



PPG Industries, Inc. Second Quarter Financial Results

Recorded Commentary Question and Answer Session Only – July 16, 2009

Operator

Our first question comes from the line of Sergey Vasnetsov. Please proceed.

Sergey Vasnetsov – Barclays Capital

Hi, good afternoon. Could you comment on such a big difference between the European and US decorative coatings results? We know that your business [in commercial] housing bubble, but nonetheless, think the difference is huge.

Chuck Bunch - PPG Industries, Chairman and CEO

Sergey, good afternoon. This is Chuck Bunch. I would say that performance in our architectural coatings business in Europe was very good. Obviously the demand is weaker, but I think we offset that with some aggressive cost actions. And so the performance was very solid here in North America -- the volume is actually weaker than in Europe. But I think our team did a very good job in reducing their costs and their performance, although weaker in volume, was solid.

Sergey Vasnetsov – Barclays Capital

And could you comment, would you see in Asia broadly and China specifically when it comes to industrial coating?

Chuck Bunch - PPG Industries, Chairman and CEO

Our performance in Asia-Pacific in coatings in the second quarter was very good. Volume was down. Sales were down, but it was a record pretax preinterest earnings performance in the second quarter despite that. It was led by our businesses in China. They offset what I would consider weaker results in countries like Korea or Australia. And I would say that the businesses in China, especially the automotive OEM business -- they benefited from some of the Chinese stimulus plans, our protective and marine coatings business, our packaging coatings businesses. These businesses in China all had very solid quarters and we're very pleased with the results there. Industrial coatings, because some of the industrial end use markets are more tied to the Chinese export markets, weren't quite as strong, but we had many of the domestic Chinese businesses were among our strongest.

Operator

We have a question from the line of David Begleiter from Deutsche Bank. Please proceed.

David Begleiter – Deutsche Bank

Thank you. Chuck, could you comment on the trends you're seeing in raw material costs, as well as selling price increases in your coatings businesses?

Chuck Bunch - PPG Industries, Chairman and CEO

Let's talk about raw material costs. I would say that after some weakness at the end of last year in raw material input costs for us, the pricing environment has stabilized. If you remember, during the first quarter, oil prices got down to below \$40 a barrel. Then they started moving up late in the first quarter and through the second quarter. We therefore had a lot of suppliers who were attempting to get prices up in the second quarter. And so far, what I would say is that it's a bit of a standoff in terms of raw material input. The biggest benefit we're still experiencing is the natural gas prices, which have remained weak, and that is helping us. That is the unhedged portion, so that's been the biggest positive story. The other raw material prices are now -- let's call it stable.

Similar for pricing, we have I think a more stable pricing environment. If oil prices and raw materials remain stable -- so at this point, I would say, our pricing actions are modest at this point, either positive or negative.

David Begleiter – Deutsche Bank

Is your pricing ahead of or equal to your raw material costs do you believe in coatings?

Chuck Bunch - PPG Industries, Chairman and CEO

Well, I think what you saw David, last year, as we talked, we usually have a little bit of a lag both in absorbing the costs and being able to move those through to our customers. So we were probably a little bit behind the curve at this time last year. Then we were able to get some modest price increases and in some markets. And so I would say now the situation for the last several quarters has been stable. Prices for our raw materials not going up, although our suppliers are attempting to discuss those with us, and by and large, our pricing actions are neutral with our customers.

Operator

Our next question comes from the line of Kevin McCarthy of Bank of America.

Kevin McCarthy – Banc of America

Good afternoon. I heard you say that you expect to remain pretty cautious as it relates to acquisitions and of course watch cash carefully. However -- understandable given the last nine months, but -- on a forward-looking basis, I guess you could also argue it's a buyers' market right now. You've got 1.5 years of SigmaKalon behind you and end use markets in architectural and industrial that are pretty fragmented. I guess my question is what sort of conditions would you be looking for, Chuck, to accept a little bit more risk in terms of adding to the portfolio here in the coatings side?

Chuck Bunch - PPG Industries, Chairman and CEO

Well, what I would say, Kevin, is that the market for coatings acquisition opportunities is a little slow right now. We have not seen very many companies or properties being offered. We have been fairly inactive, but I think in many cases you're seeing companies that are focusing on execution on improving their returns. And so we have not seen a lot of opportunities.

And certainly last year and earlier this year, the discussions that we did have, there was still an expectation on the part of the sellers that the valuations should be similar to what the market was in '07 or early '08 when the earnings were stronger. So I think there's still a little bit of a dislocation there. So we're going to obviously look at opportunities. We haven't seen anything yet that we would regard as a real bargain opportunity.

We also have, as you know, a stock price at PPG that we think has room to move on the upside. So that would be an alternative if we continue to see this level of excess cash and our operating performance and cash flow continues strongly. I think we would also look to modestly have share buybacks as part of our program.

Kevin McCarthy – Banc of America

Understood. That's helpful. Follow-up, if I may -- on Slide 6, you show a seasonal sales growth index comparing 2Q to 1Q. Was wondering if you could comment on the outlook in coatings for 3Q versus 2Q and what sort of sequential pattern you might foresee there?

Chuck Bunch - PPG Industries, Chairman and CEO

I would say that we're looking for a still decline versus the third quarter of 2008, but if you're looking from a, let's call it a seasonal standpoint, I think that it's going to be in coatings a little favorable in the third quarter to what would traditionally be a second quarter to third quarter falloff anyway. So I think the volume declines that we would normally see from second to third quarter historically will be a little less. And one of the reasons there is we think there will be a little more strength in the automotive OEM and industrial markets. I think a lot of the destocking has already taken place. We see here in North America that General Motors and Chrysler, who have -- were virtually out of the car production business in the second quarter, we do look for them to start production here later this month and through the rest of the quarter.

Operator

Our next question comes from the line of Bob Koort of Goldman Sachs.

Amy Zhang – Goldman Sachs

Good afternoon. This is Amy Zhang on behalf of Bob. Two quick questions. First one, in terms of the saving benefit you are talking about -- \$250 million on the run rate basis, how much of this target saving benefit is sensitive to the underlying economic conditions? In other words, if we see some improvement, material improvement in this economic environment, would you still be able to produce that \$1 per share savings benefit? Or probably you have to give back some?

Chuck Bunch - PPG Industries, Chairman and CEO

Well, at this point, our view would be that these reductions that we've made, these structural cost reductions are somewhat transparent to our customers. We intend to be able to by reorganizing our supply chain. We would not anticipate that these types of cost savings would be shared with our customers, as you know, in the businesses that have been most impacted by this downturn, such as our automotive coatings or our glass businesses. These are businesses that are still struggling, and as Bill indicated, we're still losing money in our glass segment. So at this point, we need these cost reductions to return to solid levels of profitability for PPG.

Operator

Our next question comes from the line of John Roberts of Buckingham Research. Please proceed.

John Roberts – Buckingham Research

With GM and Chrysler now out of bankruptcy, are they more interesting customers to you now that their balance sheets are in better shape and they shed some of the legacy liabilities?

Chuck Bunch - PPG Industries, Chairman and CEO

I would think as stand-alone companies, these are healthier. They have better balance sheets. We feel that they represent -- they have always been good customers, although the outlook in the longer term was always somewhat cloudy. Now I think there's a little more certainty, and so they are certainly attractive customers for us. We intend to continue the position that we have had before their bankruptcy in terms of supply. So we think that we will be able to start back up with them as they ramp up production, and we think that they represent good opportunities for us to grow with them. And in the case of General Motors, their businesses outside of North America that weren't as touched by these bankruptcy, the bankruptcy challenges -- we see them continuing to do well in markets like China, like Korea, like Latin America. So we think they present a very solid opportunity to grow.

John Roberts – Buckingham Research

Are you concerned at all that Europe's auto production may be propped up here by their cash for clunkers program and that there will be an uncharacteristic drop later this year when that comes off?

Chuck Bunch - PPG Industries, Chairman and CEO

I think we -- I think there is obviously a risk that this has pulled forward some of the demand and that will probably mean that the continued improvement that you would like to see at the bottom of a recession won't be as strong in 2010 in Europe. So I think that is a valid point. We won't get to the kind of growth that maybe we would have had if we had gone down to the depths this year.

But I think especially in the case of Europe where it takes you a little longer to implement restructuring actions to close plants, I think it's given all of actions to close plants, I think it's given all of us -- the car manufacturers and the automotive suppliers, the dealers and the like -- a little more time to adjust to these economic conditions. But I think we'll see some of that same phenomena here in North America. The scrappage program will I think bring forward some sales and I think we're already hearing that it's bringing interest into the dealers' lots. There's more inquiries, and we hope that in the case here that it will restart the industry, and that even though it may steal a few sales from next year, I think the sales have been so depressed at this point that eventually you will get stronger pent-up demand as we go forward.

Operator

Our next question comes from the line of PJ Juvekar. Please go ahead.

PJ Juvekar – Citi

Good afternoon.

Chuck Bunch - PPG Industries, Chairman and CEO

Hi, PJ.

PJ Juvekar – Citi

Chuck, you talked about this automotive OEM ramp-up in the US. Is that a third quarter event or more like a fourth quarter event? And if we think that production is running at 7 million units or so, where do you think that could go?

Chuck Bunch - PPG Industries, Chairman and CEO

I think you're going to see improvement here in the third quarter. If you remember last year in North America, production levels started being taken down dramatically in the third quarter. We are going to see a restart, especially at Chrysler and General Motors in this quarter. So we think you'll see some impact here in the third quarter and it will continue on into the fourth quarter because we have really been producing in North America at lower than these depressed sales levels. So right now, inventories are healthier from that standpoint than they have been in a number of years. So I think we'll see some improvement here in the third quarter and that should continue on into the fourth quarter.

PJ Juvekar – Citi

Okay. And then quickly, on chlor-alkali, spot caustic prices have come down, some contract prices are likely to come down, but you talked about chlorine prices, natural gas is down. When you look at all of those moving parts, do you think you can hold your margins in that 13% to 14% range in the second half?

Chuck Bunch - PPG Industries, Chairman and CEO

I think in the third quarter, we'll have I think a challenge to hold the margins that we saw in the fourth quarter. The prices were coming down through the quarter, so we ended up in -- at the end of the quarter certainly not at the same pricing level or profitability. Yes, we are helped by what's happening in natural gas or ethylene, but I think it will be a challenge for us to maintain this level of profitability in the third and fourth quarter.

Operator

Our next question comes from the line of Silke Kueck of JPMorgan. Please proceed.

Silke Kueck – JPMorgan

Yes, good afternoon. I have two questions. One is a question of clarification on the US architectural business. Did I hear correctly that you said that the US architectural stores business was down double digit, but that the do-it-yourself business was up double digit?

Chuck Bunch - PPG Industries, Chairman and CEO

Yes. That was correct. The stores business in the second quarter was off low double digits from the previous year, and our national accounts business and dealer business were slightly positive.

Silke Kueck – JPMorgan

Was slightly positive.

Chuck Bunch - PPG Industries, Chairman and CEO

They were in mid single digits volume gain.

Silke Kueck – JPMorgan

Very good results. And I have a question on the cost savings. The annualized run rate of \$50 million in cost savings, can you tell which areas of the income statement benefit? I saw that SG&A costs were down more than \$200 million in the quarter on a year-over-year basis, and also your gross margin improved nicely by a couple of hundred basis points. So can you tell where these cost savings are more noticeable?

Chuck Bunch - PPG Industries, Chairman and CEO

I would say they are split between let's call it supply chain improvements or manufacturing. We closed a number of factories there at the end of 2008 and here recently in the second quarter. So some of that will flow directly to the margins as part of our variable cost reduction. But we also took out significant overhead costs, so that is why you're seeing some improvement in the RS and GA. So I would say it's probably a mix between the two and that trend will continue.

Operator

Our next question comes from the line of Don Carson of UBS. Please proceed.

Don Carson – UBS

Yes, thank you. Just a couple of housekeeping items first. Bill, I don't know if you went over this, but the corporate expense was down sequentially, and just wondering what drove that and what you think a sustainable corporate expense level is? And then just also wondering about the year-over-year depreciation decline, what's driving that?

Bill Hernandez – PPG Industries, CFO

Well, I guess let's talk depreciation first. A lot of the things we've closed down have -- we've eliminated depreciation since we no longer have them. We've also gotten rid of our automotive glass business, so that's closed down quite a bit of our depreciation as well. In terms of the corporate expense, part of that is equity earnings.

Vince Morales – PPG Industries, VP Investor Relations

The biggest change in corporate expense this quarter really was in currency conversion, Don. This is Vince. The currency conversion, the rates shifted sequentially. We had a currency conversion gain this quarter. If you recall back to the first quarter, we had actually a currency conversion loss versus, again, the fourth quarter rates. So if you look on a run rate basis, corporate was running about -- it's running on constant items of about \$30 million exclusive of the stock options and the currency gain was \$8 million this quarter. The currency loss last quarter was an equivalent \$8 million.

Don Carson – UBS

Okay, and then on the chlor-alkali, you were talking rates in the low 80s, which is quite a bit above the industry rate, which has been around the 72% range. Just wondering what's driving your higher rates. And can you just talk a bit about the average ECU for the quarter -- where you ended the quarter?

Chuck Bunch - PPG Industries, Chairman and CEO

Well, I would say, Don, on our capacity utilization, we were a little stronger outside of our US plants. We have four plants, two in the US, two outside the US. Our operating rates were stronger and historically are outside the US. So those are running above kind of US industry averages. I would say our two US plants have been running maybe slightly ahead of industry operating rates, but, as we look at the last half of the second quarter, those operating levels came down a little bit.

And in terms of the ECU, we don't give out prices on specific prices on ECU levels. We have said that they were coming down through the second quarter and we finished the second quarter arguably 25% below where we had been in the first quarter, and the trends right now in the third quarter are mixed. Obviously caustic prices are still weak. There are spot prices that have been leading the contract prices down, but there are a number of actions and pricing on chlorine, including some that we have announced that we hope will stabilize the ECU pricing environment in the second half.

Operator

Our next question comes from the line of David Begleiter of Deutsche Bank.

David Begleiter – Deutsche Bank

Thank you. Chuck, I know the question has been addressed or asked somewhat, but on your cost actions, how much of these costs are variable in nature that may come back as volumes ramp up, whether it's in R&D or in SG&A?

Chuck Bunch - PPG Industries, Chairman and CEO

I would say that our intent is to make sure that the costs, especially the costs of where we've taken these restructuring actions, that we are making let's say a long-term judgment in our costs and ability to deliver services -- so that at this point we have talked maybe in one case, in one of our glass furnaces where we've said we've actually idled the furnace with the opportunity to bring it back at a later date. But if you look at most of the rest of our cost actions in

manufacturing, typically we're closing plants such as the one we closed in the second quarter in automotive coatings in Canada, our intent would not be to bring those to -- to bring that production not be to bring those to -- to bring that production back at that location and consolidate it in our other facilities.

And likewise, with our overhead costs, we're looking at opportunities or ways to do things more efficiently, more productively, so I would say that we are not looking to add these costs back at a later date. We are looking for new ways to do business, because under the kinds of collapses in demand that we've seen, we understand now that we have had to challenge ourselves now on the way we do business, so we intend for these changes to be longer term.

David Begleiter – Deutsche Bank

Thank you.

Chuck Bunch - PPG Industries, Chairman and CEO

Thank you, David.

Operator

The next question comes from the line of Dmitry Silverstein of Longbow Research.

Eugene Fedotoff – Longbow Research

Hi. This is Eugene Fedotoff sitting in for Dmitry. I have a follow-up question on raw material costs. Can you quantify the delta in raw material costs year-over-year?

Vince Morales – PPG Industries, VP Investor Relations

Eugene, this is Vince, if you remember last year, oil ran up in the second quarter, in early third quarter. And we typically lag oil inflation, so we didn't really see a sizable inflationary impact in coatings raw materials until the second half of the year. So our year-over-year deflation from raw materials is fairly benign in the second quarter.

Eugene Fedotoff – Longbow Research

Okay. Thanks. And then on domestic architectural market, particularly on your store [chain] sales, sales are down double digits and your competitor announced price declines in the channel. Just wondering, what is your stand on pricing in that channel?

Chuck Bunch - PPG Industries, Chairman and CEO

Are you referring to the Sherwin Williams announcement on retail prices in their stores business?

Eugene Fedotoff – Longbow Research

That's correct.

Chuck Bunch - PPG Industries, Chairman and CEO

Our stores channel is more focused on the professional painter. We have at this point not tried to compete aggressively in what I would call retail or DIY paint from our stores channel, and we would view Sherwin Williams as competing with our customers. And I can't comment on whether those pricing actions on their part are designed to get them competitive at those levels. So our pricing to the professional segment through our stores has been stable this year. We have taken a number of actions to reduce costs. We have lowered our store count in the face of this weaker

economic and construction environment. And we actually feel that we are stabilizing in that business and our performance is improving, despite the fact that the volume is still showing a decline in the second quarter.

Eugene Fedotoff – Longbow Research

Thank you. And last question, if I may, on chlorine, price increases, given big demand, do you think those price increases will stick and do you expect them in the third quarter or fourth quarter? Thank you.

Chuck Bunch - PPG Industries, Chairman and CEO

Well, it's -- we certainly hope that these price increases will stick. We would see some of that benefit starting in the third quarter, although if they were all implemented, the full benefits would be seen in the fourth quarter.

Operator

The next question comes from the line of Frank Mitsch of BB&T Capital Markets.

Frank Mitsch – BB&T Capital Markets

Hey, good afternoon, guys.

Chuck Bunch - PPG Industries, Chairman and CEO

Hi, Frank.

Vince Morales – PPG Industries, VP Investor Relations

Good afternoon.

Frank Mitsch – BB&T Capital Markets

Hey, sorry if I missed it, but did you quantify on an EPS basis what the foreign exchange negative impact was? And if not, was it around 10%?

Bill Hernandez – PPG Industries, CFO

\$0.09 to \$0.10, Frank.

Frank Mitsch – BB&T Capital Markets

Okay, great. If currencies stay where they are right now, you would anticipate they would be a little bit less in the third quarter, is that fair?

Bill Hernandez – PPG Industries, CFO

Yes, probably about half of that I think in the third quarter.

Frank Mitsch – BB&T Capital Markets

All right, and then I caught the part where your net gas unfortunately hedged at \$8 per MMBtu in this second quarter. Where does that stand for the third and fourth quarters right now?

Bill Hernandez – PPG Industries, CFO

It's, it will be very similar. We did -- we've been hedging actually three years out for one third and then we have a little more of that hedged now, especially with the volume decline. So the hedge position will be similar in the third and fourth quarters.

Operator

Our next question comes from the line of PJ Juvekar.

PJ Juvekar – Citi

Yes, hi. I just had a quick follow-up question, couple of follow-up questions. First, on the raw materials benefit, your raw materials typically begin to lag the commodity markets by one to two quarters. So we saw a big benefit in 2Q. Do you expect the benefit to narrow as we go ahead, because oil prices have gone up?

Chuck Bunch - PPG Industries, Chairman and CEO

I would say it -- the raw material prices, PJ, are fairly stable right now. As you know, the prices have gone up and the suppliers would like to pass some increases on, but at this point, I think given the weak economic environment, we think that raw material prices appear stable here in the near term.

PJ Juvekar – Citi

Okay, and Chuck, quickly, on the European architectural business, your volumes held up, but margins are still below the US margins. Can you comment about the cost structure there and what have you done in last 18 months in terms of improving that cost structure?

Bill Hernandez – PPG Industries, CFO

Well, what I would say is actually we're very pleased with the performance of the architectural business in Europe and the margins were very solid. As you could see, they were double-digit margins in the second quarter. That's obviously the strongest point of the season. But if you look at the comparison to our US or North American architectural business or other architectural businesses that we have around the world, this is actually a better performance. If you look at our business here in North America, it is in the performance coating segment. The performance coating segment has higher margins than what you see in the architectural Europe segment. But we also have some very strong businesses in that segment as well. So I would say like for like, the European performance is very good in architectural.

Operator

Our next question comes from the line of Bob Koort of Goldman Sachs.

Amy Zhang – Goldman Sachs

Thank you. This is Amy again on behalf of Bob. I have some quick follow-up questions. The first one is for your North America architectural paint business; the volumes at the store channel have been underperforming the national account distribution channel dramatically. And heading to the second half of the year, would you expect the volume trends of the store, at your stores to stabilize the weak level or we should expect some sequential improvement or even some sequential deterioration?

Chuck Bunch - PPG Industries, Chairman and CEO

I think that the volume -- if you look at the stores, our stores business, it's more exposed to the commercial segment, it's more exposed to new home construction -- both of which have been weaker than what we would consider the DIY channel where I think you're seeing a little better performance on the part of the consumer. Repainting is a low end, or a low cost way to make home improvements. And so I would say that at this point, we don't look for any further declines in volume for our store channel. But some of the trends where we haven't seen significant improvement in new home construction in commercial is sluggish out there. I'm saying that volume shouldn't improve significantly and the improvements that we have seen in that channel have been from our own cost reduction initiatives.

Amy Zhang – Goldman Sachs

Got you. And then my second follow-up question is in Europe, obviously your architectural paint volume is much better than a lot of people would have expected. And just wondering, is there any particular regions that represent a big benefit for PPG, or do you take marketing share from some of your major competitors and some product lines or areas?

Chuck Bunch - PPG Industries, Chairman and CEO

I would say that as we've been talking about the former SigmaKalon architectural business, it's very well positioned. They had a lot of momentum over the last couple of years in the marketplace. They controlled a lot of their own distribution, so that gives us -- I think we're not as subject to the vagaries of the retailers in some cases in Europe. We have a little more control. I think we've done a good job in positioning the business. Share has been stable to slightly positive, and although we've been exposed in the UK to a weak construction market, we have missed some of the weakest markets in Europe like Spain or Italy. And I think with our focus on the repaint market, the smaller painters in Northern Europe, in France, that has given us a more stable business profile.

Operator

Ladies and gentlemen, that concludes the Q&A portion of today's presentation. I would now like to turn the call back over to Mr. Charles Bunch.

Chuck Bunch - PPG Industries, Chairman and CEO

Thank you, very much, for joining us and we look forward to continuing our dialogue with you in October for our third quarter results. Thank you.