

# Building Materials: From the Ground Up

The sector continues to produce distressed properties, although buyers' growing confidence could stabilize valuations

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There's no question that the building products market is in shambles. With an abundant supply of commercial and residential real estate, there seems to be little cheer for companies that rely on housing or new construction. Moody's even pushed back its previous projection for a housing bottom, and now believes that it won't be until the third quarter that the housing market suspends its fall.

Tax credits temporarily breathed some life into the sector, although sales quickly deflated once the credits expired. Additionally, housing starts have still barely lifted from last year's record low of 500,000. On the commercial side, real estate prices are currently 43.2% below their peak in October 2007 and are only 0.9% above the recession low recorded in October 2009 nationwide, according to Moody's.

"Residential construction is near an all-time low," **Bernard Markstein**, a vice president and senior economist for the **National Association of Homebuilders Housing** says, adding that starts have fallen even further year over year.

"Ultimately, there will have to be a correction. The two million-plus new homes that were built in 2005 was just too many, but 500,000 is just too few," Markstein says, citing that the demographics suggest something will give soon. He points to growing families, a population that is living longer, and an expanding immigrant population.

"The nation continues to grow and will need more housing," says Markstein, who estimates that total

housing starts need to be at least 1.6 million annually to keep up with the future demand.

Acquirers are showing cautious optimism as well.

"Multiples are inching up because people are starting to believe the housing market will improve, but good companies, which are struggling, can still be acquired for attractive prices today," says one private equity professional.

In the last week of November, for instance, Ares Management and Freeman Spogli teamed up to acquire Floor & Décor Outlets of America Inc. On its face, one might assume it's a distressed transaction. On the contrary, Floor & Décor has expanded significantly since 2005, and as of last year, was showing sales exceeding \$225 million and gross margins of roughly 40 percent.

Elsewhere, strategics are dipping their toes back in the water. In November, home improvement giant Rona (the "Home Depot" of Canada) expanded its operations by acquiring MPH Supply Limited, a company that specializes in the distribution of plumbing products, operating five branches. The transaction also included the acquisition of Bathrooms Limited. The price tag was undisclosed. The deal was Rona's fifth acquisition of 2010.

To be sure, a number of buyers in the building products segment could be characterized as being opportunistic. Private equity firm BlackEagle Partners made a series of purchases betting on a recovery in the sector. It formed US LBM Holdings in November,

**BUILDING MATERIALS** continued on page 46

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2009, and has since acquired three regional operations from Stock Building Supply. Last February, US LBM added Edward Hines Lumber Co., out of Chicago, onto the platform, and now operates 30 locations in six states.

"We started this platform with the thesis that the housing market will return to normalcy. The median in housing starts was one million for 40 to 50 years. Right now we are at 500,000, which just isn't enough," says **Bryan Tolles**, a vice president with **BlackEagle**. "Overall, revenue is down 25% at US LBM, but the business is still profitable and this is not a quick flip for us."

Thanks to the length of the downturn, some assets are running

out of time. Tolles says he has been shown more than six potential deals in one week and that these companies continue to market themselves aggressively.

**Morty White**, a managing director with **Wynnchurch Capital**, echoes this sentiment.

In July 2009, Wynnchurch Capital acquired Senco Brands out of bankruptcy for \$42 million. According to White, Senco was a good brand that fell victim to the down housing market. The Cincinnati-based company manufactures power tools, nails and fasteners. It had been family operated for 70 years.

While the dealflow is appealing, White is sensing changes to the demand dynamics. He says, "When we acquired Senco there weren't that many competing firms interested in the sector; that is changing." **MA**