



ANALYST QUICK NOTES

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Masco Corp. (NYSE: MAS: BUY)

Target Price: \$40

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2/13/2017

What's New?

- On February 9, Masco reported 4Q16 net revenues of \$1.76 billion, up 3% from the prior year.
 - This was below our estimate of \$1.81 billion.
 - It was above the StreetAccount consensus of \$1.75 billion.
- Adjusted earnings rose 14% to \$0.33 per share, which missed the StreetAccount consensus of \$0.34 and our estimate of \$0.34.
 - One unanticipated factor was that quarterly results were hurt by approximately \$0.02 per share as a result of medical costs from employees that are self-insured by the company.
 - The shares were off initially but rebounded after the Street seemed to understand these costs.
- North American sales rose 3%.
 - Sales remained strong in big box stores.
 - Management also believes that its domestic and international markets are seeing continuing growth.
 - MAS believes it is gaining market share in the plumbing and paint segments and with the KraftMaid cabinet brand.
- International sales increased 8% in local currency, boosted by the international plumbing businesses.

What about a cross-border tax?

- We have had some questions about the possible implications of a cross border tax on Masco.
 - The truth is that it is impossible to know without knowing what the legislation will be but...
- Masco could potentially fare better than many of the companies in our universe.
 - Again, this is all speculative, but the company's tax rate is about 36%.
 - They could potentially benefit from a reduction in corporate tax rates.

- As for a tax, or lack of deductibility on finished goods or components from overseas, we don't think MAS would fare too badly despite the fact that the implementation of any potential tax is unknown.
- In broad strokes, the company has very substantial production in the U.S. There are about 40 factories in the U.S. and about 13 overseas.
 - In addition, we believe that the U.S. factories have capacity if Masco wanted to shift some business here to avoid the tax.
- The paint and window businesses are essentially U.S. businesses and we don't think there is much concern about a cross border tax.
- In the cabinet business, the company does import some wood and materials, but the company could potentially do more here if it made economic sense.
- The faucet business does have some overseas production that is imported into the U.S. (and also has some overseas production that is sold overseas).
 - MAS has significant domestic production and possibly some capacity.
 - A tax could possibly make some of their domestic-made faucets more competitive relative to competition that is made overseas and taxed.
 - We think it would be hard to raise prices on all but the most innovative products -- and even in this respect, Masco has a good record of innovation.

What Does Masco Do?

- Masco manufactures home improvement and building products.
- Masco has four segments, which had 2016 sales of \$7.4 billion.
 - Cabinets and Related Products, which include the KraftMaid brand (13% of 2016 sales).
 - Plumbing Products, including Delta Faucets (48%).
 - Decorative Architectural Products, including Behr paint (28%).
 - Windows and Other Specialty Products, including Milgard (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 80% of revenue is linked to repair and remodel and 20% to new construction.
- MAS is one of the biggest suppliers to Home Depot & Lowe's.
 - 33% of Masco's 2015 sales were to HD.
 - Lowe's represents less than 10%.

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.
 - About 30% of the company's 2016 sales came from products that were introduced within the prior 36 months.
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