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## PPG Industries

Primed to grow  
in coatings

*Michael McGarry*  
President and CEO

**Dow and DuPont in merger talks**  
**Solvay completes Cytec acquisition**





# PPG Industries

## Primed to grow in coatings

After a long transformation, PPG Industries is sharpening its focus on organic growth and investments in coatings. The company is now the largest coatings producer by revenue, and it is aiming to build on that by developing new technologies and investing in high-growth markets and adjacent sectors. While organic growth will be the emphasis, acquisitions will still play a key role since PPG sees itself as a consolidator in the coatings space.

When PPG president and CEO Michael McGarry took the helm in September, he inherited a new leader in the coatings industry. PPG was the top coatings producer in 2014, with \$12.1 billion in coatings sales. As recently as 2012, PPG was number two, behind AkzoNobel. It moved into its current position after a series of divestitures and acquisitions, such as last year's acquisition of Comex and the spin-off of its commodity chemicals business to Axiall (then Georgia Gulf) in 2012, going back over a decade under former CEO, now executive chairman, Charles Bunch. Bunch was PPG's chairman CEO from 2005 until August 2015.

The company's program of divestitures is "essentially done," McGarry says. Coatings currently account for 93% of PPG's sales, with the rest coming from its flat-glass and fiber-glass business. There is no active process to sell the glass business, although a sale is possible, company executives say.

That PPG has chosen to focus on coatings is no accident. "The fact that what we produce is generally appearance or functionally critical to end products but a relatively small percentage of cost leads to sticky customer relationships and our being able to earn a reasonable return on investment," says PPG executive v.p. and CFO Frank Sklarsky. Growth in coatings does

correlate to growth in GDP, although it is generally a bit higher. Demand is expected to grow 3%/year in the United States from 2014 to 2019 and about 1.5–2.5%/year in Western Europe during the same time frame, according to IHS Chemical. In emerging markets, annual growth is expected to be mid-single digits or higher from 2014 to 2019, reaching 8%/year in China, IHS Chemical adds.

### Key technology investments

PPG is aiming to grow by investing in technology and taking advantage of its global presence and market leadership, especially in certain coatings subsectors. "One major focus is

we are going to put more emphasis on organic growth,” McGarry says. The company aims to grow faster than the market while “continuing to consolidate the coatings space,” he adds.

Some parts of the company have set the template for how to operate in the years to come. “Our most successful business the past few years has been our aerospace and automotive OEM [original equipment manufacturer] businesses,” McGarry says. “And what they’ve done better than others is anticipate the energy reduction and lightweighting trends ... to provide products customers can’t get elsewhere.” An example of this is products for the automotive OEM market that allow manufacturers to apply multiple layers of coating at the same time. “The paint plant is half as big, so instead of having four ovens, you need two ovens,” McGarry says. “It’s a faster cure at a lower bake temperature, a faster bake cycle, and fewer ovens.”

Automotive and aerospace manufacturers are also using different substrates—an area that PPG believes plays into its strengths. In a car, “the door might be steel; the hood might be aluminum; the bumper might be plastic,” McGarry notes. “And you want it all to come together with a perfect color match the first time. It all has to look the same.”

Developing technologies that can work with a variety of environments and substrates is a key part of PPG’s R&D effort—and pushing out new products is crucial to growing relationships with customers and growing the company. PPG spent \$509 million on R&D in 2014 and \$479 million in 2013. Each year the company’s R&D spending amounted to about 3% of sales. “We have more R&D as a percentage of sales than anyone else in coatings,” McGarry says.

A key part of driving growth will be optimizing that R&D effort. “We run [with a] very business-unit-oriented focus,” McGarry says. “I want to see more technologies cross the boundaries between the business units.” Markets with similar requirements will often be served from different units—for example, buses in the company’s refinish unit with OEM trucks in the automotive OEM unit and motorcycles in the industrials unit. “We may have solved a problem on a motorcycle that we face somewhere else or we may have solved a problem on a big truck, and now we need to solve it on a bus,” McGarry says. “Getting more line of sight across the businesses is important.”

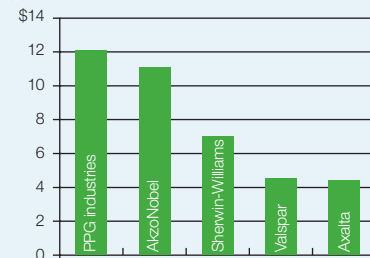
Right now, this issue mainly is treated as one of personnel. The company has begun moving R&D personnel around across the

different business units. “We are going to get some transferring of people across the business units in the R&D area, and that will drive faster transfer of technology,” McGarry says.

Technology can move even across business lines that may not appear, at first glance, to have much in common. “I was just with Home Depot, and we showed them one of the

### Coatings leaders

(by revenue in billions of dollars)



Source: IHS Chemical; company reports.

sealants we are making for them that will be launching April,” McGarry says. “It came out of our aerospace business, and now it’s in our architectural business. We are going to do more shifting of these technologies, and do it faster.”

### M&A still in the mix

PPG is interested in the adhesives and sealants business because of similarities it shares with the company’s coatings core. These include technological similarities and similarities in customer bases. “We have an opportunity to get more important to our customers in the [automotive] paint and body shop,” McGarry says. “For sealants and adhesives that are applied in the same body shop where they apply paint, we can also provide the adhesives and sealants.”

PPG has not shied away from acquisitions in the adhesives and sealants space. In June, the company closed the acquisition of Revocoat (Saint-Just-en-Chaussée, France), a maker of sealants, adhesives, and dampers for the automotive market. Revocoat, which had 500 employees, was a “true adjacency” to PPG’s automotive OEM coatings business, said Cynthia Niekamp, PPG senior v.p./automotive coatings, when the deal was announced.

While PPG is not looking too far afield from coatings, such adjacencies are on the company’s radar. “Criterion number one [for acquisitions] is it needs to be in our wheelhouse,” Sklarsky says. “We define our wheelhouse as coatings, sealants, and adhe-

sives. We put the latter two in there because it’s a similar customer base, technologies we know, it can be sold in a similar way, and it’s technology intensive.”

Any adjacent acquisition would need to be close to the coatings process, however. “A lot of adhesives and sealants are applied by the same [people] or in the same area,” McGarry says. “If it’s applied in the paint shop, yes [it’s something PPG would look at]. If it’s applied by a painter, yes. But we are not going to get into things like commodity adhesives and sealants. It needs to be associated with somewhere in the paint process.” Lightweighting plays a role here, too; the weight of structural adhesives in planes is important to the overall weight, for example.

Acquisitions in general will remain crucial to PPG’s growth for the foreseeable future, even as the company emphasizes technology and organic investment. The company has spent about \$400 million on acquisitions in 2015, according to Sklarsky. Other acquisitions have included powder coatings maker IVC Industrial Coatings and microwave-absorbent coatings maker Cuming Microwave.

Acquisitions are one of four key buckets into which PPG divides its uses of cash. They are, in order of priority, investing in organic growth, including both R&D and capital spending; maintaining a dividend; acquisitions; and share buybacks, according to Sklarsky. Capital spending has averaged about 3% of sales in recent years, as has R&D. PPG has also increased its dividend for decades, and the company targets a dividend payout ratio of about 25–30%, according to Sklarsky.

M&A and buybacks are “more discretionary” than organic investment and dividends, Sklarsky says. The company’s preference among the two discretionary categories is M&A, although timing and opportunities play a role in the actual allocation of cash. “There is always going to be a balance,” Sklarsky says. “The timing of how you do it in any given quarter would depend on the timing of the close of acquisitions.” PPG recently raised its guidance for share buybacks, aiming for \$2–2.5 billion in 2015 and 2016, up from \$1.5–2.5 billion previously.

While a number of deals are in the pipeline, very large acquisitions are hard to come by. “There are fewer acquisition opportunities in the billion-dollar-plus category,” Sklarsky says. “Most of what we see is in the \$100–500-million [revenue] range.”

Large acquisitions have boosted PPG in the past. In November 2014, the company closed its \$2.3-billion acquisition of Comex—and

the integration is going well, according to McGarry. “Comex was primarily an architectural play,” McGarry says. “So what we’ve done is allowed the architectural team to run mostly impeded.” Comex has opened 170 new concessionaire locations this year, nearly all in Mexico, he adds. PPG is also implementing systems so employees at particular locations have specific knowledge of how the paint market operates in their area. “For example, we know all the schools get painted during the three months that they are off,” McGarry says. “So long before that, we need to know who is specing the paint, who is buying the paint, [and] who is applying it.”

Meanwhile, PPG has folded Comex’s businesses in protective and marine, as well as industrial, coatings into PPG’s larger operations. The strategy has yielded results. “For the first nine months of the year, we grew high single digits in [Mexico]. We’re taking a lot of share, and increasing the density of the network,” McGarry says.

For acquisitions of any size, the company aims for targets that “give us either significant added customer exposure, technology that would take us longer to develop or more expensive [to develop] internally, and hopefully ... an increment of growth that would be slightly higher than our corporate average growth rate,” Sklarsky says. “There can be exceptions to that, where you have unique technology.” Some recent deals have involved PPG’s expanding the reach of a product since smaller producers often have difficulty expanding into markets like Asia.

In terms of regions, acquisitions in Asia are appealing but difficult to execute. “Asia is growing vast, but unfortunately the private owners in Asia have unrealistic expectations of either doing [initial public offerings] or getting paid some huge multiple,” McGarry says. However, sellers in the United States and Europe have a more realistic grasp on valuations and the M&A process generally, so most of PPG’s acquisitions have been in those regions. Some deals, like Revocoat—which has operations in Russia and Turkey despite being based in France—have involved emerging-market expansion even when the target was based in the developed world.

Meanwhile, PPG is in no hurry to divest its glass business, although a divestiture may occur eventually. “We’re not marketing our

glass business,” McGarry says. “I’m focused on the glass and fiberglass businesses getting better every day.”

### Staying on top

PPG is optimistic about its outlook for 2016. “There are pluses and minuses throughout the world. ... Generally, we feel very good about our automotive OEM business. It’s performed better than the market,” Sklarsky says. While the automotive business has been strong in North America and is on the mend in Europe, it is emerging markets that are truly fueling growth, both in automotive OEM and automotive refinish. “As the base of vehicles grows in some developing markets, so too will refinish,” Sklarsky says. The industrials business varies by end market, but the positives, such as electronic and packaging, outweigh the negatives, such as oil and gas. The architectural coatings business has been solid and should remain so as long as GDP growth holds up in the United States, Sklarsky notes. The Comex acquisition has also boosted results in architectural coatings. Marine coatings’ growth has been slow, but protective coatings’ growth is gaining steam as municipal finances improve and the commercial construction market in North America ramps up, Sklarsky says.

The company remains bullish on China despite the recent turmoil there. “In China, our focus is on the consumer and the emerging middle class,” McGarry says. “If you think about problems happening in China now, it’s about overcapacity in commodity businesses. But we are painting cars going to the middle class, painting appliances going to the middle class.” While the Chinese automotive market slipped a bit during the summer, early trends in the fourth quarter were positive, PPG says. The country is also filled with new drivers, a boon for the automotive refinish business. PPG’s nonautomotive businesses there are also focused on the growing middle class. “People go from eating on the street to eating at home, and that requires more packaging,” McGarry says. “We are painting airplanes, and the Chinese are traveling more than ever before.”

Europe is another potential upside for PPG. “I think Europe has turned a corner,” McGarry says. The European Central Bank’s introduction of quantitative easing should help boost growth, and southern European economies are growing again, albeit from a low base. France, PPG’s biggest market in Europe, remains sluggish—but if it begins growing, the impact would be major. “We’ve always said 30–40% of any sale in Europe drops of the bottom line, so it would have a significant impact on earnings,” McGarry says. PPG’s European businesses are already running at record-high profit margins, so increases in volume would flow through to earnings easily. “We have ample manufacturing capacity [in Europe],” Sklarsky says. “When we talk about adding volumes in Europe, we don’t have to add any administrative fixed cost and maybe a little variable manufacturing or selling cost but not much. No new brick and mortar, no new back office ... incremental volume there will accrete [to earnings] at a nice rate.”

Regardless of what happens in Europe, McGarry is focused on deepening PPG’s customer relationships. “Instead of us coming and saying, ‘Hey, we can paint it blue,’ how about we provide longer-lasting [product life], more beauty, heat management, [and] reflectivity?” McGarry says. “We have a 3-million color library.”

He also wants to see the company, which is over 130 years old in addition to having over \$10 billion/year in revenues, have a higher profile. “I’d like a higher profile for PPG. That helps out in our consumer businesses,” McGarry says. “We have [paint brands] Glidden, Olympic, [and] Pittsburgh Paints, but ... most consumers who walk into a store don’t know that those products are made by PPG.” Raising the company’s profile could be a simple matter of putting PPG’s logo on more paint cans. As the largest paint supplier in the world, there will be many cans to choose from. “We want to get bigger and drive consolidation,” McGarry says. “One of the differentiators in judging whether I’m going to be a success or not as CEO is how much do we separate ourselves from the competition.”

—VINCENT WALK IN PITTSBURGH



**SKLARSKY:** *New volume in Europe would boost profit.*

