

PPG INDUSTRIES INC
 Form 10-Q
 October 29, 2012
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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, 2012
 Commission File Number 1-1687

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

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

| | |
|---|---------------------|
| One PPG Place, Pittsburgh, Pennsylvania (Address of principal executive offices) (412) 434-3131 (Registrant's telephone number, including area code) | 15272 (Zip 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 | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input type="checkbox"/> |

(Do not check if a 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, 2012, 153,350,372 shares of the Registrant's common stock, par value \$1.66-2/3 per share, were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PPG INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Income (Unaudited)

(Millions, except per share amounts)

| | Three Months | | Nine Months | |
|---|--------------------|---------|--------------------|----------|
| | Ended September 30 | | Ended September 30 | |
| | 2012 | 2011 | 2012 | 2011 |
| Net sales | \$3,845 | \$3,849 | \$11,552 | \$11,368 |
| Cost of sales, exclusive of depreciation and amortization | 2,288 | 2,353 | 6,869 | 6,897 |
| Selling, general and administrative | 816 | 806 | 2,488 | 2,432 |
| Depreciation | 89 | 86 | 265 | 260 |
| Amortization (Note 6) | 27 | 30 | 83 | 92 |
| Research and development | 113 | 108 | 337 | 321 |
| Interest expense | 54 | 51 | 155 | 159 |
| Interest income | (10 |) (11 |) (29 |) (32 |
| Business restructuring (Note 7) | — | — | 208 | — |
| Asbestos settlement – net (Note 18) | 3 | 3 | 9 | 9 |
| Other charges (Note 18) | 24 | 14 | 214 | 60 |
| Other earnings | (45 |) (53 |) (111 |) (143 |
| Income before income taxes | 486 | 462 | 1,064 | 1,313 |
| Income tax expense (Note 11) | 122 | 120 | 253 | 340 |
| Net income attributable to the controlling and noncontrolling interests | 364 | 342 | 811 | 973 |
| Less: net income attributable to noncontrolling interests | (25 |) (31 |) (97 |) (94 |
| Net income (attributable to PPG) | \$339 | \$311 | \$714 | \$879 |
| Earnings per common share (Note 10) | \$2.21 | \$1.98 | \$4.66 | \$5.55 |
| Earnings per common share – assuming dilution (Note 10) | \$2.18 | \$1.96 | \$4.61 | \$5.48 |
| Dividends per common share | \$0.59 | \$0.57 | \$1.75 | \$1.69 |

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

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PPG INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Comprehensive Income (Unaudited)

(Millions)

| | Three Months | | Nine Months | |
|---|--------------------|--------|--------------------|--------|
| | Ended September 30 | | Ended September 30 | |
| | 2012 | 2011 | 2012 | 2011 |
| Net income attributable to the controlling and noncontrolling interests | \$364 | \$342 | \$811 | \$973 |
| Other comprehensive income, net of tax: | | | | |
| Pension and other postretirement benefits (Note 12) | 13 | 45 | 71 | 94 |
| Unrealized currency translation adjustment | 85 | (410) |) 38 | (126) |
| Net change – derivatives (Note 15) | (4 |) (32 |) (10 |) (29) |
| Other comprehensive income (loss), net of tax | 94 | (397) |) 99 | (61) |
| Total comprehensive income (loss) | 458 | (55) |) 910 | 912 |
| Less: amounts attributable to noncontrolling interests: | | | | |
| Net income | (25 |) (31 |) (97 |) (94) |
| Unrealized currency translation adjustment | (5 |) 16 | (3 |) 8 |
| Comprehensive income (loss) attributable to PPG | \$428 | \$(70) |) \$810 | \$826 |

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

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PPG INDUSTRIES, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheet (Unaudited)
(Millions)

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,392 | \$ 1,457 |
| Short-term investments | 619 | 25 |
| Receivables (less allowance for doubtful accounts of \$78 and \$71) | 3,190 | 2,830 |
| Inventories (Note 5) | 1,777 | 1,607 |
| Other | 799 | 775 |
| Total current assets | 7,777 | 6,694 |
| Property (net of accumulated depreciation of \$6,092 and \$5,893) | 2,759 | 2,721 |
| Investments | 424 | 387 |
| Goodwill (Note 6) | 2,706 | 2,660 |
| Identifiable intangible assets - net (Note 6) | 1,066 | 1,125 |
| Other assets | 874 | 795 |
| Total | \$ 15,606 | \$ 14,382 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Short-term debt and current portion of long-term debt (Note 8) | \$ 636 | \$ 108 |
| Asbestos settlement (Note 18) | 654 | 593 |
| Accounts payable and accrued liabilities | 3,105 | 2,996 |
| Business restructuring (Note 7) | 95 | 5 |
| Total current liabilities | 4,490 | 3,702 |
| Long-term debt (Note 8) | 3,365 | 3,574 |
| Asbestos settlement (Note 18) | 234 | 241 |
| Deferred income taxes | 263 | 272 |
| Accrued pensions (Note 12) | 992 | 968 |
| Other postretirement benefits (Note 12) | 1,226 | 1,307 |
| Other liabilities | 904 | 872 |
| Total liabilities | 11,474 | 10,936 |
| Commitments and contingent liabilities (Note 18) | | |
| Shareholders' equity (Note 13): | | |
| Common stock | 484 | 484 |
| Additional paid-in capital | 851 | 783 |
| Retained earnings | 9,734 | 9,288 |
| Treasury stock, at cost | (5,504) | (5,506) |
| Accumulated other comprehensive loss | (1,704) | (1,800) |
| Total PPG shareholders' equity | 3,861 | 3,249 |
| Noncontrolling interests | 271 | 197 |
| Total shareholders' equity | 4,132 | 3,446 |
| Total | \$ 15,606 | \$ 14,382 |

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

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PPG INDUSTRIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statement of Cash Flows (Unaudited)
(Millions)

| | Nine Months Ended September 30 | |
|---|-----------------------------------|--------|
| | 2012 | 2011 |
| Operating activities: | | |
| Net income attributable to controlling and noncontrolling interests | \$811 | \$973 |
| Adjustments to reconcile net income to cash from operations: | | |
| Depreciation and amortization | 348 | 352 |
| Pension expense (Note 12) | 122 | 101 |
| Business restructuring (Note 7) | 208 | — |
| Environmental remediation charge (Note 19) | 159 | — |
| Equity affiliate earnings, net of dividends | (13 |) (30 |
| Asbestos settlement, net of tax | 6 | 6 |
| Cash contributions to pension plans | (59 |) (114 |
| Restructuring cash spending (Note 7) | (63 |) (15 |
| Change in certain asset and liability accounts: | | |
| Increase in receivables | (310 |) (390 |
| Increase in inventories | (92 |) (190 |
| Decrease (increase) in other current assets | 1 | (45 |
| Increase in accounts payable and accrued liabilities | 88 | 115 |
| Decrease in noncurrent assets | (15 |) (16 |
| (Decrease) increase in noncurrent liabilities | (18 |) 8 |
| Change in accrued tax and interest | (90 |) 40 |
| Other | (44 |) (18 |
| Cash from operating activities | 1,039 | 777 |
| Investing activities: | | |
| Capital spending: | | |
| Additions to property and long-term investments | (226 |) (235 |
| Business acquisitions, net of cash balances acquired (Note 4) | (53 |) (56 |
| Deposit of cash into escrow (Note 4) | (26 |) (3 |
| Release of cash held in escrow | 19 | — |
| Purchase of short-term investments | (730 |) (125 |
| Proceeds from maturity of short-term investments | 120 | 724 |
| Payments on cross currency swap contracts | (23 |) (10 |
| Monetization of cross currency swap contracts | 1 | — |
| Collection of notes receivable (Note 16) | — | 90 |
| Return of capital, equity affiliate (Note 16) | — | 78 |
| Reductions of other property and investments | 42 | 31 |
| Cash (used for) from investing activities | (876 |) 494 |
| Financing activities: | | |
| Debt: | | |
| Net change in borrowings with maturities of three months or less | (8 |) 2 |
| Proceeds from other debt | — | 4 |
| Proceeds from long-term debt, net (Note 8) | 397 | — |
| Repayment of long-term debt (Note 8) | (71 |) (400 |
| Repayment of acquired debt (Note 8) | (119 |) — |
| Repayment of other debt | (12 |) (6 |

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| | | | |
|---|---------|---|----------|
| Settlement of forward starting swaps (Note 15) | (121 |) | — |
| Proceeds from termination of interest rate swaps | 29 |) | 19 |
| Other financing activities: | | | |
| Issuance of treasury stock (Note 13) | 110 |) | 70 |
| Purchase of treasury stock (Note 13) | (92 |) | (633) |
| Dividends paid (Note 13) | (267 |) | (268) |
| Dividends paid on subsidiary common stock to noncontrolling interests (Note 13) | (74 |) | (36) |
| Other | (13 |) | (22) |
| Cash used for financing activities | (241 |) | (1,270) |
| Effect of currency exchange rate changes on cash and cash equivalents | 13 |) | (41) |
| Net decrease in cash and cash equivalents | (65 |) | (40) |
| Cash and cash equivalents, beginning of period | 1,457 |) | 1,341 |
| Cash and cash equivalents, end of period | \$1,392 |) | \$1,301 |

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

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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. In the opinion of management, 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, 2012, and the results of their operations for the three and nine months ended September 30, 2012 and 2011 and their cash flows for the nine months then ended. 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, 2011.

The results of operations for the nine months ended September 30, 2012 are not necessarily indicative of the results to be expected for the full year.

2. New Accounting Standards

In May 2011, the Financial Accounting Standards Board (“FASB”) issued an amendment to the fair value measurement guidance and disclosure requirements that established common U.S. Generally Accepted Accounting Principles (“GAAP”) and International Financial Reporting Standards (“IFRS”) measurement and reporting requirements. The new requirements were effective for the first interim or annual period beginning after December 15, 2011 and were to be applied prospectively. PPG adopted the new requirements in the first quarter of 2012; however, the adoption of this guidance did not have a material effect on its consolidated financial position, results of operations or cash flows. In June 2011, the FASB issued an amendment to the requirements for presenting comprehensive income. The new requirements were effective for the first interim or annual period beginning after December 15, 2011 and were to be applied retrospectively. The standard requires other comprehensive income to be presented in a continuous statement of comprehensive income that would combine the components of net income and other comprehensive income, or in a separate, but consecutive, statement following the statement of income. PPG adopted these new requirements in the first quarter of 2012.

3. Fair Value Measurement

The accounting guidance on fair value measurement establishes a hierarchy with three levels of inputs used to determine fair value. Level 1 inputs are quoted prices in active markets for identical assets and liabilities, considered to be the most reliable evidence of fair value, and should be used whenever available. Level 2 inputs are observable prices that are not quoted on active exchanges. Level 3 inputs are unobservable inputs used for measuring the fair value of assets or liabilities.

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Assets and liabilities reported at fair value on a recurring basis:
(Millions)

| | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|---------|-------|
| At September 30, 2012 | | | | |
| Short-term investments: | | | | |
| Commercial paper and restricted cash | \$— | \$380 | \$— | \$380 |
| Marketable equity securities | 4 | — | — | 4 |
| Other current assets: | | | | |
| Foreign currency contracts ⁽¹⁾ | — | 3 | — | 3 |
| Equity forward arrangement ⁽²⁾ | — | 101 | — | 101 |
| Investments: | | | | |
| Marketable equity securities | 63 | — | — | 63 |
| Accounts payable and accrued liabilities: | | | | |
| Foreign currency contracts ⁽²⁾ | — | 5 | — | 5 |
| Other liabilities: | | | | |
| Cross currency swaps ⁽²⁾ | — | 66 | — | 66 |
| At December 31, 2011 | | | | |
| Short-term investments: | | | | |
| Commercial paper and restricted cash | \$— | \$21 | \$— | \$21 |
| Marketable equity securities | 4 | — | — | 4 |
| Other current assets: | | | | |
| Foreign currency contracts ⁽²⁾ | — | 1 | — | 1 |
| Interest rate swaps ⁽²⁾ | — | 1 | — | 1 |
| Equity forward arrangement ⁽²⁾ | — | 56 | — | 56 |
| Investments: | | | | |
| Marketable equity securities | 56 | — | — | 56 |
| Other assets: | | | | |
| Interest rate swaps ⁽²⁾ | — | 25 | — | 25 |
| Accounts payable and accrued liabilities: | | | | |
| Foreign currency contracts ⁽²⁾ | — | 6 | — | 6 |
| Forward starting swaps ⁽²⁾ | — | 92 | — | 92 |
| Natural gas swap contracts ⁽²⁾ | — | 9 | — | 9 |
| Other liabilities: | | | | |
| Cross currency swaps ⁽²⁾ | — | 120 | — | 120 |
| Foreign currency contracts ⁽²⁾ | — | 1 | — | 1 |

(1) \$2 million of this balance is designated as a hedging instrument under U.S. GAAP.

(2) This entire balance is designated as a hedging instrument under U.S. GAAP.

Assets and liabilities reported at fair value on a nonrecurring basis:

As a result of finalizing a restructuring plan, as discussed in Note 7, "Business Restructuring", long-lived assets with a carrying amount of \$10 million were written-down to their fair value of \$7 million, resulting in a charge of \$3 million, which was included in the business restructuring expense reported in the nine months ended September 30, 2012.

These long-lived assets were valued using Level 3 inputs.

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4. Acquisitions

During the nine months ended September 30, 2012, the Company closed three acquisitions related to its coatings businesses. The total cost of these acquisitions was \$207 million, including debt assumed of \$122 million. These acquisitions also provide for contingent payments and escrowed holdbacks. Substantially all of the acquisition activity relates to the two acquisitions described below.

In early January 2012, PPG completed the purchase of European coatings company Dyrup A/S (“Dyrup”), based in Copenhagen, Denmark, from its owner, Monberg & Thorsen A/S, a public holding company, for \$44 million, of which \$26 million is currently being held in escrow. As part of the transaction, PPG assumed debt of \$120 million and acquired cash of \$6 million. Dyrup, a producer of architectural coatings and woodcare products, operates six manufacturing facilities throughout Europe, and its products are sold primarily in Denmark, France, Germany, Portugal, Poland, and Spain through professional and do-it-yourself channels.

Also in early January 2012, PPG completed the purchase of the coatings businesses of Colpisa Colombiana de Pinturas and its affiliate, Colpisa Ecuador (“Colpisa”), for \$38 million, of which \$2 million is currently being held back as contingent payments. Colpisa manufactures and distributes coatings for automotive original equipment manufacturer (“OEM”), automotive refinish and industrial customers in Colombia and Ecuador.

The preliminary purchase price allocations related to the acquisitions made in 2012 resulted in an excess of purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed, which has been recorded as an addition to goodwill. The Dyrup and Colpisa acquisitions included an \$8 million flow-through cost of sales, primarily in the first quarter of 2012, of the step up to fair value of inventory acquired.

The following table summarizes the fair value of assets acquired and liabilities assumed as reflected in the preliminary purchase price allocations for the Dyrup and Colpisa acquisitions recorded as of September 30, 2012.

| | |
|---|------------|
| | (Millions) |
| Cash | \$6 |
| Current assets | 132 |
| Property, plant, and equipment | 80 |
| Goodwill | 17 |
| Other non-current assets | 40 |
| Total assets | \$275 |
| Short-term debt | (110) |
| Current liabilities | (61) |
| Long-term debt | (10) |
| Other long-term liabilities | (12) |
| Net assets | \$82 |
| Total purchase price including cash in escrow and contingent payments | \$82 |

In October 2012, the Company reached a definitive agreement to acquire certain assets and the business of Spraylat Corp., a privately-owned industrial coatings company based in Pelham, N.Y. Spraylat had annual sales of approximately \$125 million in 2011. The company operates production facilities in the U.S., Europe and China, and it employs about 300 people. Spraylat specializes in high-quality industrial liquid and powder coatings with excellent performance characteristics that are applied to metal, glass and plastic substrates. The transaction is expected to close in late 2012 subject to regulatory approval and customary closing conditions.

During the nine months ended September 30, 2011, PPG spent \$56 million on several acquisitions, including purchase price adjustments related to acquisitions that were completed prior to December 31, 2010. In May 2011, PPG acquired the assets of Equa-Chlor, Inc. for \$28 million, of which \$3 million is held in escrow until May 2013. PPG assessed the fair value of the assets acquired and liabilities assumed, which consisted principally of property and operating working

capital. PPG recorded a net benefit of \$9 million stemming from a bargain purchase gain of \$10 million reflecting the excess of the fair value of the net assets acquired over the price paid for the business and a \$1 million loss related to the flow-through cost of sales of the step up to fair value of acquired inventory. The gain is reported in Other earnings in the accompanying condensed consolidated statement of income for

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the nine months ended September 30, 2011. The remaining amounts spent on acquisitions during the nine-month period ending September 30, 2011 represent other acquisitions in the coatings businesses.

5. Inventories

Inventories as of September 30, 2012 and December 31, 2011 are detailed below:

| | September 30, 2012 (Millions) | December 31, 2011 |
|-------------------|-------------------------------------|----------------------|
| Finished products | \$1,023 | \$935 |
| Work in process | 159 | 144 |
| Raw materials | 479 | 414 |
| Supplies | 116 | 114 |
| Total | | |