

Crash or correction?



That's the question weighing heavily on the minds of all stakeholders in the housing market in both Canada and the United States, as central banks on both sides of the border use successive and sharp interest rate hikes as a means to curb soaring inflation.

The result, not surprisingly, has been a marked drop in home sales and new housing starts. This has made for sensational headlines and the citing of opportunistic data related to drops in home sales, selling prices and new housing starts. As such, a closer look at the numbers is warranted to truly assess whether we're experiencing the onset of a housing market crash or "just" a correction to pre-COVID-19 pandemic levels of activity.

Canada

CONFIDENCE

Consumer confidence in Canada continued to drop 6.6 points in July 2022 after having already dropped 8.8 points in June 2022 to 72.8 (2014 = 100), as many households continued to feel the impact of soaring inflation and rising interest rates. This resulted in 33.3% of Canadians feeling pessimistic about their current finances and eroding purchasing power.

Moreover, Canadians are less confident about job prospects, with only 17% believing there will be more opportunities in six months. As a result, only 11% of survey respondents believe summer 2022 is a good time to purchase large-ticket items.

SALES

The sharp increase in interest rates by the Bank of Canada, including the most recent 100 basis point hike on July 13 to 2.50%, have muted the resale market in Canada. The result was a drop in national home sales by 24% year over year as of June 2022 – including -5.6% in June 2022 alone – and the average national home price by 14% since February 2022.

PRICE

Notwithstanding the above-mentioned drop in the average national home price by 14% between February and June 2022 to \$665,850, CIBC estimates the average national home price needs to drop by a further 25% to reach pre-COVID-19 levels.

In addition to rising interest rates, rising costs of construction caused by ongoing disruptions in global supply chains and severe labour shortages are also contributing the national affordability crisis. As none of these are expected to be resolved anytime soon, those looking to purchase a newly constructed home should not expect pricing relief in the short to medium term.

STARTS

According to Canada Mortgage and Housing Corp., the annual pace of housing starts slowed in June 2022 compared to May 2022, as the seasonally adjusted number of new housing starts decreased by 3% to 273,841. The decrease was consistent across all urban asset classes, with starts of multiresidential dropping 2% and single-detached urban starts dropping by 4%.

FORECASTS

In late July, Royal Bank of Canada downgraded its outlook for the Canadian housing market, calling for a "historic correction" that is expected to be the worst in the last 40 years as a result of the aggressive interest rate hikes the Bank of Canada was forced to implement to curb soaring inflation. RBC is forecasting home sales to decrease by 23% in 2022 and a further 15% in 2023, with the national benchmark home price dropping by more than 12% from peak to trough by Q2 2023. This will make the anticipated correction the sharpest of the last five.

Not surprisingly, the downturn is expected to be most pronounced in Ontario and BC, where average home prices are the highest across Canada, as sale volumes are forecasted to drop by 45% and 38% in 2022 and 2023, respectively, while prices are expected to drop by 14% from peak to trough. Although the more affordable parts of the country are expected to be less impacted, RBC still forecasts sales volumes to decrease by more than 20%, with price decreases ranging between 3% and 8%.

Despite the pessimistic outlook, the bank offers the caveat that this historic correction should be characterized as a "welcome cooldown" after a red-hot, pandemic-induced buying frenzy over the last two years that created a national affordability crisis, putting homeownership out of reach for many Canadians.

It's believed that solid demographic fundamentals resulting from factors like smaller families, more people living alone, soaring immigration during the post-pandemic era and the unlikely risk of near- to medium-term overbuilding will maintain the supply-vs.-demand fundamentals in the overall market, notwithstanding the expected interest rate-induced cooling-off period over the next 12 to 18 months in the volume of home sales and new housing starts.



United States

CONFIDENCE

The National Association of Homebuilders (NAHB) Sentiment Index came in below analyst estimates in July 2022 and fell for the seventh straight month, this time by 12 points – the second largest on record excluding the COVID-19 pandemic – and to its lowest level since May 2020 at 55, slightly below the critical support level of 60. The extent of the drop is largely related to the rapidity of the increase in mortgage rates to +6.00% (30 yr/fixed).

All three components of the index fell: the gauge that measures current sales conditions dropped by 12%, the gauge that tracks prospective buyer traffic dropped by 11% and the gauge that assesses sales expectations over the next six months fell by 11%.

Many believe what we are seeing today is not the onset of a crash in the housing market, but only a normalization to pre-pandemic levels after a two-year period of exceptionally high demand for housing, as the drop to 55 is nowhere near the crash to only 10 during the sub-prime mortgage market crash of 2008.

However, if this data discourages homebuilders, the current supply-side shortage that has led to a massive run-up on prices and an affordability crisis will only be exacerbated, particularly when combined with the recent spike in mortgage rates to their highest levels since 2008.

SALES

Sales of existing homes in the US tumbled to a two-year low in May 2022, marking the fourth straight monthly drop in sales volume. Existing home sales fell 3.4% to a seasonally adjusted annual rate of 5.41 million units in May 2022, the lowest since June 2020 when sales were recovering from the COVID-19 lockdown.

Economists polled by Reuters estimate that a housing market “downturn” would need sales to drop to between a rate of 4.0 million and 4.5 million. However, it should be noted that the resale market remains fairly hot,

as the National Association of Realtors reported that new listings are still averaging a record low of only 16 days on the market and 88% of homes sold in May 2022 were on the market for less than a month.

PRICE

Meanwhile, as a result of the ongoing supply-side shortage, prices jumped to a record high of more than US\$400,000 for the first time, notwithstanding the fact that mortgage rate increases are pushing first-time homebuyers out of the market, dropping their share of market to just 27% in May 2022.

STARTS

US housing starts in June 2022 missed expectations, while building permits exceeded forecasts, indicating that although homebuilding is currently slowing, homebuilders plan to keep building at a healthy rate on the expectation that demand will soon rebound once interest rate hikes are digested.

Taking a closer look at the numbers provides further evidence that the housing market appears to be normalizing to pre-pandemic levels, not crashing. More specifically, US housing starts came in at 1.56 million vs. pre-COVID 19 levels of 1.1 million to 1.4 million, whereas building permits were 1.69 million, still well-above the pre-COVID-19 range of 1.2 million to 1.5 million.

FORECASTS

As the US economy starts to slow down and inflation is tamed, mortgage rates should start to moderate slightly back to or possibly below 5%, which may serve as a tailwind to the housing market, creating a housing market where prices will continue to appreciate at historical levels.

Moreover, the housing market continues to face significant supply-side constraints resulting from years of underbuilding during the aftermath of the 2008 subprime mortgage crash that destroyed consumer confidence in the industry. Many believe the inventory hole is so deep that it would take more than a decade of overbuilding to rebalance the equilibrium between low supply and ultra-high demand.

An illustration of the current low level of supply in the US housing market is evidenced in the months of supply on hand, which currently stands at only 2.6 months based on the May 2022 run rate. Historically, 6 to 7 months of supply in the US housing stock has been viewed as a balanced market, and past housing crashes typically only occurred when the index pushed past 10 months into low double digits.

As such, a material amount of new supply needs to come into the market to have any meaningful impact on US housing prices, and that can only come from the new construction market. Demand is forecasted to remain high, as virtually a whole generation of individuals post 2008 either stayed at home or rented longer. That generation is now more than 10 years into their respective careers, entering the start of their prime earning years and waiting on the sidelines trying to find supply.

Supply-side Stimulus needed to break the vicious affordability circle

The affordability circle in housing is vicious. Excessively high home prices discourage demand. Low demand disincentivizes homebuilders from building new homes as they fear being stuck with unsold product, particularly when the cost of construction is soaring due to the factors cited above. The resulting lack of new supply maintains the imbalance between supply and demand, which keeps housing prices high and affordability out of reach. As such, Robert Dietz, Chief Economist at NAHB, believes that affordability is the single greatest challenge facing the housing market and that policymakers need to address the supply-side issue to help builders produce more affordable housing.



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EY transaction snapshot

Our Recent Transactions in Home & Building Products

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ROBOVER

has been acquired by



EY* acted as the exclusive financial advisor to Robover Inc.



*Ernst and Young Orenda Corporate Finance Inc.

The Transaction

Founded in 1999, Robover is a Quebec City-based manufacturer of insulating glass units, tempered glass and other glass products. Over the years, the Company has become a leader in the Quebec residential insulating-glass industry.

ODL, Inc. is a leading Michigan-based building-products manufacturer and supplier of decorative and clear door-glass and entry treatments, including door glass, door glass blinds, and retractable screen doors for the residential market. It has operations in the Unites States, Canada, the United Kingdom and China.

The Win-Win

The combination of Robover with ODL will create a North American powerhouse in the window-and-door industry, with over 100 years of combined experience. It will extend geographical reach and promote a robust and innovative product line-up by joining Robover’s insulating expertise with ODL’s Blink Blinds + Glass expertise, with the objective of becoming the leading light and privacy solutions provider to the North American window-and-door market.

About EY’s Home and Building Products Industry Coverage

EY M&A Lead Advisory has been advising mid-market home and building products (“HBP”) companies in Canada on their merger, acquisition, divestiture, financing and corporate finance strategy requirements for several years. We are one of Canada’s largest mid-market corporate finance advisory firms with more than 60 dedicated M&A professionals in 11 offices across Canada, including a team of 10 who cover the HBP industry. With access to more than 480 transaction professionals in Canada (and +10,000 worldwide) via our broader Strategy & Transactions practice, we provide independent, seamless and fully-integrated transaction services that span the spectrum from idea generation to post-closing merger integration. We close an average of 30 transactions each year, ranging from \$10 million to +\$500 million in transaction value. EY’s Strategy & Transactions practice offers a full suite of integrated transaction and corporate finance-related services from a team of seasoned and polyvalent professionals. We have deep bench strength, coast-to-coast coverage, extensive relationships with all forms of capital and the expertise to assist with all your transaction needs.

Select Q2 2022 Transactions

The following are brief summaries of selected transactions in the North American home and building products industry from the second quarter of 2022:

BUILDING PRODUCTS DISTRIBUTORS

- ▶ Boston, MA-based Southeast Building Supply Interests acquired Mound, TN-based Wallace Building Supply, Inc. The terms of the transaction were not disclosed.

Wallace Building Supply, Inc. distributes building materials such as framing materials, trusses, roofing, decking and railing, brick, mortar and others.

- ▶ Tampa, FL-based Gulfeagle Supply, Inc. acquired Farmingdale, NY-based Brightview Window & Door Distribution Corp. The terms of the transaction were not disclosed.

Brightview Window & Door Distribution Corp. distributes and supplies building products like vinyl siding and windows, new construction and replacement windows, and doors.

- ▶ Rochester, MN-based Outdoor Living Supply, LLC acquired Truckee, CA-based The Rock Garden. The terms of the transaction were not disclosed.

The Rock Garden supplies natural stone, hardscapes, and architectural elements such as mantles and hand-hewn stone furniture to residential and commercial clients.

- ▶ An unknown buyer acquired Denver, CO- based Summit Materials, Inc. for US\$47.8 million.

Summit Materials, Inc. supplies aggregates, cement, ready-mix concrete and asphalt to public infrastructure, residential and non-residential end markets.

BUILDING PRODUCTS MANUFACTURERS

- ▶ Toronto, ON-based Birch Hill Equity Partners Management Inc. and Montreal, QC-based Investissement Québec acquired Quebec City, QC-based Polycor Inc. for US\$467 million.

Polycor Inc. operates as a stone company providing custom stone blocks, slabs, tiles, mosaics, architectural stone, curbs and landscaping products.

- ▶ Roswell, GA-based SiteOne Landscape Supply, Inc. acquired Moseley, VA-based Yard Works, LLC. The terms of the transaction were not disclosed.

Yard Works, LLC manufactures and recycles premier landscape products for residential and commercial markets.

- ▶ Columbus, OH-based Worthington Industries, Inc. acquired Kansas City, KS-based Level5 Tools, LLC. for US\$80 million (earn out of US\$25 million). The transaction represents an enterprise value of approximately 2.4x revenue and 12.9x EBITDA.

Level5 Tools, LLC manufactures drywall finishing tools such as flat boxes, corner tools, nail spotters, skimming blades, hand tools and others for the construction of drywall projects.

- ▶ Dallas, TX-based Eagle Materials Inc. acquired the assets of a Northern CO-based readymix concrete and aggregates manufacturing business for US\$121.2 million. The transaction represents an enterprise value of approximately 0.7x revenue.

HOME BUILDERS

- ▶ Troy, MI-based Champion Home Builders, Inc. has agreed to acquire all the operating assets of Laurinburg, NC-based Manis Custom Builders, Inc. for US\$10 million.

Manis Custom Builders, Inc. provides custom and modular home builder and floor plans services.

LUMBER AND WOOD

- ▶ Boise, ID-based Boise Cascade Wood Products, L.L.C. has agreed to acquire Havana, FL-based Coastal Plywood Company for US\$512 million.

Coastal Plywood Company provides plywood, lumber, and treated wood products.

- ▶ Woodstock, ON-based Gillfor Distribution Inc. acquired Bolton, ON-based AFA Forest Products Inc. The terms of the transaction were not disclosed.

AFA Forest Products Inc. distributes construction plywood, commodity lumber and specialty products to the retail, wholesale and industrial market.

ELECTRICAL AND HVAC

- ▶ Newport News, VA-based Ferguson Enterprises, LLC has agreed to acquire Corona, CA-based Minka Lighting, Inc. The terms of the transaction were not disclosed.

Minka Lighting, Inc. manufactures lighting products and fans for both interior and exterior spaces.

Transaction Snapshots (cont'd)

- ▶ Berkeley Heights, NJ-based Hayward Holdings, Inc. acquired certain assets of Norcross, GA-based Halco Lighting Technologies, LLC. for US\$55 million.

Halco Lighting Technologies, LLC manufactures lamps and ballasts providing an alternative of interior decor and source of light.

PLUMBING, VALVES AND FITTINGS

- ▶ Lawrenceville, GA-based Plumbing Distributors, Inc. acquired Augusta, GA-based W.A.Bragg & Company, Inc. The terms of the transaction were not disclosed.

W.A.Bragg & Company, Inc. distributes residential and commercial plumbing, electrical and irrigation supplies.

- ▶ Montreal, QC-based Deschenes Group Inc. acquired Vaughan, ON-based Crane Supply, the Canadian distribution business of Crane Holdings, Co. for C\$380 million.

Crane Supply distributes pipes, valves, fittings and piping accessories to industrial and commercial contractors.

WINDOWS & DOORS

- ▶ Sweden-based ASSA ABLOY AB acquired Rochester, NY-based Caldwell Manufacturing Company North America, LLC. The terms of the transaction were not disclosed.

Caldwell Manufacturing Company North America, LLC manufactures fenestration hardware for window and door manufacturers.

- ▶ Caroline Dallaire (President) along with the management team of Levis, QC-based P.H. Tech, Inc. (the "Company") and Montreal, QC-based National Bank Private Investment and Levis, QC-based Desjardins Capital acquired the Company. Terms of the transaction were not disclosed.

P.H. Tech, Inc. manufactures PVC frames for windows, patio doors and regular doors for builders, renovators, architects and others.

- ▶ Carmel, IN-based Allegion plc acquired Farmington, CT-based Stanley Access Technologies LLC and assets related to the automatic entrance solutions business from New Britain, CT-based Stanley Black & Decker, Inc for US\$900 million.

Stanley Access Technologies, LLC. manufactures, installs and provides services for automatic doors.

BUILDING ENVELOPE

- ▶ France-based Compagnie de Saint-Gobain S.A. has agreed to acquire Pointe-Claire, QC-based Kaycan Ltd. for US\$928 million. The transaction represents an enterprise value of approximately 2.0x revenue and 11.2x EBITDA.

Kaycan Ltd. manufactures and distributes exterior building materials and is the leading manufacturer of siding products in Canada.

- ▶ Toledo, OH-based Owens Corning has agreed to acquire Cortland, IL-based Natural Polymers, LLC. The terms of the transaction were not disclosed.

Natural Polymers manufactures spray polyurethane foam insulation for building and construction applications.

- ▶ Dallas, TX-based Renovo Home Partners acquired Dallas, TX-based Woodbridge Home Solutions, LLC. The terms of the transaction were not disclosed.

Woodbridge Home Solutions, LLC provides installation services of products including windows, siding, soffit, fascia, doors and others.

- ▶ Herndon, VA-based Beacon Roofing Supply, Inc. acquired Willowbrook, IL-based Complete Supply, Inc. The terms of the transaction were not disclosed

Complete Supply, Inc. distributes residential roofing and exterior building supplies to contractors and home builders.

- ▶ Dallas, TX-based Builders FirstSource, Inc. acquired Henderson, TX-based Panel Truss Texas, Inc. for US\$150 million. The transaction represents an enterprise value of approximately 1.1x revenue.

Panel Truss Texas, Inc. manufactures trusses for the multi-family apartment and residential and commercial markets.

- ▶ Dallas, TX-based Builders FirstSource, Inc. acquired Boise, ID-based Valley Truss Company, Inc. for US\$30.5 million. The transaction represents an enterprise value of approximately 1.2x revenue.

Valley Truss Company, Inc. manufactures metal plate connected wood trusses for builders and contractors in the residential and commercial construction industries.



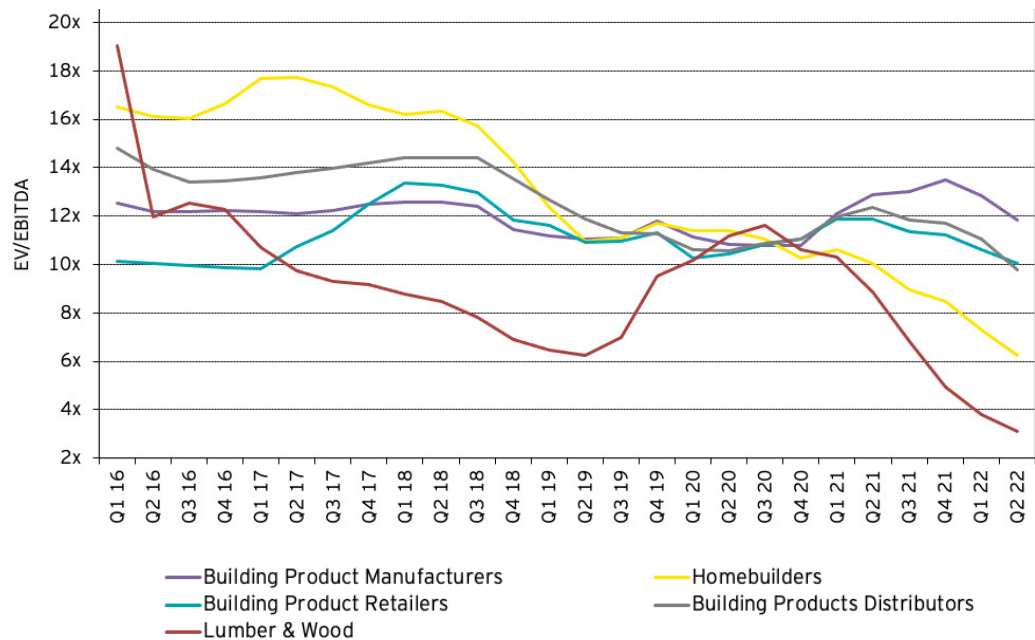
FLOORING

- ▶ Las Vegas, NV -based Eco Depot Inc. acquired Saint-Augustin-de-Desmaures, QC-based Seskai Concrete Solutions Inc. The terms of the transaction were not disclosed.

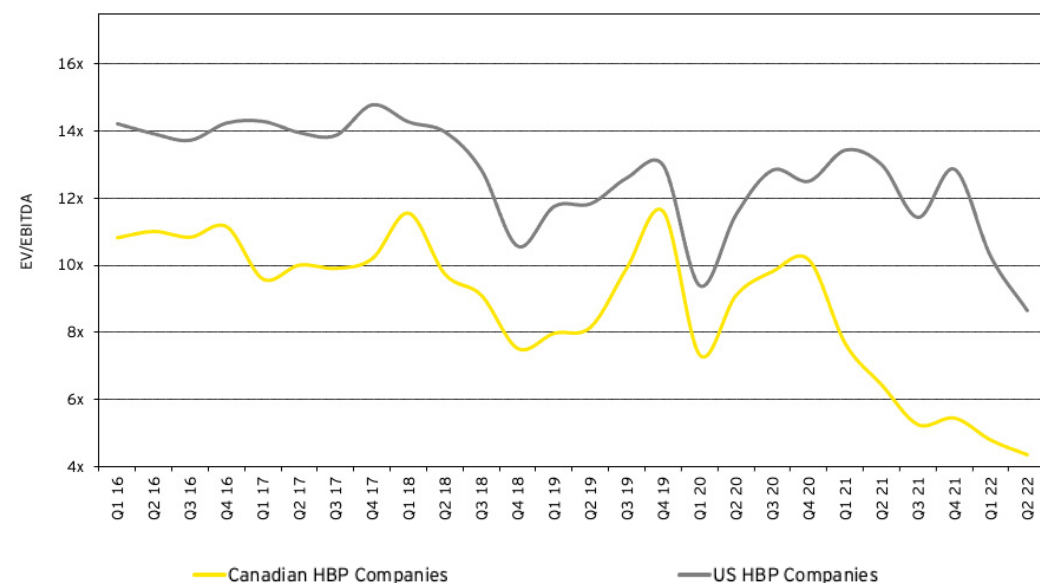
Seskai Concrete Solutions Inc. provides a spray-on formula for existing concrete and additive formula for new pour concrete, for all types of concrete surfaces.

Ernst & Young Orenda's Home & Building Product Indices

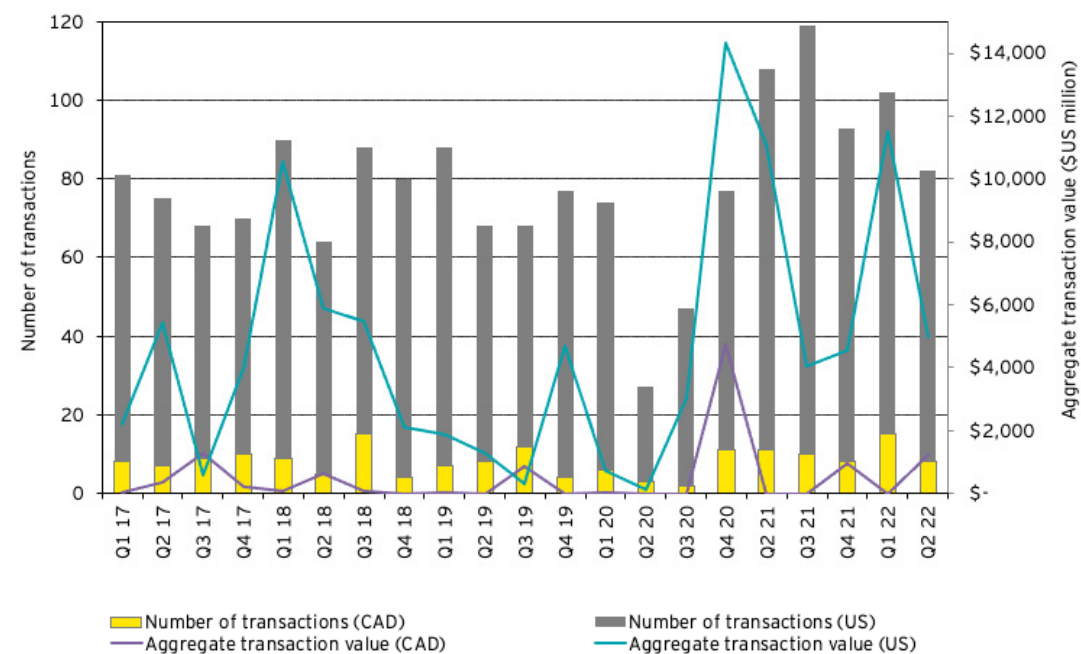
NORTH AMERICAN ENTERPRISE VALUE TRENDS BY SECTOR L4Q AVERAGE



NORTH AMERICAN ENTERPRISE VALUE BY COUNTRY L4Q AVERAGE



NORTH AMERICAN TRANSACTION VOLUME AND REPORTED TRANSACTION VALUE



Note: The indices used in this newsletter have been compiled by Ernst & Young Orenda Corporate Finance Inc. solely for illustrative purposes. The companies chosen are publicly traded companies that are commonly used for industry composites to show stock performances within a sector. The indices do not include all public companies that could be categorized within each sector, and were not created as benchmarks, nor should they imply benchmarking or recommendations for a particular stock and/or sector.

Charts: EY Orenda Corporate Finance Inc. | Data source: Capital IQ, Inc., Bloomberg | * Ernst & Young Orenda Corporate Finance Inc.

ERNST & YOUNG ORENDA'S HOME & BUILDING PRODUCTS INDEX

Our home and building products index includes the following publicly traded companies:

Company name	Ticker	Company name	Ticker
US TRADING COMPS			
A.O. Smith Corporation	AOS	Masco Corporation	MAS
Acuity Brands, Inc.	AYI	Masonite International Corporation	DOOR
Advanced Drainage Systems, Inc.	WMS	Meritage Homes Corporation	MTH
American Woodmark Corporation	AMWD	Mohawk Industries, Inc.	MHK
Apogee Enterprises, Inc.	APOG	Mueller Industries, Inc.	MLI
Armstrong World Industries, Inc.	AWI	NVR, Inc.	NVR
At Home Group Inc.	HOME	Owens Corning	OC
Beacon Roofing Supply, Inc.	BECN	PGT Innovations, Inc.	PGTI
Beazer Homes USA, Inc.	BZH	Pool Corporation	POOL
Bed Bath & Beyond Inc.	BBBY	PulteGroup, Inc.	PHM
BlueLinX Holdings, Inc.	BXC	Quanex Building Products Corporation	NX
BMC Stock Holdings, Inc.	BMCH	Simpson Manufacturing Co., Inc.	SSD
Boise Cascade Company	BCC	Stanley Black & Decker, Inc.	SWK
Builders FirstSource, Inc.	BLDR	Summit Materials, Inc.	SUM
Burnham Holdings, Inc.	BURC.A	The Home Depot, Inc.	HD
Continental Building Products, Inc.	CBPX	The Sherwin-Williams Company	SHW
D.R. Horton, Inc.	DHI	Toll Brothers Inc.	TOL
Eagle Materials Inc.	EXP	TopBuild Corp.	BLD
Emerson Electric Co.	EMR	Trex Company, Inc.	TREX
Floor & Décor Holdings, Inc.	FND	U.S. Concrete, Inc.	USCR
Fortune Brands Home & Security	FBHS	Universal Forest Products, Inc.	UFPI
Foundation Building Materials, Inc.	FBM	Vulcan Materials Company	VMC
Generac Holdings Inc.	GNRC	Watsco, Inc.	WSO
Gibraltar Industries, Inc.	ROCK	Weyerhaeuser Company	WY
GMS Inc.	GMS		
Griffon Corporation	GFF	CAD TRADING COMPS	
Hovnanian Enterprises, Inc.	HOV	Company name	Ticker
Hubbell Incorporated	HUBB	Canadian Tire Corporation, Limited	CTC.A
Huttig Building Products, Inc.	HBP	Canfor Corporation	CFP
Interface, Inc.	TILE	Doman Building Materials Group Ltd.	DBM
JELD-WEN Holding, Inc.	JELD	Goodfellow Inc.	GDL
KP Home	KBH	Hardwoods Distribution Inc.	HDI
Lennar Corporation	LEN	Interfor Corporation	IFP
Lennox International Inc.	LII	Leon's Furniture Limited	LNF
Louisiana-Pacific Corporation	LPX	PFB Corporation	PFB
Lowe's Companies Inc.	LOW	Richelieu Hardware Ltd.	RCH
M.D.C Holdings, Inc.	MDC	Taiga Building Products Ltd.	TBL
M/I Homes, Inc.	MHO	West Fraser Timber Co. Ltd.	WFG
Martin Marietta Materials, Inc.	MLM	Western Forest Products	WEF

ERNST & YOUNG ORENDA'S HOME & BUILDING PRODUCTS INDUSTRY TEAM



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SELECTED HOME & BUILDING PRODUCTS TRANSACTION CREDENTIALS

has been acquired by

EY* acted as the exclusive financial advisor to Robover Inc.

EY Orenda Corporate Finance Inc.

has acquired

EY* acted as the exclusive financial advisor to Guillevin International Co.

EY Orenda Corporate Finance Inc.

has acquired

EY* acted as the exclusive financial advisor to Guillevin International Co.

EY Orenda Corporate Finance Inc.

has been acquired by

David Moss, an Ontario-Based Entrepreneur, and

EY* acted as the exclusive financial advisor to Bristol Sinks Inc.

EY Orenda Corporate Finance Inc.

has sold a majority stake to

A Canadian specialty hardware distribution and manufacturing company

EY* acted as financial advisor to Inter-Co Inc.

EY Orenda Corporate Finance Inc.

completed an investment in

EY provided transaction support and transaction fee services to Banque Nationale.

EY Orenda Corporate Finance Inc.

Completed an investment in

EY provided transaction support and transaction fee services to Novacap Investments, Inc.

EY Orenda Corporate Finance Inc.

has been acquired by

Birchview Capital

EY* acted as the exclusive financial advisor to Waterloo Biofilter Systems Inc.

EY Orenda Corporate Finance Inc.

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

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