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Masco Corp. (MAS)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Welcome to Masco Corporation's Third Quarter 2024 Conference Call. My name is Ludie 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'll now turn the call over to Robin Zondervan, Vice President, Investor Relations and FP&A of Masco Corp. You may begin.

Robin L. Zondervan

Vice President, Investor Relations and FP&A, Masco Corp.

Thank you, operator, and good morning, everyone. Welcome to Masco Corporation's 2024 third quarter conference call. With me today are Keith Allman, President and CEO of Masco; and Rick Westenberg, Masco's Vice President and Chief Financial Officer.

Our third quarter earnings release and 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 will now turn the call over to Keith.

Keith J. Allman

President, Chief Executive Officer & Director, Masco Corp.

Thank you, Robin. Good morning, everyone, and thank you for joining us today. Please turn to slide 5. For the third quarter, we delivered strong operating results, as we focused on driving the full potential of our portfolio through leading brands, innovative products and exceptional customer service. Net sales were in line with the prior year, as we saw demand continue to stabilize, most notably in our Plumbing segment.

Our gross profit margin rose 90 basis points to 36.7%, as a result of our ongoing initiatives to drive operational efficiencies and achieve cost savings. Our solid execution resulted in operating profit of $360 million, an increase of $12 million or 3% over the prior year.

Our operating profit margin expanded 60 basis points to 18.2%, marking the sixth consecutive quarter of year-over-year margin expansion. In addition, our earnings per share grew 8% to $1.08 per share.

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Moving to our segments. Plumbing sales increased 2% overall and 1% excluding the impacts of acquisitions and currency. In local currency, North American Plumbing sales increased 2% overall and 1% excluding the impact of acquisitions. In International Plumbing, sales increased 3% in local currency, led by growth in our key markets of Europe and China.

Operating profit for the segment was up $17 million to $242 million. Operating margin expanded 100 basis points to 19.9%, driven by higher volumes and our continued focus on productivity, efficiency and cost savings initiatives.

Additionally, we continue to demonstrate our leadership in water quality and innovation through new product launches that leverage our channels and brands. We launched a tankless reverse osmosis water filtration system this quarter across our Delta and Brizo brands. This system is certified to filter out more than 90 contaminants from your drinking water and is both easy to install and maintain.

At Hansgrohe, we launched the [ph] powder spray (00:04:58) faucet where micro-fine water cascades from beneath the faucet spout for easier washing of foods, like fruits and vegetables, at a lower flow rate for water conservation and less cleanup. Hansgrohe also received the Superbrand Germany Award in the quarter. This prestigious award recognized Hansgrohe's dedication to excellence, quality and service to our customers.

Finally, we reached the one-year anniversary of our acquisition of Sauna360 during the quarter. We're proud of the work our team has done to successfully integrate this business, which includes the recent launch of Tylö branded saunas into our existing Watkins dealer network.

Moving to our Decorative Architectural segment. We announced earlier this quarter the completion of the sale of Kichler Lighting. We are confident that this transaction to further streamline our portfolio will drive greater value for Masco shareholders, as we focus on the strategic initiatives of our core Plumbing and Decorative Architectural businesses.

Sales in the Decorative Architectural segment decreased 3% in the quarter or 1% excluding the impact of currency and divestitures. Overall paint sales were down low single digits. DIY paint sales remained challenged, decreasing mid-single digits, while PRO paint sales continued to show strength, growing high single digits. Operating profit for the segment decreased $6 million to $138 million, while operating margin remained strong at 18.1%.

We were pleased once again this quarter with our performance in PRO paint. We're proud of our continued sales growth with the PRO painter and we are continuing to invest to drive additional growth going forward.

We have an incredibly strong relationship with The Home Depot, which dates back over 40 years. For multiple decades, we have partnered with The Home Depot to distribute our products in their over 2,300 stores. We continue to partner with them on strategic initiatives centered on the strength of our brand, our unmatched service and the award-winning quality of our products to drive share gains in both DIY and PRO paint categories.

Turning to capital allocation. We continue to generate strong free cash flow during the quarter and maintained a solid balance sheet. As a result, we executed on our capital deployment strategy and returned $255 million to shareholders through dividends and share repurchases.

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We plan to deploy the net cash proceeds from the sale of Kichler Lighting, consistent with our capital allocation framework. Therefore, we now expect to allocate approximately $750 million in total to share repurchases or acquisitions in 2024.

Now a few comments on our full-year outlook. Overall, sales for the total company were within our expected range for the first three quarters of the year. However, the divestiture of Kichler will impact the remainder of our year and the DIY paint market remains challenged. Therefore, we now anticipate that sales for the full year will be down low single digits compared to our previous expectations of plus or minus low single digits.

However, due to the strength of our operational performance year-to-date, we now expect that our full year operating margin will be approximately 17.5%, which is at the top end of our previously guided range of 17% to 17.5%. We now anticipate adjusted earnings per share for 2024 to be in the range of $4.05 to $4.15 per share compared to our previous expectations of $4.05 to $4.20 per share.

We continue to believe that the long-term fundamentals of our repair and remodel markets are strong. And that...

[Technical Difficulty] (00:09:14-00:12:31)

Operator: Excuse me, ladies and gentlemen, please stand by. Your conference will resume momentarily. Thank you.

[Technical Difficulty] (00:12:36-00:15:28)

Operator: And excuse me, presenters, you may continue.

Keith J. Allman

President, Chief Executive Officer & Director, Masco Corp.

Okay. I apologize for that interruption. I know that we're all very busy today. There's a lot of calls that need to be done. So my apologies.

As I was talking with respect to the long-term fundamentals of our repair and remodel markets, we believe they're strong. And that structural factors, such as the age of housing stock, consumers staying in their homes longer, higher home equity levels and household formations for millennials will drive increased repair and remodel activity in the mid- to long-term.

We believe we're well positioned to capitalize on future volume, as our capacity, efficiency, productivity and cost structures are set up to drive favorable incremental benefits from additional volume. With these favorable fundamentals, the continued successful execution of our strategic initiatives across our portfolio and our disciplined capital deployment, we are well positioned to outperform the competition and deliver double-digit EPS growth through cycles for our investors.

Now, I'll turn the call over to Rick to go over our third quarter results and 2024 outlook in more detail. Rick?

Richard Westenberg

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

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Thank you, Keith, and good morning, everyone. Thank you for joining. As Robin mentioned, my comments today will focus on adjusted performance, excluding the impact of rationalization charges and other one-time items.

Turning to slide 7. Sales in the quarter were in line with the prior year and increased 1%, excluding the unfavorable impact of currency. Our acquisition of Sauna360 in the third quarter of last year added 1% of growth to our third quarter results. However, this was offset by the impact of our Kichler divestiture during the third quarter.

In local currency, North American sales were in line with the prior year, while International sales increased 3% in local currency. Despite relatively flat sales overall, our initiatives to drive operational efficiencies contributed to another quarter of strong gross margin performance at 36.7%, an expansion of 90 basis points year-over-year.

SG&A as a percent of sales was 18.6% and was impacted by the timing of marketing spend in our Decorative Architectural segment, as mentioned during our second quarter call. Overall, our operating profit grew $12 million to $360 million in the quarter and our margin was strong at 18.2%. Our margin performance was primarily driven by executing on our cost savings initiatives. We also grew EPS during the quarter by 8% to $1.08 per share.

Turning to slide 8. Plumbing sales increased 2% in the third quarter. Currency had a minimum impact on the results. Volume in our Plumbing segment drove an increase in sales of 2% and acquisitions contributed 1% to growth year-over-year. This was partially offset by unfavorable mix, which reduced sales by 1%.

North American Plumbing sales increased 2%, driven by our acquisition and solid performance in the retail and e-commerce channels. In local currency, International Plumbing sales increased 3%, driven by favorable volume and pricing actions, partially offset by unfavorable mix. Demand continues to show signs of stabilizations in Europe, and while the China market remains challenged, we benefited from our pipeline of projects in the quarter.

Segment operating profit in the third quarter was $242 million, up $17 million or 8% year-over-year, and operating margin was 19.9%, up 100 basis points. This operating profit performance was driven primarily by cost savings initiatives and higher volumes, partially offset by unfavorable mix and higher commodity and freight costs.

Turning to slide 9. Decorative Architectural sales decreased 3% in the third quarter. Currency and the divestiture of Kichler lowered sales by 1% each. In the quarter, total paint sales decreased low single digits. PRO paint sales were up high single digits and DIY paint sales decreased mid-single digits.

The DIY paint market remain soft, and we now anticipate our full year DIY paint business to be down high single digits versus our previous expectation of down mid-single digits. In our PRO paint business, however, we continue to expect sales for the year to increase low single digits.

Operating profit was $138 million and operating margin was 18.1%. Operating profit was down $6 million year-over-year, impacted by the timing of marketing spend, an unfavorable price/cost relationship and lower volume, partially offset by cost savings initiatives.

Turning to slide 10. Our balance sheet remains strong, with gross debt-to-EBITDA at 2 times at quarter end. We ended the quarter with $1.6 billion of liquidity, including cash and availability under our revolving credit facility. Working capital as a percent of sales was 16.4% and reflects the impact of the divestiture of Kichler as well as our continued discipline with regards to our working capital level. As a result of the divestiture impact, we now anticipate our working capital as a percent of sales to be approximately 16% at year-end versus our previous guidance of 16.5%.

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During the third quarter, we repurchased 2.5 million shares for $192 million and paid a dividend of $63 million to shareholders. As Keith mentioned, we plan to deploy the next proceeds from the sale of Kichler, consistent with our capital allocation framework. As a result, we now expect to deploy approximately $750 million, up from $600 million during the year towards share repurchases or acquisitions.

Now, let's turn to slide 11 and review our outlook for 2024. For total Masco, our year-to-date top line has largely been in line with expectations. Last quarter, we updated our second half expectations to roughly flat as market conditions remain challenged. The fourth quarter, however, will also now be impacted by our divestiture of Kichler. As a result, we currently anticipate full year sales to be down low single digits versus our previous guide of plus or minus low single digits.

Despite this change, with our strong execution and operating margin performance year-to-date, we now expect full year operating margin to be approximately 17.5%, which is at the high end of our previous guide of approximately 17% to 17.5%.

In our Plumbing segment, we are maintaining our top line expectation of full year 2024 sales to be plus or minus low single digits versus prior year, and our expected full year operating margin to be approximately 19%. In our Decorative Architectural segment, we are lowering our 2024 sales expectation to be down mid-single digits year-over-year versus our previous guidance of down low single digits, primarily due to our divestiture.

In addition, the DIY paint market remained soft and has not shown signs of a material rebound. However, despite lower expected sales, we are maintaining our anticipated full year operating margin of approximately 18%.

Finally, as Keith mentioned earlier, we are updating our 2024 EPS estimate to be in the range of $4.05 to $4.15 per share. This assumes a 219 million average diluted share count for the year and a 24.5% effective tax rate.

As mentioned, there continues to be choppiness in the overall market. That said, we are focused on execution and controlling what we can control to deliver results within this range.

Lastly, additional financial assumptions for 2024 can be found on slide 14 of our earnings deck.

With that, I would like to open up the call for questions. Operator?

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Susan Maklari with 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 focusing in on the DIY weakness that you highlighted in Decorative Architectural. Can you just talk a bit about how those sales trended through the quarter? How you're thinking about the implications of perhaps the election and the broader macro uncertainty? And as we get past some of that, how you think things there could come back as we look over the next couple quarters?

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

A

Susan, it's Keith. Good morning. As you know, we really don't break down inside the quarter, month-to-month performances, as that can be quite variable depending particularly on year-over-year and what happen with regards to new product launches, infill of stock, et cetera.

So I would tell you that it's been fairly consistent through the quarter and that there wasn't any particular notable change within the quarter. So I'll speak to that in that fashion.

With regards to the election, we don't really view the election or the – how the results go, specifically as it relates to DIY paint. We think of it more holistically about what that means for our overall business. And fundamentally, I think like so many issues that we face in a volatile environment, like we have now, it really puts a premium on the ability to respond both in terms of our supply chains and our commercial teams, the ability for us to get price if needed, based on the strength of our innovation pipeline and the strength of our brands, and how we are doing with regards to overall shelf space and market share. So it's really for us, in terms of the election, a question of how well we're able to respond.

And I think if you look at the various challenges that we've experienced with our team and our operating system, over the course of the last several years, whether you look to the capacity issues in paint that we faced a couple years ago, whether you look to the tariff situation that we faced and how we've [ph] broaden (00:27:21) our margin up above pre-tariff levels where we sit today, I think all those things point to the fact that our portfolio of small ticket, a more resilient, less volatile products together with our team and our operating system has put us in a position we're able to respond.

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So, we're really looking at the election of – as just being on a high alert and being ready to respond to the challenges that may or may not come our way.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Okay. That's helpful color. Thank you. And then, turning to the margin, despite all the uncertainty that's out there, it's impressive to see the consolidated expectations at the higher end of the guide. Can you just talk to some of those factors that you noted around the company specific initiatives? And how we should be thinking about those continuing to come through as we think about year-end and maybe even into next year?

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

Sure. We're definitely pleased with our margin performance. It's come in as expected. And this was our sixth – as we said in the prepared remarks, this was our sixth consecutive quarter of margin expansion and it has been executed in a volatile environment. So I think, again, that goes back to what we intended when we designed our portfolio to be less resilient – or excuse me, more resilient, less cyclical, higher margin. So it's that combination of a robust portfolio, the operating system and our teams.

We got particularly strong gross margin performance. And of course, that's really from our focus on operational excellence, cost savings initiatives. And yeah, 17.5% is strong for us, and it's at the top end of our range. We expect the full year margins to expand for the entire company and for both our Plumbing and Decorative segments, and we certainly will carry that momentum into next year.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Thank you for the color and good luck with everything.

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

Thanks, Susan.

Operator: Your next question comes from the line of Michael Rehaut with JPMorgan. Please go ahead.

Andrew Azzi
Analyst, JPMorgan Securities LLC
Q

Hi, everyone. Thank you for taking my questions. This is Andrew Azzi on for Michael Rehaut. Good morning. I just wanted to ask, maybe, I believe your 2026 targets were predicated on a 3% to 5% R&R growth rate for the next couple years. Is that kind of still the right way to think about it? And maybe, high level, maybe if we can get your thoughts on the repair and remodel and market for next year?

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

Sure. Thanks, Andrew. When you think about that more normalized 3% to 5% growth rate for R&R, we have not changed that. That is our expectation of what a "normal" or historical growth rate for R&R is, and we still expect that. Certainly, when this market turns to that normal rate of growth is up for debate, and our crystal ball is no

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clearer than anyone else. And that, as I said earlier today, puts a premium on our ability to respond quickly, and we've demonstrated that we have that capability.

So we haven't changed our expectations of what the R&R market is. We think the fundamentals are very strong. When you look at mid- to long-term of what drives R&R, it's about home equity, it's about home price appreciation, it's about consumer confidence. And so when those things start to turn, and we think when you see the reduction in rates and when you think about the underbuilt or the deferred R&R spend in the deferral state that we're in, we're poised in the mid- to long-term. It's just unpredictable of when that will turn. We're not changing our 2026 expectations or guide, if you will.

Andrew Azzi
Analyst, JPMorgan Securities LLC

Q

Thank you. I appreciate that color. And then maybe in terms of the PRO paint business, it's nice to see it being pretty resilient, obviously, in the past few quarters. Can you kind of review maybe the current size of the business and how we should think about the growth opportunity going forward?

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

A

We're very pleased with the growth in PRO paint and our ability to gain share and to hold that share. And that goes back to the strength of the Behr brand, the strength of our deep relationship with our great channel partner in Home Depot in the 40 years that we've been working together, as we mentioned. Certainly, our innovation pipeline, the quality in the can and how well recognized that is.

And when we gain share and we look at the Net Promoter Score of our new customers [ph] in the PRO side or (00:32:09) customers who have increased their share of our buy, the Net Promoter Scores are fantastic. So try us, you'll like us sort of thing. And that's really what's happening. So we're very happy with the – our performance in PRO. Andrew, what was the second part of your question?

Andrew Azzi
Analyst, JPMorgan Securities LLC

Q

I suppose kind of like the size of the business and how we should think about the growth opportunity, maybe even alongside DIY going forward.

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

A

Right. It's approximately $900 million and – in terms of the size of our PRO paint market. And we expect to continue to grow above market and gain share going forward.

Andrew Azzi
Analyst, JPMorgan Securities LLC

Q

Is that – on the above market growth, is that kind of on the DIY and PRO or just on the PRO?

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

A

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We believe, and it's hard to judge particularly DIY market size from one quarter to quarter, as I've consistently said on these calls, but we believe we're holding our own and holding our share in the DIY market, maybe gaining a little bit, but the DIY market continues to be challenged.

Andrew Azzi
Analyst, JPMorgan Securities LLC

Q

Thank you very much. I really appreciate your time.

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

Aatish Shah
Analyst, Evercore Group LLC

Q

Hi. This is Aatish on for Steve. Thanks for taking my questions. I just want to start with – within Dec Arc, it was mentioned the updated sales guide primarily was due to the divestiture of Kichler. But turning to the margin piece, how much of a benefit would you say to the current margin guidance is due to the divestiture of Kichler?

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

A

Yeah. Hi, Aatish. Good morning.

Aatish Shah
Analyst, Evercore Group LLC

Q

Hey. Good morning.

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

A

This is Rick. So with regards to – as you indicated, the sale of Kichler translated into us revising our guidance downward with regards to our top line, down to mid-single digits for the Decorative Architectural Products segment as well as for total Masco down low single digits.

We don't disclose individual profitability by business unit. We have indicated in the past that Kichler's margin performance was below that of the segment and below that of Masco overall.

So the divestiture is accretive. We haven't quantified it, but I would say that our increase in our margin expectation is really through the course of the year, because as you may recall, we came into the year with an expectation of about 17% operating profit margins. We increased that a couple times through the course of the year, and now we're expecting 17.5% operating profit margins for the year.

And yes, Kichler is a contributing factor to that, but I would say equal or more than that is our operating performance across the business units and being able to continue to deliver the productivity and the cost efficiencies that Keith alluded to, to be able to deliver operating profit margin expansion in the face of a challenging market.

Aatish Shah
Analyst, Evercore Group LLC

Q

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Great. That's super helpful. Just one more. Then just talking about the – for the paint category overall, can you talk about the mix effect? And then specifically within DIY, are you seeing any trade up or trade down trends within the category? Thanks.

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

A

Not really much in paint. We saw a little bit of mix impact in Plumbing in the quarter, but no in paint. We've worked really hard across our portfolio, across the assortment, across our channels, et cetera, to work to reduce the variability in our margin. There's still some that exists, but we've done a particularly good job in paint and we really haven't seen them – with our broad assortment in terms of price point coverage, we really haven't seen a significant mix hit in coatings.

Aatish Shah
Analyst, Evercore Group LLC

Q

Great. Thank you.

Operator: Your next question comes from the line of Trevor Allinson with Wolfe Research. Please go ahead.

Trevor Allinson
Analyst, Wolfe Research LLC

Q

Hey, good morning. Thank you for taking my question. First one on DIY paint. Clearly, that's faced some headwinds over the last few years following some really strong performance during the pandemic. Do you think that market has reset to the point where, moving forward, you expect it would grow in line with the overall R&R market?

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

A

I don't know that I'd say that it would grow in line with the overall R&R market. But when you think about how in the past it has been a declining sub-segment for us in terms of DIY, I do believe that's going to turn around and go to growth, and I think it's because of the fundamentals. When you look at the influx of millennials that are forming households and getting into the housing market, the healthy levels of home equity that continue to be a support investment in your home and the DIY position, the fact that we know through our research that millennials are not only DIYers, but they're repeat DIYers as we follow them over the last couple years.

So we do think that there will be a return to growth in DIY paint. The question is when.

Trevor Allinson
Analyst, Wolfe Research LLC

Q

Right. Yeah, that makes sense. Okay. And then, on Kichler, clearly had an outsized exposure to China imports for a relatively small size of the business. You gave a rough framework on your last call about your China import exposure. I would assume that that improves here with the Kichler divestiture. Any way you can roughly frame your updated exposure to Chinese imports post the sale? Thanks.

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

A

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Yeah. I would tell you that from a concentration perspective, as it relates to the revenue, Kichler had a higher concentration of Chinese imports than the other portions of our business, but it's relatively small when you look at the overall scheme of things.

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

Yeah. Trevor, maybe just to dimension a bit. I think you alluded to the fact that we commented in our Q2 earnings call that since the Section 301 tariffs were implemented in 2019, we've reduced our exposure as a total Masco enterprise by about 30%. With the divestiture of Kichler, that takes us up closer to 40% in terms of a reduction of our exposure. It still leaves a significant exposure, but we've done a lot of work, and we continue to do a lot of work, in terms of our sourcing footprint to continue to mitigate and manage that exposure.

Trevor Allinson
Analyst, Wolfe Research LLC
Q

Okay. That's very helpful. Appreciate the color there and good luck moving forward.

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

Thank you.

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

Spencer Kaufman
Analyst, UBS Securities LLC
Q

Hey, guys. Good morning. This is actually Spencer Kaufman on for John. Thank you for the questions. The first one, you talked a fair amount about how the DIY paint market continues to be challenged. How much lower are DIY paint volumes today relative to 2019 levels?

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

Well, I don't have that number top of mind. I know they are slightly lower, but I don't have that actual number top of mind. I can get to that after the call.

Spencer Kaufman
Analyst, UBS Securities LLC
Q

Okay, no problem. And now that the PPG has announced the sale of its architectural coatings business to AIP, how closely did Masco look at these assets? Did you engage in the bidding process? And can you talk a little bit about your decision to just not pursue those assets more aggressively? Was there a conflict with your strategy with Home Depot? Or how should we think about how this played out?

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

Of course, we looked at it. We looked at it in depth and we gave it a hard analytics. But at the end of the day, we have to make decisions that we believe will be the long-term interest of our shareholder value. And this wasn't a fit for us. I'm not going to go into details beside that – beyond that. I'll tell you, we've competed against PPG and

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others in the industry that are very strong, and we're confident in our ability to continue to do so successfully. And this just – this acquisition just wasn't something that we were interested in.

Spencer Kaufman
Analyst, UBS Securities LLC

Q

Fair enough. Thank you.

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

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Morning, everyone. Thank you for taking the questions. So the – in Plumbing, the good margin result, despite the higher commodity and freight. I guess, I'm curious if commodity and freight costs have – if they have indeed actually come in as a greater headwind than what you initially thought, and as a result, if you've offset those by more either cost reductions or price. And then, specifically, as we kind of get into 2025, is there – should we think about any need for additional price to be taken in the Plumbing segment? Thank you.

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

A

Sure. This is Rick. And I guess to provide a bit of a timeline for commodity and freight overall, we came into the calendar year not expecting it to be a significant headwind or tailwind. Obviously, as we all saw in Q2, the appreciation of commodity costs, namely copper and zinc, go up significantly. Actually, copper, as you may recall, hit an all-time high in May at over $5 per pound. And that is when we commented in our Q2 call, that would represent a headwind with regards to our second half result. And that's because, as we've commented before, it takes about six months between when we observe commodity costs in the market until they hit our P&L, as they flow through the sourcing and inventory pipeline. And so we're seeing that headwind. And as we indicated, we are unfavorable from a price/cost perspective in Q3, and we expect that to continue in Q4. And that is in line with our expectations as we came out of the Q2 call.

I mean, that's pretty locked in right now in terms of our expectations. That's dialed into our guidance for the year. And despite those headwinds, in terms of the commodity cost, we are actually, through the cost initiatives and the pricing during the course of the year, able to offset that from an overall margin perspective. And thus, we're expanding our margins in Plumbing 100 basis points in this quarter and we would expect margin expansion in Q4 and for the calendar year in Plumbing.

Now, commodity costs have subsided a bit more recently, but they still remain elevated. They remain elevated to 2023. They remain elevated relative to historical levels. And so that's a factor as we go into 2025, and that will factor into our pricing strategy as we go into next year.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you for that, Rick, very helpful color. And then secondly, I think going back to a prior question that was around your 3% to 5% longer-term market growth, I wanted to ask specifically on 2025, as we kind of sit here in Q3, looking ahead, kind of given how we're exiting the year, around DIY and R&R overall. Just any kind of initial thoughts on what 2025 R&R could look like, what you're planning for and sort of any implications to how we're starting 2025 relative to how you're planning the year to shape up? Thank you.

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

A

Appreciate the question, but we'll talk about 2025 on our next call when we're together next. I would leave you with the thought that I've been consistently talking about with regards to the fundamentals. And we think the fundamentals are strong in our industry, but we'll get to the specific 2025 in our next call.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Okay. Thanks, Keith. Good luck, guys.

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

A

Thank you.

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

A

Thank you.

Operator: Your next question comes from the line of Phil Ng with Jefferies. Please go ahead.

Philip Ng
Analyst, Jefferies LLC

Q

Hey, guys. Hey, Keith, when I look at your Plumbing business, I think last quarter, you were generally constructive on an inflection in North America maybe, but International was bottoming out a little bit, but that recovery could be a little slower. International was actually quite strong. So can you talk about what are you seeing in both of these markets? And obviously, no one's got a crystal ball, but how do you kind of see the recovery and the pace and the momentum in these two sub-segments within Plumbing?

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

A

So, starting with International, Phil, pleased with the performance. We grew 3% in the third quarter. In this kind of market environment, that really speaks to Hans Jürgen and his team at Hansgrohe and what they've been able to accomplish.

I would characterize it, as particularly in Europe, is showing signs of stability in our key markets, particularly in Germany. China is a bit more volatile. We were able to deliver growth in the quarter. And again, that speaks to the team and the ability to gain share and the strong pipeline of trade projects that we have that continue to flow through. So we expect International, in aggregate, to be down low- to mid-single digits for the full year. That said, this is a good opportunity for us to outperform the market and gain share. And that's what we plan on doing.

In the United States, close to home here, we're seeing good e-commerce market. The market continues to, we believe, grow a little bit there. Our retail performance has been quite strong in the US as well. The trade I would say is a little bit more challenged, but fundamentally stable in North America.

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Philip Ng
Analyst, Jefferies LLC

Q

Okay, super. On your PRO side for paint, great growth, outperformed the market. As you kind of work with your channel partner, any other growth initiatives that you have slated for perhaps next year or maybe more shelf space? And then just given some of the weakness you've seen in DIY, do your lines have the ability to kind of swing production from DIY to more PRO paint just because you're seeing certainly more momentum there?

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

A

We do. And that's a key component of our whole strategy to be less cyclical, more resilient, higher margin. That is to work on margin differentials across channels, to work on margin differentials across our assortment, and to be able to flex our capacity, should the demand go from one type of channel or installation process to another. Yeah. We absolutely have that flexibility, and we have a new plant coming online very nicely in Heath, Ohio.

So that's really what puts this portfolio in good shape. We have capacity to support our expected growth for several years. And even with that available capacity, we're able to produce very strong margins. So the – when the turnaround in the market does occur, we're in a position to meet demand and also deliver some very nice drop-downs on that incremental volume. So, yes, we have the capacity to – our capacity is flexible.

In terms of what we're doing to drive PRO paint, our recipe is working. And the more PROs that try it, the more PROs that like it, and we've shown that we're able to maintain and have that share gain be sticky. So things like buy online, pick up in store, expanding delivery options, expanding our outside sales force, enhancing loyalty programs, we're working very closely with our channel partners to continue to grow this segment, and we're doing a good job at it, I believe.

Philip Ng
Analyst, Jefferies LLC

Q

Okay. Appreciate all the great color.

Operator: Your next question comes from the line of Keith Hughes with Truist. Please go ahead.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Thank you. With the divestiture of Kichler, I know you still are looking for M&A as part of your use of cash flow, but will we continue to see bolt-on transactions in Plumbing Products, maybe some things or something like that in the coverings market? Or would you look something a little further afield in terms of – for future activity?

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

A

Yeah, Keith, good morning. It's Rick. So from an M&A perspective, our strategy is pretty consistent and clear. We are focused primarily on bolt-on acquisition opportunities, really within our plumbing, coatings or wellness businesses. So that's really our focus. And we've demonstrated that with, for example, the Sauna360 transaction that we anniversaried this quarter, but that's what you would expect to see from us. We're not averse to a bigger transaction, but that would be still within one of our core business segments.

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Keith Hughes
Analyst, Truist Securities, Inc.

Q

Okay, and one follow-up. When did Kichler close?

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

A

September 18.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Okay. Thank you.

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

A

Sure.

Operator: Your next question comes from the line of Mike Dahl with RBC Capital. Please go ahead.

Christopher Kalata
Analyst, RBC Capital Markets LLC

Q

Hi. It's actually Chris Kalata on for Mike. Just a quick follow-up on the M&A. Given your pipeline to date, should – is it safe to assume the most likely outcome for Kichler proceeds will be share buybacks at this time?

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

A

We haven't announced any particular thing from an M&A perspective. So absent an announcement from our perspective, yes, we would follow our capital allocation framework, and the proceeds would be allocated to share buyback.

So the – just to clarify, we had about $150 million of net proceeds. So that increased our capacity for share buybacks or acquisition from $600 million to $750 million for the year.

Christopher Kalata
Analyst, RBC Capital Markets LLC

Q

Got it. Understood. And then just shifting over to Dec Arc and paint margins specifically, could you just kind of give us a bit more color on how overall core paint margins performed relative to your expectations, kind of where we are in the price/cost relationship? And in terms of the timing shift in marketing spend and cost savings, just a bit more color on expectations for the next quarter and how trends to date compare relative to your expectations?

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

A

Sure. From a Decorative Architectural Products segment perspective, our expectation – first of all, we delivered what we would consider strong margins in the quarter at 18.1%, and we reaffirmed our guidance in terms of margins for the year at approximately 18%. Effectively, what that is driven based off of is this cost performance within our businesses, within the Decorative Architectural Products segment, because we are facing a negative

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price/cost relationship. So as we've mentioned before, pricing in our Decorative Architectural Products segment is expected to be down low single digits.

Our commodity dynamic is roughly flat. We are seeing some pressure from a commodity input perspective, TiO2 and resin, but largely, this year our expectation is flat. So therefore, our price/cost expectation for the year and what we saw this quarter was down low single digits. So we're basically offsetting that headwind with regards – with our cost savings initiatives and expecting modest operating profit margin expansion this year versus last year. Hopefully, that addresses your question.

Christopher Kalata
Analyst, RBC Capital Markets LLC

Q

It does. Thank you. Appreciate that.

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

A

Sure.

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

Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Oh, hi. Thanks. I wanted to ask on PRO paint and a follow-up on your share gain there. For at least this year, are you gaining shelf space? Is that the basis of your share gains, or is the outperformance really coming against the broader market?

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

A

It's against the broader market, I would say. Shelf space is really not that critical of an item. But when you're talking about the PRO segment, we've got sufficient and appropriate shelf space, no real change in it. It's more about our offering, our ease of doing business, the quality of the installation, the ease of the installation, and the customer and consumer pull that comes from that strong Behr brand and our innovation.

So those are all more of the determining factors and our sales force effectiveness, of course, than shelf space per se.

Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Okay. Thanks. And I kind of want to shift gears to some of the smaller parts of your portfolio on the wellness side. I was wondering what you're seeing there considering it's a little bit more of a bigger ticket offering that you provide?

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

A

Yeah, sure. It's Rick. We are seeing relative stability. Effectively, we don't disclose wellness performance in and of itself, but we're seeing stability, and the performance has been in line with our overall Plumbing segment. So, in

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Q2, we saw some growth in wellness, as we disclosed in our prior call, and we're seeing similar performance in Q3. Largely, I would consider it flattish.

Now, keep in mind, in our wellness business, we did acquire Sauna360. So we're seeing the benefit inorganically in terms of growth year-over-year. But from an organic perspective, we're seeing rough stability and improvement. So we're optimistic about the business, particularly going forward. We think the business is really well-positioned in terms of its product offering, its complimentary products now with the Sauna – with the acquisition of Sauna360, and we continue to gain share in the market. So we're well-positioned when the market does turn around. But today, I would characterize it as stable.

Garik Shmois
Analyst, Loop Capital Markets LLC

Q

Great. No, I appreciate that. Thanks.

Operator: Your next question comes from the line of Anthony Pettinari with Citigroup. Please go ahead.

Gregory Andreopoulos
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Good morning. This is Gregory on for Anthony this morning. A lot's been discussed already, but maybe just one on Plumbing. So thinking about Plumbing volume, you spoke about solid performance in retail and e-commerce channels. I'm wondering if you can kind of discuss what you've seen in wholesale and trade, specifically where sentiment is and kind of your thoughts on inventories in that channel relative to historical norms for this time of the year.

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

A

Inventories are really right where they typically would be. Certainly, Q3 is generally a strong quarter for us in terms of that segment, and there are some inventory fluctuations associated with that. So I would say inventories are where they need to be. Accounting for seasonal variation, no real change there.

The trade segment was down a little bit, feeling a little bit of pressure and the sentiment, as I talk to our customers, in trade is really the same sentiment that we all share across the whole portfolio, which is this is a volatile market. It's certainly stable in trade. There's nothing that particularly concerns the channel from who – from the folks that I talk to, other than the fact that it's unpredictable. And the question is, when will this turn? There's very much optimism in terms of the overall fundamentals. And we're putting a premium on having the inventories in the right spot and being able then ready to respond with capacity. That's how I would characterize the trade channel.

Gregory Andreopoulos
Analyst, Citigroup Global Markets, Inc.

Q

Understood. Thank you, Mr. Allman.

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

A

Mr. Allman is my dad. You can call me Keith.

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Operator: [Operator Instructions] And there are no further questions at this time. I would like to turn it back to Robin Zondervan for closing remarks.

Robin L. Zondervan

Vice President, Investor Relations and FP&A, Masco Corp.

We'd like to thank all of you for joining us on the call this morning and for your interest in Masco. Thank you and have a wonderful day.

Operator: Thank you. This concludes today's conference call. Thank you all for participating. You may now disconnect.

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