

PRIVATE EQUITY: CAPITALIZING ON SUPPLY CHAIN ISSUES IN THE BUILDING PRODUCTS SECTOR

By Paul Giovannoni and Mark Flournoy

The past three years sparked supply chain issues across industries, but for building products manufacturers and suppliers, the disruptions continue to cause problems for some and opportunities for others.

Equipment that used to be easily obtained, such as electrical transmission and distribution equipment, has become difficult to procure.

Strains on the supply chain have extended lead times, reduced availability and created challenges for owners and contractors alike. An emerging trend across the built environment is the extension of backlogs at large original equipment manufacturers (OEMs), resulting from material shortages and increased demand from select sectors in the built environment.

Many customers are not able to forecast their needs as far in advance as some bulk purchasers (like large utilities), and there is pent-up demand for products



that require shorter lead times. Customers are increasingly willing to turn to alternative solutions that match their schedules. This creates opportunities for smaller, more nimble OEMs to step in and fill the gap in the market. With demand high and supply chain challenges continuing, the market for critical components is becoming less price-sensitive, which too creates opportunities for smaller providers.

Since niche OEMs have been gaining market share, many are looking for capital to expand their operations into different product lines or geographies, creating opportunities for private equity investors to accelerate their growth. Additional capital may allow firms to expand their shop floors, invest in new energy-efficient technologies, or scale their

workforces. Private equity firms and strategic sponsors have been targeting companies in this space, contributing to a spike in mergers and acquisitions (M&A) activity over the past 18 months.

Powering the Grid

Take for example products needed to improve the delivery and capacity of the U.S. electricity grid. Heightened strain on the electrical grid due to increased electrification is a continuous driver of demand across the country for transformers, switchgear and related equipment.

Transformers play a vital role in increasing or decreasing the voltage of electrical power as it moves through the grid, allowing it to be transmitted over long distances with minimal energy loss. Switchgear, on the other hand, refers to a collection of electrical components used to control and protect the power distribution system. Switchgear includes circuit breakers, fuses and other devices that help isolate and protect electrical equipment in the event of a fault or overload. Together, transformers and switchgear are essential for maintaining the stability and reliability of the electrical grid, ensuring that electricity is delivered safely and efficiently to residential and commercial buildings.

Demand Drivers

Despite longer lead times, transformers and switchgear are in high demand across a broad range of industry segments, and without this equipment, construction projects get delayed or put on hold. The aging installation base of electrical infrastructure is also driving demand as these components are replaced. In addition, increasing electricity usage is placing more stress on older equipment, accelerating the aging process.

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Investment in electrical generation capacity is quickly expanding to meet market needs. [The Energy Information Administration \(EIA\) estimates](#) that electricity generation more than doubled its share as a percentage of all renewable energy generation to nearly 25% in 2022 from 10% in 2010. The EIA estimates that renewable energy generation will account for nearly 44% of renewable electricity and is expected to increase by 64% through 2050. Federal legislation is attracting the interest of investors as several recent funding vehicles were recently codified to strengthen U.S. infrastructure.

[The Bipartisan Infrastructure Law \(BIL\)](#) provides the largest infrastructure investment in U.S. history, totaling more than \$550 billion through 2026. A significant portion of this is allocated toward addressing an infrastructure deficit that is expected to grow. Nearly \$62 billion in funding is going to the Department of Energy with the primary goal of building grid resiliency and reliability as well as implementing advanced technology to improve efficiency.

[The Inflation Reduction Act \(IRA\)](#) additionally funds many important projects related to manufacturing. It sets aside more than \$20 billion toward

grid hardening and resiliency, and more than \$40 billion toward advanced energy product manufacturing. This will expand generation capacity across the country and incentivize development of critical infrastructure. Consequently, American manufacturing companies are positioned to benefit from a legislative boon, fueling investment in the production of domestic infrastructure projects.

Shifting Backlog Dynamics

Along with exacerbated lead times, manufactured products have also been dealing with cost increases in raw materials for the past two years. Pricing for equipment is typically subject to change and often escalates over a short period of time.

To create stability through volatile times, public utility buyers are increasingly purchasing orders well in advance. Public utilities are forecasting the demand on the electrical grid and securing budgets to account for the predicted demand.

As a result, these cost-sensitive purchasers are also placing large block orders more frequently and further into the future. Large block orders are typically placed with a large OEM three to four years ahead. The manufacturing backlog created at large OEMs leaves fewer slots for private engineering, procurement and construction (EPC) firms to obtain equipment on a shorter-term basis depending on need.

EPC firms often find themselves squeezed out of available manufacturing slots because of bulk utility orders. Private development does not benefit from the same predictability that public utilities are afforded, which complicates planning for equipment needs. Firms that do not want to stock inventory for future jobs are required to resort to alternative solutions for tighter timetables. Alternatively, companies that once typically went to a large, commoditized producer are unable to procure the quantity required to fit their schedules.



As a result, EPC firms are increasingly seeking out new relationships with regional and specialty manufacturers to procure equipment. Price is typically a secondary consideration, behind the availability and quality of this equipment.

Regional firms can move upmarket to meet unaddressed demand for manufactured equipment, harnessing their strengths without compromising on price to bring in new business. As these manufacturers whittle away market share at the higher end of the market, they can widen margins on highly engineered products that are more expensive. Even as the market stabilizes, these manufactures have the opportunity to retain share through providing better service and more customized products with shorter lead times.

Opportunity With Regional, Specialty Manufacturers

Specialty manufacturers who build custom equipment and equipment oriented toward repair and replacement have been particularly attractive to private equity buyers. The suppliers are generally more nimble in their production and supply more attractive



lead times for buyers. Additionally, these suppliers often have a greater customer service orientation and can create long-term, more valuable relationships. Specialty manufacturers across the country are highly fragmented. These companies are often regionally based and focus on serving specific markets. Purchasers of specialized equipment often value the in-person opportunity to contribute to the design process. Increased spending in this space has attracted considerable investment interest from private equity and strategic sponsors alike.

This is not limited to electrical transmission and distribution equipment, but also includes a broad array of building products such as insulation, plumbing equipment and heating, ventilation and air conditioning systems (HVAC). Residual supply chain complications are changing the way firms traditionally procure equipment, with a renewed emphasis on high-quality products that are consistently and readily available.

Manufacturers stepping in to fill the unaddressed gap for larger-volume commodity purchase orders can benefit from additional capital to expand production. This presents an attractive opportunity for private equity investors to partner with vendors to provide access to resources that can accelerate this growth.

Increased electrification and energy consumption across industries are examples of trends creating opportunities for private investment to fuel growth. Navigating a rapidly shifting marketplace is complicated and nuanced. Investors in this space face many challenges when evaluating a business such as:

- Where are the market opportunities created by macro trends and challenges?
- How is the competitive landscape evolving?
- What drives procurement decisions and stickiness among customers?
- How do we evaluate the ways to create long-term value of specific assets?

It's important for private equity firms looking to make investments in building products to work with partners who understand the nuances of the markets, the changing economics of construction, and the shifts in demand from builders and consumers.

What began as supply chain challenges, delaying production of critical equipment such as electrical switchgear, has evolved into opportunities for investors who understand the building products market and how to leverage their investments to create long-term value.

Authors



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Segments where Paul has direct experience include infrastructure services, engineering, building products and distribution, industrial services, energy and cleantech, HVAC services, construction materials, construction technology, utility services, specialty trade contractors, general contractors, and construction equipment and tools.

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