Building Products market update

Industry Consulting Team | Q2 2022

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Highlights

- Supply chain pressure and labor shortage continues with no clear end in sight
- Interest rate hikes expected to cool off red hot housing frenzy
- Continued consolidation, the big get bigger
- Strong repair and renovation spend

Figure 4: Housing Market Index (1)

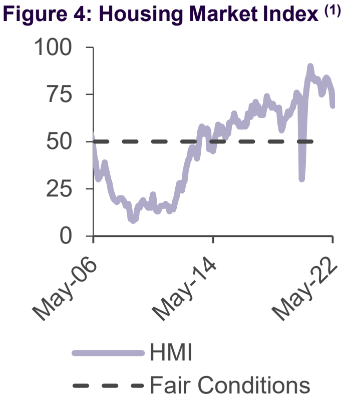
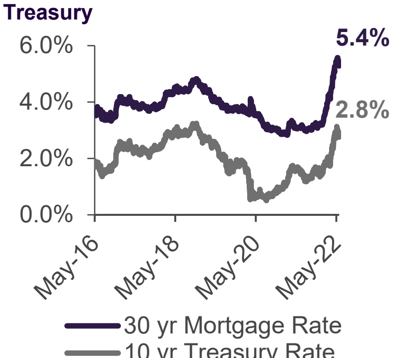


Figure 5: 30 year Mortgage & 10 year Treasury



Inflation Continues: It is no secret that building product prices rose rapidly in the 2nd half of 2021, but many thought the rate of growth would slow into the start of 2022. However, the surge in energy prices triggered yet another round of price increases mostly hitting in late Q1 and Q2 pricing strategies. Energy price increases affect transportation costs right away which companies try to offset by adding or updating their fuel surcharge policy. It takes more time for manufacturers to get the updated price into the marketplace and often takes a quarter to start realizing the changes. This adds pressure to margins, and even some of the largest companies have reigned in margin expectations for YE 2022. The debate still exists on just how much of the price increases can be passed through to the end user. So far spending remains strong indicating demand still outweighs the pricing pressure, but companies remain cautious with forecasts. Raw material prices for building product manufacturers will need to correct before material price decreases can be realized in the market. Softwood lumber has decreased materially over the past few weeks and even steel prices have corrected modestly to pre-Ukraine Russia conflict levels. Other metals, rock, and petro chemical based products such as PVC remain elevated but do have the ability to correct relatively quickly if prices subside.

Figure 1: Inflation

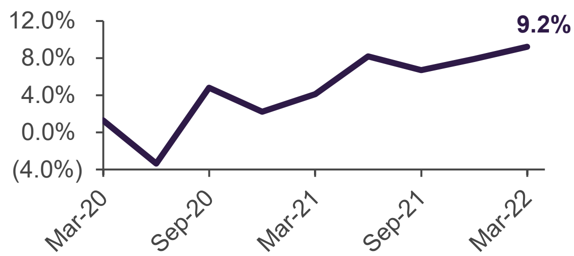
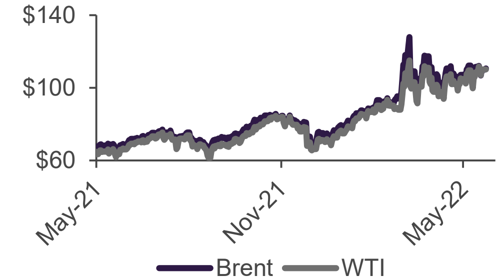
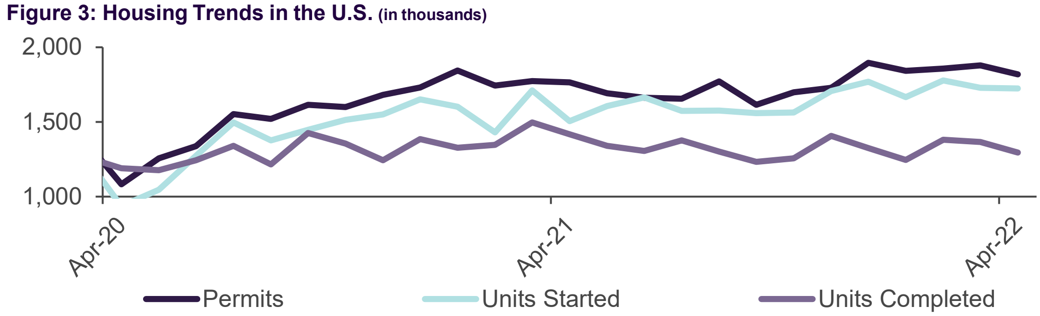


Figure 2: Crude Oil ($ per barrel)



Residential: While mortgage rates have increased, favorable demographics and tight supply have continued to support housing construction. The number of new homes under construction is near peak levels, but is partially inflated due to the elongated build timelines. You can also see this phenomenon in the decrease in completions despite strong starts over the last year. Permits and starts remained strong at 1.82MM and 1.72MM respectively. We expect these to decrease for the June reading, but remain above the long term average of 1.4MM.

Figure 3: Housing Trends in the U.S. (in thousands)



There are many headline concerns around how buyers will deal with higher rates with little to no relief from decreased home values. This reduction in buying power is real and is estimated that a 1% increase in mortgage rates equates to roughly $100K less in buying power. That assumes income remains constant and the buyer is buying an average value home. This will impact first time and affordable home buyers first and potentially secondary home markets as buyers re-prioritize a shrinking amount of disposable income. Homebuilders who serve these markets are already looking for ways to keep their product affordable by tweaking location, size, and quality of finishes where they can. There is also a growing percentage of potential buyers who may not move forward to acquire a new home simply due to the fact they are now rate locked in to their current low rate mortgage. These headwinds should cool off the crazy bidding wars and allow some inventory to re-build to more normal levels later in the year. Ultimately, inventory levels must correct in order to promote the competition needed to see more predictable trends in home values and volume.

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(1) Indices are based on surveys that rate market conditions. An index number of 50 or higher indicates a higher share of participants view conditions as good rather than poor.

Sources: FRED, Bloomberg, IHS Markit, Brent, WTI, S&P Capital IQ, NAHB, U.S. Census Bureau, U.S. Dept. of Housing and Urban Development, Bankrate

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Lumber: Random length lumber has a unique story right now since it has experienced significant deflation over the last 9 weeks dropping nearly half in value since the early March high. That's good news for the end users who finally have one line item in the budget that is actually getting cheaper. On the other hand, Q2 performance for lumber related companies will be much different that Q1 which offered near record high prices on a fairly consistent basis. These aggressive price swings make forecasting very challenging. Prices are expected to remain well above the more predictable pre-pandemic levels, but remain volatile inside a new widened range. Per Random Lengths, historical price of random length lumber per thousand BF averaged $385 between 2015-2020 and $781 between March of 2020 and present. The current futures price is $651, indicating there could be more decreases ahead. Best guess, I expect pricing will remain seasonally volatile at an elevated range of $650-950 through the remainder of the year.

Multifamily: Confidence in the market for new multifamily housing turned downward in the first quarter of 2022, according to results from the Multifamily Market Survey released by the National Association of Home Builders. "The decline in the MPI indicates incipient caution on the part of multifamily developers, " said NAHB chief economist Robert Dietz. "This caution has not shown up yet in the multifamily starts rate, which remains quite strong, but the MPI typically leads changes in starts by one to three quarters."

Repair and Remodel: Renovation activity and spending are at a four year high, general contractors are in great demand, and homeowners continue to hire pro help at a high rate. Planned renovations spending has increased year over year for the first time since 2018, and recent homebuyers spent nearly double the national median spend (Source The 2022 Houzz and Home Study).

Figure 6: Random Length Lumber ($ per thousand board ft.)

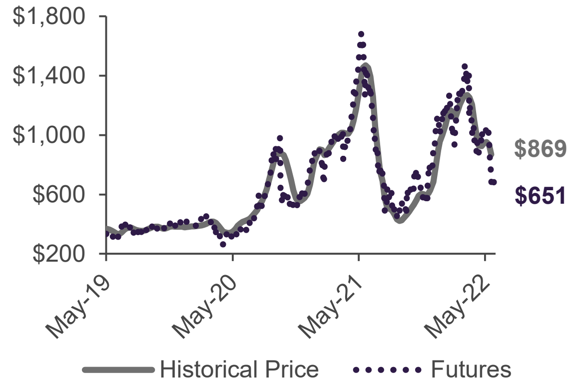


Figure 7: Remodeling Market Index (1)

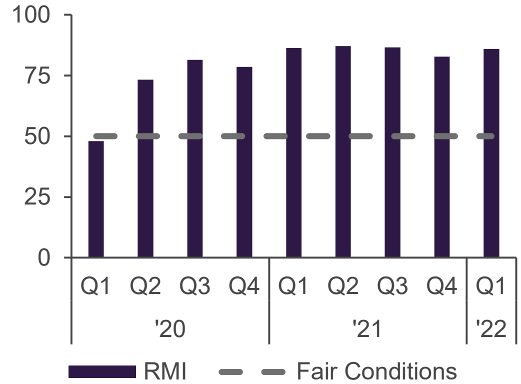
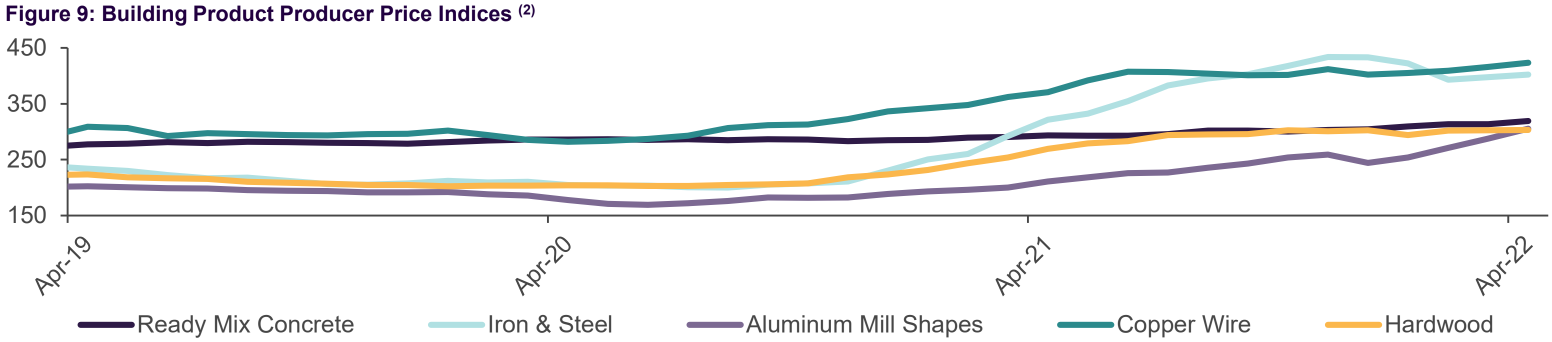


Figure 8: Recession Indicators

Select Indicators	Recession Condition Flag	Current Status
Yield Curve (3M/10Yr Treasuries)	Inversion (3-month yield greater than 10-year)	
Intermediate Yield Curve (2/10Yr)	Inversion (2-year yield greater than 10-year)	
Change in Fed Funds Rate	Year-over-year increase with a 12-month lag	
ISM Manufacturing Index	Activity contracts for 3 months in a row	
New Building Permits	Year-over-year declines greater than 9% for 3 months	
Leading Economic Indicators	Declines four consecutive months	
Unemployment Rate	Increases for 3 months in a row	
Weekly Jobless Claims	Year-over-year increase greater than 20%	
Crude Oil	Year-over-year increase greater than 50%	

Figure 9: Building Product Producer Price Indices (2)



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(2) PPI is used as an economic indicator. PPI's have an index base set at 100 for the month prior to the month that the index was introduced. Price changes are measured in relation to that figure. An index level of 110, for example, means there has been a 10% increase in prices since the base period.

Sources: Bloomberg, Random Lengths, Chicago Mercantile Exchange, NAHB, Truist Securities, U.S. Census Bureau, Bureau of Labor Statistics