

NEW RISK ALERT: (MAS)

Masco's New 10-K Raises Red Flags as Receivables and Inventory Soar

New language in latest 10-K also reveals the emergence of new digital competitors.

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This alert compares the language used in the company's latest filing with the period before. [Research](#) suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Unnecessary Language Tweak Stokes Skepticism

In the footnotes of its 2020 [10-K](#), Masco Corporation, a designer and manufacturer of home improvement and building products, added a sentence to its section on receivables that was not included in the prior year's annual report:

"Our receivables balances are generally due in less than one year."

Since Masco classifies its receivables as current assets on the balance sheet we already assumed they were due within a year. It's not immediately clear why this sentence is necessary unless "generally due" may be a hint that there's trouble ahead.

Inventory Restocking or Something Nefarious?

Our analysis reveals that while Masco grew year-over-year sales 7% in 2020, the company's receivables grew 14%. In 2019, year-over-year sales and receivables growth were perfectly aligned, each increasing 0.7%. Likewise, Masco's allowance that includes doubtful accounts grew 33% in 2020 after growing just 9% the prior year.

Large customers like Home Depot appear healthy so the spike in receivables is both puzzling and concerning.

Even more troubling, Masco's inventory is also growing much faster than its cost of sales (COS). Inventory grew 16% in 2020, yet Masco's COS increased just 6.1%. The year prior (2019) year-over-year inventory fell slightly and COS was flat.

The Bear Case

- The health of Masco's customers may be deteriorating
- The company may be channel stuffing
- Inventory may be obsolete

The Bull Case

- The inventory build is intentional following pandemic related supply chain disruption
- The spike in receivables may suggest Masco's big box retail customers are also rebuilding inventory to serve a hot housing market

The combination of soaring inventory and receivables is hard to ignore, especially with the inclusion of the unnecessary language change in the footnotes. Until Masco provides additional information, it's a warning to investors to proceed cautiously.

The Winkler Group has contacted Masco for an explanation and to learn whether the new language in the annual report indicates a change in receivables policy. We will update subscribers when we develop new information.

Masco Identifies Emergence of New Competitive Threat

The skepticism only increases when investors consider that competition is rising. In its latest annual report, Masco identifies a new type of competitor in the space. In its 2019 annual report, Masco offers a boilerplate warning with regard to competition in its plumbing segment:

"We face significant competition from private label products. Many of the faucet and showering products with which our products compete are manufactured by foreign manufacturers that are putting pressure on price."

In its 2020 10-K, Masco adds language identifying a new type of competitor:

*"We face significant competition from private label products and **digitally native brands**. Many of the faucet and showering products with which our products compete are manufactured by foreign manufacturers that contribute to price competition."*

Digitally native brands were born online and sell directly to consumers, cutting out middlemen and often competing on price, convenience, and brand. Though Masco doesn't mention digitally native brands again, investors would be smart to monitor for slight changes in market share in 2021. Should a digitally native brand take significant share, Masco is constantly evaluating acquisition targets complementary to its portfolio.

Masco Warns of Price Volatility in Key Raw Materials

Masco's Decorative Architectural Products segment includes branded cabinet and door hardware, functional hardware, wall plates, hook and hook rail products, and picture hanging accessories. In its 2019 annual report, Masco did not flag raw material costs as an issue:

"We import certain materials and products for this segment that have been and may in the future be subject to duties and tariffs."

In its 2020 report, Masco identifies the ingredients needed to make these products and warns that pricing is volatile:

"Certain products in our Decorative Architectural Products segment contain propylene, methyl methacrylate (MMA), titanium dioxide and zinc. We have multiple sources, both domestic and foreign, for the raw materials used in this segment. We have encountered price volatility for propylene and MMA and, to a lesser extent in this segment, zinc. To help reduce the impact of this volatility, from time to time we may enter into long-term agreements with certain significant suppliers or, occasionally, use derivative instruments. We import certain materials and products for this segment that have been and may in the future be subject to duties and tariffs."

Hedging aside, investors that pay attention to the prices of these raw materials will likely obtain a more accurate margin profile for this product segment.