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Masco Corp. (MAS)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

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

Renee Benedict

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

Thank you, Jerry, and good morning. Welcome to Masco Corporation's 2023 third quarter conference call. With me today are Keith Allman, President and CEO of Masco; and David Chaika, Masco's Vice President, Treasurer and Investor Relations.

Our third 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 statement. We 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 this morning. Before we get into our results, I want to take this opportunity to welcome Masco's new CFO, Rick Westenberg, who joined the team on October 16.

Rick is an accomplished executive with more than 25 years of experience, including nearly 15 years leading global finance organizations. We're excited to have Rick onboard and look forward to him participating in our fourth quarter earnings call in February.

I would like also to take this time to thank Dave Chaika for serving as Interim CFO over the last several months. Dave quickly stepped into the position and successfully led our finance team during this transition, and we greatly appreciate his support.

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With that, let's turn to our third quarter results. Please go to slide 5. In the third quarter, we demonstrated our ability to execute and the earnings power of our business model, despite a challenging environment, which saw a top line decrease 10%. Volume was down 12%, partially offset by pricing actions and favorable currency impacts of 1% each. While sales were down $225 million, our continued focus on driving cost savings initiatives and a favorable price/cost relationship resulted in an operating profit decline of only $2 million in the quarter. This strong execution resulted in operating profit margin expansion of 170 basis points to 17.6% and a decremental margin of only 1%. Our earnings per share for the quarter grew 1% to $1 per share.

Turning to our segments, Plumbing sales declined 11% in local currency with North American and international plumbing each declining 11%. In North American plumbing, overall demand remained soft with the wholesale and e-commerce channels performing moderately stronger than the retail channel.

In international plumbing, demand trends weakened in our key markets of Europe and China, in line with our expectations. We continue to expect our overall international plumbing market to be down high single digits for the full year.

Despite the top line decline, we successfully drove plumbing margin expansion of 230 basis points to 18.9% in the third quarter. This strong margin performance was driven by pricing actions, commodity and freight deflation and significant cost savings initiatives, particularly in our North American plumbing business.

We also completed the strategic bolt-on acquisition of 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.

Turning to our Decorative Architectural segment. Sales declined 10% in the quarter. DIY paint sales declined low double digits. PRO paint sales declined low single digits against a mid-teens comp in the third quarter of 2022. On a three-year stacked basis, our PRO paint comp is over 65%, demonstrating the significant market share we have captured with PRO painters through the strength of the Behr brand, quality of our products and our commitment to exceptional service.

Together with our partner, The Home Depot, we believe we have a significant opportunity to continue to grow share in the PRO paint market. Additionally, we are honored that Behr was recognized as The Home Depot 2023 Marketing Innovation Partner of the Year. This recognition is a testament to our creative marketing campaigns and our 45-year partnership with The Home Depot.

Turning to capital allocation. We continue to generate significant free cash flow during the quarter and maintained a strong balance sheet. As a result, we executed on our balanced capital deployment strategy and returned $109 million to shareholders through dividends and share repurchases, including buying back 800,000 shares for $45 million in the quarter.

Now turning to our outlook for the remainder of 2023. With our strong execution, we now anticipate earnings per share for 2023 to be in the range of $3.65 to $3.75 per share, up from our previous guidance of $3.50 to $3.65.

While the near-term demand for the repair and remodel market remains uncertain, we will stay focused on controlling what we can by closely managing costs, minimizing the impact of lower volumes and driving our margins back to at least 2019 levels of 18% in each segment.

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We believe our portfolio of low-ticket repair and remodel products, our market-leading brands and innovation and our geographic diversification positions us for growth and stability through cycles. As we look over the longer-term, we believe the fundamentals of our repair and remodel markets are strong and supportive of long-term growth. These include high home equity levels, the age of housing stock, and homeowners staying in their homes longer. We remain committed to investing in our brands, capabilities and people to drive strong growth when market conditions improve.

With favorable fundamentals, and the continued successful execution of our growth strategy, along with our free cash flow and disciplined capital deployment, we are well positioned to drive value creation for the long-term.

On our fourth quarter call, we will provide our 2024 outlook as well as an updated view on the margin expansion potential of our business over the longer term.

I'd like to conclude with a thank you to our employees for their hard work and dedication to driving operational excellence and delivering for our customers and shareholders.

Now I'll turn the call over to Dave to go over our third 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 one-time items.

Turning to slide 7. Sales in the quarter decreased 10% and excluding currency, decreased 11%. North American and international sales both decreased 11% in local currency. Our continued focus on operational efficiency helped drive gross margin expansion of 430 basis points to 35.8%.

Our SG&A as a percent of sales was 18.2%. Despite our decline in sales, operating profit in the third quarter was $348 million, down only slightly year-over-year. Operating margin expanded 170 basis points to 17.6%. This strong operating profit and margin performance was due to pricing actions, lower freight and commodity costs and cost-saving initiatives, offset by lower volumes, resulting in EPS growth of 1% to $1 per share.

Lastly, in the third quarter, we received an insurance settlement in our Decorative Architectural Products segment related to the severe weather event that occurred in Texas in 2021. This weather event significantly impacted our suppliers' ability to produce the raw materials necessary for us to manufacture certain paints and other coating products. This settlement has been excluded from our results is a non-GAAP adjustment.

Turning to slide 8. Plumbing sales in the quarter decreased 10% and, excluding currency, decreased 11%. Lower volume decreased sales by 14%, partially offset by net selling prices, which increased sales by 3%. North American plumbing sales decreased 11% in local currency. International plumbing sales decreased 11% in local currency as demand continued to soften in many European markets and China.

Segment operating profit in the third quarter was $225 million, up $5 million year-over-year, and operating margin expanded 230 basis points to 18.9%. Operating profit improvement was driven by pricing actions, lower freight and commodity costs and cost-saving initiatives, partially offset by lower volumes. The completion of our Sauna360 Group acquisition had minimal impact on our results due to closing late in the third quarter.

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Turning to slide 9. Decorative Architectural sales decreased 10% for the third quarter. Paint sales declined high single digits with PRO paint sales decreasing low single digits against the mid-teens comp in the third quarter of 2022. With a two-year PRO sales comp in the mid-teens and a three-year PRO sales comp of over 65%, we are clearly demonstrating the significant share we have gained and retained over the past three years.

Operating profit was $144 million and operating margin expanded 110 basis points to 18.3%. Operating profit was impacted by lower volumes, partially offset by cost saving initiatives. We are also starting to see relief in certain paint input costs with modest low single-digit deflation in the third quarter, and we expect modest low single-digit deflation in the fourth quarter on these raw materials. For the full year, we continue to anticipate low single-digit inflation for our paint raw material basket with second half deflation not fully offsetting first half inflation.

Turning to slide 10. Our balance sheet remains strong with net debt-to-EBITDA at 1.7 times at quarter end and approximately $1.6 billion of balance sheet liquidity. Working capital as a percent of sales improved 40 basis points to 18.1%, and net working capital days improved by 12 days, primarily due to lower inventories. With this improvement in working capital, net cash from operating activities year-to-date was $928 million, an improvement of $408 million compared to prior year.

We expect free cash flow conversion to be approximately 110% for the full year. During the third quarter, we repurchased approximately 800,000 shares for $45 million. Share repurchases were lower in the quarter as a result of us completing the acquisition of Sauna360.

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 acquisition of Sauna360 for approximately EUR124 million and year-to-date share repurchases of approximately $125 million, we expect to deploy up to $225 million for share repurchases in the fourth quarter, subject to market conditions. This will bring our full year share repurchases to approximately $350 million.

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 continue to expect sales to decline in the range of 10%. However, with our strong execution year-to-date and margin performance, we now expect full year margins to be approximately 16.5%, increase from our previous guide of approximately 16%.

In our Plumbing segment, we expect 2023 sales to be down in the range of 9% to 10%, improved from our previous expectation of down 10% to 12%. We also anticipate the full year plumbing margins to improve and be approximately 17.5%, increase from previous guide of approximately 17%.

In our Decorative Architectural segment, we continue to expect sales to be down in the range of 8% to 10%. However, we do expect our decorative margins to improve and be approximately 17.5%, increase from our previous guidance of approximately 17% due to cost-saving initiatives.

Finally, as Keith mentioned earlier, thanks to our strong execution, our 2023 EPS estimate is now $3.65 to $3.75, up from our previous guide of $3.50 to $3.65. This assumes a 24% effective tax rate and a 227 million average diluted share count for the year, which is slightly higher than the 226 million share count we guided to last quarter. 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 questions. Operator?

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Michael Rehaut of JPMorgan. Please go ahead.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Thanks. Good morning everyone.

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

A

Good morning, Mike.

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

A

Good morning, Mike.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Wanted to start with the increased guidance, driven by the higher margin outlook and really zero in a little bit on kind of the drivers of each and specifically trying to think about cost-saving initiatives as well as raw material trends and how we should think about any of these benefits as perhaps they've begun to accrue as you moved throughout 2023, and if there's any way to think about carryover benefits on either the cost saves or the raw materials trends as we look into 2024.

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

A

So we clearly have, Mike, margin momentum going into 2024 and that will continue. The main drivers of our margin are variable cost productivity, a little bit on the fixed cost side. We've talked about a small plumbing plant that we've closed. But really, it's about continuous improvement in that culture of execution that we've demonstrated in the past and continue to do that. So we've got good productivity initiatives that we're driving.

We've had some pull-through of now full year benefit of price increases that we've executed midyear last year that's now affecting us full year this year. And we're getting full benefit of that by and large here in the third quarter and we expect that to continue. And of course, if commodities stay where they are or maybe even change to the lower side going into 2024, that would be a benefit for us as well leading into 2024. So I think the margin story for us, in summary, is that we've got good momentum here coming through in this quarter, and there will be some benefits for us as we look into 2024.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Okay. Appreciate it. I guess, secondly, we had a competitor last night talk about early thoughts around 2024 and kind of shared expectations for the market to be down slightly based on current trends.

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I was wondering if that's something that at this point, again, given how you've seen the trajectory play out so far in 2023 and given still kind of depressed existing home sale turnover, if that kind of matches directionally at least the way you're thinking about things at this point and how you overall kind of characterize the demand backdrop. I know as you've kind of noted, 2023 has played out as you largely expected. But clearly, some of the headwinds appear to be at least in place as we're entering 2024 at this point?

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

A

Yeah, Mike, as I said, we'll be providing a lot more detailed view on 2024 on our fourth quarter call in February. In terms of sharing some of our initial thoughts and perspective on what 2024 looks like as we sit here today, I would say that our assessment of the market based on what we're seeing now in terms of our order patterns and our view agrees with most industry experts and economists, I'd say, and that, it looks to us like 2024 is going to be a flattish year for R&R, we have rates, being stubborn and holding up, consumers are still getting a little pinched by that, existing home sales are at what I think is about a 20 year low.

So I would say, generally speaking, for our view of 2024 in R&R is that it's going to be flattish. And in that flattish environment, we fully expect to outperform the market and grow and expand margins. We have leading brands around the globe with Delta, and Hansgrohe, we have demonstrated and have strong share gain momentum with our innovation pipeline, our new products and our leading channel positions, particularly in wholesale and our premium position in China, which is holding up better than some of the lower priced segments in China.

So we've demonstrated our ability to grow and retain share in PRO paint, that will continue because we're focused on that. And you see that we are continuing to invest behind that initiative. So I think that top line story, together with our demonstrated margin momentum, we're focused on margin execution. And with our strong drop-down and incremental volume, market outperformance in a flash environment will drive margin enhancement.

Of course, we're continuing to lean out our operations and keep a keen focus on total cost productivity, which is the hallmark of our execution culture, so longer – you know, so in 2024, I think we're – as we sit here today in agreement with the general assessment of a flattish market and we intend to outperform in that market. I think importantly, longer term, we believe that there's a significant rebound in R&R spending when things normalize due to the strong fundamentals. We've talked about these, the age of housing stock, strong home prices, strong equity levels and what we believe to be pent-up demand for R&R spending.

So it's a volatile time and I think based on our demonstrated execution, we're ready to go into 2024 and feel good about it. And we're going to continue to invest in our brands, service, innovation to drive above-market growth and win in the recovery.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. That was – appreciate the answer and the thoughts, Keith. Thanks very much.

Operator: Our next question comes from the line of Joe Ahlersmeyer of Deutsche Bank. Please go ahead.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, everybody. Good morning. And thanks for taking the question.

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

Hey, morning, Joe.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.
Q

I was wondering, I know you don't disclose price for your Dec-Arc segment, but I was wondering if you could give, at least directionally, if price added to the top line in the quarter and margin in the quarter. It didn't look like – it's maybe in the first quarter where you didn't call it out.

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

Yeah, Joe, we're not going to get any specific discussion on price. So price overall for Masco was around 1%, a little more in plumbing, roughly flattish in decorative. As we've talked about many times, we tend to be price/cost neutral in decorative over time. We have seen some sustained raw material deflation. Likely, price could be a little bit of a headwind here in the fourth quarter, but maintain profit dollars.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.
Q

Right. That makes sense. And so as a follow-up, as you're talking about getting back to 18%, that includes, I suppose, the deflation plus giving back the price. Because that's the mechanical margin benefit on the way down, right?

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

I think when we talk about getting back to the 2019 margin levels of 18%, it's more about driving cost savings initiatives, more about driving growth. If there is deflation and the inverse relationship to – if you do end up giving back price, that could help. But I think we really – we're focused on improving margins from a cost productivity and driving growth side of things.

Joe Ahlersmeyer
Analyst, Deutsche Bank Securities, Inc.
Q

Understood. All right. Thanks a lot.

Operator: Our next question comes from the line of Sam Reid of Wells Fargo. Please go ahead.

Sam Reid
Analyst, Wells Fargo Securities LLC
Q

Awesome. Thanks so much guys for taking my questions here. Wanted to maybe dig in a little bit on PRO paint. It's been a great growth engine for you guys, understanding there's been a little bit of get back this year. Can you give us an update though on what the next leg of growth is from here? And maybe touch on some of your initiatives, specifically. I'm thinking job site delivery and maybe where you are in terms of building out your PRO paint sales force.

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

A

Yes. Thanks for the question, Sam. PRO paint has been a great story for us and a lot of hard work and focus for really a decade now. It wasn't too long ago when this was just a small piece of our business, and we've grown it now to be quite material. And the story has really been around staying focused on that segment of the market that we think we have a value proposition that really works.

And it's that contractor who also paints and does other things and is already in the aisle shopping at The Home Depot. And when you couple that with the quality of our paint and our brands and our innovation that we put in the can, it's – and our cost competitiveness, it's a very strong story for that contractor.

We think that's about half the PRO paint business. And when we – in total. And when we look at where we are today in terms of our overall volume, I think the important story to start with is we are just getting started. We have a relatively small share of that focused part of the market that we're going for. So there's some nice white space to go after.

The success that we've had to date and the success that continues to resonate with the PRO paint are based on today's Net Promoter Scores that we look at very closely. So we're holding on to the share, because it's not a one-time benefit. It's a benefit that has value to these focused contractors that continues. And it's about service. It's about reducing the friction and making it an easy process and an easy experience for the PRO painter to go through. So we are – there is no big silver bullet that we're looking to spend a significant amount of money and that we think is going to – or hope is going to drive the benefit.

It's doing more of the same and staying focused on service. So yes, that includes buying online and picking up in the store ordering. It includes expanding our delivery options which, of course, includes job site delivery. We still have significant room to expand our PRO sales outside sales force, both at Behr and at Home Depot. We continue to enhance our loyalty programs, the list goes on.

So it's fundamentally about the blocking and tackling and delivering and service proposition to a targeted contractor [indiscernible] (00:28:45). In terms of where we are in the buildout, it's early innings. I mean, when you look at the share that we have today and the share potential that we think we have, we're just getting rolling.

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

No, that's helpful. And maybe one more on paint, touching more on backlog here. So just – do you have a sense as to where those backlogs sit for your PRO paint customers? And then maybe another one just on project sizes, are you finding that project sizes maybe are mixing a little bit smaller, projects that still keeping PROs relatively busy? Thanks.

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

A

Hey, Sam, on the backlog, we'd say that the PRO painters in general worked through really significant backlogs over the past couple of years. It's probably more at a normalized level, still a decent demand but at a much more normalized backlog level.

In terms of project size, that's a difficult stat to get a handle on, anecdotally maybe a little bit. But you really can't – don't have hard data to back that up at this point, probably a little early for that.

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

A

Haven't really seen a significant change in our ticket size.

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

Got you. No, that's helpful. Thanks so much guys. I'll pass it on.

Operator: Our next question comes from the line of Matthew Bouley of Barclays. Please go ahead.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Good morning guys. Thanks for taking the questions. Just one on the international market. It sounds like you kept guidance unchanged. But there was some weakening in those markets. And I guess if I heard you correctly, that was already in line with your expectations.

My question is, do you think those international markets have found a trough here? Or would there be risk to those markets weakening a bit further? And since you gave some color on R&R into 2024, just curious if you have any thoughts on how those international markets may play out into early next year? Thank you.

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

A

Yeah. Matt, it's always tough to tell if you're on the bottom or you're coming up, where we are in terms of stability. It's a battle all the time period for sure. We have seen softening in international.

In Central Europe, Germany's economy is under a little bit of pressure. Of course, we've talked about China and we understand what's happening there. We do expect the softening to continue. I should say, we do expect it to be soft in Q4. Hansgrohe is very resilient. We are gaining share significantly in Europe.

So to combat those choppy market conditions, the team has just gone to work and really penetrated not only in Europe, but also doing a fine job holding up in China and continuing to grow in some of our higher growth markets.

In terms of where we see 2024, I'm not going to get into the specifics of calling it down on the region-by-region [audio gap] (00:31:44) we are beginning to see some favorable signs in terms of more steady demand coming out of Europe, and that gives me a lot of positivity.

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

A

Hey, Matt, I'd just add, you're right. We did anticipate the international markets declining. So the deceleration that we saw here in 3Q was roughly in line with our expectations. And yeah, to Keith's point, there are signs of stabilization. I'd say it's a little too early to call it a certainty or a trend, but definitely there are signs of stabilization.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

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Got it. Okay. Thanks a lot guys. And then second one on the retail channel. It sounded like it might have been a little weaker in plumbing relative to wholesale. Clearly, on the paint side, you might have seen DIY decelerating a bit. I'm curious what that means for promotional activity. What are you kind of seeing at the retail level in terms of trying to address some of that kind of deceleration out there? And how might that impact your margin outlook? Thanks guys.

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

Right. Where we sit today, it's been fairly consistent with what it's been in the past. And I would say that not only applies to our plumbing business but also to paint, meaning that we do have periodic sales around some holidays. We have some new little price in spots. But by and large, it really has not – we have not seen any significant change in the promotional environment. And that's a choice. Obviously, we are strategic partners with our customers. But really, that is their choice. And then sometimes we participate in the funding and in others we don't. So that's really up to them. And to this date, at this time we really haven't seen much of a change at all in the promotional environment.

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, Matt.

Operator: Our next question comes from the line of John Lovallo of UBS. Please go ahead.

John Lovallo
Analyst, UBS Securities LLC
Q

Good morning guys. Thank you for taking my questions. The first one is, what did you see in terms of plumbing mix? Was geographic mix still a headwind internationally? And then in terms of plumbing pricing, I think it was 4% through the first half. I think it was 3% in the third quarter. Are you expecting further tapering as we move into the fourth quarter?

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

Yeah, John, let me take the pricing. Yes, we do expect further tapering in the fourth quarter as we analyze the majority of our price increases. We did take some selective price actions in plumbing earlier this year that will continue through, but the majority of our larger increases are annualized now as we head into the fourth quarter. So it will be a little bit of a benefit, but smaller than what we saw in 3Q.

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

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On the mix side, not a real material impact, but we have seen some mix impact, mainly geographic mix in our international business. So we are a premium player in China. We like that position. We think that's a more resilient position, more consistent position to be in. And it feeds into the strength of our Hansgrohe and Axor brands.

And when China is under pressure a little bit more than the overall international market in general, that gives us a little bit of geographic mix. But it's not particularly material in the quarter nor do we expect it to be throughout the year. A little bit [indiscernible] (00:35:14).

John Lovallo
Analyst, UBS Securities LLC

Q

Okay. Understood. And then paint and coatings revenue was down high single digits and total segment sales were down 10%. How much was the hardware business down and what you're seeing there? What were sort of the drivers of the declines there?

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

A

Yeah. Our lighting and hardware businesses were down double digits a little bit more than the segment, John. They tend to be a little more DIY-oriented type products. So they pulled back a little bit more than our paint and coating products in aggregate. So we did see more softening – sort of consistent softening, but we did see softness here in the 3Q on the lighting and hardware businesses.

John Lovallo
Analyst, UBS Securities LLC

Q

Got it. Thank you guys.

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

A

Thanks, John.

Operator: Our next question comes from the line of Adam Baumgarten of Zelman. Please go ahead.

Adam Baumgarten
Analyst, Zelman & Associates

Q

Hey, good morning guys. Just maybe kind of backing into the fourth quarter margin guidance. Pretty big step down sequentially, I think kind of bigger than maybe typically or seasonal. Just kind of anything to note there in terms of headwinds on the margin side?

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

A

No, nothing beyond really what we've talked about. We may see a little bit more of international mix in our Plumbing segment that could provide a little bit more headwind. Dave, maybe you can add some color on to that. But we've – the fourth quarter is typically our slowest from a seasonality perspective. We do have costs that come in the fourth quarter such as true up on various accounts, compensation accounts and that sort of thing. That can have some headwinds.

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We've got a little bit of – we bring up and started to more aggressively ramp up our new factories. We have a new paint facility outside Columbus in Ohio and we have a new plumbing plant in Serbia. So there will be a little more expenses there and headwinds. But I think it's – when you think about our margin and where we're going to be driving this in 2024, I think it's best to think about the full year 2023 margins and then that strong incremental that I've talked about earlier on the call as it relates to share growth.

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

Yeah. Adam, I think Keith had a good summary in general. It remains an uncertain market. So there is some caution probably in the fourth quarter on the margin side, but we do anticipate continued pressure from lower volumes, potentially a little bit of negative mix in plumbing as well as we have planned startup costs in both – in plumbing and decorative with our European faucet and shower facility coming online as well as our Heath, Ohio paint manufacturing and distribution center coming online.

Adam Baumgarten
Analyst, Zelman & Associates
Q

Okay. Got it. No, that's helpful. And then just maybe if you can touch on POS trends at retail throughout the quarter and maybe into October, if you're willing to share that?

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

Yeah. We don't really like to break it down within the quarter as there's a lot of variability in terms of load in from new products and other comps and that sort of thing, and it certainly varies. With respect to POS, I'd say, we're seeing some fairly good trends.

Adam Baumgarten
Analyst, Zelman & Associates
Q

Okay. Thanks. Best of luck.

Operator: Our next question comes from the line of 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

Good morning, Sue.

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

Morning, Sue.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

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My first question is, maybe taking a step back, there's been obviously a lot of focus on the consumer in the last month or two and thinking about housing and their ability to spend as rates move higher, how would you characterize the consumer today as you kind of look across the business?

And any thoughts on shifts that are there, either positive or negative? And what that could suggest for next year as we think about the potential for maybe rates to change, either up or down and where things could kind of come together with that?

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

A

I'd characterize it by saying it's a mixed bag, Susan. When we look in Europe, we did see a pullback in the consumer, and there's some noise there with various legislation that's been – it's now clarified to a degree anyway, more than it was last time we talked as it relates to driving for non-fossil fuel heating systems in Central Europe and Germany. And that's taking away some of the consumers' willingness to spend on, say, bath remodel projects and that sort of thing as they're concerned with putting in greener heating systems for what they thought was pending legislation. It looks like that's going to now be protracted out to 2028. So we expect that consumer to start to come back. So in Europe, the consumer was kind of a little later to the game and the pullback, if you will, and is now coming back in Europe.

In the US, holding up fairly well for us. As expected, I should say. So we're not seeing any accelerated slowdown whatsoever. And again, I think there's a lot of volatility and uncertainty, and it's – the full impact of inflation, I think, is yet to be seen in the consumer. But by and large, the consumer is still holding in pretty good for us in our products. And I think that's driven by the bang for the buck, if you will, that the consumer sees in painting a room and in changing out faucets and light fixtures, where it's a relatively inexpensive investment in your home.

I think with work from home, where that's not fully going to go back to everybody working in the office, and that puts more wear and tear on the paint. And it's not that expensive to do it. And you can do a DIY, if you want. So I think that combination has helped us.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay.

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

A

Susan, I would add too. I mean, consumers clearly have been resilient [audio gap] (00:41:27) consumers now since there have been significant increase in rates and inflation over the past couple of years. That said, they have demonstrated, they are resilient. When you look at [indiscernible] (00:41:38) levels, they're feeling very good about their home. So we do think that when things do stabilize that, that consumer will be very interested in remodeling their homes. And as Keith alluded to, we do think there will be a nice pent-up demand that we fully intend to capitalize on.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. That's helpful color. And then thinking about capital allocation, I know that you closed the acquisition this quarter. As you think about priorities for cash and especially maybe on the buyback side, any thoughts on how that could come together over the next couple of quarters?

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

Hey, Susan, our typical philosophy is to allocate all of our free cash flow after dividends to share repurchases or acquisitions. So with our significant cash flow and our pausing of share repos in the third quarter, we do tend to be fairly aggressive here in the fourth quarter, and we talked about allocating $225 million likely towards share repurchases. If you look at 2024, I think if you follow that basic formula of excess free cash flow or free cash flow after dividends allocated to share repurchases of the acquisition, you'd be right in the ballpark on how we're thinking about share repos for next year.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Okay. That's helpful. Thank you. Good luck with everything.

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

Thanks Sue.

Operator: Our next question comes from the line of Garik Shmois of Loop Capital. Please go ahead.

Garik Shmois
Analyst, Loop Capital Markets LLC
Q

Hi. Thanks for taking my question. Question on DIY paint, just the move to down low teens year-on-year versus down low single digits, I think in the second quarter. Just curious that was a sizable change on a year-on-year basis, just -- but curious how trends performed sequentially there?

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

Yeah. On DIY paints, we did see softening in 2Q actually and continued softening here in 3Q. I think you have to look at the low level existing home sales which are about 13-year low. We haven't seen this level existing home sales since 2010 at the end of the housing crisis. So we think that is affecting DIY paint sales. So that market is softer here in 3Q, roughly in line with our revised expectation coming out of 2Q.

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

Garik, I would say that the fundamentals are still supportive of DIY paint, particularly when you think about millennials going into the housing market. And the basic research that we've done is that the millennials are DIYers and not only for a single project, but they're return DIYers. And paint, as we've shown with regards to – if there is such thing as a fun DIY project, that's how it's viewed. And our positioning with that is favorable for us.

Garik Shmois
Analyst, Loop Capital Markets LLC
Q

Understood. Thanks a lot. A follow-up question just on commodity costs. I think you mentioned you started – you're starting to finally see some relief here. Maybe if you can walk through some of the baskets that are particularly beneficial right now in the fourth quarter, if there's any early look into 2024 on the raw material side, that would be great.

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

A

Well, container costs have come down off their peak levels. That certainly has helped with freight. Some of our metals such as zinc is off the 2022 high. Copper, I think is at about $3.50 a pound now. 2022 high was closer to $4. So that's come off. Now we haven't really seen that roll through the P&L because of the time on the water and then the flow through of our inventory, but that would be a 2024 tailwind for us.

All-in-all in plumbing, let's call it low single-digit deflation for the year. In paint, certain input costs have moderated, we've seen resins moderated a little bit. We're starting to see a little bit of deflation in the third quarter, but still inflation based on a full year. It's not – we believe, not going to be enough to cover the inflation we saw in the first half. So let's call it approximately, last all in for the total company for the full year. And then the reduced commodity costs that we're seeing in the back end of the half of the year here would be benefits for us in 2024.

Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Great. Thanks again. Best of luck.

Operator: Our next question comes from the line of Stephen Kim of Evercore. Please go ahead.

Stephen Kim
Analyst, Evercore ISI

Q

Yeah. Thanks very much guys. I appreciate all the color. I guess, my first question is related to your targeted 18-plus-% operating margins, you're pretty close in both segments. But in Dec-Arc, I'm curious as to whether or not there's a subsegment, particularly either hardware or lighting, where you're further away from your target than you are in paint. Basically, is that true? And is maybe painting or – sorry lighting or hardware a little further away? And then also within plumbing, is there a subsegment or a couple of areas worth calling out within your plumbing portfolio, where again maybe you're a little further away from your targeted levels?

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

A

Yeah. When you look across, Steve, in our segments and within segments, not everything is the same margin. So there is a distribution of margins. And when you think about hardware, hardware is lower margin than paint. And that is an area where we're looking to improve. And I will tell you that 18% is the target that we're shooting for now, but we think we have significant room to continue to drive that even higher. And as I mentioned in my prepared remarks, we'll be talking about where we see some long-term margin targets on our call next quarter.

Within plumbing, we have a broad plumbing platform. And we've talked before about how there's a continuum of margin in that platform from some of the beautiful chrome-plated jewelry in the kitchen and bath and plumbing to some of the less decorative components, say, of a plastic shower pan that we would install in our bathing business. So there is variability in margin. And I think the key takeaway I'd like to share with you is that we've demonstrated the ability to execute and drive margin, be it with our focus on where we play and with our Masco operating system to drive efficiencies. So we'll be tackling the whole business, but yes, there's variability, of course, across our segments.

Stephen Kim
Analyst, Evercore ISI

Q

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So within plumbing, there's not a particular, let's say, way of talking about it – or segments out maybe by country or sort of price point or something like that, where you're a little bit further away from your goal within that segment?

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

Well, there's not a whole lot of variability when we look geographically. And we look at all these things. We look at margin variability on a product-type basis. We look at margin variability based on the raw component makeup of the products. We look at margin variability across channels. So that's all part of our operating system that we use to drive improvements. But we're not going to break it out specifically by those components as we talk here.

Stephen Kim
Analyst, Evercore ISI
Q

Okay. That's fine. Regarding overall your improved margin, you talked about cost savings and some of those – I think you highlighted there's a little bit of raws that are starting to come to you as a benefit. And then you have freight, which you called out as well. But you've also talked about just sort of other productivity initiatives and so forth.

So I'm curious as we look into, let's say, the fourth quarter. If you were to sort of segregate out things like freight and price over raws, how much is, would you say, related to productivity, like things that are more sort of permanent cost-saving efforts that you've made? I mean, would you put that in the 10 to 20 basis point range overall? Or I mean, is it – just if you can help us understand what some of those initiatives have been adding or are expected to add here maybe in the fourth quarter or if you want to talk the full year or whatever.

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

Hey, Steve, we have made very nice improvements on the productivity line. Recall, we had some inefficiencies in the back half of 2022, particularly in plumbing that we've done a very nice job getting on top of. I'd say in terms of bucketing, the biggest driver is clearly getting our price/cost relationship back to where it should be throughout this year. So we've had a very nice cost recovery this year since we did lag it a bit last year. So that's the biggest bucket. The productivity is a nice tailwind to help with that, but the biggest bucket is the price/cost recovery.

Stephen Kim
Analyst, Evercore ISI
Q

Okay. Thanks very much guys.

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

Thanks, Steve.

Operator: Our next question comes from the line of 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, just wanted to follow-up. You mentioned that brass deflation for the year should kind of run in the down low single-digit percentage. Should we assume that

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was likely inflationary in kind of the first quarter and perhaps the fourth quarter is trending down maybe in the mid-single-digit percentage or better range as we sit today?

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

Yeah, Truman, that's about right.

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

Hey, Truman, I'd add too, the copper and zinc are down, but they have been bouncing around, too. They've gone down these levels, have gone back up close to the 2022 averages. So – it wouldn't run that consistently through 2024 at this point, but it does look like it will be a little bit of a benefit.

Truman Patterson
Analyst, Wolfe Research LLC
Q

Okay. Okay. Got you. And then as we look at your margin performance in both segments on a year-over-year basis, is there any way you could frame how much your investments in both businesses stepped up in the third quarter? Or was it relatively light versus your expectations kind of given the margin performances? I'm just trying to understand if perhaps some of these costs are really fully hitting in the fourth quarter that might have been expected in 3Q?

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

Yeah. I'd say investments were roughly in line with what we anticipated in 3Q, maybe a little bit light. We do plan to continue to invest in our business. As Keith talked about, it will impact a little bit on the fourth quarter, but roughly in line with probably what we saw in 3Q. I'd say the margin improvement is much more of our – as we've talked about the productivity improvements as well as getting the price/cost relationship back to where it should be.

Truman Patterson
Analyst, Wolfe Research LLC
Q

Okay. Perfect. Thank you guys.

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

Thanks, Truman.

Operator: Our last question comes from the line of Phil Ng of Jefferies. Please go ahead.

Philip Ng
Analyst, Jefferies LLC
Q

Hey, guys. Thanks for squeezing me in. I guess for you, Dave, you kind of mentioned price/cost was a huge driver for margins this year, particularly plumbing. Your products have obviously resonated with consumers showing good pricing power, and your competitor has actually alluded to taking price next year in plumbing. Do you have any pricing actions geared for 2024? And when we look at the pace of price/cost spread widening this year, do you see that spread widening the pace of that spread, widening even faster perhaps next year?

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

Again, we'll get into detail for 2024 on the next call. We've taken some targeted price in plumbing this year here in the third quarter. And our demonstrated ability, as you mentioned, with our pricing power is to stay in front of – to keep price/cost in our sites and go after price through our channels when we need it. We tend to keep it and hold on to it longer in plumbing than we do in decorative, given our relationship with a significant customer in coatings.

So our pricing power is pretty strong. It's too early to say if we're going to take price next year. We'll have to see what that means in terms of our innovation pipeline and our new products that come out and where commodities ultimately end up. So too early to call whether or not we're going to do any price in plumbing in 2024. But certainly, if needed, we've got the capability and the pricing power with our brands to be able to do that.

Philip Ng
Analyst, Jefferies LLC
Q

Okay. Keith, just to clarify, you meant 3Q price increase in plumbing. That was last year, right? Not so much...

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

Right.

Philip Ng
Analyst, Jefferies LLC
Q

...you've – okay.

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

We've taken some targeted – that's correct. Sorry about that. We've taken some targeted price here earlier in this year as well.

Philip Ng
Analyst, Jefferies LLC
Q

Okay. Okay. Makes sense. And then on the DIY side of things for paint, any color on where volumes are shaking out right now as of fourth quarter in terms of your guidance relative to pre-COVID levels? And Keith, you kind of mentioned that you see good momentum going forward long term on DIY, just given the millennial cohort. Do you see that kind of flipping in 2024 in terms of trends in DIY versus wholesale? The PRO channel has definitely held up much better than DIY this year in the retail channel.

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

Yeah. The DIY market during COVID was a bit of a roller coaster where it took a significant improvement. If you recall, when folks were reticent to have PROs in their homes, and then when that kind of fear of COVID relaxed a little bit and people are more comfortable with PROs coming in, PRO took off and DIY went down. And that I think it bodes – it speaks to our diversification and our strength in PRO for that customer, that we can handle that variation and be there to catch that and grow share.

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But it has been an up and down market. I will tell you where we sit now in DIY, that absolute volumes are lower than our pre-pandemic, call it, 2018 levels in DIY. With respect to – if I think – as I said, we'll get into more detail about next year on our fourth quarter call. I'm not so sure that the millennial cohort will be enough to really drive significant growth overall in the DIY segment. But we'll talk about where we see DIY more in detail on the next call.

Philip Ng

Analyst, Jefferies LLC

Q

Okay. Thank you. Appreciate the color.

Renee Benedict

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

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

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