# Owens Corning Inc. [NYSE: OC]

## Initiate at BUY at 7.5% | PT: $271.73

November 18th, 2024

CIMG Investment Research

## Owens Corning: Manufacturing Upside Since 1938

Owens Corning Inc (NYSE: OC) is a global building and construction materials provider headquartered in Toledo, Ohio. Founded in 1938, OC manufactures and sells products in the United States (77%), Europe (11%), Asia Pacific (4%), and internationally (8%). The company reports four segments: Roofing, Insulation, Composites, and Doors. The Roofing segment accounts for 34% of revenue and manufactures laminate and strip asphalt roofing shingles, oxidized asphalt materials, and roofing components used in residential and commercial construction. The segment sells through distributors, home centers, and lumberyards, as well as to individual contractors and manufacturers. The Insulation segment represents 30% of revenue. It manufactures thermal and acoustical batts, loosefill insulation, spray foam insulation, and accessories primarily under the Owens Corning PINK brand (the first trademarked color in history). This segment sells to insulation installers, home centers, lumberyards, retailers, and distributors. The Composites segment accounts for 17% of revenue and manufactures and fabricates glass reinforcements in fiber, fabrics, non-wovens, and composite lumber with hundreds of use cases. This segment sells its products directly to parts molders, fabricators, and shingle manufacturers (including their own Roofing segment). Finally, OC recently completed an acquisition of Masonite, the leading American door manufacturer, inorganically entering the commercial door space.

## Investment Thesis

**The Street underappreciates OC's acquisition of DOOR, dismissing synergy credibility and becoming distracted by the election and severe weather tailwinds.** On February 9, 2024, OC management announced an acquisition of leading door manufacturer, Masonite, for $3.9 Billion ($133/share), implying a 38% premium to the previous day's closing share price. OC and DOOR investors vehemently opposed this decision, with some shareholders even attempting to sue the company to block the sale. The week following the deal announcement, OC stock fell ~13%, and the company was downgraded by multiple sell-side analysts. Many investors felt that OC's FCF was better used continuing to repurchase common stock and issue a dividend and did not believe that OC management's projected $125 million in synergies were feasible. Since March 1, 2024, OC stock has risen ~30%, but many investors' opinions on the DOOR acquisition have not changed. Instead, OC has benefitted from substantial tailwinds stemming from elevated severe weather activity and a Republican win in the 2024 general election. InE not only believes that this acquisition was an excellent choice by OC's management, but that OC is a perfect owner for the Masonite brand, drawing on their extensive supply chain and distribution network to diversify OC's offerings and lower DOOR's operating costs.

**Roofs installed during the housing bubble (1997-2006) are rapidly nearing replacement age, sustaining OC's pricing power through CIMG's holding period.** One of the primary drivers of OC's roofing business is domestic repair & remodel (R&R) spending, which accounts for 70% of the segment's revenue, with the other 30% split between new home construction and storm repairs. When looking at FRED Housing Start data, the housing bubble in the late 1990s and early 2000s resulted in the largest volume of housing starts throughout the entire history of the metric, peaking at 2.24 million houses in January 2006. At the time, the useful life for an installed asphalt shingle roof was 25 years. This has resulted in elevated roofing demand in the last 4-6 quarters, as the 1997-98 houses begin to require repairs. Even though the market incorrectly credits this demand spike to Hurricanes Ian, Idalia, and Helene, all parties agree that elevated demand only increases OC's pricing power. InE thinks the market is missing the larger, sustained increases in demand coming from early 2000s housing starts, distracted by less meaningful tailwinds like severe weather.

## Industrials and Energy


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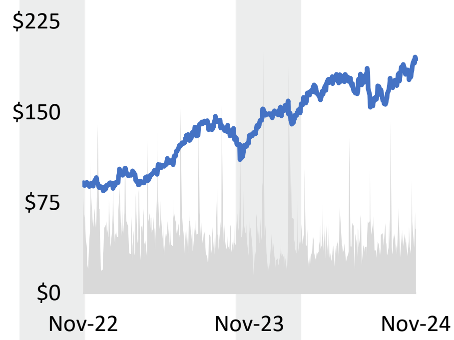
Figure 1: OC 2 Year Stock Chart

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|---|---|
| Price | $193.99 |
| Dividend Yield | 1.23% |
| PT | $271.73 |
| Upside | 40% |
| 52-Week Range | $128.79-199.54 |
| Dil Shrs Outstand | 85.79 M |
| Mkt Cap | $16.64 B |
| Ent Value | $22.26 B |
| NTM P/E | 11.86x |
| NTM EV/EBITDA | 7.89x |

**Management consistently returns >50% of free cash flow to shareholders, and recent M&A activity indicates that more effective uses for that capital are on the horizon.** Since 2014, OC management has returned >50% of their ~$700m average annual FCF to shareholders, primarily through dividends and share repurchases. The stock has a respectable ~1.5% dividend yield and has consistently raised DPS (although that is also a function of the share price going up and the yield staying the same). More impressively, OC management has reduced their shares outstanding by 23% since January 1, 2019, repurchasing ~25 million shares. Conservative investors have historically been drawn to OC for their consistent capital allocation; but InE also recognizes that consistent dividends and repurchases indicate that management has no better ways to reinvest cash back into improving the business. However, with the DOOR acquisition representing the largest acquisition OC management has made to date by a wide margin, and the fact that management has indicated that once they delever their balance sheet, there is the possibility to continue to seek out opportunities for inorganic growth, InE believes that management may see more effective opportunities to allocate FCF towards. The potential sale of the glass reinforcements business would also generate sufficient cash to support future M&A activity. InE sees this as a call option because in the worst case, the cash from the sale is used to delever and management resumes share repurchases, increasing CIMG's ownership in the business.

**Despite a dominant market position, OC trades at the lowest valuation of all building product companies, representing an entry point for the long-term shareholder.** In a recent expert call, a former executive at OC responded when asked what the biggest question facing his company was going forward, "You got to be asking, why is the valuation so low, it is literally the lowest valuation of all the building products companies." This executive wasn't wrong; on a NTM P/E and NTM EV/EBITDA basis, OC trades at the lowest valuation of its peer set (AWI, BLDR, FBIN, JELD, MAS, MHK, SHW, TREX, WHR). There are a few plausible reasons InE sees for the market valuing OC at such a discount, all of which we see valid pushback for. First, a group of investors believes that the market refuses to acknowledge that the recent margin improvements in the roofing segment will permanently alter the margin profile of the business. They see recent elevated storm levels as a short-term demand tailwind that is unlikely to persist in the future. However, returning to our earlier point about overbuilding in the early 2000s, InE sees demand for Roofing products growing over the next 10 years, as the roofs on overbuilt homes from the housing bubble near replacement age. Another cause of an unwarranted discount is what InE believes is an incorrect consensus sum-of-the-parts valuation done by sell-side analysts. According to Bank of America Research, "The Roofing segment represents ~81% of OC's current valuation." This weighting would imply that the roofing business should trade at 12.81x NTM EBITDA, a multiple that ties with the 13.00x NTM Multiple InE arrived at through looking at recent roofing acquisitions. This valuation implies that the #1 market share insulation business, #2 market share door business, and #2 market share composites businesses trade at approximately 3.21x NTM EBITDA, a discount that InE believes is completely unwarranted. After projecting out each segment's EBITDA and adjusting the multiples to a discount of recent transactions and current peer trading multiple averages, InE values the rest of the business closer to 5.50x, implying immediate upside.

## Valuation

To model OC, we used a sum-of-the-parts valuation with NTM EBITDA multiples on each segment and then discounted the summed segments back to present value using a 10% discount rate, arriving at an implied share price of $265.64. We also used a 3-statement model with a 2% LTGR to sanity-check our SOTP valuation and arrived at an implied share price of $277.82. Using a blended valuation that assigns a 50% weighting to both methods, we arrived at a price target of 271.73, implying 40% upside from 11/15/2024's close.

## Company Overview

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## Industry Overview

OC operates in four different subcategories within the building products industry. All four subcategories are relatively fragmented, but OC holds majority or near-majority market positions in all of them. OC has the #2 market share (12%) behind CRH plc (NYSE: CRH), a Dublin-based manufacturer of building products. The roofing market is driven by housing stock age, R&R spending, and severe weather. OC oscillates between the #1 and #2 market share in the doors segment with JELD-WEN (NYSE: JELD). The door industry is driven primarily by new construction. OC is the largest global producer of insulation, holding a 10.9% market share. The insulation market is driven by R&R spending, new construction, and discretionary repair spending related to energy conservation. OC holds substantial market share in an extremely fragmented composites business, which is primarily driven by new construction and industrial spending.