

AlixPartners

The future of
Germany's heating
industry: Charting
a path forward



Germany's heating industry faces significant transformation, fueled by the push for decarbonization and regulatory changes. A key driver was the leak of the "Gebäudeenergiegesetz" (GEG) regulatory draft in March 2023, sparking widespread concerns about a potential ban on fossil fuel heating systems. This fear triggered a surge in demand for heat pumps, with sales climbing by 51% by the end of 2023.

That boom, however, was fleeting. In the first half of 2024, heat pump sales plummeted by over 50%. This sharp drop wasn't merely a market correction, but volatility created by regulatory missteps and shifting political winds.

With the 2025 German federal elections (Bundestagswahl) now looming and the opposition challenging the current GEG, the future of the industry is uncertain. This article unpacks the industry's evolution and regulatory environment, examines its future outlook, and recommends pragmatic short- and long-term strategies to ensure a sustainable future.



A market at a crossroads

Germany's heating market has long been dominated by traditional technologies.

Gas-fired systems accounted for

77%

of the market in 2014, and still hold a

61%

share as of 2023.

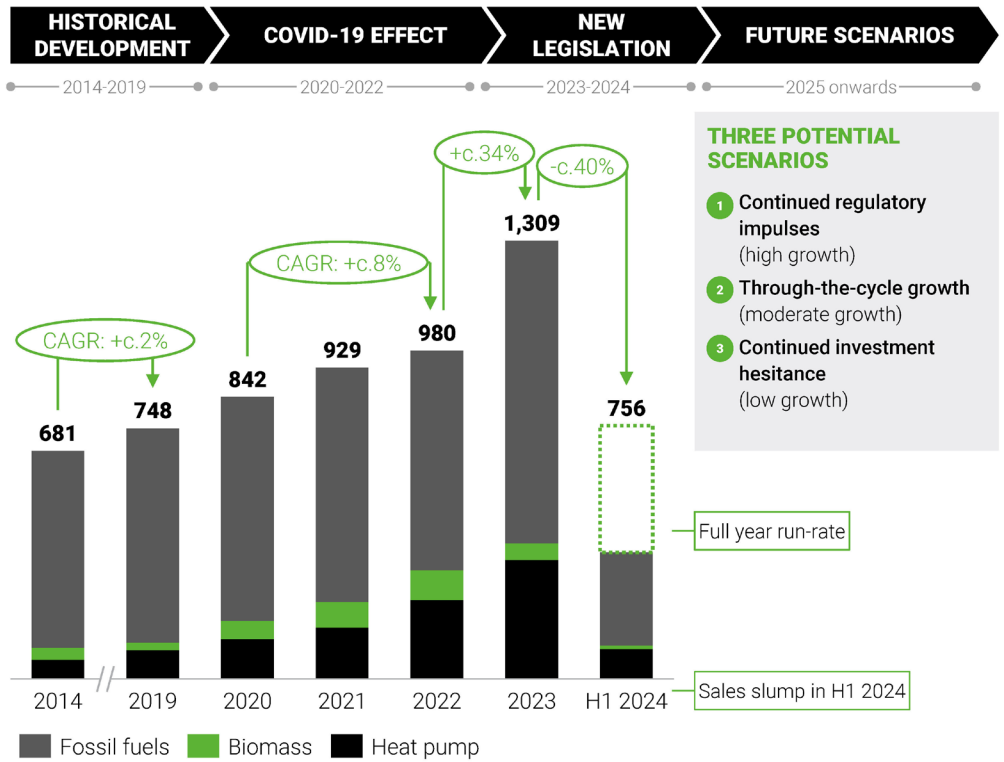
A distinctive feature of the German market is its three-tiered structure: manufacturers sell to wholesalers; wholesalers supply installers; and installers are contracted by the end customer. This arrangement makes access to installers critical for manufacturers; without it, even the most innovative or competitively-priced products may fail to reach the market. This is particularly relevant in the renovation and repair segment, where individual homeowners rely on installers for guidance and procurement. In contrast, new builds and larger renovation projects are often contracted through developers or architects, who may have different sourcing strategies.

Despite these nuances, German manufacturers still benefit significantly from the overall market structure, as it offers them a degree of protection against foreign competitors like Daikin, whose market penetration often falters due to a lack of established installer networks.

From 2020-2023, however, the market experienced upheaval driven by a confluence of geopolitical tensions, the COVID-19 pandemic, the growing push for decarbonization, and regulatory volatility (figures 1 and 2).

The industry now finds itself at a crossroads. Will it stabilize and continue to grow, or will it face prolonged stagnation? And how will regulatory uncertainty factor in?

FIGURE 1: MARKET DEVELOPMENT OF HEATING SYSTEMS IN GERMANY ('000 UNITS)



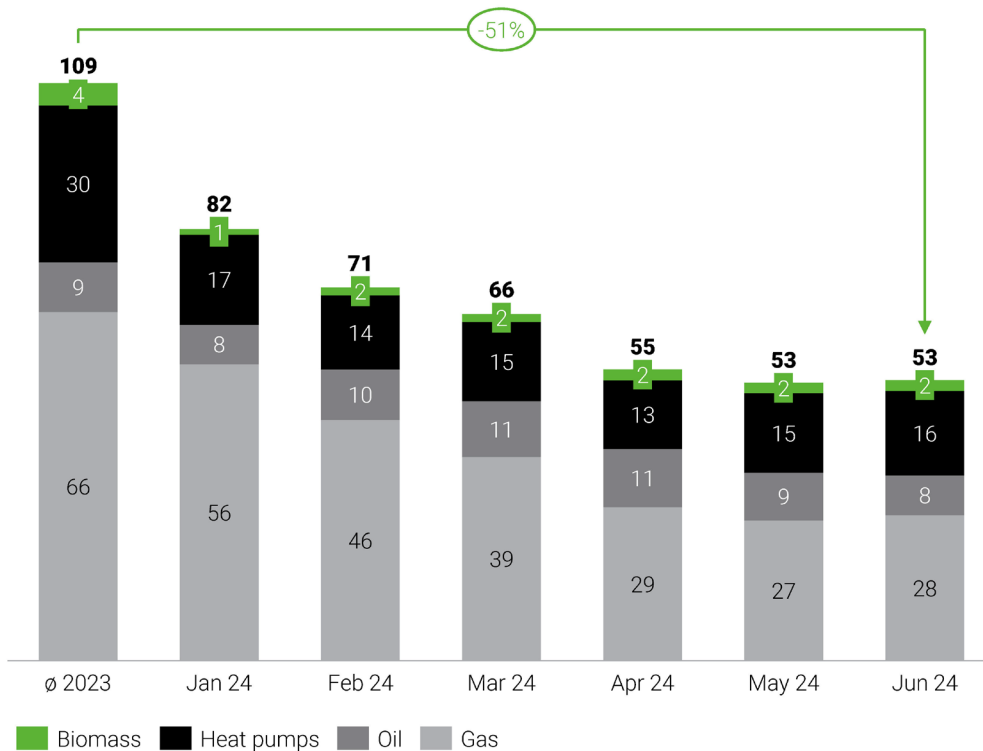
THREE POTENTIAL SCENARIOS

- 1 Continued regulatory impulses (high growth)
- 2 Through-the-cycle growth (moderate growth)
- 3 Continued investment hesitance (low growth)

Full year run-rate

Sales slump in H1 2024

FIGURE 2: HEATING MARKET IN GERMANY ('000 UNITS)





Regulatory background

The leak of the GEG regulatory draft in March 2023 triggered media attention in Germany, with headlines dominated by reports of strict regulations and potential bans on fossil fuel heating systems (figure 3). What began as an ambitious attempt to phase out fossil fuel heating systems quickly turned into a chaotic year-long series of revisions, characterized by political disagreements and media campaigns.

FIGURE 3: INTRODUCTION OF THE GEG IN GERMANY

Germany: Early media leak of GEG

MARCH 2023

Draft version of GEG leaked and published by BILD/Axel Springer



Widespread media coverage of GEG

THROUGHOUT 2023

German media coverage conveys the impression that heat pumps may become mandatory and fossil fuel heating may be banned



EU heat pump action plan delayed; CEOs respond

DEC 2023

Delay of EU heat pump action plan

JAN 2024

Heat pump firms' CEOs write to the EU commission, calling the delay "a mistake that jeopardizes growth"



IMPACT OF A DIFFICULT INTRODUCTION

Short-term uplift in heat pump sales

- Panic purchases by intermediaries and consumers
- Early replacement of older oil and gas heating systems in anticipation of a possible "heating ban"
- Stockpiling of heat pumps by intermediaries due to fears of supply bottlenecks

Adjustment of initial GEG draft

- More flexible transition periods
- Additional financial subsidies
- More precisely formulated legal text

EU heat pump action plan delay

- EU is said to take the concerns seriously, however an action plan has not yet been put in place

Source: Media coverage; AlixPartners analysis

The current GEG is a comprehensive regulation that consolidates several older laws, including the “Energieeinsparverordnung” (EnEV) and the “Erneuerbare-Energien-Wärmegesetz” (EEWärmeG). Its aim is to reduce the energy consumption of buildings and promote the use of renewable energy sources.

Key provisions include:



New buildings:

From January 1, 2024, new buildings in designated areas must use heating systems with at least 65% renewable energy. Exceptions apply to district heating and direct electric heating systems.



Existing buildings:

Heating systems over 30 years old that lack low-temperature or condensing technology must be replaced. If a heating system fails irreparably, property owners have three years to install a new system that complies with the GEG.



Transitional periods:

Generous transition timelines are provided for new buildings and renovations outside designated areas, with deadlines extending to 2026 or 2028, depending on the municipality's size and heat planning.

The opposition has been vocal in its [criticism of the GEG](#), indicating that, should they win the 2025 federal elections, they may revise or roll back key decarbonization measures. This political instability leaves the industry in a climate of uncertainty, delaying investments in renewable heating technologies.

Industry concerns about regulatory chaos have reached Brussels, with several manufacturers and industry representatives taking the rare step of writing directly to EU Commission President Ursula von der Leyen, stressing the urgent need for consistent policies to safeguard the industry's future. Several companies had already expanded their production capacities in anticipation of the heat pump boom, but with demand now plummeting, these facilities risk being underutilized—further increasing pressure on manufacturers. Recent political developments only intensify these concerns, as the market's long-term trajectory now also hinges on the outcome of the 2025 elections.

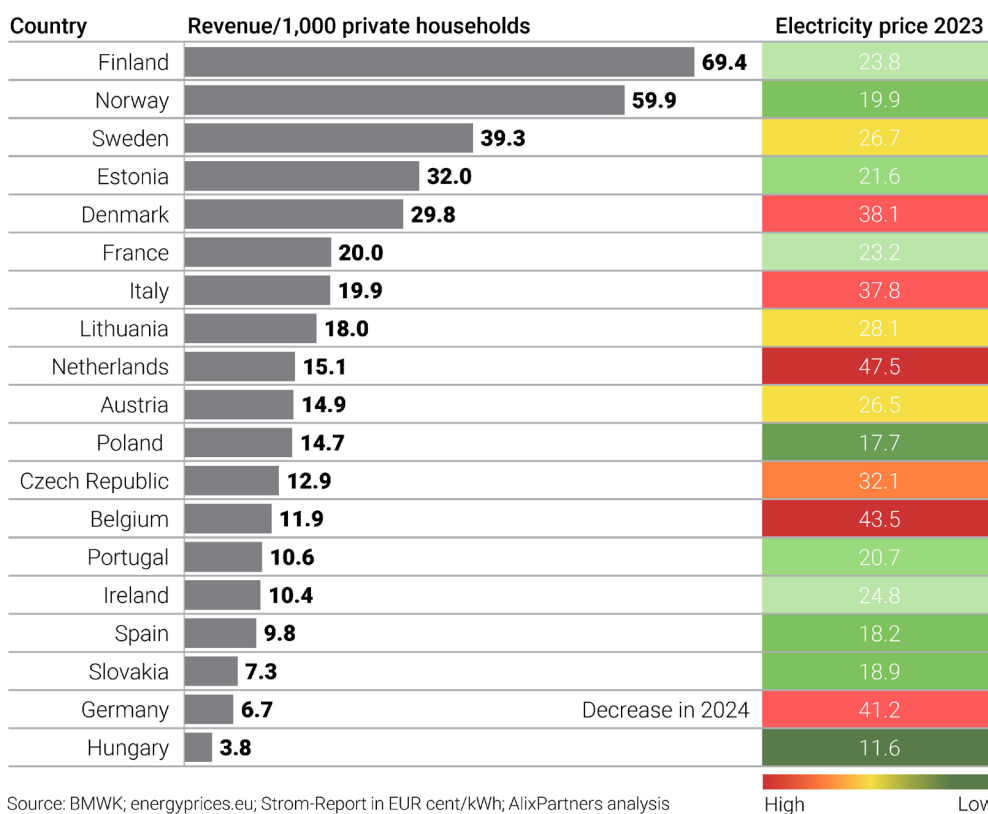


The international view: Germany lags in adopting renewable heating technologies

Germany currently lags several European countries in adopting renewable heating technologies. Finland installed 69.4 heat pump units per 1,000 households in 2022, for example, while Germany installed just 7.3 (figure 4). Sweden and Norway have also been quicker to embrace heat pump technology, thanks in part to longstanding political support and favorable regulatory environments.



FIGURE 4: HEAT PUMP PENETRATION IN EUROPE IN 2022



While Germany continues to navigate the complexities of its domestic market, it is important to recognize that this represents just one segment of a broader, highly dynamic global heating industry.

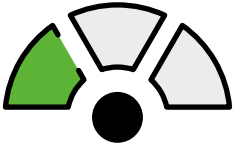
To secure sustainable growth, German manufacturers must increasingly shift their focus to export opportunities. Expanding into international markets not only diversifies revenue streams but also mitigates the risks associated with domestic regulatory uncertainties. However, distribution structures in other countries often differ fundamentally from Germany's three-tiered system, with direct sales, online sales, or other models playing a much larger role.

This requires manufacturers to adapt their sales organizations accordingly to remain competitive in international markets.

Future development

While the German heating market has seen considerable overall growth over the past decade, its growth in recent years has been heavily impacted by the extraordinary factors already mentioned, including the pandemic, the raw materials crisis, geopolitical tensions and regulatory uncertainty around the GEG—all leading to market anomalies that disrupted long-term trends.

As the market normalizes, companies must plan for the post-boom period with agility and cost reductions. Looking ahead, three potential market scenarios emerge:



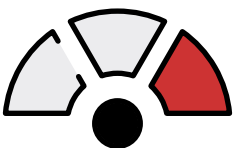
Low case:

This assumes that demand was pulled forward due to the external shocks of the pandemic and the Ukraine war, and that the market will return to its long-term trend. A continuation of the Compound Annual Growth Rate (CAGR) of 2% for the overall market and 8% for heat pumps (from 2014-2019) is expected.



Medium case—the likely scenario:

In this scenario, part of the transformation observed from 2019 to 2022 is seen as sustainable, though initially accelerated by external factors. The market grows at a CAGR of 5% for the overall market and 19% for heat pumps, following the 2014-2022 development. This case represents a likely recovery path.



High case—the unlikely scenario:

This optimistic case assumes that the transformation trends are fully sustainable, with 2023 being an outlier due to external factors. The overall market could grow at a 9% CAGR (similar to 2019-2022 levels), with heat pumps continuing to grow at 19% annually. This case assumes a robust transition away from fossil fuels.

A significant factor driving future demand is the ageing stock of heating systems in Germany. With 21.6 million heating systems currently installed, only 1.7 million (7.9%) are heat pumps. Despite some improvements in the past year, around 30% of heating systems in German households are still over 20 years old. Under the current GEG regulations, these outdated systems will need to be replaced within the next 10 years with systems that utilize at least 65% renewable energy. This presents a considerable opportunity for the heat pump market.

However, the replacement of these old systems will not happen immediately. There are transition periods until 2026 or 2028 for older buildings in smaller municipalities, meaning that while the goal to install 500,000 heat pumps annually is achievable, it will unfold gradually over time.

At the same time, high interest rates significantly impact the construction and renovation sectors. Elevated borrowing costs make new builds and large-scale renovations more expensive, potentially dampening demand for new heating systems. If interest rates remain high over an extended period, this could slow the adoption of heat pumps and other heating technologies, particularly in the private housing sector.

Adding to this uncertainty is the political climate. The forthcoming 2025 federal elections, and the growing opposition to the GEG, leave both consumers and manufacturers uncertain about whether to invest in renewable heating technologies or wait for clearer guidance.

Strategic recommendations for a sustainable future

To secure the future of the German heat pump industry, industry players must take both immediate and long-term actions.

We propose the following strategies:

| | |
|---|---|
| <p>Short-term 2025</p> | <p>With no significant demand impulses anticipated in the domestic market until the end of 2025, the regulatory environment remains unpredictable, compounded by EU initiatives like the Heat Pump Action Plan and the approaching German elections. Companies should prepare for a continued suppressed market in 2025, focusing on break-even adaptations, cost flexibility, and financing adjustments. Maintaining operational discipline and optimizing financial management will be crucial to navigate this period of stagnation. As new business will be low, shifting the focus toward profitable repair (i.e. parts and service) business should be a key consideration. Additionally, engaging with policymakers to advocate for stable regulations will be essential to mitigate uncertainty.</p> |
| <p>Mid-term 2026 TO 2030</p> | <p>A recovery to moderate growth from 2026 onwards is possible, driven by the eventual stabilization of regulatory frameworks and renewed demand from ageing heating systems. To capitalize on this, companies should ready their go-to-market strategies, emphasizing consultative selling and establishing themselves as trusted partners to reduce investment complexity and consumer uncertainty. As competition from mature international players intensifies both in Germany and abroad, manufacturers must focus on internationalization, capturing opportunities in less saturated markets with favorable domestic conditions.</p> <ul style="list-style-type: none">• Optimize cost structure: Companies need to rigorously scrutinize their cost base, supply chain, and manufacturing setups, with a particular focus on leveraging low-cost countries (LCC) where feasible. Flexible labor schemes and operational spend compression will be essential to remain competitive in both domestic and international markets.• Cash and financial management: Active portfolio management, diligent working capital optimization, and scrutiny of capex plans will help companies maintain liquidity and operational stability. Stakeholder management, especially in securing financing, will be critical amid ongoing uncertainty in the financial community, as lowered debt capacity and market volatility persist. |
| <p>Long-term 2030 AND BEYOND</p> | <p>In the long run, the success of the German heat pump industry will depend on its ability to meet decarbonization targets and keep pace with technological advancements. Companies should invest in research and development to ensure their products remain competitive and explore opportunities to collaborate with global partners to enhance their market position.</p> |

Where next?

The German heat pump industry faces a tough road ahead. With no material demand impulses expected before 2026, companies must navigate an extended period of market stagnation while preparing for a potential mid-term recovery. The regulatory landscape is fraught with uncertainty, influenced by both EU initiatives and the outcome of the 2025 federal election, which could reshape the GEG and impact the industry's trajectory.

Despite these challenges, the green agenda is likely to persist in the long term, offering eventual support for growth. However, competition from international players—who may enjoy more favorable conditions in their home markets—adds complexity. German manufacturers must expand their international reach to counteract domestic overcapacity and competitive pressures.

In the short term, focusing on cost discipline, high-margin parts-and-service business models, financing, and operational flexibility will be critical. Mid-term, companies must position themselves as trusted partners for consumers, simplifying investment decisions and ensuring they are well-prepared for the eventual return to moderate growth. Those companies that effectively manage cash, costs, and stakeholder relationships while expanding their global footprint will be best positioned to lead in a rapidly-evolving market.



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These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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