

2019

Construction Materials – Favorable Economics and Selective Buyers

September 20, 2019



While Economic Fundamentals are Favorable, Buyers of Construction Materials Firms Remain Selective

If headlines are any metric, there is ample reason to be concerned about an emerging recession in the United States. In August, the two-year treasury yield exceeded the ten-year yield (often an early sign of recession), and in early September tariffs on more than \$112 billion in Chinese goods took effect. Meanwhile, housing prices and starts appear to have leveled off and even declined somewhat versus prior years. Each of these developments are driving dire headlines in the financial media and increased uncertainty in a growth cycle that is already historic in its duration.



Despite recent developments, the performance of public Construction Materials companies remains positive. Most of FMI's Construction Materials Index ("CMI") firms reported gains in both volume and pricing in the United States during the second quarter, with wet weather being one sticking point for many producers. Of FMI's CMI firms, GCC, Martin Marietta, and Vulcan Materials all exceeded analysts' revenue expectations, and Cemex, CPI, and Vulcan exceeded expectations for Q2 GAAP earnings per share (EPS). Nearly every company with the CMI indicated that weather disrupted Q2 performance, increasing pressure on companies to regain lost volume in the second half of 2019.

Select Construction Materials Index Companies Q2 2019 Performance

Company	Revenue Q2 2019	Revenue ▲ (YOY %)	EPS Q2 2019	Analyst Revenue Expectations	Analyst EPS Expectations
CMI Member Firms Reporting Q2 2019					
Cementos Argos S.A.	732.0	(2.0%)	0.01	MISS	MISS
CEMEX, S.A.B. de C.V.	3,523.0	(4.8%)	0.06	MISS	EXCEED
*Construction Partners, Inc.	227.3	16.5%	0.33	MISS	EXCEED
**Eagle Materials Inc.	370.6	(5.9%)	0.94	MISS	MISS
Granite Construction Incorporated	789.5	(2.2%)	(2.09)	MISS	MISS
Grupo Cementos de Chihuahua, S.A.B. de C.V.	240.5	3.5%	0.08	EXCEED	MISS
Martin Marietta Materials, Inc.	1,279.5	6.4%	3.01	EXCEED	MISS
The Monarch Cement Company	50.3	3.5%	3.34	N/A	N/A
Summit Materials, Inc.	552.6	0.6%	0.32	MISS	MISS
U.S. Concrete, Inc.	367.5	(9.1%)	0.04	MISS	MISS
Vulcan Materials Company	1,327.7	10.6%	1.48	EXCEED	EXCEED
CMI Member Firms Reporting 1H 2019					
Buzzi Unicem S.p.A.	1,728.2	13.7%	0.75	EXCEED	N/A
Colas SA	6,638.6	6.1%	(3.57)	N/A	N/A
CRH plc	15,039.8	7.9%	0.77	EXCEED	EXCEED
HeidelbergCement AG	10,470.8	9.2%	1.22	MISS	MISS
LafargeHolcim Ltd	13,382.9	0.2%	1.33	MISS	MISS
Titan Cement International S.A.	893.8	7.5%	0.19	EXCEED	N/A

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Outlook & Drivers

Even though an eventual recession is inevitable, there is reason to remain positive on the construction materials sector. The two critical drivers of construction materials volumes remain fundamentally strong: Residential construction (housing) and Highway construction (infrastructure)

Residential Construction

Annual production of new homes, a key driver of ready mix, aggregate, and asphalt volumes, appear to be range bound at the 1.15 to 1.33 million (seasonally adjusted) level for 2018 and 2019. For comparison purposes, the U.S. averaged 1.58 million annual starts from 1970 to 2007. As a result, the median age of housing stock is increasing, growing from an average of 25 years old in 1989 to 40 years old in 2019. This is creating strong pent-up demand for housing in the U.S., particularly as the number of households in the United States continues to grow. Interest rates, a key driver of housing starts, have also declined more than 100 basis points since January 1, which may reinvigorate the housing market in the second half of 2019 and into 2020.

U.S. Households vs. Private Housing Starts (1980 through 2018)



Highway Construction

Even without a Federal infrastructure bill, the U.S. infrastructure market is stronger than it has been in more than a decade. State and local infrastructure spending, which often accounts for two thirds or more of overall infrastructure spending in the U.S., exceeded \$300 billion annually (seasonally adjusted) for the first time in April 2019. With numerous state and local infrastructure spending bills driving increased spending, the market will likely improve even if the FAST Act expires in October 2020 and federal spending is held at current levels. The wild card of an infrastructure package, which appears to be one of the few areas of potential agreement between the two major parties, may increase in probability in the event a recession does rear its head over the next two years.



Mergers & Acquisition Activity

The market for mergers and acquisitions (“M&A”) in 2019 continues to be active with many sellers in the market. However, relatively few deals are closing compared to what was a busy first half of 2018. The juxtaposition of sellers’ strong financial performance with the potential for a recession over the course of the next 12 - 24 months has added a layer of complication to transaction pricing. Sellers now want their business valued on current strong performance, while buyers are tempering projections based potential future risks. The effect of weather on public companies’ income statements has also made larger transactions increasingly difficult to finance. These combined dynamics have led buyers to be increasingly selective and continue to focus on small to mid-sized transactions with clear synergy opportunities.

Outlook

In short, while the specter of a recession appears to be hanging over the market, the fundamentals of the U.S. construction materials industry remain strong. As a result, FMI anticipates continued growth in the sector in the second half of 2019 and into 2020. However, improvements in profitability among public companies will be needed to drive an increase in M&A transaction closings. A return to more normal weather patterns would go a long way to making this a reality. Until then, the market for transactions will continue to be dominated by small to mid-sized transactions that hold ample synergies for acquirers.

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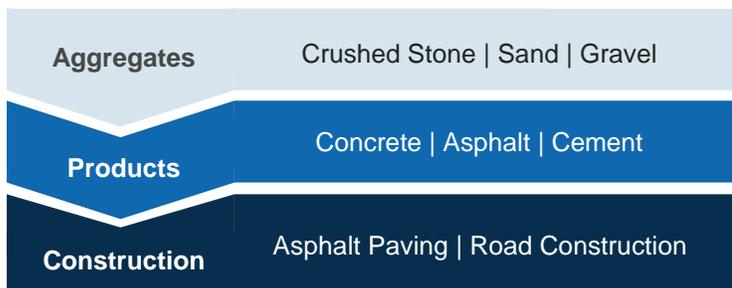
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Recent Transactions

 has been acquired by The undersigned served as the exclusive financial advisor to Windsor Rock Products in this transaction. FMI Capital Advisors, Inc.	 has been acquired by The undersigned served as the exclusive financial advisor to Walker Sand & Gravel in this transaction. FMI Capital Advisors, Inc.	 has been acquired by The undersigned acted as the exclusive financial advisor to Peckham Industries, Inc. in this transaction. FMI Capital Advisors, Inc.	 has been acquired by The undersigned acted as the exclusive financial advisor to Midwest Minerals in this transaction. FMI Capital Advisors, Inc.	 has been acquired by The undersigned acted as the exclusive financial advisor to McCartney Construction in this transaction. FMI Capital Advisors, Inc.	 has acquired The undersigned acted as the exclusive financial advisor to Midwest Minerals in this transaction. FMI Capital Advisors, Inc.	 has acquired The undersigned acted as the exclusive financial advisor to Shockey in this transaction. FMI Capital Advisors, Inc.
 has acquired the assets of The undersigned acted as the exclusive financial advisor to Graymont in this transaction. FMI Capital Advisors, Inc.	 has acquired select assets of The undersigned acted as the exclusive financial advisor to E.J. Brennan, LP in this transaction. FMI Capital Advisors, Inc.	 has acquired select assets of The undersigned acted as the exclusive financial advisor to Berks Products in this transaction. FMI Capital Advisors, Inc.	 has acquired the assets of The undersigned acted as the exclusive financial advisor to EJB Paving & Materials Co. in this transaction. FMI Capital Advisors, Inc.	 has been acquired by The undersigned acted as the exclusive financial advisor to Hudson River Construction Company, Inc. and Albany Asphalt & Aggregates in this transaction. FMI Capital Advisors, Inc.	 a portfolio company of BMC Enterprises, Inc. has acquired select aggregate assets from The undersigned acted as the exclusive financial advisor to Breckenridge Material Company in this transaction. FMI Capital Advisors, Inc.	 has been acquired by The undersigned acted as the exclusive financial advisor to Levy in this transaction. FMI Capital Advisors, Inc.

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