Owens Corning NYSE:OC
FQ2 2023 Earnings Call Transcripts
Wednesday, July 26, 2023 1:00 PM GMT
S&P Global Market Intelligence Estimates

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Currency: USD
Consensus as of Jul-25-2023 6:56 PM GMT

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

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Call Participants

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Wolfe Research, LLC
Presentation

Operator

Hello, everyone, and welcome to Owens Corning Second Quarter 2023 Earnings Call. My name is Daisy, and I’ll be coordinating your call today. [Operator Instructions] I would now like to hand the call over to your host, Amber Wohlfarth from Owens Corning, to begin. Amber, please go ahead.

Amber Wohlfarth
Vice President 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 2023. 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 of 2023. 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 homepage. 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 and presentation, both of which are available on owenscorning.com.

Adjusted EBIT is our primary measure of period-over-period comparisons. And we believe it is a meaningful measure for investors to compare our results. 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 will 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. During our call this morning, I’ll provide a broad overview of our second quarter performance and the work we are doing to strengthen and grow our company. Ken will then provide more details on our second quarter results. And then I’ll come back to discuss what we are currently seeing in our markets and our near-term outlook.
Overall, in Q2, Owens Corning delivered another outstanding quarter, highlighting the capability of our teams, the value of our product lines and the earnings power of the company. This strong performance continues to be driven by the actions and initiatives implemented by our team over the past several years to strengthen our commercial positions and improve our operating efficiencies, driving higher, more resilient earnings.

I'll speak further to this in a few moments. But we'll now begin our review of the quarter, as always, with our safety performance. At Owens Corning, our commitment to safety is unconditional. During the second quarter, we maintained a very safe environment with an RIR of 0.59. 2/3 of our facilities have operated injury-free this year and more than half have done so for over a year.

Financially, we delivered revenue of $2.6 billion, similar to second quarter 2022, with adjusted EBIT of $534 million, up 2% year-over-year, and adjusted EBITDA of $664 million, resulting in an adjusted EBIT margin of 21% and adjusted EBITDA margin of 26% for the company in the quarter. In addition, we generated free cash flow of $372 million in the quarter, similar to the same period last year. And consistent with our capital allocation strategy, we returned $160 million to investors through dividends and share repurchases.

During the quarter, each of our business segments continued to perform extremely well relative to market conditions, especially our North American businesses. In Insulation, we continued to see the impact of good price realization, which helped to offset the impact of lower volumes. In Composites, as expected, we saw the positive benefits of moderating costs and stabilizing demand trends driving mid-teens margins. And in Roofing, we saw increased storm activity result in stronger demand while price realization remained favorable. These results continue to highlight the work done by our teams to strengthen the earnings power of the company and position us for long-term success by leveraging our company's unique attributes and leading market positions.

Commercially, we are innovating at a faster pace, expanding our digital solutions, building stronger customer partnerships and achieving price realization that reflects the value of our products and brand. Operationally, we are focused on increasing our efficiencies and optimizing our manufacturing networks, investing in factory automation and process technologies to increase productivity and making targeted capacity expansions.

All of this work is connected through the framework of our enterprise strategy, which we launched almost 2 years ago, focused on strengthening our core product and market positions, expanding into new product adjacencies and developing more multi-material and prefabricated solutions. This strategy not only leverages our material science, market and manufacturing expertise in new ways, it capitalizes on key secular trends around housing, sustainable building solutions and changing construction practices, which create long-term growth opportunities for our company.

Over the past few years executing this strategy, we have made both structural improvements and strategic investments within each of our businesses, which leverage our core enterprise capabilities to improve our performance and position us for additional growth. Within Insulation, we have significantly improved our fixed cost position through a number of network optimization and productivity initiatives while investing in new capacity and new product platforms that increase our growth potential as the world continues to need more energy-efficient solutions.

Within Composites, we are pivoting to higher-value applications focused on the building and construction, renewable energy and infrastructure markets by expanding key product platforms such as nonwovens and investing in new product lines such as structural composite lumber and decking. And within Roofing, we continue to focus on expanding our contractor network, innovating new products, increasing our shingle capacity and driving our roofing component attachment rates higher as we expand our multi-material system offering.

Overall, through our investments and our execution, we have built our company to grow at a faster rate, produce higher, more consistent earnings, be more capital-efficient and continue to generate significant operating and free cash flow. In short, Owens Corning is a substantially stronger company today. And we
continue to demonstrate that even within more challenging market conditions, we have the strategy, the team and the operating discipline to keep performing at a high level.

Our improved performance is also driven by our commitment to be a leader in innovation and sustainability. During the first half of 2023, we continued to accelerate our product and process innovation, launching 17 new or refreshed products spanning core platforms in our Roofing, Insulation and Composite businesses.

Notable among our second quarter launches was the introduction of our new Owens Corning Lumber offering used for deck framing. An extension of last year's WEARDECK acquisition, OC Lumber is a structural composite material that provides an alternative to traditional wood and steel. This new material is reinforced with our Advantex Fiberglas, a proprietary erosion-free technology that add strength and durability to resist mold, mildew and pest from its contact with salt and freshwater and installs just like wood.

With opportunities to displace traditional materials and expand our product lines across residential and commercial structures, we didn't just acquire a decking company. We gained a new technology and capability to enter new markets and build a much bigger business. OC structural lumber is a great addition to our family of market-leading products and solutions and a great example of how investments in product innovation are helping our customers win and grow in the market while creating new growth avenues for our company through material conversion opportunities.

Finally, before I turn it over to Ken, I'd like to provide an update on our sustainability efforts. In May, we published our 17th annual sustainability report, which serves as a blueprint for how our 19,000 employees across the world are pursuing and delivering on our mission to build a sustainable future through material innovation.

Among our noteworthy first half accomplishments was the completion of a major renewable electricity supply agreement, which is expected to come online in stages through 2024. The agreement represents a major achievement for our company in Europe and a significant contribution to reducing our overall carbon emissions. In addition to wind-driven virtual power purchase agreements already in operation in Finland and Sweden, the new agreement means that 100% of our European production sites and our science and technology centers will be covered by contracts supplying renewable electricity to support our sustainability goals.

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.

Turning to Slide 5. As Brian mentioned, we delivered another strong quarter with consolidated net sales of $2.6 billion and adjusted EBIT of $534 million. We continued to realize the benefit of positive pricing, including carryover from actions we took last year, which partially offset the revenue impact of lower volumes in two of our segments.

In addition, input cost inflation continued to moderate. This, along with ongoing commercial and operational execution, resulted in record adjusted EBIT margins of 21%. Adjusted earnings for the second quarter were $385 million or $4.22 per diluted share compared with $379 million or $3.85 per diluted share in the same quarter of 2022.

Slide 6 shows the reconciliation between our second quarter 2023 adjusted and reported EBIT. For the quarter, adjusting items totaled approximately $47 million, all of which related to charges associated with our ongoing cost optimization and product line rationalization actions. Consistent with prior periods, these costs are excluded from our second quarter adjusted EBIT.
Turning to Slide 7. I'll comment on our cash generation and capital deployment. The strength of our earnings, along with continued discipline around management of working capital, operating expenses and capital investments, generated free cash flow of $372 million for the quarter. Capital additions for the second quarter were $122 million or 5% of revenue, up $17 million from 2022.

We remain focused on reducing our capital intensity over time through productivity and process innovations. As a result, our return on capital was 20% for the 12 months ending June 30, 2023. At quarter end, the company had liquidity of approximately $2 billion, consisting of $968 million of cash and nearly $1.1 billion of availability on our bank debt facilities.

During the second quarter, we returned $160 million to shareholders through share repurchases and dividends, bringing the total year-to-date cash returned to shareholders to $343 million. In the quarter, we repurchased 1.1 million shares of common stock for $113 million and paid a cash dividend totaling $47 million. We remain focused on consistently generating strong free cash flow, returning approximately 50% to investors over time and maintaining an investment-grade balance sheet while executing on our business strategies to grow our company.

Now turning to Slide 8. I'll provide more details on the performance of each of the businesses. The Insulation business delivered a strong second quarter with margin expansion both year-over-year and sequentially. Q2 revenues were $905 million, a 3% decrease from the second quarter of 2022, while EBIT grew 4% year-over-year. We continue to see solid realization of previously announced pricing actions and favorable product and customer mix across the business more than offsetting the impact of lower volumes and ongoing inflation.

In technical and global insulation, revenue was down slightly year-over-year with positive price and favorable mix, primarily within Europe, more than offset by lower volumes tied to the overall weaker macro environment versus prior year. Additionally, the sale of our insulation operations in Russia contributed to the year-over-year revenue decline.

North American residential insulation revenue was down in line with the overall revenue decline for the segment. As expected, positive pricing and incremental revenue from the Natural Polymers acquisition were more than offset by lower volumes. As builders continued to work through their backlog, demand for residential insulation began to track closer to lagged housing starts.

Insulation EBIT for the second quarter was $163 million, up $6 million compared to 2022. Positive price and favorable mix more than offset the impact of lower volumes and moderating inflation. Overall, Insulation delivered EBIT margins of 18% in the second quarter.

Before I turn to a review of our Composites business, I’d like to address a matter related to the Paroc subsidiary of our Insulation business. Paroc is currently reviewing an issue with certain products within its marine insulation line, which may not meet specific fire safety requirements. The products at issue accounted for approximately $3 million in sales revenue during 2022. Paroc took voluntary steps to recall and withdraw the products from the market and is cooperating with regulatory authorities and customers to address the matter. We'll provide relevant updates on this matter as necessary.

Now please turn to Slide 9 for a summary of our Composites business. In the second quarter, the Composites business continued to experience the impact of the softer macro environment. As anticipated, sales for the quarter were $620 million, down 14% compared to the prior year on lower volumes and the net headwind from divestitures and acquisitions.

EBIT for the quarter was $87 million, down $67 million from the same period a year ago. The EBIT decline was primarily due to lower volumes and associated production downtime. Additionally, the sale of our DUCS manufacturing assets in Chambéry, France and our operations in Russia last year contributed to the year-over-year EBIT decline.

We continued to experience price pressure in the quarter but maintained another quarter of positive price/cost as we saw inflation moderate and transportation become deflationary. Overall, Composites delivered 14% EBIT margins for the quarter.
Slide 10 provides an overview of our Roofing business. The Roofing business delivered its strongest quarter of top and bottom line performance. Sales in the quarter were $1.1 billion, up 10% compared to the prior year. Higher demand in the quarter, including stronger storm-related demand, and positive price realization drove the year-over-year increase.

In the quarter, the U.S. asphalt shingle market on a volume basis was up 13% compared to the prior year with our U.S. shingle volumes trailing the market primarily due to our lower inventory level of shingles as we exited Q1 and throughout Q2. Through the first half of the year, our volumes outperformed the market.

For the quarter, EBIT was $338 million, up $80 million, primarily on positive price/cost and higher volumes, partially offset by higher manufacturing costs. We continued to see input costs moderate in the quarter and benefited from deflation overall for materials, primarily asphalt, as well as delivery. All of this resulted in EBIT margins of 30%.

Slide 11 summarizes our full year 2023 outlook for key financial items. General corporate expenses are now expected to range between $215 million and $225 million. This is an increase from our prior outlook and reflects higher performance-based compensation driven by the strength of our results. Interest expense is now estimated to range between $70 million and $80 million, lower than our prior outlook and reflecting higher interest income on our cash balances.

We continue to expect our full year effective tax rate to be 24% to 26% of adjusted pretax earnings and our cash tax rate to be 26% to 28% of adjusted pretax earnings. Finally, our outlook for capital additions is unchanged at approximately $520 million, which is at or below depreciation and amortization, estimated to range between $520 million and $530 million.

Now please turn to Slide 12. And I'll turn the call back to Brian to further discuss our outlook. Brian?

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

Thank you, Ken. Our second quarter results continued to demonstrate the progress we have made in elevating the performance of the enterprise to generate higher, more resilient earnings. As we move into the third quarter, we expect inflation to continue to moderate but the impact of higher interest rates and ongoing geopolitical tensions to result in continued market uncertainty and slower global economic growth.

That being said, we anticipate many of our end markets to be relatively stable with housing sentiment in the U.S. turning more positive, the roofing market remaining robust driven by significant first half storm activity and many of the key verticals within our nonresidential businesses continuing to hold up.

Based on this near-term market outlook, for the third quarter, we expect our volumes to be relatively stable sequentially with positive overall pricing year-over-year. Additionally, we anticipate input costs to continue to moderate, leading to positive price/cost in the quarter. Overall, for the company, we expect our performance in Q3 to result in net sales similar to the prior year while generating high-teen EBIT margins.

Now consistent with prior calls, I'll provide a more detailed business-specific outlook for the third quarter. Starting with our Insulation business, we expect revenue to be down low single digits versus prior year as positive price realization and favorable currency are more than offset by lower demand resulting from the decline in U.S. light housing starts, softening demand in Europe and lower commercial spending.

In our technical and global insulation businesses, we expect revenue to be relatively flat versus prior year. Continued price realization resulting from our previously announced increases, which we begin to anniversary in Q3, and favorable currency are expected to be offset by lower volumes tied to the broader macro environment in Europe as well as softer demand in North America and the impact of the sale of our Russian operation.

In our North American residential insulation business, we anticipate lower demand versus prior year, similar to the volume decline we saw in Q2 as builders work through their backlog and demand for
insulation continues to track closer to lagged housing starts. Also, at the beginning of August, we will anniversary the acquisition of Natural Polymers.

From a cost perspective, we expect input materials, energy and delivery to continue to moderate, resulting in fairly neutral inflation for the quarter and positive but narrowing price/cost. We also expect to realize the impact of planned maintenance downtime and production investments in the quarter. Given all this, we expect to deliver mid-teen EBIT margins for the business.

Moving on to Composites. In the third quarter, we expect revenues to be down mid-single digits versus prior year with slightly lower volumes versus prior year and price becoming negative in the quarter. The year-over-year comparison will also be impacted by last year’s exit and sale of the Russian operation.

We anticipate Composites pricing will be negative as we see favorable contract pricing more than offset by lower spot pricing. These year-over-year spot price declines versus peak pricing realized in Q3 2022 are being driven largely by market pressures in Asia. While we expect inflation to continue to moderate, we anticipate price/cost will be a headwind in the quarter.

Given the slower demand environment in glass reinforcements versus prior year, we will continue to balance our production to current demand levels as we evaluate market conditions and manage working capital. Overall, we anticipate margins in the third quarter for Composites will be similar to what we saw in Q2.

And in Roofing, we expect revenue to be up mid-single digits. In terms of volume, we anticipate ARMA market shipments to be up mid-single digits versus prior year with our shingle volumes in the quarter tracking largely in line with the market. In the quarter, we expect to continue to realize positive price from our previous price announcements made this year.

Deflation is anticipated to become more meaningful as asphalt costs continue to increase sequentially but remain lower on a year-over-year basis and transportation cost remains a tailwind. Overall for Roofing in the third quarter, we anticipate generating EBIT margins approaching what we delivered in Q2.

With that view of our businesses, I’ll close with a few enterprise comments. As I shared at the start of the call, we have built a stronger company through our execution and investments, which can be seen in our ability to generate consistently strong and more resilient earnings, cash flow, returns on capital and ultimately returns to our investors. We’ve also built an incredibly strong balance sheet, which we will leverage as we continue investing to strengthen the long-term performance of the company.

We remain committed to a capital allocation strategy with a balanced approach, focused on organic growth and productivity investments; acquisitions, which leverage our unique material science, manufacturing and market expertise; and returning approximately 50% of free cash flow to shareholders over time through dividends and share repurchases. As we move forward, we will remain focused on delivering strong financial results and positioning the company for long-term success. With that, we will now open the call up for questions.
Question and Answer

Operator

[Operator Instructions] Our first question today comes from John Lovallo from UBS.

John Lovallo

UBS Investment Bank, Research Division

I guess, the question would be, can you help us just sort of bridge to that 30% Roofing EBIT margin in the second quarter, whether that's sequentially or year-over-year? And maybe more importantly, how sustainable is this margin level? It seems like you think it's sustainable at least in the second quarter. But do you think that we'll revert closer to those 20% trend margins over time?

Brian D. Chambers

President, CEO & Chair

Thanks, John. Let me maybe bridge a little bit to our -- we started with a guide. As we came into Q1, we were kind of in that 23% range. We guided around those numbers for Q2. And I think a few things factored into the step-up in margins in the quarter. One was a significant uplift in volume. So if we look at overall demand in the market in Q2 and throughout the quarter, we saw a pretty significant increase in weather events and storm activity. And that really accelerated manufacturing shipments in the quarter. In fact, in Q2, ARMA shipped a record -- recorded a record number of manufacturing shipments of about 48 million squares, so a lot of material flow over there.

Our volumes were very strong in the quarter, but we did -- we couldn't keep pace with, I think, some manufacturers that had more inventory on the ground. We've outperformed those ARMA shipments over the last few quarters. So we came into the quarter with a little less inventory to meet that demand level. So in the quarter, we saw a step-up of volumes that helped drive our margin performance but lagged a little bit the overall market shipments. I think that was a big factor in it. We also continued to see some additional asphalt deflation roll through, some material deflations roll through the P&L. And that came through because of such strong volumes. I mean, those costs immediately kind of flowed through to the P&L. And that resulted in some stronger margins.

And then the third factor I would say is in our Roofing and Components business, we saw a really nice step-up in demand there as distributors, I think, were restocking some lower inventory levels in anticipation of stronger roofing demand to service these weather-related events. And we saw that step-up. And for us, that's a significant part of our business and high-margin business. So I think those were kind of the three factors that stepped up the margin performance.

But as you said, Roofing business just delivered an outstanding quarter, great execution by the team, continued focus on servicing our customers and getting them the materials they need. So as we kind of pivot that and go into the back half of the year, a lot of this storm activity is not going to get serviced within a quarter or 2. So we do think that creates a pretty robust demand environment as we move into the third quarter and probably through the back half of the year.

And I think those stronger volumes, along with some continued price realization, we gave a guide to Q3 that we thought we could sustain these kind of margins. I would say a little bit of difference between Q3 and Q2 sequentially is that we expect our shipments to mirror closer to ARMA. We think a lot of that inventory of a lot of other manufacturers have been cleared out. So I think shipping rates are going to kind of mirror capacity rates. And so we think our shipments in the quarter are going to be up year-over-year, but they are going to be a little lower sequentially.

So I think that's a little bit in the guide to Q2 margins. And then we're going to see how some of the material costs play out for us as we go forward. But clearly, the business is running on all cylinders, really good performance, really good execution by the team. And as we track as we go into next year, we'll
continue to look at the margin performance of the business. But we think in the near term, we're going to continue to run at these levels.

Operator

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

Kathryn Ingram Thompson
Thompson Research Group, LLC

Focusing on Composites, a two-part question on Europe and U.S. For Europe, where you talked about spot pricing being down, to what extent are you seeing pricing pressure in Europe specifically for Chinese imports or Chinese producers? So we're starting to hear a little bit more pricing pressure for them. And then just a clarification on Composites in the U.S. Did you see a similar trend from a volume standpoint for your composites going to the roofing end market as you did for your roofing shingle volumes?

Kenneth S. Parks
Executive VP & CFO

Thanks, Kathryn. Thanks for the question. On the European question, I guess, what I would say is this, we have not seen a similar amount of pricing pressure in Europe from Chinese imports as maybe we've seen within the Asia-Pacific region. On the last couple of calls, we talked about the fact that the Chinese producers and the market in China, not stepping up significantly for local demand. We've seen more of the Chinese product moving into markets such as India.

And if you think about where we have contract pricing versus spot pricing, the majority of our business in the U.S. and in Europe is really tied to more contract pricing. And as you know, we kind of set those prior to going into a year. The spot pricing environment is heavily focused on Asia. So where we're seeing most of the spot pricing pressure is in Asia. And it does run to exactly what you talked about, Chinese imports, but less going to Europe, more going to other Asia markets such as India. There's probably a little bit of incremental in Europe but nothing that we would call out specifically.

And we've seen customers not only in Europe but in the U.S. really as we move through 2023 so far to kind of stick with the contract terms that we had agreed to last year around our arrangements. And I think that kind of runs to the fact that what we saw coming from '22 to '23 is a step-down in volumes in Europe as well as in the U.S. But they haven't continued to step down. It feels like they've kind of moved to a level and then they've kind of stabilized as we've seen in Q2 and exactly what we're kind of calling for in Q3.

Now that kind of leads to your second question, which is what are you seeing in the U.S. as far as volumes? We did see a step-down in volumes in the U.S. I would say in the spaces where we are where we are operating with building and construction solutions, we are seeing those hold up a little bit better. And obviously, for the reasons that you call out, not only roofing mat but the other places where composites are going into the building and construction markets, whether it's plumbing fixtures or other things such as that as the U.S. housing market holds up. We are seeing a little bit of headwind in other areas, other end markets, some of the other end markets that glass fibers goes into.

I'd just finalize it by saying specifically while we've seen glass reinforcement volumes move around, one of the things that this confirms to us and we want to make sure that you guys see this as well is this just further solidifies what we're saying about the pivot of Composites from glass reinforcements only to solutions that move further down the value stream. One of the best examples of that are our nonwoven materials, right? So as we're moving further downstream and turning glass fibers into nonwoven mat, other veil products, things such as that, those tend to have stickier arrangements with our customers.

They're more specified into the solution, whether it's shingles or whether it's film for gypsum boards or whatever that might be. But we are seeing that to start to offset some of the volatility in glass reinforcement volumes across the markets around the world, whether that be Europe, U.S. or in China. So hopefully, that gives you a little bit more color. But the reality is I think that we're seeing good contractual
pricing hold and we're seeing the spot pricing movements really affect the Asian market. But thanks for the question.

**Operator**

Our next question is from Stephen Kim from Evercore.

**Stephen Kim**  
*Evercore ISI Institutional Equities, Research Division*

Great quarter. Thanks for all that info on Composite, that was very helpful. But I wanted to ask you about the Insulation business and particularly the pricing outlook. We have -- you certainly talked a lot about the lagged starts. But as we all know, that's yesterday's news. And the more recent data coming out of particularly single-family start -- regarding single-family starts from the census have been extremely strong.

So I wanted to get a sense, are those numbers that you've seen in the last couple of months from the census, are they stronger than what you had previously expected? And is it your expectation that this could provide an opportunity for additional price increases from -- versus what you saw last December? You implemented one in last December. I'm thinking that we could be due for another one. I was curious if you could talk about the outlook, given the starts data that we've seen. And then if you could just briefly talk about what the pricing dynamic looks like overseas on the technical side of your business, in particular, I was thinking Paroc over in Europe.

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

Thanks, Stephen. Maybe start with the U.S. res question. And I think you've said it well in terms of I think the continuing strength and recovery we're seeing in housing certainly makes us more optimistic as we move through the year than we probably started the year. So as you've talked about, we -- the demand in our res business over the last several quarters has really been driven more by completion rates than light housing starts.

We expected to see that backlog continue to get worked through in Q2 and that our demand would start to follow more of that historic trend of like housing starts. We saw that in markets. There's still some markets that are very strong and builders are working through backlog. But we saw that start to come through. We expect to see that in Q3.

But to your point, I mean, the fundamental housing demand in the U.S. market is still very strong and, we think, getting stronger in terms of what we're seeing in some of the builder comments recently. We're certainly seeing that reset of consumers that we expected around higher interest rates and the fundamental need for more housing. Housing has been underbuilt. There's no inventory to work through. So we've continued to maintain that any slowdown would be shallower in duration or shallower in impact than previous cycles and the duration would be much shorter. And we continue to believe that.

And I think to your point, we're seeing that really coming through in the second quarter, where second quarter starts were actually higher than first quarter starts. When you look at the June activity, starts, completion and permits all kind of coming together at a higher than 1.4 million rate. So that's stepping up. And we think that continues. So I think our view would be the housing market is certainly turning more positive.

And that bodes well for demand trends as we finish the year and go into next year. So in the near term, might be a few quarters of some volume declines on a year-over-year basis. Sequentially, we're finding it stable. And then we think there's growth opportunities as we finish the year and going into next year. So I think that's, I think, a good view on the overall outlook for res housing that sets up well for us.

Around pricing, we've been maintaining a very good price management in the business. We're managing and looking at future costs. We're looking at future demand trends. So in terms of future pricing actions, we take a look and make those decisions as we move further down the year. But certainly, the demand
The environment is setting up a little stronger than we would have thought as we started the year. With regards to technical inflation pricing, we've seen a step down in demand on a year-over-year basis.

But as I talked about in the outlook, we're seeing those volume trends hold and sequentially pretty stable. So that's been good to see those demand trends stabilize even at current levels. And the price management, the team has been very, very well. So we continue to see good price realization on previously announced increases. We're seeing that across our technical inflation product lines, including in Europe. And so that's where we give a guide of continued kind of price realization on previously announced increases there. And we think that's going to continue into Q3.

Operator

Our next question is from Truman Patterson from Wolfe Research.

Trevor Scott Allinson
Wolfe Research, LLC

This is Trevor Allinson on for Truman. I wanted to touch on natural gas in your Composites and Insulation businesses. Natural gas prices have come down pretty considerably in both the U.S. and Europe. And I know you have hedging programs in place that can impact some of the potential deflationary benefits that you actually recognize.

I'm just curious, what are you actually baking in, into your 3Q estimates for deflation? It looks like Composites, you're actually talking about maybe potentially modest inflation. Are you expecting to start to see any of those natural gas benefits start to flow through in 3Q? If so, can you quantify those? And then if not, when do you expect from a timing perspective that you actually start to see some year-over-year deflation benefits?

Kenneth S. Parks
Executive VP & CFO

Sure. So I'll start out by just outlining again quickly how we hedge because that will help to answer the question. And then I'll give you a little bit more color. As we've talked about, we kind of have a very disciplined approach that's been in place for a while, where in every quarter, we're always looking 5 quarters out and we're hedging the prices on natural gas wherever we can, both in the U.S. and in Europe. So there's always layers of hedging if you just think about constantly looking at that.

So if you think about -- let's go to your question about the third quarter of 2023. We would have a certain number of layers of hedging that started to get placed back in Q2, Q3 of 2022. And if you think about the economic environment and the pricing environment around natural gas at that time frame, the prices had kind of peaked to their highest prices in Q3 and Q4 of last year. So if you roll all that together, what that means is that as we get to Q3, as we're layering on hedges, we've certainly got some hedges in there that are at something closer to today's market, right?

We've also got some layers that were put in place back in Q2, Q3, Q4 of last year that are running at a higher rate than current market rate. What that means is we are probably going to still see a little bit of inflation. Maybe it's much more comparable when we think about the net price we pay affected by the hedge itself. But where that will start to roll off is when we get past 4 or 5 quarters past that peak of what we saw in Q2, Q3 of last year. So effectively, what's happening via hedge program, as it would be in any case, is you're taking what's happening in the market today and you're kind of moving it along the next few quarters where you hedge.

And we're kind of getting now to that point in time in Q3, Q4 of this year where those higher-priced hedges are rolling off and we are going to see more of the benefit from the lower prices. We're already seeing benefit from the lower market prices. But we will see more of that as we move forward. I won't quantify it yet because the demand and the pricing all play into it. But just like you saw in Q2, we should see better energy pricing both in our Composites business and in our Insulation business. And that's a benefit to our results and included in our outlook.

Operator
Our next question is from Phil Ng from Jefferies.

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

Congrats on the strong quarter. Ken, appreciate all that great color on Composites. I mean, you called out some pricing pressure. But just curious, how do you see yourself managing that margin profile? And how should we think about contract pricing looking out to 2024 as that resets? Do you feel pretty comfortable that pricing on the contract side will hold up pretty well?

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

Yes, it's always hard to make a prediction fully at this point in time. But I would say go back to my comment on where do we have contracts. We have contracts primarily in the U.S., we have contracts in Europe. The contracts tend to run around and with customers who are looking for specific products being sold to them that they want to purchase. And what we love is now as the business is thinking about those discussions, because of the value of the offering and the relationship and the kind of solutions that we're providing under those contractual arrangements, the discussion doesn't just run to pricing, right?

And that's part of the reason that you saw us make the decision last year to think about the DUCS product versus our other products is that DUCS can move around in pricing much more commodity-like. It's got a lot less specificity as to who provides it and much more who can provide it at the lowest cost. So we now look at the portfolio and say what we're providing under contracts looks a lot more like a negotiation around a solution, that pricing is one of the elements, but it's not the only element. So comparatively over the last several years, we are in a much better place as we're going into contract price -- or contract arrangements, where it's not just a pricing discussion.

Now in Asia, I will tell you as it continues to be a spot pricing market, we will likely continue to see some tougher discussions around pricing in those markets as the Chinese market continues to kind of operate at the levels it's been at for the last 18 to 24 months and local production is being not used fully in the Chinese domestic market but as it's being kind of exported to other places. And I've called out India in prior quarters as well as earlier in this call. So pricing discussions there could be tougher. But I like the fact that we are having good discussions that go well beyond pricing and into the solution that we're delivering in markets where we have contracts in the U.S. and in Europe.

**Operator**

Our next question is from Michael Rehaut from JPMorgan.

**Michael Jason Rehaut**  
*JPMorgan Chase & Co, Research Division*

Congrats on the results. I just wanted to focus in a little bit on also the Insulation outlook and just trying to understand or parse out a couple of drivers here. First off, I want to make sure that I understand the slight step-down in EBIT margin sequentially into 3Q, if that's mostly driven by planned maintenance downtime and production investments.

And then looking into the back half, I guess, echoing an earlier question around pricing for the back half, if you could just remind us around typically for the business when there's usually in terms of a cadence of price increases in a normal market, if historically the business does enact any price increases in the back half, if you can just remind us of that. And given the potential for starts, which have more recently stabilized or improved a little bit, how does that interplay with how you're thinking about the current environment?

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

Thanks, Michael. Yes, let's talk a little bit on the sequential moves in EBIT margins skewed 3 versus Q2. I think a couple of drivers inside of that. One is that, as you mentioned, we are expecting to take a little bit
more planned maintenance downtime in the quarter. We've been running these assets to service demand very hard. They require annual maintenance. And we're trying to stagger these out where we can hit some in Q3, maybe a little bit in Q4 but trying to get to those maintenance issues that we have and address those and be in front of then the anticipated demand recovery that we do think with higher starts to come at us here to finish this year and into next year.

So I think we're very conscious of how we're planning our manufacturing maintenance downtimes in a way that gets to the needed equipment upgrades we need to make that drives our productivity, that drives our cost efficiencies but also sets us up well as we go into next year with the anticipation of volumes getting stronger that we're able to service that demand. So there's going to be some of that in Q3 that we're going to hit.

And then I think some of it is around some narrowing price cost. And this gets to the pricing question. We are going to be comping against some price increases last year that have rolled off. So I think in our guide, we talked about a positive price/cost but narrowing. And that's really around the fact that there has not been other new increases announced this year versus last year on that piece. So the combination of those two is going to put a little bit of downward pressure on margin performance sequentially in the business.

If I step back and just think about pricing overall historically to your question, generally in our res inflation, we try to time increases that can be communicated through to our customers and through to builders in a way that they can put those into their cost of goods and estimates as they're building homes. So generally, we try to look at something sometimes in the fall. For sure, we look at end of year increase announcements historically that allows our customers to plan for the following year. So that's been the historic cadence in the business.

And to your question around how that's going to play out relative to starts going forward, again I think we're going to continue to look at our input cost overall, not just material costs, labor cost inflation, some other areas of increasing costs that we're seeing in the business, how we best look at that relative to pricing. And then we'll look at the demand environment. And we'll make those decisions as appropriate, when we look at finishing out the back half of the year.
And then we talked a lot about the margin performances within the business and the company with a focus that we believe we were taking actions and initiatives that would not only increase the overall margins of every business and the company but create a more sustainable and a more resilient margin profile for the company. And that is really the work we have been doing commercially, operationally through strategic investments to kind of step up the growth rate, step up the margin rates that they're not just higher, they're more resilient and then also continue to look at operating and free cash flow, how we do capital allocation, return cash to shareholders, how we make specific investments more efficiently in our CapEx deployment.

And all of that, it really is accumulation of work that we outlined in the strategy. So when we look at the margin performances in our businesses today, these are what we have been working to get to. And we've been talking about raising the margin profile. Particularly in Insulation, we said we were taking structural improvements around productivity investments. In automation and in process technologies, we are doing optimization of our networks that we thought we could structurally change the margin profile of inflation by 250 basis points. I think that's coming through.

We talked about investments in Composites around network optimization, the shift to higher-value products that Ken has talked about that bring a better margin profile, that we would shift that up. And in Roofing, we talked a lot about our investments to expand our contractor network, to expand our shingle components business and get a higher attachment rate and to make investments in new products and innovation that would drive demand at the contractor level that would result in growth in our laminate product offering. And we've seen that and we've talked about investments, spending capacity to service that around our Medina laminator.

So I think in every business, we've taken very focused actions to structurally improve the operating performance in terms of capacity utilization rates, productivity, cost structures as well as commercially through innovation, through customer partnerships, through other investments to really strengthen the value of our products and brand. And I think all of that is kind of coming to fruition with the margin performance we're now seeing. With a step-down in volumes, we're getting good value in price realization. We're seeing good factory cost utilization and optimization rates. We're seeing good productivity. And we're seeing those efficiencies play out.

So all of that, I think, is what we envisioned a few years ago when we laid this out. The teams have just been executing extraordinarily well around all of these initiatives. And it's a lot to take on. But we're very proud of the work that we've been able to accomplish. The teams are doing very, very well. And again, I think this positions us really well to weather kind of this downturn that we're working through today in some of our volumes but really position us for growth when we start to see volumes uplift in terms of the margin potential overall for the company and inside these businesses. So we're very happy and pleased with the performance where we're at to date. And we see more opportunity to continue to grow the company.

Kenneth S. Parks
Executive VP & CFO

And Rafe, I would just add because I think Brian covered everything really well. I think it's a great opportunity, and I'd be remiss not to say this, which is since November 2021, which seems like a really long time ago, but it wasn't that long ago, all of our markets until this year have been hitting on all cylinders, right? So while we've been telling you guys the story and doing exactly what we said, which is kind of working through the structural changes and the market changes and the portfolio changes to get the company where it needs to be, we knew that while markets are all hitting, everybody is kind of waiting for the proof point of the fact that do we see that come out in the results?

And I just would challenge each of us, including you guys, to look at our results and realize that not only have we now in 2023 in softer or mixed markets, as we may want to say, delivered exactly what we said we were going to do in Q1 with more structurally higher operating margins, again even higher in Q2. And we just gave you an outlook for the same kind of story in Q3 on continued kind of mixed markets in different regions of the world. So I just say that because I think that it's important to remind ourselves that we are now in a point of delivering proof points. And I feel good that the organization has really
executed and so far delivered to and on track to deliver 3 quarterly proof points of saying exactly what we said we were going to do.

**Operator**

Our next question comes from Mike Dahl from RBC Capital Markets.

**Michael Glaser Dahl**  
*RBC Capital Markets, Research Division*

Just a follow-up on the Roofing dynamics, just first part to make sure we understand correctly some shifting dynamics between 1Q, 2Q, some of it's probably geographic on storms, but some of it was, if I heard you correctly, maybe your competitors weren't able to get out in front of some of the demand that started to come through in 1Q while you could service it, which meant they kind of had some inventory waiting on the ground when demand continued to be strong in 2Q.

When you say that's kind of now equalized, I guess, first, is that accurate? Second is when you think about the outlook for 3Q, is that now inventory is kind of lean across the manufacturers, so you're all in the same spot? Have you increased your production to try to intentionally get more inventory out? And when you think about kind of the sell-in versus sell-out, do you think you're basically matching with that 3Q guide? Or do you think there will be some restocks? I know there's a few kind of parts in there, but that would be great if you could address those.

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

Sure. We'll try, Mike. I'm going to try to hit them maybe in reverse order. I think, yes, you've characterized kind of Q3 versus Q2, so Q2, our volumes versus ARMA volumes. Yes, I think we had been -- had very solid demand in Q4, Q1 relative to ARMA shipments. We've outperformed the market. So coming into the quarter, we felt that many other manufacturers probably were carrying more inventory. So there's always a surge when you have a storm event that distributors put purchase orders in. They were able to service that surge in a shorter time period because of inventory on the ground.

We think a lot of that's cleared out and back to our guide then that why we believe Q3 volumes for ourselves, for the rest of the industry kind of match what can be produced and what can be shipped out. So I think we fundamentally believe we have a very strong share position. We've outperformed the market in the first half. And we've got great contractor demand, great contractor support. So I think this is just a bit of a timing issue between quarters in terms of shipments to demand and some shipments coming out of inventory in Q2 that we don't think repeats in Q3.

I would think that Q3 volumes, although it's always tough to predict kind of sell-out demand of distribution versus their buying patterns in, but I would think given the strength of the market and particularly in storm markets, their sell-out is going to equivalent -- it would be equivalent to sell-in. So I think we're going to see pretty even demand in terms of that.

In terms of production, we have increased our laminate production. In fact, we produced more laminates in the first half than ever, given our capacity investments, given our productivity investments. But the demand for our brand and our products remain incredibly strong. So we're going to work hard in Q3 to try to continue to service that demand and service our customers. But it's a robust market. We feel good about our share position. And we think it's going to be strong here in Q3.

**Operator**

This is all the time we have for Q&A today. So I would now like to hand back to Brian for any closing remarks.

**Brian D. Chambers**  
*President, CEO & Chair*
Thanks, Daisy. And I just want to take a moment to thank everyone for joining us on today’s call and for your interest in Owens Corning. And we look forward to speaking with you again during our third quarter call. Thanks, everyone.

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