

## Trex Company, Inc.

# Deck the halls with double-digit growth; Raise estimates and PO

Reiterate Rating: BUY | PO: 90.00 USD | Price: 80.92 USD

## CEO meetings highlight early stage growth opportunities

We hosted TREX CEO Bryan Fairbanks for investor meetings in Chicago on Tuesday, 12/19. We came away from the meetings incrementally bullish. Our key takeaways: 1) we think Trex's moat (its brand and manufacturing capability/use of recycled materials) is wider today than any time in its history, 2) TREX is well positioned to drive conversion to composite decking through its consistent innovation and marketing, 3) Railing is a meaningful opportunity and ripe for consolidation within Trex's existing distribution, 4) Utilization is below peak levels and Trex already has the capacity to support growth through 2025, and 5) TREX has a clear vision for capital use: prioritize organic growth investments and stock buybacks. See inside for details on each takeaway.

## Raise 2024E EPS/revenue forecasts; Reiterate Buy

We raise our 2024E EPS estimate by 6% to \$2.33 (7% above consensus) to reflect a stronger revenue growth outlook. We anticipate YoY revenue growth above Trex's long-term 11-13% target in 2024 given: 1) continued outperformance of composite decking relative to other building product categories due to the conversion from wood, 2) \$60-80mm of revenue that will fall in 1H24 instead of 4Q23 due to an early buy timing shift, 3) distributors are entering 2024 more confident than last year following strong sell-out performance in 2023 despite a choppy macro environment, 4) Trex has a robust product launch schedule (strongest since 2019 in our view) including color and geographic expansion for Signature, 5) adjacent categories are gaining traction (including recently launched fasteners and entry level railing), and 6) we believe Trex (and Azek) are gaining share from smaller tertiary brands.

## Expect strong incremental margins in 2024 as well

We expect incremental EBITDA margins in the high-30% range in 2024 driven by improving utilization (roughly 150bps of gross margin expansion for every \$100mm of sales). We also expect a return to modest SG&A leverage in 2024 (20-30bps) following a significant step-up in marketing expense in 2023 (which will stay elevated).

## Valuation could re-rate on lower rates, higher growth

We raise our PO to \$90 (from \$68) now based on a target multiple of 25X EV/2024E EBITDA (from 20X). We believe a higher target multiple is justified given the lower interest rate environment and outlook for above-trend growth in 2024.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	2.14	1.80	1.87	2.33	2.62
GAAP EPS	1.80	1.80	1.87	2.33	2.62
EPS Change (YoY)	37.7%	-16.0%	4.2%	24.4%	12.4%
Consensus EPS (Bloomberg)			1.85	2.18	2.54
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	37.9x	45.1x	43.2x	34.8x	30.9x
GAAP P/E	44.9x	45.1x	43.2x	34.8x	30.9x
EV / EBITDA*	24.7x	28.6x	27.6x	23.3x	21.0x
Free Cash Flow Yield*	1.1%	0.5%	2.6%	1.4%	2.0%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 6.

20 December 2023

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	68.00	90.00
2023E EPS	1.85	1.87
2024E EPS	2.19	2.33
2025E EPS	2.45	2.62

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### Stock Data

Price	80.92 USD
Price Objective	90.00 USD
Date Established	20-Dec-2023
Investment Opinion	C-1-9
52-Week Range	40.69 USD - 81.12 USD
Mrkt Val (mn) / Shares Out (mn)	8,796 USD / 108.7
Free Float	99.4%
Average Daily Value (mn)	61.32 USD
BofA Ticker / Exchange	TREX / NYS
Bloomberg / Reuters	TREX US / TREX.N
ROE (2023E)	33.4%
Net Dbt to Eqty (Dec-2022A)	40.5%
ESGMeter™	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"](#).

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Timestamp: 20 December 2023 05:00AM EST

# iQprofile<sup>SM</sup> Trex Company, Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	36.7%	27.6%	27.7%	29.9%	28.7%
Return on Equity	37.7%	32.3%	33.4%	32.0%	29.6%
Operating Margin	27.3%	24.3%	25.1%	26.5%	26.9%
Free Cash Flow	99	40	225	125	177

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.0x	1.1x	1.8x	1.1x	1.1x
Asset Replacement Ratio	NA	NA	NA	NA	NA
Tax Rate	24.2%	25.2%	25.3%	25.5%	25.5%
Net Debt-to-Equity Ratio	-19.5%	40.5%	2.4%	-2.6%	-6.4%
Interest Cover	NA	NA	NM	NA	NA

## Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	1,197	1,106	1,092	1,255	1,368
% Change	35.9%	-7.6%	-1.2%	14.8%	9.0%
Gross Profit	461	404	449	528	579
% Change	NA	NA	NA	NA	NA
EBITDA	362	312	323	383	426
% Change	40.4%	-13.8%	3.5%	18.4%	11.3%
Net Interest & Other Income	0	0	(2)	3	3
<b>Net Income (Adjusted)</b>	<b>247</b>	<b>201</b>	<b>203</b>	<b>250</b>	<b>276</b>
<b>% Change</b>	<b>37.1%</b>	<b>-18.8%</b>	<b>1.3%</b>	<b>23.0%</b>	<b>10.5%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont. Operations (GAAP)	247	201	203	250	276
Depreciation & Amortization	0	0	0	0	0
Change in Working Capital	(70)	(58)	109	(16)	(17)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	81	73	60	50	58
Capital Expenditure	(159)	(176)	(148)	(160)	(140)
<b>Free Cash Flow</b>	<b>99</b>	<b>40</b>	<b>225</b>	<b>125</b>	<b>177</b>
<b>% Change</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>
Share / Issue Repurchase	(81)	(397)	(33)	(85)	(135)
Cost of Dividends Paid	NA	NA	NA	NA	NA
Change in Debt	0	0	0	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	141	12	39	79	121
Trade Receivables	151	98	120	137	150
Other Current Assets	109	176	104	107	115
Property, Plant & Equipment	460	590	694	804	886
Other Non-Current Assets	59	57	53	53	53
<b>Total Assets</b>	<b>920</b>	<b>934</b>	<b>1,010</b>	<b>1,180</b>	<b>1,325</b>
Short-Term Debt	0	222	57	57	57
Other Current Liabilities	89	69	131	136	139
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	107	125	123	123	123
<b>Total Liabilities</b>	<b>195</b>	<b>415</b>	<b>310</b>	<b>315</b>	<b>319</b>
<b>Total Equity</b>	<b>725</b>	<b>518</b>	<b>700</b>	<b>865</b>	<b>1,006</b>
<b>Total Equity &amp; Liabilities</b>	<b>920</b>	<b>934</b>	<b>1,010</b>	<b>1,180</b>	<b>1,325</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Sector

Building Products

## Company Description

TREX is the largest manufacturer of residential composite decking and railing in the US and a leading manufacturer of commercial railing and staging systems. TREX products are sold through both distribution and retail channels and are stocked at over 6,700 locations. Beginning in 2023, TREX will operate in one reportable segment, Residential. In 2022, the Residential segment generated 96% of total revenue while the Commercial segment generating the remaining 4%.

## Investment Rationale

We rate TREX shares Buy. Following channel destocking, we believe TREX is well positioned for long-term material conversion away from wood to composite decks and continued gross margin expansion.

## Stock Data

Average Daily Volume

757,782

## Quarterly Earnings Estimates

	2022	2023
Q1	0.62A	0.38A
Q2	0.79A	0.71A
Q3	0.14A	0.57A
Q4	0.23A	0.21E

## CEO meetings highlight early stage growth opportunities

We hosted TREX CEO Bryan Fairbanks for investor meetings in Chicago on Tuesday, 12/19. We came away from the meetings incrementally bullish. Our key takeaways:

1. We think Trex's moat, its brand and manufacturing capability (ability to use recycled material), is wider today than any time in the companies' history.
2. TREX is not a just beneficiary of the conversion to composite - TREX is driving the conversion through its consistent innovation and marketing. TREX now has the full breadth of composite decking product from entry level to premium, which should further solidify its position with its distributors and retail,
3. Railing is a meaningful opportunity. TREX is already a leader in the \$3bn+ railing market, but its overall market share is still low. The railing industry is fragmented and ripe for consolidation – it has many of the same characteristics as composite decking 10-15 years ago. TREX has significant opportunity to convert its existing distribution away from smaller brands and improve attachment rates to its decks.
4. Utilization is below peak levels and Trex already has the capacity to support growth through 2025. The ramp-up in capacity in 2025 (processing) and 2026 (decking) will come with some incremental investment but the long-term return on Trex's capacity investments remain the highest in building products. Trex's continuous improvement initiatives should help offset inflation, while longer term initiatives like recycling and automation could also contribute to margin expansion.
5. Trex would consider annual pricing to offset inflation longer term but not in 2024.
6. TREX has a clear vision for capital use: invest in organic growth and buyback stock. M&A is a distant 3rd priority given the strong returns in the existing business and TREX ability to build organically with high returns.

## Raise 2024E EPS/revenue forecasts; Reiterate Buy

We raise our 2024E EPS estimate by 6% to \$2.33 (7% above consensus) to reflect a stronger revenue growth outlook. We anticipate YoY revenue growth above Trex's long-term 11-13% target in 2024 given: 1) continued outperformance of composite decking relative to other building product categories due to the conversion from wood, 2) \$60-80mm of revenue that will fall in 1H24 instead of 4Q23 due to an early buy timing shift, 3) distributors are entering 2024 more confident than last year following strong sell-out performance in 2023 despite a choppy macro environment, 4) robust product launch schedule (strongest since 2019 in our view) including color and geographic expansion for Signature, 5) adjacent categories are gaining traction (including recently launched fasteners and entry level railing), and 6) we believe Trex (and Azek) are gaining share from smaller tertiary brands.

### Exhibit 1: BofA estimate changes

We are raising our 2024E EPS estimates 6% on Trex

Building Products	New 2023E	Old 2023E	Consensus 2023E	New vs. Old	New vs. Consensus	New 2024E	Old CY 2024E	Consensus 2024E	New vs. Old	New vs. Consensus
TREX	1.87	1.85	1.85	1%	1%	2.33	2.19	2.18	6%	7%

Source: Bloomberg, BofA Global research estimates

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## 1Q consensus EPS looks too low

We believe 1Q24 consensus estimates are too low and model \$0.67 of EPS vs. Visible Alpha estimates of \$0.55 driven primarily by revenue upside (we forecast 45% growth vs. Visible Alpha 26%).

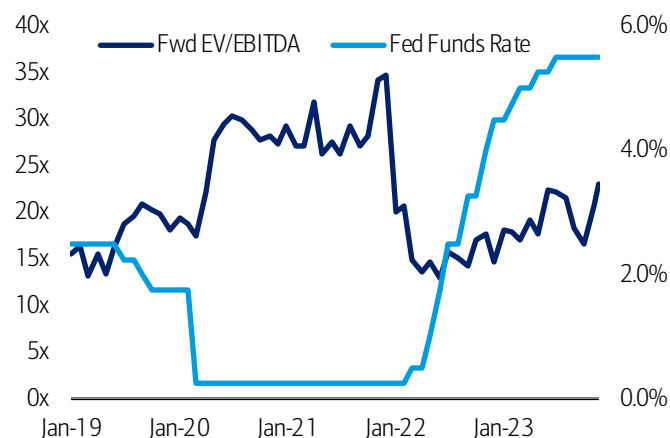


## Lower rates, accelerated growth = higher valuation

We are increasing our target multiple for TREX to 25X EV/2024E EBITDA (from 20X). We believe a higher target multiple is justified given the lower interest rate environment and additional growth opportunities from adjacent categories. TREX's average relative forward EV/EBITDA vs. peers increased to 2.0X during the period of July 2019-February 2022. Over this period, the Fed Funds rate fell from 225 bps to 25 bps. This compares to a previous six 6-month average of 1.7X and 1.8X during the Fed's latest hiking cycle.

### Exhibit 2: Fwd EV/EBITDA vs. Fed Funds Rate

TREX's valuation increases in lower rate environments



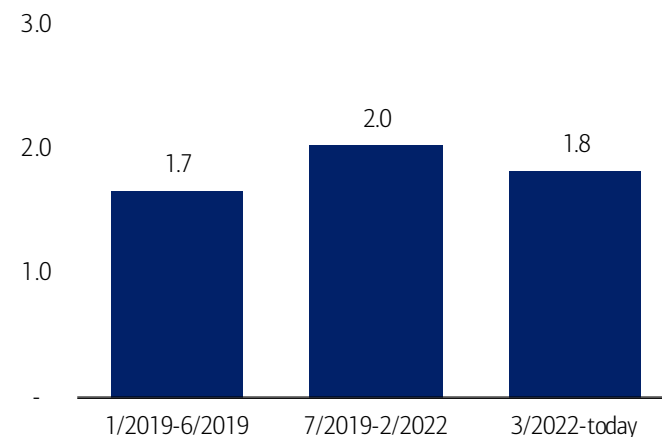
Source: Bloomberg

Note: Data through December 19, 2023

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### Exhibit 3: Fwd EV/EBITDA relative to peers

TREX's relative fwd EV/EBITDA increased during the last rate cut cycle



Source: Bloomberg

Note: The Fed was began cutting interest rates in July 2019 and held at 25 bps until March 2022. Peers include AZEK, OC, AWI, FBIN, MAS and MHK.

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## Price objective basis & risk

### Trex Company, Inc. (TREX)

Our \$90 PO is based on a 25X 2024E EV/EBITDA multiple, which is slightly above TREX's trailing 5-year average (22X), given a favorable growth outlook and a lower rate backdrop. We believe EV/EBITDA is the most appropriate metric for valuing the building product companies.

Upside risks to our PO: 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 gains, 4) stronger than anticipated pricing, and 5) continued consumer preference towards enhancing the overall outdoor living space.

Downside risks to our PO: 1) a slowdown in residential repair & remodeling spending, 2) a slower than expected conversion from wood decks to composite decks, 3) market share loss, 4) a mix shift in consumer preferences away from outdoor living, 5) a slowing US economy and 6) rising interest rates.

## 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
<b>BUY</b>				
	Armstrong World Industries, Inc.	AWI	AWI US	Rafe Jadrosich
	D.R. Horton, Inc.	DHI	DHI US	Rafe Jadrosich
	Latham Group, Inc.	SWIM	SWIM 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
<b>NEUTRAL</b>				
	Builders FirstSource Inc	BLDR	BLDR US	Rafe Jadrosich
	Dream Finders Homes, Inc.	DFH	DFH US	Rafe Jadrosich
	KB Home	KBH	KBH US	Rafe Jadrosich
	Lennar Corporation	LEN	LEN US	Rafe Jadrosich
<b>UNDERPERFORM</b>				
	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



## **iQmethod<sup>SM</sup> 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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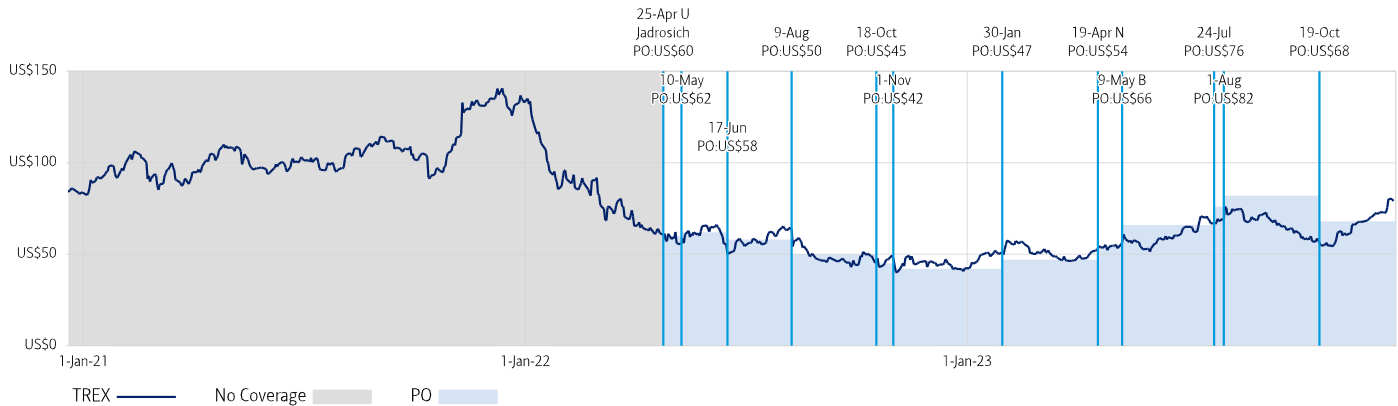
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# Disclosures

## Important Disclosures

### Trex Company, Inc. (TREX) 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 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	41	47.67%	Buy	23	56.10%
Hold	14	16.28%	Hold	8	57.14%
Sell	31	36.05%	Sell	9	29.03%

### Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

<sup>R1</sup> 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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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> 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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