

Market Update – March 2010

For the Concrete Block Association

Presentation Notes

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ABOUT THE AUTHOR

Glen Ford is the founder and Director HobsonFord Associates. He is well-known for his thought-provoking analysis of key market trends. Well-researched and authoritative, Glen provides depth and rigour to market analysis.

Glen started his career as a management trainee for Tarmac in 1984. He has 14 years experience of managing operations and a thorough understanding of corporate and business management. He completed an MBA in 1997 and went on to spend six years working in Tarmac's corporate team, working on market analysis and M&A activity.

Glen started his own consultancy in 2004 and is supported by a number of associates and advisors who work with him.

Glen is also a Director of the Argenti Institute for Corporate Strategy and is a Director of Aegis Trust Ltd, a family-based, not-for-profit organisation.



PRESENTATION NOTES (see attached slides)

OPENING COMMENTS

In 2009 my view was largely optimistic, in the face of overwhelming depression across the industry. My logic was simple – the cut in supply and skills had been so great and so fast that there was little prospect of over-supply bearing over the industry for years, as it had done so in the 1990s. Moreover, the reduction in demand for concrete blocks and masonry products was not driven by a reduced need, it was driven by an absence of finance. That had to change, especially as the action by Alastair Darling and Mervyn King started to feed through.

In 2010, my view is one of caution. I expect that volumes will continue to recover to some extent in 2010 and into 2011, but there are key unbalances in the economy that point to more troubled times ahead. I am also cautious about the state of the masonry industry and whether it will have the capability to respond to future changes in the market – does it have the skills, expertise and capacity to respond?

My caution over the economy is based upon the pain that we all know will have to be borne over the coming years to deal with the national debt. Also, interest rates can only go one way and that will have a sizeable impact upon the housing market and the economy.

My caution over the masonry industry is based upon the knowledge that current volumes represent a historical low – reflecting the dire lack of supply of housing. That has to change over the next 10 to 15 years, because housing is not a nice-to-have, it is a basic need.

Slide: Headlines

The outlook for concrete blocks and masonry is positive. Volumes will continue to grow, although some moderation should be expected within a few years. The supply of affordable housing remains a problem – there is not enough - and this will require innovative solutions. The strong focus on cost and increased employment should be positive news for the masonry industry.

The overhang from public debt is considerable and will bear down upon the economy for many years. Tax rises and spending cuts will dampen the economy. But the expected reduction in public investment is more of a concern to heavyside products than masonry, which is mainly driven by private sector demand.

The reduction in masonry capacity – skills and materials - is a key concern to builders and it will be to the industry at large. If volumes pick up then customers will not wait around, they will use alternative build methods.

Slide: Starts are Key Indicator

This graph shows private housing starts and concrete block deliveries (all blocks) from 1970. Whilst blocks are used in more applications than just private housing starts, the strength of correlation between the two is striking.

Concrete block deliveries and housing starts are at an historical low point, which suggests the trend over the next 15 years will be decisively upwards.

Slide: Modest Recovery In Volumes

This chart shows concrete block deliveries from 1970 and forecast to 2015. The chart also highlights the previous recessions and subsequent recoveries – each time period is shown by a different colour.

This pattern suggests that following a recession there is typically a sharp rebound, although volumes can over-expand and lead to a subsequent fall within a few years. Changes in volumes can be erratic.

The forecast is by HobsonFord, as represented by the fan. We expect there will be a sharp recovery of volumes over the next few years, although volumes will remain below pre-recession levels. There is a degree of risk around the strength of rebound and hence the fan shown in the graph, although all indications suggest significant growth of some measure.

Slide: Not Enough Houses

This chart shows new house completions since 1900 for Great Britain. This clearly indicates the historic low point of 2009, which is unsustainable in the longer-term.

Slide: New Housing Policy Needed

The supply of new housing is relative to the growth in the number of households.

This chart shows the net balance – shortage or surplus – of houses relative to the number of households. A surplus means that there is an adequate supply of housing for the population at large. A shortage means that a number of would-be households are not able to access their own home. They may be living with parents or relatives, or there may be overcrowding, with several families living in the same dwelling – separated into smaller units (i.e. bedsits and the like).

This chart shows the extent of the looming housing crisis. For much of the last century there was an acute housing shortage – until the 1970s when, following years of large council build programmes, the supply of housing was brought into balance with the number of households.

We have again reached a critical point – there is a net shortage of housing and this is expected to get much worse over the next 20 years. This assumes build rates at pre-recession levels – i.e. circa 200,000 homes per year. The reason for this change is the anticipated change in the UK population through the baby-boomers living longer than their children – i.e. the effects of an ageing and growing population. This is made worse by the fact that older people tend to live in smaller households – 1 or 2 people – and they tend to remain in larger properties.

The shortage of affordable housing will drive the need for a new housing policy – in fact we have already seen these some of these changes.

Slide: House Prices Are Too High

The one very large fly in the housing recovery ointment is house prices. They are simply too high. This chart shows the trend in house prices, adjusted for inflation, from 1975 to 2009.

Previous rises in house prices – seen in the 1970s and 1980s – were offset by inflation or subsequent falls or a period of stagnant prices. In contrast, over the past 10 years we have seen exceptional house price inflation, but a low level of general inflation. This was stimulated by an expansion of cheap credit, low interest rates

and increased planning regulations – which artificially constrained supply. The result is a legacy of high house prices.

Like over-valued stock, this is a barrier to future sales – at least it will restrict the number of people that will be able to afford free-market housing in the future.

The implication is that there will be limited upward movement for house prices, when adjusted for wages and inflation, and this will restrict demand, because of affordability.

Free-market housing will become the prerogative of the wealthy and those that can access family support. This will – of course – create pressure for other forms of more affordable housing, although this will take time to translate into build programmes.

Slide: Housing Conclusion

There have been many booms over the past 16 or so years – a credit boom, a house price boom and a boom in commercial building. There has not been a housebuilding boom. Therefore, the drastic reductions in demand seen over the past 18 months are not part of a cyclical downturn from an over-heated market – it was driven by a lack of finance.

However, the high price of free-market housing will restrict the recovery in the private sector. Moreover, this will create the need of innovative and cost effective solutions – the era of affordable housing has only just begun.

The implications for concrete blocks is positive. There are likely to be modest gains in the short-term and there is the opportunity to win back share from timber if the industry can successfully position itself with builders and regulators.

Slide: Public to Private

This slide shows the forecast from the 2010 Budget on investment across the economy. This indicates the expected switch from public sector investment – as seen in 2008 and 2009 – to a reversal from 2010/11 onwards. This should be good news for masonry, as the industry is more exposed to private sector demand.

Slide: Public Sector Peak

This chart shows gross public sector investment – in constant prices – from 1971 to 2015, as proposed in the 2010 Budget.

The peak of spending in 2009/10 is shown in contrast to previous levels. We are likely to see dramatic cuts in public investment for many years to come. However, as stated previously, the negative impact upon concrete blocks will be modest because the main demand for masonry is from the private sector.

Slide: Public Debt Hangover

This table is based on the 2010 Budget and shows the increase in public debt expected over the coming years. This will have a significant impact upon the economy for many years to come, as increasingly the focus of the Government will be to service and contain this debt.

Slide: Summary for Concrete Blocks

Given the massive reductions in demand seen over the past 18 months – and the impact upon the masonry industry - there is good reason to be cautious.

Indeed, my view is one of caution. The economy is benefiting from the policy interventions of late 2008 and 2009 – with record low interest rates, the Bank of England injecting money into the economy, and record levels of public spending. This has to change over the coming year and this will dampen the economy, although hopefully not into a double dip recession.

However, the outlook for masonry and concrete blocks is brighter than for most sectors. The switch from apartments to houses will also benefit masonry, as the intensity of use of masonry products is much greater with houses than with apartments.

There is a tangible opportunity to re-position the sector against timber, to win back share. Masonry is a cost effective and trusted solution, it also creates local employment through site trades.

But will the industry have the capability – the expertise, skills, market and technical know-how, leadership and the capacity to respond and to exploit this opportunity?