AMERICA'S CONSTRUCTION SUPPLIER

First to arrive at US construction sites, Ferguson is last to leave. Brunswick talks with CEO **KEVIN MURPHY.**

In moving its primary listing to the NYSE from London this year, Ferguson is bringing the company back home, where it has served the US construction industry for 70 years. Today, Ferguson is a $23 billion leading North American distributor that provides expertise, solutions and products to construction projects across the country—from infrastructure, plumbing and appliances to HVAC, fire, fabrication and more. It transferred its primary listing from the London Stock Exchange to the NYSE in May to align listing location with sales, operations and management.

Its ubiquitous presence in the building trades offers Ferguson an extraordinarily informed glimpse into the present and medium-term health of a critical US market. In short, Ferguson is a bit of a national economic indicator. Its CEO, Kevin Murphy, was born into the business, his father having started an Ohio pipe and supply company that Ferguson eventually acquired. After a steady rise at Ferguson, Murphy took the top job six months before the pandemic arrived. Under his leadership Ferguson managed to thrive amid that difficulty.

In an interview with Brunswick's Rebecca Kral and Andrew Williams, Murphy outlines Ferguson's strategy for growth, explains how its culture is designed to train leaders and explains why his own story offers inspiration to associates joining Ferguson via acquisition.

Your career at Ferguson began when it acquired your father's pipe and supply company in Ohio?

My father started a company called Midwest Pipe and Supply, based in Columbus, Ohio. Very early on, I started working in the warehouse loading and unloading trucks, working our will-call counter, doing inside sales, making deliveries and eventually going on the road as a salesperson. I've done essentially every job that you can think of inside a wholesale operation.

As my father moved into retirement, I was essentially managing the business. We were a good growth business, and it got to a place where it was either, "Let's expand significantly and go regional," or, "Let's hunker down and be a great local niche player."

Then Ferguson came knocking. We sold the business to Ferguson on June 4, 1999. I found a home with the talented associates of Ferguson who gave me a great opportunity. In terms of passion, knowledge for the business, real desire to succeed and grow, I met some of the most amazing people here. They embraced me, and the rest is history.

"MEDIUM TERM—THREE TO FIVE YEARS—WE SHOULD HAVE A ROBUST HOUSING MARKET."

What qualities do you think most enabled your rise at Ferguson?

You try at every level to be the best at what you're doing for the organization. But what really made Ferguson a good fit for me was a culture established long before I arrived, a culture where you will succeed if you care more about developing those around you than you care about your own position .

You've said Ferguson is the first to arrive at the job site and last to leave. How does that work?

We're involved from the very start of a project—from the first shovel of dirt being turned at a construction site partnering with the utility contractor for the underground water, wastewater, storm water or reclaimed water piping systems.

As the building begins to take shape, we supply all the rough-end plumbing, the heating, ventilation, air conditioning and air purification. Then move to the finished plumbing—toilets, sinks and faucets. Then ultimately, the lighting, appliances, and even indoor fire suppression—we touch the entire construction of the property.

In the case of multifamily and commercial, we have a business that handles the ongoing maintenance, repair, and operations of that building. Then, if there is a teardown, we'll start the building life cycle all over again with our customers.

How did the 2008 financial collapse change Ferguson?

In the years leading up to 2008, Ferguson was heavily skewed to new residential construction. We were building 2.2 million housing starts in this country with seemingly no end in sight. We also had a balance sheet that was significantly more levered than where we are today and we were also a bit out of balance as it relates to labor expense.

Those lessons really influence how we think about the business today. Now we're a more balanced business with 56% residential and 44% non-residential. We're 60% repair, maintenance, and improvement, and 40% new construction.

Today, if there is a slowdown in new residential construction, we're a much more balanced organization and can better navigate market challenges. And it's the same thing for commercial and public works spending. That balance creates resilience.

Additionally, we maintain a very strong balance sheet. We target a net debt to EBITDA, range of one to two times. We're not to the bottom edge of that range yet; we're finishing the half year at 0.8 times. And we are committed to staying at the lower end of that range which gives us flexibility should we go into another downturn and want to ramp up our investment in things like technology, market distribution centers or further acquisitions.

You took over in September of 2019, about six months ahead of the pandemic. How did Ferguson manage to withstand the pandemic so well?

My first half-year conference call was in March of 2020. We had a board meeting in London and instead of delivering the H1 results live from the London Stock Exchange, I had to come home immediately and conduct the call remotely because of looming travel restrictions.

I got a crash course in how to work through investor relations in a dynamic situation. The questioning really took a pivot. Everyone was concerned, and rightly so, about liquidity. Essentially, they were asking: "How long can you hold your breath underwater if things get bad?"

WHEN WE SURVEYED OUR ASSOCIATE BASE, WE WERE PLEASED TO HAVE A TWO-POINT IMPROVEMENT IN ENGAGEMENT DURING ONE OF THE TOUGHEST SUPPLY CHAIN ENVIRONMENTS THAT WE'VE EVER SEEN.

We made it through by doing what we always do: Start with the truth. We talked about the variable nature of our cost base, and our strong liquidity position because of our healthy balance sheet. We talked about how our strategy was safety first for our associates and our customers. And we talked about the essential nature of the products that we supply to the marketplace.

Putting the health of our associates first meant that we moved over half our 28,000 associates to remote work. Even though our services were essential—meaning we could continue operating—we closed our showrooms and counters to customers and vendors for a period of time.

We continued the essential nature of our business, such as our truck fleet. But we made sure we took a cautious approach to our associates' safety, even if our competitors weren't doing that in the local marketplace. Then we gradually re-opened as things progressed, and the demand curve became supportive, especially on the repair, maintenance and improvement side.

It really helped that we had a digital interface that allowed customers to place orders online with curbside pickup. They could text the counter when they arrived and someone would run their materials out so that the transaction could be done at safe social distance. Or they could order online for next-day delivery, and track through geo-positioning of our truck fleet—like you can an Uber—to exactly where that truck was in relation to their job site.

As the pandemic progressed, we relied on the strengths of Ferguson—our global supply chain, our world-class sourcing operations, our digital tools, and our associate base—to flourish during a time of rapid change and supply chain chaos that ensued after the pandemic lockdown.

You mention supply chain chaos—did Ferguson encounter much of that?

We were right in the heart of all of those disruptions, and we were not immune to them—and we were not certainly immune to the knock-on effects of inflation inside of that. But we're really proud and pleased at the way we managed it—we actually grew our market outperformance.

The reason was, number one, we have scaled long-term relationships with our branded suppliers that date back decades, 70 years in some cases.

Second, we source products from 31 different countries around the globe. We have a world-class supply chain of over 1,600 locations and distribution centers and work to make sure that we are the best path to market for our suppliers.

Any project will be more simple, successful, and sustainable because Ferguson is a part of it. Our associates make sure of that.

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Could any company have been immune to backups at the ports?

We were seeing roughly 30% on-time and in-full rates from our top 20 suppliers, which was about half of what we were normally seeing. But our supplier relationships, global sourcing operations and strong balance sheet allowed us to have 95+% in stock inventory at the local level for our customers where and when they needed it.

If you look at our import centers, we're able to bring product quickly from the coasts into our regional networks and then down to the local branch. That was a huge driver for outperformance for our company. And it offered our associates a great deal of confidence knowing that they had access to product that our competitive landscape didn't.

Do you expect residential construction demand to remain strong?

From a medium-term perspective, that new construction housing marketing should be an attractive market—I say that fully mindful of what pricing and interest rates can do to near-term demand.

But medium term—three to five years—we should have a robust housing market. When we came out of '08, '09, the country underinvested in new construction. You need roughly 1.5 million starts a year to get us to equilibrium to take care of household formation, disaster recovery, immigration, and second homes in the US. And we had been under that 1.5 million mark for quite some time. It's debatable, but people would suggest that we're still under-built by 3.5 million units in this country.

"Our drivers see our customers more than our salespeople. They're the best salespeople we have," says Murphy.

COVID—with its effect on remote work and hybrid work—likely has extended what the commutable distance to urban areas is because people aren't going into the office every day. If you've extended that distance, that's bullish on single-family new suburban construction.

The same is true for RMI [renovation, maintenance, improvement]. Homeowners have a strong desire to improve the interiors and exteriors of their homes because they are spending so much time in them working remotely. Our best indicator of remodeling activity is existing home turnover because people will remodel their house or repair and finish their house pre-sale and post-sale. We're still very confident in what the medium term can bring with RMI and new construction for housing.

We have a pretty good early indicator as to when we're starting to see changes in new residential construction because we would see a lack of bidding activity or a lack of construction activity of our waterworks business, which is the first on the job. And we haven't seen that to date.

You've said that Ferguson represents about $23 billion of a very fragmented $300 billion market. Is there any limit to how much you can grow your market share?

We've got a great North American market opportunity. For our nine different customer groups, we have leading positions, number one or number two for 75% of our revenue. Yet even in our largest market share customer group, we only have roughly 26% share. We expect to outpace the market by three to four points per year, based on the strength of our supply chain, digital investment, associates and a suite of value-added services.

Complementing our organic growth, we'll add roughly 1–3 points of annual growth by acquiring companies and consolidating those fragmented markets as we go. We made six acquisitions in the first half of this fiscal year alone. If you look across our nine customer groups, there are 10,000+ competitors across the nation, mostly small- to medium-sized independent businesses.

Our acquisition strategy is two-pronged: first,

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geographic bolt-ons, where an acquired firm brings local relationships into Ferguson, and Ferguson in turn provides its strengths to enable those local relationships to flourish. It's a case where one plus one equals far more than two. Second, capability acquisitions where we can take a specific capability and leverage it across our bricks-and-mortar and across our digital channels. That enables us to grow and take share while improving our operating margin performance and be solidly cash generative. It's a great balance.

Is it typical for Ferguson to retain talented management at acquisitions?

If a business owner has a value set that says, "We care about the development of the people that have made this business successful," then we're the best home for your company. Because we're going to provide opportunities for those people to grow and flourish in a way that perhaps wasn't available to them as an independent family business.

We start by looking across the North American landscape and, from a local level all the way up through our top leadership, we have a strong understanding as to what parts of the country would make a good geographic bolt-on, and what types of companies we're looking for. Then we start building relationships over years and years—the sale of an independent business is, in many cases, the single biggest decision they'll make in their lives. Everyone needs to make sure the relationship is right.

We look for companies that have a good track record, that have good local relationships, and with shared values. The biggest part of the purchase price in many cases is goodwill. That goodwill is represented by the intellectual capital of the local relationships they have in the marketplace. Also, that company can't be simply selling products in the market based on price. They've got to charge for the value they provide and be rewarded for it.

Why did you move your primary listing to the US?

We believed our listing structure should mirror the profile of our sales and operations. On March 10th, our share register voted with over 95.5% approval to demote the premium listing in London and move the primary listing over to the US.

That allows us to maintain our great UK shareholders, but also attract an entirely new group of US domestic capital into our shareholder register. It also allows us to move our indexation, as well as our sell-side analyst coverage from Europe into the US, where there's a greater understanding of the markets that we compete in. And as we become better known in the public markets, it will allow our associates—99% of whom are in the US and Canada—to be recognized for how they positively impact construction and repair and maintenance inside the US.

"ANY PROJECT WILL BE MORE SIMPLE, SUCCESSFUL AND SUSTAINABLE BECAUSE FERGUSON IS A PART OF IT. OUR ASSOCIATES MAKE SURE OF THAT."

What has led your mission to lower your carbon footprint and be on top of ESG issues?

We set out goals to reduce our carbon emissions by 35% over five years. We will achieve this by improving our facilities with LED lighting and HVAC retrofits, piloting electric battery medium- and heavy-duty trucks and increasing renewable energy. Our carbon footprint is important, but we think we can make an even bigger impact through our "handprint." We are in a unique position to guide our customers to more sustainable solutions for their projects in areas like carbon and water, for instance.

You'll see a growing and dedicated effort to make sure that we're influencing innovation and design at the manufacturing level, and then how products get specified and put into place in construction across North America—products like high-efficiency HVAC equipment and appliances, and efficient solutions for water and wastewater applications.

Regarding our social efforts, our Ferguson Cares program empowers our associates to give back to the local community in areas like housing, water scarcity, and the development of skilled trades as a career path. Across our company, you'll see a passion to give back to the communities where we live and work.

Has the labor shortage affected Ferguson?

Certainly. Our associates are working harder for every unit of volume that we ship out because they're checking on product three, four times. They're talking with customers three, four times more than they used to because of the supply chain chaos.

And yet when we surveyed our associate base, we were pleased to have a two-point improvement in engagement during one of the toughest supply chain environments that we've ever seen.

The driver and warehouse positions inside of our company, which are so fundamental to what we do, are tough to fill right now. If you look at the driver shortage developing inside of our industry, it's concerning. We have to ensure we are at the right compensation levels and we are providing variable compensation in line with company performance. As importantly, we need to stay focused on career progression to make our company a long-term home. In fact, our drivers see our customers more than our salespeople. They're the best salespeople we have. ◆

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