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Comment & Opinion

Who is making the money?

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> "Over the last four years housebuilders shares have on average increased by around 250%, whereas merchants are up by 50% and, in the recent announcements, double digit increases in dividend payments have been the norm for the housebuilders."
>
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The last few weeks have seen a raft of announcements from the large housebuilders – all unfailingly disclosing impressive results for 2015 driven by high single digit to mid-teens percentage growth in both completions and average sales value.

In addition, these results have been accompanied by positive messaging from CEOs about their specific businesses being in excellent shape to continue growing: strong land banks, sound finances, government policy, and mortgage availability and affordability – consumer confidence allowing.

So great news for all in the supply chain then?

Possibly, and certainly not bad news. However, you only have to compare the relative composite share price index of housebuilders and merchants to see one group of shareholders have benefitted more than the other. Over the last four years housebuilders shares have on average increased by around 250%, whereas merchants are up by 50% and, in the recent announcements, double digit increases in dividend payments have been the norm for the housebuilders.

There are a number of factors at play here – not least the depths to which housebuilders results and values had fallen – but including, perhaps most critically, the level of competition in the merchants market operating to the benefit of the builders. The fact is now, in most territories and product sets, housebuilders have multiple and very credible supply options bought about by investment and operational improvement of merchants. These include in-fill depot developments, specialist product knowledge and sourcing improvements, use of IT and e-commerce, and distribution investment. It begs the question whether the merchant class have undersold their wares as prosperity has returned to the sector.

Drilling further down into the market highlights another key trend that has, and will continue to, create uneven returns through the supply chain. Whilst we have seen an increase of completions back up to around 150,000 per annum from the lows of 2008, the major housebuilders now account for close to 50% of those, compared to just over 30% in 2010. Consolidation in the sector – the acquisitions of Banner by CALA, Shepherd by Galliford, Millgate by Countryside are examples – has created some of this shift. However, the balance sheet strength and high land bank availability of the major builders compared to regional, independent counterparts is a more long term and endemic factor. This in turn will allow the major merchants to gain more share of the new build market through national agreements.

Where does the above leave the independent, regional merchant in its search for growth?

Probably where it always has – maintain a strong focus on the local RMI market which still accounts for some 70% of all residential building spend and play to the strengths of service, responsiveness and specialist knowledge. Whilst the housebuilders may attract the headlines, it is the level of RMI spend that will dictate the profit opportunity for the merchant market. This was well evidenced by the negative trading statements from the major merchants in Q3 last year on the back of slowing RMI spend.

In this regard, European referendum wobbles aside, I believe the UK residential RMI market should provide future growth opportunities as a low inflation, low interest rate and modest GDP growth environment persists accompanied by two specific positive factors – the onset of the national living wage and the relaxation of pension access regulations. To my mind the latter, in particular, will provide a new impetus to RMI spend as house owners in their mid-50s have the opportunity to access their pension and re-invest it in their house whilst still young enough to enjoy it and have it produce an investment return over their remaining years.

Another factor that will also impact how returns are spread throughout the supply chain is the direction of travel towards off site, modular build employing different products and skill sets. L&G's recent announcement of creating a new division, L&G Homes, which will make a £55m investment in a 555,000 sq ft factory near Leeds (the largest in Europe) developing around 3,000 pre-fabricated homes per annum, has the potential to change some of the long-held relationships that exist in the industry.

So, answering my question in the title, there should be enough activity for everyone to make money although, as in all walks of life, some will "be more equal than others". Avoid getting distracted by the green eyed monster of envy and maintaining a keen focus on strengths should allow all participants in the supply chain to drive growth and achieve results that will help deliver objectives, whether they be reinvestment in the business or realisation of value at some point through a sale or private equity transaction.

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