mcollins@buildingia.com

The Recovery Puts on a Rally Cap

Industry Enters the Sixth Inning of its Long Comeback

BY MICHAEL COLLINS

A 50-year veteran of the building products industry recently described the state of the industry's recovery as being in the sixth inning. There is a good deal of evidence to support that assertion.

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Participants in the door and window industry are all too familiar with the way the market behaves during its decline phase. We all wear the battle scars from what happens when the market bounces along the bottom for a few years. Further back in our collective memory, though, is what the market looks like when it still has several years until it peaks. Indeed, we believe the consensus among manufacturers and distributors is that the market feels as if it has two or three more years of good growth before we might hit a soft patch.

Important in that statement is not only the notion of the additional time for growth, but also the fact that it is likely to be a soft patch – not a full, deep recession as was the case in the past. The current market is not characterized by any of the types of activities that led to the housing bubble, such as home buying with no down payment, mortgages with toxic rate resets or similar factors.

Construction Hits a Homer

Returning to the present market, we see things that confirm that there is still a great deal of building activity taking place, tempered by forces that indicate softness in the market. Of concern to the door and window segment are the continued reports of glass shortages across the industry.

Distributors considering adding new window products report that they are placing as much weight on a new supplier's lead times as on the price or quality of the products.

Construction labor is another area where shortages persist. While the absolute level of unfilled construction jobs varies from month to month, there is a persistent worker shortage. The Associated General Contractors of America tracks construction employment by state each month. In March 2016, there were 45 states where construction payrolls rose compared to March 2015. That month, however, there were only 28 states where the number of people on construction payrolls had increased vs. the prior month. By July 2016, the number of states where payrolls grew compared to the same month the prior year had dropped to 39 states, and increases compared to the prior month fell to 23 states.

An Economic Winning Streak

The Federal Reserve's Beige Book always provides a wealth of information regarding the overall market. The July 2016 report was no exception and painted a picture of continuing growth, though it's slower and geographically uneven. The report highlighted modest economic expansion across most Federal Reserve districts. General labor market conditions were stable, with growing employment levels. Consumer spending grew, but at a slower rate than in the last year. Continuing low oil prices left the energy sector in a generally weak state. Manufacturing activity was mixed across the districts, although the future outlook for that sector remained generally positive.

The reporting districts indicated that residential real estate activity had strengthened since the previous period. This supports the notion that there are several years of growth ahead. If we were not headed into a period of continued growth, we would not be seeing things such as glass and labor shortages. Single-family home sales increased overall, with the strongest growth reported in Boston, Cleveland and St. Louis. Importantly, low inventories of unsold homes were reported across districts, further evidence of improving home prices and new construction.

New construction growth was positive across the districts as well, and Cleveland and Kansas City reported particularly strong growth in single-family home building. However, builders in Philadelphia, Richmond, St. Louis and San Francisco reported being hampered by a lack of available home lots on which to build.

Closing with the baseball metaphor with which we began, there are a number of implications of being in the sixth inning. It is a time to catch your breath and make a plan for your next move. It is a time when star players reveal themselves and one group or another can end up ahead.

In short, it is a time to gather your momentum and make a concerted push to capture every opportunity.

Michael Collins is an investment banker and a partner in Building Industry Advisors. He specializes in mergers and acquisitions in the door and window industry.