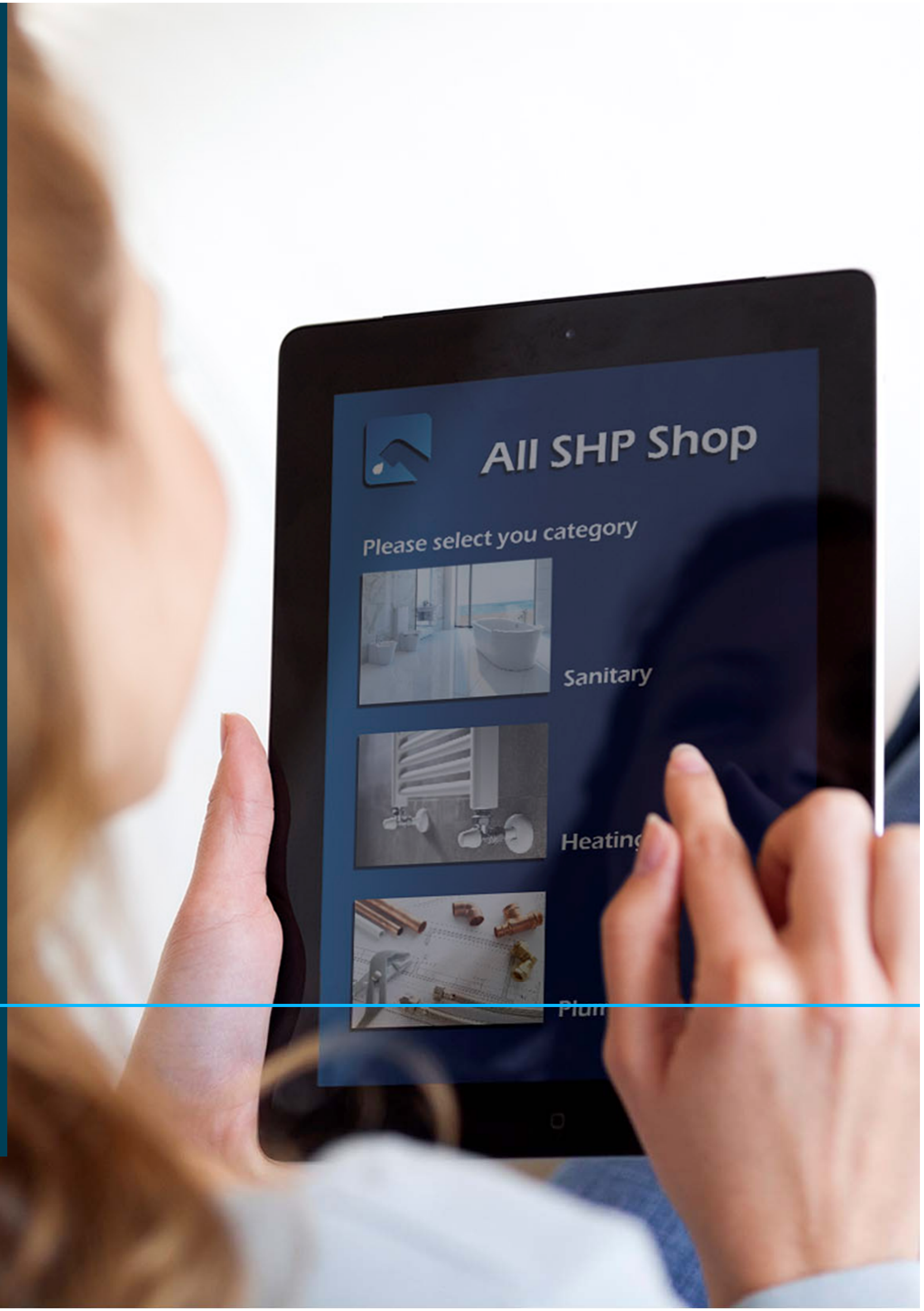
ROLAND BERGER STUDY

The impact of the growing online market on the sanitary, heating & plumbing industry

Munich/Amsterdam, October 2013

Roland Berger
Strategy Consultants



Our study of the impact of web shops on the SHP market shows that online sales will grow rapidly but will stabilize at ~7% market share

Introduction & methodology

> Roland Berger has conducted a brief study of the impact of online shops on the sanitary, heating & plumbing market (SHP market)

> This study is partly based on 24 interviews with industry experts from the Netherlands, Germany, UK and Belgium

> The study is structured in three parts:
  - Current situation
  - Online drivers and 2017 forecast
  - Challenges for all players in the value chain

SUMMARY

Online SHP sales currently account for **1-2% of the total market** in NL, GE and BE, and 3% in the UK

Over 80% of all online SHP sales consist of **sanitary products sold to homeowners**

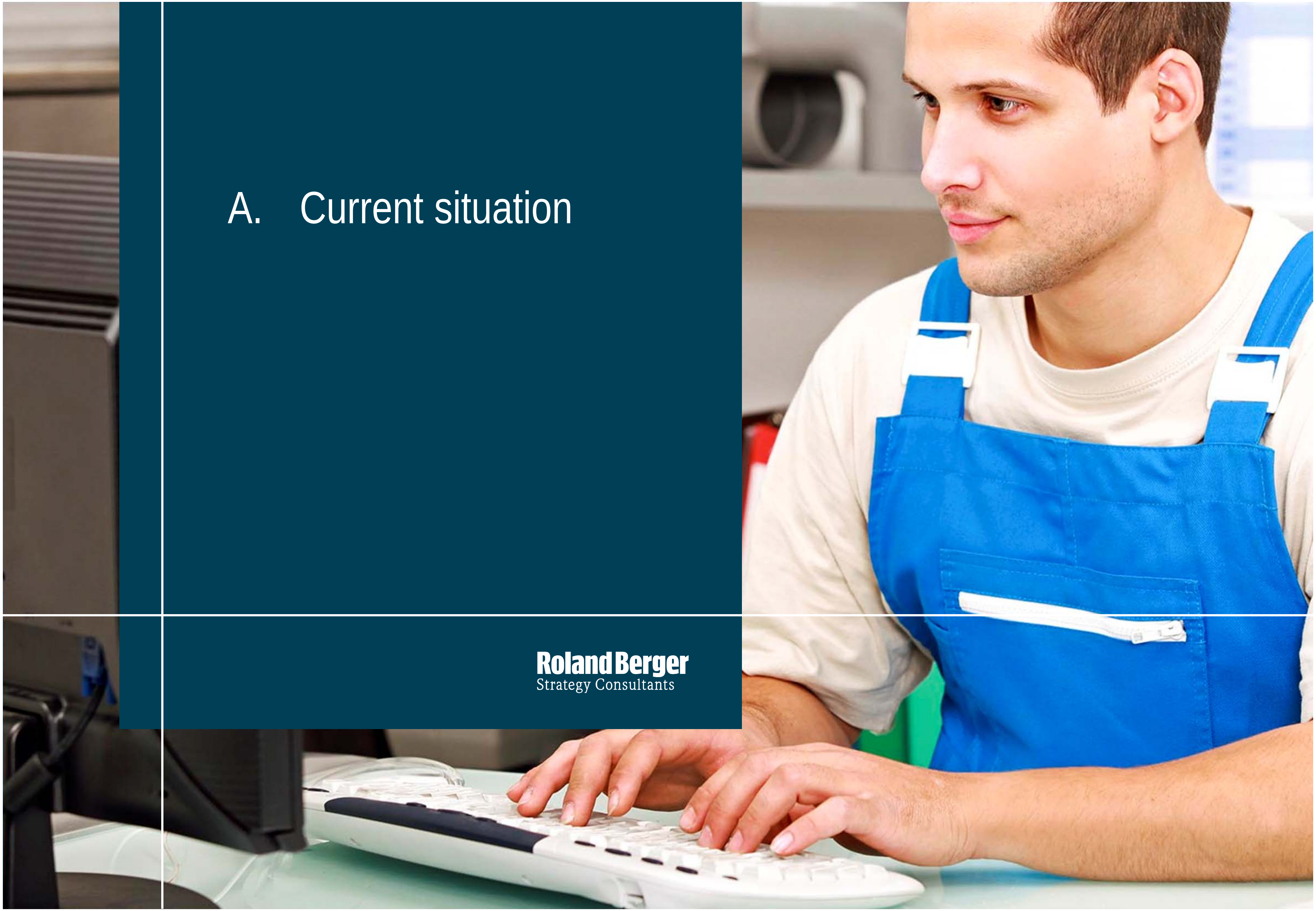
The online growth, which depends on the online attractiveness of products and types of end users, is mainly driven by the price transparency created by web shops

In 2017, the online SHP market will account for 6-7% of the total SHP market, depending on the relative number of homeowners per country

Each SHP player faces distinct challenges in adapting to the growing online market

Contents

A. Current situation



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In most countries today, online shops have 1-2% market share – The UK is slightly ahead with 3% online share

SHP markets of four Northern European countries, 2012

Country	Market [EUR bn]	Online share
UK	7.0	3%
Belgium	1.6	1%
Netherlands	2.6	1-2%
Germany	14.0	2%

Key online players

The German SHP market is used as the example in this document. Most insights apply to the other countries as well

The SHP market can be split into three segments and thirteen product categories

Size of product categories in Germany, 2012 [EUR m]

Total market[1) 14,000

SANITARY
5,600

Taps & showerheads
1,600

Furniture
e.g. bathroom cabinets
1,000

Sanitary accessories
e.g. toilet roll holder
300

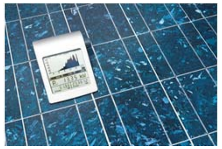
Sinks & toilets
Only in front of wall parts
1,600

Shower walls & toilet seats
600

Baths & shower trays
e.g. bathtub
500

HEATING
4,200

Heaters & boilers
e.g. central heater
1,600



Climate
e.g. heat pumps, solar panels
600

Heating accessories
e.g. thermostat
800

Radiators
~80% standard, ~20% design
1,000

Floor heating
200

PLUMBING
4,200

Pipes, valves & fittings
3,300

Other installation
Includes behind the wall parts of toilet
900

1) Market at distributor selling prices

X = Size of market in Germany, 2012 [EUR m]

End users can be split into seven categories

Size of SHP end user segments in Germany [EUR m]

- **Total SHP market** 14,000 (100%)
  - **New construction** 4,200 (30%)
    - **Non-residential** 1,200 (30%) – New offices, schools, hospitals, factories, etc.
    - **Residential** 3,000 (21%) – People buying a new-build house are often directed to a merchant by the developer
  - **RMI[1)]** 9,800 (70%)
    - **Non-residential** 2,900 (21%) – Maintenance and reno-vations in offices, schools, hospitals, factories, etc.
    - **Residential** 6,900 (49%)
      - **Landlords & tenants** 2,600 (19%) – (Large) institutions, commercial landlords and some tenant purchases
      - **Homeowners** 4,300 (31%)
        - **Ad hoc repair** 800 (6%) – Buying a single new product because the current product is broken
        - **Small replacement** 800 (6%) – Single product purchase because end user wants something new
        - **Larger scale renovation** 2,700 (19%) – Renovation of (nearly) entire bathroom/heating system. Defined as involving five SHP products or more

1) Repair, maintenance & improvements

X = Size of market in Germany, 2012 [EUR m]

Source: Euroconstruct; Eurostat; Roland Berger analysis

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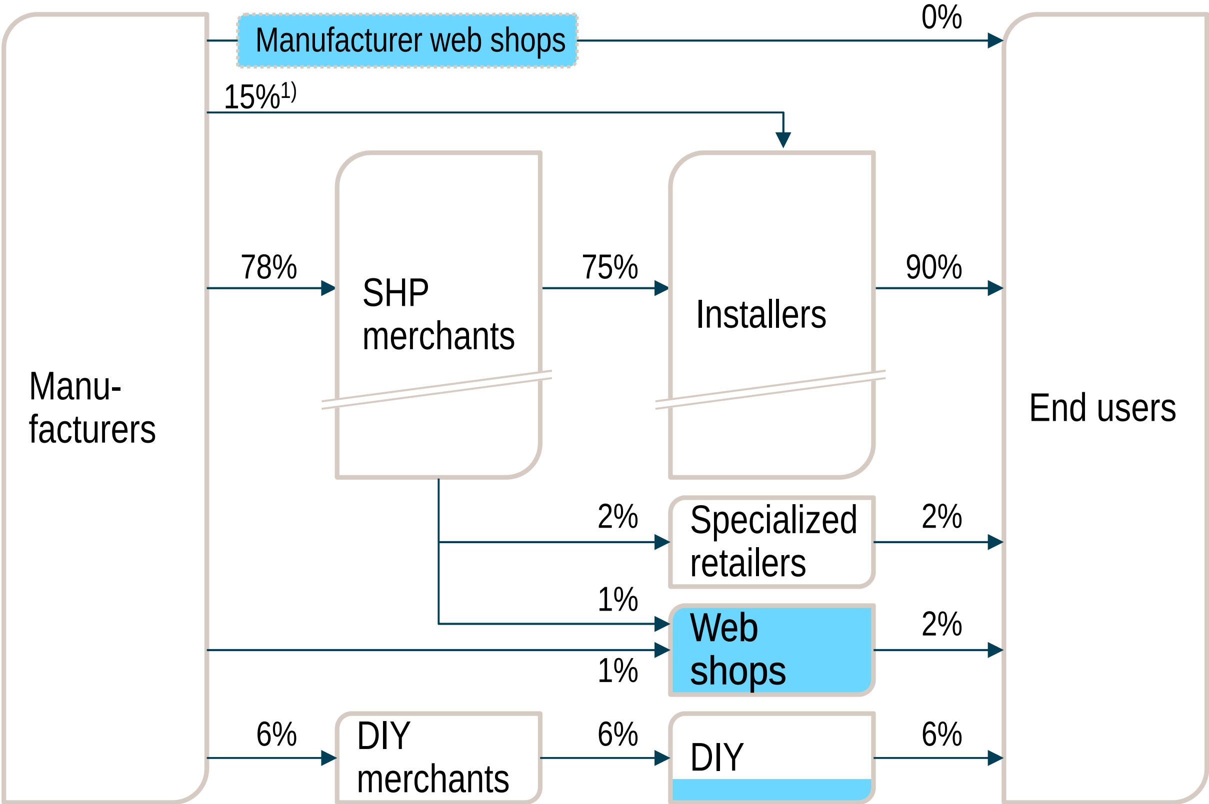
The traditional three-tier model is the dominant channel – To date, web shops have gained a market share of ~2%

Value chain of SHP market in Germany, 2012 [%]



% = 2012 market share Online offers

1) Direct sales channel from heating manufacturers (e.g. Viessmann & Buderus) to installers circumventing merchants

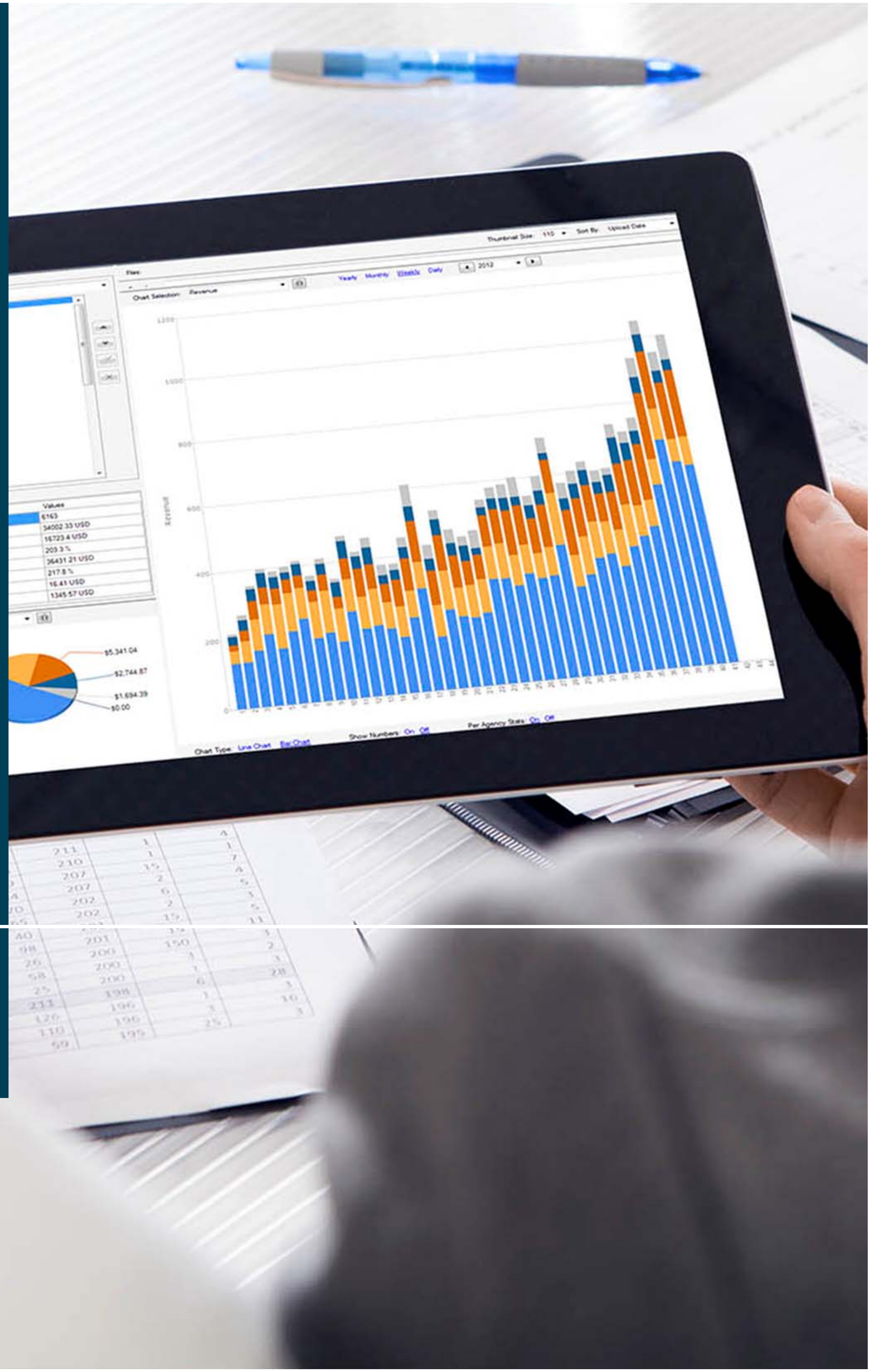
The majority of SHP products are sold via the traditional three-tier model: from manufacturers to merchants to installers

Over time, specialized retailers and DIY have gained a small, stable market share

Web shops currently have a market share of 1-2% and are growing annually by 30-40%

Source: VDS; Roland Berger end user survey; Expert interviews; Roland Berger analysis

B. Forecast of online market share



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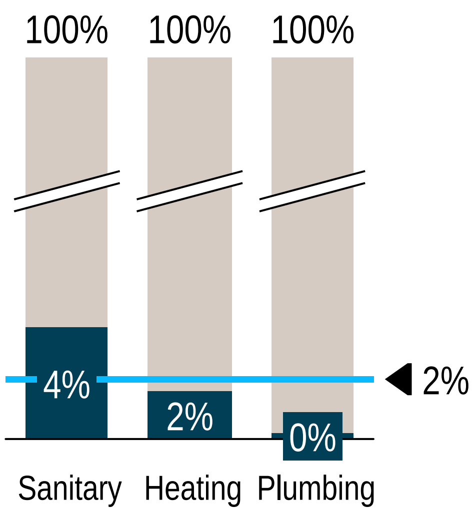
The growth of the online SHP market is driven by four types of drivers

Online SHP market drivers

2012



DRIVERS of online growth

SYSTEMIC DRIVERS

Systemic drivers increase online retail in all industries

PRICE TRANSPARENCY

The internet increases price transparency, which puts pressure on prices in general and on the list price system in particular

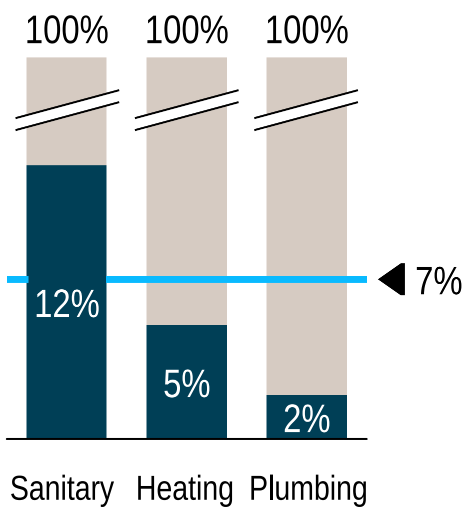
PRODUCT CONSIDERATIONS

Simple products are more attractive online than technically complex products

END USER CONSIDERATIONS

Not all end users have the time or the incentive to order via web shops

2017



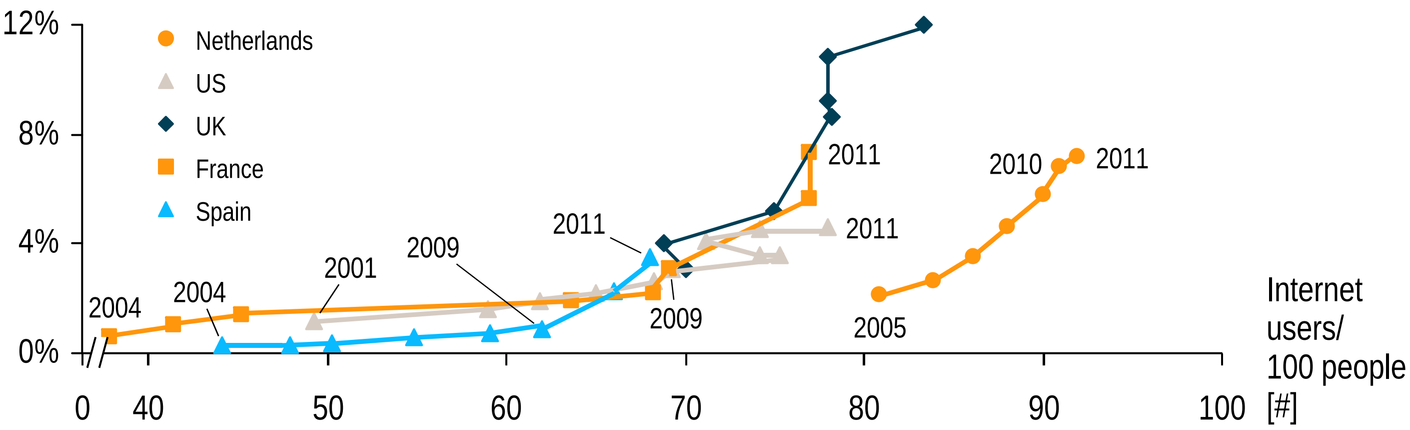
Offline
Online

Source: Roland Berger

Across all industries, the increase in online retail is driven by the growing number of internet users and online tools

Systemic online retail drivers

Increasing (mobile) internet penetration



Growing importance of apps and social media

Path intelligence

ComQi

Retailers can check the movements of shoppers and adapt their shops accordingly

QR code

Number of "QR reader" users is growing, many new business models evolving

Virtual mirror app

Application that makes it possible to virtually try on clothing & jewelry while shopping online

Social commerce

Revenues via social media commerce growing strongly

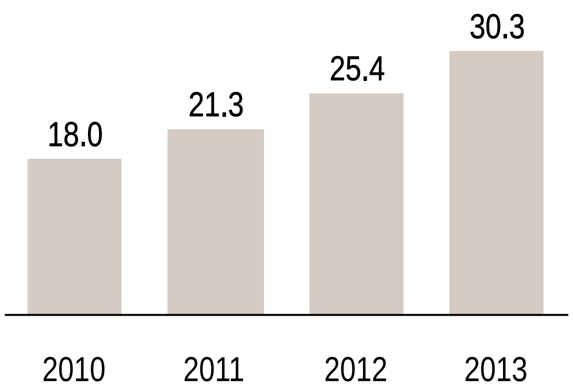
Source: Roland Berger analysis

Online retail's growth is also driven by easier online payments and logistic innovations

Systemic online retail drivers

Development of electronic payment methods

No. of e-payments worldwide [#]



Traditional financial players and newcomers are continuously improving payment methods

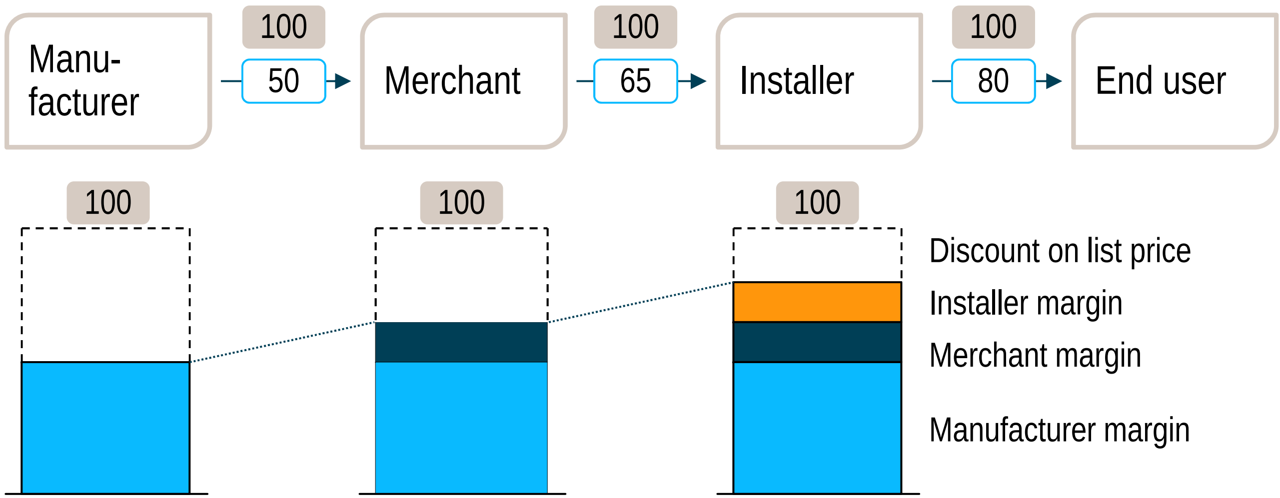
Continuous logistic innovations

Same-day delivery	Order before lunch and DHL delivers it the same day
Click & collect in store	Order at Bol.com and pick it up at Albert Heijn
Unmanned pickup points	Kiala has thousands of pickup points across Europe

Source: Roland Berger analysis

In the three-tier sales model, SHP products are typically sold using list prices as the reference point

SHP value chain and typical prices [EUR]



Manufacturer
- Sets a (non-binding) list price for each product
- Sells it for roughly half the list price

Merchant
- Shows the list price in showrooms (to visiting end users)
- Sells it to the installer at a price far under the list price

Installer
- Initially shows end users the list price and gives a small discount
- Bargaining customers receive larger discounts

List price [EUR]
Sales price [EUR]

Historically, both merchant and installer used list prices set by the manufacturer as a reference

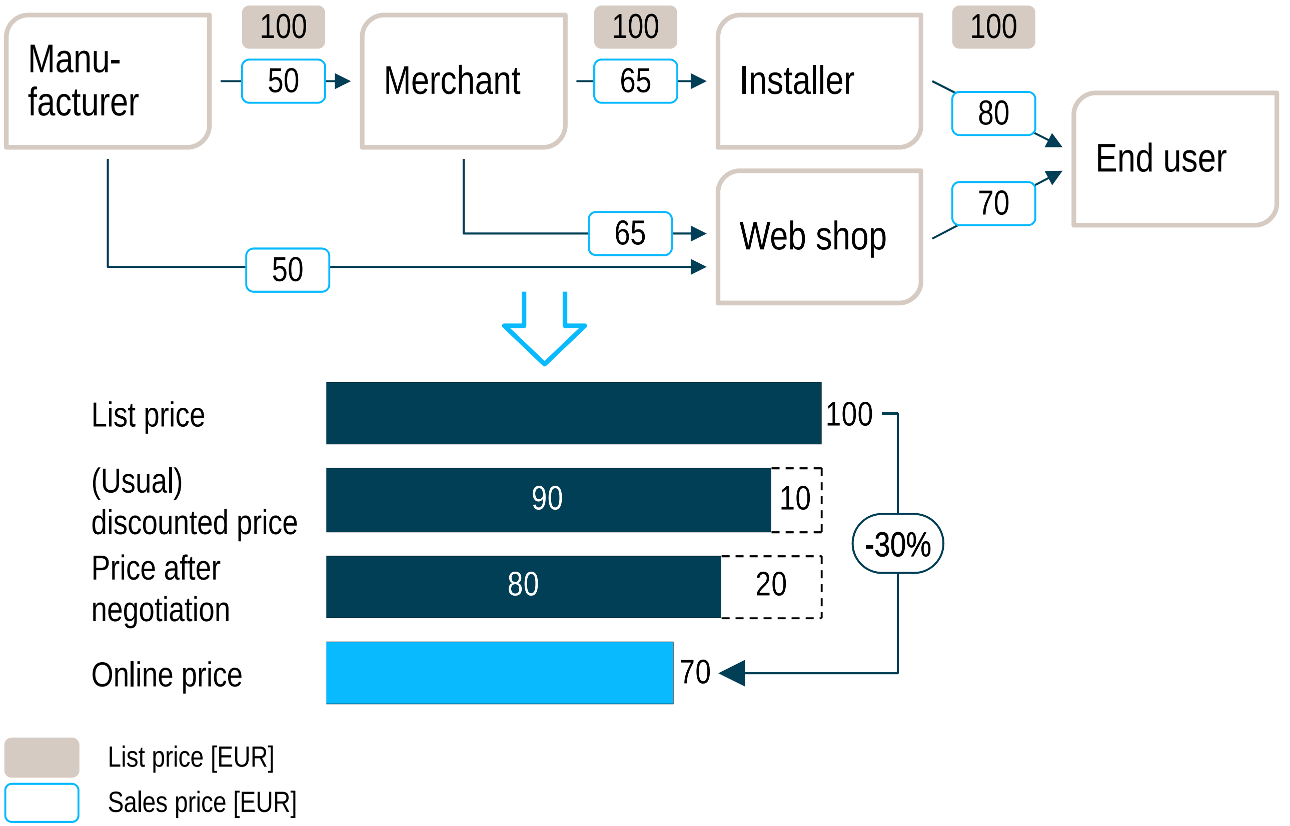
The list price allows installers to earn a margin on the product without making it transparent to end users

This system is increasingly under pressure due to the price transparency created by web shops

Source: Expert interviews

Because they do not quote list prices, web shops appear much cheaper than installers

Installer prices vs. web shop prices, 2012 [EUR]



In general, the internet increases price transparency in all industries

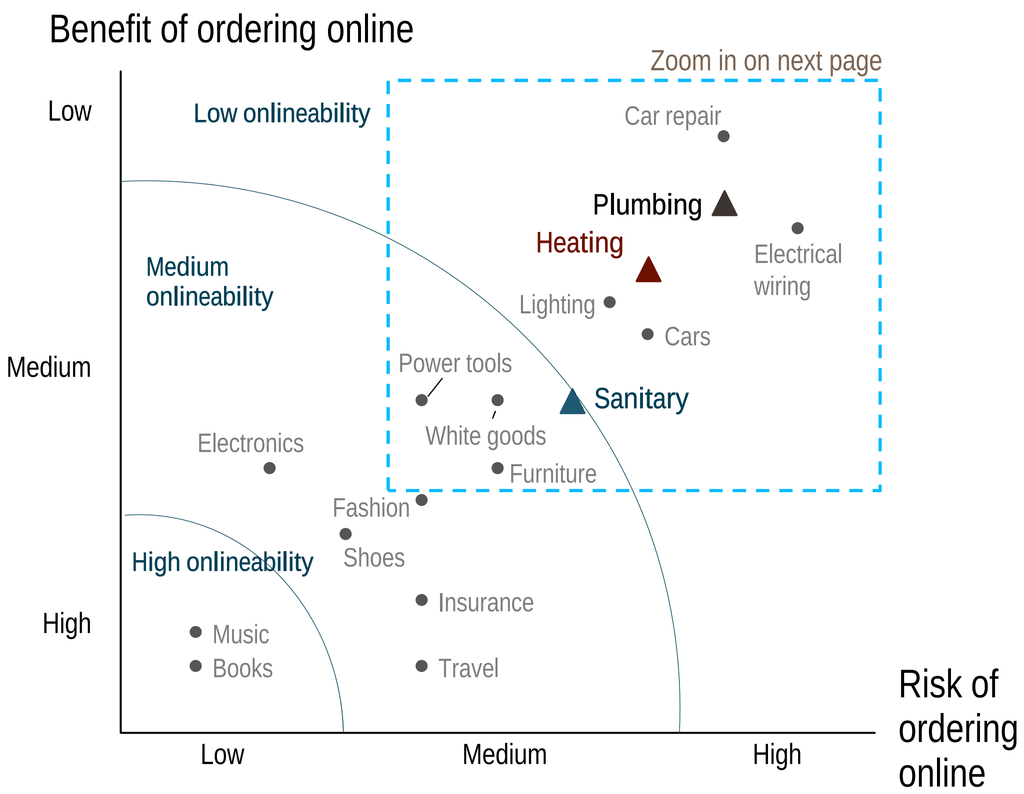
In the SHP industry, the system of list prices makes the price difference between installers and web shops seem larger than it is

In addition, web shops have a different business model (e.g. less service), resulting in lower costs and thus slightly lower prices

Source: Expert interviews

In our experience, the "onlineability" of products is typically determined by the benefit and perceived risk of ordering online

Onlineability matrix



Online attractiveness of products is typically driven by:

Perceived benefit of ordering online:
> Savings vs. alternative options
> Convenience from home
> Ease of delivery and return if wrong

Perceived risk of ordering online:
> Technical complexity of ordering and installation
> Level of routine in buying/using the product
> Access to risk reduction measures (e.g. guarantee)

SHP products have relatively low "onlineability", however, the large price differences between offline channels and web shops still drives online growth

Source: Roland Berger analysis

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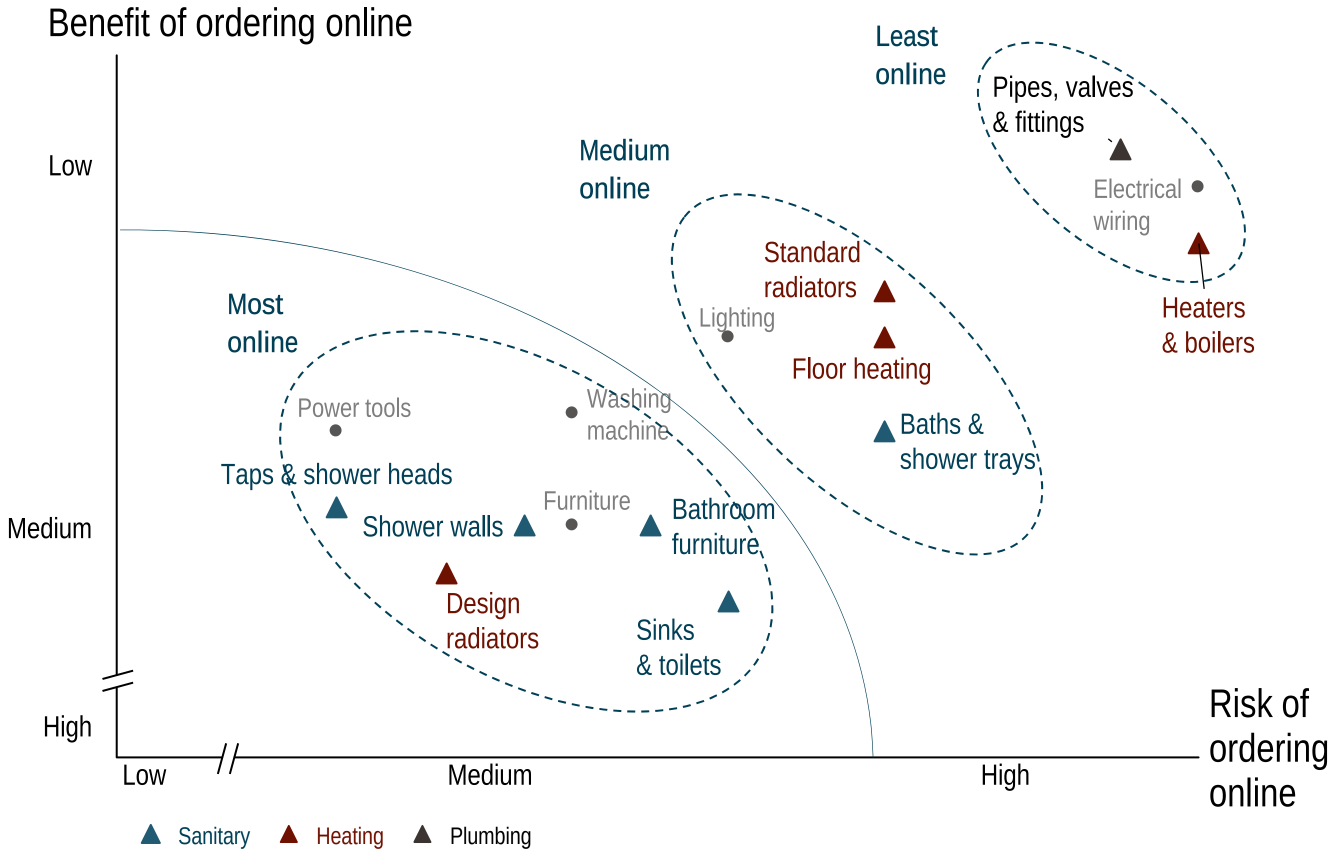
Sanitary products that are easy to install are most attractive online – Technical heating and installation products are least attractive

Onlineability matrix for SHP products



The financial benefits of buying SHP products online can be high due to the large (e.g. 30%) on/offline price difference and the high purchase value (up to EUR 10,000)

For simple (branded) sanitary products, it is easier to find the same product online and install it (or let the plumber install it)

It is much more difficult/risky to order the right heating and installation products online in view of the risk of surprises and extra costs at installation

Source: ABN AMRO; USP; Roland Berger end user survey; Expert interviews; Roland Berger analysis

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Homeowners are the only end user segment that is highly likely to order online

Likelihood of end user segments to order online

Market	Segment	Sub-segment	End user	Rationale	Likelihood
Total SHP market	New construction	Non-residential		> For new construction, custom deals are made with merchants and/or manufacturers, so web shops have no price advantage here > Only individuals who have their own house built may order via web shops	Low
		Residential			Low
	RMI	Non-residential		> Companies and institutions usually have maintenance contracts with their preferred plumbing/installation suppliers > Employees are not incentivized to research prices online	Low
		Residential	Landlords & tenants	> Most landlords outsource their maintenance and have regular plumbers > Only small landlords and tenants may order online	Medium
			Homeowners	> Homeowners like to orient themselves online and are willing to invest a lot of time (except for ad hoc replacements)	High

Source: Expert interviews

In conclusion, only a limited part (~20%) of the SHP market is strongly affected by online competition

Online attractiveness of products and users

Users		% of market	Products: Sanitary	Heating	Plumbing
					
			40%	30%	30%
New construc-tion	Non-residential	9%	<2%	<2%	<2%
	Residential	21%	<2%	<2%	<2%
RMI[1)]	Non-residential	21%	<2%	<2%	<2%
	Landlords/ tenants	19%	2-8%	2-8%	<2%
	Homeowners Ad hoc repair	6%	8-20%	2-8%	<2%
	Home owners Small replacement	6%	20-50%	8-20%	<2%
	Home owners Large renovation	19%	20-50%	8-20%	<2%

~20%

1) Repair, maintenance & improvements

Level of online attractiveness: <2% 2-8% 8-20% 20-50%

Only ~20% of the SHP market is strongly affected by online competition:
- > Sanitary products are most attractive online (less heating and installation)
- > Mainly homeowners buy online (other users rarely order online)

On average, we expect web shops to gain 1/3 of this part of the market over time, resulting in a future market share of ~7%

Source: Market reports; Roland Berger end user survey; Expert interviews; Roland Berger analysis

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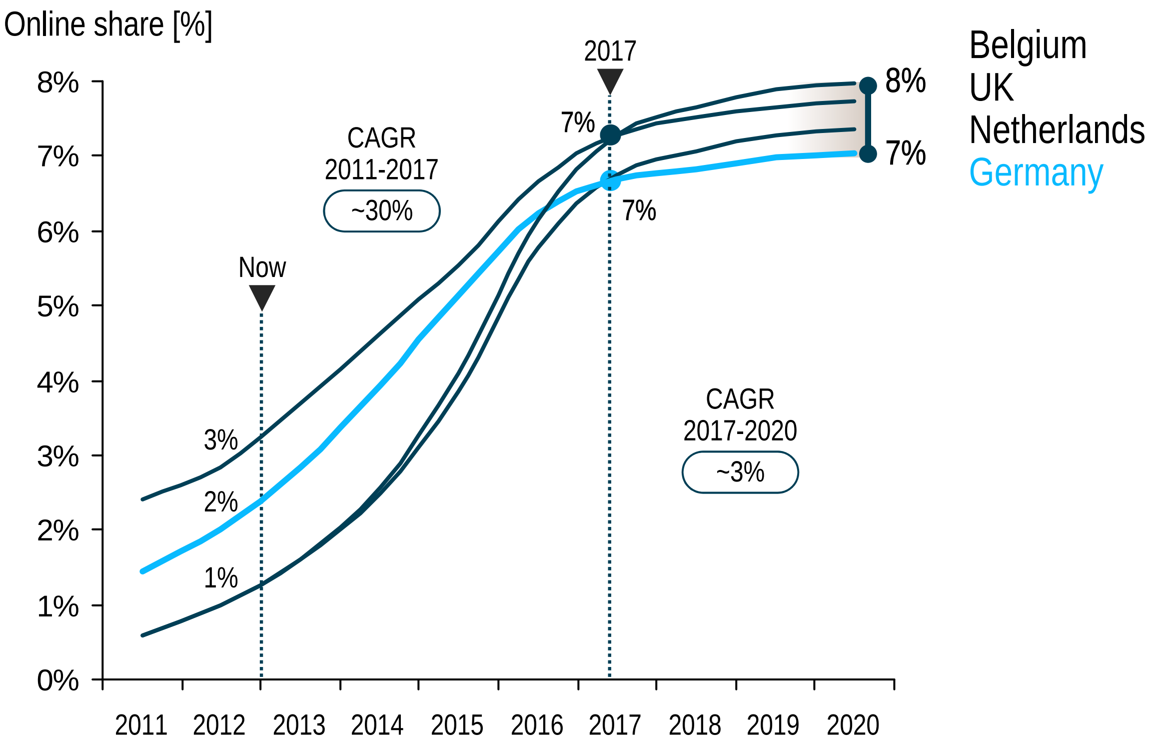
With some country differences, the online SHP market will continue to grow until 2017 and will stabilize at 7-8% thereafter

Online SHP market share across countries, 2011-2020[1)] [%]



The online SHP market will continue to grow at 30-40% per year in most countries

This is driven by systemic factors, price transparency and product/user factors

As of 2017, growth will slow down:
> Not all products are suitable for online sales
> Not all end users are likely to order online
> The on/offline price difference will decrease

The online market share will be higher in countries with relatively many homeowners (e.g. UK and BE)

1) The year 2017 is forecasted as the year when rapid growth has ended; regulations and/or internet innovations may change this

Source: AMA Research; Expert interviews; Roland Berger analysis

C. Challenges for all players in the value chain

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C

Against this market background, we see challenges for each player in the SHP value chain

Selected challenges per SHP value chain player

Manufacturer	How to **exploit online chances** while managing risks? How to **integrate online sales into the sales channel mix** and politics? How to optimally set up web shop/partner and organize logistics effectively? Consider online sales in **brand and price positioning?**
Merchant	How to offer an **attractive alternative for online**: increase service, guarantee? **How to exploit online?** Set up web shops with/without plumbers? Increase private label share? Supply web shops? Move away from list price system? Sell directly to consumers?
Plumber	Confronted with increasing client (price) pressure, how to **quote attractive prices** that can **compete with web shops** while still maintaining healthy margins (e.g. using hourly rates, service, guarantees, etc.)? How to leverage direct client relationship?
Web shop	Benefiting from online price transparency and consumer preference, **how to sell more products to more consumers**? e.g. expand range, cross sell, offer bundling with installation, service, guarantees, etc. How to source products directly from manufacturers?
DIY	**How to accelerate growth of own DIY online channel**? How to exploit stores optimally, e.g. by providing advice, service, demonstrations? How to set prices offline and online and use price differentiation to attract customers?

Source: Expert interviews, Roland Berger


It's **character**
that **creates**
impact!