FMI Capital Advisors

FMI's Construction Materials Outlook

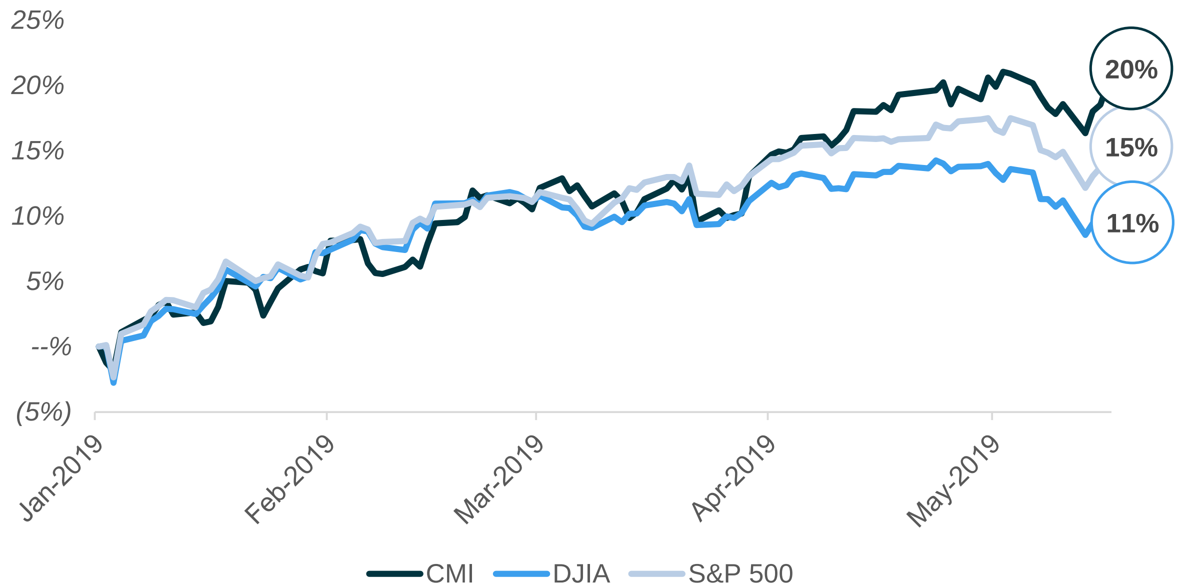
First Quarter 2019 Update

Improved Performance and a Robust Outlook are Likely to Reinvigorate the Construction Materials M&A Market

The first quarter of 2019 was relatively quiet for M&A activity in the Construction Materials sector. While several bolt-on transactions were announced, the market appeared to be taking a breath following a stock market downturn in the second half of 2018. Lofty expectations for CM companies in 2018 were thwarted by weather, tariffs, and other factors outside of the industry's control. FMI has dubbed 2019 the ***"Show Me Year"*** as Q1 - Q2 performance is critical to show investors that 2018 was an anomaly, and that backlogs/outlook for the future justify premium valuations.

As first quarter results are reported, the results are largely positive. FMI's Construction Materials Index (CMI) companies exhibit robust gains in volumes, pricing, and stock price performance.

FMI's Construction Materials Index: Year to Date Performance (2019)



FMI's CMI is up over 20 percent year to date, compared to 15 percent & 11 percent for the S&P 500 and Dow Jones Industrial Average

CMI Earnings Reports (Q1 2019)

Revenues and volumes for most CM companies were generally up, year-over-year in Q1 2019. However, several companies missed earnings expectations from market analysts due to a variety of reasons.

Company[1]	Market Analyst Revenue Expectations	Market Analyst EBITDA Expectations	YTD Stock Performance
CEMEX, S.A.B. de C.V.	HIT	HIT	(9.3%)
Construction Partners, Inc.	EXCEED	EXCEED	59.2%
Eagle Materials Inc.	HIT	MISS	47.9%
Granite Construction	HIT	MISS	1.6%
Grupo Cementos de Chihuahua (GCC)	HIT	MISS	8.8%
Martin Marietta Materials, Inc.	HIT	EXCEED	26.7%
Summit Materials, Inc.	EXCEED	MISS	39.8%
U.S. Concrete, Inc.	HIT	MISS	38.2%
Vulcan Materials Company	EXCEED	HIT	31.6%
Median			**31.6%**
Mean			**27.2%**

Source: Capital IQ, FMI
(1) Only companies that reported Q1 earnings per GAAP standards, trading on a national exchange

Select Highlights From Earnings Reports

Granite Construction (NYSE:GVA) - Reported a 10% year-over-year increase in revenues but faced weather related issues in the western United States, primarily in California, which led to lower than expected margin performance.

Martin Marietta (NYSE:MLM) - Reported record Q1 revenues and EBITDA, with growth of 17% and 28%, respectively. Growth attributed to increases in both volumes and pricing. The company is forecasting annual growth in volumes of 6 - 8% overall in 2019 on top of pricing improvements of 3 - 5%.

Summit Materials (NYSE:SUM) - Reported an increase of 5.5% in net revenue, although flooding in the Midwest negatively affected the company's cement business. The company reported strong growth in pricing and volumes in its aggregates business, particularly in the eastern United States, but missed analyst expectations.

U.S. Concrete's (NASDAQCM:USCR) - Q1 total revenues increased 1.6% year-over-year, with aggregates revenue up 25% vs. 2018. The company's ready-mix division faced weather-related issues, particularly in California.

Vulcan Materials (NYSE:VMC) - Reported a 17% increase in revenues and a 15% growth in EBITDA vs. Q1 2018. The company noted strong performance in their aggregates segment with growing public construction demand.

Economic Growth

Looking forward, economic performance continues to drive favorable tailwinds for the market, as demonstrated by a 3.2 percent annualized growth rate in Gross Domestic Product for Q1 2019. Infrastructure related construction and non-residential construction across the country will be an additional catalyst.

Construction Put in Place Growth for Selected Markets

	Actuals					Forecast	
	2014	2015	2016	2017	2018	2019	2020
Transportation	7%	7%	(3%)	4%	15%	9%	8%
Highway and Street	4%	7%	2%	(4%)	4%	5%	4%
Residential	14%	14%	11%	12%	3%	1%	0%
Non-residential	9%	14%	8%	2%	4%	4%	0%

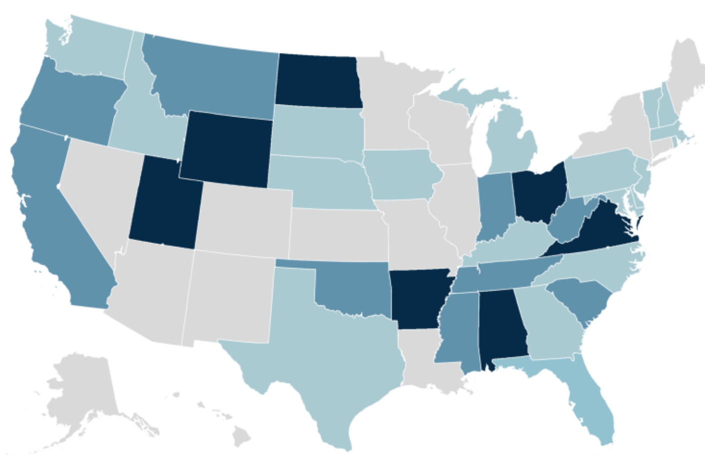
Growth in non-residential construction shows optimism, while residential markets appear stable

Infrastructure spending related discussions between President Trump and Democratic congressional leaders have also provided additional momentum to CMI stock prices. While substantial obstacles to new legislation persist, infrastructure legislation appears to be one of the few areas where Democrats and the President can broadly agree. President Trump, House Speaker Nancy Pelosi, and Senate Minority Leader Chuck Schumer agreed on a $2.0 trillion infrastructure package in a meeting on April 30th. While no details were agreed upon surrounding how an infrastructure package would be financed, the mere discussions sent stocks higher. That said, President Trump also announced that no infrastructure deal would come to fruition before an agreement was reached on a North American trade deal, and while he was still under investigation.

State Funding

While the federal infrastructure carrot will continue to hang in front of the sector, states have demonstrated their ability to pick up where Washington has failed. California, Texas, Florida, Georgia, Washington and others continue to drive increased spending on infrastructure, having passed previous funding measures. For example, California's SB1 injects $52 billion into California infrastructure, creating strong opportunity for materials firms and contractors in the state, despite the lack of a robust infrastructure package from Washington, D.C.

So far in 2019, **Alabama, Arkansas, North Dakota, Ohio, Utah, Virginia, and Wyoming** have passed new funding initiatives. These state infrastructure packages are influencing construction materials volumes across the country and driving optimism for many industry CEOs.



Recurring Transportation Funding Legislation By Year Enacted

Enacted 2013 - 2015 | Enacted 2016 - 2018 | Enacted 2019

Renewed Optimism & Market Outlook

Optimism for the CM industry has been renewed by continued stability in the housing market, spending growth for the non-residential & infrastructure sectors, and hope of new state & federal legislation. However, with rosy forecasts come high expectations. Analysts are projecting meaningful increases in revenues and profits for public companies in the sector. Of FMI's 16 CMI companies, analysts expect a median improvement in 2019 revenue of five percent and a median 17.2 percent improvement in EBITDA. In other words, investors expect the weather issues of 2018 to be a one-time event, and the aforementioned catalysts to drive improved operating leverage and profit margins.

There are still wild cards on the horizon that could drive optimism from the market, including trade disputes, potential interest rate increases, and continued inclement weather. Several factors can mitigate these concerns as negotiations with China appear to be ongoing, the government has implied a cooling of interest rate hikes, and weather has seen some improvements.

Activist Investors

A recent development in the CM market is the emergence of "activist investors" – financial companies that take significant stakes in public companies with the goal to quickly implement changes and improve stock performance.

So far in 2019:

- Sachem Head Capital Management has purchased a large share of Eagle Materials and secured a board seat
- Cevian Capital, Europe's largest activist investor, has built up a large stake in CRH (formerly Oldcastle) and obtained a position on the board

Actions in the past from these activist shareholders include: *Management reorganizations, share buy-back programs, divestitures/spin-offs, and other operational initiatives*

High analyst expectations, a strong market outlook, and continued optimism for additional market catalysts (i.e. state & federal infrastructure legislation) are likely to drive a rebound in M&A in the latter half of 2019.

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