PRIVATE EQUITY PERFOMANCE IMPROVEMENT

Building materials companies:

Three value creation paths for the recovery

From shallow to deep business models

Introduction: Where are we in the cycle?

In the last four years, companies have faced a sequence of disruptive events: Covid-19, sharp energy and raw material inflation, soaring interest rates, exploding freight costs, and the Ukraine war. These have affected the construction related industry more severely than other sectors.

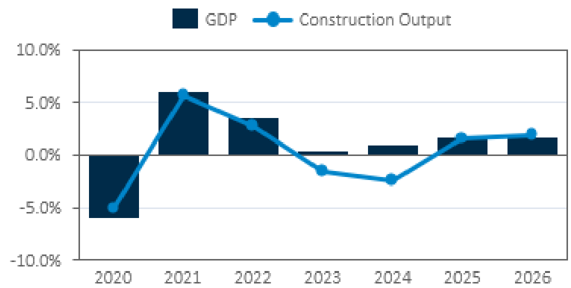

Figure 1: *GDP and construction output in EC-19. Year to year change, % in real terms (Source: Euroconstruct 2024 - 97th Conference)*

For Private Equity investors this has meant delays in planned exits, adjustments to business plans and investments, and, in many cases, the need to manage financing-related pressures.

Market expectations are converging toward the view that the bottom of the cycle in Europe might be reached in 2024, with a small overall decline in construction output, but with infrastructure and renovation showing growth. 2025 is expected to be a year of timid recovery for residential new builds, driven by the evolution of interest rates, stabilization of building material prices, and an increase of housing prices.

Implications for Private Equity investments in construction related companies

For many Private Equity firms and portfolio CEOs, the pressure is mounting to accelerate performance for an exit and monetize the expected positive trend in 2025. Many PE funds have increased their holding periods and need to prepare the exit now or recover underperforming assets.

The challenging volatile period since 2020 and especially the downturn since 2022, have made evident the weaknesses and strengths of companies' business models. Based on recent A&M project work and conversations with CEOs in the European building materials sector, we found that crisis performance and resilience is closely correlated with the **depth of the business model.**

Deep versus shallow business models in building materials

We can cluster companies in the building materials sector into three general groups: **shallow, intermediate, and deep models,** each determined by the combination of two dimensions: the **depth in the distribution** and the **products/services offering** (Figure 2).

Businesses, business units, or product segments that have a shallow **distribution model,** such as those focusing on distributors with push approaches clearly have performed less well. Businesses that go deep in distribution, such as those with strong prescription activity, sustained end-user marketing or powerful loyalty programs, or forward integration have shown more resilience. An example is companies in the dry-lining segment that tend to pursue a strong prescription approach and have built deep e-commerce links with clients.

Characteristics of deep business models (examples)	
Distribution	**Products/services**
• Strongly prescription driven • End user marketing to create pull demand • Showrooms, distribution centres • Vendor managed inventory programs • Loyalty programs • Strong e-commerce links with clients	• Added-value products • High rate of innovation and differentiation • Breadth of product offering • Bundling of components into systems • Demanding certification hurdles taken • Solutions not product oriented

Figure 2: *Typical characteristics of deep business models along the two dimensions distribution and product/services (A&M analysis)*

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On the **products/services offering** dimension, the winners are those companies that strongly focus on added value and differentiation and have a limited share of commodity-grade products. An important performance driver is also the extent to which products and services can be bundled into system solutions. An example is the flat roofing sector, where businesses focusing on system sales outperform those with component sales approaches.

Depending on the model, we can identify a typical scorecard of the current company situation (Figure 3). Shallow models tend to strongly underperform in revenue and EBITDA evolution and face liquidity and financing pressures. Companies with deep models tend to have suffered moderately in revenues and EBITDA and show a solid liquidity position.

	Revenue evolution	EBITDA evolution	Liquidity situation	Financing situation
Shallow model	--/-	--	--/-	--/-
Intermed. model	-	--/-	-/+	--/-/+
Deep model	-/+	-/+	+	+

Figure 3: *Qualitative scorecard of current situation: Business model versus performance along four performance dimensions (A&M analysis).*

How to create value accelerating out of the down-cycle

Private Equity firms and portfolio companies need to decisively prepare for the expected upturn. This is the moment for an honest and objective diagnosis of the strengths and weaknesses of their business models. The depth of the business model correlates with performance, not only in crisis times but also when the market is strengthening.

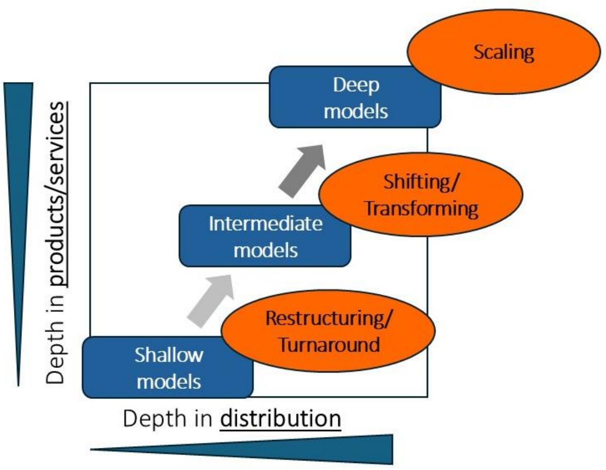

Figure 4: *The three value creation paths depending on the current business model depth (A&M analysis)*

Deep models create value by monetizing their loyal client base (for instance, by leveraging pricing power and increasing cross-selling) or by scaling up their model via internationalization or bolt-ons. Such companies have performed robustly, and they are less cash constraint. They have now the chance to get ahead of the pack by deploying CAPEX and other investment plans. The scale-response often requires penetration of new geographic markets, or the professionalization of a company. Many European companies, for example, seek expansion in the North American market, which poses a substantial execution challenge.

SCALING: Typical challenges

- Build the right team and organization.
- Optimize the target operating model in new geographies or business segments.
- Adapt products/business models to country specifics.
- Scale up distribution and manage potential channel conflicts.
- Optimally and effectively deploy growth Capex.
- Accelerate buy-and-build strategies; merger integration of ad-ons/bolt-ons and platform companies.
- Transform company culture.
- Optimize pricing.

Intermediate models typically consist of various business units, lines, or countries, some of which perform well while others struggle. They tend not to have liquidity issues but may suffer in terms of volume and profitability, and in some cases, face covenant pressure. These companies need to quickly transform and shift their business models by focusing on the successful components and expanding them.

SHIFTING/TRANSFORMING: Typical challenges

- Strong change management and effective setup and execution of transformation plans to deepen the business model.
- Tough decision-making to prioritize businesses, countries, etc.
- Focused and effective investments for top-line growth.
- Disposals and carve-outs.
- Revamp the product portfolio, R&D, and service offerings.
- Get the operating model and channel mix right.
- Improve the cost position.

Shallow models. Companies that are under liquidity pressure or have covenants issues, need a complete evaluation and potentially a restructuring. The business model might not be sustainable, and the question is whether it can be shifted to a deeper model. These companies are often in a difficult situation, requiring a strong focus on the basics: cash management, cost-out, and topline recovery programs. They have little leeway to invest in expansion right now but need to solve pressing immediate issues and think hard about the midterm feasibility of the business.

RESTRUCTURING / TURNAROUND: Typical challenges

- Instill the right sense of urgency, avoid procrastination or wishful hoping for better times.
- Execute the right level of cost-out and speed of execution.
- Rigorous cash-management.
- Short term topline recovery without dropping prices and evaporating margins.
- Reduce inventory levels without affecting customer service levels to the extent that it harms the topline.
- Refinancing challenges and covenant resets.

Time is of essence now, and companies need to start with a frank and objective assessment of their business model. Each situation requires a clearly defined value creation path, and even companies with deep models face significant challenges ahead.

How A&M can help

A&M supports clients along the three value creation paths: **Scaling, Shifting/Transforming, and Restructuring/Turnaround**. A&M projects typically start with an **objective and rigorous diagnostics** of the **business model and performance**. We then support the CEO and their management team in **setting up a clearly prioritized, structured, and realistic transformation or execution program**. In most cases, A&M then further supports the company in the **follow-through and successful delivery.**

A&M draws on a network of **experts in the construction and building materials sector** across Europe and the world, serving leading building material companies around the globe as advisors and former C-level executives. With **11.000 professional worldwide** and a strong **coverage of North America, Europe, Middle East, Latin America, and Asia** we can help clients in their global business challenges.

A&M's differentiated **action- and results-oriented approach** to supporting clients relies on the active and sustained involvement of **senior resources, experts, and former industry operators** throughout the entire project. A&M has an outstanding track record, specifically in driving operational and commercial improvements, delivering bottom-line results, and in situations that require a sense of urgency.

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With over 10,000 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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