



2015 State Of The Industry: Building Products

Executives in the building and construction industry face many strategic questions in 2015. To help them navigate the road ahead, L.E.K. Consulting shares its views on three key areas: 1) the state of the M&A market; 2) key challenges for channels and 3) effects of the hourglass economy on the industry.



What is the State of M&A Market Conditions?

Expectations for strong growth remain favorable within the building products sector causing high transaction multiples (with some transactions approaching or exceeding 12-13x EBITDA for top-performing companies) and continuing to attract quality assets to the M&A market. Though commercial market M&A has lagged residential activity to date, we expect to see it rebound in the coming years. Distribution assets continue to be very hot.

The pace of new (and expensive) capital entering the sector through high-multiple transactions creates a number of questions that executives at incumbent competitors in this industry segment should consider:

- Would you sell at this multiple? If not, how could you create a growth strategy to justify a similarly high multiple for your business in order to boost shareholder value? Failure to create such a strategy would be detrimental to shareholder value.
- How have new capital and ownership coming into the sector affected your business and the industry as a whole? How will this impact investment and capacity, channels, additional consolidation and pricing? How do these disruptions create opportunity for (or pose risk to) your business?



What are the Key Challenges for Channels?

Many building products channels will struggle to add value through the same capabilities as they have employed in the past. For example, as homeowners and contractors increasingly use the Internet to research products, opportunities for channels to uniquely educate and influence customers through traditional means will become more limited.

We believe that the online channel in building products will continue to take channel share (transaction channel share has nearly doubled in the past four years but it still lags the broader consumer receptivity the online channel enjoys). As homeowners and contractors become more web-savvy and gain greater influence over purchasing decisions, many brands have begun taking advantage of social media platforms, product selection and education forums, dealer/contractor locators, visualization and takeoff tools as well as other online resources in an effort to build customer loyalty and create "pull" for their brands. All of these investments compete with many of the traditional sources of added value from distributors.

In addition, competition from newer, more disruptive ecommerce players represents a significant challenge for traditional building products firms. By having customers order directly through online outlets such as AmazonSupply, contractors have not only reduced inventory capital requirements but also spent less time securing products themselves. Notwithstanding the ramp up in web activity, speed and service remain sources of competitive advantage for brick-and-mortar distributors, whose localized inventories are often a better fit for contractors who may not be able to wait several days for product shipments from online retailers.

As a result, manufacturers must look for new ways to engage both homeowners and contractors. Creating greater differentiation that protects and elevates the brand, as well as changing business models to align with customers' needs will define the industry's leaders going forward, while those that choose to commoditize will trail the pack.

Demand in the building and construction industry is now strong. Manufacturers that can develop and position targeted products across key segments of the channel (as well as provide product information and other tools online) will be well-positioned to turn healthy profits and grow market share.



How is the Hourglass Economy Affecting the Industry?

The "hourglass economy" is a macro trend in consumer spending; some economists refer to it as the "hollowing out of the middle," while politicians lament the pressures on the middle class. These same forces are at work in building products. Demand at both the upper and lower ends of the building product spectrum continues to outstrip broader growth in many categories.

Given the steady erosion of the mass middle, some businesses may need to consider new strategies that will be most effective in this effort. Questions should include:

- Is your company's brand properly positioned?
- Is the value proposition of the existing product line suitable for the targeted segment(s)?
- Are the right channels being utilized?
- Do you have the right price points?
- Is there sufficient differentiation between good/better/best within your line up?

Our Building Products Practice

L.E.K. Consulting is renowned as a leading adviser to the diverse building materials and industrial products sector, with more than 3,000 projects completed around the world. L.E.K. understands the fiercely competitive industrial building materials market across the entire life cycle, from commodity materials to specialty building products and construction.

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