



State of the Residential Construction Industry

Perspectives Spanning the Value Chain

BUILDING PRODUCT MANUFACTURERS

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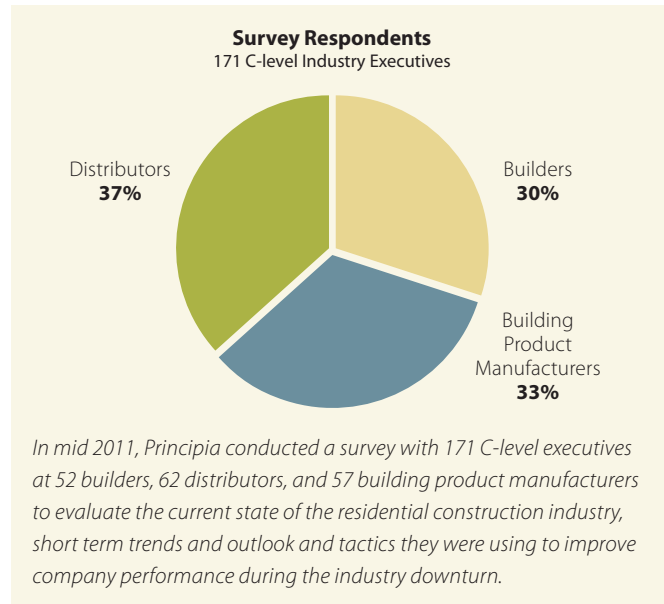
The residential construction industry remains in a state of flux. On one hand, survey respondents see 2011 shaping up to be no worse than 2010. Overall indications are that 1st half of 2011 was slightly below 1st half 2010 and the overall year looks to be flat.

However, all respondents (building product manufacturers, distributors and builders) expect next year to show a slight rebound of around 3% to 5%, which has been the perennial hope of the last few years.

Principia believes that industry executive's sentiment is mirroring consumer confidence, or lack thereof. There have been signs that the economy is stabilizing but lingering fears of a double-dip recession continue to undermine confidence in an imminent strong recovery. We do see pockets of expansion especially in the area of repair and remodeling activity and in the product categories typically associated within this sector.

Interestingly, for each time period surveyed builders were more positive in their outlook than distributors who in turn were more positive than building product manufacturers as shown on the subsequent figures. This is most likely a reflection of the margins achievable at each step of the value chain – with greater margins achievable closer to the property owner.

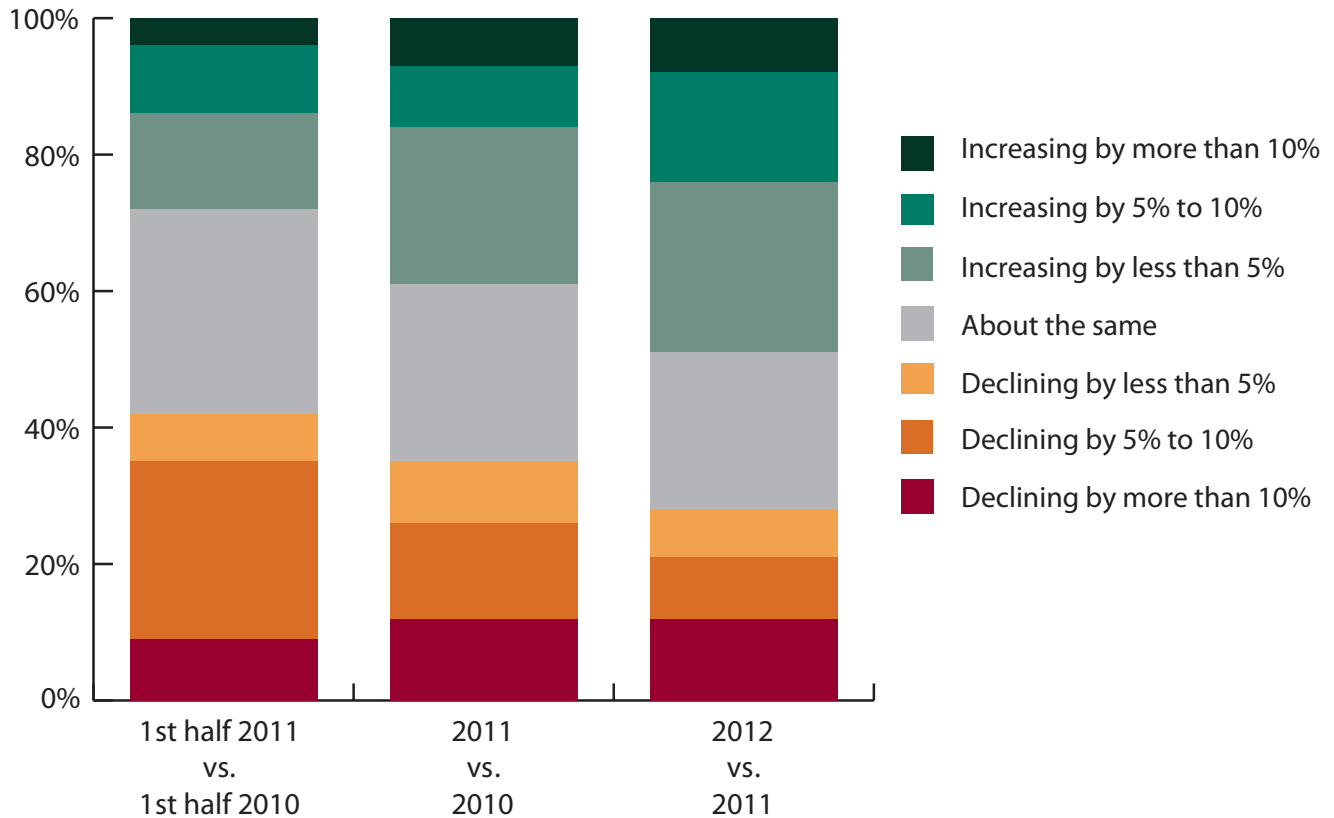
To a large extent, building products companies are looking to similar tactics that they have used in the past to weather the storm. The combination of the top three initiatives that industry participants are using indicate that they will hunker down with efforts focused on customer retention along with evaluations of which customer groups are profitable and which are less profitable. An active customer management program enables building products companies to cultivate the most beneficial relationships and fiscally manage lesser profitable accounts.



On the operation side of the ledger, we see cost efficiency and pricing and margin management as concurrent activities with customer relationship management. Many of our clients either systematically or manually scrutinize every opportunity for the value it may bring to the company. Finally, the fourth factor, increasing share, reflects the fact that in stagnant markets better performing companies are active, not passive.

Identifying where and how to grow business in this environment is critical to success and separates leaders from the rest of the pack.

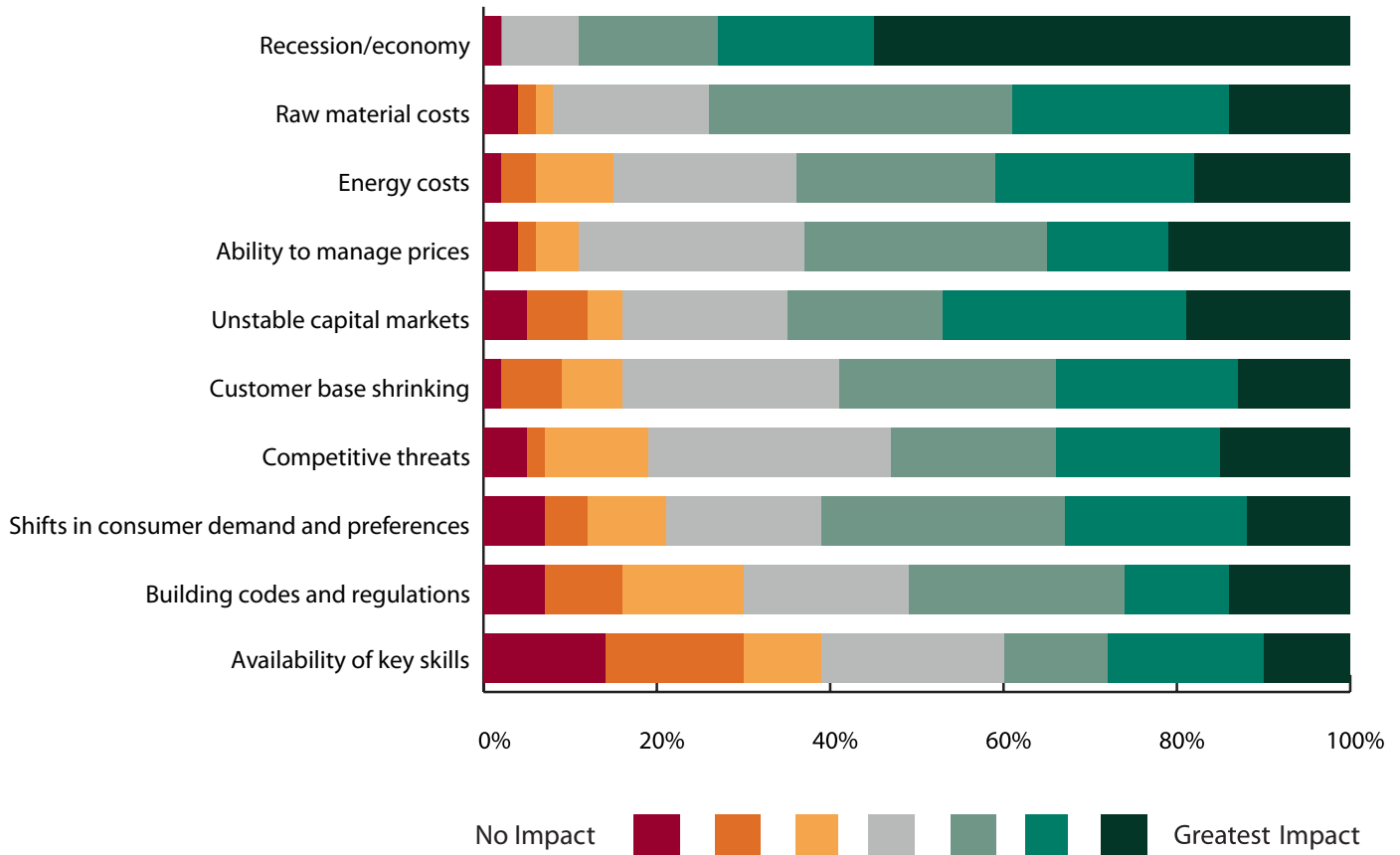
How do you see building products demand changing in the near term?



■ Building products manufacturers were only slightly more positive going forward from the 1st half 2011 expecting modest growth increases for the remainder of this year.

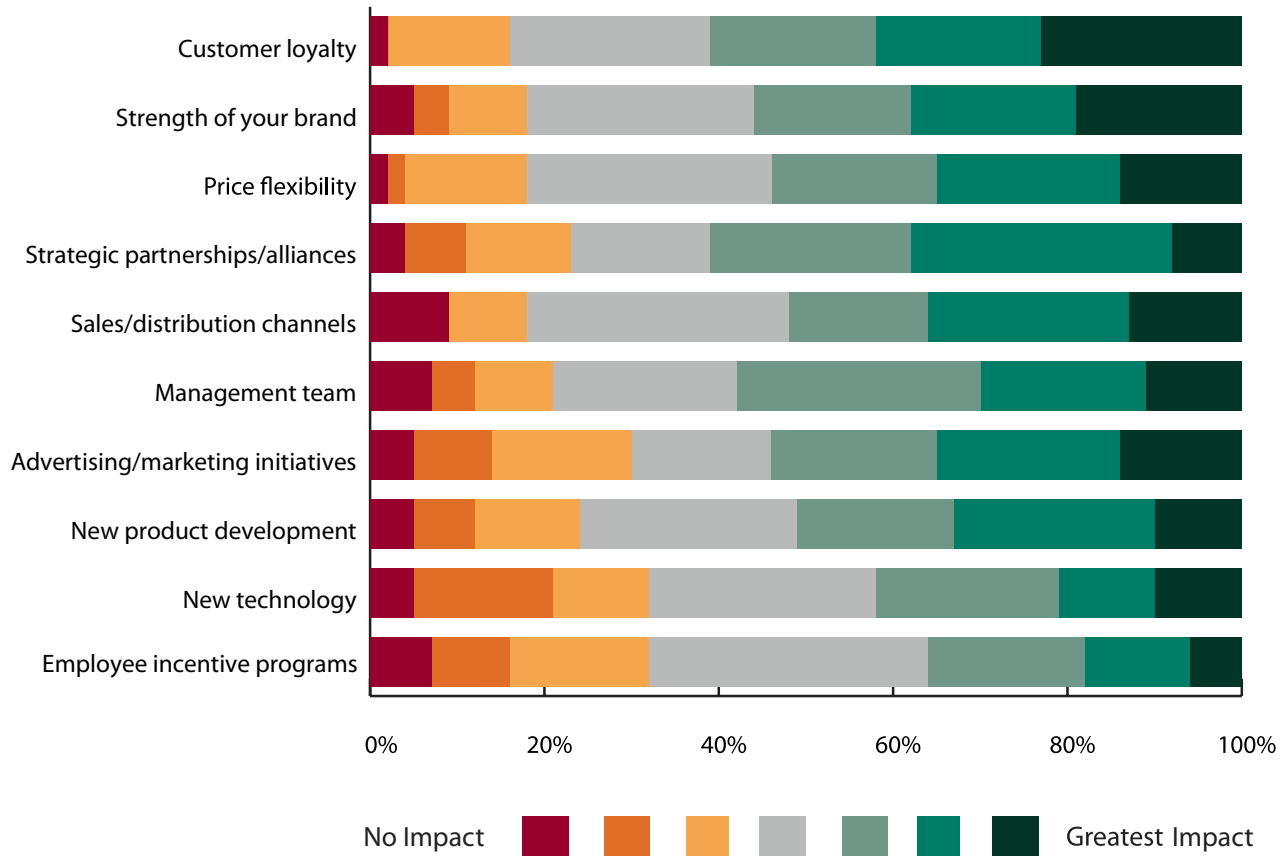
■ However, 70% of building product manufacturers see next year at least as strong as this year and a full 50% see growth of 5% or more next year.

What external factors will have the greatest overall impact on your business growth prospects?



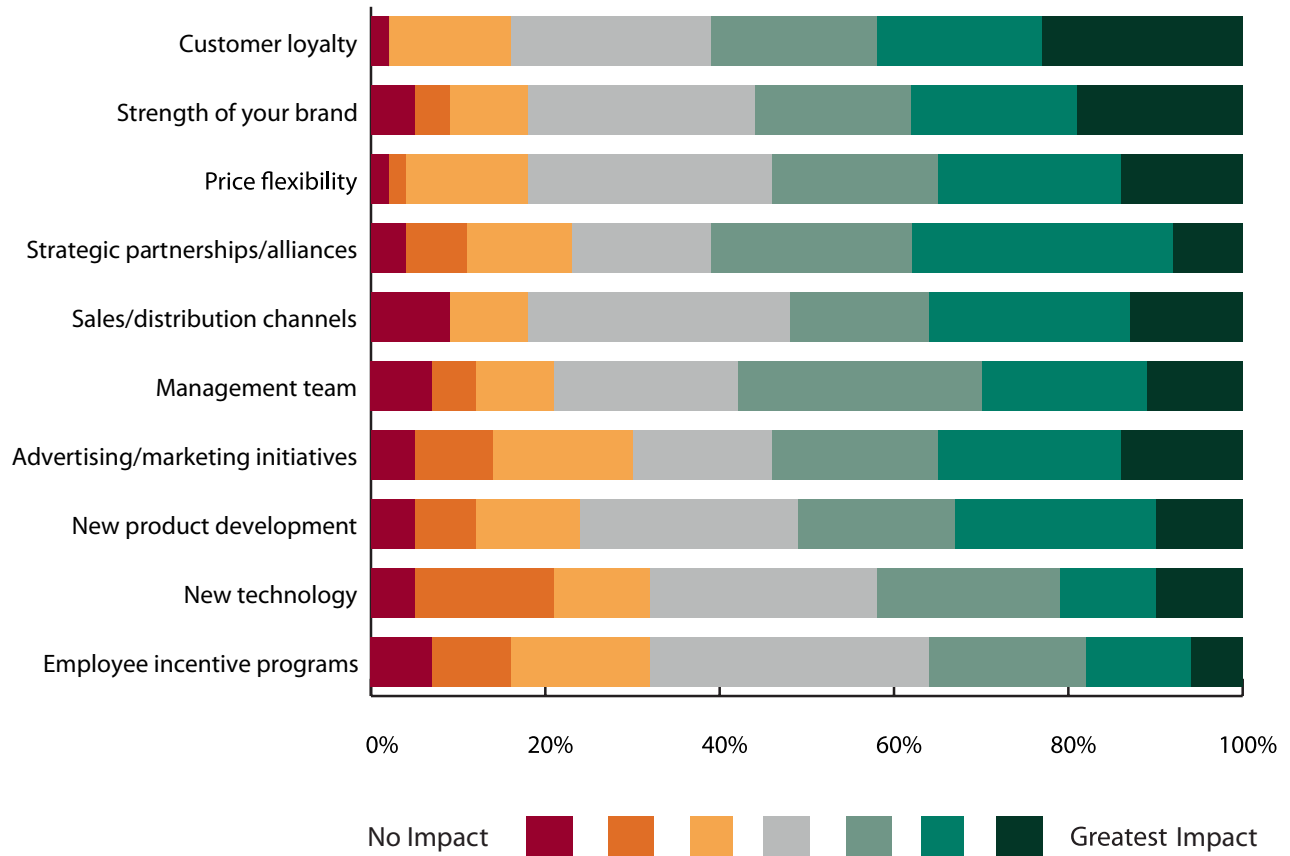
- Over 90% of the building products manufacturers executives indicated that economic uncertainty is the major factor impacting their businesses. Reduced spending in both new construction and repair and remodeling has made the competitive environment extremely tough.
- Manufacturers are more focused than ever on margin management and see raw material and energy costs as key components to overall COGS.
- On the marketing front the ability to hang on to customers in a contracting business as well as the ability to manage prices are the other significant external factors impacting growth.

Which of the following internal factors will affect your company's overall revenue and margin growth in 2011?



- Building products suppliers are relying on their long term customer loyalty to drive revenue and margin growth and count their brand strength as key to short term success.
- However, in a market with ever increasing competition and consolidating supplier base, manufacturers are being flexible in their pricing policy and administration.

Which initiatives will you use to drive revenue and margin growth over the next two years?



- Building product manufacturers will use a balanced approach between internal and external measures to drive shareholder value.
- On the internal side cost efficiency improvement is the leading initiative undertaken. However, this initiative can only drive margin improvements to a certain degree as the most of cost of goods sold is in raw materials.
- Therefore, the most effective building product manufacturers will use a combination of customer management and pricing and margin management. The customer management programs that Principia runs typically entail identifying the drivers of customer value and ensuring that you are pricing to value. In addition, manufacturers must understand their margin contributions at the most granular level – including individual customers, product lines and market segments.
- Externally, suppliers are focused on expanding into new markets and increasing share in current markets nearly equally with new product introductions as effective means to grow.

Conclusion

- The number of homes in housing stock, the age of those homes and overall income of homeowners leads to a more optimistic outlook for repair and remodeling. Tightness of home equity funding and lower home values are mitigating factors however.
- It is expected that remodeling expenditures will focus on upgrades, especially those focused on energy efficiency including windows and doors, insulation, solar panels, and cool roofs.
- Building product manufacturers looking to capitalize on growth segments need to identify which of their current products are best suited to capture share. Further, BPMs need to evaluate what adjustments need to be made to make their value proposition to most appeal to property owners while at the same time maximizing margins by focusing on their most profitable product lines.



About Principia

Principia, founded in 1995, is a marketing consulting firm focused on building materials and chemicals. We help our clients increase market share, grow revenues and improve margins.

Our industry focus translates into the knowledge and market access needed to have visibility up and down the value chain. Our end to end coverage, from raw materials through the final user, delivers the acute Voice of Customer insights required to best evaluate market realities.

Our actionable recommendations for better decision making have led to a long track record of client performance improvement based on the foresight delivered in every Principia engagement

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