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Masco Corp. (MAS)

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MANAGEMENT DISCUSSION SECTION

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Good morning. Sam Darkatsh, and on behalf of Raymond James, we'd like to welcome you to the Masco Corporation presentation for today. With us today from Masco, Rick Westenberg, Chief Financial Officer. Also in the back of the room, Dave Chaika, Vice President, Treasurer and Investor Relations; as well as Robin Zondervan, Vice President, Controller and Chief Accounting Officer.

Rick, I think you mentioned your prepared remarks are about 20, 25 minutes or so. So, it should leave us a couple of minutes perhaps for Q&A, but there will be a breakout session immediately following downstairs. So with that, Rick, welcome to the Raymond James Conference.

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

Great. Thank you, Sam, and good morning, everyone. It's good to be here. It's my first Raymond James Conference and excited to be part of the activities this week. And really appreciate everyone joining this morning, particularly given the early start, 7:30 Monday morning. We're glad you could join us. And for those joining by webcast, good morning and good afternoon.

What I understand is that there are a number of participants that are new to the Masco name. So, I'll generally keep my comments high level. I'll walk through really the Masco story here this morning. But obviously, as Sam mentioned, there will be time for Q&A and there's a breakout session after this as well. So why don't we get started? So, I'll provide just an overview of Masco and I'll get into a bit more detail as I go through the presentation.

So, Masco is a global leader of the design, manufacture and distribution of building products and home improvement products really for the repair and remodel industry or the R&R industry of the housing segment. In terms of the overall size of Masco, Masco in 2023, generated approximately \$8 billion of revenue. And on that \$8 billion of revenue, generated over \$1.3 billion of adjusted operating profit, which translated into an operating profit margin of 16.8%. Notably, that was up about 120 basis points year-over-year versus 2022.

In addition to the operating profit performance, Masco has historically been a really strong cash generator at or around 100% cash conversion. We're stronger than that in 2023, generating over \$1.1 billion of cash flow. That was on the heels of strong operating performance as well as some favorable working capital during the course of the year.

Masco really focuses on three competitive areas and we believe there are competitive advantages. One, brands; two, product innovation; and three, service. And you can see here at the bottom of the slide the real portfolio of brands that Masco owns and operates. I'll get into a bit more detail on some of the more prominent brands later in the presentation, but I thought it was really appropriate to have the portfolio of brands really on the opening slide of the presentation.

Masco operates its business in two segments; the Plumbing Products segment and the Decorative Architectural Products segment. While they're distinct segments, they share a lot of the same characteristics, and they fit a consistent theme, as you'll see with regards to the Masco portfolio. First of all, both of the segments contain really what we consider leading brands and really focused on innovation. Second, all of the brands, for the most part, are focused on the R&R industry. About 88% of Masco sales from a total company perspective are in the R&R part of the industry, with about 12% being in new housing. And I'll talk a bit more about that in a moment.

Another common thread of our portfolio is really low ticket items. So, we think about Plumbing Products, faucets, showerheads, as well as paint products. Low ticket items, which are really designed for the R&R industry and are really less cyclical. Yes, we are exposed to housing, but on a much more muted basis. And again, very focused on customer service. And you'll see the channel mix that we participate in here in a moment.

I'm going to get into a bit more detail on each of the segments here. So starting with Plumbing Products. The overall size of our Plumbing Products segment was approximately \$5 billion, just under \$5 billion in 2023 and generated 18% operating profit margins. So, a really strong performance.

In terms of the composition of the segment, we have a number of businesses and brands, but there are really three businesses I'd like to highlight for you. Two are really in the core plumbing space and that is Delta Faucet Company and Hansgrohe. We think are both significant leaders in their respective geographies.

Delta here in North America, which owns a few brands, but to name of the key brands, Delta, its namesake brand, Brizo and Peerless. And is really one of the three largest, if not the largest, Plumbing Products company here in North America, in the US market, specifically. And we have Hansgrohe, which is a German-based company which is truly our global footprint in the Plumbing Products segment. Hansgrohe owns the Hansgrohe brand as well as AXOR, which is a premium shower and faucet brand. But it's worth noting that within the Hansgrohe family, [ph] that it operates (00:05:55) – it has operations or sales centers in 50 countries around the world and sells products in even more – in about 150 countries around the world. So a really great complement to the North America business that we have in Delta, and has been an important growth engine for Masco overall.

The third business I want to highlight is our wellness business, which is our seller of hot tubs and recently added to the portfolio saunas. And that's our Watkins Wellness business. You may recognize some of the brands Hot Springs, Caldera hot tubs. It's really a global leader in terms of the manufacturer of hot tubs. And I mentioned we added saunas to the portfolio recently. In Q3 of 2023, Watkins and Masco acquired Sauna360, which is a Finnish sauna company, which is a real good complement to the Watkins business that sells through a dealer network here in North America, but also has sales internationally as well.

In terms of the composition of sales, you can see here on the right-hand side a breakdown of our sales in the Plumbing Products segment that is about 82% in terms of R&R. So, not inconsistent with the 88% I mentioned before in terms of the consolidated Masco performance, and 18% in terms of new home construction. In terms of our channel mix, you can see that 53% which is over half, is through the wholesale or trade channel, 19% is retail, the 11% of specialty dealer. That's really the channel that our hot tubs are sold through. And then 17% e-commerce, which continues to inch its way up in terms of proportion of sales of our products.

So, turning to our second segment, the Decorative Architectural Products segment. In 2023, we generated over \$3 billion of sales and a very similar operating profit margin of 17.8%. So again, another strong contributor in terms of profit and profit margin. In terms of the composition of Decorative Architectural Products, there's really three businesses; Behr, which is a coatings or paint business which hopefully everyone is familiar with. I'll come back to them in a minute. There's a hardware, a building hardware product company called Liberty Hardware, which is kind of knobs and pulls really for kitchen, bath and other applications. They also sell shower doors. And then third is a lighting business, Kichler.

But Behr is really the lion's share of this segment in terms of the business. And it's important to note that Behr has a really strong symbiotic relationship with the Home Depot. So in terms of the Behr brand, specifically, we sell that really exclusively through the Home Depot. And it's been a partnership that goes back more than 40 years. And really is a complement – it's truly a partnership between the Home Depot and Behr.

And while traditionally Behr has been a very strong, really a preeminent DIY or Do-It-Yourself paint brand, over the last 10 years or so, we've really established a foothold with regards to the Pro segment of the business. And really over the last 10 years have built the business to a sales level in the Pro portion customer base of about \$900 million. And that's an area of focus for us going forward. We anticipate that to grow more significantly than DIY, and that's been something that we and the Home Depot have teamed up with, with regards to initiatives, whether it's additional sales or product experts on the store floor or delivery options where you can order online, take delivery at the store or even jobsite delivery. So, continue initiatives like that to really drive that business going forward.

In terms of the composition of sales, you can see off to the right that given the focus with regard – and the partnership with the Home Depot, heavy concentration with regards to the R&R business. So, 97% in this particular case and really focused on the retail distribution channel.

As I mentioned in my opening remarks, there's really three areas of focus and competitive advantage for Masco; brands, product innovation and service. And this page speaks to really the second of the three, the product innovation. You can see off on the right-hand side, really a sample set of some of the products innovation that we, in terms of Masco, the portfolio of companies have brought to market. But one of the things that we really measure is, is our vitality. Because we think it's very important to bring new products, whether it's new technology, new functionality, or just simply new design and new products in general to the market to keep the freshness in the showroom, to really drive interest from with our channel partners, and then, of course, ultimately with our end customers.

And so one of the ways we measure that is through a vitality index. And how we – how to interpret that is, the 25% target that we've really been focused on is that in any given year, 25% of our sales are generated by new products that have been introduced to the market. Again, even new designs in the last three years. And again, we think that's very important in terms of driving customer interest and traffic through the showrooms and the show floors.

In terms of our distribution, we really look to cover the broad end of the spectrum, just not only in terms of our channel go-to-market, you can see it through trade, retail, e-commerce, but also in terms of our product offering. And we think about it in a good, better, best framework. I'll take Delta as an example of that.

So, Delta has a few brands, but as I mentioned before, has Peerless, Delta and Brizo. And they all play an important part of the ecosystem. Peerless plays more on the economic or cost conscious customer, so on the lower end of the market. Delta plays more in the more of the mainstream, the better part of the segment. And then Brizo is our premium or luxury brand within Delta. And so what that allows us to do is it covers the broad spectrum in terms of price points but doesn't – but allows each of the brands to play within a specific area without stretching them too far. So, they represent a certain value proposition to the customer.

In terms of our sales mix, and this is on a total Masco basis, about 80% of our sales are here in North America with about 20% in international markets. And that's mostly the Hansgrohe business, and that is predominantly in Europe and China.

In terms of our channel mix, you can see here, I would really combine wholesale and specialty dealer. It is about 45% of our sales mix in terms of distribution, about 45% of it is retail and just over 10% is e-commerce. And in terms of our end customers, you can think of it as roughly 50/50 in terms of DIY and Pro. But Pro is, as you can see is a little bit greater than 50% of our end customer sales. And that continues to be a growing opportunity for us here at Masco.

So I'm going to talk – I'm going to spend a couple of minutes talking about the fundamentals of the R&R industry, which we believe are – have been historically and will be in the future, very attractive and really complementary to what – Masco's portfolio will fit very well within that.

So in terms of the R&R industry, historically it has grown at about 1% to 2% above GDP. So think of that as 3%, 4%. And I'm talking about the US market now specifically. Now, we've seen some volatility in the recent number of years really with the pandemic and the pull forward of R&R activity really into 2020, 2021. And we saw the implications of that pull forward really in late 2022 and here most recently in 2023 where the industry was down and Masco in turn was down from a sales perspective. And we're continuing to see softness in the market here early in 2024. We guided to sales being down in the first half of the year, on a year-over-year basis. And we're seeing that really year-to-date. We're seeing sales down.

With regards to our margin expectations, our margins are expected to be flat in the first half of the year on a year-over-year basis. So everything is going to be at a really at a lower level. That said, we're expecting, as the interest rate environment improves and consumer confidence continues to be resilient, that we'll see an improvement in activity in the R&R industry in the second half of the year. Obviously, we don't know exactly when that inflection point will occur, but ultimately in 2025 and beyond, we're anticipating that the R&R industry returns to more, "normalized" growth levels that is above GDP. And part of the reasons for that are really the fundamentals of the business – I'm sorry, fundamentals of the industry.

First is home price appreciation. So, as we all know, home prices – home appreciation has been significant over the last number of years. And while, although it has plateaued more recently, it's at higher levels overall. And why that's important is because when there's equity in the home, homeowners feel more confident in terms of investing in their home. So doing that remodeling project, so that's a real contributor to long-term fundamentals.

Second is, at least in the US, the housing age – age of the housing stock on average is about 40 years. And importantly, about 1.7 million homes will be added to the – what was often referred to as a prime remodeling

window of 20 to 40 years of age. And 1.7 million homes will be entering that window over the next three years. And why that's important is because we've seen that the housing – the houses in that that kind of window of age, spend about 15% to 20% more on remodeling. So, a really healthy tailwind.

In terms of homeownership and household formations, the millennial population, we've seen has followed a more trade – has started to follow a traditional path in terms of housing formation – household formation and house ownership. Perhaps at a bit of a lag, but with that size of cohort coming through the system, it's another tailwind to the industry. And overall, consumer confidence is a big driver. And we've seen kind of really through the last number of years the consumer really – confidence really be resilient.

So speaking to Masco specifically, in terms of our growth expectations, we're expecting growth to be above the industry levels. And we've proven that in the past and we expect to perform above industry levels going forward, and that is in each of our markets that we participate both here in North America as well as internationally. And so therefore our growth expectations are in the range of 3% to 5% organically. We complement that with inorganic or acquisition growth, really targeting in the 1% to 3% range. And that'll depend on any given year depending on the M&A activity.

A good example or illustration of this is the Sauna360 acquisition that I referenced previously that we acquired in Q3 of 2023. A really, really a bolt-on to our Watkins Wellness business. And that's really our focus in terms of our acquisition strategy is bolt-on acquisitions that are strategic fit with our existing plumbing, paint and wellness business. And Sauna360 is expected to add about 1% of sales increase on a year-over-year basis here in 2024. So, a good illustration of the type of activity that we focus on at Masco.

In addition to the growth profile, top line growth profile is our margin. And we're focused on healthy margins but also expanding our margins, and are really focused on a few data points. In 2022, 15.6% operating margins. In 2023, we increased that to 16.8% operating margins. We've guided to 17% operating margins here in 2024 and have set a long-term target in 2026 to achieve 18.5% operating profit margins.

And that's really driven by three elements. One is a pivot to growth back in the industry. And we at Masco generate about 25% to 30% drop-down margins on incremental sales. So, that's obviously accretive to our margins today. Second is pricing discipline and opportunistic pricing. And third is operational efficiencies really productivity, automation and cost reductions in terms of driving margin expansion.

Complementing our operating profit performance and margin expansion is really our share buyback activity. I'll talk about capital allocation in a bit more detail in a moment. But our share buyback program is really programmatic, and we expect to add about 2-plus-percent in terms of EPS growth. So when you look at our operating profit growth as well as our share buyback program, we expect and we have delivered double-digit EPS growth really through cycles and that's illustrated in the performance that Masco has demonstrated over the 2019 to 2023 period where Masco delivered 14% compounded annual growth rate in terms of EPS.

So, with regards to the capital allocation strategy here at Masco, there's really four pillars to that. First and foremost is reinvesting in the business. And what we mean by that is investing about 2% to 2.5% of our net sales into capital expenditures. In 2024, we've guided that we would spend about \$200 million or about 2.5% of sales into capital and in terms of our business. Second is maintaining an investment grade balance sheet and credit rating. We currently have a solid investment grade credit rating at all three agencies, BBB or BBB equivalent, and that's underpinned by the health of the business and the health of our balance sheet. From a leverage perspective, we target debt to EBITDA of 2.5 or less at the end of 2023, we were at 2.0. So within that range.

Third is maintaining a relevant dividend. We target a 30% payout ratio. You can see what our current dividend is in 2024. It's about a 1% to 2% yield and we've been able to increase our dividend for 11 years in a row. And fourth, really importantly is after reinvesting in the business, ensuring a strong investment grade credit rating and satisfying our dividend, we deploy all excess cash to shareholders through share buybacks or through acquisitions. So clearly, we don't know necessarily the acquisition activity going into any given year, but any cash flow that doesn't use towards acquisition, we give back to shareholders. And we do that in a very disciplined programmatic way. In 2024, we've guided that we would have approximately \$600 million that we would deploy to either acquisitions or share buybacks in this calendar year.

So in summary, just to highlight some of the key takeaways. First is Masco is focused on three areas that we believe are competitive advantages and that's the brands – our brands, product innovation and service. Second is, there are really attractive fundamentals of the business. Yes, there's been volatility as of late, but we believe in the next period of time, as the industry reverts back to its normal growth pattern, we'll see healthy levels of growth in the industry and Masco is really well-positioned to take advantage of that growth and expand margins, as I articulated. And third is our disciplined and consistent capital allocation strategy, where we reinvest in the business, make sure we've got a healthy balance sheet and investment grade credit rating, and really deploy cash to shareholders through dividends and share buybacks to really focus on driving shareholder value.

So with that, Sam, I'll turn it back over to you, to see if we have any remaining time for questions.

QUESTION AND ANSWER SECTION

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Q

Questions for Rick? I'll start with a couple here. So you've mentioned 2.5 turns debt leverage, 1.5 to 2 roughly right now. Why is that the optimal capital structure? You mentioned that you have a low ticket orientation, which suggests that you're a low beta type of business. Might that argue for a higher leverage or what informs the decision to be 2 turns levered?

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

A

Well, again, our objective is to be less than 2.5 times. But really that's in form Sam, by discussions with the agencies and in our overall health of our balance sheet. So for us, it's important for us to remain investment grade, to be able to continue to invest in the business, and really deploy capital to shareholders beyond that. But we think that's a really appropriate place to be in terms of making sure we manage through the cycles.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Q

You mentioned that the year has started off a little soft, could you go through each of your businesses where you're seeing pockets of strength and notable weakness, if you could?

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

A

Sure. And we don't break down too much in terms of detail by business. But I would say that overall, what we've seen is pretty consistent kind of softness. And what I mean by that, just to put into context, is low-single digits on

a year-over-year basis in terms of sales. And we don't break down kind of by month. But year-to-date, we've seen consistency with our guide.

What I would say is from a North America perspective, it's been consistent with that. Europe and China continue to be a bit tenuous with regards to how that will play out. And we do anticipate that turnaround really in those markets are likely to take a bit longer than in North America. And then our coatings business, we've seen similar softness, particularly in the DIY space. But again, I would say it's pretty consistent across the board in that low-single digit varies a little bit by segment.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Questions here in the room? Yeah, please.

Q

Q

[indiscernible] (00:26:35-00:26:45)

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

Sure.

A

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Repeat the question.

Q

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

Oh, sure. So, the question in the room was, in terms of the 3% to 5% growth expectations, how much of that is price versus volume? In the face of deflation, how do we think about the pricing environment? Did I get that? Perfect.

A

So with regards to the 3% to 5%, the majority of that is volume. So, we do expect on a go-forward basis, really low-single digit pricing in the Plumbing segment and really fairly neutral pricing with regards toward Decorative Architectural Products, specifically in the coatings space. And really from a – so, that's hopefully answer to your first question.

In terms of the deflationary environment, we've seen commodity specifically really plateau. So, we don't expect any – we're not forecasting any significant change in commodities in the near-term, but nobody can predict the markets. But in that environment, we would expect again to see relatively modest, low-single digit pricing appreciation in the Plumbing part of the business. And on the -- on the Decorative Architectural Products, which is mostly Behr Paint, we have an agreement with the Home Depot, which is we basically align price and cost. And so, we'll flex up or flex down with regards to the overall cost structure from a pricing perspective as it pertains to Behr specifically.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Q

Other questions. You mentioned China earlier. In the case we get renewed tariff attention, remind the group what your finished goods and component exposure is from China if you could?

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

A

Yeah. Obviously a relevant topic. What I would say is, we have about just under a third of our direct input costs are sourced out of China. And that's from a global perspective. We have been focused on moderating that over time, that has come down over the last couple of years. We've got some really good suppliers that are based in China and we've been focused on diversifying our footprint to Vietnam and to some other markets around the world. But that's a gradual change – a gradual transition. And we'll monitor it very closely going forward.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

Q

Do you think you're overindexed, underindexed or similar as the primary competitors?

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

A

Tough to say, Sam, specifically. We don't have that data. But I don't think we're uniquely positioned relative to the competitors.

Q

Any other final questions here before we move to breakout? Yes, please.

Q

[indiscernible] (00:29:37)

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

A

Sure.

Q

[indiscernible] (00:29:38-00:29:51)

Richard Westenberg

Chief Financial Officer & Vice President, Masco Corp.

A

Yeah. So the question is, some context with regards to the size of the bolt-on acquisitions and also how does Sauna360 fit in terms of the kind of the low ticket profile?

So in terms of, as I illustrated before, Sauna360 really fits the profile of our acquisition strategy, which is bolt-on acquisition. So it represents about 1% of our sales. So, it fits within that and strategically fits as a bolt-on to our Watkins Wellness.

Admittedly, the Watkins Wellness business in terms of hot tubs and saunas is a bit of a higher price point, but we feel is a really important complement to our business and really represents significant growth potential because of the secular trend towards wellness.

Sam Darkatsh

Analyst, Raymond James & Associates, Inc.

And with that, we'll continue this in the breakout. Thank you.

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