

March 2, 2018

## Beacon Roofing Supply Inc: (BECN)

Theodore Wind

Sector: Industrials

Industry: Trading Companies and Distributors

Current Price: \$52.54

Target Price: \$65.13

Beacon Roofing Supply distributes roofing supplies as well as other complimentary materials such as siding, windows, and waterproofing systems to residential and commercial customers in the United States and Canada. Beacon Roofing Supply's customers include contractors, homebuilders, building owners, and other resellers.



## BUY

Current Price: \$52.54  
 Target Price: \$65.13  
 Market Cap: 3.56B  
 Beta: 0.98  
 ROIC: 5.29%  
 WACC: 8.19%  
 D/E: 42.9%  
 Credit Quality Rating: BB+

## Catalysts:

- Short Term(within the year): Changes in the corporate tax rate as well as rebuilding from recent hurricanes
- Mid Term(1-2 years): Better economic conditions increases disposable income for people to update their homes and offices
- Long Term(3+): Recent acquisitions will increase economies of scale and allow Beacon to build a larger network of customers

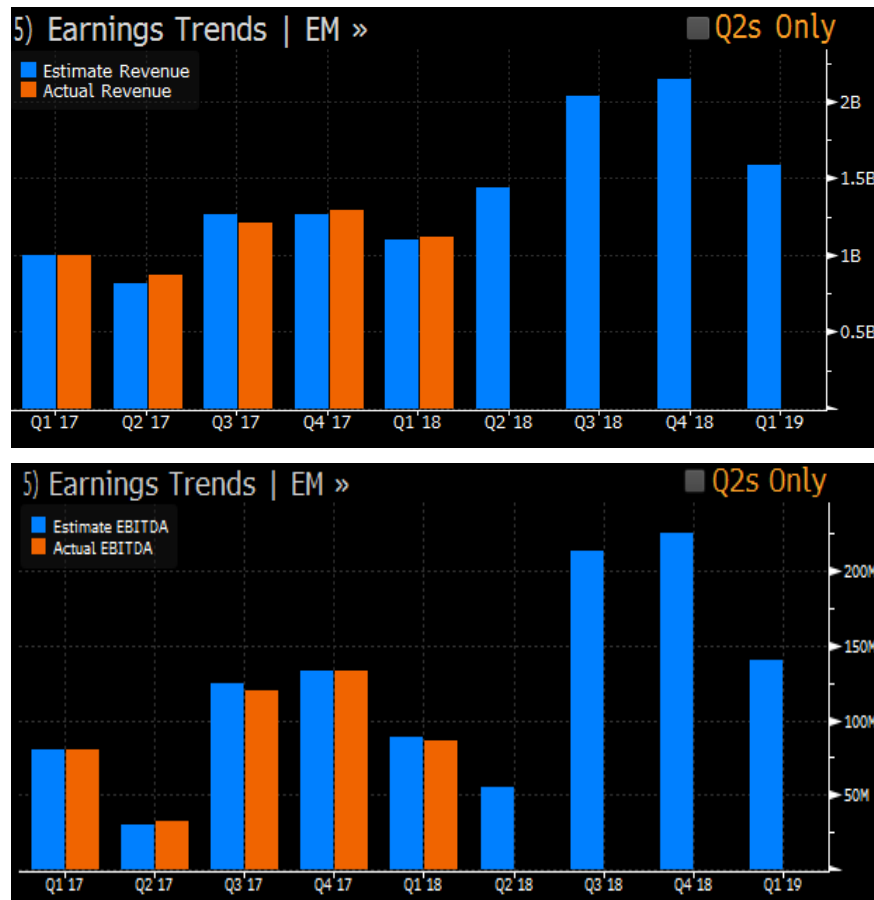
**Thesis:** Beacon Roofing Supply is currently the largest publically traded roofing distributor in the United States and second largest roofing supplier in the nation. Beacon Roofing is set to benefit from the new United States tax reform at set the corporate tax rate at 21%. This new tax reform will allow them to generate more profits, and therefore better returns to shareholders. They also stand to benefit from the recent acquisition of Allied Building Products. This acquisition will provide important synergies for Beacon allowing them to increase their operating margin in the near future. Beacon Roofing is also going to benefit from the recent positive economic reports. These reports show near all-time lows in unemployment as well as an increase in wages paid to employees. This is extremely exciting for Beacon because that means these households now have more disposable income to put into their house and make renovations. Beacon Roofing is a buy now because they are poised to have a very successful 2018 due to their continued diversification of the company to complimentary products paired with the recent tax reform and synergies from the merger with Allied.

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## Earnings Performance:

Beacon Roofing is projecting a significant increase in revenue in 2018 up from their \$4.4 billion in 2017 to an estimate of \$6.6- \$6.9 billion in 2019. Much of this increase comes from their acquisition of Allied building products; however, they also project future growth. According to their CFO Joseph Nowicki stated they had a 12% growth in quarter one of 2018, 8% of which was organic. This included a 9.6% increase in residential roofing, an 11.7% increase in complimentary products, and a 4.3% increase in non-residential roofing. Their revenue projections for 2018 come from favorable pricing trends and likely stronger hurricane related demand than originally anticipated. Their revenues are weakest during the winter months; however, that is not necessarily a bad thing for Beacon. According to Nowicki, the company actually wants nasty winters because it increases demand in the spring and summer months, so decreased revenue is not necessarily a bad sign for Beacon. Beacon Roofing's past revenue estimates and actuals can be seen in the first graph below.

The next graph shows past EBITDA performance as well as EBITDA estimates going forward. According to their cash EBITDA Beacon has been able to outperform analyst estimates four out of the last five quarters, and 3 consecutive years in a row. This is an extremely positive sign because this shows Beacon has been able to control costs more than analysts have estimated. They have attributed much of this success to their sixty percent to forty percent fixed to variable cost ratio. They also believe they can improve their margins due to their recent acquisition of Allied. They expect to achieve about 40 million dollars in synergies in 2018. Beacon also expects prices on their goods to increase especially in the second and third quarters due to higher than expected demand. Beacon Roofing is providing shareholders exactly what they should be looking for which is increased revenues as well as increased EBITDA margin.



## Acquisition of Allied Building Products:

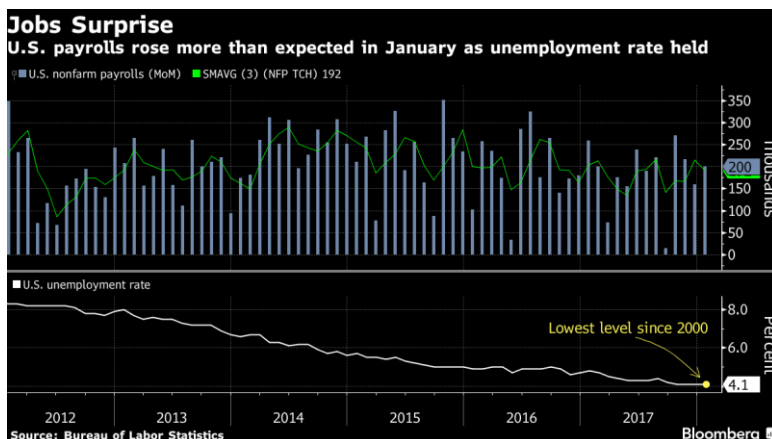
On August 24, 2017 the merger between Beacon Roofing and Allied Building Products was announced and the deal was completed on January 2, 2018. The deal was for \$2.6 billion in cash, which was about 8 times EBITDA. They financed this cash acquisition with debt and their implied cost of debt is 5.20%. This acquisition is exciting for Beacon because it not only expands their product offering, but it also increases the company's network across the United States. This acquisition was initiated mainly to increase their supplemental product offerings. This is the sector where Beacon is growing the most and allows them to diversify away from just roofing. These areas include siding, windows, doors, decking, trim, waterproofing, insulation and solar. Their footprint within the United States also increases significantly from this acquisition. They increased the number of locations by 208 to a total of 589 locations in all fifty states. It also increases their presence in important states like Texas, Florida, and California. Another key factor besides expansion that Allied brings to Beacon are better margins going forward. This stems from synergies between the two companies as both are major distributors of construction products. Allied is one of the largest public wholesale building materials distributors. Beacon expects to see \$30-\$40 million dollars in synergies the first year and \$110 million dollars in synergies in the first two years. These synergies will mainly come from three places; branch consolidations, SG&A related savings, and procurement benefits. The acquisition of Allied was extremely important for the growth of Beacon going forward because of the synergies provided which allows Beacon to improve margins and return profits to shareholders.

## Economic Factors:

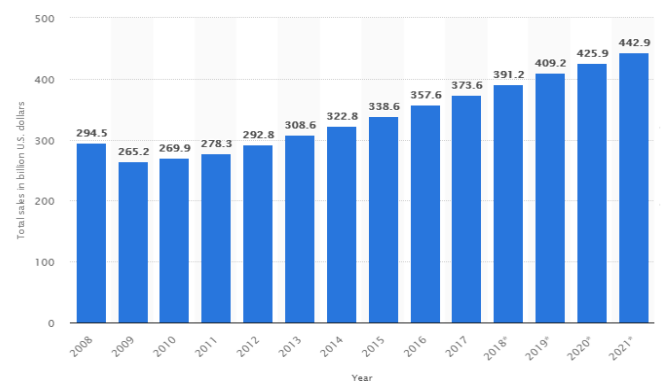
The United States recently passed legislation dropping the corporate tax rate from 34% to 21%. This is a significant decrease and one Beacon is set to take advantage of going forward. As shown in the table below the previous estimated effective tax rate was between 38% and 39%, however after the passage of the new legislation the effective tax rate drops almost 10% to between 29% and 30% in 2018. Then they project it to drop to about 26-27% in 2019. The change in effective tax rate will create larger profits that can explain the predicted increase in earnings per share as well.

	2018 Current	2018 Previous
<b>Revenue</b>	<b>\$6.6 - \$6.9 billion</b>	<b>\$6.6 - \$6.9 billion</b>
<b>Adjusted EBITDA*</b>	<b>\$560 - \$600 million</b>	<b>\$560 - \$600 million</b>
<b>Adjusted EPS*</b>	<b>\$3.40 - \$3.70</b>	<b>\$2.95 - \$3.25</b>
<b>Effective Tax Rate</b>	<b>29% - 30%</b>	<b>38% - 39%</b>

Another important economic factor is the most recent unemployment and wage report. As you can see in the graph below the US payrolls rose more than expected in January, which is a positive sign for the housing industry, especially when it is paired with the lowest unemployment since 2000. This is a great sign because this means more people have jobs therefore more households will have money to spend on home improvements. Beacon, especially with their recent acquisition of Allied, is better positioned than ever to take advantage of this market because of their commitment to expand into complementary products. Another positive trend that can be seen in the second graph from the North American Retail Hardware Association shows the total sales of home improvement retailers in the United States. While Beacon is not a retailer it is a distributor, therefore the increase in sales and projected increase in sales in the future is a great sign looking forward for Beacon. Their complimentary product division is growing at the fastest rate and there is no better time as the economy is booming and people are willing to spend money.



**Total sales of home improvement retailers in the United States (in billion U.S. dollars)**



Another factor, one that will lead the charge for the increased revenue in 2018 for Beacon were Hurricanes Harvey and Irma that hit the United States last year. Families are moving back home to houses in dire need of repair. They are going to need improvements to their roofs, new siding, and new windows just to name a few things and these are all products that Beacon deals. Especially exciting is their increased presence in Texas because the east side was devastated by hurricane Harvey and now they are well positioned to take advantage and help provide families and businesses with the materials they need to repair destroyed properties. According to estimates in the most recent conference call, Beacon estimates that they will gain \$120 million dollars in additional revenue due to the hurricane damage alone. This is the perfect time to gain extra revenue because of the benefits now gained by the tax reform as well as the increasing operating margins. Now is the perfect time to buy because Beacon will start realizing these profits soon, as Spring is coming around the corner and many Southern states already have the weather necessary to start building.

## Competitor Analysis:

Name	Ticker	Mkt Cap	Rev - 1 Yr Gr	OPM LF	WACC
Median		2.43B	12.22%	4.94%	9.42%
100) BEACON ROOFING SUPPLY INC	BECN US	3.60B	11.95%	4.38%	7.78%
101) GMS INC	GMS US	1.27B	9.49%	5.50%	9.01%
102) BMC STOCK HOLDINGS INC	BMCH US	1.26B	12.48%	2.96%	9.82%
103) OWENS CORNING	OC US	9.09B	16.12%	9.34%	10.64%

Above is a competitor analysis that breaks down year over year revenue growth, operating margin, and WACC. It is difficult to do a competitor analysis because there are not too many companies that focus on roofing and have the kind of complimentary offerings that Beacon offers, however here are a couple within the same industry that will help to understand how Beacon is performing. Looking at the year over year revenue growth first, Beacon is slightly below the median of their competitors at 11.95% compared to 12.22%, however this should be much improved this year as they anticipate a large growth in revenue from hurricane repairs as well as new revenue from their increased footprint across the country.

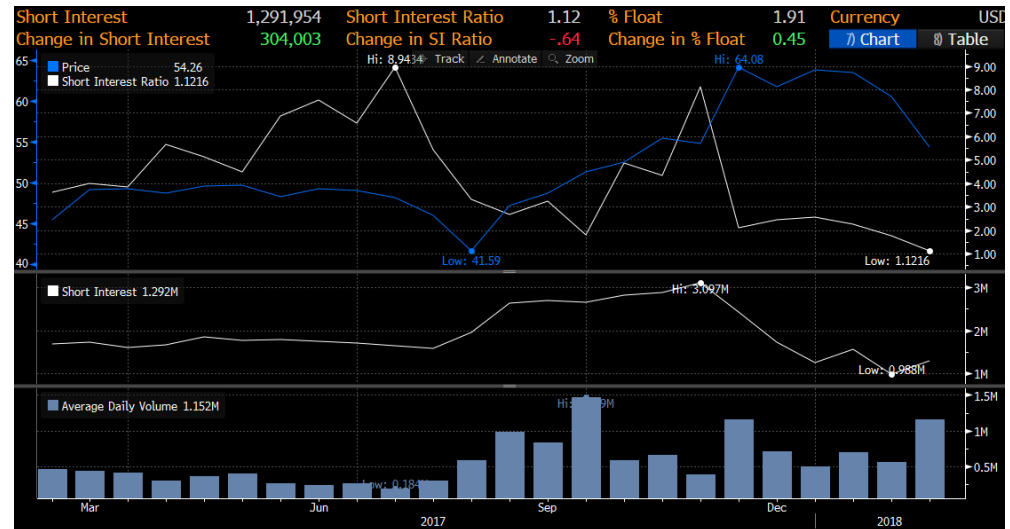
The next number I looked at was their operating margin. This number was also slightly below the median. However, this is an area where they are going to improve in 2018 due to their synergies with Allied. It also shows that there is room to improve in the industry because others have been able to successfully increase their operating margin. The cost savings will come from the ability to consolidate locations as well as SG&A savings.

Beacon Roofing has the lowest WACC of its competitors listed, which signifies that they have the lowest risk associated with their company. This means they are able to finance with cheaper debt than their competitors, which allows them to take on CAPEX projects that their competitors might not be able to take on. I believe the risk is lower because Beacon is trying to diversify away from just roofing both residentially and commercially. They continue to grow into other complimentary areas of business, which helps them to continue to grow their revenue as can be seen below with their three year growth rates in each division.

9) Prod Seg   FA PROD »	2017 Rev	3Yr Gr
Residential Roofing Products	2.4B	29.01%
Non-Residential Roofing Pro...	1.3B	13.27%
Complementary Building Pro...	723.1M	28.30%

## Short Interest/ Ownership:

The short interest in Beacon has been very volatile over the last year and I believe this is because they missed their GAAP estimate's of revenue in the third quarter of 2017 as well as their GAAP EBITA. However, if you look at their cash revenue and EBITA over that time they only missed their third quarter revenue projection while still providing a positive surprise with their cash EBITA. Another reason their



short interest spiked in November was because there were two insider transactions that were both selling shares. The first transaction was made by, Executive VP, Ross Cooper who sold 2000 shares, and the second was made by the CEO Paul Isabella and he sold 40,000 shares. There does not seem to be an event that triggered these transactions other than potentially profit taking as CEO's compensation package is heavily weighted with common stock. Since November however, the short interest is now lower than it has been over the past two years and I believe this is because of the official merger with Allied in January as well as the corporate tax reductions which will significantly help their margins this year and in years to come.

Following up on the low levels of short interest here is a look at the ownership summary of Beacon's stock. What jumps out immediately is that hedge fund managers are the second highest ownership group of the stock and their ownership percentage is increasing. This is a positive sign for Beacon because hedge fund managers are often the hardest group to please as they are looking for high yield stocks and only invest if they believe the stock has potential to move significantly up or down. In Beacon's case however, I believe it is fairly safe to assume that the hedge fund managers are mostly long because the short interest in the stock is so low. Therefore, I believe this signifies a time to buy as hedge fund managers continue to increase their ownership stake in Beacon

Top Ownership Type (%)				
54) Ownership Type	02/25/18	Curr	Change	
41) Investment Advisor	79.76	79.61	-0.15	↘
42) Hedge Fund Manager	12.67	12.77	+0.10	↗
43) Insurance Company	2.86	2.88	+0.02	↗
44) Pension Fund	2.54	2.55	+0.01	↗
45) Bank	0.73	0.73	0.00	↔
46) Sovereign Wealth Fund	0.61	0.61	0.00	↔
47) Government	0.30	0.31	+0.01	↗
48) Individual	0.29	0.29	0.00	↔
49) Brokerage	0.12	0.12	0.00	↔



## Conclusion:

In conclusion, I believe Beacon Housing is currently undervalued by 22.35% in the market. I believe they are going to be able to generate more returns to shareholders this year because of three events. First being their acquisition of Allied Building Products. This acquisition is important because it expands their complimentary offering that excludes roofing, and it will expand their network across the United States. They will also be able to improve their operating margin by consolidating locations and lowering SG&A costs. Another reason the company will improve their earnings is because of the lower effective tax rate they will be paying in 2018 of about 29% and then in 2019 of about 27%. This significantly helps Beacon because right now their effective tax rate is about 38%. These savings should go directly to shareholders and is a major reason why their EPS estimates increased from \$3.25 to \$3.70 for 2018. Finally, the third factor that will push Beacon's growth is revenue from the recent hurricanes, Irma and Harvey especially. These hurricanes did significant damage to two major markets in Florida and Texas respectively. Beacon previously projected revenue of \$100 million strictly from hurricane related activity, however they have recently upped that estimate to \$120 million. I believe this is a perfect storm of factors that will provide increased revenues, increased operating margin, and increased profit margin all in 2018 alone. I believe Beacon Roofing is a solid company who continues to grow and find ways to diversify, now is the time to buy some BECN stock and earn over twenty percent returns when it hits its target price of \$65.13

## Beacon Roofing Supply, Inc. (becn)

## CENTER FOR GLOBAL FINANCIAL STUDIES

**BULLISH**

Analysis by Al Capone

3/1/2018

Current Price:

\$53.23

Dividend Yield:

0.0%

Intrinsic Value

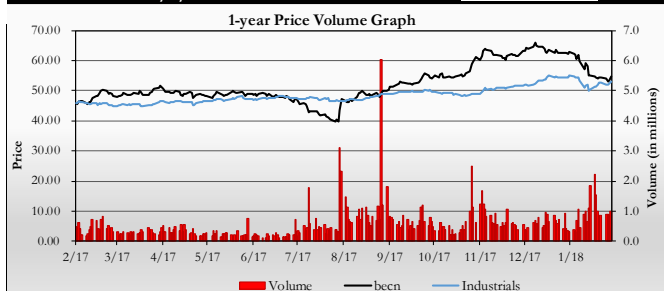
\$55.20

Target Price

\$65.13

Target 1 year Return: 22.35%

Probability of Price Increase: 93%



Description	
Beacon Roofing Supply, Inc., together with its subsidiaries, distributes residential and commercial roofing materials, and other complementary building materials to contractors, home builders, retailers, and building materials suppliers.	
General Information	
Sector	Industrials
Industry	Trading Companies and Distributors
Last Guidance	February 12, 2018
Next earnings date	May 2, 2018
Market Assumptions	
Estimated Equity Risk Premium	5.00%
Effective Tax rate	21%

Market Data	
Market Capitalization	\$3,620.24
Daily volume (mil)	0.49
Shares outstanding (mil)	68.01
Diluted shares outstanding (mil)	63.41
% shares held by institutions	109%
% shares held by investments Managers	87%
% shares held by hedge funds	11%
% shares held by insiders	0.36%
Short interest	1.90%
Days to cover short interest	1.29
52 week high	\$66.48
52-week low	\$39.57
Volatility	29.07%

Past Earning Surprises		
Quarter ending	Revenue	EBITDA
12/31/2016	-0.75%	42.95%
3/31/2017	6.96%	3.98%
6/30/2017	-4.41%	-0.53%
9/30/2017	1.78%	5.52%
12/31/2017	2.09%	29.48%
Mean	1.13%	16.28%
Standard error	1.0%	5.4%

Market and Credit Scores	
Recommendation (STARS) Value--0	
Recommendation (STARS) Description--0	
Quality Ranking Value--B	
Quality Ranking Description--Below Average	
Short Score--0	
Market Signal Probability of Default % (Non-Ratings)	-1.2%
CreditModel Score (Non-Ratings)--bb+	

Industry and Segment Information	
LTN Revenues by Geographic Segments	LTN Revenues by Business Segments
U.S.--96%	Wholesale - Building Products--100%
Canada--4%	--
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Management	
Isabella, Paul	CEO, President & Director
Nowicki, Joseph	Executive VP, CFO & Treasurer
Cooper, Ross	Executive VP, General Counsel & Corporate Secre
Jorgensen, Gregory	Chief Accounting Officer & Vice President
Nelson, Christopher	Chief Information Officer and Vice President
Swank, C.	Executive VP & Chief Commercial Officer

Total Compensations Growth	
-100% per annum over 4y	
-100% per annum over 3y	
-100% per annum over 4y	

Peers	
GMS Inc.	Foundation Building Materials, Inc.
Fastenal Company	Armstrong World Industries, Inc.
BMC Stock Holdings, Inc.	MSC Industrial Direct Co., Inc.
Owens Corning	W.W. Grainger, Inc.
Watco, Inc.	United Rentals, Inc.

Profitability	
	becn (LTM)
Return on Capital (GAAP)	6.4%
Operating Margin	5%
Revenue/Capital (GAAP)	1.33
ROE (GAAP)	11.6%
Net margin	3.7%
Revenue/Book Value (GAAP)	3.12

becn Historical	
6.93%	
4.71%	
1.47	
7.3%	
2.7%	
2.68	

Peers' Median (LTM)	
10.86%	
13.33%	
0.81	
26.2%	
7.6%	
3.44	

Invested Funds	
	becn (LTM)
Cash/Capital	32.2%
NWC/Capital	19.1%
Operating Assets/Capital	18.8%
Goodwill/Capital	29.9%

becn Historical	
3.1%	
36.9%	
23.8%	
36.2%	

Peers' Median (LTM)	
3.9%	
27.2%	
49.7%	
19.2%	

Capital Structure	
	becn (LTM)
Total Debt/Market Capitalization	0.55
Cost of Debt	4.1%
CGFS Rating (F-score, Z-score, and default Probability)	B
WACC	6.3%

becn Historical	
0.33	
5.1%	
9.0%	

Peers' Median (LTM)	
0.49	
4.8%	
8.5%	

Forecast Assumptions	
	Explicit Period (6 years)
Revenue Growth CAGR	12%
Average Operating Margin	6%
Average Net Margin	3%
Growth in Capital CAGR	7%
Growth in Claims CAGR	4%
Average Return on Capital	7%
Average Return on Equity	10%
Average Cost of Capital	7%
Average Cost of EquityKc	10%

Continuing Period	
2%	
5%	
4%	
2%	
2%	
9%	
11%	
7%	
10%	

Sensitivity Attribution Analysis	
Revenue	49.1%
Operating costs	47.3%
Capital expenditures	3.2%
Discount Rate	0.4%

