

AZZ INC. | AZZ

BUY

Raises FY'25 Guidance, Issued Just Two Months Ago; Increasing Target to \$100

PRICE \$81.23

PRICE TARGET \$100.00

KEY TAKEAWAY

This morning, AZZ raised the midpoint of its FY'25 sales guidance by 2% (to \$1.58B), EBITDA by 3% (to \$335M), and EPS by 6% (to \$4.75). Prior guidance was issued just two months ago (February 1, 2024). The increases reflect strong end-market demand, lower interest expense (its Term Loan B was repriced on March 20, 2024), and higher equity income. The company's AVAIL joint venture (previously its Infrastructure Solutions segment) is benefiting from strong data center and electric power demand, we believe. We are increasing our FY'25 EBITDA forecast by 2% to \$338M and introducing a FY'26 estimate of \$356M. Our 12-month price target goes from \$75 to \$100 (10.9x FY'26 EV/EBITDA).

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KEY POINTS

Raises recently issued FY'25 guidance. This morning, AZZ increased the midpoint of its FY'25 guidance ranges as follows: sales from \$1.55B to \$1.58B (+3% yr/yr), adjusted EBITDA from \$325M to \$335M (+3% yr/yr) and EPS from \$4.50 to \$4.75 (+11% yr/yr). The company originally issued FY'25 guidance on February 1, 2024.

The catalysts appear threefold: (1) stronger end market demand, (2) lower interest expense, and (3) higher income from its AVAIL JV. AZZ raised its FY'25 equity income forecast from \$10M–\$12M to \$15M–\$18M, which includes its 40% ownership of AVAIL (previously the Infrastructure Solutions segment). We believe that AVAIL is benefiting from strong data center and electric power demand.

Strong nonbuilding starts. Metal Coatings demand is correlated to nonbuilding construction activity, which includes electrical T&D, power plants, bridges, highways, and water, we believe. According to Dodge, nonbuilding starts increased 16% in 2023, to a record \$297B (see **Figure 1** on page 2). This follows a 24% increase in 2022. Nonbuilding starts are up 21% YTD through February 2024.

Housing leading indicators are strengthening. Residential construction is a top end market for Precoat Metals (at least 15% of segment sales, we believe). In February 2024, single-family housing starts increased 35% yr/yr and permits 30% yr/yr (U.S. Census Bureau). Coincident housing indicators are more muted, with housing under construction –6% and housing completed +4% in February. We see Precoat Metals benefiting from single-family strength as FY'25 progresses.

Raising estimates. We are increasing our FY'25 EPS estimate from \$4.49 to \$4.65 (+9% yr/yr) and EBITDA from \$333M to \$338M (+4% yr/yr), primarily to reflect lower interest expense and higher equity income from AVAIL. Note that on March 20, 2024, AZZ repriced its \$980M Term Loan B, reducing the interest rate margin by 50 bps, which will result in annual interest rate savings of ~\$5M.

Introducing FY'26 estimates, raising price target to \$100. We are introducing a FY'26 revenue forecast of \$1.65B (+5% yr/yr), EBITDA of \$356M (+5% yr/yr), and EPS of \$5.07 (+9% yr/yr). At Precoat Metals, we have revenue growth accelerating from +4% in FY'25 to +8% in FY'26, reflecting its new greenfield plant in Missouri. We are increasing our price target from \$75 to \$100, which is based on 10.9x our FY'26 EV/EBITDA forecast and assumes modest multiple expansion.

COMPANY STATISTICS

52-Week Range	\$34.59–\$82.10
Market Capitalization (M)	\$2,383
Average Daily Volume (000s)	149
Debt/Total Cap	52%
Dividend	\$0.68
Shares Outstanding (M) fd	29.3
Estimated 3-yr EPS Growth	13%
Enterprise Value (M)	\$3,355
Float (M)	28.6

FINANCIALS

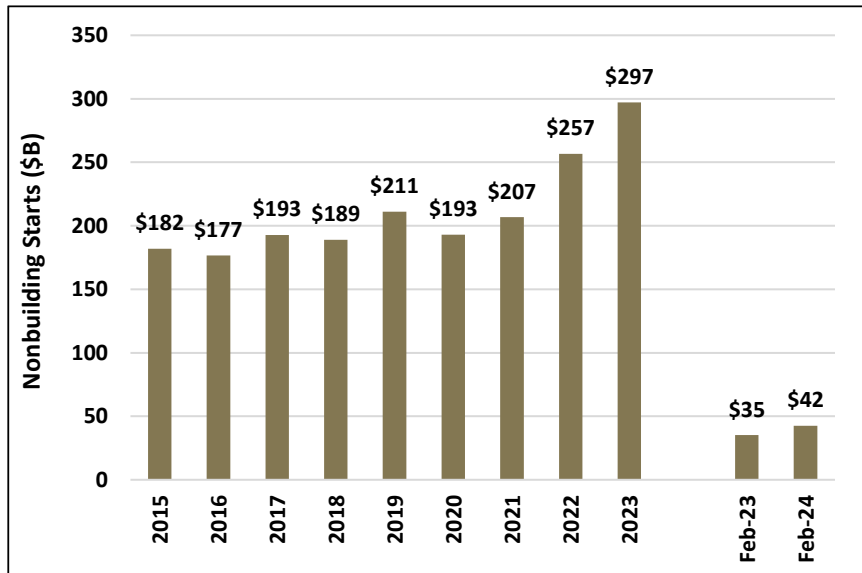
FYE Feb	2023A	2024E	2025E	2026E	
P/E Ratio	23.3x	19.0x	17.5x	16.0x	
EV/EBITDA	12.5x	10.3x	9.9x	9.4x	
Revenue (M)	\$1,324	\$1,524	\$1,570	\$1,650	
Op Inc (M)	\$174	\$224	\$240	\$257	
EBITDA (M)	\$267	\$326	\$338	\$356	
EPS	Q1	\$1.10	\$1.14A	\$1.34	\$1.50
	Q2	\$1.21	\$1.27A	\$1.35	\$1.53
	Q3	\$0.78	\$1.19A	\$1.15	\$1.22
	Q4	\$0.30	\$0.67	\$0.81	\$0.81
Total		\$3.48	\$4.27	\$4.65	\$5.07
Consensus		---	\$4.30	\$4.74	\$5.55

Consensus estimates from FactSet

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Nonbuilding demand should benefit AZZ. Nonbuilding starts reached \$297B last year, up 16% yr/yr, to an all-time high, according to Dodge. While it only represents two months, we would note that nonbuilding starts are also up 21% yr/yr on a year-to-date basis through February 2024. To us, it is notable that after years of operating in a range from \$177B–\$211B, starts surged to nearly \$300B last year. AZZ should operate on a lag to starts. Thus, recent data should benefit the company throughout FY’25, we believe.

Figure 1. Nonbuilding Demand Continues to Strengthen



Source: Dodge Construction Network

Valuation. On an EV/EBITDA basis, AZZ is currently trading at 9.9x our FY’25 EV/EBITDA estimate. Over the past five years, AZZ has traded at 8.5x forward EV/EBITDA, according to Bloomberg. Our \$100 price target is based on 10.9x our FY’26 EV/EBITDA forecast, thus assuming modest multiple expansion. We have long expected AZZ’s multiple to expand when leverage returned to the target range of 2.5x–3.0x. We are nearly at that point.

Risks. Risks to the stock and to the achievement of our price target include macro-economic conditions, operational inefficiencies, and higher input costs. Historically, AZZ’s metal coatings business has proven somewhat recession resistant; however, Precoat is more prone to economic downturns, in our view. Management expects to pay down some debt in Q4’24; however, this is a seasonally weaker quarter, which could make it more challenging for the company to reduce leverage.

AZZ Inc.
Earnings Model

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(\$ millions)	2024E					2025E					2026E				
	May	Aug	Nov	Feb	Feb	May	Aug	Nov	Feb	Feb	May	Aug	Nov	Feb	Feb
	Q1A	Q2A	Q3A	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Sales	\$390.9	\$398.5	\$381.6	\$352.5	\$1,523.5	\$402.5	\$407.5	\$395.0	\$365.0	\$1,570.0	\$432.5	\$435.0	\$407.5	\$375.0	\$1,650.0
Cost of sales	293.9	301.3	293.5	275.8	1,164.4	299.3	304.1	300.3	284.1	1,187.7	320.5	322.9	308.5	291.2	1,243.2
Gross profit	97.0	97.2	88.1	76.7	359.1	103.2	103.5	94.7	80.9	382.3	112.0	112.1	99.0	83.8	406.9
SG&A	31.5	36.2	35.3	32.1	135.2	36.3	36.0	35.0	34.8	142.0	38.6	37.7	36.6	37.3	150.2
Restructuring & other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Operating income	65.5	61.0	52.8	44.6	224.0	67.0	67.5	59.6	46.2	240.2	73.4	74.4	62.5	46.5	256.7
Interest expense, net	28.7	27.8	25.9	25.6	107.9	25.0	24.8	24.5	24.3	98.5	24.0	23.8	23.5	23.3	94.5
Earnings of unconsolidated subs	(1.4)	(1.0)	(8.7)	(1.0)	(12.1)	(3.8)	(3.8)	(3.8)	(3.8)	(15.0)	(3.0)	(3.0)	(3.0)	(3.0)	(12.0)
Other income, net	0.0	(0.1)	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Pre-Tax income	38.2	34.3	35.7	20.0	128.2	45.7	46.5	38.9	25.7	156.7	52.4	53.6	42.0	26.2	174.2
Income taxes	9.7	6.0	8.8	4.8	29.2	11.0	11.2	9.3	6.2	37.6	12.6	12.9	10.1	6.3	41.8
Net income (cont. ops.)	28.5	28.3	26.9	15.2	99.0	34.7	35.3	29.6	19.5	119.1	39.8	40.8	31.9	19.9	132.4
Income from disc. ops.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Loss on disposal of disc. ops.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net income (disc. ops.)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net income (loss)	28.5	28.3	26.9	15.2	99.0	34.7	35.3	29.6	19.5	119.1	39.8	40.8	31.9	19.9	132.4
Accrued dividends, preferreds	(3.6)	(3.6)	(3.6)	(3.6)	(14.4)	(3.6)	(3.6)	(3.6)	(3.6)	(14.4)	(3.6)	(3.6)	(3.6)	(3.6)	(14.4)
Net income to common	24.9	24.7	23.3	11.6	84.6	31.1	31.7	26.0	15.9	104.7	36.2	37.2	28.3	16.3	118.0
EPS (cont. ops.)	\$0.98	\$0.97	\$0.92	\$0.52	\$3.39	\$1.19	\$1.21	\$1.01	\$0.67	\$4.08	\$1.36	\$1.40	\$1.09	\$0.68	\$4.53
Shares outstanding (diluted)	29.2	29.2	29.3	29.2	29.2	29.2	29.2	29.2	29.2	29.2	29.2	29.2	29.2	29.2	
Transaction related expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Amortization of intangible assets	6.4	5.9	5.9	5.8	23.9	5.7	5.6	5.5	5.4	22.1	5.3	5.2	5.1	5.0	
Acquisition related D&A	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other	0.0	5.8	4.5	0.0	10.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Income tax impact of adjustments	(1.5)	(2.8)	(2.5)	(1.4)	(8.2)	(1.4)	(1.3)	(1.3)	(1.3)	(5.3)	(1.3)	(1.2)	(1.2)	(1.2)	
Adjusted net income	33.4	37.2	34.8	19.6	124.9	39.1	39.6	33.7	23.6	135.9	43.8	44.7	35.7	23.7	147.9
Adjusted EPS (cont. ops.)	\$1.14	\$1.27	\$1.19	\$0.67	\$4.27	\$1.34	\$1.35	\$1.15	\$0.81	\$4.65	\$1.50	\$1.53	\$1.22	\$0.81	\$5.07
EBIT	66.9	62.1	61.5	45.6	236.1	70.7	71.2	63.4	49.9	255.2	76.4	77.4	65.5	49.5	268.7
D&A	18.5	20.2	20.4	20.3	79.3	20.5	20.5	20.8	20.8	82.5	21.5	21.5	22.0	22.0	87.0
Other adjustments	0.0	5.8	4.5	0.0	10.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Adjusted EBITDA	\$85.4	\$88.0	\$86.4	\$65.9	\$325.6	\$91.2	\$91.7	\$84.1	\$70.7	\$337.7	\$97.9	\$98.9	\$87.5	\$71.5	\$355.7
Percent of sales:															
Gross margin	24.8%	24.4%	23.1%	21.8%	23.6%	25.6%	25.4%	24.0%	22.2%	24.3%	25.9%	25.8%	24.3%	22.3%	24.7%
EBITDA margin	21.8%	22.1%	22.6%	18.7%	21.4%	22.7%	22.5%	21.3%	19.4%	21.5%	22.6%	22.7%	21.5%	19.1%	21.6%
Operating margin	16.8%	15.3%	13.8%	12.7%	14.7%	16.6%	16.6%	15.1%	12.6%	15.3%	17.0%	17.1%	15.3%	12.4%	15.6%
Pre-tax margin	9.8%	8.6%	9.3%	5.7%	8.4%	11.4%	11.4%	9.8%	7.0%	10.0%	12.1%	12.3%	10.3%	7.0%	10.6%
Net margin (cont. ops.)	7.3%	7.1%	7.0%	4.3%	6.5%	8.6%	8.7%	7.5%	5.3%	7.6%	9.2%	9.4%	7.8%	5.3%	8.0%
SG&A as a % of sales	8.1%	9.1%	9.3%	9.1%	8.9%	9.0%	8.8%	8.9%	9.5%	9.0%	8.9%	8.7%	9.0%	10.0%	9.1%
D&A as a % of sales	4.7%	5.1%	5.3%	5.7%	5.2%	5.1%	5.0%	5.3%	5.7%	5.3%	5.0%	4.9%	5.4%	5.9%	
Tax rate	25.3%	17.4%	24.6%	24.0%	22.8%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%
Yr/Yr Change:															
Revenues	88.7%	(2.0%)	2.2%	4.8%	15.1%	3.0%	2.2%	3.5%	3.5%	3.1%	7.5%	6.7%	3.2%	2.7%	5.1%
Gross profit	61.6%	(4.2%)	20.6%	25.2%	21.3%	6.4%	6.4%	7.4%	5.5%	6.4%	8.5%	8.3%	4.6%	3.5%	6.4%
SG&A	(1.9%)	(3.1%)	27.6%	28.0%	10.5%	15.0%	(0.7%)	(0.8%)	8.4%	5.1%	6.4%	4.8%	4.4%	7.4%	5.7%
Adjusted EBITDA	62.6%	(0.8%)	25.3%	15.1%	21.8%	6.8%	4.3%	(2.6%)	7.3%	3.7%	7.3%	7.8%	3.9%	1.1%	5.3%
Operating income	134.7%	(4.9%)	16.4%	23.3%	29.0%	2.2%	10.6%	12.9%	3.4%	7.3%	9.6%	10.2%	4.7%	0.6%	6.8%
Net income	85.8%	12.8%	45.8%	104.9%	49.2%	21.8%	24.7%	9.9%	28.2%	20.4%	14.6%	15.4%	7.9%	2.1%	11.1%
Adjusted EPS	4.3%	5.0%	52.0%	120.2%	22.8%	16.9%	6.4%	(2.6%)	20.3%	8.9%	12.2%	13.0%	6.0%	0.4%	8.9%

Source: Company reports and Thompson Davis & Co. estimates

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Buy: Company/Industry has strong fundamentals, attractive valuation; outperforms the relevant indices in over the next 12–18 months

Hold: Stock is fairly valued; no compelling reason to buy or sell stock today; cautious about prospects over the next 6–12 months for industry or company; neutral performance relative to the relevant indices.

Sell: Fundamentals of industry or company are deteriorating; company not expected to have consistent earnings growth over next 12–18 months or business model is questionable; underperforms the relevant indices in the next 12–18 months.

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Price targets, when established, represent our best estimate of the market price of a stock in 12 months. A 12-month price target is highly subjective and the result of numerous assumptions, including company, industry, and market fundamentals, both on an absolute and relative basis, as well as investor sentiment, which can be highly volatile.

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Thompson Davis & Co., Inc., rating distribution by percentage (as of April 8, 2024):

	#	%
BUY	25	96
SELL	0	0
HOLD	1	4
TOTAL	26	100.0%

Rating and Price Target History for AZZ Inc. (AZZ) as of December 29, 2023

Date	Rating	Price	Target
3/31/2023	Buy	\$38.20	\$60
10/11/2023	Buy	\$48.52	\$65
12/21/2023	Buy	\$54.38	\$75

