



Stiernberg Consulting White Paper Connecting the Dots Q4 2008

Manufacturers in the Residential Systems Market Identify Market Opportunities and Constraints

How do manufacturing executives view the residential systems market? Stiernberg Consulting's survey of manufacturers in this arena took the pulse and provided insights. These survey results provide a look at current realities and an outlook on the future through manufacturers' eyes.

Overview

A group of manufacturers who compete in the residential systems market participated in an online survey to look ahead on 2008-09 business conditions from their individual vantage points. The survey questions tapped their views on industry trends—both challenges and opportunities. The survey respondents represent a cross section of product categories including audio, control, automation, AV networking, video, media storage and management, wire/cable, lighting, and furniture, racks, and accessories. They were asked to rate and comment on the potential impact of these trends on their own businesses. Results reveal patterns of both threats and upsides specific to the residential systems market.

What Keeps You Up at Night?

The survey respondents were asked what types of challenges, risks, or obstacles manufacturers are concerned about in terms of potential threat to business. The top four challenges identified are:

- #1 Pricing pressures and shrinking margins
- #2 Product development cycles are too long
- #3 Hard to find good people
- #4 New competitors entering the market

Survey Results:

Challenges, Risks, or Obstacles	% Rs.
Pricing pressures and shrinking margins	63%
Product development cycles are too long	44%
Hard to find good people	31%
New competitors entering the market	31%
Not enough end-user demand for high performance systems	25%
Dealers positioning themselves as “the brand” in end-user’s minds	19%
End-users aren’t adopting new technology quickly enough	19%
Hard to get financing for growth—funding sources don’t understand our industry	19%
Increasing indirect competition—end-users’ discretionary \$’s are being spent on other things	19%
Channels aren’t growing fast enough to keep up with demand potential (i.e. not enough trained systems integrators or custom installers)	13%
Technology changes too quickly—can’t keep up	13%

Percentages do not equal 100% due to multiple answers allowed.

What About the Economy?

The manufacturer respondents’ comments on obstacles coalesced on several themes, or megatrends, playing out in the industry. One of their biggest concerns is the economy in general. A facet of the current economic picture, and one that the news media appear to have a morbid fixation on, is the downturn in the housing market. It’s true that the homebuilding slowdown has the potential for significant impact on manufacturers since many custom installers rely on new construction as a primary customer base.

Narrative comments on the economy and the residential construction market included:

“Slowdown in construction.”

“The plummeting US housing market will impact new home starts and impact our industry. We don’t know how long the cycle will last.”

“Our main issue is recession and the effect it has on discretionary spending.”

A key point here is the uncertainty surrounding how long the US home construction downturn will last. This points to the renovation/retrofit market as an opportunity, both short and long term.

What About Commoditization?

Another set of obstacles relates to the forces of commoditization. Prices continue to erode. This is driven by cheaper offshore manufacturing and new generations of product that continue to evolve in quality even as prices decline. In addition, the service side—design, installation, training, and repair—is also becoming commoditized. This is exacerbated by big box retailers (e.g. Best Buy, Wal-Mart) becoming involved in installation—with arguably wide variations in quality from store to store. While the ultra-high-end residential market remains stable, there continues to be downward movement, taking with it prices and quality. As manufacturers as well as channel members look for greater efficiencies, scale, and market share, the trend toward commoditization of goods and services continues.

Narrative comments on commoditization include:

"Capabilities of big box retailers to properly set up and service customers making the overall impression of our products less positive."

"How far will 'good enough' take the market down to pure commodity products that render brand value worthless?"

"The commoditization of residential custom installation by the 'hang and bang' chains...could hurt the industry on many levels: 1. Dilute the true intention of 'custom' installation by providing cookie cutter solutions with mediocre or poor service thus lowering the bar. 2. Flood the market with low end product, confusing the end user and reducing their opportunity to be educated about best practices and best products. 3. Pressure the independent CI's/dealers to lower their margins and purchasing power."

One manufacturer respondent observes that all this has taken its toll on innovation, spawning generations of “me too” products.

What Are the Upsides?

Is it all gloom and doom? Are there opportunities amidst the current market challenges? The survey respondents were asked to identify the opportunities in the market. Results reveal that the top three upsides are:

- #1 Increasing end-user awareness and demand for our products
- #2 Growing sophistication of dealers in the channel
- #3 “iPod Culture” brings renewed focus to entertainment technology.

Survey Results

Upside Trends or Opportunities	% Rs.
Increasing end-user awareness and demand for our products	88%
Growing sophistication of dealers in the channel	63%
"iPod Culture" brings renewed focus to entertainment technology	44%
Offshore OEM suppliers are delivering higher quality at attractive prices	31%
"Lean Thinking" approach to business increases profits without diminishing quality or brand cachet	25%
More channel options including two-step distributors, low voltage contractors, and entertainment specialty retailers	25%
More options for promotion, including online, training programs, showcase installations, etc.	25%
Industry consolidation has made experienced managers available in the job market	13%
Vulnerable competitors have gone out of business	13%
Product development has become more efficient	6%

Percentages do not equal 100% due to multiple answers allowed.

Narrative comments on market opportunities illuminated the concept that even negative trends can have positive ramifications for some—in every problem there's an opportunity. One manufacturer points out that with the economy tightening around the consumer with higher gas prices and less available consumer credit, staying at home for entertainment takes on a higher value. And the constricted housing market drives some homeowners to stay put and remodel or upgrade, rather than sell and move to a new house.

What About Home AV/IT Networking At Home?

AV and IT convergence stimulates the market with new technologies, new generations of integrated products, and new systems configuration possibilities. Related to this phenomenon is the emerging customer group that is more versed and comfortable with AV/IT technology than previous generations. Not limited to the stereotypical male geek, the profile of the emerging customer also includes a new generation of tech savvy females.

Can Commoditization Spawn Optimism?

Maybe commoditization isn't all bad. One relevant trend is the commoditization of video and display products, such as high definition televisions and flat panel displays. In addition, quality audio upgrades and new audio applications (such as whole-house music systems with iPod docking stations) can represent market opportunities that are not limited to upscale new construction projects. As the industry moves from a component mentality to a systems focus, the value of design and installation of whole-house and integrated AV solutions increases.

Narrative comments on market optimism include:

"Cocooning trend will grow due to soaring gas prices and unstable economy. People may opt to stay home and remodel for home theater rather than sell (their home) due to the market."

"Merging of AV and IT functions driving a new business opportunity for IP-based AV."

"Young people are bringing their tech savvy habits into a sophisticated marketplace and adopting new ideas more readily."

"Audio remains an option for upselling to customers and there remains a mature and tangible cost-performance relationship that yields benefits for the customer's experience. Unlike good video, which has become much more available and raised customer awareness/appreciation, high quality audio remains unknown to most consumers and many of the dealer/integrators new to the business."

"Overall, the industry is exhibiting extraordinary growth (over the long term). Consumers are becoming increasingly knowledgeable and demanding high-end solutions...The "screenager" generation is transitioning into careers now and in the next decade will become more viable, tech-savvy consumers. The same cohort will contribute the industry's first, sizable, female customer base."

Analysis and Interpretation

Stiernberg Consulting monitors the residential AV systems market continually. The survey data yielded new insights as well as support to prior observations. Here are our conclusions from the recent study.

1. While the industry is in a slump in 2008 and into 2009, the opportunities outweigh the obstacles long term.
2. The integration of AV and IT networks in both new and existing homes is an exciting long-term opportunity.
3. Savvy manufacturers recognize the need to support their channels of distribution through innovative, high value products with solid margins and progressive business programs.
4. When new construction slows down, the retrofit market remains a solid opportunity to re-market to existing customers.
5. While not necessarily a new idea, there is business growth available to those in our industry who market to rapidly evolving end-user segments such as tech savvy females and Millennials (a/k/a Generation Y—people born circa 1976—1990).

A Look To The Future

Is our industry in the middle of both the best of times and the worst of times—a virtual tale of two cities? There's no doubt that there are frustrating trends exerting their effects on the residential systems market—downturn in construction, tight credit, increased competition, and more. But at the same time,

opportunities abound. Those manufacturers in our industry who have the perspective on the trends, an actionable business plan, and the agility to move forward amidst current conditions in the competitive environment are the ones who prevail.

Questions about this whitepaper? Call 818-784-8618

About This Series

Stiernberg Consulting conducts surveys, monitors market conditions, talks to industry stakeholders, and identifies trends and issues on a continuous basis. Our White Paper Series brings the results of these efforts to the industry on a quarterly basis. Topics range from market dynamics to best practices. All White Papers are offered free of charge.

About Stiernberg Consulting

Founded in 1993, Stiernberg Consulting provides business development services in three primary areas: Applied Strategic Planning, Competitive Intelligence, and M&A advisory work. We offer unique programs and services geared to business growth and the development of results-oriented action plans. We serve the converging entertainment technology, music products, and electronic systems industry worldwide. Please visit www.stiernberg.com for complete details.