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BIA Executive Insights

Analysis, strategy, and insights for decision makers in the building products industry.

September 2020

When a Share-the-Wealth Deal Makes Sense, Don't Fret About Timing the Market

By Michael Collins, Managing Director, BIA

One of the most common—and strongest—reactions that I heard on news of **BMC's** merger with **Builders FirstSource** (BFS) was surprise. It appears very few people were aware that talks about combining were under way, and the occasional rumors that circulated often were dismissed as being too enormous to be believed. Why now?

Upon reflection, I can see why the shock waves were so powerful. That's because what BFS and BMC did was a different class of deal than is often seen, and not just because it's an $11.2 billion combination.

Sellers sometimes want to hand over the keys to the store, take their winnings, and retire or go do something else that is calling to them. However, most deals call for the previous owner to hang around a while, though that's mainly to assure the transition goes smoothly.

The BFS-BMC merger, by contrast, was what you might call a share-the-wealth deal. It's one in which the people who helped make their company valuable are teaming up with other smart investors to achieve more equity than each could achieve on their own—or, at the least, generate profits without many of the anxieties that come with total ownership.

There also are cases in which the seller gets a payoff and then invests in the new owner's company. With BFS and BMC, it's an all-stock transaction, so the only payoff is in the form of stock in the new venture. You could say that both parties truly see this as a merger, not a roll-up. The only person walking away afterward is BFS CEO Chad Crow, and plans for his departure had been announced long ago.

Both sets of principal shareholders at BFS and BMC intend to stay invested in construction supply. They view this combination as a great way to increase market share, generate higher EBITDA margins, and take advantage of construction trends that favored the investments they've already been making in trusses, components, and value-added products.

Many investors will tell you they like share-the-wealth deals because it means the seller keeps skin in the game and, thus, will work hard to make the transaction succeed. There's also less concern about exactly when to pull the trigger, because the payoff occurs over time.

If you want to sell and walk away, it makes sense to time the transaction so that your property looks as attractive as possible. Of course, some buyers seek companies with bargain valuations. That's all part of the game. But if you have different objectives—if you could see yourself remaining and helping continue to make your operation prosper—then timing shouldn't be as much a factor in your decision as is the quality and character of the people that want to deal with you.

Whichever way you prefer to go, the current environment remains very conducive to selling a lumber operation.

Is there something that you would like to see covered in a future issue of BIA Executive Insights? Write to us with your request.

Increasing Number of Dealers Are Taking Pains to Explain Lumber Prices and Supply

By Craig Webb, President, Webb Analytics

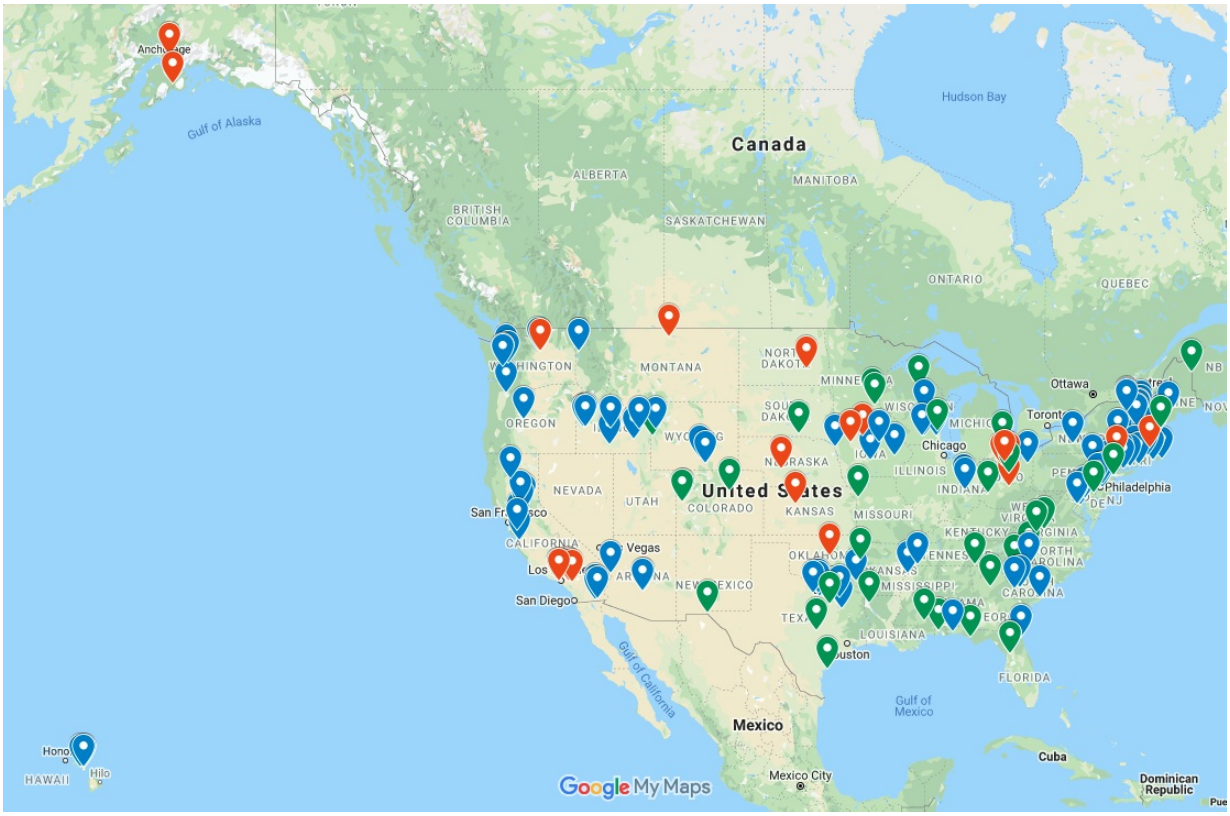
I have been impressed lately with the number of dealers from around the country who have emailed their customers to explain why lumber prices have risen so sharply this year. If you have yet to do so, I recommend you do the same.

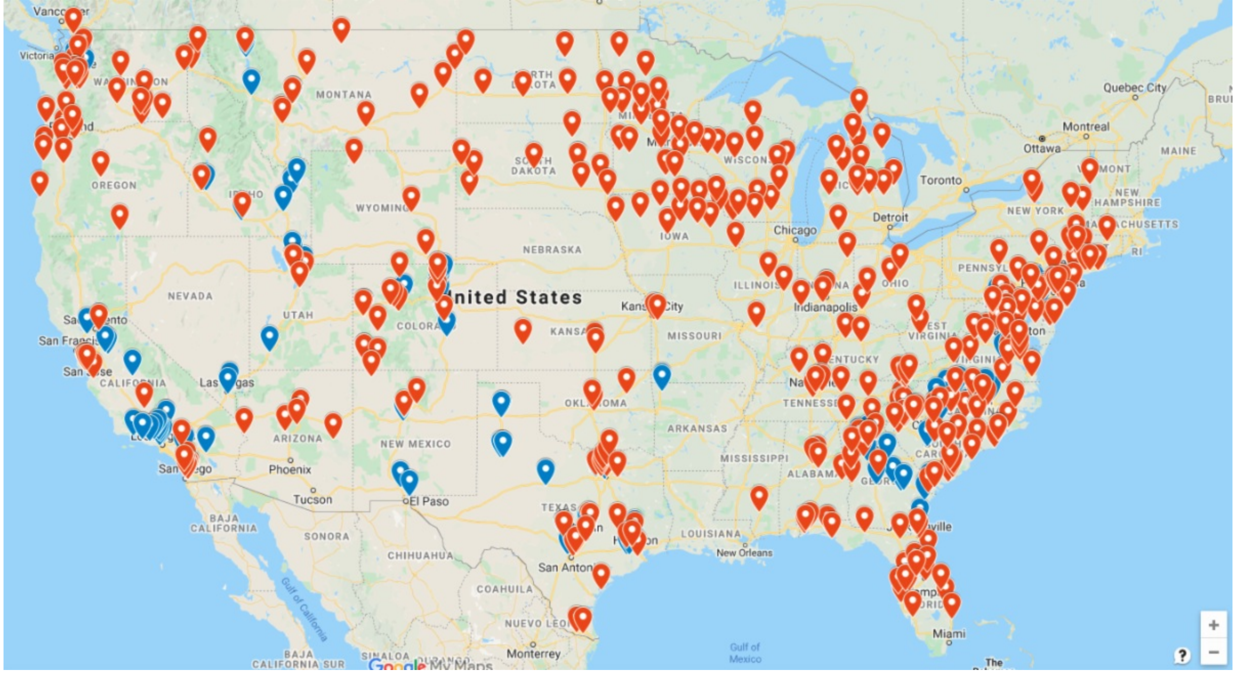
I have met a lot of very smart people in the LBM business who are shocked by the surge in sales this year at the same time COVID was shutting down big parts of the economy. The close attention you pay to supply and demand have helped you keep track of the unusual factors that have produced a head-snapping rise in prices. But your customers typically aren't anywhere near as attentive. Alarm bells sounded by groups like the National Association of Home Builders end up providing an alert but not an education. It's a situation that demands subtlety, empathy, and consistency from your operation. In such a case, an open letter can be the best way to respond.

Take **Hayward Lumber**. President Marc Mizgorski's Aug. 18 e-mail took care to recognize customers' concerns about both availability and prices. While Mizgorski didn't try to make promises he might not be able to keep, he did have a suggestion: "We are managing inventory levels carefully, but we also don't have endless quantities on hand," he wrote. "… We have rail cars and trucks of commodity lumber moving building materials towards our seven locations in California, but be patient as there may be spots where we are short on a particular dimension or panel. At times there may be a late truck, and we apologize for any delays. Our procurement team is working very closely with our suppliers, and they are communicating with them throughout the day for the most up to date information."

Mizgorski also made a request of customers: Stay in touch. "Make your product decisions early and place your orders with plenty of lead times," he wrote.

Paul Rogers of **Shepley Wood Products** took a similar approach. "Rational thinkers know that no situation in our market is static for long and crises soon pass," he wrote. "For our part, our best defense to protect you from such volatility is to understand and buy against your needs and temper the price fluctuations through contract purchasing and average-costing."





With the BFS-BMC Merger Under Way, It Now Takes Two Maps to Track LBM Deals

This issue's report on openings, closures, and acquisitions requires an awfully big asterisk. The map at top shows the 193 locations that have seen a change through mid-September; deals are marked by blue pins, greenfield openings by green pins, and closures by red. That's a lot of action, though it's still 33% less than what we saw over the same period last year.

But that upper map excludes the impact of last week's announcement that **Builders FirstSource** (BFS) will merge with **BMC Stock Holdings**. That deal will take approximately 160 BMC branches (blue pins on the lower map) and give them BFS names.

How long some of those branches will last after the deal closes is up for debate. Executives from both companies have said they expect some branches from both sides to be shuttered, mainly in markets where there are both BFS and BMC locations. Area dealers and outside investors are expected to watch those actions closely in hopes of acquiring a ready-built lumberyard that the new BFS no longer needs.

So far this year, there have been 132 LBM locations involved in deals, 39 greenfield openings and 22 closures. As often is the case, **SRS Distribution** led the way in August and early September. Its **Heritage Landscape Supply Group** kept growing, this time buying **Silver Creek Supply**, a landscaping/irrigation firm with seven branches in Idaho and one in Wyoming. Heritage also opened another of its retail-oriented outlets, **HLS Outdoor**, in Eagan, MN.

In Hawaii, **HPM Building Supply** bought **Miyake Concrete**, a four-unit operation on the island of Maui. The stores will be renamed Miyake-HPM Building Supply. It's the first major deal in the Aloha State since a Canadian company bought **Honsador Group** in 2017.

Kodiak Building Partners virtually doubled its employee count in one deal by acquiring **Carpenter Contractors of America** (CCA), a truss/components specialist. (More on this below.) In addition, two of Kodiak's units opened greenfield operations. **Freedom Materials** launched a new operation called **Freedom Acoustics**. It's in Newark, DE. And,Kodiak joined with its **Jenkins Lumber and Hardware** operation to create **Jenkins Drywall and Insulation** in Etna, WY.

US LBM was triply busy. First, it purchased **Maner Builders Supply**, with operations in North Charleston and Aiken, SC, and Augusta, GA. Later in the month, its **Universal Supply** unit opened a branch in Newark, NJ, while **Hines Supply** opened a new branch in West Chicago.

Elsewhere …

- **L&W Supply**, the drywall division of ABC Supply, bought **Drywall Supply Inc.**, a three-unit operation based in Colorado.
- **Foundation Building Materials** bought Marriott Drywall of Waukesha, WI.
- **84 Lumber** officially opened a truss plant in Mansfield, OH.
- **Porters Building Centers** in Smithville, MO, closed.
- **Burke (SD) Building Center** reopened in a new location after its previous location was destroyed in 2019 by a tornado.

Why Kodiak Buying CCA Makes Sense Today

Like the merger of**BMC** with **Builders FirstSource**, **Kodiak Building Partners'** recently announced acquisition of **Carpenter Contractors of America** (CCA) show the vibrancy of M&A activity in the LBM segment today.

CCA provides lumber components like

trusses and wall panels, and also provides field installation services. It has four facilities in Florida and one each in Illinois and North Carolina. CCA employs about 2,000 people, which is close to the combined number of workers at Kodiak's 83 current locations.

The CCA acquisition makes particularly good sense at a time like this. Builders increasingly favor methods of utilizing components onsite that have been manufactured offsite. When you throw in CCA's ability to install these components for customers, it becomes the right idea at exactly the right time. Suppliers that can help customers divert labor costs from the field to an offsite factory stand to perform very well in the next five to 10 years.

Most buyers in the building industry have come through the pandemic flush with cash and with their lending relationships intact. Participants along the entire length of the supply chain, from builders and contractors through to distributors and manufacturers, are limited only by the supply of material and labors in their current growth plans. Companies like CCA address that need.

Interest on the part of buyers to expand their geographic territories and product offerings has helped maintain the pace of acquisitions, despite the pandemic. Sellers, for their part, always respond in markets when inquiries by buyers increase in tempo.

Wayne Rivers' Seven Ways to Discover Whether You Have 'Transferable Value'

Over the past 31 years, Wayne Rivers of the Family Business Institute says he has visited with thousands of construction leaders. A few are great, he says, but plenty of others “struggle along putting out a different kind of fire each day with little idea where they’ll be in two or three years.” That daily grind holds out little promise for what he calls *transferable value*: What a business is worth to someone else without the original owner.

Put differently, transferable value is determined by how well your business runs without you, Rivers says. It’s a key factor when potential buyers size you up. Rivers suggests you look in particular at these seven criteria:

1. Customers loyal to the company, not just to the owner.
2. Standard operating procedures (SOPs).
3. A unique niche in business that is resistant to commoditization.
4. Predictable, recurring revenue.
5. A proven plan for growth and profitability.
6. Loyal, motivated employees that will stay with the company and the new owner after the previous one departs.
7. A super-talented management team.

How do you rate? Rivers suggests this test: Take a four-week vacation. “If you break out in a cold sweat at the mere thought of being away from your company for a month, that tells you that your business probably lacks transferable value,” Rivers says. “If, on the other hand, you can take a four-week vacation, and your team runs the company seamlessly, that's a great sign! You're well on your way to establishing transferable value.”

GMS Earnings Add Hopeful Insights Into COVID's Impact on Construction

GMS
GYPSUM MANAGEMENT & SUPPLY, INC.®

One advantage of **GMS** following a fiscal calendar that begins every May is that its quarterly reports go one month further than do peers like **BMC, Beacon, Foundation Building Materials,** and **BFS**. These days, that’s particularly useful..

While we only know the others’ performance through June, GMS’ fiscal first quarter takes us through July and, thus, provides a deeper view into the pandemic. In addition, GMS gets about 55% of its revenue from commercial projects and the other 45% from residential builders. This means it can provide insights into two different worlds.

What can we learn? First, GMS' says sales of wallboard decreased 4.0% from the year-earlier quarter, while sales of ceiling products decreased 11.9% and sales of steel framing sank 16.2%. Lower volumes were to blame for all three, but while wallboard prices fell from a year earlier, the prices for ceiling and steel goods increased.

"Commercial construction … remained relatively more challenged than the residential market during the quarter," GMS said in a news release issued Sept. 3. That same day, VP and CFO Scott Deakin noted to analysts that commercial construction faces a "relatively more challenged demand environment" than residential.

"Residential, while still down year over year, continued to improve during quarter and into August." Deakin continued. Added President and CEO John Turner regarding residential sales: "Now we're maybe getting almost flat on a year to year basis. I mean, it's hard to imagine that trend isn't going to continue and eventually flip to positive with the starts numbers that we've seen."

"We believe Q2 could be the bottom as a direct result of that recovery in residential," Turner continued later. "For us, I hope most of the commercial forecasts are showing down 8, 9, 10 [percent] for the year, some of them in low-double digits, some of them at 5. So it's kind of all over the board, but you get that consensus into that 8, 9. I think we're kind of in the heart of it, in that regard. But I do think, if you look at the July numbers, if the July starts numbers were to repeat, and then in August, and then in September, we start seeing those kinds of numbers. Then our Q3 and our Q4 will be much better than otherwise, that's for sure."

We Can Answer Your Most Pressing M&A Questions

*** How do the most active buyers in today's market value my company?**
*** What parts of the business should I change to improve its valuation?**
*** When is the right time to sell?**

These are questions that are commonly asked by the owners of building products manufacturers and distributors. Our work in selling and raising

capital for companies puts us in a unique position to help answer these important questions. Regardless of when you might decide to approach the market, please contact me to have a confidential discussion about your company and ways to maximize its value for the owners.

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