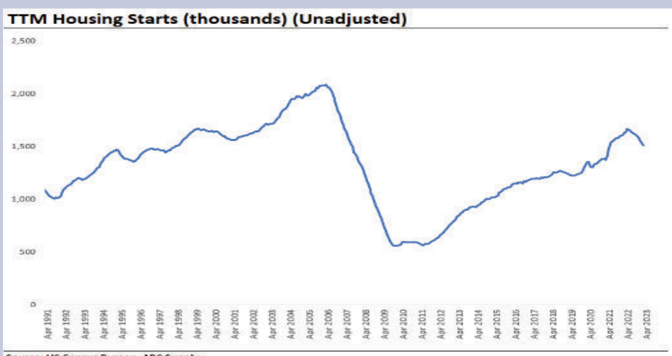
L&W SUPPLY MERCHANDISING UPDATE - SPRING 2023

Housing starts have softened, but a strong construction backlog and growing builder confidence has kept demand relatively strong. The pace of building has slowed compared with the peak of the last two years, but remains at some of the highest levels in the last decade.

In his update, Kevin Hocevar provides an overview of the choppy start to the year.

DEMAND

- US Housing Starts (seasonally adjusted) were down in Q1, but historically high backlogs have softened impact in the short term.
- Non-Res Put in Place Construction was down 14% in the first part of 2023, but there was wide variation across sectors (manufacturing and construction drove a significant part of the decline) and geography.
- After six months of declines, the Architectural Billings Index was above 50 in March.



INFLATION

- Inflation on several key product cost drivers like freight, energy and paper eased considerably in Q1.
- Labor/wage inflation continued to rise in Q1, but the rate of increase slowed from prior quarters.
- The pace of price increases on key product categories (wallboard, steel, ceilings, etc.) has been much lower in the past nine months as costs continue to stabilize.

KEY PRODUCT UPDATES

WALLBOARD

- Q1 manufacturer wallboard shipments were down 1.3% YOY but was still at a historically strong 26.5 BSF pace.
- Wallboard availability has improved significantly in all markets with only a few specialty products remaining tight. Additional capacity coming online in 2023 will improve availability in those markets in the next upcycle.
- Glass mat availability continues to improve and all indications are that supply will continue to improve throughout 2023.

STEEL

- Q1 manufacturer steel shipments (reported by SFIA) were up 15.3% YOY indicating a solid start to 2023.
- After 18 straight weeks of increases beginning in November, Galvanized coil pricing is down over the last 8 weeks as overall demand is light and lead times short.

CEILINGS

- A better than forecasted 1H2023 market doesn't change the overall 2023 forecast of LSD volume decline.
- Opportunities with ceilings will vary by the vertical with education, transportation and health care leading the way and, conversely, retail and office, historically the largest segment within the ceilings business, lagging.
- No significant manufacturing capacity issues; few raw material constraints; transportation costs normalizing

OTHER PRODUCTS

- Fiberglass insulation availability is improving, but still challenging. Loose fill insulation supply remains tight.
- Rigid insulation production has improved significantly in the past few months.
- Joint compound availability has stabilized as overall demand has softened.

MARKET HIGHLIGHTS FROM

KEVIN HOCEVAR Director of Research - ABC Supply

Since our last write up for 4Q22, a lot has changed. In 4Q22, sentiment was poor as housing affordability hit multi-decade lows with mortgage rates touching 7% and home prices only recently coming off current cycle highs.

That was then. Flash forward to today and things are different. Since mid-2022, home prices have trended lower and mortgage rates have come down from over 7% in late-October/early-November 2022 to 6.71% as of the week of June 8th. When coupled with continued wage growth, this has resulted in housing affordability improving off of trough levels. Signs that these dynamics were benefiting housing demand were evident early in the quarter as sentiment at the International Builders Show was much better than expected. That favorable sentiment was followed by favorable housing data. The seasonally adjusted annualized rate (SAAR) of new homes sold was 651,000 in 1Q23. Though down on a year-over-year basis, this was the best quarter since 1Q22. Results from the twelve largest publicly traded homebuilders suggest net new orders (i.e. gross orders minus cancellations) were down only 12% year-over-year in 1Q23, much better than feared (hence why many homebuilder stock prices are up 30%-50% YTD), while equity analyst forecasts suggest net new orders for these builders start growing again in 2Q23 and beyond. Multi-family housing starts continued to grow in 1Q23 with units under construction at roughly 50-year highs. Existing home sales bounced to a SAAR of 4.33 million in 1Q23, up from 4.18 million in 4Q22. Favorable demand has even led to home prices stabilizing with new and existing median home prices seeing month-over-month improvements in February and March.

So is it time to declare victory? Though our base case is still that 2023 is a down year for housing followed by growth in 2024, there remain uncertainties. Housing affordability, while off trough levels, remains near multi-decade lows. Inflation is easing but slowly and is resulting in the Fed continuing to suggest it will hold rates higher for longer. Broader macro risks such as regional banking, tightening credit, or potential risks in commercial real estate (particularly office) are also factors to consider. But at the end of the day, nothing changes in the mid- to long-term for construction markets in that housing is under built and demographics are favorable which should result in solid market conditions overall over the next few years (although there are likely to be bumps along the way).