When Cyclicality Is No Longer Temporary: European Building Materials

This is neither a sector comparable in size to software and tech under the threat of artificial intelligence nor one with the same breadth of issuers.

Anyway, I think it is important to regard it as a guide that reminds us that credit portfolio managers are, on occasion, forced to revise their investment assumptions.

The problems and the stress across European building materials and construction credits are acute, more visible than software industry and, to a large extent, idiosyncratic. This fact is certainly not new and, importantly, the most vulnerable names have been well known to the market for some time.

I refrain from writing down the companies that outperform and those that lag. This text is about European firms, but the same conclusions apply to the American market.

In my view, the sector weakness was initially cyclical and only later evolved into solvency concerns as end markets remained persistently depressed—2026 marks the fourth consecutive year of subdued demand, particularly in European residential construction. The long-awaited recovery in volumes has repeatedly failed to materialise, leaving issuers increasingly reliant on pricing actions, cost efficiencies and "financial engineering" to sustain EBITDA. Consequently, investors-slowly- have become far more discriminating, placing greater emphasis on earnings resilience, cash conversion and deleveraging capacity. This credit selection or tiering is evident not at the broader sector level, where the general industry sometimes outperforms the wider euro highyield index, but rather at the individual issuer level, with some companies continuing to trade around par while others are quoted in the low 80s failing to participate in any broader credit rally.

What continues to surprise me is that many investors who remained exposed to the most challenged credits underestimated the warning signs borrowers had been sending over several quarters. The market did not question sufficiently how long weak end markets and inflationary pressures could be absorbed before exerting pressure on credit metrics, liquidity profiles and looming debt maturities. The debate is no longer whether companies can protect their margins, but whether EBITDA is sufficient to support the business and, more importantly, whether it can consistently translate into sustainable free cash flow after interest costs, maintenance capex, and other unavoidable cash outflows.

Looking across balance sheets, EV/EBITDA multiples and vertically integrated business models, the principal driver of underperformance has ultimately been strained capital structures and excessive leverage(as usual),largely irrespective of issuers' exposure to infrastructure, renovation, new construction, residential, or higher value-added products. In other words, leverage has mattered more than business mix. Inflation on raw materials has probably been the second component (see here the distributors' problems for example).

The sector now finds itself at a delicate juncture: servicing debt obligations while addressing liability profiles weakened by a prolonged downturn, deteriorating credit metrics and ratings hovering precariously just one notch above the CCC category. On this point, I would argue that rating agencies are excessively generous towards certain issuers, where market confidence continues to rely more on expectations of a cyclical recovery than on a demonstrated ability to generate sustainable free cash flow. Ultimately, credit investors should be asking not when end markets will recover, but whether these businesses can withstand another year or two of subdued demand, high inflation, without compromising their access to capital markets. This is what matters. Still imperfectly understood.