

Beacon Roofing Supply, Inc. (BECN)

Baird 2Q13 Roofing Survey Results

BAIRD

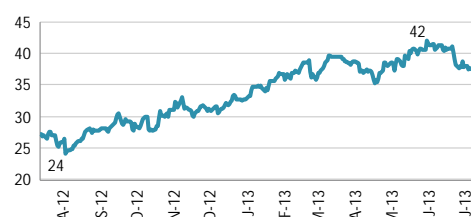
Maintain Outperform rating and \$42 price target. Results from the Baird 2Q13 Roofing Survey suggest unfavorable weather depressed otherwise solid underlying re-roofing volumes, and similarly delayed the February price increase. That said, we believe near-term expectations reflect this, and investors will likely focus on BECN's outlook for 4QF13 (September). Overall, respondents' 2H13 forecast is consistent with our estimates, underscores our favorable secular view on BECN, and we recommend watching for opportunities to get more aggressive on any pullbacks.

- **Maintain Outperform rating and \$42 price target** based on 10.5x EV/C2014E EBITDA.
- **No estimate changes** at this time.
- **Residential volumes solid, despite weather headwinds.** Our channel checks indicate residential volumes increased 2%+ in 2Q13, improving modestly sequentially (+1.4% in 1Q13) reflecting ongoing momentum in underlying re-roofing trends. Several respondents noted a temporary overhang from colder/wetter weather that pressured 2Q13 trends in some markets, though we expect unfavorable weather damage could be a potential positive longer-term. Looking to 2H13, our contacts' outlook is for mid-single-digit volume growth, moderating only slightly vs. the previous quarter's outlook due to weather delays.
- **Price increases still seen as sticking, but slightly delayed by weather.** Survey respondents indicate 2Q13 pricing increased +1.5%, with nearly 70% reporting at least a partial impact from the February price increase. Here too, commentary focused on unfavorable weather, which temporarily increased channel inventories and hindered more substantial price realization. To this end, survey results suggest that price increases appear to be steadily gaining momentum into the summer season. Overall, we believe the pricing environment should improve as weather challenges abate, and view the 3Q13 pricing outlook for low-to-high single digits as reasonable.
- **2H13 residential outlook (volume + price) favorable.** Respondents' outlook for residential growth (volume + price) of high-single-digits+ is consistent with our outlook for improving trends, as underlying re-roofing demand steadily improves, weather headwinds abate, residential construction continues to gain momentum, and y/y comparisons ease going forward.
- **Nonresidential trends still flattish.** 2Q13 growth rates within non-residential improved slightly vs. 1Q13, with low-single-digit growth comprised of volumes +1.1% and pricing +0.4%. While trends benefited from easing comparisons, weather-related noise likely depressed growth rates. Looking to 2H13, respondents' outlook (volume + price) of low-single-digits+ moderated vs. the previous quarter's outlook, likely due to weather-related delays.

Beacon Roofing Supply is a super-regional distributor of residential and non-residential roofing products as well as complementary building products.

RESEARCH UPDATE

1-Year Price Chart



Stock Data

Rating:	Outperform
Suitability:	Higher Risk
Price Target:	\$42
Price (7/11/13):	\$39.75
Market Cap (mil):	\$1,944
Shares Out (mil):	48.9
Average Daily Vol (mil):	0.42
Dividend Yield:	0.0%

Estimates

FY Sep	2012A	2013E	2014E
Q1	0.39 A	0.37 A	
Q2	0.07 A	(0.02) A	
Q3	0.62 A	0.73 E	
Q4	0.60 A	0.77 E	
Fiscal EPS	1.67 A	1.85 E	2.11 E
Fiscal P/E	23.8x	21.5x	18.8x
Calendar EPS	1.65 A	1.90 E	2.11 E
Calendar P/E	24.1x	20.9x	18.8x

Chart/Table Sources: Bloomberg and Baird Data

**Please refer to Appendix
- Important Disclosures
and Analyst Certification**

Investment Thesis

The call. We rate BECN Outperform. Our \$42 price target is based on approximately 10.5x EV/C2014E EBITDA, a slight premium to the 9x long-term NTM average but a discount to recent levels (~11x). We view BECN as a very attractive, defensive, and domestic growth stock with mostly recurring revenue streams and catalysts from new construction, pricing, storms, and ongoing consolidation of the highly fragmented industry. BECN has now delivered two consecutive years of organic growth within the company's targeted +5-10% range in spite of continued variability around weather/storms, underscoring the company's very favorable secular story, solid long-term organic growth, augmented by acquisitions, leveraged into strong earnings growth and long-term shareholder value creation.

Leader in large and highly fragmented market. Beacon competes in the highly fragmented, \$17 billion roofing materials market with over 1,500 distributors. Of those, only about 75 operate in more than one state with only a few competitors approaching regional or national scale (ABC Supply, Allied Building Products, Roofing Supply Group, and SRS Roofing Supply).

Favorable industry dynamics. The business is un-exportable and products have low obsolescence. Beacon has a diverse business model (geographies, customers, residential/commercial, re-roof/new construction), that is recession resistant, with high recurring revenue streams (we estimate 80%+) and significant operating leverage. Over the long term, we believe BECN can achieve average organic sales growth of 5-10% with EPS growth in the low- to mid-teens. BECN is also positioned to supplement organic growth through acquisitions, targeting 10-15% incremental sales growth per year, leading to overall targeted growth in the 15-25% range.

Cost-out programs. Cost reduction continues to be an area of focus, especially at recently acquired companies. "Cost-out" programs are designed to examine costs line-by-line to produce annual cost reductions. The company also manages branch locations via a proprietary benchmarking model, which can serve as a guide for key ratios and setting cost levels.

Residential (50% of F2012 sales). Recent re-roofing trends have softened somewhat, reflecting difficult comparisons following strong hail storm activity and difficult weather in 2Q13. Excluding this noise, however, we expect to see a return to trend-line organic growth within the company's +5-10% targeted range in 2HF13 as comparisons normalize (although "core" trends remain in this range). Although only 10-15% of industry volumes today, a continued recovery in new residential construction would also be a positive catalyst for unit demand as well as price increases.

Non-residential (37% of F2012 sales). Geographic exposure is primarily in the Northeast, Midwest, and eastern Canada. Repair demand is significant, representing the vast majority of revenues, and we expect steady underlying repair trends overall (benefitting from easing prior-year comparisons near-term), with new non-residential construction activity expected to remain lackluster.

Complementary building products (13% of F2012 sales). With most complementary products sold into the residential end market, this segment has seen stable trends in recent quarters amid strengthening residential construction trends and should benefit from easy comparisons for the foreseeable future.

Balance sheet/share repurchases. The balance sheet remains in very good shape with debt/cap 29% and total debt to EBITDA of 1.7x vs. a peak closer to 4x. Beacon currently has no share repurchase authorization.

Key risks to our Outperform rating. Risks include further customer repair delays/deferrals, an adverse change in the pricing environment, potential gross margin swings due to mix, inability to make acquisitions, and/or investor expectations outpacing fundamental improvement as housing market fundamentals turn increasingly positive.

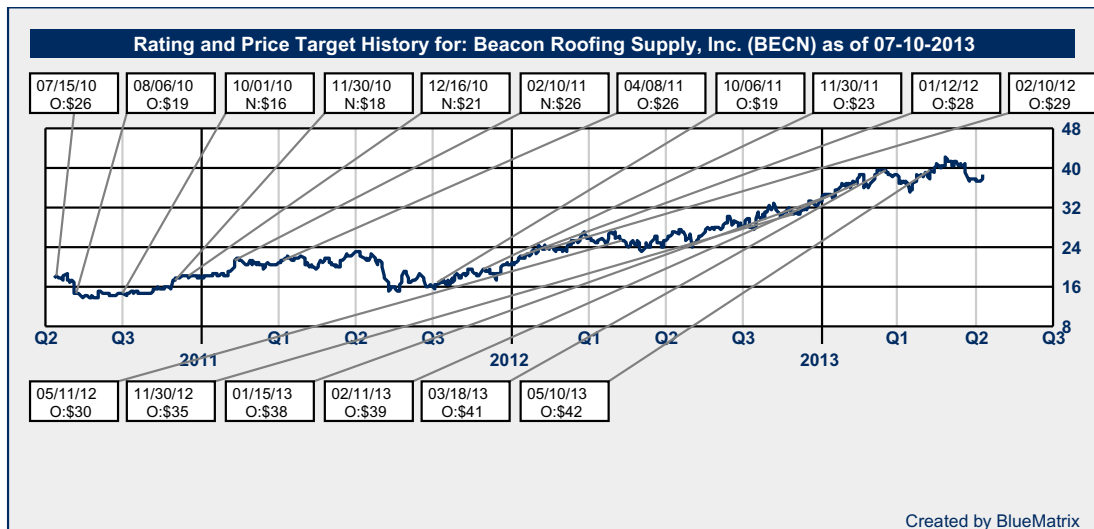
Risks & Caveats

Fundamental risks include seasonality (March quarter can be breakeven, plus or minus) and cyclicity (consumer re-roofing and new home construction trends), supplier terms/product availability, sustainability of price increases, acquisition availability/integration, management/IT systems/controls, goodwill/amortization from acquisitions, unpredictability of storms and materials pricing, relatively high degree of fixed costs and occasional moderate financial leverage.

Company Description

Beacon Roofing Supply is a super-regional distributor of residential roofing (50% of F2012 sales), non-residential roofing (37%) as well as complementary building products (13%), an approximately \$17+ billion market in aggregate. Beacon serves its 40,000+ customers through a network of 229 branch locations with up to 11,000 SKUs per branch in 38 states and Canada. Beacon's acquisition strategy of buying and maintaining purchased brands has enabled the company to establish itself as either the No. 1 or No. 2 distributor in nearly every market served.

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