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Masco Corp. (MAS)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Welcome to Masco Corporation's First Quarter 2023 Conference Call. My name is Michelle, and I will be your operator for today's call. As a reminder, today's conference call is being recorded for replay purposes. [Operator Instructions]

I will now turn the call over to David Chaika, Vice President, Treasurer and Investor Relations. Please go ahead sir.

David A. Chaika

Vice President, Treasurer & Investor Relations, Masco Corp.

Thank you, Michelle, and good morning. Welcome to Masco Corporation's 2022 first quarter conference call. With me today are Keith Allman, President and CEO of Masco; and John Sznewajs, Masco's Vice President and Chief Financial Officer.

Our first quarter earnings release and the presentation slides are available on our website under Investor Relations. Following our remarks, we will open the call for analyst questions. Please limit yourself to one question with one follow-up. If we can't take your question now, please call me directly at 313-792-5500.

Our statements today will include our views about our future performance, which constitute forward-looking statements. These statements are subject to risk and uncertainties that could cause our actual results to differ materially from the forward-looking statements.

We've described these risks and uncertainties in our risk factors and other disclosures in our Form 10-K and our Form 10-Q that we filed with the Securities and Exchange Commission. Our statements will also include non-GAAP financial metrics.

Our references to operating profit and earnings per share will be as adjusted unless otherwise noted. We've reconciled these adjusted metrics to GAAP in our earnings release and presentation slides which are available on our website under Investor Relations.

With that, I'll now turn the call over to Keith.

Keith J. Allman

President, Chief Executive Officer & Director, Masco Corp.

Thank you, Dave. Good morning, everyone, and thank you for joining us today. Please turn to slide 5. I'm pleased with the start of our year and want to thank our employees and supplier partners for executing well in an environment that remains challenging.

We are focused on winning in the recovery by continuing to engage with our customers, launch new products and expand the breadth of our brands, at the same time, managing our costs in these uncertain economic times.

In this period of volatile macroeconomics and slowing demand, our top line decreased 10% in the first quarter, against a strong 12% comp. Volume was down 14%, partially offset by pricing actions of 6%.

While operating profit declined in the quarter, primarily due to the lower volume, higher input costs and continued investments for future growth, our strong execution delivered a decremental margin of approximately 20%. Our earnings per share for the quarter was $0.87.

Turning to our segments, Plumbing sales declined 8% in local currency, with North American and International Plumbing declining 10% and 3%, respectively. Both our North American and International Plumbing businesses continue to further strengthen their industry-leading brands, customer service and new product development.

In North American plumbing, Delta faucet launched new products at the Kitchen & Bath Industry Show, such as the Delta ShowerSense Digital Shower and the Delta steam shower, each offering consumers a more customizable shower experience.

In our spa business, Watkins Wellness launched a complete redesign of its top-selling HotSprings' Highlife offering. These spas have exciting new features to enhance the consumer experience that we believe will help Watkins outperform the competition even in a challenging market.

In our International Plumbing business, Hansgrohe launched new products at ISH, the world's leading plumbing trade show, including a new product portfolio of sanitary ceramics and bathroom furniture paired with their premium faucets and showers. Additionally, they introduced the next generation of their in-wall iBox valve which allows installers to connect any type of plumbing fixture without the need for major construction work.

Hansgrohe also displayed their focus on the environment, with a concept study of a bathroom that consumes 90% less water and energy, highlighting their commitment to the development of innovative and sustainable products. With our strong brands, geographic diversity and innovative products, our Plumbing segment is well positioned to continue to gain global market share.

Turning to our Decorative Architectural segment. Sales declined 10% in the quarter against a strong 17% comp. PRO paint declined mid-single digits against a tremendous comp of over 50% in the quarter of 2022. And DIY paint sales declined high single digits.

In the quarter, Behr continued to launch new products and services and received recognition for their industry-leading customer satisfaction. We gained shelf space with our adjacent pink categories such as aerosols, interior stains, caulks and sealants and applicators as these programs expanded into additional stores. We launched Behr DYNASTY Exterior for the summer painting season, expanding the lineup of our number one rated Dynasty paint line.

And we continue to invest in people and capabilities to better serve the PRO painter by adding additional sales reps, increasing job site delivery capabilities and expanding our loyalty programs. Lastly, in a recent third-party paint satisfaction study, Behr earned the number one rating in the exterior paint category and the number two rating in interior paint, demonstrating the strength of the Behr brand, quality of our products and our exceptional service performance.

Turning to capital allocation. With our strong free cash flow and balance sheet, we returned $121 million to the shareholders through dividends and share repurchases, as we bought back 1.1 million shares for $56 million in the quarter.

Now, turning to our outlook for the remainder of 2023. While we delivered solid first quarter results, we remain cautious and continue to expect softening demand trends in 2023, as our markets adjust to increasing interest rates, persistent inflation and tighter consumer spending.

In this uncertain environment, we are focused on adjusting our costs and minimizing the impact on margins from lower volumes. We have enacted select hiring freezes and have reduced staffing with head count down approximately 5% year-over-year. We announced the closure of one of our plumbing manufacturing facilities, and we have delayed the opening of our new spa plant, as we continue to balance investing to win in the recovery with cost reductions.

With the actions we are taking to address this dynamic environment, our continued strong capital deployment and the uncertain macroeconomics, we continue to anticipate earnings per share for 2023 to be in the range of $3.10 to $3.40 per share.

While near-term market conditions remain challenging, we believe the long-term fundamentals of our repair and remodel markets are strong. Though cyclical factors such as home price appreciation and existing home turnover will likely remain a headwind for 2023, we believe structural factors, such as consumers staying in their homes longer, the age of housing stock and high home equity levels will drive increased repair and remodel activity in the years to follow.

I'd like to remind you of the strength of Masco and the power of our focused business model. Our portfolio of low-ticket repair and remodel products with market-leading brands and product and geographic diversification provides growth and stability through cycles. We arguably have the strongest portfolio of brands in the building products industry; with Delta and Hansgrohe in the plumbing industry and Behr and Kilz in paints and primers. Our products are found everywhere consumers want to shop. We are able to leverage consumer and customer insights across all channels. This drives powerful innovation as evidenced by our 25% vitality index and leading customer satisfaction as evidenced by numerous customer satisfaction and service awards. And through the execution of our Masco operating system, we look to drive operating margin expansion through cost productivity and volume leverage.

As demonstrated in the first quarter, we will continue to invest in our brands, capabilities and people to outperform the competition in both the near and long term. With favorable fundamentals for our portfolio of low-ticket repair and remodel-oriented products and our continued focus on executing our growth strategy, together with our strong free cash flow and capital deployment, we are positioned to drive shareholder value creation for the long term.

Before I turn the call over to John, I wanted to take a moment to thank him for his over 27 years of service to Masco. He has been an invaluable partner, not only to me, but the entire organization, our board and the investment community during his tenure with the company. He will be missed and we wish John all the best in his future endeavors.

John will be leaving us at the end of May, and we are in the process of selecting his successor. We have strong internal candidates and have engaged a search firm to assist in conducting a thorough external search as well. While we complete this process, Dave Chaika, Masco's Vice President, Treasurer and Investor Relations, has been appointed as our Interim CFO. Dave has over 20 years' experience with the company, starting in our M&A department and progressively adding additional responsibilities, including treasury, risk management, financial planning and analysis and Investor Relations.

Additionally, prior to Masco, Dave was a Vice President in the commercial banking industry and an officer in the US Navy. Now for the final time, I'll turn the call over to John to go over our first quarter results and 2023 outlook in more detail. John?

John G. Sznewajs

Chief Financial Officer & Vice President, Masco Corp.

Thank you, Keith, and good morning, everyone. As Dave mentioned, my comments today will focus on adjusted performance, excluding the impact of rationalization and other onetime items.

Turning to slide 7. Sales in the quarter decreased 10%, and excluding currency, decreased 9%. Lower volumes decreased sales by 14%, partially offset by net selling prices of 6%. North American sales decreased 10% in the local currency. International sales decreased 3%.

Despite lower volume, our strong execution in the quarter resulted in our gross margin expanding 150 basis points to 33.6%. This is the first time in seven quarters that we've expanded gross margins as we are now recovering the significant cost inflation we have absorbed over the past two years.

Our SG&A as a percentage of sales was 17.8%, due to higher brand and marketing investments such as trade shows and sales meetings to support our growth strategy of investing in our brands, service and innovation.

Operating profit in the first quarter was $312 million, and operating margin was 15.8%. Operating profit was impacted by lower volumes, higher input costs and growth investments, partially offset by higher net selling prices. Lastly, our EPS in the quarter was $0.87.

Turning to slide 8, Plumbing sales in the quarter decreased 10%, against the 9% comp, and excluding currency, decreased 8%. Lower volume decreased sales by 12%, partially offset by net selling prices, which increased sales by 5%.

North American plumbing sales decreased 10% in local currency. This was driven by continued lower demand that we started to experience in the third quarter of last year. This lower demand was fairly broad-based across product categories and channels.

Our spa business, which is approximately 15% of the segment declined over 20% that has now worked through the significant backlog generated from the spike in demand for its products. International plumbing sales decreased 3% in local currency, against an 18% comp as demand softened in many European markets and China.

For Plumbing overall, changes in channel inventory positions during the quarter did not significantly impact our results. Segment operating profit in the first quarter was $202 million, with an operating margin of 16.5%.

Operating profit was impacted by lower volumes, higher brand and marketing investments, partially offset by higher net selling prices. This resulted in a decremental margin of 19%. While input costs have declined from their peak levels, particularly container costs, overall input costs remain elevated.

Turning to slide 9, Decorative Architectural sales decreased 10% in the first quarter, against a strong 17% comp. Paint sales declined high-single digits, with PRO paint sales decreasing mid-single digits against a robust comp of over 50% in the first quarter of 2022.

DIY paint sales declining high-single digits. Keith mentioned, we gained shelf space with our adjacent product offerings such as aerosols, interior stains, caulks and sealants and applicators.

For PRO paint, we are investing along with our partner and our joint capabilities to continue to grow share in this large and growing market.

Lastly, our operating profit was $133 million and the operating margin was 17.6%. Operating profit was impacted by lower volumes and higher input costs, partially offset by higher net selling prices. While we have seen modest sequential relief in certain paint input costs, other input costs continue to experience upward pressure such as TiO2, labor and transportation costs and the overall input basket remains elevated.

Turning to slide 10. Our balance sheet remains strong with net debt to EBITDA at 2.2 times at the end of the quarter. We ended the quarter with approximately $1.3 billion of balance sheet liquidity. Working capital as a percent of sales declined 100 basis points to 19.1% and a net 13 day reduction.

With an improvement in working capital, net cash from operating activities was $33 million, an improvement of $260 million compared to prior year. With expected lower volumes and less supply chain disruptions this year, we anticipate working capital as a percent of sales to continue to improve and be approximately 16.5% at year end.

During the first quarter, we repurchased 1.1 million shares for $56 million, returned $65 million to shareholders through dividends. As we discussed on our fourth quarter call, we anticipate deploying approximately $500 million towards share repurchases or acquisitions for the full year, with activity likely more weighted to the second half of the year.

Lastly, we have retired $200 million remaining on our term loan that matures today by borrowing on our revolver. We will likely repay outstanding borrowings on our revolver during the third quarter.

Now let's turn to slide 11 and review our outlook for the year. We had a better than planned start to the year. However, we believe the delayed impact of rising rates, tighter credit and lower consumer spending in the face of persistent inflation have yet to fully play out in the economy.

With these uncertain times as the backdrop, we are maintaining our full year outlook at this time. For Masco overall, we are planning for volumes to be down in the low double-digit range, partially offset by low single-digit pricing. Based on this assumption, we expect 2023 sales to decline approximately 10% with operating margins of approximately 15%. At this time, currency is projected to have a minimal impact on our 2023 results.

Our SG&A as a percentage of sales trended below normal levels during the pandemic. However, as we continue to invest in our business for future growth, while maintaining cost discipline, we expect this percentage to increase back to the more normalized pre-pandemic level, to be around 17.5% for 2023. As always, we will take appropriate actions to address our costs as the year develops based on market conditions.

In our Plumbing segment, we expect 2023 sales to decline in the range of 10% to 14%. We anticipate the full year Plumbing margins will be roughly flat with 2022 segment margins at approximately 16%. Lower volumes and plant setup costs will impact margins with favorable selling price increases partially offsetting these headwinds.

In our Decorative Architectural segment, we expect 2023 sales to decline in the range of 5% to 10%. Looking specifically at paint for 2023, we currently anticipate our DIY paint to decrease high single-digits and our PRO paint business to decrease mid-single-digits as we cycle over 25% PRO paint growth in 2022.

We anticipate full year Decorative Architectural margin to be approximately 16%. This is largely due to our significant pricing actions in this segment and typically only recover the dollar amount of inflation. As a result, all else equal, operating profit dollars remain neutral from cost recovery pricing actions but results in margin compression. We are also planning an increased investment in people and capabilities in 2023 to drive future growth in our PRO paint business to have a greater impact in the coming quarters.

Finally, as Keith mentioned earlier, our 2023 EPS estimate remains $3.10 to $3.40. This assumes a 226 million average diluted share count for the year and a 24% effective tax rate. Additional modeling assumptions for 2023 can be found on slide 14 in our earnings deck.

Before I conclude, I want to take a moment to thank Keith for his 10 years of partnership, our board and the entire Masco team for everything over the last 27 years. Leaving Masco is bitter sweet for me. I look forward to keeping in touch with my friends and colleagues here and watching the company's continued growth and success. Dave is a very capable executive. We have worked together for more than 20 years, and I know the finance team won't miss a beat under a steady leadership in his new role as interim CFO. And I'm proud of everything that we have accomplished together at Masco and wish the team the best of luck in the future.

With that, I'd like to open the call for Q&A. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question will come from Matthew Bouley at Barclays. Please go ahead.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Good morning everyone. Thanks for taking the questions and I just want to pass along my best wishes to John. So just on the overall margin outlook, given your first quarter margins came in ahead of the full year guide, previously, you guys had spoken to sequential margin improvement across the business. And so now the guide mathematically implies lower margins for the balance of the year. So my question is, is that just conservatism? Is there still a path to sequential margin improvement in either segment? Or is there something out there that could still take margins lower? Thank you.

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

A

Hey, Matt. Maybe – this is Keith. I'll start off and John, maybe you could add some detail. I think when you think about margins and our performance vis-à-vis, the outlook, it's really driven by volume. And as we've talked in the past, incremental volumes, decremental volumes are in around that 30%, 30% to 35% range. So that is a fundamental driver of what's happening to our margins.

Additionally, as I talked in my prepared remarks, we endeavor to strike a balance here of managing our costs in these uncertain times. And we've demonstrated our ability to do that thus far, and we'll continue to do that. But it's also important that we continue to invest in our business. So you'll see continued investments in marketing and advertising. For example, this quarter, we had two significant trade shows, which when added up, are material investments for us that haven't happened in many years.

We're getting together more as an organization in terms of sales meetings to continue to drive. So there's, additional investments on top of the headwind that we plan on experiencing from lower volumes.

And then there's pricing actions that counter that. And we'll take – we have taken pricing, and we'll see those anniversary here mainly in the second quarter and then a little bit into the third quarter. So hopefully, that gives you a little bit of an idea of what's driving our thoughts on the margins as we look to the year.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.
A

And Matt, maybe just add a little bit of color – further color to Keith's comments. Our prior statement was really that, we would see sequential year-over-year improvement every quarter as we go through the year. And so, – and what we intended to convey was that Q1 of this year would be better than Q1 of last year, et cetera, et cetera, as the year rolled out.

And so as we look at our margins going forward, the back half of the year margins get a little – the comps get a little bit easier because we – margins decline, particularly in the fourth quarter. And so we think we can get there for each of the subsequent quarters from here. But yes, it will be lower than where we're at here in the Q1.

Matthew Bouley
Analyst, Barclays Capital, Inc.
Q

Got you. Okay. Yeah. Thanks John for that clarification and thanks Keith. So second question, you mentioned in Decorative that there were some shelf space wins in your adjacent categories. I'm just curious, if you can kind of put a little finer detail on that. Any color around kind of load in? Or was there a margin impact from that in the Decorative business?

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

Well, I'll kind of get into the specifics on the load in. The margin on these is very good. I think it's a good business for us. We've been working with our partner, The Home Depot, and caulk and sealants, applicators, stains, some of the products that we've talked about and as evidenced by the fact that we're rolling it out to additional stores, it's working.

And it's really attributed to the Behr brand and the team out at Behr and their execution. So, good business for us, it's building. Clearly, the main portion of our business, obviously, is in the liquids. But this is good, and it's been a strategic effort for the team, and it's successful.

Matthew Bouley
Analyst, Barclays Capital, Inc.
Q

All right. Thanks Keith. Good luck guys.

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

Thank you.

Operator: Your next question will come from John Lovallo at UBS. Please go ahead.

John Lovallo
Analyst, UBS Securities LLC

Q

Good morning guys and thank you for taking my questions. Maybe just dovetailing off of Matt's question there, I mean, 15.8% margin in the first quarter, 2Q and 3Q are generally well above the first quarter and the full year outlook is 15%.

I mean, I know we're only through the first quarter, but maybe if you could help us frame the sort of the upside and downside case there. I mean, let's say that demand stays relatively flat from where it is today, I mean, where could those margins actually shake out?

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Yeah. John, maybe I'll start and Keith feel free to chime in. So John, as kind of Keith alluded to answering Matt's question, we did deliver some strong performance in Q1 and obviously the 6% price helped and as Keith also just referenced, a lot of that pricing benefit starts to subside as you go through the year.

I mean, [indiscernible] (00:27:33) some benefit in Q2 because that's when a lot of the pricing got initiated, but that benefit will really subside pretty significantly as you go into the back half of the year. So with that benefit going away, that will have some impact on margins.

As Keith also mentioned, we do expect volumes to be pressured this year. If you think about the strong comps we're up against here in the first half of the year – volumes were softer in the back half of the year last year. So we continue to expect that down. So with overall, our 10% guide to the top-line being down, I think that weighs on it.

And then we've got some additional investments that we're making. Keith mentioned the fact that we're continuing to invest in programs and initiatives across the entire portfolio, but very specifically in the PRO paint initiative. I mean kind of headwind we've got and we've got a couple of facilities that are starting up in the back half of the year that will create some expense headwind to us.

So that – all those things are kind of pressuring margins. Now to your question, if volumes remain flat for me could there be some upside to that? Yes, there could be and I expect there to be, if volumes remain flat, but that's not the model that we're forecasting at this point. Keith, I don't know if there's any color.

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

A

Yeah, just create a little bit. I think the declining volume is the pressure on the margins where we could see some potential upside if we didn't see that volume decline. We had nice execution in the quarter. Our drop-down or decrementals is typically in that 30% range. And we've done a pretty good job of that in Q1. And if we can continue to do that, that would be some potential upside.

There's always an opportunity for commodity costs to come down, really when we look at where they were in this first quarter, we haven't seen that deflation. They remain elevated. So we think we have our guide in the right place given the uncertainty in the macro economics, and we're going to continue to invest in our brands, while driving and watching – driving productivity and watching our costs.

John Lovallo
Analyst, UBS Securities LLC

Q

Okay. That's helpful, guys. And then maybe more of a high-level strategy question here. If we think about the PRO paint effort at Home Depot, I mean, what do you see as sort of the biggest challenges to growth there? Is there a sufficient dedicated sales force? Are there enough specialty products needed to complete bigger jobs? Where do we get – how do we get to the point where it's very competitive with Sherwin or PPG? I mean what are sort of the missing elements in your view?

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

A

Well, I would tell you, I think we are competitive as evidenced by, I think, 45% two-year stack of growth in PRO. You don't get that without being competitive. I like where our product offering is. There are certainly tweaks we can continue to make to the offering, but we've got the right price points, and we have a very strong brand. So it's really about execution.

And when we look at what's happened to the customer base over the last couple of years when we've had this extraordinary growth is that we've been able to, because of our supply chain prowess, get our paint in the hands of more painters. And what we're seeing and have significant data with regard to Net Promoter Scores and customer satisfaction and how they view both our product and the total service offering with our partner, The Home Depot, it's very strong.

So the challenge is continuing to execute, to continue to deliver on our brand promise and continue to have the right price and the right service proposition and delivering. So I think we're competitive and it's – certainly we have tough competitors, but I think as evidenced by what the team has been able to do, we're looking forward to the challenge.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Yeah. And John, I'd also point out to you, maybe just add – sorry to cut you off, to add to Keith's comments...

John Lovallo
Analyst, UBS Securities LLC

Q

No.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

...as you kind of take a look at the business, we've grown this to a $900 million business. It's in a market size, call it, $9 billion, $10 billion. So what I like about how we're positioned and everything that Keith just said, we think we've got a great runway in front of us for future growth. Because of our relatively small presence in the overall market, even though it's a $900 million business, we've got a lot of opportunity to continue to grow this over the coming years with the – not only the quality of the product, the initiatives, the people, the strength of the combination of Behr and everything that the team has done, along with our channel partner, The Home Depot. It's a very powerful combination the two companies, and so we think that gives us a lot of opportunities for growth going forward.

John Lovallo
Analyst, UBS Securities LLC

Q

Yes. I probably should have said even more competitive as opposed to just being competitive. So I appreciate the color. Thank you, guys.

Operator: Your next question will come from Mike Dahl at RBC Capital Markets. Please go ahead.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Good morning. Thanks for taking my questions. Keith, I think in part of your opening remarks about kind of the caution that you're trying to express in the guide and recognizing there's some uncertainty in how the economic environment plays out and the lag effect of some stuff that we're all seeing out there.

And more specifically, you're a month in to the quarter. Your comments seem maybe a little more hedging around second half. Can you give us a little bit more color on what you're seeing at the start of 2Q and whether you've seen – notwithstanding the comps, whether you're seeing any evidence of a significant change in customer behavior across your businesses?

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

A

Sure, Mike. As you know, I am a little bit reticent to talk about in quarter and where that looked month-to-month as there's a lot of variability there if a prior period had fewer days or if there was a load in for a new product launch or those sorts of things. So we tend to stick to the quarter. I will tell you that we did see a little bit of softening through the quarter and that coming out in April, it's fairly consistent with how we exited the quarter.

So it's not that we're trying to signal what we're seeing in terms of something different than really what came out of the quarter is pretty consistent. It's more of understanding that we're in volatile times and that we're one quarter in. And we'll – as we'll learn a lot in the second quarter, and we'll look at the guide and we'll look at – have a more informed opinion. It's just an extremely volatile period right now. That's what we're saying. Nothing at all about any, sort of, in-quarter or how we exit the quarter? Or how we're doing at the beginning of this quarter.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Okay. That's fair. That makes sense. And then the second question, just back on price/cost, I think, clear enough in terms of some of the price commentary where you get the carryover that then fades. I would think that costs follow a somewhat similar trajectory in terms of highest in the first half of the year on inflation and then maybe lower in the back half. But can you just give us a little more sense of from a pure price/cost standpoint, how you expect the year to progress as we go out over 2Q to 4Q?

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

A

I think we've done a pretty good job of recovering. We'll anniversary some significant price that we gave mostly in the second quarter. I think the – we've taken some pockets of further price increases in our Plumbing business where we need it. And we'll continue to evaluate it. But I think the fundamental message is there's an anniversary of the significant price increases that we gave last year that will come into the second half. And really, the dependency as it relates to margin is on the volume.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

And Mike, I guess what I would add to Keith's comments are, while inflation may have moderated from the peak, maybe in the second quarter of last year, inflation, it's moderated – it's been sticky, it's kind of moderated at a higher level than we had expected. And so that's your way into how you think about higher price/cost cadence for the year. I mean, while it's going to be better than this time last year, it's still – ultimately when you look at cooper, it's still hovering around $4 a pound. Some of our paint costs, as we mentioned in our prepared remarks, where we've seen a little bit of moderation and have stayed at kind of elevated levels. We're still seeing some pressure in some inputs, especially things like TiO2.

So I would say that's going to be an impact. And overall, we're calling for kind of flat inflation down here in 2023, which is probably higher, but it is higher than what we thought about at the beginning of the year. So because of inputs remaining high, other costs like labor continues to be sticky, pallets, transportation continue to be high. As Keith said, [indiscernible] (00:37:28) price selectively here in the first part, it's going to be – we're still seeing fairly sticky inflation.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

That's very helpful. Thanks, John. Thanks, Keith.

Operator: Your next question comes from Michael Rehaut at JPMorgan. Please go ahead.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. Good morning, everyone. And John, it's been a pleasure working with you and best of luck in the future. First question, I wanted to zero in a little bit on the paint segment. I guess both of my questions are kind of centered on that. First, if you could talk any bit about the competitive backdrop, we've heard a lot about Sherwin-Williams potentially getting more aggressive.

And I'm wondering specifically, when you talk about investments in the segment over the coming quarters, where those investments will be concentrated in terms of either personnel or potentially other types of marketing or even promotions or brand spend. If any of that is in response to possibly the overall competitive backdrop becoming a little more fierce?

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

A

Thanks, Mike. Certainly, we have very solid competition in paint, and that makes us better. And we're going to continue to drive our investments, particularly in the PRO, but also in the aisle and in DIY, where we're extremely strong.

We've fared quite well in the last two-year stack. As I mentioned, it's 45% growth when you talk about the PRO. And we're going to continue to invest in that. We think we have a good proposition for the segment of the PRO painters that we're going after. And that investment really isn't so much a competitive response as it is a strategic plan that we've set out since this business was $50 million, not too long ago, and we've grown it up to, as John said, about $900 million. So we're going to continue to invest in that.

I'm not going to get into the specifics of our plans going forward, but we're going to continue to invest in it to continue to develop our service capabilities and to continue with what we already have in terms of strong Net Promoter Scores and to grow those.

What we've done today are things like buy online, pick up in store, ordering, expanding our delivery options where we do more job site delivery, certainly expanding and developing our outside PRO sales for at both – at Behr and at The Home Depot, enhancing our loyalty programs. There's a number of things that we've done and we'll continue to do. So it's a competitive business, but we're faring well, and we're going to continue to invest in it and expect to continue to gain share.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Mike, maybe to address specifically one component of your question related to promotions – promotional activity. There, I'd say, overall, the level of promotion in the industry has been fairly moderate and perhaps similar to last year. And we continue to think we offer a price competitive in market, and we have a product and we think that there will be selective promotions, but we don't see it elevating or escalating over the coming weeks, months, whatever.

To the extent our channel partner decides to pursue promotions, that's their decision. But ultimately, we will support them in that, if that's the direction they choose to go, but that's their decision, not our decision.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Right. That's very helpful. And I appreciate the color on the promotions as well. I guess, secondly, maybe just kind of taking a longer-term view on the segment from a margin standpoint, your guidance for margins this year would be lower than what you've seen in quite several years. And I'm just trying to triangulate how much of that decline, let's say, from a longer-term average of 18%, 19%, just pulling up here, it's actually right on the nose, 19% from 2012 to 2021.

How much of that might be the dollar matching of cost inflation that drives some margin contraction versus anything that you might consider structural. In other words, either – and I'm not – I don't know this, but I'm just asking, for example, if the Paint business has maybe a little bit of a lower margin profile, given that it's smaller than DIY and has higher investments or at least in the near-term or if there's anything that's changed in terms of how we should think about the margins over the next three to five years?

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Yeah, Mike, I'll take a stab at this, and Keith, feel free to chime in. So if you take a look at the differential that you cited, and you consider the price/cost relationship that we've got, as we've said before, it results in margin compression. And if you consider the amount of price we put in, we put in the double-digit pricing over the course of the last couple of years. And if you think about a 10% price increase would lead to about 180 basis point to 200 basis point margin contraction, that accounts for the vast majority of that margin compression, Mike, that you cited.

There are some – some of the investments would be a headwind that we had because you bring on a new sales force, there's always cost ahead of sales generation. And so that will be a little bit of a headwind to it. So those would probably be the significant things. There's not a – there's a little bit of a margin differential in PRO because of some of the investments that we've made in things like people, job site delivery and other capabilities, the loyalty program that Keith cited a couple of minutes ago. So that will be a little bit of a headwind and create a little bit of margin headwind. But the bulk of it is going to be the price recovery relationship that we've got. Keith, I don't know if there's anything else?

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

I think you hit it, the volume decline, the price/cost recovery dynamic and the continued investment in PRO.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

Great. Thanks so much.

Operator: Your next question comes from Adam Baumgarten of Zelman. Please go ahead.

Adam Baumgarten
Analyst, Zelman Partners LLC
Q

Hey. Good morning, everyone. Just on the decremental margin piece, I believe last quarter, you were talking about overall decremental margins maybe being in that low 20% range, and you're around 20% for the first quarter. Is that still kind of how you're thinking about the balance of the year or has that changed at all?

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.
A

Adam, as Keith mentioned on the call or in his prepared remarks, we're working hard to keep our cost under control and keep our decremental – and focus on our decremental margins and keeping them around that 20% level. Obviously, things could change if volumes were to deteriorate more significantly than we were forecasting, that could have an impact on it. But we're working hard to keep our decrementals around 20% this year.

Adam Baumgarten
Analyst, Zelman Partners LLC
Q

Okay. Got it. Thanks. And then just on the price increases in plumbing, I think it was 10 days or so ago, maybe a week in Delta, Brizo and Peerless. Just wondering how that's being accepted by the market, just given that we're not hearing a lot of price increases, broadly speaking, out there in building products?

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

I think – it's understandable when you look at the massive inflation that we've experienced. And we were a little bit behind in getting that pricing in place, and it's – no one is ever happy to hear about price increases, but the channel understands what we've all been through and also what the competition has done. So I think it's going quite well.

Adam Baumgarten
Analyst, Zelman Partners LLC
Q

Hey, great. Thanks a lot. Best of luck.

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

Thank you, Adam.

Operator: Your next question will come from Susan Maklari at Goldman Sachs. Please go ahead.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Thank you. Good morning. And let me add my best wishes to John. My first question is speaking about the cost environment. You've obviously set a fairly cautious tone there as you're looking at the next couple of quarters. But what are you watching specifically within the business to determine if you need to take additional actions? Or what would make you more confident to add incremental investments?

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

Susan, I think there's an external and an internal view that we look at, the usual suspects in terms of external data, in terms of home prices and home equity increasing existing home sales, better-than-expected GDP in US, Europe, China, consumer confidence. And those are the externals that we look at, but really our action would be more fundamentally triggered by what we see in terms of POS and incoming order rates. So that's really what we would key on to say, hey, it's time to maybe look at a different investment rhythm based on what the market is seeing. And that's – I think that's the key is that there's flexibility. And having activation points that we look at and having those plans on the shelf and of course, we have those.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC
Q

Okay. And then when we think about the quarter, there were obviously some events that came through late in March, as it relates to the banking environment and the consumer lending in there. Have you seen any change in the tone from both retailers as well as dealers on the Plumbing and the Paint side? In terms of their willingness to take inventories into the season or any change in how they're thinking about the outlook and the approach to demand?

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

No, really not at all. In terms of inventory position, we actually – I think it was small. I wouldn't say it was material, but we had a little restocking in our Plumbing segment where some of our bigger wholesalers put in a little bit more inventory. Certainly, we want to be ready for the spring selling season. And I think when our business leaders look across the channel inventory, I'd say we think we're in pretty good – positioned for the level of demand that we're seeing at this point. So no real hesitation in anticipation of some sort of event or turn down as it relates to inventory.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.
A

You know, what I would also say, Susan, is that event probably did caused us to add a little bit more caution to our stance and our outlook going forward not only because there's going to be – there could be some ripple effect through the economy that is unanticipated or unforeseen. And so that's kind of the way we digested that event.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thank you very much. Good luck.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Thanks.

Operator: Your next question will come from Keith Hughes at Truist. Please go ahead.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Thank you. Questions on Plumbing. You called out the spa business in size, and it's declined in the quarter. Are there any other sub-product categories or channels that are outsized and affecting the volume decline in the quarter?

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

A

Could you say that again? You broke up just a little bit, Keith, the last part of your question, are there any other channels...

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Yes. Any of the Plumbing channels or products that are outsized in terms of their decline in the fall in the business in the first quarter?

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

A

But for spas, it's been pretty consistent and broad-based, Keith. When we look at product categories from bathing to accessories to fixtures, taps and showers, pretty consistent retail to trade. I would say that maybe trade held up a little bit better earlier on in the quarter as we were working through some of the backlogs and some of the bigger projects, but it's been pretty consistent.

But you're exactly right. We have experienced some 20% decline in the quarter in spas. Now that's after a three-year run of some 50% growth. So it's been a real strong period of growth. And I think the new launches in spas and the total new refresh of our best-selling line of spas it's just fabulous. I think that's going to really help us compete in this challenging environment. But it's been pretty consistent but for the spa business as it relates to the decline.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

And second question on that, even if we ex out the spa, it's still a pretty notable unit decline across the rest of Plumbing, in an industry that's not really known for a lot of cyclicality even in the tough periods. What are you hearing in the channel of why the business has fallen off pretty notably in units?

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Yes. I mean, Keith, we've seen some degradation in volume. That said, I would kind of point you to the fact that we were up against a pretty significant comp in the beginning – from first quarter last year, a 9% comp is quite strong for this segment. And so I think that plays into some of the volume decline that we saw in the year, just up against the big number from the first quarter of last year.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Okay. All right. Thank you.

Operator: Your next question will come from Stephen Kim at Evercore ISI. Please go ahead.

Stephen Kim
Analyst, Evercore ISI

Q

Thanks a lot, guys. And John, we're going to miss you, but best of luck. I wanted to follow up a little bit on your margin commentary. I think basically, just to really be crystal clear, I think that you talked about the margins on a year-over-year basis, that delta year-over-year improving sequentially through the year. So that seems to imply a 2Q operating margin better than 17.2%. Want to just make sure that I'm understanding what you're saying. And also, will this year-over-year progression kind of hold true across both segments?

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

We didn't give commentary specifically by – the cadence by segment. I would say that your commentary about the company in total, Stephen, is right. I mean so what we said is year-over-year sequentially, we improved Q2 could be a bit of – might be a bit of a challenge for us. But as we go into the back half of the year, things that – the ability to expand margins sequentially gets better because on a year-over-year basis, just because of the softer margins we posted in the back half of last year.

Stephen Kim
Analyst, Evercore ISI

Q

So you're saying that you may not have a better year-over-year comparison in 2Q versus 1Q?

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Yes, well, you know, the quarter hasn't played out, but that could be the case.

Stephen Kim
Analyst, Evercore ISI

Q

Okay. Second, I guess, would be the – is there anything about your outlook, which envisions a longer duration of a challenging environment? So are we talking about maybe some things extending into fourth quarter, maybe longer than you had previously thought or anything about the duration that is worth commenting on?

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

A

Well, there's a lot of volatility that remains to be seen. Our current thinking is that we'll go to growth as we exit this year and enter into next year. But that certainly remains to be seen.

Stephen Kim
Analyst, Evercore ISI

Q

Okay. Perfect. Thanks so much.

Operator: Your next question will come from Tim Wojs at Baird. Please go ahead.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Hey, everybody good morning, and John, good luck on everything. Maybe just on the Plumbing side, if you can maybe just give us an update on kind of what you're seeing on the supply chain. I know Keith, you talked about that kind of getting better in the second quarter and having pretty good visibility on that kind of going through the back half of the year? And just kind of an update on what's going on there.

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

A

Yes, Tim, I would say that we've executed better than expected in the first quarter. Frankly, as the supply chain has come around, there's still some work to do. We have pockets of tightness with some of the supply base. But all in all, I'd say it's getting better as the volumes have eased a little bit. Our delivery rates are improving productivity, et cetera. So I would say, all in, while it's not perfect, it's getting better.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. Good. And then just maybe on the Plumbing business within the International business, I mean, any change to how you're thinking about that business over the course of the year? And the reason I ask is it performed better than I would have thought, and I think Q1 was actually the most difficult comparison. So maybe just how you're thinking about that business, both kind of cyclically in Europe and then kind of competitively with some of your competitors there.

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

A

There really hasn't been a change in how we're thinking about the International business, but I will tell you that the way we are thinking about it is that we expect it to have more volume pressure as we look through to the end of the year than what we've experienced so far. It's held up really nicely. And I think declined 3% against a strong 18% comp. So in this kind of environment, that's really strong.

When we think about how we're looking at that for the full year is to be down overall high single-digits. So we are experiencing – are not experiencing – we are expecting a little tougher top-line environment there than what we've experienced so far. But that's not a change in our thinking.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Good, good.

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

A

Hey, Tim, you had asked in terms of the competition. We're doing very well relative to competition in Europe, and we are most definitely taking share. Hansgrohe team is doing an outstanding job.

Timothy Ronald Wojs
Analyst, Robert W. Baird & Co., Inc.

Q

That's great to hear. Thanks guys.

Operator: Your next question will come from Truman Patterson at Wolfe Research. Please go ahead.

Truman Patterson
Analyst, Wolfe Research LLC

Q

Hey. Good morning, everyone. John, it's been great working with you over the years, and good luck in the future. I'm hoping that you all can discuss the sequential ramp in Plumbing op margins quarter-over-quarter, pretty nice ramp. Do you think that some of the operational inefficiencies over the past couple of years, there's been labor, transportation, some supply chain stuff that have weighed on those margins are kind of largely behind you at this point? And then is there any way you might be able to quantify some of the costs that might be embedded in the back half of the year? I think you mentioned some brand and marketing investments, plant investments, et cetera.

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

A

So the team has done a good job of getting our efficiencies in order. As you well know, in a period of declining volume, that is an ongoing effort as we work to balance depending on where the volumes go, our variable costs and how our shifts run. So it's – the work is never done when you're in a volatile environment like this. But I would say that the significant amount of our inefficiencies that we've experienced associated with the last couple of years are fixed and behind us and the team got after honestly a little quicker than I thought they would. So that was a nice positive in the quarter.

In terms of the specific spend, that we'll have – we have a new plant start-up, there will be some start-up costs in our European plant that we're moving – continuing to move forward with. So that would be a little bit of a headwind. And then the reduced volume and the drop down of that is the main driver.

Truman Patterson
Analyst, Wolfe Research LLC

Q

Okay. Perfect. And then, John, I believe you said that the overall inflation bucket this year should be flattish, a little bit higher than what you were expecting three months ago. But is there any way you might be able to kind of break it out by segment? I believe last quarter, you were expecting Plumbing raw materials to be down like low single-digits and Dec Arc closer to flattish. Anyway you can help us think through that?

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.

A

Yes. I'd say on that, we're seeing continued, I guess, moderated but still high levels of copper prices. You know, copper hasn't come down like we thought, so it's still hanging in there at $4. We thought it might retrace a little bit more.

The other thing I would tell you is on the paint input side. Those are trending a little bit higher than we would have expected at this point as well with TiO2 facing upward pressure. And so I think on both ends – in both segments, I should say, Truman, we're seeing things being stickier perhaps on the Plumbing side than we would initially have forecasted three months ago, a little bit more upward pressure on some of the inputs like TiO2 on the paint side.

Truman Patterson
Analyst, Wolfe Research LLC
Q

Perfect. Thank you all. Good luck in the upcoming quarter.

John G. Sznewajs
Chief Financial Officer & Vice President, Masco Corp.
A

Thanks.

Operator: Your final question will come from Phil Ng at Jefferies. Please go ahead.

Philip Ng
Analyst, Jefferies LLC
Q

Hi, guys. Thanks for squeezing me in. And John, congrats, and thanks for all the help and as well as you, Dave, appreciate all the help, and congrats on the new role.

I guess my question for you, Keith, perhaps appreciating you're largely in R&R, there's been a fair amount of excitement on new construction to spring selling season, not necessarily the perfect read-through, but it sounds like your guidance is at least factoring a step down in demand perhaps in the back half this year. Curious if your view and channel partners' outlook on demand this year has changed much in the, call it, the last few months. And how do you kind of see the year progressing on the demand side?

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

It really hasn't changed much. And when you look at our full year guide compared to how Q1 fared, it's pretty consistent across both segments. So I'd say not a lot of change, really. And again, we're one quarter in.

Philip Ng
Analyst, Jefferies LLC
Q

Okay. Helpful. And then from a mix standpoint, anything you want to call out? I mean, at least we're hearing maybe the high end of the market is holding up a little better. But curious if you're seeing any nuances on mix and what kind of impact that could have on margins, especially, in the more mixed macro backdrop in the back half of the year potentially?

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

Really haven't seen anything material, Phil. A slight but not material, maybe a little bit of trade down in Europe in Plumbing. But beyond that, net for the company, we haven't really seen any significant mix impact or trade down, and our guide doesn't really reflect that either.

Philip Ng
Analyst, Jefferies LLC
Q

Okay. Appreciate all your help guys.

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

A

Thank you.

David A. Chaika
Vice President, Treasurer & Investor Relations, Masco Corp.

A

Thanks, Phil.

David A. Chaika

Vice President, Treasurer & Investor Relations, Masco Corp.

Thank you all for joining us on the call this morning and for your continued interest in Masco. This concludes today's call.

Operator: Ladies and gentlemen, this does conclude your conference call for this morning. We would like to thank everyone for participating and ask that you please disconnect your lines.