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## ANALYST QUICK NOTES

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**Masco Corp. (NYSE: MAS: BUY)**

**Target Price: \$40**

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**1/17/2017**

### Why Buy Masco?

- Recent indications of strong holiday sales at building supply stores suggest continuing demand for home improvement products.
  - SpendTrend: +10.1 Dec, 7.5 Nov, 8.1 Oct.
  - Commerce Dept.: 0.9% Dec, 8.2% Nov, 1.6% Oct.
    - Reminder: HD was lapping a 10.6% U.S. comp in December 2015.
  - MAS is one of the biggest suppliers to Home Depot & Lowe's. Some 33% of Masco's 2015 sales were to HD. Lowe's represents less than 10%.
- Masco is categorized as an Industrial stock. The sector is outperforming Retail since the election.
- MAS has more insulation from Internet competition than most of our consumer/retail universe.

### What about Interest Rates?

- We do not expect the current cycle to peak unless 30-year mortgage rates jump towards 6% (from a current 4.2%).
  - About 85% of revenue is linked to repair and remodel and 15% to new construction.
- Private Fixed Residential Investment is still near a 66-year low, at 3.5% of GDP, and well below the average of 4.6% since 1946.
  - We expect PFRI to approach and likely exceed the long-term average before this current expansion is done.
  - Based on calculations from the Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters, Private Fixed Residential Investment is expected to reach only 3.6% of GDP when the final numbers are tallied for 2016 and 3.7% of GDP for 2017.

### Management Color on the Sector from 3Q Call

- Masco: End markets in North America and Internationally remain strong.
- The company continues to leverage underlying market strength by introducing new products, improving sales-mix, penetrating new markets, and gaining share with industry-leading brands.
- Double –digit sales growth with Pro Paint initiative at HD. Doubling Pro Hub stores to 200 this year. MAS hopes this will drive additional comp growth in 2017.
- Behr Marquee, its highest price point DIY product, is posting exceptional comps, again at HD.
- Based on success, MAS is expanding a KraftMaid cabinet product for Lowe’s to 500 from 250 stores.
- There is strong demand for repair and remodel products, as consumers are trading up.
- Plumbing shows strong consumer-driven demand at both wholesale and “large retail customers.”
- KraftMaid had a strong performance in the retail channel resulting in double-digit growth and share gains.
- “The consistent thing about this recovery has been some choppiness.”
- “Fundamentally the demand drivers and the foot traffic that we’re seeing particularly in repair and remodeling are strong.”
- MAS is seeing good growth in spas and cabinets, which are big ticket and in entry level (“A good sign for the nature of the recovery.”).
- Management said that the housing market continues to be choppy at times, but the multi-year recovery remains on track. As a reminder, the company is deliberately discontinuing some cabinets that had been sold directly to builders at unfavorable margins.
- Masco CEO: “Fundamentally my view hasn’t changed – good macros.”

### What Does Masco Do?

- Masco manufactures home improvement and building products.
  - Following the spinoff of the installation business in 2015, Masco has four segments, which had 2015 sales of \$7.1 billion:
    - Cabinets and Related Products, which include the KraftMaid brand (14% of 2015 sales);
    - Plumbing Products, including Delta Faucets (47%);
    - Decorative Architectural Products, including Behr paint (28%); and
    - Windows and Other Specialty Products, including Milgard windows (11%).
  - Approximately 20% of the company’s sales are international, dominated by the UK and Europe.
    - Plumbing has the most international exposure, at about 40%.
  - About 85% of revenue is linked to repair and remodel and 15% to new construction.

### Investment Conclusion:

- We remain optimistic that Masco's expertise in developing new products and management's efforts to make the business more efficient will boost the shares as the housing and remodeling market improves. We continue to expect a multiyear housing recovery.
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