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Masco Corp. (MAS)

J.P Morgan Homebuilding & Building Products Conference

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MANAGEMENT DISCUSSION SECTION

Michael Rehaut

Analyst, JPMorgan Securities LLC

Okay. Good morning, everyone. Thanks for joining us. My name is Mike Rehaut. I'm the senior analyst covering the homebuilding and building products space for JPMorgan. We're kicking off day two of our 17th Annual Homebuilding & Building Products Conference. I want to thank all the companies yesterday for participating and we've been nice lineup today as well.

We're going to kick off today with Masco Corporation and pleased to have with us Rick Westenberg, CFO.

As with prior presentations, this will be a fireside chat, but I'll turn over to Rick initially just for a few words on Masco to set the stage, and then we'll dive into the fireside and also have time at the end for questions from the audience.

So, Rick, thanks for joining us.

Richard Westenberg

Vice President, Chief Financial Officer and Treasurer, Masco Corp.

Great. Thanks, Mike. Good morning, everybody. It's great to be here at the JPMorgan builders conference and really appreciate everyone joining this morning here in person as well as via webcast.

What I thought I would do is just provide just a couple of minute overview on Masco for those that may not be as familiar with the company.

So, Masco is an approximately $8 billion building products company that's really focused on the repair and remodel sector of the industry, primarily in North America. About 80% of our business is in North America, but we do have a global footprint. About 20% is international.

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We're organized in two primary segments. One is Plumbing, which is anchored by our our Delta, Hansgrohe, as well as our Watkins Wellness businesses. In 2023, we generated just shy of $5 billion of revenue in that segment, but 18% margin. So really healthy margins.

As I mentioned, we've got an international footprint. It's really anchored by our Hansgrohe international plumbing business, which operates in over – sells product in over 150 countries. So, for us, something that's not fully appreciated.

Our second segment is the Decorative Architectural Products segment, which is anchored by our BEHR brands. So, the vast majority of our Decorative Architectural Products segment is paintings or coatings business. Again, anchored by BEHR, which we partner very closely with the Home Depot. We've been partners with the Home Depot for over 40 years.

In addition to the coatings, we have a lighting business as well as a building hardware business. It has just over $3 billion of revenue and 17.8% margin. So, again, strong margins.

In terms of the Masco portfolio overall, it's really the foundation on strong brands. As I mentioned, a few of them. Strong brands, product innovation, and customer service. Really focused on above market growth and margin expansion.

We also in terms of capital allocation strategy, have a very consistent and disciplined capital allocation strategy that's focused on first and foremost reinvesting in the business to drive growth. Second is an investment grade credit rating. And then third is a resilient dividend. We have a 30% payout ratio in terms of our dividend, and we've grown the dividend 11 years in a row.

And then fourth is returning all available cash to shareholders, either through the dividend or through share buybacks. And we've guided this year to return approximately $600 million to shareholders through share buybacks. That is, in absence of any M&A activity that we may have, which I'm sure we'll talk about, Mike.

But anyway, that's just really a synopsis of Masco overall and really excited to be here again this morning.

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QUESTION AND ANSWER SECTION

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. Thanks, Rick. Appreciate the overview. So, just jumping into the fireside chat here in terms of the questions. First, wanted to hit on the macro growth, the market growth backdrop for 2024 and potentially even next year. Obviously not asking for any type of guidance. But you continue to expect for this year the repair model market to be flat to down low single digits. I was wondering if you could kind of just review the drivers of this year's market dynamics and what might change potentially to lead to growth next year?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Sure. So, Mike, as you indicated, we've guided our expectations for the R&R industry here in North America is flat to down low single digits. For clarity, we do expect our international business or international industry to be down low to mid-single digits. So, a little bit of a more of a headwind there in the international markets, particularly in China.

What I would say in terms of where we're headed, just a couple of things. First is, as I think people appreciate, there was a significant pull forward of R&R activity, particularly in 2021 and 2022. And we're seeing the repercussions of that. A little bit of a hangover of sorts with regards to the pull forward activity.

And we're starting to cycle through that. We've seen that in our own business. So, last year, in 2023, the first three quarters of the year, our revenue was down 10%. But in the last six months, so Q4 of last year and Q1 of this year, it was down 2% to 3%. So we're seeing that stabilization as we cycle through that pull forward impact.

And in fact, we're seeing a little bit of pent-up demand with regards to the higher interest rate environment that I think we all recognize may be higher for longer, but the stabilization is there. And what we're seeing is improvement in terms of the orders return to more normal seasonality. So, a stronger Q2, a stronger Q3, and the sort. So, kind of return to normalization.

But I think importantly as we look forward is really the strong foundation of the industry. The fundamentals are very strong. You've got what we've experienced is strong home price appreciation over the last few years and is therefore strong home equity, and people feeling confident to reinvest in their homes, which is a strong secular trend.

Secondly is the age of the housing stock. Every year it gets older. But importantly, there's about 1.7 million homes, incremental homes that will enter what is often called the prime remodeling age of 20 years to 40 years. And why that's important is because homes in that that age bracket tend to spend 15% to 20% more discretionary remodeling projects. And we're anticipate or it's estimated that there'll be about 20% more homes in that category in 2025 than there were in 2020.

And then you've got the secular trends in terms of the millennial home ownership as well as household formation. And so, it really bodes well. And what we're anticipating and it's really a triangulation of data points is that we would expect that that ultimately the industry here in North America to return to more normalized growth in the 3% to 5% annualized growth space.

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Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. And maybe just a little more granular driving into second half of this year versus first half. You continue to expect to outperform the market this year overall by 1% to 2% this year. Sales down slightly year-over-year in the first half versus a modest growth outlook in the back half. So when thinking about that back half growth, is that simply a function of comps or does the – do you see any inflection in market demand or other trends driving that back half improvement?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Yeah. So, there is a dynamic of comps with the decline in the industry that I indicated really started in late 2022, and we saw that throughout 2023 sets for more favorable – set up for more favorable comps, particularly in our international market as we think about the second half of the year. But importantly, what we're seeing in the business is, as I mentioned earlier, is stabilization. And so, the industry and our business has declined at a decreasing rate. And what we're seeing is some favorable trends, not only in stabilization, but some opportunities.

So I think just to mention it as a data point, in Q1, in North America, our Delta Faucet Company wholesale business actually grew and Delta grew overall in Q1. So that's shaping up to be favorable and we're seeing that slowly manifest itself across the industry. I think it's a matter of timing. As I mentioned, the fundamentals are strong. And so, it's not a matter of if, but when. And so, we're tracking it very closely. Things are encouraging. I mean, we see 2024 really as a kind of a transition year. And we see things stabilizing here as we progress during the course of the calendar year.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. So, maybe shifting a little bit to even longer term goals around growth. You've set your organic growth goals at 3% to 5% annually on a longer term basis. And part of that is outperforming the market a little bit. How do you breakdown that growth goal by segment? Kind of thinking about Plumbing versus Decorative Architectural. And what do you see in terms of the opportunity for share gains in each of those segments

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Yeah. No, I appreciate it. Yeah. So, in terms of our expectations of 3% to 5% growth, we haven't specifically broken it down by each of our segments. But it's fair to say that our growth expectations are fairly similar within that range for both of our segments. And what I would say is, as I mentioned in my opening comments, we expect above market growth. And that's something that we're very focused on and really a function of our brands, our products and our service.

What I would say specifically in terms of where we're focused on driving growth and above market growth, are there kind of three specific areas. One, is in North America Plumbing and specifically in the wholesale business where we're investing in terms of displays, product innovation, et cetera. And so, we're seeing, as I mentioned, growth already here in Q1, but that's really a longer term focus of ours.

Second, is in the international space, Hansgrohe specifically. And in terms of that, we've seen performance against our primary competitor really outperform in terms of our performance on a global basis and specifically in Europe. And although the industry is down, as I mentioned before, we're gaining share in that environment, which is encouraging and sets up well when the market does turn to grow.

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And then third is really in the coatings space in the pro specifically. And we've been able to with our partnership with the Home Depot really investing in the pro paint space. We can talk more about that. But the pro paint space is an area that we've seen significant progress. We've actually grown 60% on a stacked basis over the last three years through 2023. And so, that bodes well in terms of the initiatives that we put in place. And we're continuing to double down on those and grow in the pro paint space.

So, those are the areas that I would highlight as areas that we're focused on in terms of growth and above market growth specifically.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Right. No, that's perfect. And actually kind of leads to kind of a subset question around that pro paint opportunity that I wanted to zero in on a little bit more. So, if – obviously a lot of success and I think when you look at the last two years or three years arguably being able to not just capitalize on some challenges more broadly that the market saw in terms of some of the competitors out there but hold on to those gains, which is equally as impressive. And so, thinking about the next two years or three years for the pro paint efforts, maybe if you could dive a little bit more into what the playbook is to continue to gain share?

During the first quarter pro paint was roughly flat. It's similar to DIY. And I think conceptually a lot of people think about pro paint still having a little bit of a stronger growth profile relative to DIY. So maybe just kind of talk about what the opportunity is for pro? What would that translate to in an ongoing growth rate over the next two years or three years? And again, how to get there?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Sure. So, as I alluded to, some of the success that we've had historically or at least in the past few years and maybe for context, BEHR brand in terms of paint has historically been known as a DIY paint brand. And it holds a significant share in the DIY paint segment. We believe it's about a third – 33% market share, roughly speaking. We have grown the pro paint business from close to nothing to what we estimate is about a 20% share in the last kind of few years, really anchored off the growth that we've experienced over the last three years.

And to dimension that, our pro paint business is about a $900 million business. And the overall, we think addressable pros industry is about $5 billion here in North America, so just shy of 20%. And so, we see that as an underrepresented share and an opportunity. Now, obviously, we need to invest and go after that opportunity.

And the areas that we're focused on in partnership with the Home Depot is, first, is really making sure we've got the resources at the retail stores, the sales reps, the product rep, to really reduce the friction in terms of the purchasing experience.

The second is, make it convenient for the pros. And that is really enabling more convenient and more flexible delivery options, order online, pickup in store, onsite delivery, those types of mechanisms.

And third is the loyalty program to make sure that we – as we gain share, that we retain that share. And I think we're really, really optimistic in terms of the progress that we've made and what that translates into going forward as we recognize the successes and focus on growth to grow their share, but also the business overall.

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Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. Shifting to margins. Your long-term goals for margins for the company Plumbing at and Decorative at roughly 20%, 19% to 20% respectively, which is approximately 100 bps, 150 bps above our 2024 estimates. So, I guess the question is why not higher ostensibly? What are the incremental margins for both businesses? And are there structural limits to the profitability by segment in terms of either product reinvestment or your relationship with Home Depot that perhaps prevents a higher level of profitability over time?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Sure. So, maybe for context and background, the margins you mentioned, which I'll come back to our margins we put out for 2026. But for some context, and I'll talk about Masco overall. In 2022, our margins for – operating profit margins for Masco were 15.6%. And before the pandemic they were anywhere between 15% to the mid-16%. Fast forward to 2023, we achieved 16.8% operating profit margins. And we've guided to approximately 17% margins here in 2024.

And as you alluded to, Mike, we've put out long-term margins for Masco of 18.5% in 2026. And so, it really represents from 2022, but almost a 300 basis point margin expansion. And relative to where we are, call it today, about 150 basis point margin expansion. And so, we feel really good about the progress that we've made and that we intend to make and we're committed to making over the near medium term.

And the reason we put those margin targets out there for 2026 was to be able to communicate the margin potential of the business. We intend to grow above market as well as expand margins, and we wanted to make sure that that was clear and understood. What I would say is that in terms of our incremental margins, what we call oftentimes our drop-down margins are about 25% to 30%.

And that's a big part of what's going to help drive the margin expansion that we see between now and 2026. And so, we of course will reinvest that in the business because we want to grow above market and grow margins at the same time. And so, I think that helps dimension the opportunity that we have in front of us, particularly as the market turns back to a growth dynamic here in the 3% to 5% range over the next couple of years.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Okay. Appreciate it. Wanted to shift also to focusing a little bit on the acquisition strategy, M&A bolt-ons, I believe, looked at as contributing, 1% to 2% of incremental growth. I think, in terms of the algorithm over time on average. I'm sorry, 1% to 3% actually have here. Can so – just would love to dive into this a little bit, maybe just talk about the opportunity by segment and if there's the potential for any larger acquisitions over time as well.

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Yeah. So, Mike, as you stated, our growth algorithm is generally 3% to 5% organic growth, which we've mentioned plus an additional 1% to 3% inorganic growth. And we have a range because as we all know M&A activity is lumpy. But it's an important part of our growth algorithm. Our focus, in terms of acquisition targets are really bolt-ons. Bolt-ons, what we mean by bolt-ons are businesses or companies that really fit and are consistent with our strategic philosophy. But importantly, within our product portfolio. We're not looking to add an additional line of business. A third leg is often referred to.

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Our focus is on acquiring companies that are – that we can bolt-on to our existing businesses. And a couple of examples of that recently was the Steamist acquisition in late 2021, early 2022, which bolted on to our Delta business. And then more recently in 2023, the Sauna360 acquisition that closed in the Q3 of 2023, that [ph] is finish on a (20:26) business that we bolted on to our Watkins Wellness platform and has been an excellent addition to the portfolio. But is really going to leverage the existing business and dealer network that we have here in North America. As it pertains to larger acquisitions, we're not averse to a larger acquisition, but that is in our mainstream focus. It'll be more opportunistic.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Right. So, talking about not adding a third leg. I think one of the questions that we get from time-to-time is, the Kichler acquisition that has since being acquired, gone through some ups and downs and so kind of curious on your take of Kichler at this point, in terms of – how it's performing, [ph] it's fit (21:14) in the portfolio. So at the time of acquisition, it had about $450 million of – all right. I thought that would be a repeat of the original.

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

We return from intermission.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Yes. Everyone on the webcast. We are okay, thank you. So as I was – as I was asking about the Kichler acquisition. So, has had some ups and downs, wanted kind of your updated thoughts around the performance of the business. How it fits or still fits or may not fit in the business today as part of the portfolio. At the time it was acquired, it had annual revenue of $450 million. So, just trying to get a sense of maybe the size of it today as well? And again, any kind of thoughts on its fit within the company?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Sure. Again, maybe for broader context. Kichler is a business we acquired a number of years ago, it's a lighting segment and it fits within our Decorative Architectural product segment. We don't disclose the size and performance of specific business units. We report obviously at a segment level, but we do disclose that – lighting business i.e., Kichler is about 3% of Masco's revenue. So, it puts in perspective, in terms of the size of that business relative to broader Masco.

In terms of performance, what I would say is the team over the last couple of years has done a tremendous job, really restructuring the business and positioning the business for success and they've taken actions, some hard decisions, in terms of exiting certain unprofitable or low profit lines of business, addressing pricing opportunities as well as of course cost opportunities and is again really positioned – turned around the business, in terms of where it stands in the portfolio and from a profitability standpoint.

What I would say as a general matter, as we talked about M&A previously, we – Masco had a long history of really buying and selling companies and we look at our portfolio on a regular basis, on a periodic basis and we assess, in terms of strategic fit both on the acquisition and disposition side. So obviously no comments with regards to any specific business unit. But I just want to add that's something that that we look at on a regular basis.

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Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Okay. Also on the plumbing side, you mentioned Steamist and Sauna360. I think in general, the awareness of wellness and some of those added types of products and features in our home are – in or around the home are getting better and better understood. Your competitor also in the plumbing space has kind of made a lot of noise around digital, various types of Wi-Fi-enabled monitoring, etcetera. You actually made an acquisition in 2020 of SmarTap, smart bathing system monitoring, monitors and controls the temperature and flow of water. So, how do you think about that element of the equation within the water space, within the home, if there's other avenues maybe to drive, in terms of growth for the business?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Sure. What I would say is one of the key tenants of – one of our key strengths is product innovation. And we look at that both organically and inorganically. And so, Mike, you referenced a couple of acquisitions that were largely product-based acquisitions that were bolt-ons to our business, which have been successful. And as I mentioned before, our bolt-on strategy is focused on targets that are strategic fits in our business.

We'll add obviously to our business financially, but also oftentimes provide technology, incremental technology, but it's not limited to acquisitions. In terms of our focus on product innovation, we look at really water quality and water sustainability. And one example that I would reference that is going to be launched here in Q3 of this year is the Delta reverse osmosis water filtration system that we launched in the Vegas Building Product Show, in terms of a new product and that's an organic based development. But those are the types of opportunities that Masco, particularly in the water quality and the plumbing space focus on.

I guess another one is, that I'd reference is Watkins Wellness, which is a spa or hot tub business. And we launched a FreshWater IQ system, which really monitors the quality of the water and really provides the customers with information and really digitally communicated information with regards to managing the chemistry in their hot tub. So, those are our organic examples that complement the acquisition strategy that you referenced.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. I have one or two more questions. But maybe I'll pause here. If there's any questions from the from the audience. Yeah.

Q

Just curious, Home Depot has made a big move to bolster their Pro exposure. Just any thoughts? What, if any, impact that will have in your efforts with them to bolster your Pro business?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Yeah. So the acquisition you're referring to is, Home Depot announced an acquisition of SRS Distribution. That business is focused really on roofing, landscaping and pools. So, it doesn't have a real direct impact or very limited direct impact, in terms of our business with the Home Depot. But I think it's illustrative of the commitment to the Pro. I mean that's one of the investment thesis that I know they put forward. And for us, as I mentioned before, partnering with the Home Depot, in terms of continuing to build the Pro business, particularly in the

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Coatings not limited to the Coatings, but particularly in the Coatings business. So, I think it is just a reinforcement of that orientation of focusing on competing and having good amount of service level to the Pro.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

And just one more, if I could. We heard from a bunch of companies yesterday talking about, existing home sales would be good for your business and obviously would be good for yours as well. But, painting, plumbing typically thought to be lower. cost projects happen on a more regular basis. So, just your thoughts on existing home sales picking up versus just getting past that pull forward that maybe you had a couple of years ago and what would be the bigger drivers for your business over the next couple of years?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Yeah. Good question. Interestingly [ph] I mean existing (29:18) home sales does have an impact. But it is a bit more muted in our business, particularly in the repair and remodel side of the business. In Masco, about 90% of our business is in repair and remodel. And the interesting fact is, existing home sales have historically run, $5 million to $6 million. They're down closer to $4 million, $4.5 million now. So, they're suppressed, but that's compared to about 130 million installed base and 90% of repair and remodel projects are initiated by homeowners that haven't recently moved. And so, the critical mass is really based off of existing home or existing homes that are out there.

In the home equity that I mentioned before is a real driver, in terms of consumer confidence and willingness to invest in their home. So that's the foundational part of the industry. Existing home sales does help though. Obviously, it's been impacted by the higher interest rate environment. And so, I don't have a particular prediction on when that that will change or pivot, but it will ultimately, I think there's pent-up demand. And so that will be helpful as it returns to more normalized levels in the coming years. And it does have a bit of a bigger impact on our paint business, particularly the DIY business, as I mentioned earlier is a bigger part of our paint business. So it does have an impact, but what we're seeing is, our future growth isn't dependent on that. But it will be a helpful tailwind once that does pivot.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Sure.

Q

[ph] Paint is a pretty cozy (31:04) industry. Have you seen any competitive response to the [ph] BHER success (31:11) in recent years?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

It's a competitive environment. I think, what I would say is, there's an increased amount of focus on the pro really across the board. But we feel really good about the initiatives that we had and the success that [ph] is BHER out (31:28) and the partnership with the Home Depot has never been stronger with regards to going after the Pro, I mean pursuing the Pro, where we think we're well positioned is the Pro that paints. So the Pro that's going into a home center to effectively do a multifaceted project and paint is a key element of that. And we're able, in

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partnership with the Home Depot, provide that solution to them and continue to make it an attractive purchase experience.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Any other questions? We have a few minutes left. I'll throw one more out. But if anyone has anything, just raise your hand. But the last kind question I was kind of curious on a little bit was on the e-commerce side. Currently your e-commerce accounts for about [ph] 17 of (32:32) the last slide deck, 17% of Plumbing, a mid-single-digit percentage on Decorative. How do you see it? The channel – e-commerce channel evolving over the next two or three years? And what type of impact could that have on Masco? And what steps do you feel you need to take to ensure positioning in that channel over the next few years?

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

A

Sure. So e-commerce has been an important and growing – an important channel for us. As you mentioned, we have about 17% of our sales on the Plumbing side that go through the e-commerce channel. And it's more significant in Plumbing than it is on the Decorative Architectural product side because that's mostly paint and e-commerce isn't as important in that space. Although as I mentioned before, we are working with the Home Depot on a number of initiatives to facilitate that transaction.

Delta has been really a leader in the e-commerce space and they continue to invest in terms of the people, their capabilities, the resources in that. And e-commerce is important not only in terms of the transactional element. But also driving traffic to the Delta brands and the new products. As I mentioned before, product innovation is really important and product innovation isn't limited just to technology, it's design and capabilities. And to get awareness of our new products out there. For example, the reverse osmosis water filtration system, driving digital traffic is a key element of that. And it also helps with our partnership with our omni-channel partners, with the homedepot.com etcetera. And so, it really helps drive traffic, in terms of transactional, but also in terms of consideration. And so it has continued to be an increasing part of our go-to-market strategy. And the team is focused on continuing to invest in that space and continue to lead in that space.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Perfect. Well, we're just about out of time. So, I'm willing to close it off here. Thanks again, Rick and also Robin, for all your help coordinating. We will continue the conference at 9 AM with TopBuild. Later today will be joined by homebuilders, Taylor Morrison, LGI and Smith Douglas, rounding out early afternoon with Forestar Group. So thanks again, Rick. Appreciate it. And we'll be back here in a few.

Richard Westenberg
Vice President, Chief Financial Officer and Treasurer, Masco Corp.

Great. Thank you.

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