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# PPG Industries, Inc. (PPG) CEO Michael McGarry on Q3 2019 - Earnings Call Transcript

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Q3: 10-17-19 Earnings Summary

*Press Release* SEC *10-Q*

EPS of $1.67 beats by $0.06 | Revenue of $3.83B (0.24% Y/Y) misses by $-64.61M

## Earning Call Audio

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PPG Industries, Inc. (NYSE:PPG) Q3 2019 Results Earnings Conference Call October 17, 2019 2:00 PM ET

**Company Participants**

John Bruno - Director, IR

Michael McGarry - Chairman and CEO

Vince Morales - SVP and CFO

**Conference Call Participants**

Ghansham Panjabi - Robert W. Baird

Christopher Parkinson - Credit Suisse

Bob Koort - Goldman Sachs

Michael Sison - Wells Fargo

Frank Mitsch - Fermium Research

David Begleiter - Deutsche Bank

Eric Petrie - Citi

Kevin McCarthy - VRP

John Roberts - UBS

Don Carson - Susquehanna

Arun Viswanathan - RBC Capital Markets

John McNulty - BMO Capital Markets

Jeff Zekauskas - JPMorgan

Duffy Fischer - Barclays

Dan Rizwan - Jefferies

Vincent Andrews - Morgan Stanley

Stephen Byrne - Bank of America

Mike Harrison - Seaport Global Securities

Dmitry Silversteyn - Buckingham Research

Garik Shmois - Longbow Research

Jim Sheehan - SunTrust Robinson Humphrey

**Operator**

Good afternoon and welcome to the PPG Industries Third Quarter 2019 Earnings Conference Call. My name is Carrie and I will be your conference specialist today. [Operator Instructions]

I would now like to turn the conference over to John Bruno, Director, Investor Relations.

Please go ahead.

**John Bruno**

Thank you, Carrie, and good afternoon, everyone. Once again, this is John Bruno. We appreciate your continued interest in PPG and welcome you to our third quarter 2019 financial results conference call. Joining me on the call from PPG are Michael McGarry, Chairman and Chief Executive Officer; and Vince Morales, Senior Vice President and Chief Financial Officer.

Our comments relate to the financial information released on Thursday, October 17, 2019. I will remind everyone that 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 up - sorry, the opening comments Michael will make shortly. Following Michael's perspective on the company's results for the quarter, we will move to a Q&A session.

Both the prepared commentary and discussion during this call may contain forward-looking statements, reflecting the company's current view of future events and their potential effect on PPG's operating and financial performance. These statements involve uncertainties and risks, which may cause actual results to differ. The company is under no obligation to provide subsequent updates to these forward-looking statements.

This presentation also contains certain non-GAAP financial measures. The company has provided in the appendix of the presentation materials which are available on our website, reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures. For additional information, please refer to PPG's filings with the SEC.

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

**Michael McGarry**

Thank you, John, and good afternoon everyone. We appreciate you joining our third quarter earnings call.

Today we reported third quarter 2019 financial results. For the quarter, our net sales were about $3.8 billion and our adjusted earnings per diluted share from continuing operations were $1.67. Earnings were a record for any third quarter. Consistent with our improvement targets, we delivered strong year-over-year adjusted earnings per growth - per share growth of 15%.

Our earnings growth was driven by continued selling price realization and strong cost management. This quarter we accelerated our momentum in margin recovery with segment margins up about 220 basis points versus last year.

As we stated in the past, our overall objective is to return to the aggregated segment margins that we maintain prior to this recent inflationary cycle and we believe this objective is achievable in 2020.

Now let me provide some additional color on our third quarter results. Our net sales in constant currency were higher than the prior year by about 2%. Sales volumes were down nearly 3% and were notably impacted by weak global industrial production that continue to affect global automotive production and most of our general industrial end use markets.

This weakness was also broad based geographically. Aggregate selling prices were 2.6% higher, marking the 10th consecutive quarter of improved selling year-over-year selling prices and our sixth consecutive quarter with selling price increases of at least 2%.

We're continuing to work with our customers to ensure that we are receiving fair value for our products and services and expect price gains of about 2% in the fourth quarter, despite a more difficult pricing comparison in the prior year fourth quarter.

Finally, our net sales were affected by significant unfavorable currency translation of about 2% or nearly $80 million. We expect unfavorable currency translation to continue at a similar rate in the fourth quarter.

Moving to some business trends in the third quarter. In our Performance Coatings reporting segment, Aerospace coatings continued to deliver very strong volume growth, outpacing industry performance in most major regions. In automotive refinish, sales were higher as strong selling price gain and acquisition sales from SEM outpaced lower sales volumes reflecting lower demand in most regions as many of our customers focus on inventory management.

Year-over-year organic sales were again higher in our architectural coatings EMEA business driven by higher selling prices. Aggregate sales volumes were slightly lower as we saw mix demand trends by country during the quarter.

In Mexico, our PPG-Comex business increased organic sales aided by higher selling prices. Sales volumes remain soft as consumer demand reflected the overall lower economic activity in Mexico's economy. The PPG-Comex business continued its growth by adding nearly 100 concessionaire stores through September of 2019.

Organic sales volumes in architectural coatings Americas and Asia Pacific modestly increased during the quarter as sales volume growth in the DIY and independent dealer channels offset lower sales volumes at our company owned stores, including a difficult comparison period last year where we delivered strong high single-digit percentage growth.

Led by strong growth in the Asia region, our protective marine coatings business continued to deliver above industry sales volume growth, a mid single-digit percentage during the quarter. We expect sales to remain at elevated levels in the fourth quarter, albeit with lower year-over-year growth due to the significant growth we have experienced in the past year.

In our Industrial Coatings reporting segment, sales volumes continue to be adversely impacted by weak industrial demand in most major regions of the world. Global automotive OEM industry builds declined, including the impact of unexpected or unintended and extended customer shutdowns in multiple regions during the quarter.

In aggregate, PPG's automotive sales volumes were lower by mid to high single-digit percentage, consistent with the reduction of global builds. As a partial sales offset, our automotive OEM business realized higher selling prices in each major region for the third consecutive quarter.

Weak global industrial production activity impacted most of our general Industrial Coatings business subsegments, including wood, general finishes and transportation end markets. Also, our packaging coatings sales volumes decreased modestly as solid beverage can demand was offset by weakness in other packaging end market segments. We expect this business to return to growth in 2020.

From an earnings perspective, as I mentioned earlier, our third quarter adjusted earnings per diluted share was $1.67. Our earnings were negatively impacted by about $10 million on unfavorable foreign currency translation, or about $0.04 per share.

Our effective tax rate was about 23% in the third quarter, which is higher than the approximately 21% rate in the third quarter of 2018. The increase relates to realizing lower nonrecurring favorable discrete tax items in the third quarter of 2019. We're anticipating a tax rate of about 24% for the full year 2019.

Our EPS results were supported by increase in our selling prices, improved manufacturing performance, excellent progress on our cost savings programs, which delivered about $20 million in cost savings during the quarter and remain in line with our objective.

In addition, as we targeted, we benefited from achieving comparable margins in our U.S. and Canadian architectural business to the third quarter of 2017, before our customer assortment changes. The four acquisitions that we have made in the past year also contributed positively to earnings, although at overall lower than company average margins.

As we look ahead, we expect global economic activity to remain weak in the fourth quarter. We expect global general industrial demand to remain unfavorable year-over-year and roughly comparable to what we experienced in the third quarter.

Year-over-year sales comparisons will ease in the automotive OEM business, but we still forecast aggregate global automotive builds to decline in the fourth quarter compared to prior year.

Positive developments around regional and country trade disputes could provide a spark to industrials demand as inventory levels in many of our end-use markets remain low. Specific to our businesses, we believe that lower U.S. interest rates could add growth in the U.S. housing market and also favorably impact automotive OEM and U.S. architectural sales. There will be continuing impact to our sales related to customer shutdowns in the automotive OEM business in the U.S.

In Latin America, we anticipate economic activity to be similar to that experienced in the third quarter, and we'll continue to add new PPG-Comex concessionaire locations to expand our customer reach.

In Asia, demand rates are expected to remain consistent in comparison to the third quarter. In the fourth quarter sales comparisons to last year will be easier given the weakness in Asian demand that occurred late last year. We expect demand growth will return in China next year.

Economic demand in Europe, is expected to remain soft as industrial production is forecast to remain at low levels. And our Automotive OEM business comps are also easing year-over-year and we should experience a lower sales volume decrement in the fourth quarter.

We expect our architectural business to continue to grow, driven by higher selling prices and strong cost management. Brexit remains an overhang and is beginning to modestly impact our business trends. We continue to closely monitor the situation and then prepare contingency plans to the best of our ability to prepare for unknown impacts.

As we said last quarter, we continue to work with our supplier base to ensure that our input costs are reflective of current industry demand conditions, including the ongoing uncertainty and weak global industrial production. We will continue to focus on reducing our cost structure, and we target to reduce $20 million of cost in the fourth quarter related to our cost savings program, including the newest program we announced in the second quarter, which will have a full-year run rate savings of about $125 million upon completion of the program.

Earlier today we provided EPS guidance specific to the full year of 2019. The guidance of $6.17 to $6.27, which includes an unfavorable impact from foreign currency translation of $0.18 to $0.20 per share. This puts us at a low to mid range of our original full year 2019 adjusted earnings per share growth of 7% to 10%, excluding currency translation impacts. While we would like to be closer to the upper end of the range, our earnings performance has been very solid when considering the severity of the downturn in the global industrial activity.

We have generated strong cash flow through the first nine months of 2019, with cash generation of nearly $1.3 billion. This is an increase of about $600 million when compared to the same period last year and has been driven by strong working capital management. Our focus on cash flow generation will continue and our goal remains to reduce working capital as a percent of sales compared to 2018 levels.

We completed the Dexmet acquisition early in the third quarter and continue to be pleased with the early performance of all four recently completed acquisitions including Hemmelrath, SEM and Whitford, which collectively will add about $400 million in annualized revenue.

Acquisitions remain one of our preferred cash deployment options given the value that these have created for our shareholders over the year and currently, our pipeline continues to remain solid. In addition to acquisitions, we progressed our key capital expenditures during the third quarter, and we still expect total spending to be up to 3% of sales in 2019.

In the third quarter, we increased our dividend to $0.51 per share or roughly a 6% increase. We have paid uninterrupted annual dividend since 1899 and we are pleased to continue to prioritize our dividend increases. We ended the third quarter with more than $1.5 billion of cash and short-term investments, which continues to provide us with significant financial flexibility.

Finally, I'd like to recognize and thank our employees around the world for their continued commitment to serve our customers. Every day, our dedicated employees are focused on driving the PPG Way and delivering value to all our stakeholders and shareholders.

This concludes our prepared remarks. Once again, we appreciate your interest in PPG, and now Carrie, would you please open the line for questions.

**Question-and-Answer Session**

**Operator**

[Operator Instructions] The first question will come from Ghansham Panjabi with Robert W. Baird.

**Ghansham Panjabi**

I guess, first off, you've obviously given us a really good detail on how to think about volumes for the fourth quarter. I understand it's early, but what is your initial view as it relates to the volume outlook for 2020 at this point as it relates to your major end markets, and on your margin recovery comment by 2020, Michael, are you referring to the run rate at the end of the year or margins on an absolute basis? Thanks.

**Michael McGarry**

Yes. I do expect margins to continue to improve. As you can see our margins in our performance coatings segment are essentially back to peak, and we think there is still more upside there. So we're going to continue to work hard on that. We also have made as you saw a significant more than 200 basis point improvement in the industrial segment and we still have more runway to go there.

As we said, we had positive price coming in the fourth quarter, and I would expect that we would continue to push price as we move forward as we still have an environment where we have inflation and think about salaries, warehouses, freight and distribution, things like that. So.

**Vince Morales**

And then Ghansham on your question with respect to the 2020, again a little, a little early to answer that question. But what we can say confidently is a lot of our customers are carrying very low inventory levels. Typically, they achieve their inventory levels at the end of the year, not by the end of Q3. As they've done this year, so heading into 2020 we do think there could be some inventory upside. It's too early to make a call on the economy and the other geopolitical issues, but a couple of our key industries we know auto we feel a little bit better about auto next year specifically in Asia, the biggest market and a couple of other markets in general industrial are down this year, we're hopeful they'll have at least a modest rebound next year, not counting the inventory rebuild.

**Ghansham Panjabi**

And just as a follow-up to that Vince, for the industrial segment, specifically, how should we think about operating leverage for that segmented volumes start to recover. I mean obviously you're adjusting the cost footprint and I assume some of the costs will reverse as demand picks up. I just wanted to get your sense as to operating leverage during the initial phase of improvement. Thanks.

**Michael McGarry**

Yes, Ghansham, this is Michael. That's going to be a strong positive for us. When you think about the past quarter, earnings in that industrial segment were up despite volumes being down. And we anticipate to continue to drive costs out, and so you should expect to see a nice operating leverage should volumes come back, and right now we're certainly planning on our outlook for 2020 would include some modest recovery.

**Operator**

The next question will come from Christopher Parkinson with Credit Suisse.

**Christopher Parkinson**

Regarding your volume outlook, can you kindly walk us through the key end market verticals for which you believe PPG is poised to benefit from, let's say, secular themes regulatory changes under new products, new non-BPA and the move towards aluminum cans will be one I guess in packaging, [low care] [ph] products and EV battery protective in auto. Just - you know if there are few others just generally based on what's inside of your control. What are the key verticals through which we can expect you to outperform and why? Thank you.

**Michael McGarry**

So, Christopher you covered automotive pretty well. So, I'll pass on that one. We have and in the industrial business as part of the industrial segment that one I would point to like high edge powder as one of them. And if you think about moving into packaging itself, the sustainability of the can is number one. So you could see the shift away from plastic that's going to be a long-term secular win.

For us, housing is continuing to - we got low interest rates around the world. So I think housing is continuing to be a nice little market for us. Aerospace is clearly going to be a continued winner for us, we're going to continue to outgrow the industry there with the launches that we have had, whether it's new transparencies or new coatings.

And then talk about them, we talked about in our press release MOONWALK for refinish. This is a new technology that allows people in Europe to be able to mix refinish paints more precisely, allows the technician to spend more time painting the car as opposed to mixing paint, drives higher productivity in the paint shop. So I think net-net, we're in a pretty good shape long-term wise.

**Christopher Parkinson**

And just regards to your margin outlook. Can you simply outline in order which variables will be the most material to achieving and surpassing prior peak margins just between price, input cost deflation, mix, acquisition integrations and just broader volume improvement. Just any key thoughts on how The Street should be thinking about that as we head into 2020? Thank you.

**Vince Morales**

Yes, Chris, I'll start and Michael could certainly add to what I say. But we're still sitting on a significant amount of inflation that's multi-year inflation. We have seen very little of that unwind to this point. We alluded in our call about the economy, the weakness in industrial activity. So we're still working to get price to offset this accumulated inflation, but there is a significant amount of Inflation we would not expect with the supply demand environment where it is in our supplier base.

We always do self-help; we announced the Self-Help program in May. We still have a variety of actions do against that program. We're expecting significant savings from that program that will be primarily in next year, and then the last one is, we don't know the volume outlook, so the things within our control we're managing but, as Michael just mentioned on the prior question, if we do get any volume, especially in some of our industrial businesses, we should have a significant amount of leverage. So those were - those would be the way I prioritize them.

**Michael McGarry**

And Chris, I would - the one thing I would add is that with couple of the acquisitions we made, they're below company average, they're fairly decent sized ones. I'm excited because I get a monthly report on the integration as well as the performance, and we are seeing month over month improvement.

In fact, when I looked at the Hemmelrath numbers for the month of September, it was the best month they've had ever, and obviously they're benefiting from some of our abilities to integrate them but I see even more positives coming, they have relationships with the customers that are slightly different customers than we have from a standpoint of mix, and so we're able to take the best of both worlds. They are great relationships and our great technology and put the two together. And we've already won substantial number of new program wins since we bought Hemmelrath.

**Operator**

The next question will come from Bob Koort of Goldman Sachs.

**Bob Koort**

Michael, you guys gave some commentary about your U.S. architectural business and I guess it seems like going on a few years now there's puts and takes and maybe not complete uniform consistency by channel. Can you talk a little bit about the DIY market? It sounds like maybe that's starting to percolate a little bit. Certainly we're seeing some of these housing stocks rally dramatically? Are there some signs that maybe we're going to get lift off in DIY and then in your store base, I guess I would have thought maybe some of those contractors that were hiding from the rainy weather in the June quarter would come back out in the September quarter. So is there anything idiosyncratic to your store base either regionally or end market-wise that would have precluded you from having a little bit better volume there?

**Michael McGarry**

Yes. Let me first start with the DIY. So we're gaining share in the DIY segment. Our customers are doing pretty well and inside our customers we have continued to launch new products and that's been a real positive. So when you think about the PPG timeless at Home Depot, as well as the Olympic Stain at Home Depot, both those guys are growing above company average. So we're really pleased with that.

I think the one thing that doesn't really come through when you think about our company store average is, if you remember, and some of the prior calls, we kind of talked about doing a little bit of everything in that segment. So some of its delivery, some of it is the store and some of it is what we call our premier authorized dealer network or where we're trying to make it simple for the customer to say I can pick up in a dealer location or I can pick up in a PPG store location.

And obviously we have, let's call it a little bit less than 900 stores between U.S. and Canada. But if you include that plus the nearly 5,000 dealers that we have that gives our customers a lot more opportunities to pick up paint.

And so if you look at our dealers, if you noticed in our commentary in our press release, we said dealers were positive and historically, as you know, this has been a long-term secular minus one kind of trend line dealers age out and move on. But with this new strategy we are picking up additional business through the dealers.

We added 50 new dealer locations in the third quarter. We're up to about 140 locations in the third quarter, a total of 427 new locations where they can pick up paint, and we expect that to continue to accelerate as other dealers see this work. They're going to want to jump on that bandwagon as well. So I think that's a little bit of nuance that maybe doesn't come out in the overall numbers. Hello Bob?

**Bob Koort**

Can I ask you on the balance sheet, you've been accruing cash nicely through the year and haven't been doing any share repurchase? Would that be a reflection of the acquisition activity, or is there some other reason you want to put more of that capital back to you through repurchase?

**Vince Morales**

Yes, Bob, as Michael pointed out in the opening remarks, and we've had a very good cash generation year-to-date, we've got about $1.5 billion on the balance sheet. We do have some term debt coming due in Q4, so some of that cash will be applied to the term debt coming due.

But besides that, we do have a strong balance sheet and we're still looking at a variety of acquisitions, acquisition pipeline is still rich. We are not immune to doing share repo. We haven't done any-to-date basis, the acquisition pipeline. But if the acquisition pipeline lessens or we think there is a need to do share repo for different reasons, we will do so.

**Operator**

The next question will come from Michael Sison of Wells Fargo.

**Michael Sison**

Question on the - just quickly on the stores. You said you're a little bit less than 900. Can you maybe walk us through what your strategy is there? Going forward, are you looking to continue to expand the stores or is kind of this dealer network really the area where you can have a combined growth for your business there, but just kind of curious where you think the store strategy and growth potential is going forward?

**Michael McGarry**

Yes. So Michael, what I would tell you it's our strategy hasn't changed. We're going to add stores where it makes sense in those markets that are growing. So I think the southeast and the southwest. We're not going to be adding stores in the Northeast or in the West or the upper Midwest those our focus areas for us for stores, what they are focus areas for us for this premier authorized dealer network, because we think there is plenty enough to in our stores and our dealers to adequately service our customers.

So we're going to continue to do that and I compare and contrast that to Mexico where we've added nearly 100 stores year-to-date and we're going to finish the year at nearly 200 new stores. Same thing where we've added stores in the UK, we've added stores in Australia. So we're going to take, what we call the micro-market strategy. We're going to look at each of the different markets and make the best decision for our shareholders in that regard.

**Michael Sison**

Right, and then just a quick follow-up. When you think about volume growth, whenever, I mean whether it comes next year or sooner than later. What do you think your leverage is going to be meaning, if you grow your sales to 1% is that a leverage of 2% EPS growth, 3% EPS growth and just kind of want to feel for the upside potential as we all hope that demand picks up at some point.

**Vince Morales**

Yes, Mike, this is Vince. In the past we've said pretty regularly that our leverage on a normal increase in sales is somewhere in the mid-20% range and in Europe, it's higher because of the latent opportunity we have there.

So we said, in Europe, it's in the mid 30% range. I'd actually say that if you look at the costs we've taken out globally, we're inching up to 30% on average for the globe in terms of leverage factor. Now it's always going to be based on which business etc., but on average, I think we're closer to 30% now than the 25% we were previously.

**Operator**

Our next question will come from Frank Mitsch of Fermium Research.

**Frank Mitsch**

Looking at the refinish business, following the second quarter, there was an expectation of the volumes were to improve in the third quarter given the easy year ago comp because of inventory destock that occurred and that didn't come to the - volumes were down in 3Q, and you called out inventory management as well, lower collision claim activity. Is there any reason for us to anticipate that we're going to see, a rebound in this business? Obviously, you highlighted MOONWALK so maybe from a technology perspective, but just from an overall macro perspective with new safety features in the cards, etc. How should we be thinking about automotive refinish down the line?

**Michael McGarry**

Frank, this is Michael. I think this is still a great business. So I don't want anybody to walk away, think anything differently. Certainly claims were down 1.2%, a little bit more in that in Europe, but we had a couple of large customers CEO changes who came in and take even a more aggressive approach on inventory, and we've continued to have net body shop wins in all regions of the world. So that is a positive.

When you look at our integration of SEM that is primarily a U.S.-based business. We've launched those products in Canada. The first set of products went to Australia in September. So we'll start to see some sales there. We're doing better in sundries. But I think overall the one message I want to leave you is our earnings in refinish will be up year-over-year, at the end of the year. So we're able to price effectively in this business. And this remains a great business for us.

**Frank Mitsch**

Very, very helpful. Thank you for that. And just in general, as I thought - I look at the third quarter, you hit the high end of the guidance that you put out following the second quarter. And it's clear that the macros were mostly running against you during the quarter, particularly in European activity in autos, etc. So I'm just curious what on the other side really went right for you in order to again hit the high end?

**Vince Morales**

Frank this is Vince, I'll let Michael again add here, but we are pacing ahead of our cost targets. So we did have additional cost benefit in Q3, but we thought it may come in Q4, we got off to a little bit earlier, that's one item that was helpful to us. Mike if you want to add.

**Michael McGarry**

Yes. The other one I would tell you is the automotive team. We've been challenging the automotive team to get ahead of this volume decline and they really have worked exceptionally hard to do that in the second and third quarter. And I think what we saw in the back half of the third quarter was that accelerating. So I think that would be the other one I would point to.

**Frank Mitsch**

Very interesting, so the automotive side and I presume you're talking about the OEM side was able to outpace kind of your initial expectations even though builds were down, you faced strikes et cetera that - that's very interesting that would be the area that you would point out to.

**Michael McGarry**

Yes. It's the automotive team had done a good job this year, OEM.

**Operator**

The next question will come from David Begleiter of Deutsche Bank.

**David Begleiter**

Michael, the raw is up year-over-year in Q3. And what are you thinking about for Q4 on raws?

**Michael McGarry**

Well, of course, we think about our cost is more than raws David. So in the third quarter, they were moderating. We had a couple up, we had some down, but net-net, they were moderating. As I tried to point out in my opening comments, we still have freight and distribution. If you take about dangerous good warehouse costs, especially in Asia, they have significantly increased, and so that's, that's why we continue to invest in our business, we continue to invest in our people. So that's obviously a cost on the rising side, but net-net I would say raw materials were moderating.

**David Begleiter**

Perfect, and just on the impact of the GM striking Q3 and Q4. Do you have an estimate on that impact?

**Michael McGarry**

Well, we're not going to talk about any individual customers. What I would tell you is that we have a very diverse customer mix in automotive, and so no one particular customer is going to have a significant impact on our overall business. And our team, when it was announced immediately took aggressive cost action to ensure that the impact was minor. So I think overall, like I said to Frank's question the automotive team did a good job.

**Operator**

The next question will come from P.J. Juvekar of Citi.

**Eric Petrie**

This is Eric Petrie on for P.J. So what kind of vehicles represents a market opportunity for you. How much coatings could you sell into the EVs compared to other light vehicles?

**Michael McGarry**

Well, Eric, we've always said is that the EV vehicles can be anywhere from 2 to 3 times more coatings on them than a standard vehicle. Right now, I don't have the latest number in my figure, but I think it's 0.7% of our cars are electric vehicles. So it's still a very small number. And what's interesting is that everybody does that differently. So the one guy might do their batteries might need protective coatings and other guy might just need Industrial Coatings another guy might use all three, some are using powder, some are using liquids, some use third parties, some do it in-house.

Right now, unlike when you look at a traditional car, you can use kind of broad guidelines. Right now this is still in its infancy and there is still a lot of unknowns about how this is going to shake out. But clearly what we see in every case is more paint on an EV vehicle then on a traditional vehicle.

**Eric Petrie**

For my follow-up in packaging, can you discuss the market opportunity to continue gaining share in non-BPA coatings? And then as the industry shift from plastic bottles to cans, is this a tailwind for the business?

**Michael McGarry**

Certainly the plastic to can will be a tailwind. It's too early in that process to know what that curve will look like, but it is certainly a long-term positive. Our BPA-NI as we significantly outpaced the market in '16, '17 and '18, we've been slightly less than the market in '19. We expect to be back on that track of at or above market in 2020. We have some new technology that's coming out right now.

Probably, I would say food has been probably, let's call it 70% converted, beverage is less than 50%, and it varies considerably by region with Europe much farther ahead and Asia much further behind, but there is still more work to be done there.

**Vince Morales**

Eric just back on your first question, I mean the statistics, we've seen is on our statistics, but 1% drop in plastic bottles if it converts to aluminum cans, a 6% increase in cans. We are seeing also efforts in the industry to replace single use serving cups as well. So I think the industry, the overall packaging, aluminum packaging industry does have some positive traits forward as we head into next year.

**Operator**

The next question will come from Kevin McCarthy of VRP.

**Kevin McCarthy**

I think you've been very clear that your contribution margins are higher regionally in Europe relative to the U.S., for example. I was wondering if you'd be willing to comment on which product lines are your highest and your lowest contribution margins in a given region?

**Michael McGarry**

Not something we typically comment on Kevin.

**Kevin McCarthy**

Secondly, I had a small question on the financial side. Your Slide 9 indicates net interest expense of $27 million to $28 million. And I believe the 3Q number was $23 million. And so I'm wondering why your net interest would increase $4 million or $5 million sequentially when your leverage seems to be down roughly $450 million. Does that have to do with capital structure or deployment plans?

**Vince Morales**

Well, a couple of things on that Kevin. First of all, we are paying off some term debt, but the term debt is very little interest associated with it. And one of them was close to 0% interest. So even though we're paying debt off, it doesn't have an effect on lowering the interest cost. We have been carrying extra cash and earnings of money on that cash in Q3. That will go away in Q4 as we pay down that term debt. And we do have, as its traditional in our business, seasonally a much higher CapEx spending in the fourth quarter. We typically spend 30% to 40% of our capital between October 1 and the end of the year. So we have additional capital outlays. First of all we did that earlier in the year. So those would be the biggest factors.

**Operator**

The next question will come from John Roberts of UBS.

**John Roberts**

Michael, there've been some press reports that PPG has been working as part of a joint bid for Axalta. Could we assume any trust issues for both auto OEM and refinish would be really high so that your interest is primarily in the industrial non-auto?

**Michael McGarry**

Well, John, first of all we are always flatter in people associate ourselves in the rumor market, but as you can imagine, we're not in a position to comment about another public company. We are going to continue to drive the consolidation in the coating space. And as we mentioned earlier, our pipeline remains active, but as far as any particular company, it would be inappropriate for us to comment.

**John Roberts**

Then maybe based on the IHS auto builds outlook for the fourth quarter. Could you - just based on their assumptions, can you give us maybe a range for your auto OEM coatings volumes in the fourth quarter by region and what it would roll up to in aggregate?

**Vince Morales**

So John, we're going to benefit from some easing of comps as we look at prior year. So I would look at IHS has revision that just came out this week and we would be looking at our performance being somewhere in line with those build forecast.

**John Roberts**

Okay. Thank you.

**Michael McGarry**

John, the only other thing I would add is that from a very, very small minor green shoot area, we did see build start to pick up in the last two weeks of September in China. So we'll wait and see whether this is a trend line, some of the local Chinese guys who are behind the curve on meeting the emission standards. So maybe there are just catching up, but we'll continue to keep an eye on it.

**Operator**

The next question will come from Don Carson of Susquehanna.

**Don Carson**

Yes. First question on the sustainability of the price increases. Michael, you mentioned that it was probably price increase will moderate in the fourth quarter but you've had six quarters now of over 2%. How much longer do you think you can sustain that, and particularly as you get push back from customers in the industrial sector?

**Michael McGarry**

Well, first of all, John - sorry, Don. We have not had any push back yet from customers. I mean, you get to normal push back but, at the end of the day they know full well that we've had more inflation then what we've recovered they can read the financial statements just as well as you can. So they know we're behind. They also know that we are - if you look at some of our regions, we're below then the curve line if you will on volume and some of that is because we've said we're going to need to continue to get price, and we're going to take price and if they want to move volume away, that's perfectly acceptable to us.

And so right now, we know we're going to get price in the fourth quarter, pretty optimistic we'll still have a positive price number in Q1. And we're going to continue to push because at the end of the day, we should be asking for value commensurate with the value that we create for our shareholder - or our customers and so we're going to continue to ask for it.

**Don Carson**

Then a follow-up on U.S. architectural. How do you see the industry growing given some fairly good housing data both maintenance and new homes and now that you've got the - lot of the customer mix issues behind you, do you think PPG can grow in line with the market or greater than the overall market?

**Michael McGarry**

Well, for the industry, next year, we have budgeted between 2% and 3% growth. We think that's a realistic number. Our architectural team is on the optimistic side, but I think this is a point where we have to show and not kind of like to show me state. Let's see what happens. And I think our goal would be to start with continuing to meet the industry numbers and we'll see how well the team does.

**Operator**

The next question will come from Arun Viswanathan of RBC Capital Markets.

**Arun Viswanathan**

Just a question here. Higher level and looking into 2020, if I could just ask this a different way. You guys had referenced kind of 2% plus price now for a little while. Volumes have been kind of flat to down. Next year if I think about some of your end markets, aerospace faces some pretty tough comps, architectural could be up slightly and your comments here, automotive, it doesn't really appear that it's getting better, although you cited maybe slightly better than your expectations. So when I put all that together, it sounds like next year volumes could be also flat to down slightly, and then I don't know if you're necessarily going to have the price. So just kind of trying to understand how you're thinking about sales growth from here, it would appear that next year would likely be lower than this year just given the lack of pricing actions? Thanks.

**Michael McGarry**

Well, Arun, I think it might be a little bit early to call that. When I think about some of the innovations that we have out there, I think if you think about low temperature cure that's still an opportunity for us. For aerospace we have a number of customers who were qualifying e-coat for airlines, so that's still an opportunity for growth.

We still have more share to gain back in Europe, because we have been leading the price charge over there on that. So I'm not where you are right now, it's a little early to say that. So I'm - I will say that we should be more on the positive side.

**Vince Morales**

Yes, Arun, I'll just reiterate what I said earlier. We think most of our customers and many channels are carrying very low inventory levels. So with any modest economic recovery we think there's going to be a dual effect, the recovery itself plus some kind of inventory replenishment level. So it's again too early to make that call, but as we talk to our customers, they are very low in there in terms of inventory on the balance sheet.

**Arun Viswanathan**

And just as a follow-up, it looks like you've taken some very swift action on the cost front. Those are coming through nicely. Your price cost is heading in the right direction. I guess, I'm just curious and then you have the new product pipeline. What else could you do - from a standpoint you've completed four deals, are you also open to something a little bit more transformative, the strategic review kind of unveiled that breaking the company up isn't really advantageous. But is there anything larger or more strategic that you could pursue to shift the focus a little bit forward, I guess?

**Michael McGarry**

Well, Arun. I would tell you that nothing is off the table. We're always going to be looking to do what's in the best interest of our shareholders. We're going to be disciplined though. We're not going to be doing anything that doesn't create value. We still have more opportunities when I think about the EV market, that is still a wonderful opportunity for us.

And we're obviously anxious support to play out sooner rather than later we can't control that. There is still a challenge, where the EV cars cost significantly more than a traditional car, and they have to figure out a way to get those costs more in line to selling some more cars.

**Operator**

The next question will come from John McNulty of BMO Capital Markets.

**John McNulty**

Just going back to the architectural stores business that you have. Last quarter you had expected for this quarter at least in the guidance you had kind of indicated you were looking for low single-digit demand growth. And I guess given some of the pent-up demand around the wet season, we would have thought it would be even better than that. I guess relative to those expectations what change or what was off. Is it just that it went more and more quickly to the independent dealers or is there something else in the mix that we should be thinking about?

**Michael McGarry**

Well, John, first of all, I'm not sure that in your influence came from, we grew third quarter of '18 at high single-digits, and jump in over that comp was going to be a challenge. And given the way we structured the stores and the dealers, we thought it would be a challenge. So overall, I would tell you that we're pleased with the rollout of this premier authorized dealer network. So, Vince I don't know if there's any...

**Vince Morales**

No. Well, I was going to say the same thing then maybe a different way. We look at the stores in our dealer network as were kind of merging that into a singular channel. We try to - we're trying to optimize what we do on our micro-market basis as Michael mentioned earlier. So we're not overlapping as much and whether this - whether the sale goes to a dealer or to our store is inconsequential to us.

So we have to look at these combined. And if you - again, if you look at the dealer results this quarter and year-to-date, they're up nicely, and that to lower cost to serve for us. So I think we are - it's probably more semantic than anything.

**John McNulty**

Now, that's helpful. And then on the unexpected customer shutdowns, is this something that you typically recapture as the volumes come back on. I mean do you see the customers - your customers essentially try to run harder to catch back up or is it something where look to business it's come and gone and it's kind of something we are going to have to just get passed?

**Michael McGarry**

No I would suspect that if you take the case of our friends up in Detroit, you know they're going to be short of trucks. So they're going to be trying to catch up that volume. Now on the car side, they're probably not as worried about that. But net-net I think they will be trying to optimize their inventories and it may be different at one plant versus another on how hard they are going to ramp up, but some of that volume will come back, but definitely not all of it.

**Vince Morales**

And we've seen customers curtailments on both sides of the quarter. We saw, July shutdowns are normally traditional annual time period to do shut down, some of those were extended. We saw obviously different shutdowns in September.

If you look - but again, if you look at the inventories as a microcosm in the automotive OEM business, the inventory levels are very low in almost every region relative to historical levels. And so again, I think that's another good news story at some point, they're running below - well below the historical inventory levels.

**Operator**

The next question will come from Jeff Zekauskas of JP Morgan.

**Jeff Zekauskas**

Earlier in the call Michael, you talked about raw materials moderating. Were they down about 2% in the quarter? And can you comment on raw materials in the United States and that propylene is I don't know, $0.38 a pound. And last year at this time, it was $0.58 a pound. So maybe it's down 35%. So is there much more raw material depreciation in the United States than there is in other regions?

**Vince Morales**

Let me take the third question Jeff and Michael will...

**Jeff Zekauskas**

Sure.

**Vince Morales**

In total, our cost buckets were not down 2% anywhere near that. We did, as Michael mentioned, have a variety of other costs that are elevated or still elevating. We aggregate that, and when you aggregate that we had very modest moderation of raw material cost in the quarter and year-over-year, and again that's after several years of accumulation of inflation.

**Michael McGarry**

And Jeff, I know you sounded like one of our customers with selectively picking up propylene in North America, but you forgot to mention ethylene in North America is at $0.27 in this time last year is at $0.20. So, and I always tell people we don't buy ethylene. We don't buy propylene; we buy the derivatives of these supply and demand of the derivatives is also important. So where you might have propylene down 15% you have ethylene up 30%. So there are some puts and takes.

**Jeff Zekauskas**

Well, contract ethylene was $0.33, but so secondly when you contemplate your acquisition strategy, are you - do you have a bolt-on strategy or is it something larger than a bolt-on for the next year.

**Michael McGarry**

Well, I think as we've always mentioned, we're active in looking at the pipeline and we're going to take the best use of our shareholders' money and we're going to be disciplined in that approach. So it could be either or, but right now the opportunities are historically have been on the bolt-on.

**Operator**

The next question will come from Duffy Fischer with Barclays.

**Patrick Fischer**

You mentioned a number of times kind of the cumulative impact of the inflation you've seen over the last couple of years. How much price do you need from here if you hold those cost constant, do you need to get back to par?

**Vince Morales**

That's a great question Duffy because we still need more price. And that's what we tell our sales guys and ladies every day, that we're still not on a cumulative basis recovered. It's different obviously by region by business, but we still need - we're not going to give an exact number, but it's, it's a more than we have today and cumulatively our prices that we've given at the past couple of years were up just shy of mid-single digits and then we need to be just north of mid-single digit.

**Patrick Fischer**

All right, and then historically when you've built cash sometimes you put parameters around that cash flow. You will give us a timeframe where either via acquisitions or buybacks you'll consume that cash. Is that worked in your mind historically when you've done that, and if it has or hasn't how would that impact what you might do going into 2020 with the cash you've built?

**Vince Morales**

I'll remind you that we have about $600 million or $650 million of the cash on the balance sheet today slated for term debt pay down and we did some term debt issuance in Q3. We like the interest rates and we're going to swap that out for payment in Q4. We'll look at our - we look on a recurring basis on monthly basis at a minimum at our cash and our cash uses and potential cash use for the next couple of quarters. We'll do it again certainly through the fourth quarter. And if we want to give guidance on that we'll do so in January.

Right now, as Michael said the acquisition pipelines are active and we still like to keep some dry powder to some of the things out there, but we're not immune to give it or not immune to not giving it. It just depends on what we see going forward and what we feel shareholders want to hear from us.

**Operator**

The next question comes from Laurence Alexander of Jefferies.

**Dan Rizzo**

It's Dan Rizwan for Laurence. How are you? You mentioned before on the Brexit is kind of cropping up as a headwind. I was just wondering if a - no deal Brexit means or what a deal means or if it doesn't matter as long as it is like just remove the uncertainty?

**Michael McGarry**

Well, the best thing would be, the removal of the uncertainty without having boarded prices. Right now we're not able to predict that, as you're going to get, we are prepared for either way. What we do see is our architectural business has hung in there pretty good, but then if you look at our little business up in Northern Ireland, that is way more consternation and churn up there, then there might be in, say, Southern Europe - Southern England. So I'd say it varies but at this point in time, it's still a huge watch out for us.

**Dan Rizzo**

Okay, thanks for that. And then maybe my second question, you mentioned I think adding 50 new distributors this quarter, I was wondering if we should think about it as kind of a general run rate going forward like 50 a quarter 200 a year. I mean am I thinking about that right?

**Michael McGarry**

Well, it's a new program this year. So we do have some earlier sign ups. That's probably a good number, we should probably look at for Q4 call and try to give you guys some parameters. It's too early to make that call right now.

**Operator**

The next question will come from Vincent Andrews of Morgan Stanley.

**Vincent Andrews**

Just trying to think through the comments earlier about the potential for customers to rebuild inventory next year and I guess where I'm trying to square on my head is that we've had, as you say, six quarters of a very solid 2% price increase is going through and yet the customer base seems to be running lower than average or normal levels of inventory despite the fact that it's very clear. You're going to - to continue to take pricing. So other than some economic fly up, what is it that's going to - or could cause customers to rebuild inventory levels versus if they've been at low levels for a long period of time and they're generating greater cash flow. For that reason why wouldn't they just stay where they are. So what are the pros and cons on that?

**Michael McGarry**

For the first reason why they've rebuilt and if they had confidence that their end-use demand is going to pick up. So think about the heavy duty equipment guys right, they're wondering what the heck is going on in the farming business and whether or not they're going to be selling more combines.

Right now there is a lot of churn in that segment. So they're trying to figure that out. If they had more clarity on what's the future look like, the farmers would be more willing to spend their money if they had a better idea about the crops, they'd have a better chance to spending it. So I think that would be one.

The other one is consumer confidence in China. Right now, consumer confidence in China is down TMI and China is down. And so, if they thought that the trade churn was behind them, I think people in China would get behind that and start making major purchases. Right now they have deferred on major purchases.

**Vincent Andrews**

Okay, thanks very much. I'll leave it there as we are toward top of the hour.

**Operator**

The next question will come from Stephen Byrne of Bank of America.

**Stephen Byrne**

Yes, thank you. You mentioned just a few moments ago about your volumes in OEM auto to be roughly in line with IHS expectations. It seems your third quarter volumes underperformed or were more challenged than the global auto build rate contracted. Is there something in there that you can attribute that to?

**Michael McGarry**

Part of it, Stephen, was in China. So we have a pretty good split of the local Chinese OEMs. And these guys were behind on the emission changeovers and so they were suffering from that standpoint. So they underperformed significantly, the China as well as the Asian standard. So that's probably the single biggest thing.

**Stephen Byrne**

And then just a quick one on your store - your architectural stores. If you have a loyal paint contractor to your own stores, if they were to shift to a dealer location or - is that particular mix of paint that they're buying in the composition and menu and all of that is that transferred to that dealer and how is your margin on that gallon of paint that's shifted from your store to a dealer?

**Michael McGarry**

Yes. So think about this way without getting into the specifics, we're agnostic to whether he picks up in the store, or picks up at the dealer. The key is that he can pick up at his price at the location that's most conducive for him winning the business.

**Operator**

The next question will come from Mike Harrison of Seaport Global Securities.

**Mike Harrison**

Just wondering if I can maybe build on this idea of the premium dealer channel or dealer network. Can you help us understand exactly what is changing in the model and maybe if there are any costs associated with it and what stage you're in, in this process?

**Michael McGarry**

Mike, I think we heard your question about trying to understand the differences in the business model. Your coming through pretty lately. But if I understood your question right, I will just give you one example that we have said in the Midwest. We had 8 or 10 stores in that city. We sold those stores to the dealer in that area. We're selling through that dealer, and we're no longer competing with them, slowed everybody's cost to serve. The paint contractor has the same opportunities they had before. So again, what we're trying to do is optimize our distribution points to the customer. That's really the focus of this strategy. I hope that was your question.

**Mike Harrison**

Yes, I guess, the question I was really trying to get to is what stage are we at in that process of shifting to a different strategy with the dealers or other costs associated with it?

**Michael McGarry**

Yes, Mike. We're in I would say a little bit more than a year. The first, early on it was a trial stage. We saw some real good positives with that. Now we've accelerated it. There is no real additional cost. There is some - we need to make sure when they pick up in our dealer stores that they are getting the PPG price.

So, there is some transfer data that has to happen, but that's electronic, and so I would not regard this is any material cost and as Vince said earlier, typically it's a lower cost to serve channel to support our dealers.

**Mike Harrison**

And then the other question I had was within the Industrial business, where there pockets within that business that were stronger or weaker. And just in terms of the trends across all four regions that looks like volumes were down during the quarter. Were the trends stable or were the trends worsening in industrial?

**Michael McGarry**

Yes. So I would say that the trends were somewhat moderately lower and they really varied by region. So, Europe was a little bit lighter. Asia Pacific, a little bit lighter, U.S. relatively the same, Latin America relatively the same. The segment that outperformed were like Extrusion, electronic materials, those kind of things who are on the upper end of the curve. The clear the ones that were work - weak were general finishes, wood and parts or transportation equipment under - the end of the hood parts that typically show up in our industrial segment.

**Vince Morales**

Based on our cautious outlook Mike, I'd say industrial activity modestly weakened throughout the quarter.

**Operator**

The next question will come from Dmitry Silversteyn of Buckingham Research.

**Dmitry Silversteyn**

Good morning. Thank you or good afternoon, I should say. Thank you for squeezing me in. Couple of questions. Kind of regional, I guess. Vince, you talked about sort of in your expectations for 2020 that you would expect China to recover a little bit from a macroeconomic perspective. Trying to understand, besides the easy comps in automotive, what gives you the confidence that the Chinese economy and the Chinese consumer is going to come back in 2020?

**Vince Morales**

Well, we've been talking about this all year Dmitry, the Chinese consumers still accruing buying power. Unemployment rate there is no different than it was three or four years ago. They've moved to more of a saving economy. I think they're feeling, they're apprehensive about the geopolitical environment. And our expectation, our hope is that get some more result and or some of that breaks free because they are - they moved to more of a consumption model and they've saved for, I'd say well over nine months to a year now.

And I think there'll be more comfortable spending next year. That's the biggest single item. If you look at the service economy there it's doing well. So again, I think there is still so some good trade in that economy, that would bode well for increased consumer spending.

**Dmitry Silversteyn**

And then to follow up on your comments on Comex about the growth there being on same-store basis, at least in the low single-digit range. It was a much faster business when you bought it. I think you grew it very nicely in the first few years of ownership. You talked about some kind of political headwind and economic headwind.

Looking - at your key leaves, when can we or when do you expect, whatever the situation there that's going on to resolve itself or is it something that's going to drag on to - through 2020. In other words, is there a particular data point or an event that you're looking for or is it just a matter of anniversarying whatever headwinds are being faced by that business?

**Michael McGarry**

So Dmitry, I'd say there are two factors that we're watching closely. The first one is government spending. So with the transition to the new government run by AMLA as they call him, they are cautious and they have not cranked out the government spending that we typically see. We think that will loosen up, so that should be up year-over-year. And then the other one that we're watching cautiously is major project.

So a lot of the folks that have the money who are nervous when AMLA was elected, and so they let their major projects wind down, they haven't restarted new major projects, but what's interesting is that the President has the highest approval ratings ever. And so I think - I think over time people are going to start to loosen up and start to go back to restarting major project. So those are the two factors that we're watching.

The good news is our mix continues to improve significantly. And our earnings are going to be an all-time record for Mexico and we're projecting another record year for them next year, the business feels very good about themselves. We're moving into the major paint season. As you know, the holidays, Thanksgiving through Christmas in Mexico, huge family time and this is going to be a period of time when we see our highest volumes in fourth quarter.

**Operator**

The next question will come from Garik Shmois of Longbow Research.

**Garik Shmois**

Thanks for squeezing me in. I just wanted to follow-up just on the dealer network and the evolution there. Will that end up changing your end market exposure in architectural particularly in the U.S., does it make you more exposed to new construction versus repaint or not really?

**Michael McGarry**

No, material change, Garik.

**Garik Shmois**

And then just lastly, just on aerospace, you talked about in the outlook for the fourth quarter moderating growth, but I think it's really just a function of the tough comp from a year ago. So I just want to be clear on that. And then just wondering if you could maybe provide an outlook into 2020. How you view aero just because the comp will be tough throughout the balance of next year?

**Michael McGarry**

Yes. We still expect clearly the comps that we've put in place this year in high single digits and even in Q1, Q2 and we had low double digits, it's going to be tough to jump over. But when I look at the new technology we rolled out, the new wins we've had, I'm still optimistic that they're going to have a very, very good year in aerospace.

**Operator**

The next question will come from Jim Sheehan of SunTrust Robinson Humphrey.

**Jim Sheehan**

In packaging you talked about some customers were trialing some things you had some pack tests. Could you give some more detail on that? Were these food packages or beverage packages and how did the test turn out?

**Michael McGarry**

Well, that's mostly on the beverage side, as I had mentioned earlier. Jim, the food guys are much, much further along in these conversions. So on the beverage side, you know, basically we don't get pack test results for quite some period of time. It depends upon the severity of it, whether they're moving all around the world. Send them to hot spots like Saudi and cold places like Norway or how extensive the change is, so we basically have pack tests going on all the time in this business. What I would tell you is that we fared pretty well in these things and as these tests come in typically that's been pleased to new business.

**Jim Sheehan**

And then in the European automotive OEM, I think that you had some difficult comps with last year, due to some emissions changes which had pulled forward demand and you would think that might lead to an easier comp in the fourth quarter, but it looks like the IHS numbers are still not that optimistic. Is there something else or is the export demand trend from Europe offsetting the benefit you might get from the change in the WLTP implementations?

**Vince Morales**

Yes, Jim, I think you hit the nail right on the head. We do see fewer exports out of Europe to Asia. That's one of the drags year-over-year. No different in the Asian sales in the indigenous in the region. So that's a factor, and obviously the industrial activity and the lack of industrial activity in Europe's another factor.

**Operator**

And this concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

**Michael McGarry**

Thank you, Carrie. I'd like to thank everybody on the call today for your time and interest in PPG. If you have any further questions, please contact our Investor Relations department. This concludes our third quarter earnings call.

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.