

The AZEK Company Inc.

F1Q beats; Long-term margin potential looks even higher after guidance hike

Reiterate Rating: BUY | PO: 50.00 USD | Price: 39.60 USD

F1Q beats; Guidance significantly ahead of expectations

AZEK reported F1Q24 (ended December) adjusted EBITDA 15% above our forecast due to stronger residential revenue growth and better residential margin. AZEK increased the midpoint of its F2024 EBITDA guidance by 11% driven by higher sales expectations and higher near-term incremental margins. We reiterate our Buy rating: 1) Guidance looks still conservative, 2) Azek's residential sell-out trends remain exceptionally strong and composite decking/exteriors continues to meaningfully outperform over renovation market, and 3) we see upside to margin guidance from the flow-through of PVC deflation, higher utilization, and use of more recycled materials.

Resi sell-out remained strong, 2H rev guide conservative

Importantly, sell-out continued to experience strong double-digit growth in F1Q (10%+) driven by continued material conversion from wood to composite, distribution expansion at retail (especially Home Depot), share gains with distributors and pro dealers, and new products. In F2Q, AZEK is guiding to ~8.5% YoY growth (15.5% YoY residential growth), which includes the delivery of early buy orders already received. Full year revenue guidance implies a slowdown to mid-single-digit residential growth in F2H24, which we think is conservative, given the current sell-through trends are tracking well ahead of that in an already weak repair & remodel spending backdrop.

See margin upside from PVC deflation & higher utilization

AZEK increased F2024 EBITDA guidance to \$353M-\$372M (up \$320M-\$335M and +24% at mid-point vs. F2023). F2Q guidance of \$108M-\$112M was above our expectations driven by a stronger sales outlook and higher EBITDA margin. We model F2024 EBITDA slightly above the high-end of guidance to reflect: 1) incremental margins at the high end of the 30%-40% target, 2) higher production levels as production matches more closely to sell-through going forward (lapping a \$20mm headwind in F1H24), 3) additional \$30mm benefit from PVC deflation in F1H, and 4) continued recycling content increases (~60% of PVC decking materials and growing).

Raise PO/EPS for stronger residential, GM outlook

We raise our PO to \$50 (from \$45) to reflect our higher F2024/F2025 EBITDA estimates (+6%/+8%) given the stronger residential outlook. Our PO is now based on 18X CY2025 EBITDA (vs. previous 17X) to reflect higher sector multiples.

Estimates (Sep) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.97	0.74	1.16	1.38	1.62
GAAP EPS	0.49	0.45	0.95	0.99	1.23
EPS Change (YoY)	-0.9%	-23.7%	56.9%	19.0%	17.8%
Consensus EPS (Bloomberg)			0.95	1.16	1.32
DPS	0	0	0	0	0
Valuation (Sep)					
P/E	41.0x	53.7x	34.3x	28.8x	24.4x
GAAP P/E	81.4x	87.9x	41.6x	39.9x	32.2x
EV / EBITDA*	20.2x	20.9x	16.3x	14.7x	13.3x
Free Cash Flow Yield*	-1.1%	4.7%	0.8%	3.0%	3.5%

* For full definitions of *IQmethod*SM measures, see page 5.

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Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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06 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	45.00	50.00
2024E EPS	1.06	1.16
2025E EPS	1.25	1.38
2026E EPS	2.03	1.62

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Stock Data

Price	39.60 USD
Price Objective	50.00 USD
Date Established	6-Feb-2024
Investment Opinion	C-1-9
52-Week Range	21.34 USD - 40.66 USD
Mrkt Val (mn) / Shares Out (mn)	5,775 USD / 145.8
Free Float	95.9%
Average Daily Value (mn)	47.95 USD
BofA Ticker / Exchange	AZEK / NYS
Bloomberg / Reuters	AZEK US / AZEKN
ROE (2024E)	12.2%
Net Dbt to Eqty (Sep-2023A)	21.5%
ESGMeter TM	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

PVC = polyvinyl chloride (synthetic plastic used in Azek composite decking materials)

iQprofileSM The AZEK Company Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	6.3%	5.4%	7.7%	9.3%	10.6%
Return on Equity	10.4%	7.7%	12.2%	14.4%	16.3%
Operating Margin	9.5%	9.6%	16.6%	15.4%	16.9%
Free Cash Flow	(65)	274	48	171	202

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.7x	3.3x	0.8x	1.3x	1.3x
Asset Replacement Ratio	2.5x	1.0x	1.0x	1.0x	1.0x
Tax Rate	27.7%	26.0%	29.7%	27.0%	27.0%
Net Debt-to-Equity Ratio	32.5%	21.5%	22.0%	18.0%	13.3%
Interest Cover	7.3x	4.0x	6.5x	7.2x	8.3x

Income Statement Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	1,356	1,370	1,421	1,531	1,650
% Change	15.0%	1.1%	3.7%	7.7%	7.8%
Gross Profit	409	438	527	580	646
% Change	NA	NA	NA	NA	NA
EBITDA	301	291	373	415	457
% Change	9.8%	-3.3%	27.9%	11.4%	10.2%
Net Interest & Other Income	(25)	(39)	(36)	(38)	(38)
Net Income (Adjusted)	149	111	171	200	231
% Change	-19.3%	-9.7%	107.1%	2.7%	21.4%

Free Cash Flow Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	75	68	141	144	175
Depreciation & Amortization	119	133	136	143	143
Change in Working Capital	(141)	149	(106)	(25)	(24)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	53	13	(36)	0	0
Capital Expenditure	(171)	(89)	(87)	(92)	(92)
Free Cash Flow	-65	274	48	171	202
% Change	NA	NA	NA	NA	NA
Share / Issue Repurchase	6	15	3	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	124	(6)	0	0	0

Balance Sheet Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	121	278	282	333	395
Trade Receivables	90	58	117	126	136
Other Current Assets	320	247	270	285	300
Property, Plant & Equipment	518	501	457	453	449
Other Non-Current Assets	1,335	1,282	1,203	1,156	1,109
Total Assets	2,383	2,366	2,329	2,353	2,389
Short-Term Debt	6	6	6	6	6
Other Current Liabilities	176	189	211	214	218
Long-Term Debt	585	580	579	579	579
Other Non-Current Liabilities	171	160	152	152	152
Total Liabilities	939	936	948	951	955
Total Equity	1,444	1,430	1,381	1,402	1,434
Total Equity & Liabilities	2,383	2,366	2,329	2,353	2,389

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Building Products

Company Description

The Azek Company is a leading manufacturer of composite and PVC decking, railing, trim and related building products. Approximately 71% of AZEK's revenue is attributable to the residential repair and remodeling (R&R) market, 12% to residential new construction and 17% to commercial markets. The company is headquartered in Chicago, IL and became publicly listed on the New York Stock Exchange under the ticker AZEK in June 2020.

Investment Rationale

We rate AZEK shares at Buy. We believe Azek is well positioned for ongoing material conversion from wood to more resilient composites and long-term margin expansion as the company transitions to more recycled material.

Stock Data

Average Daily Volume

1,210,887

Quarterly Earnings Estimates

	2023	2024
Q1	-0.10A	0.10A
Q2	0.18A	0.38E
Q3	0.30A	0.32E
Q4	0.36A	0.36E

Exhibit 2: AZEK F1Q24 earnings variance compared to BofA estimates

F1Q24 adjusted EBITDA beat our forecast on higher margin

Income Statement	YoY Change			Variance vs BofAe		
	1Q23	1Q24	YoY	BofAe	1Q24A	Δ
Sales (\$ mm)	\$216	\$240	11%	\$242	\$240	(1%)
Adjusted Gross Margin	24.1%	39.6%	1551 bps	36.9%	39.6%	278 bps
SG&A % of Sales	34.0%	32.1%	-183 bps	29.7%	32.1%	243 bps
Operating Margin	(12.0%)	21.0%	3297 bps	12.5%	21.0%	852 bps
Adjusted EBITDA Margin	7.0%	23.2%	1617 bps	20.5%	23.2%	267 bps
Pre-tax Margin	(16.3%)	17.7%	3398 bps	8.6%	17.7%	908 bps
Operating EPS	(\$0.10)	\$0.10	(210%)	\$0.05	\$0.10	132%
Adjusted EBITDA	\$15.1	\$55.7	269%	\$49.6	\$55.7	12%
Segment Results	1Q23	1Q24	YoY	BofAe	1Q24A	Δ
Sales						
Residential	\$179	\$223	24.2%	\$224	\$223	(1%)
Commercial	\$37	\$17	(52.6%)	\$18	\$17	(2%)
Segment adjusted EBITDA						
Residential	\$10	\$53	430.5%	\$47	\$53	12%
Commercial	\$5	\$3	(43.6%)	\$3	\$3	8%
Segment adjusted EBITDA margin						
Residential	5.5%	23.7%	1812 bps	21.0%	23.7%	266 bps
Commercial	14.0%	16.7%	264 bps	15.0%	16.7%	165 bps

Source: BofA Global Research, Company Data

BofA GLOBAL RESEARCH



Price objective basis & risk

The AZEK Company Inc. (AZEK)

Our \$50 PO for AZEK shares is based on a CY2025E EV/EBITDA multiple of 18x, which implies Azek trades in line with its historical discount to key peer Trex. We believe a discount to TREX is appropriate given AZEK's lower return on invested capital, margins and brand recognition.

Upside risks to our PO are: 1) an acceleration in residential repair & remodeling and outdoor living spending, 2) a faster than expected conversion from wood decks to composite decks, 3) faster than expected share gain, 4) continued consumer preference towards enhancing the overall outdoor living space, and 5) faster than expected transition to recycled materials.

Downside risks to our PO are: 1) a slowdown in residential repair & remodeling spending, 2) a slower than expected conversion from wood decks to composite decks, 3) potential market share loss, 4) a mix shift in consumer preferences away from outdoor living and 5) a slowing US economy.

Analyst Certification

I, Rafe Jadrosich, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Homebuilders and Building Products Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Armstrong World Industries, Inc.	AWI	AWI US	Rafe Jadrosich
	Builders FirstSource Inc	BLDR	BLDR US	Rafe Jadrosich
	D.R. Horton, Inc.	DHI	DHI US	Rafe Jadrosich
	Latham Group, Inc.	SWIM	SWIM US	Shaun Calnan, CFA
	Leslie's	LESL	LESL US	Shaun Calnan, CFA
	NVR, Inc.	NVR	NVR US	Rafe Jadrosich
	Owens Corning	OC	OC US	Rafe Jadrosich
	PulteGroup Inc.	PHM	PHM US	Rafe Jadrosich
	The AZEK Company Inc.	AZEK	AZEK US	Rafe Jadrosich
	Toll Brothers, Inc.	TOL	TOL US	Rafe Jadrosich
	TopBuild Corp	BLD	BLD US	Rafe Jadrosich
	Trex Company, Inc.	TREX	TREX US	Rafe Jadrosich
NEUTRAL				
	Dream Finders Homes, Inc.	DFH	DFH US	Rafe Jadrosich
	KB Home	KBH	KBH US	Rafe Jadrosich
	Lennar Corporation	LEN	LEN US	Rafe Jadrosich
	Smith Douglas Homes Corp.	SDHC	SDHC US	Rafe Jadrosich
UNDERPERFORM				
	Fortune Brands Innovations Inc	FBIN	FBIN US	Rafe Jadrosich
	Hayward Holdings, Inc.	HAYW	HAYW US	Rafe Jadrosich
	Masco Corp	MAS	MAS US	Rafe Jadrosich
	Mohawk Industries	MHK	MHK US	Rafe Jadrosich
	Patrick Industries, Inc.	PATK	PATK US	Rafe Jadrosich
	Pool Corporation	POOL	POOL US	Shaun Calnan, CFA

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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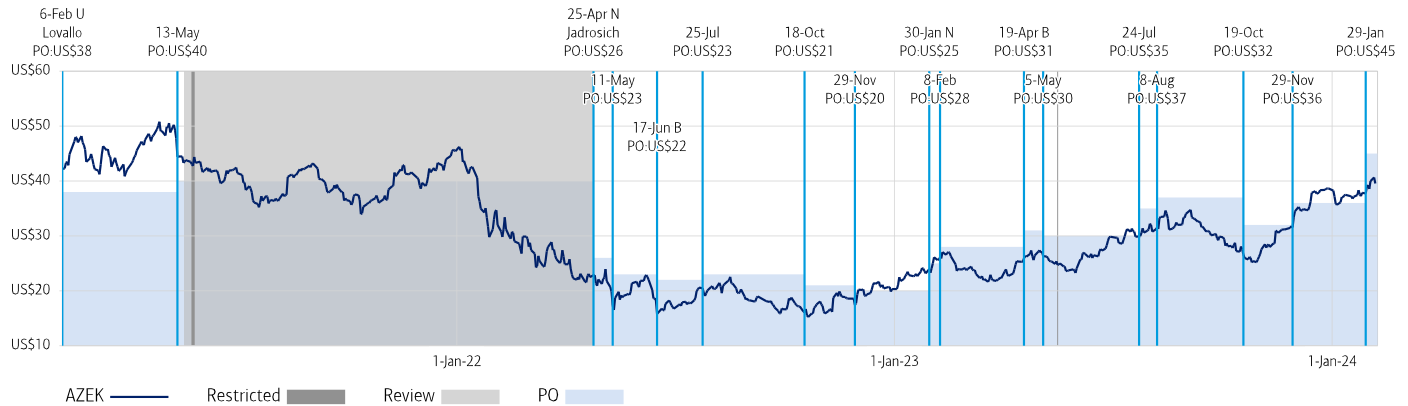
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Important Disclosures

The AZEK Company (AZEK) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Building Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	39	44.83%	Buy	22	56.41%
Hold	18	20.69%	Hold	11	61.11%
Sell	30	34.48%	Sell	8	26.67%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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