

Building Products

Reiterate Buy on AZEK/TREX: expect TREX to beat 4Q and guide 1Q above consensus

Price Objective Change

Composite decking proving to be secular growth category

We estimate composite decking dealer and retail sales grew mid-single-digits (or better) in 2023 compared to a low-single-digit decline in overall repair & remodel (R&R) spending. Composite decking grew despite a volume base that is roughly 20% higher than 2019 levels (price +30-40%). Many categories that benefitted from a boom in demand in 2021/2022 are now facing revenue declines in 2023 and into 2024 from normalization (home improvement, sporting goods, pools/spa). Composite decking has been able to grow off the higher base, which demonstrates: 1) composite decking is early stage in the conversion from wood and consumer awareness is growing, 2) decking has a large installed base making it less discretionary than other building products because of replacement demand, and 3) composite decking will hold price in a downturn.

Recent checks are still positive in tough R&R backdrop

Web traffic data and recent company commentary indicate that composite decking “sell-through” (sales to distributors) continues to grow. While there is some potential weather disruption in 1Q, January and February are primarily stocking periods for composite decking companies.

Valuation: growth outperformance warrants premium

Trex and Azek stock valuations have re-rated higher relative to peers recently, however, we think higher multiples are justified given the stronger revenue growth outperformance compared to other building product companies. Azek looks particularly attractive given its trading at the low-end of its historical discount to Trex. Azek also trades just in-line with its historical premium to building products despite stronger relative growth outlook. Trex trades at a wider premium than Azek, but its multiple is highly correlated with its revenue growth, which we anticipate to accelerate in 1H24.

AZEK remains a top pick

Azek remains a top pick in building products (added to US 1 on January 30th). We reiterate our Buy rating: 1) Guidance looks conservative, 2) Azek's residential sell-out trends remain exceptionally strong and composite decking/exterior continue to meaningfully outperform over the 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. We raise our PO on Azek to \$52 (from \$50) now based on a 19X EBITDA (was 18X) to reflect higher sector multiples.

TREX preview: we expect 4Q upside + guide > consensus

Trex is scheduled to report 4Q23 earnings on Monday, February 26th after the market close. We expect modest upside vs. consensus driven by better sales (we model \$0.21 vs. consensus \$0.19). We expect Trex to initiate 2024 revenue guidance at the high-end or above its long-term 11-13% target with incremental EBITDA margins in the high-30% range. We also anticipate 1Q24 revenue guidance ahead of street forecasts. We raise our 2024E EPS by 3% and raise our PO to \$103 (from \$90) now based on a higher target multiple of 25X EV/2025E EBITDA (from 23X) given higher sector multiples.

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Equity
United States
Building Products

Rafe Jadrosich
Research Analyst
BofAS
+1 646 855 5815
rafe.jadrosich@bofa.com

Shaun Calnan, CFA
Research Analyst
BofAS
shaun.calnan@bofa.com

Victoria Piskarev
Research Analyst
BofAS
victoria.piskarev@bofa.com

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Refer to important disclosures on page 8 to 11. Analyst Certification on page 7. Price Objective Basis/Risk on page 6.

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Timestamp: 23 February 2024 08:24AM EST

Key changes

Exhibit 1: PO changes

Raising POs for AZEK and TREX

Building Products	New Rating	Old Rating	New PO	Old PO	New Multiple (2025 EV/EBITDA)	Old Multiple (2025 EV/EBITDA)
AZEK	Buy	Buy	\$52	\$50	19.0	18.0
TREX	Buy	Buy	\$103	\$90	25.0	23.0

Source: BofA Global Research estimates

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Exhibit 2: TREX estimate changes

Raising TREX 2024E/2025E EPS estimates 3%/2%

Building Products	New 2024E	Old 2024E	Consensus 2024E	New vs. Old	New vs. Consensus	New 2025E	Old CY 2025E	Consensus 2025E	New vs. Old	New vs. Consensus
TREX	2.41	2.33	2.28	3%	5%	2.71	2.62	2.70	2%	0%

Source: BofA Global Research estimates, Bloomberg

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Recent checks are still positive in tough R&R backdrop

Web traffic data and recent company commentary indicate that composite decking “sell-through” (sales to distributors) continues to grow. While there is some potential weather disruption in 1Q, January and February are primarily stocking periods for composite decking companies.

AZEK 4Q23 – February 2nd: “We continued to experience strong double-digit sell-through growth in fiscal 1Q 2024. The retail POS data continues to experience healthy growth year-over-year. Total retail POS remained above our pro-channel sell-through. We see our residential sell-through in the mid-single digits for the balance of the fiscal year.”

FBIN 4Q23 commentary – January 30th: “Decking sales were down mid-single digits in the weaker as weaker retail sales offset strong whole channel point of sales (POS) trends. Our POS data indicates that our Fiberon wholesale sell-through consistently paced ahead of the market with strong sequential improvement throughout the year and exited the year up mid-single-digits versus last year and above the market.”

TREX 3Q23 commentary – October 30th: “Channel sell-through growth for TREX products was in the mid-single-digits in 3Q23. We expect low-single-digit growth in the 4th quarter driven by consumer demand. We expect a little bit of channel inventory build in the 4th quarter.”

Decking web traffic: Jan +19% YoY; +52% vs. Jan 2019

Web traffic to composite decking websites (AZEK, TREX and Fiberon) rose +18.6% YoY in January and was +52.4% higher vs. January 2019. By company, **Trex** (trex.com and decks.com) web traffic increased +3.0% YoY in January and rose +59.1% higher vs. January 2019. Total **AZEK** (timbertech.com + AZEK.com) web traffic rose +48.2% YoY in January and increased +48.0% vs. January 2019. **Fiberon** web traffic increased +122.7% YoY in January and rose +9.7% vs. January 2019.

Exhibit 3: Aggregated web traffic data, Y/Y

Overall January decking web traffic increased 19% YoY and rose 52% vs. January 2019

Monthly YoY Web Traffic Trend	Jul.	Aug.	Sep.	Q3	Oct.	Nov.	Dec.	Q4	Jan.	Δ*
Total Decking	4%	19%	14%	11%	18%	1%	10%	10%	19%	↑
TREX (decks.com + trex.com)	10%	27%	7%	14%	19%	10%	-10%	8%	3%	↑
AZEK (Azek.com + timbertech.com)	-9%	4%	37%	7%	23%	-4%	79%	25%	48%	↓
Fiberon	-3%	10%	-35%	-7%	-34%	-56%	-32%	-43%	123%	↑
Monthly vs 2019 Web Traffic Trend	Jul.	Aug.	Sep.	Q3	Oct.	Nov.	Dec.	Q4	Jan.	Δ*
Total Decking	29%	48%	55%	42%	61%	97%	122%	85%	52%	↓
TREX (decks.com + trex.com)	15%	36%	43%	28%	32%	67%	69%	51%	59%	↓
AZEK (Azek.com + timbertech.com)	107%	107%	111%	109%	216%	296%	473%	292%	48%	↓
Fiberon	-3%	6%	-37%	-9%	-10%	3%	-28%	-12%	10%	↑

Source: SimilarWeb, * Δ in YoY trend vs. prior month

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Valuation: growth outperformance warrants premium

The biggest pushback from investors to our bullish view on composite decking is valuation, especially after the recent run in both Trex and Azek. Year-to-date TREX has increased 13% and Azek is up 21.5% vs. the S&P Composite 1500 Building Products Index +5.5%. Trex and Azek stocks valuations have re-rated higher relative to peers recently, however, we think higher multiples are justified given the stronger revenue growth outperformance compared to other building product companies. Azek looks particularly attractive given its trading at the low-end of its historical discount to Trex. Azek also trades just in-line with its historical premium to building products despite stronger relative growth outlook. Trex trades at a wider premium than Azek, but its multiple is highly correlated with its revenue growth, which we anticipate to accelerate in 1H24.

Exhibit 4: We expect Trex and Azek's valuation premium vs. peers to widen with revenue growth outperformance

Composite decking company historical revenue growth and valuation premium

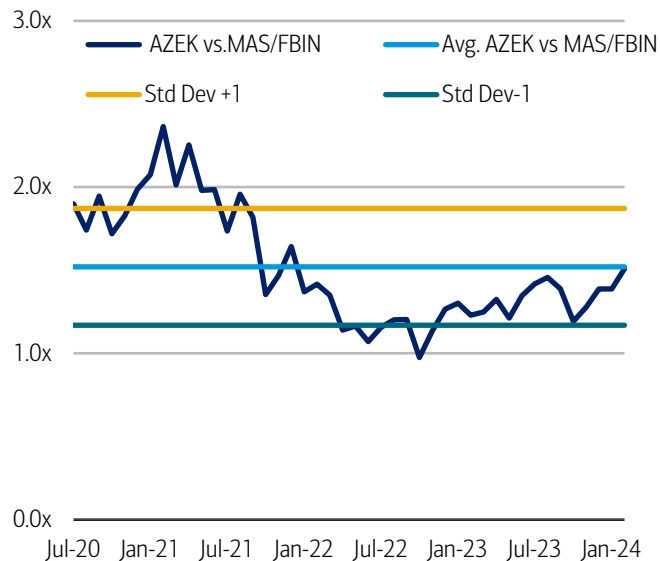
Sales Growth (ex. acquisitions)	2020	2021	2022	2023	2024E
AZEK (residential)	20%	31%	0%	12%	8%
TREX (residential)	19%	38%	-7%	3%	17%
FBIN	6%	19%	-2%	-7%	0%
MAS	7%	15%	6%	-8%	0%
Valuation	2020	2021	2022	2023	Current
AZEK Fwd EV/EBITDA	21.3x	18.8x	11.1x	15.3x	16.9x
TREX Fwd EV/EBITDA	27.3x	34.7x	14.6x	21.3x	22.5x
FBIN Fwd EV/EBITDA	11.0x	11.3x	8.8x	10.8x	11.0x
MAS Fwd EV/EBITDA	10.5x	11.5x	8.8x	11.2x	11.4x
Relative revenue growth performance vs. FBIN/MAS	2020	2021	2022	2023	2024E
AZEK (residential)	14%	14%	-2%	20%	8%
TREX (residential)	13%	21%	-9%	10%	17%
Relative valuation vs. FBIN/MAS	2020	2021	2022	2023	Current
AZEK (residential)	10.6x	7.3x	2.3x	4.3x	5.7x
TREX (residential)	16.6x	23.3x	5.8x	10.3x	11.3x

Source: BofA Global Research

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Exhibit 5: AZEK fwd EV/EBITDA relative to MAS/FBIN

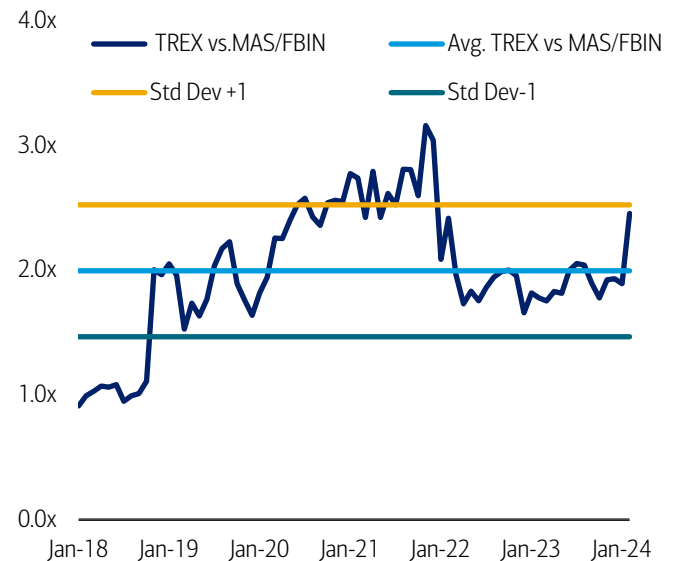
AZEK is trading in line with its historical avg. vs. MAS/FBIN



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Exhibit 6: TREX fwd EV/EBITDA relative to MAS/FBIN

TREX is trading in line with its historical avg. vs. MAS/FBIN



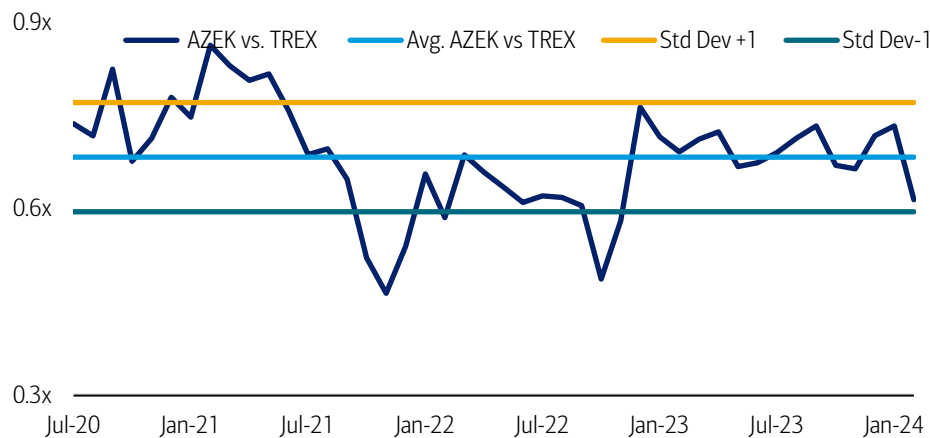
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Azek remains a top pick

Azek remains a top pick in building products (added to US 1 on January 30th). We reiterate our Buy rating: 1) Guidance looks conservative, 2) Azek's residential sell-out trends remain exceptionally strong and composite decking/exterior 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. We raise our PO on Azek to \$52 (from \$50) now based on a 19X EBITDA (was 18X) to reflect higher sector multiples.

Azek trades at the low-end of its historical valuation vs. Trex**Exhibit 7: AZEK vs. TREX forward EV/EBITDA**

AZEK is trading below its historical discount to TREX

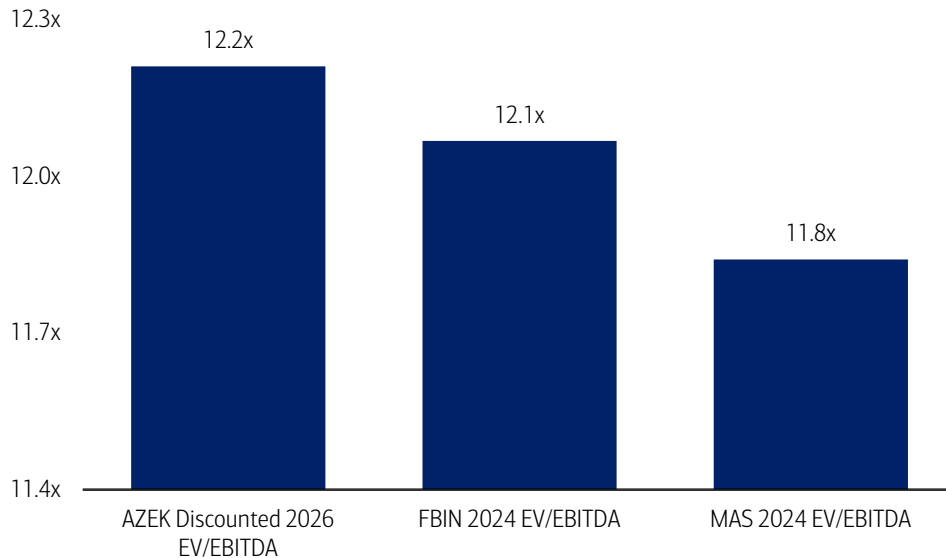


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Azek's multiple looks attractive relative to MAS/FBIN when accounting for its growth

Exhibit 8: AZEK 2026 EV/EBITDA multiple discounted back to 2024 vs. FBIN and MAS 2024 EV/EBITDA

AZEK trading at similar levels to FBIN and MAS when discounted to the 2026 multiple



Source: BofA Global Research estimates, company reports

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TREX preview: we expect 4Q upside + guide > consensus

Raise 2024E EPS/revenue forecasts; Reiterate Buy

We raise our 2024E EPS estimate by 3% to \$2.41 (5% 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.

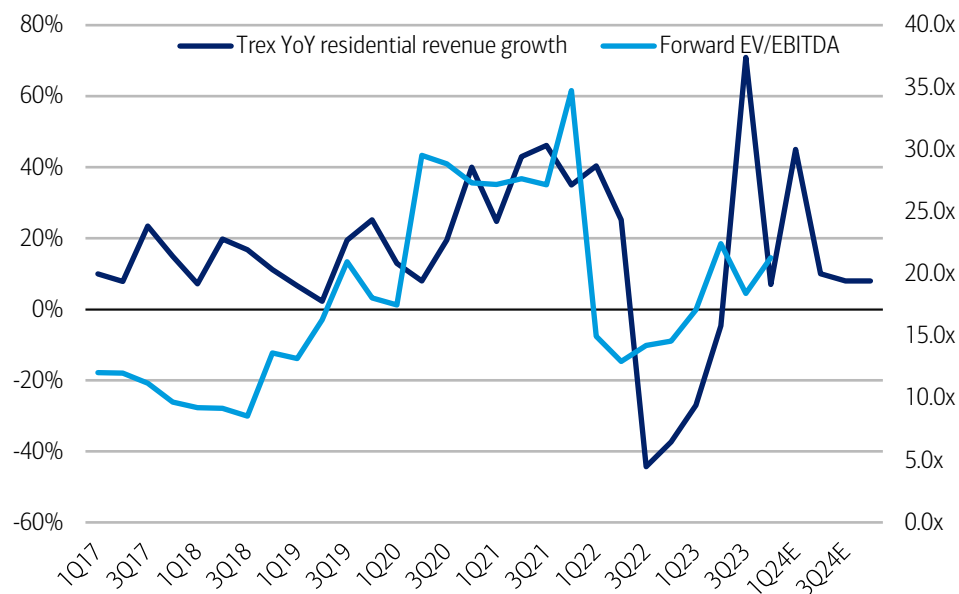
Expect strong incremental margins in 2024 as well

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).



Exhibit 9: TREX's valuation multiple and revenue growth are highly correlated

TREX historical residential revenue growth and EV/EBITDA multiple



Source: BofA Global Research, Company Data

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Exhibit 10: Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
AZEK	AZEK US	The AZEK Company	US\$ 46.49	C-1-9
TREX	TREX US	Trex Company, Inc.	US\$ 93.52	C-1-9

Source: BofA Global Research

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Price objective basis & risk**The AZEK Company Inc. (AZEK)**

Our \$52 PO for AZEK shares is based on a CY2025E EV/EBITDA multiple of 19x, 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.

Trex Company, Inc. (TREX)

Our \$103 PO is based on a 25X 2025E 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.

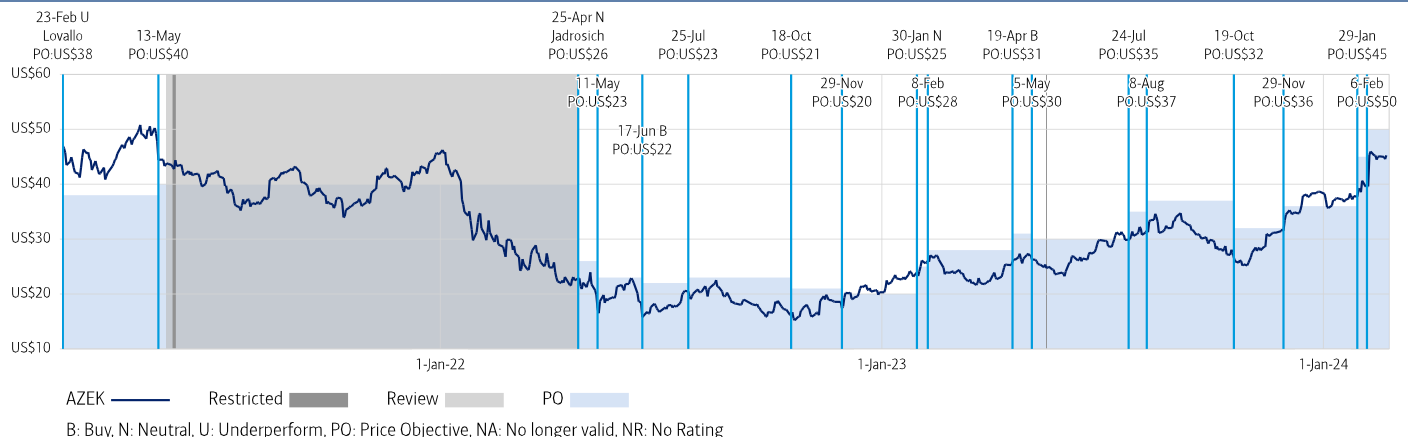
US - Homebuilders and Building Products Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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

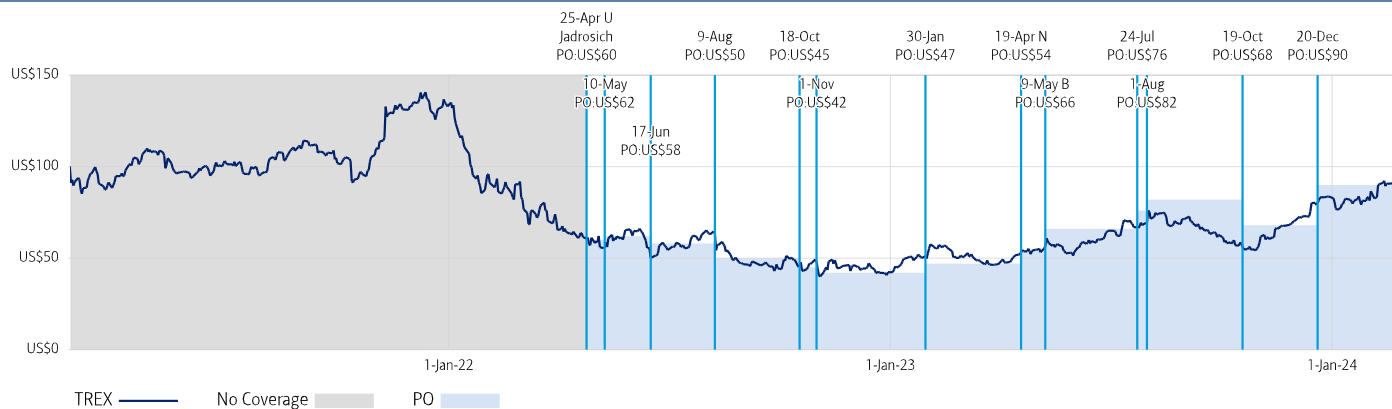
Disclosures

Important Disclosures

The AZEK Company (AZEK) Price Chart



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.

Trex Company, Inc. (TREX) Price Chart

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

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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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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
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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