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PPG Industries, Inc. (PPG)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Elliot, and I will be your conference operator today. At this time, I would like to welcome everyone to the Second 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 Alex Lopez, Director of Investor Relations. Please go ahead, sir.

Alejandro Lopez

Director-Investor Relations, PPG Industries, Inc.

Thank you, Elliot, and good morning, everyone. This is Alex Lopez, Director, Investor Relations. We appreciate your continued interest in PPG and welcome you to our second quarter 2024 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 Thursday, July 18, 2024. We have posted detailed commentary and accompanying presentation slides on the investor center of our website, ppg.com.

The slides are also available on the webcast site for this call and provide additional support to the opening comments Tim will make shortly. Following management's perspective on the company's results for the quarter, we will move to 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. 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.

Timothy M. Knavish

Chairman & Chief Executive Officer, PPG Industries, Inc.

Thank you, Alex, and good morning, everyone. Welcome to our second quarter 2024 earnings call. I'd like to start by providing a few highlights on our second quarter 2024 financial performance, and then I'll move to our outlook.

The PPG team delivered sales of $4.8 billion and our seventh consecutive quarter of year-over-year segment margin improvement. This culminated in second quarter adjusted earnings per diluted share of $2.50, which is an all-time record for the company and represents 11% year-over-year growth.

Despite increasingly challenging macroeconomic conditions, we are building top line momentum as our underlying year-over-year volume progression improved for the sixth consecutive quarter.

In the second quarter, 6 of our 10 business units delivered positive volume growth versus prior year, aided by our enterprise growth strategy initiatives. These initiatives including delivering new products and technologies to our customers, such as our innovative packaging interior can and exterior end coatings technologies as well as our new SIGMAGLIDE technology in our marine business. Each of these technologies has allowed us to gain share in their respective businesses. Our actions also include upgrading and modernizing our manufacturing capabilities to drive increased output such as in aerospace, where demand has outpaced industry supply.

One additional example of our enterprise growth strategy is where we're driving changes to the ecosystem of the business models. This includes an architectural coatings US and Canada with our Home Depot initiative, in our refinish business with our digital tools such as MOONWALK and LINQ and in our traffic solutions business as we further optimize our service and supply capabilities, which are critical value drivers in this business.

Additionally, our volume performance in the quarter benefited from our well-established business portfolio in Mexico, China and India. Overall, however, our aggregate volumes in the quarter were flat year over year, falling shy of our initial expectations as overall demand in Europe and global auto OEM production were below what we assumed in our second quarter guidance. It is important to note that our European volumes, while still negative, improved sequentially year over year versus the first quarter. Also, global industrial activity remained subdued in the quarter.

Consistent with our financial guidance in April, our second quarter automotive refinish sales were down year over year, reflecting a strong prior-year comparison and lower insurance claims. However, we remain confident that this business will have a strong second half of 2024.

In the quarter, we drove further margin enhancement, and we marked our seventh consecutive quarter of year-over-year segment margin improvement. Our aggregate gross margin was 43% for the quarter, a 180-basis-point improvement year over year.

Our Performance Coatings segment achieved all-time record segment margin of 18.7%. And our Industrial Coatings segment also improved its margin profile by 120 basis points versus the prior year.

During the second quarter, we benefited from stable upstream and downstream supply chains and the vast majority of our suppliers have sufficient or excess capacity, which is noteworthy as this occurred during the peak season for raw material consumption.

Consistent with our guidance, we experienced mid-single-digit percentage raw material deflation that we expect will normalize in the flat to low single-digit deflation for the third quarter as we anniversary prior-year impacts. This benefit was partially offset in our results by general inflation, including higher year-over-year wages and employee benefits.

We are proud to have published our 2023 ESG report in the quarter, which highlighted progress against our 2030 targets, including increasing sales from sustainably advantaged products and reducing greenhouse gas emissions throughout our own operations and our value chain.

I want to take this opportunity to provide you with an update on our previously announced strategic reviews of the architectural coatings US and Canada business and the global silicas product business.

We made good progress with these processes and are pleased to have a number of engaged and interested parties. We're working through the traditional bidding, management presentation and data provision stages and remain on our original schedule to determine a path forward for each of these assessments.

We have also made further progress in driving improvement in working capital, including lowering our year-over-year inventories during the quarter. As a result, our operating working capital was down 90 basis points year over year. We have more work to do over the balance of the year as we move towards seasonally slower sales quarters, but we have already returned to near pre-pandemic inventory levels.

We ended the quarter with a strong balance sheet and remain committed to deploy excess cash for shareholder value creation. During the quarter, we repurchased $150 million of PPG shares, bringing our year-to-date total to about $300 million. This is on top of our fourth quarter 2023 repurchases. Also yesterday, consistent with our long heritage, our board authorized a $0.03 dividend increase from $0.65 to $0.68 per share.

Now, looking ahead to the third quarter, we expect overall organic sales of flat to low-single-digit percentage growth. In Mexico, we expect to again deliver excellent financial results. We also believe that demand in China will deliver organic growth, as a result of our technology-advantaged products, but albeit at a lower growth rate than achieved in the first half of the year. In Europe, demand remains uneven by country and end use, but we expect modest sequential year-over-year improvement.

In addition to those businesses that grew in the second quarter, we expect organic growth in automotive refinish coatings and protective and marine coatings, and also, while slightly unfavorable year over year, we are expecting product – projecting, modest sequential quarterly improvement in general industrial demand.

We expect to deliver adjusted third quarter EPS between $2.10 and $2.20 per share, aided by solid operating performance. Our guidance midpoint is 4% higher than our record third quarter 2023. However, the midpoint of our guidance is 10% higher than the third quarter of 2023, excluding the impact of a higher year-over-year tax rate, as the prior year included several non-recurring favorable discrete tax items. The difference in the tax rate is reducing our year-over-year EPS comparison by approximately $0.12 at the midpoint.

We anticipate overall company selling prices to be flat in the third quarter, as the impact of certain index-based customer contracts in our Industrial Coatings segment will be offset by selling price increases in our Performance Coatings segment, including some additional incremental pricing that will be realized in the third quarter.

With regard to commodity raw materials, supply remains ample and we continue to realize benefits from moderating input costs. In the third quarter, we expect flat to low-single-digit percentage raw material deflation, lower than the second quarter as we anniversary some decreased realized in 2023.

As we have consistently demonstrated, we will drive further improvement of our operating margins, aided by sales volume growth leverage as a result of the execution of our enterprise growth strategy and self-help in manufacturing productivity and cost control initiatives, which includes continued execution of our previously-approved restructuring actions.

Our more than 50,000 employees are committed to delivering best-in-class solutions to our customers that will drive growth for PPG. Our results this quarter were made possible by our highly dedicated team around the world, who make it happen and deliver on our purpose to protect and beautify the world every day.

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

QUESTION AND ANSWER SECTION

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

John McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Good morning. Thanks for taking my question. So, I guess, maybe the first one would just be on the US, Canada architectural review. It sounds like you're getting a reasonable amount of interest. Would you say that that's increasing the likelihood of a sale versus some of the other avenues, JVs, partnerships? I think you kind of said at the beginning of all this, any option is open but it sounded like a sale was the preference. Would you say there's a high likelihood of this ending up being a sale?

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

A

Hey, John. Thanks for the question. We're very pleased with the level of interest in the architectural US, Canada business. And I will say that level of interest has great diversity across the scenarios that may end up being the final path forward. So, it's just too early at this point to say which one of those is kind of leading the pack as we've had really good interest in a number of different scenarios from full sale to JV and other forms of partnerships. So, just too early, John, but we are making good progress.

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

A

Yeah. And John, this is Vince. As we said – as Tim said in the opening remarks, we're in the normal process working with these interested parties, working with our bankers, having traditional management meetings, et cetera. So, we remain on our original schedule to determine a path forward.

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

Duffy Fischer
Analyst, Goldman Sachs & Co. LLC

Q

Yeah, good morning, guys. A question on auto OE. So, the numbers you put up were worse than – like if we're looking at just the global auto builds, S&P or IHS, so is that a customer footprint issue? Is it a destocking by the customer? First. And then do we need to anniversary that? Are there two more quarters after this that are going to kind of be down high single-digits to get to a new level of run rate?

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

Hey, Duffy, thanks for the question. Our numbers, our projections may have been a bit different than what you're seeing from some of the kind of global services – service providers. A couple of things there. We do have a very strong position in Europe, which was down more than average. And also, our projections, while services maybe are looking more at macros, our projections for Q3, in particular, are based on what we actually see in specific assembly plant schedules at the plants that we serve. And a number of them have increased, just very recently increased their summer downtimes. So, that may have a disproportionate impact versus what you may be seeing publicly.

And then finally, I'd say, as you know, we have a very strong position in China. And we did see a step down in China production plans as soon as the EV tariffs were announced. And I think some of our customers are playing it cautious here until they see how that scenario plays out because, as you know, particularly the largest producer there is exporting quite a bit there, so we do think that's a transitory item that will play out.

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

Yeah. And Duffy, this is Vince. Just a point of clarification on our materials, we provide organic sales numbers, which for us includes volume and price, as we've alluded to many times this year in this business and in our industrial segment, we have index-based pricing. So, excluding price, we're much closer to the service provider numbers that you alluded to in your question. So, you have to bifurcate price [ph] versus (00:16:28) volume.

Operator: Your next question comes from the line of Ghansham Panjabi with Baird. Your line is open. Please go ahead.

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

Yes, good morning. Thank you. Tim, could you give us a bit more color on the volume trend line in Europe during the second quarter? You mentioned it was a bit below your forecast. Which specific businesses perhaps were a little bit below? I think you call that auto OEM. And then secondly, in terms of the flattish volumes on a consolidated basis year over year for 2Q and the margin improvement, which was quite significant, can you just give us some of the high level drivers of that?

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

Sure, Ghansham. Thank you for the questions. Yeah, the volume trend in Q2 did play out a little worse than we expected, particularly at the end of quarter. June, in particular, was soft, largely driven by what I just said on Duffy's questions as certain assembly plants started to add additional down weeks and that affected US and Europe. So, that was one thing that played out.

The other one is the Deco business in Europe softer than we expected, again, particularly in the last month of the quarter. A little more color there. We're very strong in France, and that's one of our larger countries for sales. And as you know, that had some unique situations going on there. So, that did slow down for us in June. But interestingly, a subset of the Europe story is Eastern Europe has been stronger than expected, where we actually also have a very strong position in countries like Europe – I'm sorry Poland and others. So, it was really those two businesses in Europe that trended downward as the quarter progressed.

Then, the overall volume being flat versus what we had previously said was really driven globally by auto and locally in Europe by architectural. Those were the two big ones. But as I said in my opening remarks, we did – we have been improving sequentially over the last six quarters. If you go back to end of 2022, we were down negative 5% in volume, and that has steadily improved to where we're printing flat this quarter.

And also in my remarks, I said there were 6 out of 10 businesses that were positive volume for us. Just to give you some context there, last year, that was 3 out of 10. So, we went from 3 out of 10 to 6 out of 10 and we're planning on 8 out of 10 in Q3 being positive. So, a little under where we wanted to be for Q2, largely driven by end of quarter in those two businesses. But we feel good about the momentum, Ghansham.

Operator: Your next question comes from the line of Chris Parkinson with Wolfe Research. Your line is open. Please go ahead.

Chris Parkinson
Analyst, Wolfe Research LLC

Q

Great, good morning everybody. I don't think any of us are really in a doubt that the macro has been a little bit choppier than most were anticipating into the second quarter. But Tim, you've been really focusing the portfolio and your ability to outgrow certain end markets. I know it's still a bit early and perhaps tough to tell, but what would be, at this juncture, the two to three end markets where you are, by far and away, the most comfortable in PPG's ability to consistently outperform market growth rates? Thank you.

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

A

Yeah. Hey, Chris, thanks for the question. Number one, aerospace. We're really just – as I've said for the last several quarters, everything we can make is sold and shipped. We're adding capacity. We're improving productivity. We've improved output in this past quarter. So, we're selling more and we'll continue to outperform.

Despite the – I always say that with refinish, you really have to look over a full year basis with this business, because you always have order pattern issues from the distributors around the world. Refinish, we continue to gain share in refinish by execution of our digital systems, which have been widely accepted and embraced and we keep adding to that toolbox of new digital tools, Chris. So, feel really good about that.

There's packaging outperforming from a volume standpoint, and we still haven't launched everything that we've won in the last few quarters. Traffic, although not our biggest business, that's – I want to point to a business that the first couple of years, I would say, we cleaned up that business. And now, we're in a position where it is really starting to perform for us.

Other businesses vary very much by specific region, but those will be the four that overall, I would say, we're outperforming. But I do want to point out three other things. Aggregate Mexico, just Mexico across the board, whether it's PPG Comex or our Industrial segment businesses or protective and coatings, protective and marine, we're outperforming Mexico.

Aggregate China, of course, with excluding Deco, where we don't play, aggregate China, we're outperforming. Aggregate India, except for Deco, where we don't play, we're outperforming. So, that's how I would describe the businesses that I feel most confident about our over-performance going forward, Chris.

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

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Tim, as you go through the review of the US paint business, are you seeing any disruptions to the business, and particularly see any market share losses due to challenges or disruptions in the business? Thank you.

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

A

Hey, Dave. We had a very good quarter in that business. So, of course, that was something that we had some concerns about as we announced it, but internally, the team has done a really good job working with our employees, our customers, our distribution partners in the private dealer space, our big box customers. And we had a good quarter in that business, mid-single-digit growth. So, while we – it's something we're watching and monitoring very closely and trying to stay ahead of it. I'd say the team did a really good job in Q2 of doing that and we're expecting the same in Q3. There's lots of discussions. Of course, there are some anxieties. But so far, that has not had any kind of sizable impact on the financial results.

Operator: Your next question comes from the line of John Roberts with Mizuho. Your line is open. Please go ahead.

John Roberts
Analyst, Mizuho Securities USA LLC

Q

Thank you, Tim. Are you still on track with the silicas sale as well? And how do you feel about the rest of the specialty materials portfolio?

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

A

Yeah, John, thanks for the question. Silicas, we're very much on track with that, maybe even a little ahead of where we are in architectural US, Canada. We've had good interest there as well. And let's just say, we're on our original schedule.

The rest of that specialty business, we really like. And here's why because we have a leadership position in those spaces and they're high-technology spaces, which is right in our wheelhouse from a R&D capability standpoint.

So, obviously, not the biggest part of our portfolio, but that business was one of the good growth engines for us in Q2, we expect that to continue going forward. So, they're good businesses for us.

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

Stephen Byrne
Analyst, Bank of America Merrill Lynch

Q

Yes. Thank you. And Tim, if you had a clean slate of how to report your financials, you have these 10 businesses. You have some looming divestitures. If you were to report that network of businesses, would you choose two segments? And would you allocate them the way they're currently arranged? Or would you consider going down a path of either more segments or reporting revenue by business, something to drive more transparency?

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

A

Hey, Steve, it is something I've been given a lot of thought to, and we'll continue to think about it and see what things look like post architectural [ph] USCA (00:26:02), but high level, we have a group of businesses that essentially deliver factory to factory, pure business – B2B type of businesses, where they go from our factory to an assembly plant, or our factory directly to a paint shop of some kind. And that's a logical fit because they have a lot of synergies, synergies in operations, synergies in raw materials, synergies in supply chain and logistics and synergies in science and technology.

We have another group of businesses that largely goes through distribution and has a lot of value-add services, that are a key part of the value proposition like aerospace, like refinish and like protective. So, high level, I'm comfortable with it. But it's something we do look at on a regular basis. And we'll take a fresh look once this transaction is done. But I'm pretty comfortable with how we report today.

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

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you and good morning. In our model, if we look out into 2025, we start to see raw materials move up, probably low-single digits in the first half of next year. So, is that something you'll look to get ahead of from a pricing perspective in the back half of the year? Or would you take more of a wait-and-see approach?

And are there any parts of the business where – if we forget about refinish and aero, where you have well-defined pricing power, are there any parts of the business, maybe auto OEM, where you're a little more concerned about being able to pass that through?

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

A

Yeah. Hey, Vincent. So, what I would say at a very high level is there's sufficient capacity out there across the supply chain, because if you look at the total industry of coatings, we're producing less leaders than we did pre-COVID. And so, there's – high level, there's still quite a bit of capacity out there.

Of course, we do what we can to get ahead of it. And you pointed to some places where we can get ahead of it. The other businesses, largely the Industrial segment, it's typically more real-time. And in some cases, as you know, businesses are able to get pricing faster than others. And as we discussed during the last inflationary cycle, auto OEM is typically the slowest, but we eventually get there, just like we did last cycle. So, I would expect it to play out the same in any cycle that may be on the horizon, whether it's next year or the following year.

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

Michael Sison
Analyst, Wells Fargo Securities LLC

Q

Hey, good morning. Can you maybe talk a little bit about the profitability of US architectural paints? Has there been any improvement over the last year? Maybe what type of growth you think that business will generate in the second half? And then finally, Tim, when you think about the full sale, JV or partnership, how are you thinking which one would be the best transaction for shareholders?

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

A

Well, we – the best transaction for shareholders will come down to two pieces. One is what's the – what are the proceeds, what do we get paid for, what we're selling. And two, what's the long-term strategic value of anything we might be left with.

So, that's why it's really hard for me or any of us to say, here's the best shareholder value proposal right now, because the combination of those two price, proceeds and future value of anything we might be left with, we're just not there yet in the process.

But that's how we're thinking about it, is a combination of shareholder value today for what we get and shareholder value for future for how it fits with our growth strategy and what we can expect from an earnings and cash flow on the long term.

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

A

Yeah. And Mike, on current events, look, as Tim just said in an earlier question, business is performing well. Volumes are a key driver to profitability. Our volumes were up in Q2, as we said in the prepared remarks. So, we're pleased with the progress year-to-date.

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

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Good morning and congrats, Alex, on your new role. Tim, I want to ask about the expectations for the second half to be lower than you previously thought, which resulted in the full year EPS guide down. I'm just curious, roughly what was the – when you think back three months ago or even six months ago when you first put out the full year projection, what sort of level of volume growth were you expecting in the second half of the year? And where are you now in terms of expectations on volume growth through the second half of the year?

And I know that part of the reduction is tied to auto OEM and you said that you've been surprised by the extension of the assembly plant downtime. Just curious, looking back in PPG's history, when you've been surprised in the past by the auto OEMs taking extended assembly plant downtime, does that serve as any sort of a foreshadowing of recessionary environments or anything like that? Any color there would be very helpful. Thank you.

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

A

Yeah, hey, Frank. So, first of all, what changed from what we were saying about the full year to what we're saying today, it's largely a couple of big businesses like auto, global and architectural Europe. And of course, the other businesses are puts and takes, some up, some down. So, that's really the biggest driver.

And to your second question, I'm not using the recession word at all. What I see more is temporary adjustments at assembly plants just given vehicles – some – certain vehicles selling less than they expected and inventory is going up a little bit. Inventories are still very healthy compared to pre-COVID levels. But if you look at US inventories, they did creep up a little bit.

So, I think there's just some adjustment, there's caution from our customers on affordability, interest rates, things that really drive some of the vehicle purchase behavior by consumers. You probably have your own prediction on interest rates. I have mine. But at some point, that should be a pressure that comes off of new car purchases and I think our customers are just watching the same things very closely, inventories versus affordability and interest rates. But I do not see this as foreshadowing of a recession of any kind.

Operator: Your next question comes from the line of Patrick Cunningham with Citigroup. Your line is open. Please go ahead.

Patrick Cunningham
Analyst, Citigroup Global Markets, Inc.
Q

Hi. Good morning. I'm just curious on your optimism for the refinish outlook for the second half. Which regions do you expect to see the most meaningful growth? And how much of a role of MOONWALK and LINQ play for organic growth? And are you seeing anything in terms of data points or anything in order books that gives you confidence in the underlying market growth in the back half?

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

Yeah, Patrick. So, I'd say the biggest confidence point for us is really everywhere outside of Europe, where we're really still in the very early innings of launching our productivity, digital ecosystem. We started that in Europe, gained tremendous share and customer retention and subscription revenue as we launched that across Europe. And we're still very early days in the US, Australia, China, places like that. So, good confidence in the share gain as we roll out those tools around the world.

The collision rates are a question mark depending on where you are around the world. But we believe our penetration rates of these digital ecosystem is still single digits of all the body shops out there. So, we've still got a lot of runway. And as I said in my – in an earlier answer, we continue to add to that toolbox of digital productivity tools as we go forward.

So, it is, of course, the chemistry inside the can, which we're best in class at from a color match and speed and all those things. So, we feel really good about that. But a lot of our share gain right now is delivered by the productivity tools outside the can.

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

And just to get to your question on the second half of the year, just a little bit of history. Again in 2023, we had a price increase going into effect in early Q3. We had a lot of our partners buy ahead of that price increase. So, as we alluded to in the prepared remarks, we had very strong Q2 in refinish last year, softer Q3 given the buy ahead and that pattern reverses this year. So, that order pattern from our distributors is helpful for us in the back half of the year.

Operator: Your next question comes from the line of Jeff Zekauskas with JPMorgan. Your line is open. Please go ahead.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much. A two-part question. You've probably bought all your titanium dioxide through the end of the year. So, I understand that there's no TiO2 pressure this year for you. But with Chinese – with sanctions on Chinese product in Europe, is that a structural issue that is over the next four years, are you going to be facing as a base case, reasonably higher TiO2 prices or much higher TiO2 prices? How do you think about that?

And then secondly, in the quarter, your volumes in auto OEM in the US contracted and I think the production grew in the United States in the second quarter. Is that a temporary phenomenon for you or are you losing share in the US?

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

A

Okay. Hey, Jeff. On the TiO2, you are correct. We foresee no impact in 2024, not so much because of we're sitting on a whole bunch of inventory there, but more because of more contractual coverage. As we look to 2025, here's how we are thinking about it. First of all, at a very high level, we continue to reduce TiO2 consumption per batch without sacrificing performance. That's about 1% per year. And even though that doesn't sound like a big number, we've been doing it for a decade and we expect that to continue.

Second thing, specific to the tariffs and the anti-dumping, we have great flexibility around the world given the formulation work that our S&T teams have done such that we've really increased our sourcing flexibility versus where we were, say, five years ago.

And then finally, at the end of the day, if those two initiatives are not enough to counter whatever net increase in costs there may be to us, we – the biggest consumer of TiO2 is the Deco business by far, and we have demonstrated that, as necessary, we'll offset that cost with price.

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

A

Yeah, Jeff, let me just add on here to the TiO2 question before Tim goes to the next question. Two things. One, we're not either advantaged or disadvantaged versus others in the region as it relates to this issue, so it's going to be a item for all coatings users. Secondarily, not all of our production and not all of our TiO2 consumption is in the EU. We have plants outside of the EU that are not affected by the tariffs, so we still have some capability to produce, with unimpacted tariff, Chinese TiO2.

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

A

And Jeff, to your second question on automotive US specifically, first of all, the final numbers that just came in the last couple days, the production in the US was actually down, down low single-digits in the quarter and our sales were down mid-single digits. And so, some of that would be – Vince talked earlier, the production number that S&P puts out is volume, and our sales number is volume plus price. And we did have some contractual index price in that business. And then the rest of it would be specific assembly plants, specific customer mix that might vary from the kind of the industry average.

Operator: Your next question comes from the line of Kevin McCarthy with VRP. Your line is open. Please go ahead.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Yes, good morning, everyone. Tim, if I look at your second quarter organic sales results versus your forecast from last quarter, it seems to me that PPG did a very good job of forecasting in maybe 8 of the 10 verticals where you compete. The two that I see that came in a little bit lower are architectural EMEA and protective and marine coatings. And so, I was wondering if you could speak to each of those businesses and maybe educate us a little bit as to why they came in a little bit weaker than you would have thought, and whether that was because of sort of transitory or idiosyncratic reasons, or do you think you're on a different growth glide path, say looking into 2025? Any additional color on geographies or product lines, that would be super helpful.

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

A

Yeah, sure. Hey, Kevin. Let me do architectural EMEA. Yeah, we were – clearly, the results were lower than what we expected for the region in aggregate. We had – we believed that we were – you've heard me use the term bouncing off the bottom. We believed at that time we were on the bottom and we would see sequential improvement Q1 to Q2. The macros, frankly, just got worse in Europe, and that drove Deco, that drove auto OEM as well.

But a little more color there, we're number one in 10 or so countries in Europe, and our biggest is France. I did earlier reference, you've seen the election and some of the turmoil in France that added to uncertainty, and we really did see a downturn in our sales during that period in France, our largest country. So, I would say that was – that one was maybe a transitory that as things stabilize, we'll see some recovery there.

We're also number one, in most of the Nordic countries, which was also slower than the rest of the region, so a little bit of country mix there. On the offset, we're number one in Poland and a number of the Central European countries that have started to recover. So, as we think about that going forward, we do believe we will see some sequential improvement in architectural Europe in Q3. We do believe it will still be down versus prior, Kevin, but we do think that that will start to sequentially improve.

Much better story on protective and marine, as you know that business has really been a good performer for us over the last several quarters. We just – this is a project business. We just ran into a handful of project delay type transitory items that hit us in the quarter.

You should expect growth back on track in that business starting in Q3. For example, we had slower China infrastructure spending than we expected with the local government issues with the Mexican election. Pemex was delaying some of its projects. As you know, the election is behind us now and we're seeing that pick up.

We have been doing really well in gaining share in the dry dock business. We had some dry dock delays associated with going around the Cape. So, just a number of things like that that we do believe are transitory, but the underlying trends for that business, for us, are much stronger than what I would have described for the macro conditions for Deco Europe.

Operator: Your next question comes from the line of Josh Spector with UBS. Your line is open. Please go ahead.

Joshua Spector
Analyst, UBS Securities LLC

Q

Yeah. Hi. Good morning. I have two questions on the cost side. I guess, first, your European peer announced some contract renegotiations with labor force that they talked about as incremental inflationary. Is that an impact at all for PPG in the second half [ph] or (00:45:29) 2025?

And then on the other end, your corporate costs have come in better than you've guided the last couple quarters. With the reduction in guidance, are you accruing less for bonuses for this year? And is that a – sorry, a tailwind that's baked in this year and a headwind next year? If you can help quantify any of that would be appreciated. Thank you.

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

A

Yeah, Josh, this is Vince. With respect to the EU, that's – we're not involved in whatever that peer's involved with. We're under our normal process in terms of reviewing our salaries, benefits on an annual basis.

We did, as we alluded to at the beginning of the year, had a little bit of a higher wage and benefit inflation this year versus historical given the macro, but again, we expect that to trend to normal, based on what we know today, in future years.

As it relates to corporate costs, as we said in our press release, we did – due to the lower guidance for the full year, we have made adjustments, lower for some of our incentive compensation and that will – these are not big, big numbers. We'll give a full year 2025 guide, as we typically would do in January. We got to get through the rest of this year, before we look at the year-over-year impacts, especially line by line or category by category.

Operator: Your next question comes from the line of Aleksey Yemefrov (sic) [Aleksey Yefremov] (00:47:03) with KeyCorp. Your line is open. Please go ahead.

Aleksey Yefremov
Analyst, KeyBanc Capital Markets, Inc.

Q

Good morning, everyone. I wanted to ask about architectural EMEA pricing. Given these weaker volumes, is pricing holding up in this region? Or is competitive environment, perhaps, more aggressive than for your coatings portfolio overall?

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

A

Yeah. Hey, Aleksey. Given the volume challenges, we have seen, what I would call, kind of around the edges some price downward competitive actions that we've had to match in order to keep our business. That is an outlier versus most of our coatings portfolio. But I would also tell you that it's not a huge impact because there's still higher – even though, folks are trying to grab volume and the raw material deflation is just not what it was earlier in the year. us and everyone are experiencing higher wage inflation, higher employee benefit inflation than, let's say, maybe a normal year.

And we're not the only ones having to deal with that. So, I think that is having some impact, whether you're talking about architectural EMEA or where maybe it is slowing down any otherwise volume grab kind of behavior but across the portfolio, that's enabling frankly price to hold up. And that's also enabling things like other parts of our portfolio in Performance Coatings to get additional price because us and everyone else are seeing that higher wage inflation.

Operator: Your next question comes from the line of Michael Leithead with Barclays. Your line is open. Please go ahead.

Michael Leithead
Analyst, Barclays Capital Inc.

Q

Great. Thanks. Good morning, guys. With the strategic reviews on track for this quarter, presumably you'll get some level of cash in the door later this year. So, is it fair for us to assume share repurchases are currently your preferred use of excess cash at the moment, or how does the acquisition pipeline look today?

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

A

Hey, Mike. Great shareholder value accretive acquisitions would always be our preferred use of cash, whether it's from proceeds from these potential transactions or just ongoing business. That said, that pipeline is a bit thin right now. And so, we continue to look at opportunities, but overall, compared to prior years, I would assess it as thin. And perhaps that'll change going forward. Perhaps that'll change in 2025 with interest rates. But right now, it's a bit thin.

You've seen three quarters in a row, we've bought shares back. We're demonstrating that we're going to do what we said, which is we're not going to let excess cash build on the balance sheet. So, when those transactions or potential client transactions close, we will take a look at our pipeline. And if it's still thin, then we'll deploy cash as we have in the last three quarters.

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

Michael J. Harrison
Analyst, Seaport Research Partners

Q

Hi. Good morning. Was wondering, Tim, if you can give us a little bit more color on what's going on in the aerospace business. You mentioned that you're selling everything you can make, but how much better could volumes have looked in that business if you didn't have the capacity constraints? And I guess, what specific actions or how much additional capacity do you think you can unlock as we get into the second half and into 2025? Thanks.

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

A

Yeah. Hey, Mike. Just to put some scale on it, our backlog – so we produced more, sold more, had record quarter in that business, and yet our backlog still grew. So, our backlog is almost $300 million. So, whatever you have us down for as margin in that business, if we were completely unconstrained, it would be that $300 million at our aerospace margins. But going forward from that, there is nothing on the horizon that our customers are telling us that's going to slow that in the near future or midterm, at least. In fact, we're getting forecasts from them that are even higher.

So, what we're doing in the short term is, I would call them incremental capacity additions, things you can do quickly, whether it's through productivity improvement or CapEx investments, both of which we're doing. But beyond that, we're assessing do we need to do something of a larger scale. And when we're ready to talk about that, we'll let you know. But it's pretty significant backlog driven across commercial, general aviation and military, driven across transparencies, coatings and sealants and driven across OEM and aftermarket. Every one of those is getting pulled from our advanced technologies.

Operator: Your next question comes from the line of Laurent Favre with BNP Paribas. Your line is open. Please go ahead.

Laurent Favre
Analyst, Exane BNP Paribas

Q

Yes, good morning, all, and Tim, apologies, if France made you – events in France made you miss your forecast. But on – I've got a question on Industrial Coatings pricing. On the minus 3%, can you [indiscernible] (00:53:31) how much of that was indexation versus the rest? And are you seeing pressure away from indexation given weak volumes? And the second part of that question is, should we assume that the indexation part is going to get worse into H2, or are we at a trough in terms of the year-on-year impact? Thank you.

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

A

Hey, Laurent, I'm expecting lots of paint sales as the Olympics get going here, and then after the Olympics as well. So, I'm sure France recovery is on the horizon. The pricing in the Industrial segment, virtually all of it is index pricing. I don't want to say 100%, because there's always things happening around the edges, but virtually all of it is index pricing. And I don't expect that to change significantly as we look through the rest of this year.

Operator: Your next question comes from the line of Kevin Estok with Jefferies. Your line is open. Please go ahead.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Hi, this is Dan Rizzo from Jefferies. Thanks for taking my question, thanks for fitting me in. I was just wondering, you mentioned in your prepared remarks about softness in – or exports from Chinese auto EVs kind of slowing. I was wondering if they're, as of yet, anticipating a change in the environment if Trump were to take office. Like, what's the lead time between they anticipate higher tariffs and potentially lower sales and that they [ph] end, shut down (00:55:10) or slow down production.

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

A

Yeah. So, I'll start and all Trump questions I delegate to Vince. So, I'm going to let Vince handle that part. But what I want to say about the EVs is, we're a proud supplier to the number one manufacturer over there. And of course, they were doing quite a bit of export. And so, they're being cautious right now, and we'll see how that plays out as far as their overall production numbers as we move through the year.

But I do want to point out, even though – even with all the headlines on EVs happening right now or maybe in a less than positive direction, I think that's only changing the slope of the curve and not the end point destination of the curve. For 2024, even with all the news we've heard, the projection is still that EV production will grow by 14% versus last year and the production is still that 30% of every vehicle produced in China will be an EV. And of course, China produces about a third of all the world's cars. So, I think we all have to take these headlines as moderation, but not drastically story-changing headlines for EV.

Operator: Your next question comes from the line of Arun Viswanathan with RBC. Your line is open. Please go ahead.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question. I guess I just wanted to ask a couple of more questions on North American architectural and the portfolio as well. So, on architectural, I think our understanding is 4% EBITDA margins for the whole group. But maybe the stores business was recently unprofitable. I don't know if that's something you can just shed some light on.

And are you seeing any interest in the stores side of that as well? Presumably, we've heard that there's good interests on the non-stores business. But if there isn't on the stores, would you consider kind of keeping those or shutting those down or how do you proceed there?

And then on the portfolio itself, as you look into 2025, presumably you won't have architectural in North America, so you will be a little bit more industrial levered. Is there any way you can kind of give us your thoughts on how we should think about that Industrial businesses in coatings sometimes have fetched lower valuations. So, I don't know if that enters into your thinking as well. Thanks a lot.

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

A

Hey, Arun. Let me answer the North American architectural questions. Again, I think when we announced the strategic review in February, we gave some directional information, and certainly the people who are interested and engaged got the data books, et cetera, and we're providing data almost on a daily basis. We're not going to get into the nuances of the different channels.

Again, we're in a process where there's a lot of folks looking at it. They have what they need. And we're not going to certainly get into how this may or may not be split. Again, there's a multitude of different scenarios we're entertaining and we'll let that process play out over the next 60 or 75 days or whatever. So, again, we'll let that process play out. And when we get to a ultimate conclusion, I think we'll be a little more granular to answer some of your questions.

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

A

And let me take – Arun, let me take the portfolio question. Mathematically, of course, you're spot on that ex this business, we will be a little heavier in Industrial Coatings and a little lighter in Performance Coatings. But you've seen the numbers and the guidance we've given on the profitability and margin of the architectural US business. And ex that business, mathematically and going forward, despite that shift from – that you described from less Performance and more Industrial, in aggregate, we will be a higher margin and a higher growth company. We wouldn't be doing this otherwise.

And just to be clear, that there's also the benefit of us as a management team, as a PPG team, being able to focus all resources, whether it's human resources, R&D resources, capital resources, bandwidth resources on businesses that have higher growth and higher margin profiles. So, we are fully confident that this is the right thing to do for not only customers, employees, but absolutely for shareholders going forward, fully confident.

Operator: Your next question comes from the line of Jaideep Pandya with On Field Investment Research. Your line is open. Please go ahead.

Jaideep Pandya
Analyst, On Field Investment Research LLP

Q

Thank you. I guess, first question is on packaging. Could you just tell us how confident are you to keep the share that you have gained because one of your competitors had a fire because we are hearing sort of opposite messages and they seem to be confident they'll get the share back. So, just wondering how will packaging look in 2025?

My second question is, sorry to come back to architectural North America, but looking back 10 years ago, when you bought the actual business, doesn't feel like a lot has changed in terms of either the store footprint or the plant footprint, or even for that matter the profitability. And you alluded to one point, which was need for investment. So, just curious, when you look at JV models, where do you need to invest? And how do you sort of unpack and improve profitability here? Because you've yourself done it with [ph] Axel (01:01:33) in the last 10 years, and sorry to say this, but it sort of hasn't worked. So, what would you and a JV partner do here? Just curious.

And sorry to squeeze in one more. Tim, volume growth has been an issue for PPG for the last 11 quarters. How do you incentivize your sales force to go for volume if you, at all, want to do that? Thanks a lot.

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

A

Okay, Jaideep. Thanks for the questions there. On packaging, high degree of confidence that we will keep our share gains and continue to grow the share. You did mention an incident one of our competitors unfortunately had, and of course, there were some things that the industry did to get through that, but we've won a lot of share that had nothing to do with that incident. And so, we are confident going forward that our technologies inside the can, outside the can, on easy open end, our food lines, we're gaining share across a number of different spaces that had nothing to do with that isolated incidence. So, good news ahead for that business.

JV scenario for architectural US, Canada, at the end of the day, there are – I've said from beginning that we believe this business could be more successful with a partner and that partner could either buy the whole thing or do a JV. What – that partner might be able to run more velocity through the high fixed cost that company-owned stores bring, they might be able to bring more velocity through whether it's other paint products or other building products in general. So, that is the big issue where a JV may be able to help us from that velocity through your high fixed cost stores.

In volume growth, I mentioned as we move through 2023, in the first half of 2024, that we were modifying incentive comp to drive more organic growth. We've done some of that, some of that's already in place and some of it's still being implemented as we speak. And that is one element of a multifaceted recipe that we're changing to drive a higher organic profile company.

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

Aron Ceccarelli
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Hello. Hi. Good morning. Thanks for taking my question. I have a very quick one on Industrial Coating (sic) [Industrial Coatings] (01:04:36), would be interested in understanding if you can provide some color around the monthly run rate of volumes. And I would be particularly interested in the exit rate in June, if there's any area of the business that actually accelerated or decelerated at the end of the quarter. Thank you.

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

A

Yeah. Aron, thanks for the question. So, at the end of the quarter, I would say Industrial segment automotive was decelerating. As I previously mentioned, we got some further shutdown news as we move through the month of June. I would say Industrial starting to see – pretty flat, but we are starting to see some sequential improvement that we projected into Q3. And I think packaging, basis the last question, is accelerating from a volume standpoint. So, that's how I'd quantify the exit rates for Industrial segment.

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

Alejandro Lopez
Director-Investor Relations, PPG Industries, Inc.

Thank you. Elliot. We appreciate your continued interest and confidence in PPG. This concludes our second quarter earnings call.

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