

PPG INDUSTRIES INC
Form 10-Q
October 21, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 or 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For Quarter Ended September 30, 2016
Commission File Number 1-1687

PPG INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania 25-0730780
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

One PPG Place, Pittsburgh, Pennsylvania 15272
(Address of principal executive offices) (Zip Code)
(412) 434-3131
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of September 30, 2016, 263,995,244 shares of the Registrant's common stock, par value \$1.66-2/3 per share, were outstanding.

Table of Contents

PPG INDUSTRIES, INC. AND SUBSIDIARIES
INDEX

	PAGE
<u>Part I. Financial Information</u>	
Item 1. <u>Financial Statements (Unaudited):</u>	
<u>Condensed Consolidated Statement of Income</u>	<u>2</u>
<u>Condensed Consolidated Statement of Comprehensive Income</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheet</u>	<u>4</u>
<u>Condensed Consolidated Statement of Cash Flows</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>6</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>28</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>45</u>
Item 4. <u>Controls and Procedures</u>	<u>45</u>
<u>Part II. Other Information</u>	
Item 1. <u>Legal Proceedings</u>	<u>46</u>
Item 1A. <u>Risk Factors</u>	<u>46</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>46</u>
Item 6. <u>Exhibits</u>	<u>47</u>
<u>Signature</u>	<u>48</u>

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PPG INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Income (Unaudited)

(\$ in millions, except per share amounts)

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Net sales	\$3,789	\$3,725	\$11,254	\$11,214
Cost of sales, exclusive of depreciation and amortization	2,081	2,049	6,095	6,209
Selling, general and administrative	899	875	2,746	2,715
Depreciation	88	87	258	253
Amortization	31	33	91	99
Research and development, net	117	117	350	354
Interest expense	34	31	96	94
Interest income	(6)	(10)	(20)	(31)
Pension settlement charges	968	—	968	—
Business restructuring	—	—	—	140
Asbestos settlement, net	—	3	5	9
Other charges	13	21	66	71
Other income	(23)	(35)	(88)	(92)
(Loss) income from continuing operations before income taxes	(413)	554	687	1,393
Income tax (benefit) expense	(217)	133	182	333
(Loss) income from continuing operations	(196)	421	505	1,060
Income from discontinued operations, net of tax	17	18	46	49
Net (loss) income attributable to the controlling and noncontrolling interests	(179)	439	551	1,109
Less: Net income attributable to noncontrolling interests	(5)	(6)	(18)	(17)
Net (loss) income (attributable to PPG)	\$(184)	\$433	\$533	\$1,092
Amounts attributable to PPG:				
(Loss) income from continuing operations, net of tax	\$(201)	\$415	\$487	\$1,043
Income from discontinued operations, net of tax	17	18	46	49
Net (loss) income (attributable to PPG)	\$(184)	\$433	\$533	\$1,092
(Loss) Earnings per common share:				
(Loss) income from continuing operations, net of tax	\$(0.75)	\$1.53	\$1.83	\$3.83
Income from discontinued operations, net of tax	0.06	0.07	0.17	0.18
Net (loss) income (attributable to PPG)	\$(0.69)	\$1.60	\$2.00	\$4.01
(Loss) Earnings per common share – assuming dilution:				
(Loss) income from continuing operations, net of tax	\$(0.75)	\$1.52	\$1.81	\$3.80
Income from discontinued operations, net of tax	0.06	0.07	0.17	0.18
Net (loss) income (attributable to PPG)	\$(0.69)	\$1.59	\$1.98	\$3.98
Dividends per common share	\$0.40	\$0.36	\$1.16	\$1.05

The accompanying notes to the condensed consolidated financial statements are an integral part of this condensed consolidated statement.

Table of Contents

PPG INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Comprehensive Income (Unaudited)

(\$ in millions)

	Three Months Ended		Nine Months Ended	
	September 30 2016	September 30 2015	September 30 2016	September 30 2015
Net (loss) income attributable to the controlling and noncontrolling interests	\$(179)	\$439	\$551	\$1,109
Other comprehensive income (loss), net of tax:				
Defined benefit pension and other postretirement benefits, net	348	35	391	109
Unrealized foreign currency translation adjustments	(147)	(300)	(231)	(599)
Derivative financial instruments, net	8	2	—	6
Other comprehensive income (loss), net of tax	209	(263)	160	(484)
Total comprehensive income	\$30	\$176	\$711	\$625
Less: amounts attributable to noncontrolling interests:				
Net income	(5)	(6)	(18)	(17)
Unrealized foreign currency translation adjustments	(1)	3	1	8
Comprehensive income attributable to PPG	\$24	\$173	\$694	\$616

The accompanying notes to the condensed consolidated financial statements are an integral part of this condensed consolidated statement.

Table of Contents

PPG INDUSTRIES, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheet (Unaudited)
(\$ in millions)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 929	\$ 1,311
Short-term investments	46	144
Receivables (less allowance for doubtful accounts of \$46 in each period)	2,962	2,709
Inventories	1,676	1,659
Assets held for sale	443	285
Other	361	604
Total current assets	6,417	6,712
Property, plant and equipment (net of accumulated depreciation of \$3,921 and \$3,927)	2,863	2,822
Goodwill	3,701	3,669
Identifiable intangible assets, net	2,073	2,178
Deferred income taxes	516	711
Investments	328	367
Other assets	592	617
Total	\$ 16,490	\$ 17,076
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 3,567	\$ 3,419
Asbestos settlement	—	796
Restructuring reserves	42	87
Short-term debt and current portion of long-term debt	652	281
Liabilities held for sale	199	112
Total current liabilities	4,460	4,695
Long-term debt	3,752	4,026
Accrued pensions	1,001	695
Other postretirement benefits	811	1,015
Asbestos settlement	—	252
Deferred income taxes	521	460
Other liabilities	824	864
Total liabilities	11,369	12,007
Commitments and contingent liabilities (Note 15)		
Shareholders' equity:		
Common stock	969	969
Additional paid-in capital	683	635
Retained earnings	15,744	15,521
Treasury stock, at cost	(9,824)	(9,440)
Accumulated other comprehensive loss	(2,541)	(2,702)
Total PPG shareholders' equity	5,031	4,983
Noncontrolling interests	90	86
Total shareholders' equity	5,121	5,069
Total	\$ 16,490	\$ 17,076

The accompanying notes to the condensed consolidated financial statements are an integral part of this condensed consolidated statement.

Table of Contents

PPG INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Cash Flows (Unaudited)

(\$ in millions)

	Nine Months Ended September 30	
	2016	2015
Operating activities:		
Net income attributable to controlling and noncontrolling interests	\$ 551	\$ 1,109
Less: Income from discontinued operations	(46)	(49)
Income from continuing operations	505	1,060
Adjustments to reconcile net income to cash from operations:		
Depreciation and amortization	349	352
Pension expense	60	74
Pension Settlement	968	—
Stock-based compensation expense	38	42
Business restructuring	—	140
Gain on sale of equity affiliate	(20)	—
Equity affiliate earnings, net of distributions received	(8)	(20)
Deferred income tax benefit	(56)	(42)
Cash contributions to pension plans	(78)	(270)
Cash paid for restructuring actions	(40)	(31)
Cash paid for asbestos settlement funding	(813)	—
Change in certain asset and liability accounts:		
Receivables	(250)	(413)
Inventories	(31)	(89)
Other current assets	(11)	(97)
Accounts payable and accrued liabilities	135	184
Taxes and interest payable	(127)	127
Noncurrent assets and liabilities, net	46	(67)
Other	—	(17)
Cash from operating activities - continuing operations	667	933
Cash from operating activities - discontinued operations	84	53
Cash from operating activities	751	986
Investing activities:		
Capital expenditures	(258)	(262)
Business acquisitions, net of cash balances acquired	(321)	(248)
Proceeds from the disposition of PPG's interest in the Transitions Optical joint venture and sunlens business	—	47
Proceeds from sale of equity affiliate	41	—
Purchase of short-term investments	—	(97)
Proceeds from maturity of short-term investments	92	171
Payments for the settlement of cross currency swap contracts	(36)	(34)
Proceeds from cross currency swap and foreign currency contracts	37	37
Other	14	39
Cash used for investing activities - continuing operations	(431)	(347)
Cash used for investing activities - discontinued operations	(14)	(4)
Cash used for investing activities	(445)	(351)
Financing activities:		

Edgar Filing: PPG INDUSTRIES INC - Form 10-Q

Net change in borrowing with maturities of three months or less	(22)	(18)
Net proceeds (payments) on commercial paper and short-term debt	297	(392)
Proceeds from the issuance of debt	1	1,242
Repayment of long-term debt	(254)	(339)
Purchase of treasury stock	(400)	(501)
Issuance of treasury stock	29	51
Dividends paid	(309)	(287)
Other	(9)	(24)
Cash used for financing activities - continuing operations	(667)	(268)
Cash used for financing activities - discontinued operations	—	—
Cash used for financing activities	(667)	(268)
Effect of currency exchange rate changes on cash and cash equivalents	(21)	(38)
Net (decrease) increase in cash and cash equivalents	(382)	329
Cash and cash equivalents, beginning of period	1,311	686
Cash and cash equivalents, end of period	\$929	\$1,015

Supplemental disclosures of cash flow information:

Interest paid, net of amount capitalized	\$80	\$78
Taxes paid, net of refunds	\$276	\$291

The accompanying notes to the condensed consolidated financial statements are an integral part of this condensed consolidated statement.

Table of Contents

PPG INDUSTRIES, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The condensed consolidated financial statements included herein are unaudited and have been prepared following the requirements of the Securities and Exchange Commission and accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim reporting. Under these rules, certain footnotes and other financial information that are normally required for annual financial statements can be condensed or omitted. These statements include all adjustments, consisting only of normal, recurring adjustments, necessary for a fair presentation of the financial position of PPG Industries, Inc. and its subsidiaries (the "Company" or "PPG") as of September 30, 2016, and the results of their operations for the three and nine months ended September 30, 2016 and 2015 and their cash flows for the nine months then ended. All intercompany balances and transactions have been eliminated. Material subsequent events are evaluated through the report issuance date and disclosed where applicable. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in PPG's Annual Report on Form 10-K for the year ended December 31, 2015.

Revenues, expenses, assets and liabilities can vary during each quarter of the year. Accordingly, the results of operations for the three and nine months ended September 30, 2016 and the trends in these unaudited condensed consolidated financial statements may not necessarily be indicative of the results to be expected for the full year. On October 1, 2016, PPG completed the sale of its flat glass manufacturing and glass coatings operations to Vitro S.A.B. de C.V. The accompanying condensed consolidated statements of income and cash flows for the three and nine months ended September 30, 2015 and the amounts in these notes to the condensed consolidated financial statements have been recast to reflect the presentation of the results of operations and cash flows of the former flat glass business as discontinued operations. In addition, the assets and liabilities of the flat glass business are presented as "Assets held for sale" and "Liabilities held for sale" on the condensed consolidated balance sheet for all periods presented. Refer to Note 3, "Acquisitions and Dispositions", for additional information regarding this transaction.

2. New Accounting Standards

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments." This ASU addresses eight specific cash flow issues with the objective of eliminating the existing diversity in practice. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, and for interim periods therein. PPG does not believe this ASU will have a material impact on its consolidated financial position, results of operation and cash flows.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses." This ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, and for interim periods therein. PPG does not believe this ASU will have a material impact on its consolidated financial position, results of operation and cash flows.

In April 2016, the FASB issued ASU No. 2016-10, "Identifying Performance Obligations and Licensing." This ASU addresses certain implementation issues that have surfaced since the issuance of ASU No. 2014-09 in May 2014. The ASU provides guidance in identifying performance obligations and determining the appropriate accounting for licensing arrangements. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, and for interim periods therein. PPG is in the process of assessing the impact the adoption of this ASU will have on its consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting." This ASU simplifies certain aspects of the accounting for share-based payment transactions, including income tax requirements, forfeitures, and presentation on the balance sheet and the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2016 and for the interim periods therein. PPG is in the process of assessing the impact the adoption of this ASU will have on its consolidated financial position,

results of operations and cash flows.

In March 2016, the FASB issued ASU No. 2016-08, "Principal versus Agent Considerations (Reporting Revenue Gross versus Net)." This ASU clarifies the revenue recognition implementation guidance for preparers on certain aspects of principal versus agent consideration. The amendments in this ASU are effective for annual periods beginning after

6

Table of Contents

December 15, 2017 and for interim periods therein. PPG does not believe this ASU will have a material impact on its consolidated financial position, results of operation and cash flows.

In February 2016, the FASB issued ASU No. 2016-02, "Leases." This ASU requires all lessees to recognize on the balance sheet right to use assets and lease liabilities for the rights and obligations created by lease arrangements with terms greater than 12 months. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018 and for interim periods therein. PPG is in the process of assessing the impact the adoption of this ASU will have on its consolidated financial position, results of operations and cash flows.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606." This ASU replaces nearly all existing U.S. GAAP guidance on revenue recognition. The standard prescribes a five-step model for recognizing revenue, the application of which will require significant judgment. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, and for interim periods therein. PPG is in the process of assessing the impact the adoption of this ASU will have on its consolidated financial position, results of operations and cash flows.

3. Acquisitions and Dispositions

Acquisitions

On July 1, 2016, PPG completed the acquisition of MetoKote Corporation ("MetoKote"). MetoKote is a U.S.-based coatings services business with 2015 global sales of approximately \$200 million. MetoKote applies coatings to customers' manufactured parts and assembled products. It operates on-site coatings services within several customer manufacturing locations, as well as at regional service centers, located throughout the U.S., Canada, Mexico, the United Kingdom, Germany, Hungary and the Czech Republic. Customers ship parts to MetoKote service centers where they are treated to enhance paint adhesion and painted with electrocoat, powder or liquid coatings technologies. Coated parts are then shipped to the customer's next stage of assembly. MetoKote coats an average of more than 1.5 million parts per day.

PPG is in the process of obtaining third-party valuations of assets acquired and liabilities assumed in the MetoKote acquisition. As such, the allocation of the purchase price is subject to change. The following table summarizes the estimated fair value of assets acquired and liabilities assumed as reflected in the purchase price allocation for MetoKote.

(\$ in millions)	September 30, 2016
Receivables	\$ 30
Inventory	4
Property, plant, and equipment	96
Identifiable intangible assets	83
Goodwill	129
Total Assets	\$ 342
Accounts payable and accrued liabilities	10
Other current liabilities	10
Other long-term liabilities	16
Total Liabilities	\$ 36
Total purchase price, net of cash acquired	\$ 306

The pro-forma impact on PPG's sales and results of operations, including the pro forma effect of events that are directly attributable to the acquisition, was not significant. While calculating this impact, no cost savings or operating synergies that may result from the acquisition were included.

In conjunction with the 2013 separation of its commodity chemicals business, PPG conveyed to Axiall Corporation ("Axiall") its 60% ownership interest in Taiwan Chlorine Industries ("TCI"), a joint venture with China Petrochemical Development Corporation ("CPDC") located in Taiwan. Under PPG's agreement with CPDC, if certain post-closing conditions were not met following the 3 year anniversary of the separation, CPDC had the option to sell its 40% ownership interest in TCI to Axiall for \$100 million. In turn, Axiall had a right to designate PPG as its designee to purchase the 40% ownership interest of CPDC. On April 22, 2016, Axiall announced that CPDC had decided to sell

its ownership interest in TCI to Axiall. On June 19, 2016, Axiall formally designated PPG to purchase the 40% ownership interest in TCI. On August 31, 2016, Westlake Chemical Corporation acquired Axiall, which became a wholly-owned subsidiary of Westlake. PPG is currently negotiating the terms of its purchase of CPDC's 40% ownership interest.

7

Table of Contents

Dispositions

Flat Glass Business

On October 1, 2016, PPG completed the sale of its flat glass manufacturing and glass coatings operations to Vitro S.A.B. de C.V. PPG received approximately \$740 million in cash proceeds and expects to record a gain on the sale during the fourth quarter 2016. PPG reported the assets and liabilities of the flat glass business as "Assets held for sale" and "Liabilities held for sale" in the accompanying condensed consolidated balance sheets and the results of operations of the flat glass business as discontinued operations on the condensed consolidated statements of income and cash flows for all periods presented.

Under the terms of the agreement, PPG divested its entire flat glass manufacturing and glass coatings operations, including production sites located in Fresno, California; Salem, Oregon; Carlisle, Pennsylvania; and Wichita Falls, Texas; four distribution/fabrication facilities located across Canada; and a research-and-development center located in Harmar, Pennsylvania, near Pittsburgh. PPG's flat glass business included approximately 1,200 employees. The business manufactures glass that is fabricated into products used primarily in commercial and residential construction. The net sales and income from discontinued operations related to the flat glass business for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended September 30 2016		Nine Months Ended September 30 2015	
(\$ in millions)	2016	2015	2016	2015
Net sales	\$156	\$147	\$427	\$421
Income from operations	26	27	70	70
Income tax expense	9	9	24	23
Income from discontinued operations, net of tax	\$17	\$18	\$46	\$47

The major classes of assets and liabilities of the flat glass business included in the PPG condensed consolidated balance sheet at September 30, 2016 and December 31, 2015 were as follows:

(\$ in millions)	September 30, 2016	December 31, 2015
Receivables	\$ 83	\$ 79
Inventory	66	47
Property, plant, and equipment	190	196
Deferred income taxes (a)	(37)	(37)
Assets held for sale	\$ 302	\$ 285
Short-term debt and current portion of long-term debt	1	1
Accounts payable and accrued liabilities	67	72
Long-term debt	15	16
Accrued pensions	21	16
Other postretirement benefits	4	6
Other long-term liabilities	3	1
Liabilities held for sale	\$ 111	\$ 112

(a) The net deferred income tax liability is included in assets held for sale due to the Company's tax jurisdictional netting.

European Fiber Glass Business

On October 1, 2016, PPG completed the sale of its European fiber glass operations to glass manufacturer Nippon Electric Glass Co. Ltd. ("NEG") and received cash proceeds of approximately \$120 million. Manufacturing facilities in Hoogezand, Netherlands, and Wigan, England, and a research-and-development facility in Hoogezand were

included in the transaction. The European fiber glass operations manufacture reinforcement materials for thermoset and thermoplastic composite applications. They serve the transportation, energy, infrastructure and consumer markets. This transaction meets the criteria to be classified as assets held for sale and accordingly all assets and liabilities of the European fiber glass business have been reclassified to "Assets held for sale" and "Liabilities held for sale" as of September 30, 2016 in the accompanying condensed consolidated balance sheet. The results of the European fiber

Table of Contents

glass business have not been reclassified as discontinued operations, as the divestiture of the European fiber glass business did not have a major impact on PPG's ongoing results of operations.

The major classes of assets and liabilities of the European fiber glass operation included in the PPG condensed, consolidated balance sheet at September 30, 2016 were as follows:

(\$ in millions)	September 30, 2016
Receivables	\$ 24
Inventory	18
Property, plant, and equipment	55
Goodwill	