Owens Corning NYSE:OC
FQ2 2022 Earnings Call Transcripts
Wednesday, July 27, 2022 1:00 PM GMT
S&P Global Market Intelligence Estimates

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Currency: USD
Consensus as of Jul-26-2022 3:09 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations

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Presentation

Operator

Hello, everyone, and welcome to the Owens Corning Second Quarter 2022 Earnings Call. My name is Daisy, and I'll be coordinating today's call. [Operator Instructions]

I would now like to hand over to your host, Amber Wohlfarth, to begin. So Amber, please go ahead.

Amber Wohlfarth
Director of Investor Relations

Thank you, and good morning, everyone. Thank you for taking the time to join us for today's conference call and review of our business results for the second quarter of 2022. Joining us today are Brian Chambers, Owens Corning's Chair and Chief Executive Officer; and Ken Parks, our Chief Financial Officer. Following our presentation this morning, we will open this 1-hour call to your questions. [Operator Instructions]

Earlier this morning, we issued a news release and filed a 10-Q that detailed our financial results for the second quarter 2022. For the purposes of our discussion today, we have prepared presentation slides that summarize our performance and results, and we'll refer to these slides during this call. You can access the earnings press release, Form 10-Q and the presentation slides at our website, owenscorning.com. Refer to the Investors link under the Corporate section of our home page. A transcript and recording of this call and the supporting slides will be available on our website for future reference.

Please reference Slide 2 before we begin, where we offer a couple of reminders. First, today's remarks will include forward-looking statements based on our current forecasts and estimates of future events. These statements are subject to risks, uncertainties and other factors that could cause our actual results to differ materially. We undertake no obligation to update these statements beyond what is required under applicable securities laws. Please refer to the cautionary statements and the risk factors identified in our SEC filings for a more detailed explanation of the inherent risks and uncertainties affecting such forward-looking statements.

Second, the presentation slides and today's remarks contain non-GAAP financial measures. Explanations and reconciliations of non-GAAP to GAAP measures may be found in the text and financial tables of our earnings press release, Form 10-Q and the presentation slides at our website, owenscorning.com. Refer to the Investors link under the Corporate section of our home page. A transcript and recording of this call and the supporting slides will be available on our website for future reference.

Consistent with our historical practice, we have excluded certain items that we believe are not representative of our ongoing operations when calculating adjusted EBIT and adjusted earnings. We adjust our effective tax rate to remove the effect of quarter-to-quarter fluctuations, which have the potential to be significant in arriving at adjusted earnings and adjusted earnings per share. We also use free cash flow and free cash flow conversion of adjusted earnings as measures helpful to investors to evaluate the company's ability to generate cash and utilize that cash to pursue opportunities that enhance shareholder value.

The tables in today's news release and the Form 10-Q include more detailed financial information. For those of you following along with our slide presentation, we'll begin on Slide 4. And now opening remarks from our Chair and CEO, Brian Chambers. Brian?

Brian D. Chambers
President, CEO & Chair

Thanks, Amber. Good morning, everyone, and thank you for joining us for today's call. I hope all of you are continuing to stay healthy and safe.
During our call this morning, I'll provide a high-level view of our performance and the progress our team is making on several strategic investments to expand our addressable markets, accelerate growth and strengthen the earnings power of our company, all supporting our ability to continue delivering strong results in diverse market conditions. Ken will then provide details on our second quarter financial results, and I'll come back to talk about our outlook for the third quarter and broader business trends.

Now I'll turn to our second quarter results, where we delivered another outstanding quarter, in line with the expectations that we shared with you during our April call. As always, we'll begin with a review of our safety performance. As you know, safety is a top priority for our company. Year-to-date, approximately 2/3 of our global facilities remain injury-free and 1/2 of our sites have worked injury-free over the past 12 months. In the second quarter, our recordable incident rate was 0.81. This result was above our second quarter 2021 performance and reminds us of the daily focus we must have on safety in order to achieve an injury-free workplace.

Financially, we delivered second quarter revenue of $2.6 billion, a 16% increase over the second quarter of 2021; adjusted EBIT of $525 million, up 29% year-over-year; and adjusted EBITDA of $656 million. This resulted in a record adjusted EBIT margin of 20% and an adjusted EBITDA margin of 25% for the quarter. In addition, we generated free cash flow of $361 million and returned $136 million of cash to investors through dividends and share repurchases.

During the quarter, our global teams continue to execute incredibly well to service our customers and deliver strong financial results despite ongoing supply chain disruptions, regional impacts of COVID and high inflation. Positive price realization in the quarter once again offset energy, raw material and transportation inflation in each of our 3 businesses.

As we continue to outperform the market in the near term, we are also investing and taking actions to build Owens Corning for the future. Last November, at our Investor Day, we shared our strategy to accelerate the company's growth and generate higher or resilient earnings by strengthening our core businesses and expanding into new products and applications that leverage our market knowledge, material science expertise and manufacturing capabilities.

The progress we are making, driven by great execution from our teams, optimize performance across our manufacturing networks, and highly focused, growth-oriented investments establishes Owens Corning as a stronger company with increased earnings potential. This strong foundation positions us to continue delivering exceptional results even if market conditions shift from the elevated levels we've recently experienced.

I'll now share several updates that directly support our strategy and our mission to build a sustainable future through material innovation. During the second quarter, we completed our acquisition of WearDeck, a premium producer of composite weather-resistant decking for commercial and residential applications. This acquisition expands our product offering into a new high-value building material solution. With current annual revenues of approximately $60 million, we see the opportunity to leverage our glass fiber science and market knowledge to accelerate material conversion in this fast-growing product category.

Continuing with Composites. In June, we announced a new joint venture with Pultron Composites, a producer of our industry-leading fiberglass rebar. Today, fiberglass rebar makes up less than 1% of the $9 billion North American rebar market, and we see the potential to significantly grow in this space over the coming years with a more sustainable, durable product solution.

The joint venture with Pultron will expand our manufacturing capability and improve market access for our products, including PINKBAR+ Fiberglas Rebar used for flatwork and residential applications. And in July, we entered into an agreement to acquire the remaining 50% interest in an existing joint venture based in the U.S. that produces high-value nonwoven fiberglass mat that we expect to close in the third quarter.

In addition to these investments, on July 1, we completed the sale of the European portion of our composites dry-use chopped strand product line, which includes our manufacturing assets located in Chambéry, France. Our 2 other DUCS manufacturing facilities are being repurposed with minimal
capital investment to produce other glass fiber products needed to support our growth in building and construction applications.

Each of these moves support our pivot in Composites into higher-value, more capital-efficient applications focused on building and construction, renewable energy and infrastructure, all of which leverage our core glass fiber technology.

Switching to Insulation. In June, we signed an agreement to acquire Natural Polymers, an innovative manufacturer of spray polyurethane foam insulation for building and construction applications. In recent years, we've seen significant advancements in the spray foam industry that make the material a much more attractive solution. The Natural Polymers technology, in combination with our material science knowledge, will enable us to provide customers with a broader insulation product offering, featuring long-term, sustainable solutions. Natural Polymers expects to deliver annual sales of about $100 million with continued double-digit growth over the next several years. We expect to close this transaction in the third quarter.

And as previously shared, we are also moving forward to exit the Russian market. While the environment is complex to complete such transactions, we are working through the options to transfer or sell our facilities.

To complement these strategic moves, we also continue to invest in accelerating our organic growth through product and process innovation as well as expanding our sustainability leadership. During the first half of the year, the company launched more than 30 new or refreshed products across our global businesses. These products span many of the core platforms in our Roofing, Insulation and Composites businesses.

Of particular note in the second quarter was the launch of 7 products focused on supporting our leading market position in wind energy. Our continued progress in developing new and refreshed product lines is a demonstration of our ability to transform customer insights into new functionality and solutions that promote business growth.

Before I turn it over to Ken to walk through our financial performance in more detail, I'd like to share a brief update on the sustainability front. In May, we were honored to earn the top spot on the 100 Best Corporate Citizens list for an unprecedented fourth year in a row. This ranking recognizes outstanding environmental, social and governance performance and transparency among the largest publicly traded U.S. companies. This is one of several recent achievements that demonstrate the commitment of our 20,000 employees to making an impact in ESG.

While recognition is never the aim of our activities, it reinforces the importance of the work we do and the way we do it. And it inspires our team to continue toward our goals to increase the positive impacts of our products, reduce the negative impacts of our operations and help our employees and communities thrive.

With that view of our performance and strategic initiatives, I will now turn it over to Ken to discuss our financial results in more detail. Ken?

Kenneth S. Parks
Executive VP & CFO

Thanks, Brian, and good morning, everyone. As Brian commented, we delivered another record quarter with strong revenue and earnings growth across the enterprise. While demand conditions remain solid in the markets we serve, our ongoing execution was fundamental to driving this performance, allowing us to continue to manage through accelerating inflation and supply chain challenges. As we've talked about in prior calls, inflation continues to impact energy costs, nearly all material input costs as well as transportation.

In each of the 3 businesses, positive price more than offset the inflation headwinds in the quarter. Overall, second quarter operating margins reached 20%, an expansion of 200 basis points versus the same period last year.
Beginning on Slide 5, we can take a closer look at our results. We reported consolidated net sales of $2.6 billion for the second quarter, up 16% over 2021, with double-digit revenue growth in all 3 segments. Adjusted EBIT for the second quarter of 2022 was $525 million, up $117 million compared to the prior year. Adjusted earnings for the second quarter were $377 million or $3.83 per diluted share compared to $283 million or $2.68 per diluted share in the second quarter of 2021.

Slide 6 shows the reconciliation between our second quarter 2022 adjusted and reported EBIT. For the quarter, adjusting items totaled approximately $36 million. We recognized $7 million of gains on the sale of precious metals. We also recognized a $29 million charge associated with the sale of the European portion of our DUCS product line. In addition, we recorded $11 million of restructuring charges associated with our already announced actions. Finally, we recorded $3 million of costs related to acquisitions announced in the quarter. All of these items are excluded from our second quarter adjusted EBIT.

Turning to Slide 7. I'll discuss our cash generation and capital deployment during Q2 of 2022. Earnings expansion, along with continued discipline around management of working capital, operating expenses and capital investments, resulted in strong free cash flow of $361 million for the quarter while beginning to replenish historically low inventory levels. Capital additions for the second quarter were $105 million or 4% of revenue, up $12 million from 2021 as we return to more normal capital spending while we continue prioritizing investments that drive growth and productivity.

Consistent with what we shared at Investor Day, we remain focused on reducing our capital intensity through productivity and process innovations. As a result of this and our earnings growth, our return on capital continued to expand and reached 21% for the 12 months ending June 30, 2022.

At quarter end, the company had liquidity of approximately $1.9 billion, consisting of $810 million of cash and nearly $1.1 billion of combined availability on our bank debt facilities.

During the second quarter of 2022, we returned $136 million to shareholders through share repurchases and dividends, bringing the year-to-date total cash returned to shareholders to $400 million. In the quarter, we repurchased 1 million shares of common stock for $86 million and paid a cash dividend of $35 million.

We remain focused on consistently generating strong free cash flow, returning at least 50% to investors over time and maintaining an investment-grade balance sheet while executing our business strategies to grow our company.

Slide 8 summarizes the changes in second quarter adjusted EBIT from 2021 to 2022 by business. Second quarter 2022 adjusted EBIT increased $117 million over the prior year, reaching $525 million. All 3 segments delivered significant year-over-year EBIT growth.

Now turning to Slide 9. I'll provide more details on the performance of each of the businesses. The Insulation business continued to build on the strong momentum of Q1, delivering record results in the second quarter. Q2 revenues were $934 million, a 16% increase over second quarter 2021. North American residential fiberglass insulation growth resulted from positive pricing with modest volume growth.

EBIT for the second quarter was $157 million, up $45 million as compared to 2021. The EBIT increase primarily resulted from positive price more than offsetting accelerating energy, material and transportation inflation. Additionally, we benefited from favorable mix and solid execution in our manufacturing operations. Insulation delivered EBIT margins of 17% in the second quarter.

Now please turn to Slide 10 for a review of our Composites business. The Composites business delivered another strong quarter in Q2 with EBIT growth of 57% year-over-year. Sales for the quarter were $719
million, up 23% compared to the prior year. We benefited from favorable spot pricing and contract price realization as we continue to face into ongoing inflation.

The top line growth was also driven by strong commercial performance and delivered another quarter of favorable mix. From a volume perspective, we saw an impact from the COVID restrictions in China contributing to the modestly lower volumes for the overall Composites business in the quarter.

EBIT for the quarter was $154 million, up $56 million from the same period a year ago, resulting from positive price more than offsetting the impact of accelerating energy, material and transportation inflation in addition to favorable mix. Composites delivered 21% EBIT margins for the quarter.

Slide 11 provides an overview of our Roofing business. The Roofing business delivered record quarterly top and bottom line performance. Sales in the quarter were $1 billion, up 11% as compared to the prior year, with positive price realization partially offset by the anticipated mid-single-digit volume decline. The U.S. asphalt shingle market on a volume basis was down 3% as compared to the prior year with our U.S. shingle volumes slightly trailing the market.

For the quarter, EBIT was $258 million, up $24 million from the prior year as we continued to service the strong market demand, along with positive pricing more than offsetting accelerating inflation from asphalt, other material and delivery costs. EBIT margins remained strong at 25%.

Turning to Slide 12. I'll discuss our 2022 outlook for key financial items. General corporate expenses are now expected to range between $170 million and $180 million. This is an increase from our prior outlook and reflects higher performance-based compensation driven by our strong results, partially offset due to ongoing discipline around cost controls. Interest expense is estimated to be between $115 million and $125 million.

We expect our 2022 effective tax rate to be 25% to 27% of adjusted pretax earnings and our cash tax rate to be 22% to 24% of adjusted pretax earnings. Finally, capital additions are expected to be approximately $480 million, which is below anticipated depreciation and amortization of approximately $520 million.

Now please turn to Slide 13, and I'll return the call to Brian to further discuss the outlook. Brian?

**Brian D. Chambers**  
*President, CEO & Chair*

Thank you, Ken. Our global teams continue to drive our business forward, focused on servicing our customers, enhancing our market-leading positions and making strategic investments to expand our total addressable markets. As we move through the third quarter, we expect conditions in most of our applications in key geographies to remain positive even in the face of high inflation and rising interest rates.

In U.S. residential and commercial markets as well as most of our global construction end markets, we anticipate continued good demand for our solutions. Based on current trends, we also anticipate inflation to continue to significantly impact our costs across all of our businesses. Even with this inflation, we expect to maintain positive price/cost in each of our businesses in Q3 as we realize the benefits from announced pricing actions. We will also continue to closely manage the ongoing impacts of supply chain disruptions and the regional impacts of COVID on our businesses. Overall for the company, we expect to have another quarter of net sales and adjusted EBIT growth versus prior year.

Now consistent with prior calls, I'll provide a more detailed business-specific outlook for the third quarter, starting with Insulation. We expect revenue to grow mid- to high teens versus prior year, driven by a combination of continued price appreciation and modest volume growth, partially offset by the continued impact of currency headwinds, which should be similar to Q2.

In our North American residential fiberglass business, we anticipate our volumes to be up slightly versus prior year, supported by the start-up of our Eloy facility and ongoing productivity efforts. We expect price realization as a percent of sales to be similar to what we experienced in the second quarter.
In our technical and global insulation businesses, we expect volumes to remain relatively flat versus prior year as demand for our products and global building and construction applications remains stable. We would expect price realization as a percent of sales similar to what we experienced in Q2.

In terms of overall inflation, we expect material and energy costs to increase from what we experienced in the second quarter and anticipate that price realization will result in positive price/cost in the quarter. Given all this, we expect to see earnings growth in Q3 versus prior year with EBIT margins in the mid-teens for the business.

Moving on to Composites. In the third quarter, we expect revenue to increase low double digits year-over-year, primarily driven by continued price realization, partially offset by some volume impact from the sale of our DUCS business in Europe, the continuing impact of the COVID restrictions in China as well as continued currency headwinds. We anticipate composites pricing will remain steady with a slightly lower year-over-year comp versus what we saw in Q2 as we begin to anniversary some of the spot pricing increases that started as we entered into the second half of 2021.

While we anticipate inflation to continue to be a headwind, we believe we are positioned to deliver a positive price/cost for the quarter. Overall, we expect to realize strong earnings growth in the quarter versus prior year with high-teen EBIT margins.

And in Roofing, we anticipate revenue growth of high teens with ARMA market shipments relatively flat to prior year, driven by solid repair and remodel demand and ongoing regional inventory replenishment opportunities. We would anticipate our shingle volumes in the quarter to track largely in line with the market. As in our other businesses, we expect inflation to remain a meaningful headwind in the quarter with asphalt and transportation costs continuing to increase.

From a price/cost perspective, we expect to deliver another positive quarter, including realization from our upcoming increase effective in August. Overall, we anticipate earnings growth versus prior year with EBIT margins of low 20s for Roofing.

With that view of our businesses, I'll close with a few enterprise items. Our team remains committed to generating strong operating and free cash flow. In terms of capital allocation, our priorities remain focused on reinvesting in our business, especially organic growth and productivity initiatives, returning at least 50% of free cash flow to shareholders over time through dividends and share repurchases and maintaining an investment-grade balance sheet.

In addition, as evidenced by the recently announced acquisition of WearDeck and Natural Polymers and the new joint venture with Pultron, we are continuing to actively evaluate strategic investments to leverage our unique material science, manufacturing and market expertise and expand our addressable markets. We are also continuing to invest in organic growth through our product and process innovation and market development, in support of our enterprise strategy to grow through expanding our building and construction product and system offerings.

Overall, we are excited about the investments we are making to help our customers win in the market, grow our company and deliver value for our shareholders. As we move through the second half of the year, we will remain focused on delivering strong financial results and positioning the company for long-term success.

With that, I will now turn the call back to Amber to open it up for questions. Amber?

Amber Wohlfarth
Director of Investor Relations

Thank you, Brian. We are now ready to begin the Q&A session.
Question and Answer

Operator

[Operator Instructions] Our first question is from Stephen Kim from Evercore.

Stephen Kim  
*Evercore ISI Institutional Equities, Research Division*

Really great results. Thanks for all the information. I've got a bunch of questions, but I'll stick to one. On the Roofing business, where you've continued to just form historical levels. But there was one other time that your margins got roughly this high, and it was kind of in the late '09 period. And when that happened, your margins quickly collapsed in the following years. And it was caused of winter discounting, which I assume isn't going to happen again, as well as the economy and the housing market were still recovering from the GFC.

So today, when you look at your margins in Roofing and you think about the dynamics that would affect that over the course of the next few years, knowing that there's uncertainty out there but also recognizing that the drop, it seems like it's fundamentally better, I'm wondering if you could talk about why this time, we might see perhaps a more gradual descent back to a normalized level as opposed to something abrupt. And if you could also talk about how storm activity is faring so far this year.

Brian D. Chambers  
*President, CEO & Chair*

Great. Thanks, Stephen. You were cutting out a little bit, but I think it was all around kind of Roofing margins and how that progresses and storm activity. So let me talk about Roofing margins. You're right in terms of the recollections and how that played out. I think there's a couple of things that are different: one, I think, inside the market; and then one inside of our operations relative to that time period.

Inside the market, I think what we're seeing is a step-up in roofing demand, and we've seen that now over the last couple of years. So those margins that collapsed kind of coming out of '09, they were coming into a really -- a secular shift where we saw technology, more laminate installations that were extending the life cycle of roofs.

So in that period, we were seeing kind of low market demand relative to that shift to a new and higher replacement cycle. We're on the other side of that shift. So we've seen a pretty steady now replacement cycle. So I think that bodes well in terms of higher roofing demand as we go forward.

We also are really coming into a period where we see a pretty good repair and replacement market emerging because when you go back on a 20-year cycle, you look at all of the homes built in the early 2000s that are coming up on that. We think over the next several years, that's going to drive some good replacement opportunities in the market.

So I think from a market dynamic, we see good, strong demand trends continuing over the next few years. And then we -- historically, we've seen good ability to kind of maintain price relative to asphalt costs. So even though we've stepped up with a more elevated asphalt cost, asphalt shingles, still relative to other roofing shingle options, are still the most cost-effective solution for homeowners to choose.

So we think there's going to be good demand opportunity driven by replacement cycles, and the fundamental drivers of roofing being an economical choice continues even at a little bit higher price point than we are sitting today. So that's in the market.

For us, structurally, we've made changes in our operations. So I think we've become much more efficient in our conversion of to produce a shingle over the last decades, our conversion costs are more efficient and better. We're getting better throughput.
And also, over that time, we've greatly expanded our components business, which is also now a bigger part of our revenue, a bigger part of our earnings and margin performance. So internally, we feel like we're structured better than we were at that time to give us more options for good margin performance, not only through our shingle performance, but also through our components business. So I think we're set up very well as we go through the next few years.

Relative to storm demand, as I talked about in the last call, we kind of came into the second quarter trailing storm demand, and that was a bit of a wild card for the second half. Through the second quarter, we did see a fair number of smaller storms particularly in the Midwest and other parts of the country that kind of stepped up that demand.

So I'd say we are still kind of slightly trailing probably in the major storm category, but we've seen a lot of smaller storms pick up. There are certain regions of the country that are not seeing that kind of storm level activity like the Rocky Mountain regions, really another very light hail season. But broadly, we've seen that storm demand pick up.

I think we're coming in now to Q3 another big storm quarter. So as we think about Q4 and '23 volumes, I think that's going to be dependent on how the storm season kind of evolves over the next few months. But right now, I'd say it's getting better, it's gotten better and creating a good demand environment for us.

Kenneth S. Parks
Executive VP & CFO

And let me just add just one thing because I agree with everything that Brian said, obviously, but the other thing to think about in -- I like your question around kind of the gradual descent, right, if that were to happen, is -- and I know that you watch this and the rest of the industry coverage watches it. But housing starts, while we may have a varying view of what those may look like over the next few quarters, we've also been all watching very closely how completions have been tracking.

And while new housing isn't the largest piece of the market, it is certainly a piece of the market that drives kind of what's going to happen and how we might see that change as the new housing starts move. We saw one month where housing completions, especially for single-family homes, did kind of almost meet what the new housing starts were. But we still think that this kind of gap between new housing starts and housing completions can provide a little bit of -- to use my term, is a little bit of a soft landing as we move through the next few months, if the market does change.

Operator

Our next question is from Matthew Bouley from Barclays.

Matthew Adrien Bouley
Barclays Bank PLC, Research Division

I have sort of an all-around question on Composites. Looking through the 10-Q, it looked like the natural gas hedges were maybe a $30 million benefit there in the quarter. I guess the overall question is if you could sort of speak to the demand environment, particularly in Europe. And then given what's going on with energy inflation here, sort of what are your thoughts on maintaining the pricing that you'll need to sort of offset what we would think might be a continued, I guess, step-up in energy costs here?

Kenneth S. Parks
Executive VP & CFO

Yes. Great question. Thanks, Matt. The natural gas hedges were certainly a benefit. And I think the actual number is -- the $30 million that you see in the Q is probably a little bit closer to the first half number, but we did see somewhere between $16 million and $20 million in the second quarter itself. But they were certainly a benefit, and we do continue to apply that hedge strategy that I've talked about the last couple of quarters very consistently across our natural gas needs as we look at both the Insulation and Composites business.
The demand environment in Europe is continuing to be strong for the Composites business. We called out in the comments that where we did see a little bit of movement was in our China business and our China demand where we saw the impact of some COVID restrictions, which we think is driving a little bit of competitive activity that may be a little bit of a blip while the COVID restrictions are in place. And as they start to be lifted, we think it returns more to a normal scenario because what we're seeing not only in Europe but across the rest of the world for Composites is a continuing desire for our solutions that we're providing and especially as we talk about our local production for local demand.

Transportation, whether it's on the water or on the ground, continues to be a pretty significant cost and has inflation to it. So we think the solutions that we're providing and especially as we add new pieces to our portfolio like WearDeck, like our fiberglass rebar, we think that those solutions look a little sticky in the sense that customers see the value and they like to stick with them. But right now, what we're seeing is that Europe remains strong.

We do think that energy inflation will continue with -- especially in Europe. And we think that the pricing actions that are both spot pricing as well as what we negotiated coming into 2022 as we did the contract negotiations for the year are sufficient to keep us in a positive pricing to cost ratio.

We did call out last quarter that while we contracted pricing anticipating where inflation would be, we're getting the pricing, but we are also seeing inflation continue to step up, not just energy but in some other components. So that spread might narrow a little bit, but we do continue to see a positive pricing/cost spread in the business.

Operator

Our next question is from Phil Ng from Jefferies.

**Philip H. Ng**
*Jefferies LLC, Research Division*

Congrats on a really strong performance and really good execution. I think you guys kind of alluded to it, next few months, it's going to be a lookout in terms of how the U.S. market, housing market shapes up with affordability and a more choppy macro backdrop. So I'm just curious, how much visibility do you have? Have you seen any noticeable change in order patterns? And if things do slow down a bit, what's the game plan in managing your business perhaps a little differently going forward?

**Brian D. Chambers**
*President, CEO & Chair*

Thanks for the question and the comments. Yes, as you said, our -- we see these clouds kind of on the horizon, but I'd say to you, demand for our products remains strong. Our volumes, particularly in our res insulation business, was up a little bit here in Q2. We guided to some modest volume growth here in Q3. So we continue to see good demand for our products in the near term.

But having said that, as you said, we do believe the housing market is going to have to reset to this higher interest rate environment. We're seeing that occur in front of us. But we continue to see, I think, good tailwinds that are supporting -- that drive our business here in the near term.

Certainly, as Ken just alluded to, when you look at the delta between starts and completions, that's been a pretty big delta in the last several quarters. So we think there's quite a bit of backlog to work through over the next several months. While the market resets, that's going to continue to drive demand for our products.

And then as we get into '23 and, I think, a little longer term, we still see very good tailwinds just driven by strong demographics that are going to drive the need for more housing. And as we've talked about the last several quarters on this call, the housing in the U.S. has been underbuilt for so many years that I think that there's going to be continued strong demand and requirements for new construction as we go forward. So even as we reset and consumers reset to higher interest rates, now they're in that 6% range.
Historically, that’s still not out of bounds. But it does create a big shift in a reset that I think we’re going to go through.

So I think while we’re going to see some near-term choppiness, long term, I believe the fundamentals remain very strong for the need for new construction, and that certainly supports good demand for our products going forward. So I think when you talk about a slowdown, if and when we do see a slowdown come, I think we have been focused on making structural changes and improvements to our business in Insulation as well as across the company.

In Insulation in particular, we’ve been focusing on for really the last several years, really optimizing our manufacturing network. We continue to move forward with our plans that we outlined about a year ago in terms of the sale and exit of our Santa Clara facility, very large capital-intensive facility there. We’re investing -- we started up our Eloy facility. We're going to be starting up our facility in Nephi, which are smaller, more flexible assets.

So we think that we've really driven good operational cost improvements in Insulation through productivity, through automation, through these network changes that if and when a slowdown comes, we think that we are going to be able to produce very good results and stronger margins than the last time we would have seen some volume declines in the business.

So the teams have been just doing great work, I think, preparing for this day. And we'll see in terms of how that -- how the market emerges over the next few quarters, but I think we feel we’re in a good spot.

Operator

Our next question is from Kathryn Thompson from Thompson Research Group.

Kathryn Ingram Thompson
Thompson Research Group, LLC

I wanted to focus on the Composites segment in particular. First, just a greater clarification whether mix or pricing was a greater driver for performance in the quarter and get a little bit more color on what that mix is and what it means going forward.

And you had some comments on China with lower volumes, which is understandable, and your guidance is helpful just in terms of outlook in that market. But a greater clarification on the differentiation for volume and outlook for both your U.S. business and your European business, understanding that those are very different end markets.

Kenneth S. Parks
Executive VP & CFO

Yes. Thanks, Kathryn. In the quarter, pricing was definitely a larger impact than mix. We have seen over the last 4 quarters and talked about it in most of the calls, that mix wasn't accelerating improvement as we are moving through this period of kind of adjusting the approach and the products to be further down the value stream and providing solutions to our customers. And we saw a nice step up in that. And we anticipated that we would start to see that be a little bit less of an impact quarter-over-quarter, but still holding the positive mix impact that we had seen.

And to a favorable extent, it did actually provide some incremental positive improvement in the quarter, but price was a bigger impact. And that difference between price and costs certainly was favorable, and that's driven by the fact that demand is strong relatively across the globe, and we'll take those parts apart a little bit in the next -- in my next comments.

But because of that, we're able to kind of see not only good contractual pricing realization as we moved into -- that we negotiated as we move into the year, but also good spot pricing. So the combination of those 2 provide a good benefit in the quarter.

Now as far as kind of outlooks for volumes across the U.S. and Europe, I would say U.S. remains very, very strong. Our demand for products look very, very strong, heavily in the building and construction
space. In Europe, it is a different mix of business. But I would tell you is that even through the second quarter, demand for European products, our composites products remain very strong as well.

The question you had about China, yes, we are seeing a little bit lower volumes of our total Composites business. China accounts for probably $200 million, $250 million a year of revenue. And we saw that step down just a little bit. We attribute that very specifically to the China COVID restrictions and how that’s kind of impacted the on-the-ground work within China. But we do also see India remain very strong as a composites market.

So we feel good about what's going on in the business. We think that we are seeing good demand for our products because of this continuing focus on moving further down the value chain with higher-value solutions, and we expect that to continue at least through the third quarter. So we'll continue to update it as we see things change. But right now, the order books look solid within all those locations.

Operator

Our next question is from John Lovallo from UBS.

John Lovallo
UBS Investment Bank, Research Division

It's on the supply chain, you mentioned continued challenges there. We've heard from others that there might be some stabilization or at least signs of stabilization. Are you seeing anything that gives you any encouragement on that front?

Brian D. Chambers
President, CEO & Chair

Yes. Thanks, John. I think overall, we continue to be impacted by disruptions and -- but I'd say they're getting a little better in many parts of our supply chain. So I'd say, again, as the progression from where we were to start the year to where we are today, yes, I think we're starting to see some improvements in many of the inputs that we have to make our products. But I would tell you that it continues to impact our operations we -- in terms of just having to overcome the minor disruption.

So I’d say the other piece of it, I’d say they're getting a little better, and they're getting shorter in duration, but still having -- and having to overcome issues. And I guess I’d say I think our manufacturing, our operation teams, our supply chain teams have just done tremendous work over the last year and continue to do tremendous work to make that seamless in terms of minimizing the impact of the disruptions on our operations, minimizing the impact on our shipments to our customers because we still, as we’ve talked about, have very high demand for our products.

Most of our product areas are still on extended kind of lead times. So the work by the teams to overcome that has been tremendous. But it is something that still is in front of us that we have to manage through here in the quarter and, we think, we're going to have to manage through here in the near term.

Operator

Our next question is from Anthony Pettinari from Citi.

Asher Melech Sohnen
Citigroup Inc., Research Division

This is Asher Sohnen on for Anthony. Can you just talk a little bit more about the strategic rationale behind the Natural Polymers spray foam acquisition? And what kind of synergies are there to unlock with your existing fiberglass insulation business? How do margins on the acquired spray foam business compare to maybe fiberglass insulation?

Brian D. Chambers
President, CEO & Chair
Great. Thanks for the question. Natural Polymers, we think, is going to be a really great addition to our Insulation business, to our company for a number of reasons. First, it really aligns with our enterprise strategy. So when we talk about our strategy focused on enhancing our core performance in businesses and then expanding into new product and solution applications in building and construction. This fits really well inside our enterprise strategy. It puts us in a new product category, great growth potential, good margin at a much lower capital intensity than some of our other parts of the Insulation business and company. So I think it really supports well our enterprise focus on growth, stable and higher margins and lower capital efficiency.

I think it strengthens our Insulation business product offering. This is a product category that we’ve been evaluating for a long time. Our customers have wanted us to get into this. And so we think we really -- does now complement and broaden our product offering to our customers so they can fit whatever insulation solution they need to fit their customers' needs, and that sets us up well there.

And the distribution of this, the sale of this really goes through similar customers, similar channels to how we’re operating today. So we believe there's great synergy as we can take this product category now and scale it up.

Third, I’d say what attracted us to this was really Natural Polymers, the company, the business. They have a very unique product formulation with very low VOCs. They have application and performance benefits from their formulations that are unique that we think give us a great opportunity to grow and scale up.

And I think for us, as I talked about, this has been a product category we've been evaluating in a long time. We did look very diligently at health and safety issues and concerns around this, but there's just been tremendous advancements in product formulations and application standards and insulation guidelines that, we felt, address the health and safety concerns we've had about this product category. So we're very excited to add it to the product line and portfolio, and we think this is a unique product offering and gives us an opportunity to continue to grow the Insulation business and expand our margins with it.

Operator

Our next question is from Susan Maklari from Goldman Sachs.

Susan Marie Maklari
Goldman Sachs Group, Inc., Research Division

As we think about the near-term uncertainty around housing, can you just talk a bit about capital allocation and how you're thinking about further M&A deals that may come up relative to perhaps shareholder returns, buybacks, things of those nature?

Brian D. Chambers
President, CEO & Chair

Yes. Thanks, Sue. I think when we -- we've been very, I think, diligent and purposeful in our capital allocation strategy, and we've talked about this. And I think in broad terms, we don't see any changes in our current capital allocation strategy. We're very focused on great free cash flow, generating that. We're focused on an investment-grade balance sheet. We continue to focus on returning about 50% of free cash flow to shareholders over time through dividends and share repurchases.

But then we also want to continue to invest in the business through organic growth, through our capital allocation, through CapEx investments that we are going to continue to make and then through acquisitions. But I’d say when we step back and we look at the enterprise strategy that we outlined last November, we said we were going to focus on organic growth through innovation, and that would include investments in organic growth and capital to do that. And we were going to be investing in acquisitions.

So I think we want to be very thoughtful and purposeful to make sure that acquisitions that we look at -- are looking at bring uniqueness in terms of product technology or market expansion. We want to be very diligent in terms of the multiples and the price points we pay. And we think we’re doing that with these acquisitions. So we’re going to continue to evaluate a pipeline. But I would share with you, we're going to
be very thoughtful around when we make those decisions, the pricing that we do that to make sure that we are making very good investments.

The last thing I'd probably say is one of the things we've been very focused on is building a very strong balance sheet, and we have an incredibly strong balance sheet. And that great companies use the balance sheet to invest in times -- good times and bad because we want to make sure we are strengthening the long-term performance of the company, and so we're going to want to look at that.

So while we will make near-term adjustments to that depending on the market, longer term, we feel like we want to be in a position to continue to invest in the growth of the company, and we're going to want to do that.

Operator

Our next question is from Michael Rehaut from JPMorgan.

Michael Jason Rehaut  
JPMorgan Chase & Co, Research Division

I just wanted to circle back and make clear on maybe a few comments around the topic of inventory and demand patterns. And obviously, you gave the guidance by segment in terms of what you expect for volumes in the third quarter. But I was curious around if you could kind of review where inventory levels are across your 3 different businesses, particularly in the U.S. and as it relates to composites, also Europe. And to the extent that customers do begin to maybe take a little bit more of a cautious approach, reflecting some of the end markets, if there is any type of inventory risk in addition to softer order patterns that might impact the business at least on a temporary basis.

Kenneth S. Parks  
Executive VP & CFO

Maybe -- thanks, Mike, and maybe I'll start, and I'm sure Brian may want to jump in a little bit. What I would tell you at the highest level, and you heard in the comments around really good cash generation again in the second quarter, but also on top of the fact that we were building a little bit of inventory. And between the first quarter and second quarter end, we probably added about $100 million of inventory to our own inventory levels. And we believe that the distribution channel in pockets has added a little bit itself.

But across the board, what I would tell you is over the last couple of years, we've collectively -- ourselves and the distribution channel have been working with a very thin on-hand inventory level, and we've started to rebuild that. And I think this is true across all 3 businesses. But we are nowhere in a place where we have built up inventory levels that if demand patterns start to change a little bit, which we're actually not expecting much movement in demand in the third quarter. We're not sitting on inventory that has kind of peaked where we would be concerned about it.

In fact, as we move through the balance of the year, we would really be focused on all 3 businesses on continuing to deliver to our customer base against these relatively strong and stable demand patterns and having the opportunity to strengthen our inventory levels a bit more from where they are. So no concern with too much inventory level on hand and still more opportunity to get closer to historical norms.

Brian D. Chambers  
President, CEO & Chair

Yes. I would just add, I think that's the same in Roofing, Insulation and Composites. I do think, generally, we're seeing inventory levels get replenished in our customers and points of distribution. So we do see that across the board, but we're not seeing anywhere where there's an overbuild of inventory at our customer level.

Now having said that, I think every customer is becoming more concerned with the market environment and the macro environment and demand patterns moving forward. So I think there is more thoughtfulness
in what they're buying and how they're buying. But we've not seen any buildup in inventory that would cause a correction at the customer level.

And then as Ken said, we've been running with very lean inventories. So if and when we do see demand start to slow, we think we're going to be needing to run our operations in the near term just to refill to get our inventory levels up to be able to get back to normalized service levels. So that would take a few more months to work through.

**Operator**

We will take our final question from Keith Hughes from Truist.

**Keith Brian Hughes**  
*Truist Securities, Inc., Research Division*

I'll just ask a quick one here with -- as you look into the third quarter and the guidance given, do you expect the raw material dollars that you discussed in the Q, would they be relatively flat in terms of the dollars in the third quarter? Or is there going to be some latent flow-through into the period as you lag some of the commodity indexes?

**Kenneth S. Parks**  
*Executive VP & CFO*

Keith, clarify a little bit -- if you don't mind, clarify a little bit with what you're asking about raw materials flow-through. If you don't mind, rephrase that a little.

**Keith Brian Hughes**  
*Truist Securities, Inc., Research Division*

Yes. So in the Q, you discussed the number of dollars that raw materials increased, $92 million, for example, in Roofing. Is that number going to get larger as you flow through some more of the inflation? Or do you -- from what you know today, are you hitting a peak?

**Brian D. Chambers**  
*President, CEO & Chair*

No, I think in Roofing specific, Keith, on asphalt, we continue to see asphalt costs escalate, absolute costs. So we saw that through the first quarter. We saw that month-over-month in the second quarter, and we expect to see those costs continue to increase month-over-month in the third quarter. So we are seeing those asphalt costs coming through. And in most of our inflationary numbers that we're looking at, we are seeing absolute dollar increases coming through and impacting the P&L.

So again, we think we're in a good position with the price increases that we've got in place to stay and keep a positive price/cost, but we continue to see inflation cost escalating and particularly in roofing and in asphalt and in many other materials for our other businesses.

**Kenneth S. Parks**  
*Executive VP & CFO*

Yes. And yes, that's right. And thank you for the clarification. So as Brian said, seeing it all, asphalt, specifically in roofing, but we're also seeing chemicals continue to inflate. Obviously, energy, which is going into the production process, continue to inflate. So we're anticipating the environment that we've been living in for the last few quarters to continue into Q3.

**Operator**

Thank you. We have no further questions. So I'll hand back over for the closing remarks to Brian.

**Brian D. Chambers**  
*President, CEO & Chair*
Thank you, and thanks, everyone, for your time today and your questions. We appreciate your interest in Owens Corning, and look forward to speaking with you again during our third quarter call. And until then, I hope you and your families have a great, safe rest of the summer. Thanks.

Operator
Thank you, everyone, for joining today’s call. You may now disconnect your lines, and have a lovely day.