27-Jul-2023

Masco Corp. (MAS)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Welcome to Masco Corporation's Second Quarter 2023 Conference Call. My name is Michelle, and I will be your operator for today's call. As a reminder, today's conference is being recorded for replay purposes. [Operator Instructions]

I will now turn the call over to Renee Benedict, Director, Investor Relations and FP&A. You may begin.

Renee Benedict

Director-Financial Planning, Analysis & Investor Relations, Masco Corp.

Thank you, Michelle, and good morning. Welcome to Masco Corporation's 2023 Second Quarter Conference Call. With me today are Keith Allman, President and CEO of Masco; and David Chaika, Masco's Interim Chief Financial Officer.

Our second quarter earnings release and the presentation slides are available on our website under Investor Relations. Following our remarks, we will open the call for analyst questions. Please limit yourself to one question with one follow-up. If we can't take your question now, please call me directly at (313) 792-5500.

Our statements today will include our views about our future performance, which constitute forward-looking statements. These statements are subject to risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements. We've described these risks and uncertainties in our risk factors and other disclosures in our Form 10-K and our Form 10-Q that we filed with the Securities and Exchange Commission.

Our statements will also include non-GAAP financial metrics. Our references to operating profit and earnings per share will be as adjusted, unless otherwise noted. We reconcile these adjusted metrics to GAAP in our earnings release and presentation slides, which are available on our website under Investor Relations.

With that, I'll now turn the call over to Keith.

Keith J. Allman

President, Chief Executive Officer & Director, Masco Corp.

Thank you, Renee. Good morning, everyone, and thank you for joining us today. Please turn to slide 5. I'm pleased with our performance in the first half of the year. We have demonstrated the resiliency of our business and our ability to mitigate the impacts of volatile market conditions, while maintaining our focus on growth, productivity and shareholder returns.

In the second quarter, our top line decreased 10% against a strong 8% comp. Volume was down 12%, partially offset by pricing actions of 4%. While sales were down $225 million, our operating profit only declined $10 million due to strong cost recovery and improved operational efficiencies.

This solid execution resulted in operating profit margin expansion of 140 basis points and a decremental margin of only 4%. In addition, our earnings per share for the quarter grew 3% to $1.19. I'd like to thank our employees for their dedication and continued efforts to execute on our strategic initiatives and deliver strong results.

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Turning to our segments, Plumbing sales declined 10% in local currency, with North American and international plumbing declining 12% and 8%, respectively. In North American plumbing, demand trends continued to be soft across channels and product categories.

In international plumbing, as expected, the slowing demand we began to see in Europe and China in the first quarter continued into the second quarter. We continue to expect our international plumbing market to be down high single digits for the full year.

Despite the top line decline, our plumbing margin expanded 270 basis points to 20% in the second quarter. This strong margin performance was driven by pricing actions taken to recover the significant inflation we have experienced as well as improvements in operational efficiencies, particularly in our North American Plumbing business. We are focused on driving our operating profit margins back to at least the 2019 level of 18% over time, and I'm pleased with the progress we are making in the Plumbing segment.

We also executed on our bolt-on acquisition strategy by entering into an agreement to acquire Sauna360, a leader in the sauna, steam and infrared wellness industry. This acquisition complements our spa business, expands our wellness product offerings, and leverages Watkins' expansive dealer network. We expect this transaction to close in the third quarter.

Lastly in Plumbing, we are pleased that Delta Faucet was named showroom Partner of the Year by one of our large plumbing wholesale customers, demonstrating the value we provide to our customers and our strength in the wholesale plumbing channel.

Turning to our Decorative Architectural segment, sales declined 8% in the quarter against a strong 15% comp. PRO paint declined mid-single digits against a robust comp of approximately 40% in the second quarter of 2022. DIY paint sales declined low single digits against a strong low teens comp.

During the first half of the year, we secured additional shelf space in adjacent product categories, launched new products, and invested in our PRO paint business. This demonstrates the strength of our BEHR brand, quality of our products, and our commitment to exceptional service performance. Our over 40-year relationship with our paint partner, The Home Depot, is extremely strong and we believe we have a significant opportunity to continue to grow share together in the PRO paint market.

We're also excited to announce that we will begin distributing product from our new paint distribution and manufacturing facility, located in Central Ohio, in early September, and we expect to begin producing paint in the new facility in the first quarter of next year. This new facility enables our paint business to continue to provide the superior levels of service expected of us and the capacity to accommodate the growth we expect in this business.

Turning to capital allocation, we continued to generate strong free cash flow during the quarter and maintained a solid balance sheet. As a result, we executed on our balanced capital deployment strategy and returned $89 million to shareholders through dividends and share repurchases, including buying back 500,000 shares for $25 million in the quarter. With the pending acquisition of Sauna360 for approximately €125 million, our share repurchases for the year will be approximately $350 million.

Now, turning to our outlook for the remainder of 2023, as a result of our strong execution during the first half of the year, we now anticipate earnings per share for 2023 to be in the range of $3.50 to $3.65 per share, up from our previous guidance of $3.10 to $3.40.

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In this uncertain environment, we remain focused on closely managing costs, minimizing the impact of lower volumes, and driving our margins back to 2019 levels. We will continue to invest in our brands, capabilities and people to outperform the competition and deliver returns for investors, both in the near and long term.

We believe we're well positioned to weather the challenging near-term demand environment and have strong long-term fundamentals in our repair and remodel markets. Structural factors, such as high home equity levels, the age of housing stock, and a homeowner staying in their homes longer will drive increased repair and remodel activity in several ways.

Home equity levels, which are highly correlated to repair and remodeling, remain at record levels due to rapid home price appreciation and can withstand significant pullbacks in home prices and still be above 2019 levels. Also, 1.8 million more single-family homes will reach the prime remodeling ages of 20 to 39 years old through 2027. Households with homes in this prime remodeling age tend to have above-average income and home values, which supports the likelihood of investing in remodeling projects.

In addition, many homeowners have taken advantage of low mortgage rates and are likely to remain in their homes longer. And with record levels of equity, these homeowners are more willing to take on large remodeling projects to update their homes.

All of these structural forces provide tailwinds for our business and increase our confidence for a strong repair and remodel market after 2023 when the economy stabilizes. With favorable fundamentals for our portfolio and continued successful execution of our growth strategy, along with our strong free cash flow and disciplined capital deployment, we are well positioned to drive shareholder value creation for the long term.

Before I turn the call over to Dave, I want to update you on our CFO search. As I mentioned last quarter, we have strong internal candidates, and our search firm has delivered strong external candidates as well. We are in the final stages of the selection process and anticipate naming our CFO, shortly.

Now, I'll turn the call over to Dave to go over our second quarter results and 2023 outlook in more detail. Dave?

David A. Chaika

Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

Thank you, Keith, and good morning, everyone. As Renee mentioned, my comments today will focus on adjusted performance, excluding the impact of rationalization and other onetime items.

Turning to slide 7, sales in the quarter decreased 10% and, excluding currency, decreased 9%. Lower volumes decreased sales by 12%, partially offset by net selling price increases of 4%. North American sales decreased 10% and, in local currency, international sales decreased 8%.

Despite the sales decline, we executed well in the quarter, and our focus on operational efficiency helped drive gross margin expansion of 320 basis points to 36.2%. Our SG&A as a percent of sales was 17.2%. Operating profit in the second quarter was $404 million, down only $10 million year-over-year, and operating margin expanded 140 basis points to 19%. Operating profit was impacted by lower volumes, mostly offset by higher net selling prices. Lastly, our EPS in the quarter increased 3% to $1.19 per share.

Turning to slide 8, Plumbing sales in the quarter decreased 11% and, excluding currency, decreased 10%. Lower volume and mix decreased sales by 15%, partially offset by net selling prices, which increased sales by 4%.

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North American plumbing sales decreased 12% in local currency. Our wholesale plumbing channel performed well in the quarter, offset by softness in retail and spas. Our spa business declined over 20% against a strong 35% comp.

International plumbing sales decreased 8% in local currency against an 11% comp as demand continued to soften in many European markets and China. We also began to see a small negative mix impact in international plumbing, which we expect will increase in the second half of the year as the international markets will likely slow further.

Segment operating profit in the second quarter was $245 million, up $7 million year-over-year, and operating margin expanded 270 basis points to 20%. Operating profit improvement was driven by net selling price increases and continued improved operational efficiencies, partially offset by lower volumes.

Turning to slide 9, Decorative Architectural sales decreased 8% for the second quarter against a strong 15% comp. Paint sales declined mid-single digits, with PRO paint sales decreasing mid-single digits against a robust comp of approximately 40% in the second quarter of 2022. On a 2-year stacked basis, our PRO paint comp is up over 30%, demonstrating the significant share we have gained over the past 2 years.

Operating profit was $180 million, and operating margin was 20%. Operating profit was impacted by lower volumes, higher input cost and growth investments, partially offset by higher net selling prices. We've now anniversaried most selling price increases, so price increases will have little impact on the second half of 2023 for this segment.

With respect to input costs for paint, we experienced raw material inflation in the first half of the year, and our overall cost basket remains elevated. We are starting to see relief in certain paint input cost and expect modest low single-digit deflation in the second half of the year on these raw materials. For the full year, we continue to anticipate low single-digit inflation for our paint raw material basket.

Turning to slide 10, our balance sheet remains strong with net debt-to-EBITDA at 1.8 times at quarter end. We ended the quarter with approximately $1.4 billion of balance sheet liquidity. Working capital as a percent of sales was 18.9%, which matched prior year, though net working capital days improved by 9 days. With expected lower volumes and fewer supply chain disruptions this year, we anticipate working capital as a percent of sales to continue to improve and be approximately 16.5% at year-end compared to 17.4% in 2022.

During the second quarter, we repurchased approximately 500,000 shares for $25 million. We continue to execute on our disciplined capital allocation strategy and anticipate deploying approximately $500 million to share repurchases and acquisitions for the full year. With the pending acquisition of Sauna360 for approximately €125 million, we expect to deploy up to $350 million for share repurchases for the full year.

Now, let's turn to slide 11 for our updated outlook for the year. For Masco overall, our top line is developing largely as expected, and we still expect sales to decline approximately 10%. However, with our strong first half execution and margin performance, we now expect full year margins to be approximately 16%, increased from our previous guide of approximately 15%.

In our Plumbing segment, we expect 2023 sales to be down in the range of 10% to 12%, narrowed from our previous expectation of down 10% to 14%. We now anticipate that full-year Plumbing margins will be approximately 17%, increased from our previous guide of approximately 16%.

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In our Decorative Architectural segment, we expect 2023 sales to be down in the range of 8% to 10%, narrowed from our previous range of down 5% to 10%. We anticipate the full-year Decorative Architectural margin to be approximately 17%, increased from our previous guidance of approximately 16%.

Finally, as Keith mentioned earlier, thanks to our strong execution, our 2023 EPS estimate is now $3.50 to $3.65 per share, up from our previous guide of $3.10 to $3.40. This assumes a 226 million average diluted share count for the year and a 24% effective tax rate. Additional modeling assumptions for 2023 can be found on slide 14 of our earnings deck.

With that, I'd like to open the call for Q&A. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions] The first question comes from John Lovallo of UBS. Please go ahead.

John Lovallo
Analyst, UBS Securities LLC

Q

Good morning, guys. Thank you for taking my question. The first one here is, it looks like the improved 2023 outlook is really driven by the outperformance in the second quarter with the second half expectation seemingly unchanged. This seems a little bit conservative, given the magnitude of the beat in the second quarter. I know you called out, Keith, that maybe some incremental softening in Europe. But just curious, more broadly, what you're seeing that kind of keeps you a little bit more on the conservative side?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Well, clearly, John, volume is the main driver, and we're seeing a consistent performance in North America, if you will, in terms of against our expectations. We did expect to see somewhat of an increase, if you will, in the slowdown in Europe, and we did see that. So while our first quarter in Europe, I think it was down 3% – we expected that to accelerate as we saw that Europe was lagging a little bit in demand, and that has come to fruition.

So when we think about our overall guidance, I'd divide it into a couple pieces. One, in terms of the overall top line, as expected, it's coming in as we anticipated; so no real change there. I would tell you that our performance and our execution was stronger than expected. And so, we had better margin performance coming through in the first half. And so, that, I would say, John, are the components of it. We kind of – as expected on the top line, and a little bit better than expected in terms of our performance.

[indiscernible] (00:20:30)

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Hey, John, I would just add to that, that similarly, we do expect continued pressure on volumes in the back half of the year that will weigh on margins as well as additional growth investments. We also had very strong price/cost realization in the first half that will – as we lap most of our price increases, will diminish in the second half. So that's why our second half looks a little more conservative compared to what we put up in the first half.

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John Lovallo
Analyst, UBS Securities LLC

Q

Understood. And that's a good segue into my second question. Maybe – it sounds like you are anniversarying most of the price increases. How are you thinking about incremental pricing opportunities across segments as we move into the back half?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Well, that obviously depends on where commodities go. And I think we've demonstrated across our business the ability to get price, thanks to our strong brands, our innovation pipelines, how we service our channels and the value we bring to the consumer. So it really depends on where the costs go.

I think when we look at where we've gotten our price, we've gotten this year – I think over the last couple years, we've gotten in the range of 12% pricing; so pretty significant, obviously, price over the last couple years. This year, already, we've gotten some in spots; and certain categories in Plumbing where we had to catch up, we've gotten some additional pricing. We've demonstrated price/cost neutrality in Decorative over time, and we expect that to continue. But really, in terms of the outlook for pricing as we go forward, will depend on where commodities go.

John Lovallo
Analyst, UBS Securities LLC

Q

Thank you, guys.

Operator: Thank you. The next question comes from Michael Rebard (sic) [Rehaut] (00:22:18) of JPMorgan. Please go ahead.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Thanks. Good morning, everyone. Maybe just to circle back to the prior question, perhaps to try and get a finer point on it, in terms of the guidance and what looks like effectively a reiteration of the back half outlook, in the second quarter and, I think, for the year overall, the top line doesn't look like it – the top line outlook doesn't look like it's changed that much. You did have great margin performance in the second quarter, though. And it looks like, effectively, you're not necessarily expecting that better-than-expected margin performance to continue into the back half.

So I'm just trying to understand, number one, if that's correct. And number two, specifically on the margin side – and I understand your outlook on the top line remains relatively unchanged, but what perhaps is different about what you were able to achieve in the second quarter, given that the sales more or less came in line with expectations, that might not follow through fully into the back half in terms of the better-than-expected margin performance?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

I'd point to three things, Mike. Firstly, as Dave mentioned in the last question, we do expect to continue to have top line volume pressures as we go forward. As expected, Europe has softened and we continue to see the steady, if you will, softness in North America. So, volume is the biggest driver of it.

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Secondly, we enjoyed year-over-year pricing benefit in the first half, and that will fairly quickly go away as we get into the second half and lap the biggest chunks of the price increases that we came – that we put in, in 2022. So, that lapping of the price is a big factor.

And then, thirdly, as we've consistently talked about, we're going to continue to invest in our business. Now, we're making and watching our spend very carefully, but we're committed to investing to win in the recovery and to continue to gain share when we have some of these challenging top line areas, so investing in our Plumbing business and making sure that we have our capacity in the right spot with regards to our European plant that's coming online; and investing in our Decorative Architectural business with regards to continuing to build capabilities and to continue to drive above-market growth in PRO paint; getting our capacity right with our new facility in Central Ohio. And as I said, we're starting to distribute out of that. And shortly, we'll be manufacturing liquids and paint out of that building.

So, we're continuing to invest in our business, and that's some incremental headwinds as we look forward. So, those are the three main drivers with, for sure, volume being the main one.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.
A

Hey, Mike, it's Dave. I'd just add to that, we also are bringing online our European Plumbing manufacturing plant. That will be a little bit of headwind here in the second half as well. And then, also, as we've mentioned in the prepared remarks, the negative mix impact we're seeing in international is probably a little greater than we originally viewed coming into the year, which accounts for, again, the second half being a little bit softer.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

Okay. No, no, that's helpful. I appreciate that extra color, I guess, there. Secondly, maybe just to shift to the paint segment, the performance in PRO, in particular, is impressive given the strength of the year-ago comp. And I was hoping maybe to kind of maybe take a step back and give an overview in terms of where you are.

I think you've kind of noted that following the move last year, the PRO paint business is around $900 million, I think, in 2022; maybe it's a little bit less this year. But just where you think the opportunities are going forward for that business? And if you could remind us if that's a similar margin business as DIY or maybe a little bit above, and how you see the relative growth opportunity there?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.
A

Michael, I think the opportunity is to continue to drive full loyalty. That's a loyal group. And over the past three years, we have gained significant confidence and, of course, significant share when you look at our growth versus the market.

So, we very closely monitor customer experience with our product. And it's clear when we look at Net Promoter Scores and other metrics that they're very satisfied with the switch that they have made to either greater share of wallet or trying BEHR for the first time.

So, it's really about continuing to stay focused, as we have, frankly, for the last decade, on improving month-over-month, quarter-over-quarter, our capabilities in the service and generating greater loyalty. So, things like buy

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online and pick up in store, an expansion of our delivery options, our PRO outside sales force, continuing to figure out ways that we can work more closely together with the folks at The Home Depot to drive better loyalty, enhancing our actual loyalty programs; so, things of that nature.

Our capacity is also a component of that as we saw. When we're able to provide outstanding delivery in spite of what happens in the supply chain, that's a big plus for us. And so, that's part and parcel of the rationale for our new plant in Ohio. So enhancing our services, identifying new capabilities, focused on the PRO, strengthening our relationship every day with The Home Depot, that's really the story.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.
A

And Mike, on the margin front, it is a little bit lower margin than our core business because we do have additional resources behind it, mainly additional people and PRO sales reps, both outside the store and inside the store, to provide the level of service that the PRO painter demands, as well as additional loyalty programs that Keith mentioned. So it is a little bit of a lower-margin business, but still very good margin. And as we continue to grow that, we'd expect that gap to close.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

Great. Thank you.

Operator: Thank you. The next question comes from Stephen Kim, Evercore. Please go ahead.

Stephen Kim
Analyst, Evercore ISI
Q

Yes. Thanks very much, guys. Sorry, about that. Thanks very much, guys. Yes, wondering if I follow-up here a little bit on the price/cost commentary. It sounds like you saw some benefit this quarter in terms of price/cost. I'm curious as to whether or not you're including an improving outlook for price/cost in your margins forecast for Plumbing. And in general, are you still expecting to see a return to market growth in late 2023? If you could just sort of update on us on your market outlook, particularly as it relates to Plumbing.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.
A

I'll take that last part first, Stephen. We're not going to be offering up, at this point, our view on 2024. But we do believe that this is a relatively short-term dip and that this recovery will happen more sooner than later, but we're not going to get into specifics of 2023 at this point.

In terms of your question on price/cost benefit, are you really asking a question regarding our view on commodities?

Stephen Kim
Analyst, Evercore ISI
Q

Really more like just the net of price and cost in the Plumbing segment. I think you already talked about the – anniversarying pricing in Dec Arc. But within Plumbing, I'm curious, broadly for the segment, is your outlook for margins in the back half in Plumbing informed by an improving view of net price/cost?

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Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

We're going to lap the majority of our prices in the back half of the year. So we have – certainly, have seen an improvement in the first half. And we'll be netting the – or lapping the majority of our price increases that we've given in – really coming here in the third quarter – soon in the third quarter. And then, we had another – a couple of incremental price increases late in the year. So we'll have a little bit of net impact, but that – the impact of price/cost is going to certainly be less in the second half.

Stephen Kim
Analyst, Evercore ISI

Q

Okay. That's helpful. And then, second question, still staying with Plumbing, you talked about mix effect. I think it was relegated to – your comments were relegated to international, at this point. My recollection is that last quarter, you actually also started to see a little bit of mix impact – negative mix effect in Plumbing. So, I'm curious if you could provide a little bit more detail around what you're seeing. Did it intensify – is it intensifying in international? Is it spreading, in any way, into North America as well? And is there any kind of margin impact that we should anticipate as a result from negative mix shift in Plumbing?

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Hey, Stephen, it's Dave. I'll take that one. On the negative mix in international, it's really a function of countries. Our core European markets, which tend to be higher price point products, are softening a little bit more than some of our international markets. So, we have more of a geographic mix impact. It might have a little bit of trade down that we're seeing in our core European markets, but for the most part, it's more of the geographic impact on the international side.

Here domestically, we're not seeing a lot of trade down. We have a little bit of mix impact in the segment from our spa business and really more of a function of us pulling back on our lower price point, more mass or retail-oriented products last year as we worked through our backlog.

But as we got through our backlog in the spa business, the turn back on that, the retail portion or opening price point of our spa business – so you've had a little bit of impact here in North America. But broadly speaking, we haven't seen a whole lot of trade down across our other product categories.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

I think with our reconfigured portfolio of lower-ticket products, I think that really helps to mitigate the large swings that you may see in bigger-ticket items.

Stephen Kim
Analyst, Evercore ISI

Q

Okay. Any margin impact from mix?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Yes, there will be a little bit, but not much.

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Stephen Kim
Analyst, Evercore ISI

Q

Okay, great. Thanks very much, guys.

Operator: Thank you. The next question comes from Matthew Bouley of Barclays. Please go ahead.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Hey, morning, guys. Thank you for taking the questions. Apologies if I missed it, but in Decorative, you had DIY only down low single digits in the quarter, so a little bit better than your full year guide previously, but then you still reduced the full year revenue guide for the segment. So, just maybe just speak a little about what sort of drove that DIY result in the quarter and what changed in your full year outlook in spite of that? Thank you.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Hey, Matt, it's Dave. In the DIY business, we did see continuing softening throughout the quarter. And I think we expect that to continue here in the back half of the year. When you look at existing home sales, that tends to have a higher correlation with DIY paint than many of our other product categories. And with the existing home turnover being down roughly 20%, we anticipate DIY in the back half of the year probably being a little softer than we originally anticipated.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

So, for the full year, that would put our DIY business expected to decrease in the high single-digits.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Okay. Understood. Thank you for that. And then, secondly, on that new paint facility, I guess just, one, are there any start-up costs associated with that as well into the second half of next year?

And just higher level on that, curious if you could speak to sort of what this does for Masco around service levels. Where did you see room for improvement? Could it lead to additional shelf space wins or PRO expansion? Just kind of any additional longer-term expectations that might arise out of that new paint facility. Thank you.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Hey, Matt, I'll take the cost side and maybe Keith can take the second part of that question. But on the cost side, there will be some start-up costs here in the back half of the year; probably a little bit in the first half, but mainly in the back half of this year as we really ramp up the distribution and the manufacturing capacity.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Matt, if you think about the success that we've had in our paint business, it really goes down to the relationship that we have with our channel partner, The Home Depot, and our ability to provide innovation and service to our customers and the consumers that purchase BEHR. And the basis of that is really focus and the fact that

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everything we do is focused on that Home Depot customer and on our supply chain around those outstanding Home Depot point of sale. And so, what this new facility does is it gives us the capacity to be able to maintain industry-leading delivery performance. It gives us the logistical costs and ties in very tightly to where our consumers want to buy, and it really hones in our ability to provide that ongoing service.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Great. Thanks, Keith. Thanks, Dave. Good luck guys.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Thank you.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Thanks.

Operator: Thank you. The next question comes from Susan Maklari of Goldman Sachs. Please go ahead.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning, everyone.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Morning, Sue.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

My first question is in Plumbing, you mentioned that you saw some strength in the wholesale side relative to some more weakness on retail there. Can you just give us a bit of color on how you're thinking about the inventory levels across the channels, and any commentary on sell-in versus sell-out as we think about the second half?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Yes, it's been pretty consistent, Sue. There's obviously various customers who have different inventory policies based on how they want to run their business. And we work very closely with them. So there are some idiosyncrasies based on different customers. But when we look broadly across the wholesale channel – really, across both wholesale and retail, but talking specifically to wholesale now, the sell-in has been very close to the sell-out. And so, we are not seeing and nor do we expect any significant changes in terms of an inventory headwind or tailwind or destocking or restocking. We think it's in pretty good shape, it being the inventory levels relative to the demand patterns we're seeing.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

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Okay. And then, on your raws, you mentioned that you are starting to see some relief on the Decorative Architectural side of things. Can you just talk about, across both Plumbing and Dec Arc, how you're thinking about the commodity costs and the input costs and how that may flow through over the next several quarters, and maybe even into the next year?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Sure. I think in terms of inflation, we would say that it peaked back in second quarter of 2022, and it's kind of moderated sequentially since then. We have not seen much deflation, at this point. Certainly, container costs have come down off their peaks, and that's helped our freight, but most other costs have remained, I would say, elevated.

In terms of specific commodities, we have seen some pullback, say, in copper at $3.85, currently. That's below, slightly, the 2022 average. Zinc has come down below the 2022 average, but that really only started last month. So we're not going to see that roll through our P&L and into our cost of goods sold, at this point, probably until into 2024. So when we think about all-in deflation in Plumbing, for example, we'd call it low single digits for the full year. And by all-in, I mean commodities as well as non-commodity costs, like freight, et cetera. So low-digit deflation for the full year.

In terms of Decorative, certain paint input costs have moderated sequentially, for example, resins. But others, like TiO2, for example, it's still sticky, staying at elevated levels. And we did have commodity inflation in the second quarter. So our guide does not have a lot of paint raw deflation built into it.

So, all-in for the Deco segment, we're thinking about low single-digit inflation for the full year and that's after we expect some low single-digit deflation in the second half. So, all-in for Masco, the enterprise, we're looking at inflation or deflation basically to be flat for the total company.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay, that's helpful. Thank you, and good luck with everything.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Thanks.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Thanks, Susan

Operator: Thank you. The next question comes from Mike Dahl of RBC Capital Markets. Please go ahead.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Morning. Thanks for taking my questions. Keith, on the Plumbing comment in terms of you're driving that business to get back to at least 2019 levels, which was a little above 18%, and I think for five, six years, you were traveling somewhere in the 18s, if not a little bit better, it seems like you've kind of gotten the work done on price/cost, more

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or less. Is it really just a question of when do the volumes come back as far as getting to that 18%? Or what other drivers do you think you can pull or need to pull to get back there or higher?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Well, Mike, as you know, we're always focused in driving total cost productivity, continuous improvement on a day-to-day basis, better negotiation with our suppliers. And we're driving our service proposition to continue to push profitable mix, as winning Showroom Supplier of the Year from a significant wholesaler shows that we're doing just that.

So, there's other levers to pull to continue to drive on a day-to-day basis margin enhancement, and we're doing that. But clearly, with our strong innovation and brands and the ability for us to price and get that drop down in, say, that 25%, 30%, the biggest lever is incremental volume.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Got it. Okay. And then, just sticking with Plumbing, can you give us a little more color on the new acquisition? It sounds European-based, but just a little more color on maybe geographies, products, relative size, or profitability?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Sure. I'll begin by saying that we believe in our wellness business. We believe in it because it has an outstanding team. It's a great brand – a great set of brands, and we have a inherent tailwind in North America, in particular here, but globally, as it relates to wellness and the mental and physical health aspects of living better and utilizing machines like we have and brands like we have to get that done. So, we like the space.

And this is a small bolt-on acquisition. It's consistent with our capital allocation and our acquisition strategy to have smaller bolt-ons in paint and plumbing where we can drive leverage, and this does just that.

It's a sauna company based in Finland. The cost of this was €125 million. The leverage that we intend to use not only is our operational capabilities and continuous improvement in our production system, but fundamentally, our dealer network for Watkins that we have in North America.

And we've demonstrated the ability to do this as we ventured into – frankly, when we went into a different brand originally with hot tubs, and then when we went into swim spas, and now into saunas. And so, this fits very nicely with our overall strategy and with the capabilities and improvements that we can bring to the business.

We paid less than Masco's multiple. It's small. It will add about 1% of growth overall; modestly accretive to EPS. It's a smaller bolt-on. It's not in our guidance, since we haven't closed, yet. We're going to fund it out of cash on hand, maybe a little bit of short-term borrowing. But we're excited about how this can leverage our dealer network, how it continues to keep us in the forefront with things to talk about and to sell and build our brands. And this team is going to handle it very well.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Great. Thanks, Keith.

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Operator: Thank you. The next question comes from Truman Patterson of Wolfe Research. Please go ahead.

Truman Patterson
Analyst, Wolfe Research LLC

Q

Hey, good morning, everyone. Thanks for taking my questions.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Good morning, Truman.

Truman Patterson
Analyst, Wolfe Research LLC

Q

Hey, good morning. When I look at your first half performance, right, revenue is kind of in line with your expectations, but margin was much better in each of your segments to start the year. I'm really just trying to understand what's been the driver of this op margin performance. Was it a little bit better pricing environment, some cost out initiatives or lower investments, you know, maybe some accelerated cost deflation, etcetera? Just what were kind of the big drivers of that?

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Hey, Truman. It's David. Yeah, I think you hit on three of the four. It was better price realization, better cost out, and really improving our operational efficiencies. The one that really wasn't as significant as we expected was deflation. As Keith mentioned, we have seen some deflation, but that really wasn't above what we expected, especially when you consider the length of our supply chains and visibility. You know, we sort of had a pretty good understanding of what the deflation impact might be in the second quarter. So it really came down to the productivity improvements and better price realization that drove the strong performance in 2Q.

Truman Patterson
Analyst, Wolfe Research LLC

Q

There's nothing one time in nature on those kind of internal productivity improvements, where they couldn't continue into the back half of the year, is there?

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

No, nothing really one time; you know, nice improvements. I would say there's probably a little bit of timing on expenses that probably got pushed out in the second half of the year as well. So I'm going to call that a one-time event, but it did contribute to the strong performance in 2Q.

Truman Patterson
Analyst, Wolfe Research LLC

Q

Okay. Got you. And then, you know, in certain categories we heard of – in the US, specifically, we heard of a little bit of demand improvement in the back part of the second quarter. Just trying to understand across any of your channels or product categories, if you all in the US saw any sort of kind of stability or improvement.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

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No. It was pretty consistent throughout the quarter.

Truman Patterson
Analyst, Wolfe Research LLC

Q

Okay. All right. Thank you, all.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Thanks, Truman.

Operator: Thank you. The next question comes from Joe Ahlersmeyer of Deutsche Bank. Please go ahead.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thanks. Good morning, everybody. Thanks for the question.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Hi, Joe.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.

Q

Just maybe a quick housekeeping item. Can you talk about your performance in lighting and hardware, either year-to-date or in each of the first couple quarters of the year?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

These businesses really have been impacted by the market softness, as all of our businesses have. I'd say that for Q2, they were down in that 20% range. We expect them – they've taken price. We're working on cost actions, as we are across the entire portfolio. I would say that – to expect these businesses to perform roughly in line with our low double-digit volume decline expectations of the R&R market.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.

Q

Understood. Thanks. And then, just thinking about the back half guide, I'm looking at your second quarter margins relative to a few years ago, 2019. They actually look very similar, gross margin, and then margins by the segments as well. Understand the volume impact to the second half, but could you maybe parse it out between what we might see the third quarter and the fourth quarter? Might we see normal margin seasonality, or is the fact that the third quarter is likely to be down more year-over-year, likely to hit those margins a little more than the fourth quarter?

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Hey, Joe, it's Dave. I think you're more likely to see the typical margin seasonality, stronger margins in Q3 compared to Q4; Q4 tends to be a lower margin quarter, in general, with the lower volume. I think in terms of

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year-over-year, we do expect year-over-year expansion; probably less – more modest year-over-year expansion here in 3Qs from what we saw clearly in 2Q. Then considering our comp in Q4 of 2022, probably a little bit more year-over-year expansion in Q4.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.

Q

So, expansion in both of those quarters at the consolidated level on operating margin?

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Correct.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks a lot.

Operator: Thank you. The next question comes from Philip Ng of Jefferies. Please go ahead.

Philip Ng
Analyst, Jefferies LLC

Q

Hey guys. Congrats on a really strong quarter.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Thanks, Phil.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Thank you, Phil.

Philip Ng
Analyst, Jefferies LLC

Q

For me, I guess, first question, on Plumbing North America, any color how the business performed, if you kind of flushed out the spa business, because I think you have some tougher comps and potentially some destock? When does that kind of level off? I believe, Keith, you called out some relative weakness in the home center versus the PRO channel. Can you give a little more color on what's driving the relative difference in the two channels?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Yes. If I said that, I misspoke. I would say, if anything, our PRO was a little bit stronger. I think that has to do with some project backlogs working through the system. But not – I wouldn't lean too heavily enter that; it's just maybe a slight better performance in PRO versus DIY. So, I want to clear that. Could you, Phil, ask me the second part of that question?

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Philip Ng
Analyst, Jefferies LLC

Q

The first part was really more on any color on how the North American Plumbing business performed ex the spa business, because I think that part was a little more challenging. It would be helpful to remind us when do those comparison headwinds kind of – do you guys lap that spa [indiscernible] (00:50:35)?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.

A

Still seeing – you know, in North America, we saw – really, earlier we saw the volume start to turn down; so volume and top line challenged in Europe. Europe was down only about 3% in Q1, and then started to accelerate, as expected.

So, we're – in both North America and Europe in Plumbing, we're experiencing volume challenges. I would say very solid execution. We're really driving good price/cost realization, getting our supply chain back in tune and providing the service levels and the productivity and cost efficiency. That was a real driver.

So, when we think about our performance versus expectation, as we said earlier in the call, top line is kind of where we expected it to be, but our performance, particularly in Plumbing, is better than expected. We quickly got after the cost and we're driving productivity, and the team is doing a great job in both North America and Europe.

Philip Ng
Analyst, Jefferies LLC

Q

Okay. That's helpful. And perhaps a question for Dave. I mean, a lot of questions today on the relative performance in the back half on margins maybe fading a little bit versus the first half. You called out maybe some expense getting pushed out – modest expense getting pushed out in the back half and some investments that will funnel through. Can you help size some of those headwinds that we should account for to better appreciate the margin progression through the year?

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.

A

Yeah. I'm not going to size them up, Phil, but just enough to contribute to a little bit lower margin performance in the second half as compared to first half. We're talking growth investments in PRO representatives for paints; could be a little bit of additional marketing compared to the first half. But beyond that, just a little bit of headwind on the margin side.

Philip Ng
Analyst, Jefferies LLC

Q

Okay. Appreciate the color, guys. Thank you.

Operator: Thank you. The next question comes from Adam Baumgarten of Zelman & Associates. Please go ahead.

Adam Baumgarten
Analyst, Zelman & Associates

Q

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Hey, good morning, everyone. Just on the paint side, one of your large competitors is expecting a high single-digit decline in raw materials, and you guys are out looking at low single-digit inflation. Just curious maybe what the difference may be there, if it's timing or different formulations; just if you could give a little more color on that?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.
A

When we talk about low inflation, that includes everything, all-in, in the cost basket. Specifically, to your question, is that on raws? Yeah, there's different levels of vertical integration, some different supply chains that are used. So there's differences to how we manufacture and, certainly, a difference in the distribution cost structure and how we go to market. So there's a couple of big differences there, but...

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.
A

Yeah. I think it's probably more a function of timing, depending on how vertically integrated we are compared to others and what inputs they're actually buying compared to overall formulations. A little bit of the difference could be accounted for in the inventory accounting practices as well, whether it's LIFO or FIFO. We're all FIFO here at Masco.

Adam Baumgarten
Analyst, Zelman & Associates
Q

Okay, got it. That's helpful. And then, just maybe any update on the promotional environment in the paint aisle at this point, just given the softness in DIY?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.
A

Yeah. In general, I'd say the level of promotions, industry-wide, has been moderate and somewhat similar to last year. We are seeing some more selective events and promotions on certain items. We, obviously, work with our partner on events and promotions that we think will drive and help profitable sales. But ultimately, it's our channel partners' decision on the promotional environment. But I'd say it's similar to – maybe a little bit, in spotty cases – a little bit in specific promotions, as I mentioned; a little bit more, but not terribly.

Adam Baumgarten
Analyst, Zelman & Associates
Q

Okay. Thanks. Best of luck.

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.
A

Thank you.

Operator: Thank you. The next question comes from Garik Shmois of Loop Capital. Please go ahead.

Garik Shmois
Analyst, Loop Capital Markets LLC
Q

Oh, hi. Thanks. I was hoping you could talk a little bit more just on what you're seeing from the consumer. I think you mentioned that you're expecting the downturn to be a bit shallower than previously anticipated, but then DIY

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is also expected to be a little bit softer just because of the lower levels of housing turnover. So any additional color on where you think the consumer's at, at this point, would be great.

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.
A

Hey, Garik, it's Dave. Yeah, I'd say it's a little – our read is sort of choppy. The consumer seems to be strong. Clearly, when you look at spend across industries, the consumer seems to be spending in other industries, such as travel and leisure. You've seen those industries pick up significantly this year; a little more pullback in home improvement spending, probably, as affordability has been pinched a little bit as rates have risen.

So the consumer, we think, is still very interested in investing in their home, especially as home equity levels remain high, but we have seen a little bit of a pullback. And I'd characterize it as a bit choppy and a bit uneven, overall, but still think the consumer seems to be pretty healthy.

Garik Shmois
Analyst, Loop Capital Markets LLC
Q

Okay, got it. Follow-up question is just on the M&A environment. Just more broadly, has the pipeline changed at all? You're announcing the Sauna360 deal. Are other opportunities maybe consistent in size and in theme with that acquisition, or are there any chunkier opportunities out there?

David A. Chaika
Vice President, Treasurer & Investor Relations, Interim Chief Financial Officer, Masco Corp.
A

Garik, I'd say the – our pipeline has not changed. Clearly, the M&A environment has changed, as we've talked about. It definitely has been slower over the past year or so, less opportunities coming to market. Sellers clearly see that some buyers might not be as competitive, so they've pulled back, plus they don't want to potentially sell off weaker earnings. So definitely a slower M&A environment, but our outlook and our focus on bolt-on acquisitions has not changed, and we continue to cultivate some nice opportunities.

Garik Shmois
Analyst, Loop Capital Markets LLC
Q

Understood. Thank you.

Operator: Thank you. Our last question comes from Keith Hughes at Truist Securities. Please go ahead.

Keith Hughes
Analyst, Truist Securities, Inc.
Q

Thank you. Question on PRO paint. You've had just a tremendous – you and Home Depot have had a tremendous share gaining run with PRO paint. And as you said in the prepared statements, it's kind of leveling out here a little bit. I guess, what's the next step in PRO paint? Is there more products, more services you can offer the PRO painter? Where do you and your partner expect to go with this?

Keith J. Allman
President, Chief Executive Officer & Director, Masco Corp.
A

It's really about service, Keith. Ten years ago, when we started this, we made a list of the things that we could do to improve the service for the PRO painter. We have tweaked what's in the can, in some light cases, but

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fundamentally, we believe we have the brand and the innovation and the right price points to be successful. We've got a great partner in terms of the distribution channel.

So it's really about service. So it's about understanding what the PRO needs and scaling that up and making sure we're delivering that across the entire market; so, as I've mentioned before, different delivery options that they like, better loyalty programs, more improved service. It's a lot of keep on keeping on to what we've been doing and continuing to drive it, and it's worked.

It's certainly – the COVID situation and our ability to supply got our product in a lot more hands of the builders. And we saw tremendous Net Promoter Scores, so they like it. So it's a matter of staying focused and continuing to drive incremental improvements in service and to continue to grow at a greater clip than the market.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Okay, great. Thank you.

Renee Benedict
Director-Financial Planning, Analysis & Investor Relations, Masco Corp.

We'd like to thank you all for joining us on the call this morning and for your interest in Masco. That concludes today's call. Thank you.

Operator: Ladies and gentlemen, this does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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