MAKING SENSE OF SUPPLIER CONSOLIDATION

Mergers and acquisitions are happening at the briskest pace in recent memory. Here's what it means for home builders

By Tony L. Callahan

Beacon Roofing Supply and Allied Building Products, ABC Supply and L&W Supply, Builders FirstSource and ProBuild, Building Materials Holding Corp. and Stock Building Supply: Supplier consolidation has ramped up in recent years, and the list goes on and on. Consolidation has had an impact on every tier of the home building supply chain, from manufacturing to distribution to trades. While deals have gotten fatter, the competitive marketplace is thinner. As a result, consolidated companies often have an increased amount of debt: overlapping markets, product, or both; redundancies; and integration issues. They all must be addressed to maximize the anticipated savings from the consolidation.

EFFECTS ARE MARKET-DEPENDENT

What does consolidation mean for home builders? It depends on the markets that pertain to you. Supplier consolidation can affect your costs, the availability of products you use, and the service you receive. Sometimes it's for the better. Other times, not so much.

Higher costs. Companies consolidate for a host of reasons, but they typically include a reduction in selling, general, and administrative expenses (SG&A); lower material costs associated with increased volume; and higher pricing power in markets where the purchased or merged company was their largest competitor. If you're in a market where the former unconsolidated companies both operated, then you lost competition that helped to keep your costs down. The decreased competition probably resulted in higher costs for you. Still unsure? Take a look at public companies in the supply chain to see how their margins have grown. Still not convinced? Listen in on some of the public companies' quarterly earnings calls as they talk with analysts about a pending merger. On many of those calls, the analysts ask great questions about SG&A, lower material cost, and increased pricing power. I've also seen firsthand the impact of reduced competition in a local marketplace, and it's not good for home builders.

Lower costs. What if you work in a market that's *not* served by the unconsolidated companies, but the newly consolidated company has moved in and opened a startup? This probably increased competition and thus lowered your costs. Many large companies that have consolidated in recent years are opening new facilities in markets that they didn't previously serve. This is possible due to their earnings in other markets. If the newly consolidated company is opening a new facility in your market, it means it's done its homework and believes your market will support the additional competition. A new entrant often prompts downward price pressures. While there are other reasons for a home builder to go to a new entrant in their market—additional capacity; improved quality or service—price is typically the initial driver. A new entrant with lower prices will force the existing suppliers in the market to adjust prices to remain competitive, otherwise they'll lose market share and risk going under. That competition is good for home builders.

Decreased availability. How does consolidation affect products available to you? Supplier consolidation can double the stock-keeping unit (SKU) count managed by the combined company. To reap savings from the consolidation, manufacturers and distributors will, of course, want to reduce the number of redundant products they make or distribute. That means you may no longer have certain brands available to you, or the cost of those brands will increase as the consolidated company pushes you toward its preferred brand. You know what happens when a consolidated manufacturer stops making a product offered by the competitor it purchased: The product is discontinued, you have to make a conversion, and you're dealing with limited availability of service parts. I've also seen distributors increase the price of brands previously offered by the competitor they purchased. They justify it by claiming they can get you the previous brand, but that it's now a special-order product.

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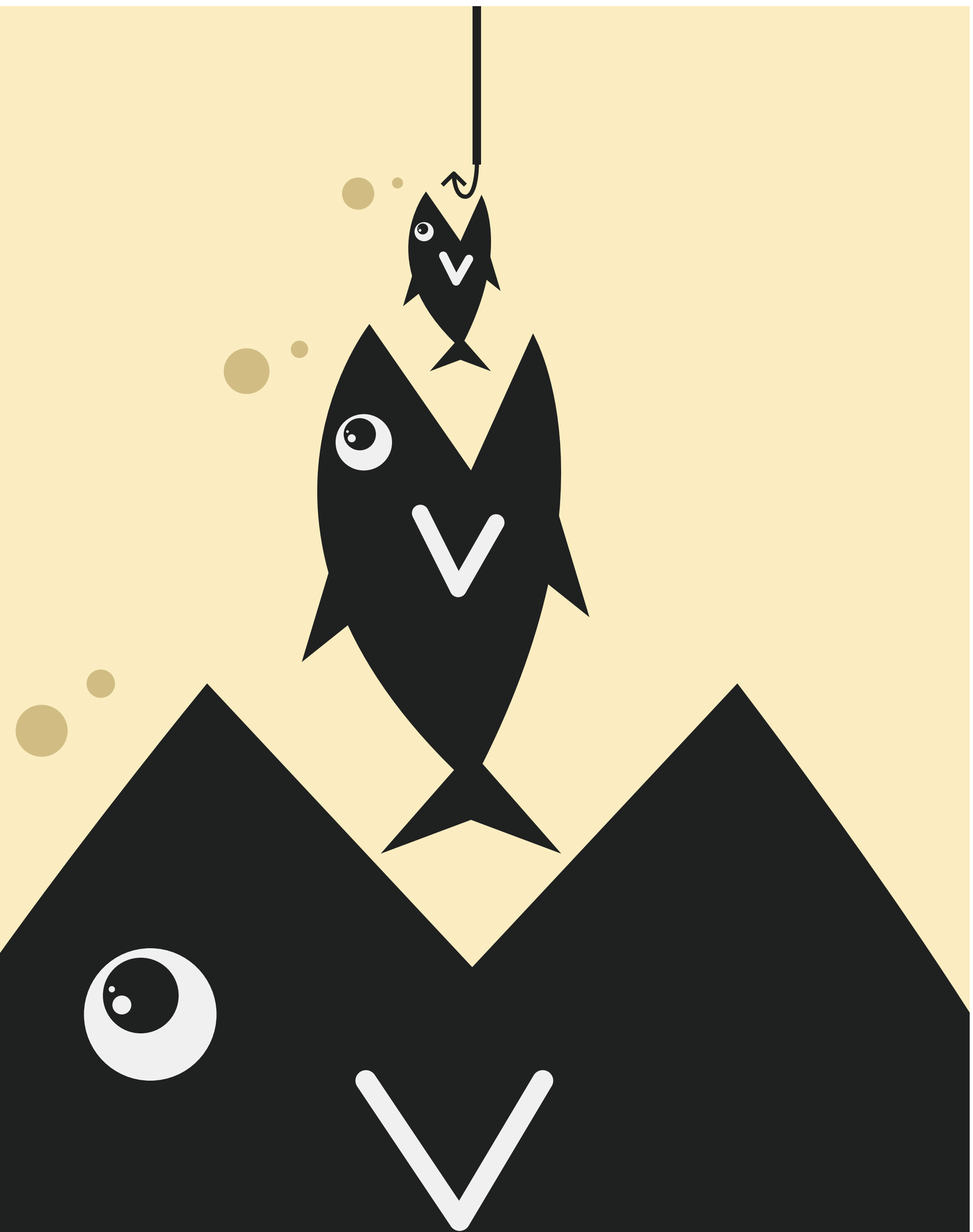
Increased availability. On the other hand, the consolidated company may bring additional product lines to your market. Sometimes products such as drywall, ceiling tile, or siding were only previously available to you via special-order or not at all from the unconsolidated companies. This works in your favor. You have an opportunity to leverage your spend with the consolidated company by purchasing more product categories from it.

This increased availability also provides more competition for those product categories. The companies in your market that previously supplied those products must address their new competition. That can prompt short-term discounts while the consolidated company works to gain customers for its new product lines and the existing suppliers fight to keep their existing customers.

Disrupted service. If local, regional, and national supplier representatives have integration tasks assigned to them that take their attention away from your account, service may be affected. Reps may also be asked to carry more customers than they did before, or your longtime, consistent rep may no longer have a job in a market where both companies had redundant positions. So, whether your existing representative has more duties assigned or is let go, the service you receive could be affected.

Improved service. On the other hand, the consolidated company may offer benefits that your previous, unconsolidated supplier didn't, such as value engineering, material quantity takeoffs, and designer services for homebuyers. I once worked with a consolidated company that had an employee embedded in my corporate architectural department. That employee was an integral part of our value-engineering efforts. He improved the use of panels and trusses on our new floor plans. During his tenure, we tweaked plans during design development and the 50 percent construction documentation phase, while other builders were doing this after their construction documents where completed—if they were doing it at all. Concurrent engineering is just one example of how a larger consolidated company with more resources can add value.



Consolidation in our industry is a fact of life, and it's going to continue: More consolidation when the market is good and less when it's shaky. Some spin-off via selling unprofitable locations during a downturn will happen, but uniformly declaring that consolidation is good or bad misses the point: It depends on the individual market and the people leading the consolidated company. Yes, consolidation requires adjustment, but it also presents opportunity. Figure out how a given consolidation affects costs, product availability, and the service you get before making a judgment. If it's good, that's great for you. If it's bad, then do something about it. Take your business elsewhere because life is too short to deal with a bad supplier. **PB**

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