Industry Top Trends Update

Building Materials

Diminishing tailwinds could pressure ratings

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What's changed?

Slowing revenue growth. A cooling housing market, high inflation, and waning consumer confidence is pressuring spending on renovations and remodeling for residential real estate. Commercial real estate building activity is also slowing.

Price increase limits. A weaker demand picture is pressuring margins and cash flow generation. Companies that focus on nondiscretionary products such as roofing or HVAC should be more resilient than manufacturers of more discretionary products such as kitchen cabinetry and bath wares.

Weaker fundamentals and rising inflation. We see potential for more negative rating actions based on slowing operating fundamentals and lower ability to manage inflationary pressures. Given a concentration of private equity ownership, more aggressive acquisitions or shareholder returns could also drive downgrades.

What to look out for?

Elevated commodity costs. Building material companies have already experienced declining margins due to the sharp rise of commodity costs and supply chain bottlenecks. Exposure to lumber, metals, plastics, and oil could pressure margins further as ability to pass through cost increases diminishes.

Shrinking order backlogs. As housing affordability worsens and consumer spending weakens, we expect demand to deteriorate as housing starts and construction activities slow. Exposure to new construction or more discretionary products could see weaker backlogs into 2023.

What if there's a recession?

A decline in discretionary products demand and new construction activity. A more significant pullback in new construction and lower remodeling and renovation activities put issuers more exposed to these segments at higher risk of underperformance, with revenue trends potentially slowing to flat or low-single-digit declines, despite underlying strength in housing. The impact of higher mortgage rates has yet to fully materialize as new home sales and first-time home purchases are declining, a trend that could continue through 2022.

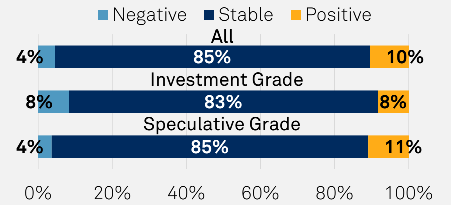
Weaker ability to pass on cost increases. Pushback by consumers could limit pricing power and put greater pressure on margins even if cost pressure subsides to some extent.

Liquidity pressure. Given the concentration of ratings in the low spec grade, many issuers have elevated leverage. Exposure to floating rate debt as rate hikes continue could deplete EBITDA interest coverage and liquidity, key indicators for lower-rated issuers.

Latest Related Research

- Real Estate Monitor: Slowing Growth Lies Ahead For U.S. Real Estate Companies, June 8, 2022
- Real Estate Monitor: Rising Inflation, Rate Hikes Cloud Outlook For U.S. Real Estate Issuers, March 30, 2022

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	55	67
Downgrades	0	2	2
Upgrades	0	6	6

Ratings data as of end-June 2022. * Year-to-date

Ratings Outlook Net Bias