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# BIA Executive Insights

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

March 2021



**How Does Inflation Affect an M&A Deal? Here's a Refresher Course You Might Need ... Someday**

By Michael Collins, Managing Director, BIA

The Sony Walkman. Big hair and bigger shoulder pads. Lines at gas stations. To these mementos of the early 1980s you can add one more: rampant inflation. For Baby Boomers, the scars they feel from the days of 18% mortgage rates remain so painful that it's easy to see why some gray-haired politicians and financiers have shown alarm



at the possibility the U.S. economy will overheat as it emerges from the pandemic.

Skyrocketing prices for lumber and many other building materials combine with worries about the impact of the \$1.9 trillion stimulus package to make even a minor uptick in the 10-year bond rate cause for concern.

Fed Chairman Jerome Powell and Treasury Secretary Janet Yellen concede we might see consumer costs rise a bit this year, but they maintain any signs of bigger increases can be controlled without harming the economy. Indeed, only 12% of the respondents to a recent National Association of Business Economist survey predicted the Fed will raise the federal funds target rate this year, while 46% predicted no increase until 2022 and 28% expected it wouldn't happen until 2023. And while mortgage rates have cracked the 3% mark, they remain far below the norm that we've seen this past decade--and nothing like the 1980s. The chart below shows how far down the rates have come.



Despite all of this, whispers of worry linger. So--as mainly an academic exercise now that could be useful to know later--let's look at how inflation can influence a merger or acquisition.

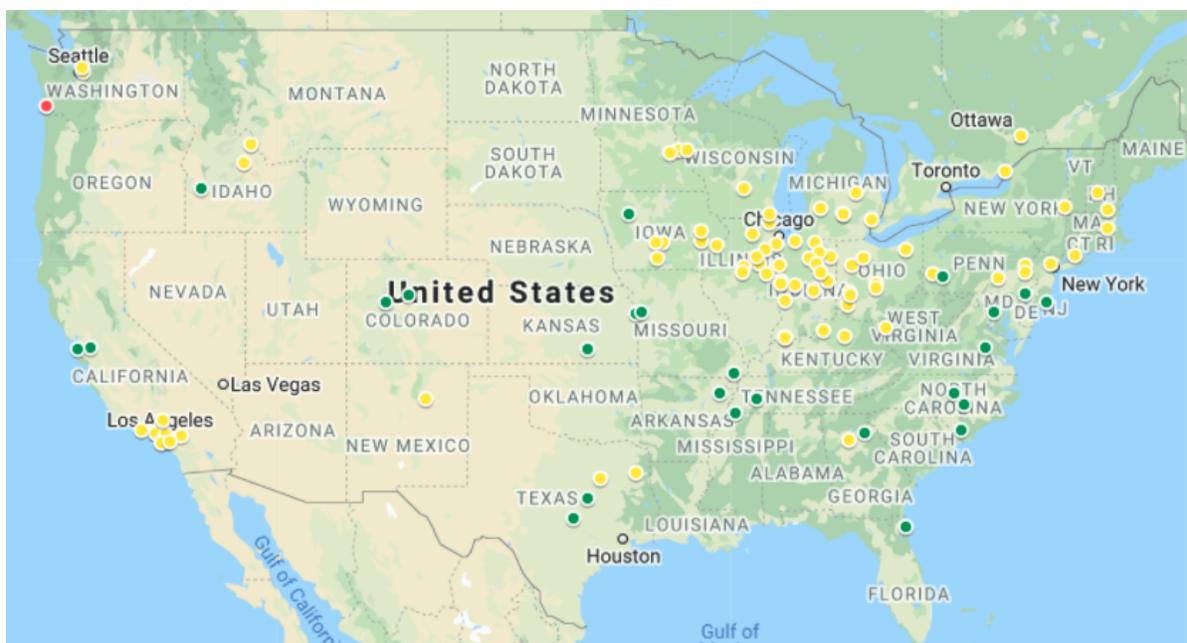
First, keep in mind that the price paid for a dealer typically is based on the value today of the future profits the buyer can expect to receive from the acquired company. Unforeseen inflation reduces the real (i.e. inflation-adjusted) value of future dollars taken in.

This means that buyers who expect inflation will return could seek to trim what they're willing to put in because they anticipate the ultimate payout won't be as good as it would be in a non-inflationary scenario. To counter that, you'll need to show your rate of profit growth will outpace the rate of inflation. You might choose to provide data in terms of units sold as well as the dollar value, as that takes inflation out of the picture. This can also come into play when buyers try to ascertain the impact of commodity price inflation over the past year.

Inflation also could affect a deal because of the way a Fed increase in borrowing costs ultimately would influence mortgage rates. Those more expensive mortgages presumably would tamp demand for homes and thus lead to slower business for dealers. However, consumers' desire for housing today is so strong that, according to a recent Evercore/ISI survey of major builders, most builders think 30-year mortgage rates would have to rise to at least 3.8% and perhaps even 4.25% before they would affect demand. We haven't seen such rates in a couple of years. Evercore also believes new-home prices could go up another 20% and demand still would be as strong as it is today.

In addition, studies indicate that lots of people are using much of their stimulus payments to reduce debt and boost their savings accounts. As a result, analysts believe more people are in shape today to make bigger down payments, thus reducing monthly costs and making a mortgage affordable even if mortgage rates rise.

From all of this you can conclude that inflation matters in deals mainly when the inflation rate is high and the duration of the inflationary period is long-term. We're not at that point yet--indeed, we're only at the point where people are getting nervous about what *might* happen. That nervousness might show up in deal discussions you're having, but it shouldn't derail the sale process.



## Midwest Giant R.P. Lumber Revives Stock+Field Farm-Ranch Franchise Out of Chapter 11

By Craig Webb, president, Webb Analytics

One of my fondest LBM memories came when I saw Robert Plummer, president of **R.P. Lumber**, pushing a cart early one morning at a Do it Best market, stocking up and looking for opportunities. His eye is no less sharp today.

On March 19, the 72-branch R.P. Lumber network grew by more than a third when Plummer's R.P. Acquisition subsidiary bought **Stock+Field**, a collection of 25 farm and ranch stores spanning the Great Lakes region from Ohio to Wisconsin. Stock+Field had filed in January for protection from creditors under Chapter 11 of federal bankruptcy law. You can see the impact of R.P.'s purchase through all the yellow dots (signaling deals) on the map above. The green dots are for greenfield openings, while the lone red dot in the Pacific Northwest signifies a closure.

"The team at R.P. Acquisition Corp. recognizes that the loss of these stores would leave a difficult hole to fill in each of their local communities," R.P. Lumber said in a news release.

"With this in mind, they will endeavor to keep the customers, the employees, and their families united as a community, rooted in the heartland." The news release then quoted

Plummer as saying: “Our focus right now is on keeping Stock+Field stores open and serving the many communities they have served for years and, in some instances, decades.”

Plummer's move makes this a rare month in which **SRS Distribution** wasn't responsible for the biggest deal. It's not for lack of trying, though: SRS was responsible for the second-biggest acquisition, taking over the **Louis T. Ollesheimer** chain of 12 roofing stores.

In related news since late February:

- \* **Professional Builders Supply** opened a distribution center in Dunn, NC, to serve customers in counties south of the Raleigh-Durham metro area.
- \* **Your Building Centers** bought **Palmerton (PA) Lumber**.
- \* **Nation's Best Holdings** acquired **Hometown Hardware** of Longview, TX
- \* **Wehrung's Lumber & Home Center** bought **Dries Do it Center** of Macungie, PA.
- \* **Jeremy French** took over **Ennis (TX) Door & Trim**.
- \* **Rocky's Ace Hardware** acquired **Clarke's Hardware** of New London, NH.
- \* **Central Network Retail Group** has opened a slew of Outdoor Supply Hardware stores over the winter. The most recent one began serving customers in Millbrae, CA, on Feb. 22.
- \* **84 Lumber's** latest truss plant opened in Richmond, VA.



## The New Stimulus Checks Could Pave the Way to Even More Investment in New Homes, R&R

The roughly \$420 billion worth of economic stimulus checks now reaching Americans are being touted by the Biden Administration as a lifeline, but for another group of citizens the money has a much different benefit: It could help them unlock the door to a new home. That's good long-term news for both builders and their suppliers.

The Census Bureau [reports](#) that, while only 15.7% of the people who received the first stimulus payment last year used the money to reduce debt, the share rose to about half of all recipients when the second stimulus payment arrived in January.

The impact of those payments can be seen in the chart above, which tracks the total amount of consumer debt--mainly from credit cards--that people owe commercial banks. It shows that, over the 12 months ended March 10, the total amount of consumer debt owed to those banks had fallen by 12.7% to \$747.84 billion. That's roughly \$108.93 billion paid down since the pandemic began. Some of that money went to car loans and other forms of non-revolving credit, the Federal Reserve [reports](#), but even with that shift, the total amount of consumer credit owed declined in 2020 for the first time in at least five years.

People who used stimulus money to pay down debt can expect to be rewarded with higher credit ratings. And if they already had low balances, they might have parked the stimulus money in a savings account. Both factors have led analysts at companies like Evercore/ISI to predict that the stimulus checks will help stimulate the housing market by, in some cases, providing a significant share of the money needed for a down payment.

Economists and analysts look forward to seeing how the current round of payments will be spent. If an even bigger share of the checks get used to pay bills, it could signal that fewer people are being hurt by the pandemic; indeed, the number of Americans struggling to buy food and pay bills dropped roughly 10%, to just over 80 million, between December and late January, Census Bureau surveys indicate. On the other hand, if the percentage of people saving the money and/or paying debt drops, it could be a sign that most of the previous activity came from upper-income people. The fact that roughly 12 million people who have joint family income over \$160,000 WON'T be getting a check this time could contribute to such a decline.

*Is there something that you would like to see covered in a future issue*

of BIA Executive Insights? Write to us with your request.



## Latest JCHS Report Predicts Remodeling Spend Will Rise About 3.3% in 2021

The unexpectedly strong home remodeling market grew by 3.2% in 2020 and is likely to rise another 3.3% this year, the Joint Center for Housing Studies (JCHS) predicted March 25. That means we're on pace to see the 11th consecutive year of expansion for the home improvement industry, JCHS says, but for different reasons than what drove the market in the last decade.

The spending forecast by the Harvard University-based center in its [2021 edition](#) of *Improving America's Housing* takes in improvements and maintenance expenditures by both homeowners and landlords.

2020 differed from previous years in several ways, JCHS found. Previous years saw homeowners relying on professional contractors to do the work, while 2020 was marked by an increase in do-it-yourself projects, as Covid fears kept pros out of homes. Meanwhile, the hotspots for remodeling moved from expensive markets on both coasts to lower-cost metros inland--a trend JCHS attributed to younger households accounting for a greater share of the total spend. Younger people are more likely to do DIY work, and they were more likely to do that work in lower-cost metros because that's where they could afford to buy homes.

Two things didn't change in 2020: The share of homeowner expenditures devoted to repair and replacement (as opposed to renovating a kitchen, for instance) continued to rise, and

ever more money was devoted to outdoor improvements.

In 2021, JCHS sees a continued shift away from expensive metros, spurred by both the search for affordable housing as well as by growth in work-from-home (WFH) opportunities. The center also predicts that projects deferred by the pandemic last year, such as in-house kitchen and bath upgrades, could get commissioned in 2021.

Older and wealthier Americans continued to account for much of the remodeling spend, JCHS said. But it also called attention to the poorest 20% of the population. This group accounts for 10% of national spending on remodeling, and "Their ability to maintain their typically older, more affordable homes is critical not only for their own well-being but also for the preservation of the aging housing stock," the center declared. It suggested that the downsizing of America's commercial real estate needs because of WFH presents an opportunity to convert underutilized buildings into affordable housing.

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