfolio that we've got as well as some selected pruning and some selected -- targeting certain geographies and segments being a lot more focused. So \$9 is a when not if.

What I'm confident in 2024 is that we will hit the 8% to 12% EPS growth that we stated in -- when we were together in May. And frankly, that 10% average EPS growth has been a target for our company for many years. And so I'm confident that as we move through 2024, a combination of the swing to positive volume plus the capital deployment that we've talked about a few times here this morning, plus some of the key innovation initiatives that we're launching now and will gain momentum in 2024. I'm confident that, that combination will get us to what we've committed to.

**Operator:** Those are all the questions we have. So I'll turn the call back over to Mr. John Bruno.

**John A. Bruno**

*Vice President-Investor Relations*

Thank you, Emily. Great job. Appreciate that. We appreciate all your interest and confidence in PPG, and this concludes our third quarter earnings call.

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

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