Building Products Market Update

Industry Consulting Team | Q1 2023

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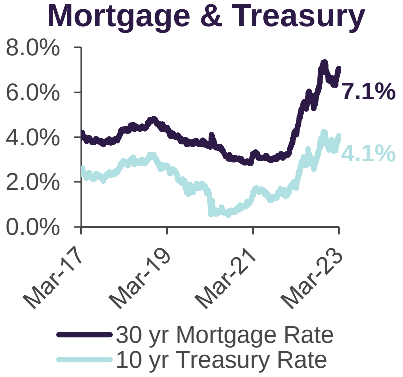
Highlights

- Sticky inflation trends add pressure to keep interest rates higher for longer
- New residential slowdown expected to be roughly halfway through cycle
- Existing home sales remain weak, but rate of decline is bottoming
- Non-residential backlog continues to keep contractors busy through 2023
- Repair & remodel spending to grow modestly in 2023
- Pricing power remains strong for most products and now focus turns to driving volume and managing inventory levels

Mortgage & Treasury



Housing Overview

Housing supply and demand continue to be heavily influenced by conflicting pressures. On one hand, the market is clearly reacting to the Fed's manufactured slow down, evidenced by slowing single-family (SF) starts down 21% in 2H22 and stunted capital markets activity. On the other hand, housing shortages remain, and population trends continue to fuel the number of households entering prime home buying years. To get a complete look at housing demand you also need to account for demolitions and second home ownership. The chart below highlights the strong tailwind of steady household growth with consistent lack of supply to fully meet demand.

Figure 1: Housing Demand & Supply Forecast

Demand Factors	2019	2020	2021	2022	2023E	2024E	2025E
Household Growth	1,620	1,823	1,801	1,881	1,780	1,780	1,780
Plus Demoilitions	200	200	200	200	200	200	200
Vacation/2nd Homes	86	150	200	100	100	100	100
Total Demand	1,906	2,173	2,201	2,181	2,080	2,080	2,080

Steady tailwind

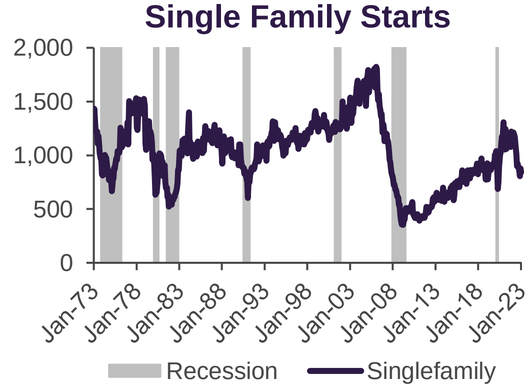
Supply Factors	2019	2020	2021	2022	2023E	2024E	2025E
Single-Family Starts	888	991	1,127	1,010	875	1,000	1,100
Multi-Family Starts	402	389	474	545	509	500	500
Total Housing Starts	1,290	1,380	1,601	1,555	1,384	1,500	1,600
Mobile Homes	95	94	106	115	100	103	105
Total Supply	1,385	1,474	1,707	1,670	1,484	1,603	1,705
Over (Under) production	*(521)*	*(699)*	*(494)*	*(511)*	*(596)*	*(477)*	*(375)*

Consistent shortage

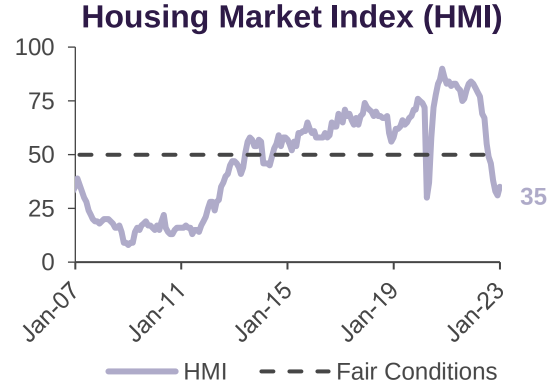
** Forecast by Evercore ISI*

A historic look at housing downturns shows that most cycles run 12-18 months with 20-30% declines in SF starts. The two most dramatic housing cycles were in the late 70's when SF starts fell 51% and during the Great Recession when SF starts fell 74%. While both downturns occurred under dramatically different economic environments, if history holds true, we are approaching halfway through the current downturn. The Housing Market Index finally rebounded from a recent low of 31 recorded in December of 2022 to 42 in February of 2023, another sign that builders believe the environment may have bottomed out.

Single Family Starts



Housing Market Index (HMI)



For the building products community, demand headwinds will remain throughout 2023. This is partially due to the balancing of prior pull forward demand as well as continued slowdown of the economy. Earnings have downside risk over the next two years as pricing power eases back in and volume begins to stabilize. Essentially, the market is trying to return to a more normalized operating environment and cannot run at a red-hot pace forever. We anticipate some easing of enterprise value expectations which should spur M&A opportunities for well capitalized companies looking to grow through a relatively moderate cycle.

TRUIST

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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Multifamily

Strong multifamily (MF) starts over the past few years have led to a huge backlog of units currently under construction. The increased spend in MF has been a nice offset to the decrease in SF spend, but that will begin to shift later this year as starts continue to moderate. Completed units available for rent are starting to hit the market, which are increasing competition and driving down rents. Developers are struggling to get new projects funded due to a mix of cooling cash flow projections, increased interest rates and stubbornly expensive construction costs. The Multifamily Production Index (MPI) is a confidence index commonly used to measure sentiment of MF builders and developers. MPI increased slightly in Q422 to 42, but anything below 50 remains in negative territory. As of January 2023, starts are down 8.1% YOY.

Lumber

The most asked question I've received over the past two years is, "what are lumber prices doing?" Lumber has been on a wild ride since May of 2020, but all signs in 2023 point to a more typical and predictable lumber price environment. The slowdown in new housing units is the main reason, but another contributor is added sawmill capacity with more coming online throughout the year.

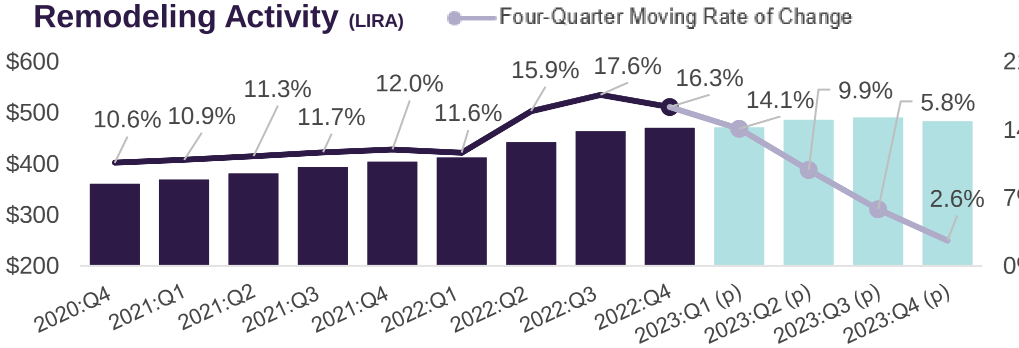
Non-Residential

Commercial and infrastructure spending remain very strong as contractors work through record back logs at record prices. There are signs that commercial expansion will begin to slow in late 2023 and 2024 as interest rates and general economic slowdown effects take hold. Infrastructure spending will be the steadfast strength in this category as funding from the infrastructure bill is just now getting started. The Architectural Billings Index is a forward 9-12 month forecast of non-residential expansion or contraction. January's ABI reading was 49 making the last 4 readings below 50 pointing to contraction later this year.

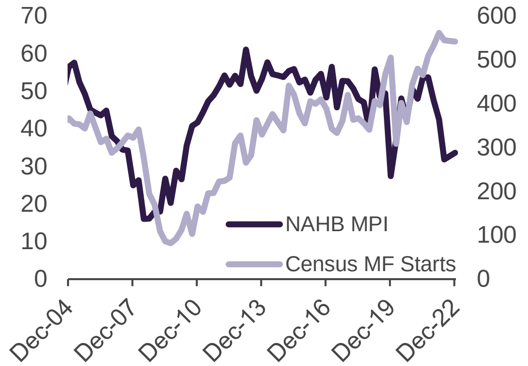
Repair and Remodel (R&R)

Existing homes sales are typically one tool to forecast repair and remodel spend since sellers often make repairs ahead of listing a home and new owners remodel to their preference. Existing home sales continue to decrease sharply so the inclination is that R&R spend will fall off at a similar pace. So far, that has not been the case. The primary reasons are the continuation of people spending more time at home as well as an unwillingness or inability for homeowners to leave their low mortgage rates.

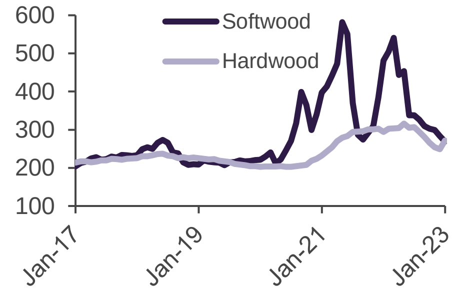
Remodeling Activity (LIRA)



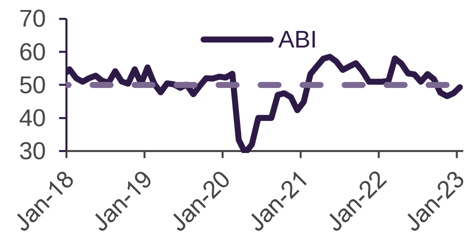
NAHB MPI and MF Starts (1)



Soft & Hardwood Lumber PPI



Architectural Billings Index



2023 International Builder Show Takeaways:

- Recent order trends point to a bottom
- Slowing remodel activity will likely return to more typical seasonal trends
- Composite decking inventories stabilizing and about to sell through
- Mostly stable pricing with a few increases in certain areas. Very little discussion on price decreases, although shrinking volumes will build pressure through 2023
- Strong Insulation pricing, weak flooring pricing
- Consolidation in wallboard, now ABC Supply, Foundation, and GMS control 50% of the market

TRUIST

(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: Chicago Mercantile Exchange, NAHB, Truist Securities, U.S. Census Bureau, Bureau of Labor Statistics, LIRA