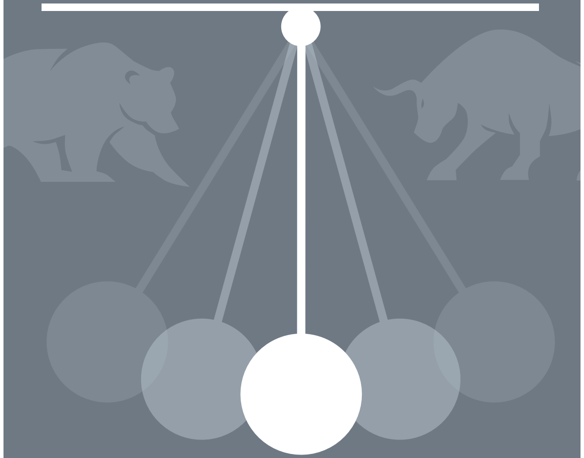
CAPTURING THE MOMENTUM

Construction Materials Review of 2020 and Outlook for M&A in 2021

FMI

MARKET SENTIMENT



This year our analysis explores the Construction Materials industry through three separate lenses:

1. Recapping the events of 2020 and the impacts on the sector
2. Examining the drivers for the industry in 2021
3. Forecasting M&A activity and sentiment for the upcoming year

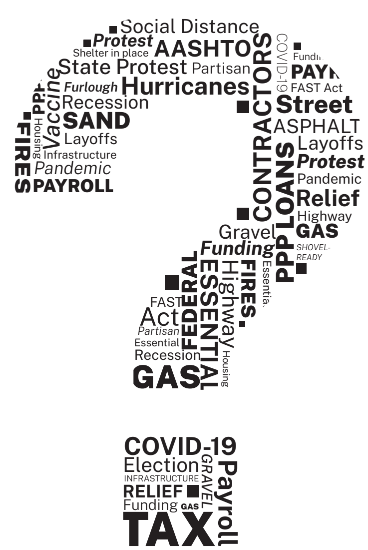
by George Reddin

2020 was a year that will forever live in history. The last 12 months have brought a battle of unique challenges, including economic distress, severe weather and political upheaval – all set against the backdrop of a global pandemic. This "black swan" event triggered a freefall across society, and the subsequent economic toll impacted every industry, including *Construction Materials (CM – including crushed stone, sand, gravel, hot mix asphalt and ready mixed concrete)*.

Beyond the global health crisis, 2020 was already set to be a pivotal year for Construction Materials, as federal infrastructure funding was in the spotlight with the Fixing America's Surface Transportation (FAST) Act set to expire in September. Throughout the year, the market sentiment operated like a **pendulum**, swinging back and forth between certainty and uncertainty. By the end of the year, optimism, earnings, and mergers and acquisitions (M&A) activity all began picking up, allowing the CM industry to finish strong. FMI expects this trend to continue into 2021, driven by new potential for funding, vaccine progress and a surprisingly robust residential market.

In the first half of 2020, questions and uncertainty created an anemic M&A market for Construction Materials. As the year progressed, activity picked up momentum – ultimately ending with a strong fourth quarter. FMI is bullish on the current market for both buyers and sellers.

Several key drivers are set to help the CM industry capture the momentum for a prosperous 2021. Many buyers started the year with well-structured balance sheets and access to low-interest debt. Election results are signaling the anticipation of new federal infrastructure funding, with CM operators poised to benefit. On January 14, then President-elect Joe Biden released his plan for a $1.9 trillion stimulus package. According to Bloomberg, "economists see much to like in Biden's stimulus [plan], even if imperfect." Public companies in the sector are seeing boosts in their stock values, encouraging an acquisitive atmosphere. The promise of capturing future earnings through solid economic fundamentals creates an attractive landscape for M&A.



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Recapping the events of 2020 and the impacts on the sector

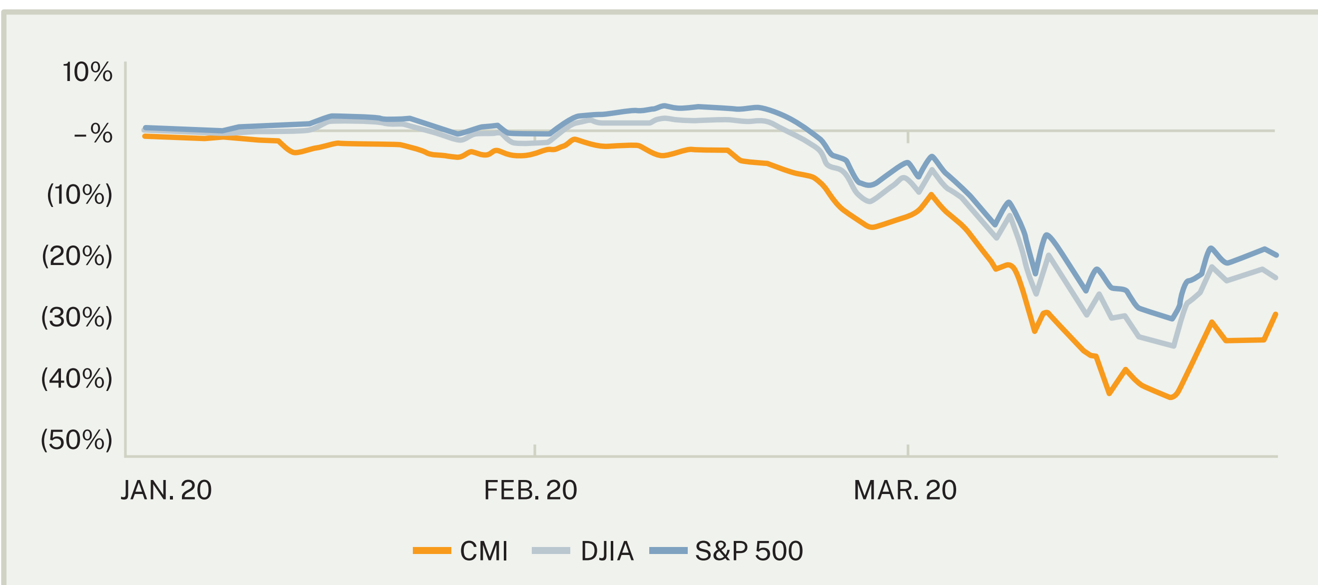
START OF THE YEAR: *CAUTIOUS OPTIMISM*

The CM industry began the year with cautious optimism and with the pendulum in a neutral position. Operators started with strong backlogs, an expectation for infrastructure spending and a long-term reauthorization of the expiring FAST Act. However, financial indicators (i.e., inverted yield curves and declining housing starts) indicated a pending recession. Economists could not pinpoint the spark of the next downturn, but many were remaining cautious. Like most historic events, it turned out that no one could have predicted the actual tipping point for the downturn – a global pandemic. It was unfathomable at the time to foresee the upcoming global health crisis and subsequent economic fallout that was about to take place.

LATE Q1: *FREEFALL*

By late February, the terms "coronavirus," "COVID-19" and "global pandemic" had become prominent throughout the world, and mounting fears were sending shockwaves into public markets, reversing the direction of the pendulum. From February 19-27, the S&P 500 dropped 13% from its peak, resulting in a loss of $3.6 trillion in market value.[1] Over the same nine-day period, FMI's Construction Materials Index (CMI),* a proprietary index of publicly traded Construction Materials firms, shed $12.5 billion in market value.[2] As travel halted, the oil markets began to feel the effects of the pandemic, with more turmoil to yet to come.

Exhibit 1: CMI and Stock Market Performance



SOURCE: CapIQ

[1] "The Week That Wiped $3.6 Trillion Off the Stock Market", The Wall Street Journal, Feb. 29, 2020.

[2] CapIQ.

* The CM index includes: Buzzi (BIT: BZU); Cementos Argos (BVC: CEMAROGS); Cemex (BMV: CEMEX CPO); Colas SA (ENXTPA: RE); CPI (NasdaqGS: ROAD); CRH (ISE: CRG); Eagle Materials (NYSE: EXP); GCC (BMV: GCC); Granite Construction (NYSE: GVA); Heidelberg Cement (DB: HEI); LafargeHolcim (SWX: LHN); Martin Marietta (NYSE: MLM); The Monarch Cement Company (OTCPK: MCEM); Summit Materials (NYSE: SUM); Titan Cement (ATSE: TITK); U.S. Concrete (NasdaqCM: USCR); Vulcan Materials (NYSE: VMC).

> *The combination of the coronavirus and what happened with oil...[was] a big one-two punch*
>
> *Warren Buffett (March 11, 2020)[7]*

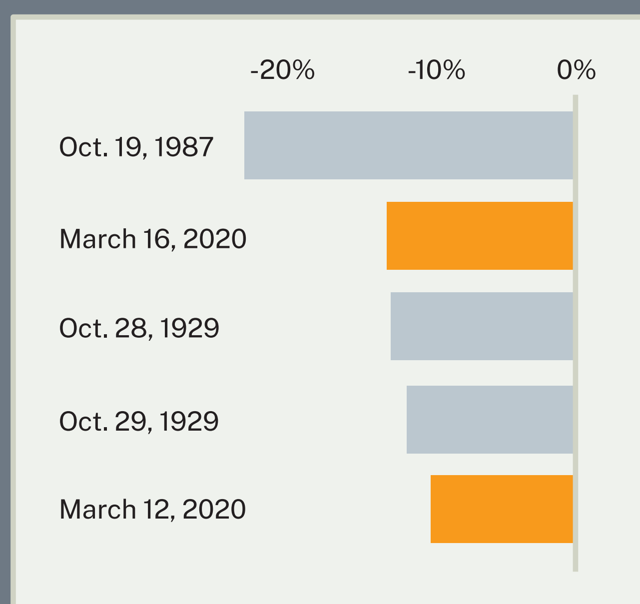
By mid-March, the United States was battling on two fronts: the COVID-19 pandemic and the economic crisis. In an effort to limit the rate of infections and "flatten the curve," state and local officials began instituting stay-at-home orders for nonessential workers and businesses. With millions of Americans at home and businesses shut down, the federal government moved swiftly. On March 27, President Donald J. Trump signed into law the Coronavirus Aid, Relief and Economic Security (CARES) Act, a $2 trillion stimulus bill that included the Paycheck Protection Program (PPP), $1,200 stimulus checks and enhanced unemployment benefits.[8]

> *[the Fed is] using all their ammunition within a three-week span. There's nothing left. They can't use monetary loosening as part of their arsenal anymore.*
>
> *Terence Wong, chief executive of Azure Capital, The Wall Street Journal (March 16, 2020)[9]*

The negative pendulum momentum continued its course into the month of March:

- March 8 – Saudi Arabia launched an oil price war campaign against Russia.[3]
- March 9 – The Dow Jones Industrial Average (the Dow) and the S&P fell by 7.8% and 7.6%, respectively (energy markets dropped ~20%).
  - For the first time in 23 years, the stock market "circuit breaker" safeguard is triggered to stop trading and mitigate an extreme decline.[4]
- March 12 – The U.S. closed its borders to all European travel for 30 days; the Dow and S&P plunged 10.0% and 9.5%, respectively.[5]
- March 15 – The Federal Reserve enacted new monetary policies, slashing interest rates and providing a $700 billion asset-purchase package.
- March 16 – The Dow, the S&P and the CMI all fell by 12.9%, 12.0% and 10.8%, respectively.[6]

Exhibit 2: Dow Jones Industrial Average, Largest One-Day Percentage Declines



SOURCE: Dow Jones Market Data

3 "Saudis Instigate Oil-Price Clash With Russia", The Wall Street Journal, March 8, 2020.

4 "Stocks Fall More Than 7% in Dow's Worst Day Since 2008", The Wall Street Journal, March 9, 2020.

5 "U.S. to Ban Travel From Europe for 30 Days Due to Coronavirus", The Wall Street Journal, March 11, 2020.

6 "Dow Plummets Nearly 3,000 Points as Virus Fears Spread", The Wall Street Journal, March 9, 2020.

7 "Warren Buffett Says Virus, Oil 'One-Two Punch' Still Not as Bad as 2008", Bloomberg, March 11, 2020.

8 "What's Inside The Senate's $2 Trillion Coronavirus Aid Package", NPR, March 26, 2020.

9 "Dow Plummets Nearly 3,000 Points as Virus Fears Spread", The Wall Street Journal. March 16, 2020.

Q2: *TRUDGING AGAINST HEADWINDS*

By April, state governors faced the difficult conundrum of how to limit the spread of the virus while still maintaining healthy economic activity. Although most construction and CM-related activities were deemed essential, there were still hurdles to overcome, including work delays, job cancellations, heightened safety protocols and the stability of project funding. In a survey conducted by the Associated General Contractors of America in April 2020, 69% of participants had projects halted in March and/or April, and 45% experienced canceled projects that were scheduled to begin sometime between March and May.[10]

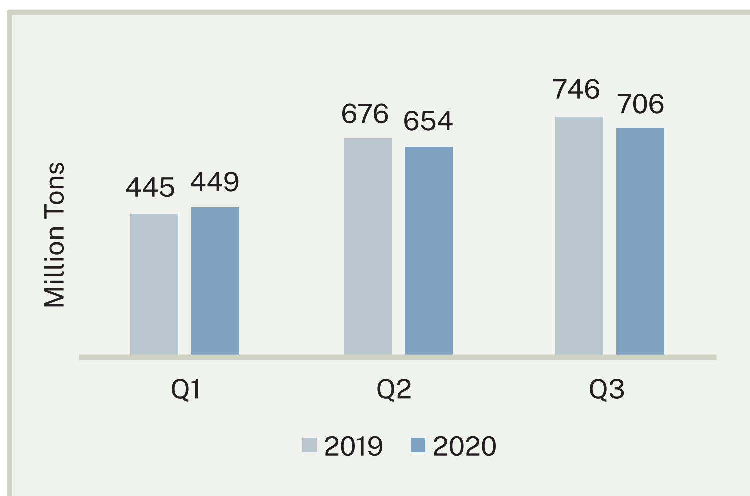
As the year progressed, many companies instituted work-from-home policies, resulting in millions of people no longer commuting. Inrix, a transportation analytics group, reported nationwide personal travel had decreased by 20% the week of March 14 and that travel was down 42% the week of March 21. On April 6, the American Association of State Highway and Transportation Officials (AASHTO) sent a letter to both House and Senate leaders requesting aid of $49.95 billion in "flexible federal funding to offset ...a 30% loss in state transportation revenues in the next 18 months." In the same letter, AASHTO called on Congress to "pass a major transportation investment package in the form of surface transportation and water transportation...in order to boost [a] yearslong economic recovery" in the wake of the pandemic.[11]

As spring became summer, uncertainty around funding and concerns about delayed projects resulted in declining backlogs. According to a May survey by the Associated Builders and Contractors, operators reported a reduction in backlogs of approximately 9%.[12]

With companies implementing work-from-home strategies and with nonessential businesses closed, demand for commercial buildings and offices declined. The Dodge Momentum Index, a monthly measure gauging nonresidential building projects in planning, plummeted 13% in the second quarter of 2020 compared to the first quarter.[13]

Aggregate producers were negatively impacted as the U.S. Geological Survey reported ~660 million metric tons of construction aggregates were produced in the second quarter of 2020, representing a 3.2% year-over-year decrease from the prior year's quarter.[14] Despite the fact that the industry was deemed essential, Construction Materials was still affected by the COVID-19 pandemic.

Exhibit 3: Construction Aggregates per Quarter – 2019 vs. 2020



SOURCE: U.S. Geological Survey

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10 AGC Coronavirus Survey Results (April 20-23), AGC.

11 "Virus Will Take Toll on State Transportation Revenue, Experts Say", Transport Topics, April 6, 2020.

12 "ABC's Construction Backlog Indicator Inches Higher in May; Contractor Confidence Continues to Rebound", ABC, June 9, 2020.

13 "Dodge Momentum Index loses ground in June 2020," Pit and Quarry, July 21, 2020.

14 "Aggregate production down in second quarter 2020", Pit and Quarry, Sept. 4, 2020.

Reactions across the CM industry to COVID-19 (March 2020):

- The CEO of Grupo Argos (BVC: GRUPOARGOS) Jorge Mario Velasquez discussed how his company had "taken measures to postpone investments...until [they had] more visibility of the future."
- LafargeHolcim (SWX: LHN) initiated an action plan titled HEALTH, COST & CASH that called for a ~$400 million reduction in capex and a ~$300 million reduction in fixed costs.

SOURCES: Grupo Argos, LafargeHolcim

Due to these unprecedented times, many companies began strengthening their balance sheets to cope with the crisis and prepare for recovery. Following the dogma of "cash is king," CM companies began exploring cost-cutting measures and eliminating unnecessary usages of capital. Ambitious, capital-intensive programs such as mergers and acquisitions and growth capital expenditure (capex) were put on hold.

Large publicly traded corporations also had the benefit of accessing debt capital markets. On the company's first-half earnings call, CRH's finance director Senan Murphy discussed how the company "took the precautionary decision to draw down on a [~$4] billion revolving credit facility and...issued [~$2] billion of bonds."[15] The smaller, privately owned CM operators received loans from the PPP to ensure their employees could remain on the payroll and operations could continue.

Despite the fact that the industry was deemed essential, Construction Materials was still affected by the COVID-19 pandemic.

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15 CRH plc (CRH) CEO Albert Manifold on Q2 2020 Results - Earnings Call Transcript, Seeking Alpha, Aug. 20, 2020.

Q3: *TREADING WATER*

Shortly after the passage of the CARES Act, there was clamoring for Congress to provide additional aid. The pendulum was beginning to shift away from crisis management toward the early steps of recovery. On May 15, the House passed the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, a $3 trillion stimulus package[16] that contained a $15 billion stopgap for state transportation departments – much less than the $50 billion requested by AASHTO, but progress nonetheless. However, the HEROES Act still needed to pass in the Senate. Former Senate Majority Leader Mitch McConnell declared the proposal "dead on arrival."[17] On July 27, Senate Republicans announced another form of stimulus called the Health, Economic Assistance, Liability Protection and Schools (HEALS) Act. The proposal had a price tag of $1 trillion and almost no provisions for infrastructure funding.[18] As the year progressed, there would be a handful of stimulus proposals; but the gap between the House and Senate remained wide.

Additional Stimulus Proposals

Announcement Date:	May 15, 2020	July 27, 2020
Legislation Name:	HEROES Act	HEALS Act
Sponsoring Party:	House Democrats	Senate Republicans
Total Spend:	$3 trillion	$1 trillion
Allocation for Infrastructure:	$15 billion for state DOTs	N/A
Status:	FAILED	FAILED

LATE Q3: *SLOW BUILD*

Two dates were circled on everyone's calendars in 2020 that would impact momentum: September 30 and November 3. The last day of September marked the expiration of the FAST Act, and the first Tuesday in November was Election Day.

Congress needed to pass legislation to fund the government and avoid a shutdown. Legislators were able to come together and pass a continuing resolution by the September 30 deadline.[19] This resolution was beneficial for Construction Materials because it reauthorized the FAST Act for an additional year and added $13.6 billion to the Highway Trust Fund.[20] This would provide state transportation departments and local municipalities funding clarity for 2021.

"A full one-year extension of highway funding provides states and communities the certainty required to plan for critical road and bridge projects," said John Barrasso (R-Wyo.), chairman of the Senate Committee of Environment and Public Works (EPW).[21] Industry leaders also praised the one-year renewal of the FAST Act.

[16, 17] Americans haven't received another round of COVID-19 stimulus because negotiations have dragged on for 6 months, Business Insider, Oct. 14, 2020.

[18] NACo LEGISLATIVE SUMMARY OF THE SENATE COVID RELIEF PACKAGE, NACo, July 27, 2020.

[19] President Trump Signs Spending Bill After Brief Lapse in Funding, The Wall Street Journal, Oct. 1, 2020.

[20] CR Secures Federal Funding, Extends FAST Act For One Year, AASHTO, Oct. 2, 2020.

[21] Congress Passes One-Year Extension of Highway Funding, US Senate Committee on Environment and Public Works, Sept. 30, 2020.

> Now that state DOTs have greater clarity around highway revenues, lettings are returning to higher pre-COVID levels and are projected to continue to be consistent with state DOT budgets in 2021.
>
> Tom Hill, CEO of Vulcan Materials (NYSE: VMC)[22]

Q4: THE START OF THE UPSWING

November proved to be a pivotal month for both CM and the nation with the pendulum on the upswing. The results of the election revealed that Joe Biden would become the 46th president of the United States. In the House of Representatives, Republicans gained seats while Democrats still maintained the majority. The Democrats ultimately took control of the Senate by winning two runoff elections in Georgia.

The 2020 election results will likely have both positive and negative impacts on the Construction Materials industry. On the plus side, the federal government should have more capital for road and infrastructure projects as part of President Biden's "Building Back Better" platform. Conversely, increasing corporate taxes results in lower cash availability for firms. On Martin Marietta's third quarter earnings call, CEO Ward Nye's assessment was that "[if] Mr. Biden is elected… [with a] Democratic-controlled House… [we are] looking at a 41% increase in highway spending." Nye also went on to say that increased regulations and taxes could spur M&A activity in the Construction Materials sector because "closely held kind of businesses start reconsidering…their long-term future."[23]

Should the new administration's control result in more stringent regulations, the results will be mixed for Construction Materials. Regulations often require further investment in equipment, raising CapEx requirements. However, from a market standpoint, this often rewards strong, cash-positive businesses by creating new barriers to entry and operating hurdles for competing businesses.

Another key development for Construction Materials was the announcement of Pete Buttigieg as secretary of transportation. Although the former mayor of South Bend has limited federal experience, some view his resume as beneficial to transportation.

"As a mayor, he has seen firsthand how infrastructure policy and investment impact families, businesses, local economy and quality of life," said Tom Smith, executive director of the American Society of Civil Engineers. As a presidential candidate, Buttigieg's infrastructure plan had a price tag of $1 trillion with $165 billion allocated to the Highway Trust Fund.[24]

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[22] Vulcan Materials Company (VMC) CEO Tom Hill on Q3 2020 Results - Earnings Call Transcript, Seeking Alpha, Nov. 6, 2020.

[23] Martin Marietta Materials, Inc. (MLM) CEO Howard Nye on Q3 2020 Results - Earnings Call Transcript, Seeking Alpha, Oct. 29, 2020.

[24] "What Pete Buttigieg will bring to the Transportation Department", Construction Dive, Dec. 15, 2020.

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Examining the Drivers for the Industry in 2021

The momentum of late 2020 appears to be carrying forward into 2021 as investors place their bets on federal infrastructure spending. In the two-day period following the Democratic sweep in Georgia, for example, the CMI rose roughly 9% versus the DJIA and S&P, which both rose by approximately 2%.[25] Depending on a few key issues, several drivers should continue to push a positive swing for CM operations. While FMI remains optimistic about the second half of 2021, it should always be noted that construction is a local business, with all economic forces affecting different geographies to varying degrees.

The CMI rose by ~9% in the two-day span following the Georgia runoff elections and the presidential election certification.

KEY DRIVERS

- **Coronavirus and vaccines**
- **Government stimulus**
- **Residential markets**
- **Nonresidential construction**
- **Highways and streets**

Coronavirus and the Vaccine

There was light at the end of the tunnel in the last months of 2020. The long-awaited COVID-19 vaccines received approval from the Centers for Disease Control and Prevention, and inoculations commenced. Experts speculate that the general population will have access to the vaccine by the end of the second quarter or the beginning of the third quarter of 2021. As herd immunity develops and the virus subsides, the pandemic is expected to dwindle, helping the economy get back on track.

Government Stimulus

Passed and signed into law at the tail end of 2020, the second round of stimulus legislation included a few provisions that should greatly benefit the Construction Materials industry. First, the bill earmarked $10 billion to help state DOTs recoup funds lost as a result of lower gas tax revenue.[26] Jim Tymon, executive director of AASHTO, praised the bill because "[the] timely federal support will help state DOTs to retain their institutional capacities and…be prepared to deliver future infrastructure investment driving economic recovery and growth."[27] Other pertinent measures in the bill include $284 billion for the PPP program, tax credits for employers to keep employees on payroll, and direct stimulus checks of $600 for qualifying individuals and dependents.[28]

On January 14, Biden released his plan for a further $1.9 trillion stimulus package – with many provisions that reinforced and added to the bill passed at the end of 2020. In a speech discussing his plan, Biden made specific reference to infrastructure funding, stating: "It's time to stop talking on infrastructure and to finally start building within infrastructure so we can be more competitive with millions of good-paying jobs, putting Americans back to work on our roads, our bridges, make them faster, cheaper, cleaner, to transport American-made goods across our country and around the world."

Optimistically, the industry expects these new policies to create positive momentum in the new year.

[25] CapIQ.

[26] NSSGA.

[27] Updated: State DOTs Net $10B In Aid From COVID-19 Relief Legislation, AASHTO Journal, Dec. 23, 2020.

[28] What's in the $900 Billion Covid-19 Relief Bill, The Wall Street Journal, Dec. 27, 2020.

Residential Markets

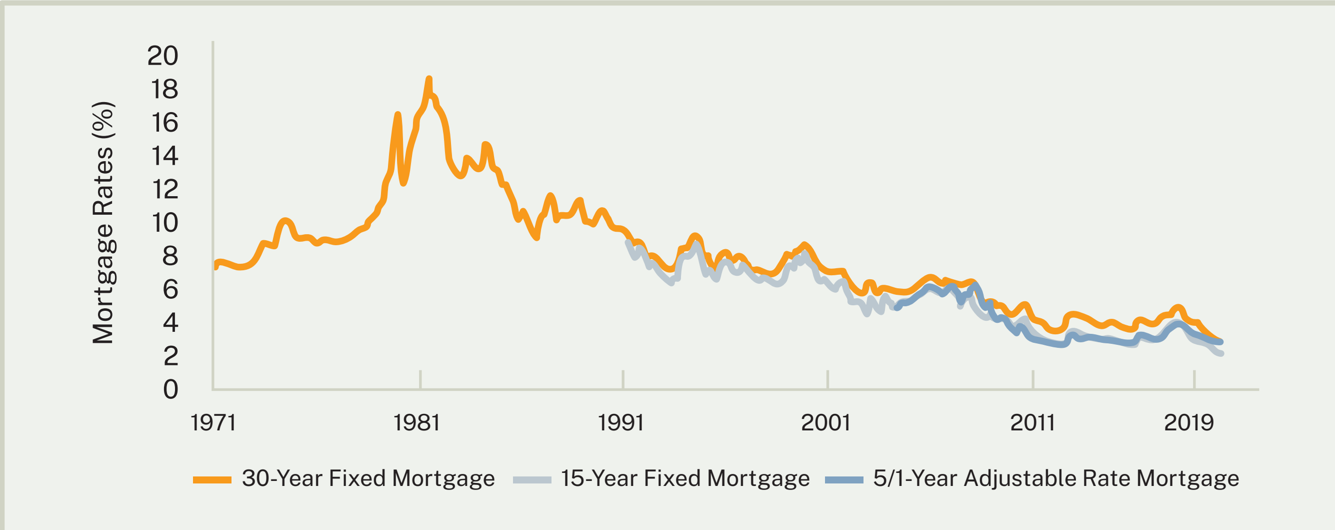
Tied directly to the CM industry, the single-family housing market was a surprise winner of 2020 as a number of factors fueled housing trends. Stay-at-home orders and remote work policies created an exodus from cities to more suburban and exurban locations. As seen in Exhibit 4, individuals and families sought more indoor and outdoor space, and moved from large city apartments to houses in smaller towns. With interest rates at historic lows, mortgage rates plummeted, allowing cheaper financing opportunities for homebuyers (see Exhibit 5).

Other key points in the residential growth story are the age and demographics of purchasers. Millennials have historically prioritized experiences, such as travel, above owning tangible assets. With low mortgage rates and travel restrictions in place, millennials flooded the homebuying market. Similarly, older generations, who also lived with travel restrictions and were on the cusp of retirement, found themselves in the market for a second home. The pandemic essentially accelerated life plans for all generations of homebuyers.

Exhibit 4: Homebuyers on the Move – U-Haul Migration Patterns

SOURCE: PwC. John Burns Real Estate Consulting analysis of pricing data pulled from uhaul.com.
NOTE: In-migration markets are those where it costs more to bring a U-Haul vehicle into that city than to take one out. The premium to bring in vehicles implies that more people are moving in than leaving.

Exhibit 5: Historic Mortgage Rates

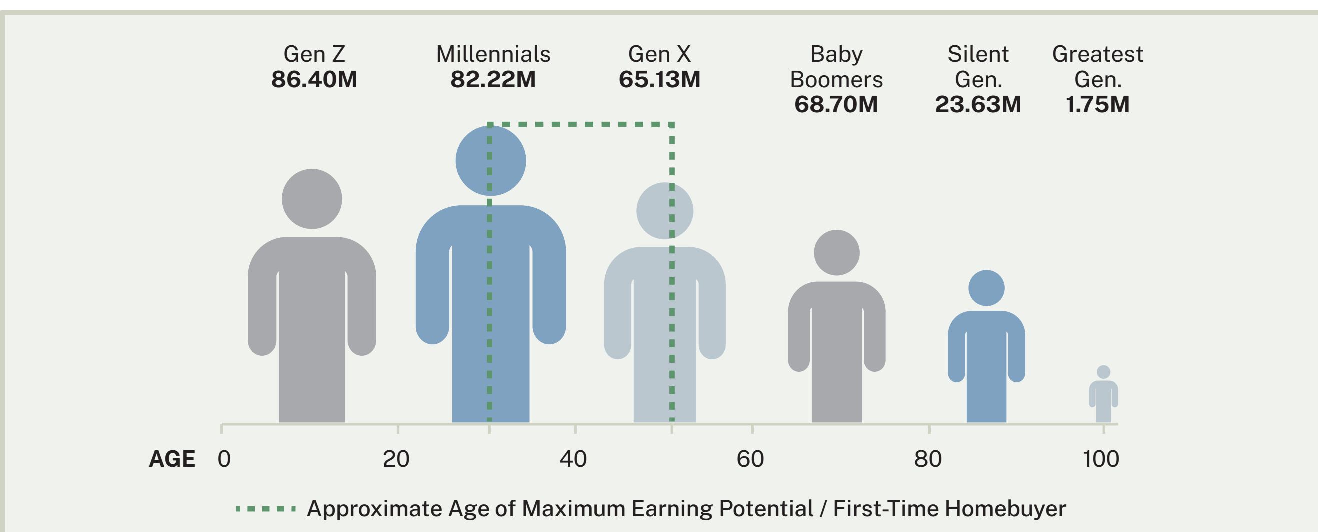


SOURCE: Freddie Mac

Residential Keys for 2021

Millennials. Millennials are the second-largest age cohort and make up more than a third of the U.S. workforce (Exhibit 6). Typically defined as individuals born between 1981 and 1996, older millennials are about to enter their prime earning years. As population demographics continue to shift, millennials stand to benefit from significant inheritance from their baby-boomer parents. According to The Economist, there is $1.3 trillion of investible assets passed down every five years in the U.S., and the rate is expected to double by the year 2036.[29, 30] Although burdened with historic amounts of student loan debt, inheritance and higher earnings will translate into greater purchasing power for millennials, which should continue to fuel housing markets.

Exhibit 6: U.S. Population by Age and Demographic



SOURCE: U.S. Census Data

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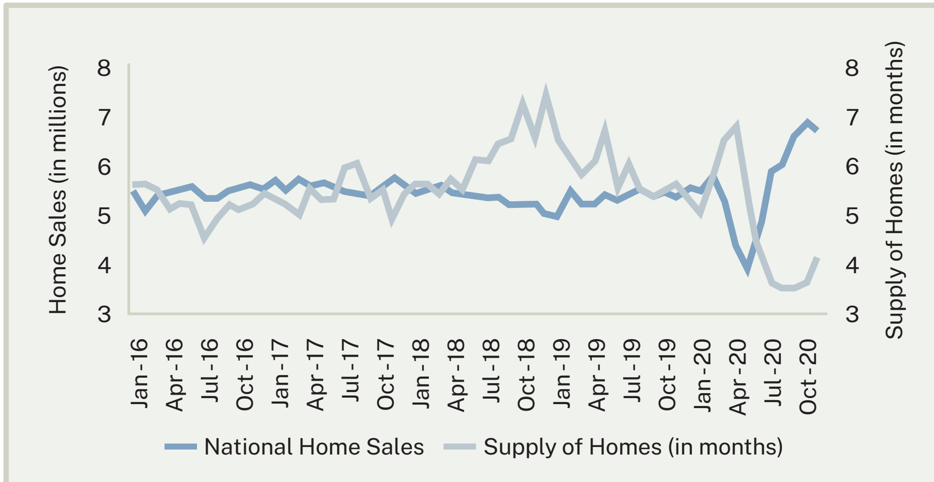
29 U.S. Population by Age and Generation in 2020, Knoema, April 16, 2020.

30 "The Generation Game", The Economist, Oct. 24, 2020.

Economics of Housing. Like all aspects of the economy, housing markets are governed by the principles of supply and demand. When supply is low and demand is high, the result is higher prices. This simple economic equation can explain much of the residential market for 2020 and should give insight into the outlook for 2021.

Using sales as a proxy for demand, Exhibit 7 demonstrates how dramatic the residential market has been over the course of five years, but especially following the fallout in April 2020. Conversely, when analyzing the monthly supply of homes, there has been a massive decline.

Exhibit 7: National Home Inventory and Existing Home Sales

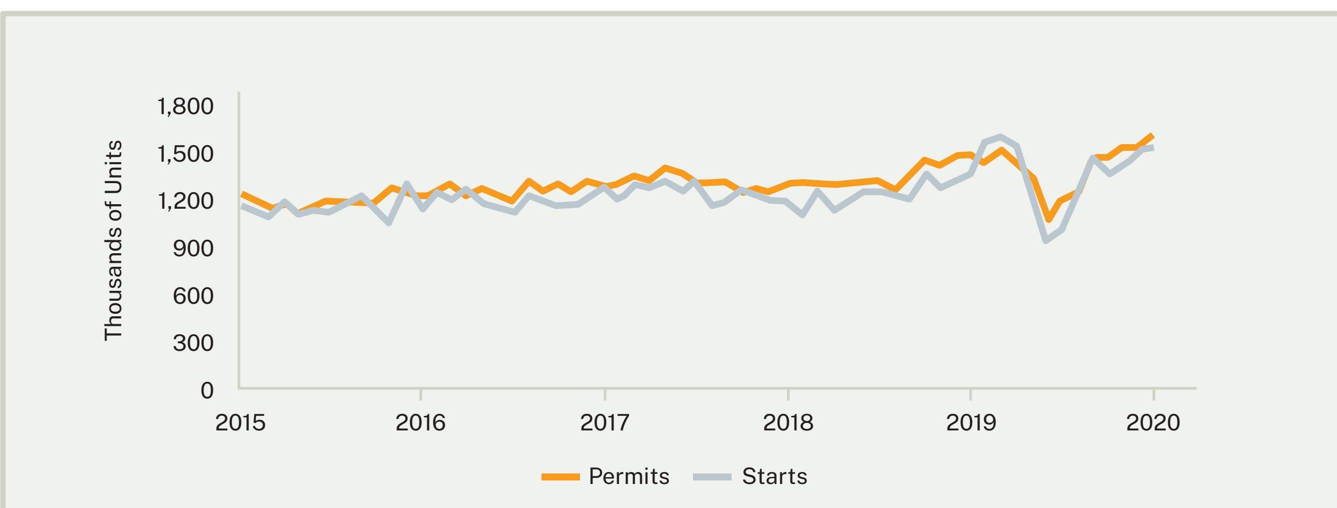


SOURCE: National Association of Realtors

This disequilibrium has pushed up home prices to the point where the National Association of Realtors reports that median sales prices are up 15% compared to last year. Returning to basic economics, when supply and demand are at a disequilibrium (particularly on the supply side), competition will enter the market. These competitors will increase the supply, which seemed to be the case at the end of 2020.

Exhibit 8 shows that privately owned housing starts and building permits are now on the rise. All of these factors can lead to the assumption that single-family residential construction should continue its momentum in 2021.

Exhibit 8: New Residential Construction *(Seasonally Adjusted Annual Rate)*



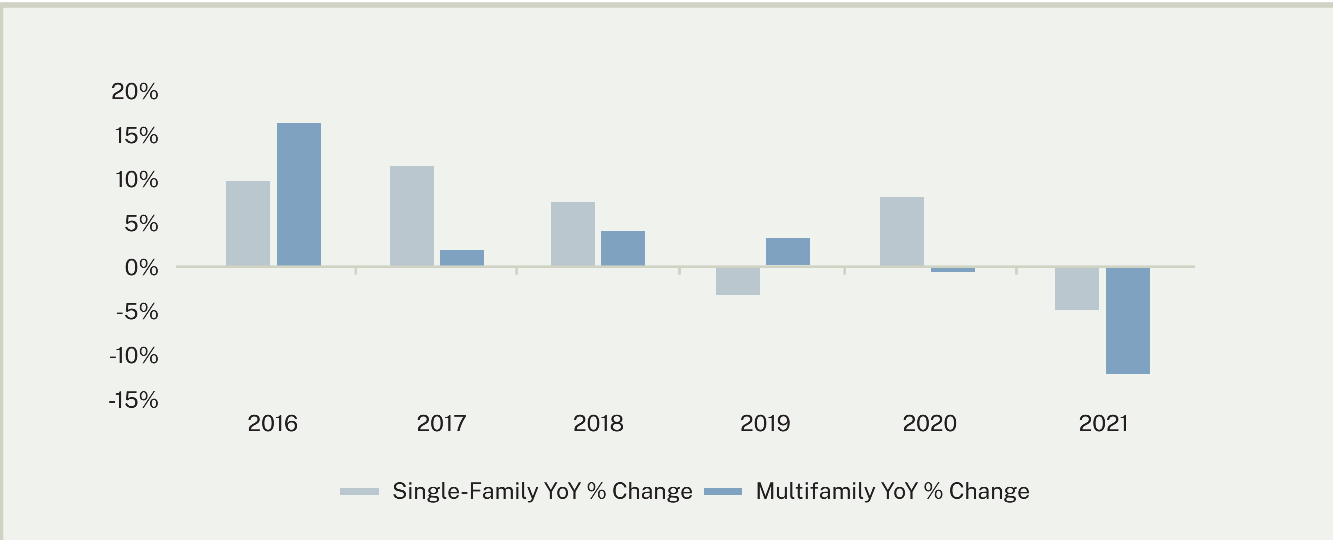
SOURCE: U.S. Census Bureau and U.S. Department of Housing and Urban Development

The multifamily construction outlook is not as robust for 2021 (as seen in Exhibit 9). The underlying theme driving the slow growth revolves around rentals. One of the greatest concerns for 2021 is the potentially enormous wave of rental evictions for individuals and families.

According to estimates from Moody's Analytics, U.S. tenants owe as much as $70 billion in back rent.[31] Experts fear that as many as 40 million people in the U.S. could face eviction.[32] A provision of the CARES Act (and subsequent extensions) prohibited landlords from evicting tenants due to failure to pay rent in an effort to mitigate the spread of COVID-19.[33] The latest relief package continues the eviction prohibition through January 2021 and also provides $25 billion in rental assistance to tenants for back rent.[34] This could have drastic and far-reaching economic implications.

Overall, FMI anticipates that the single-family residential market will continue to buoy the CM market, while uncertainty surrounds the multifamily sector.

Exhibit 9: YoY Residential Construction Change (%)



SOURCE: FMI

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31 "U.S. Poised for Wave of Evictions in January as Federal Ban Expires", The Wall Street Journal, Dec. 13, 2020.

32 "The federal eviction moratorium expires in January. It could leave 40 million Americans homeless", USA Today, Dec. 24, 2020.

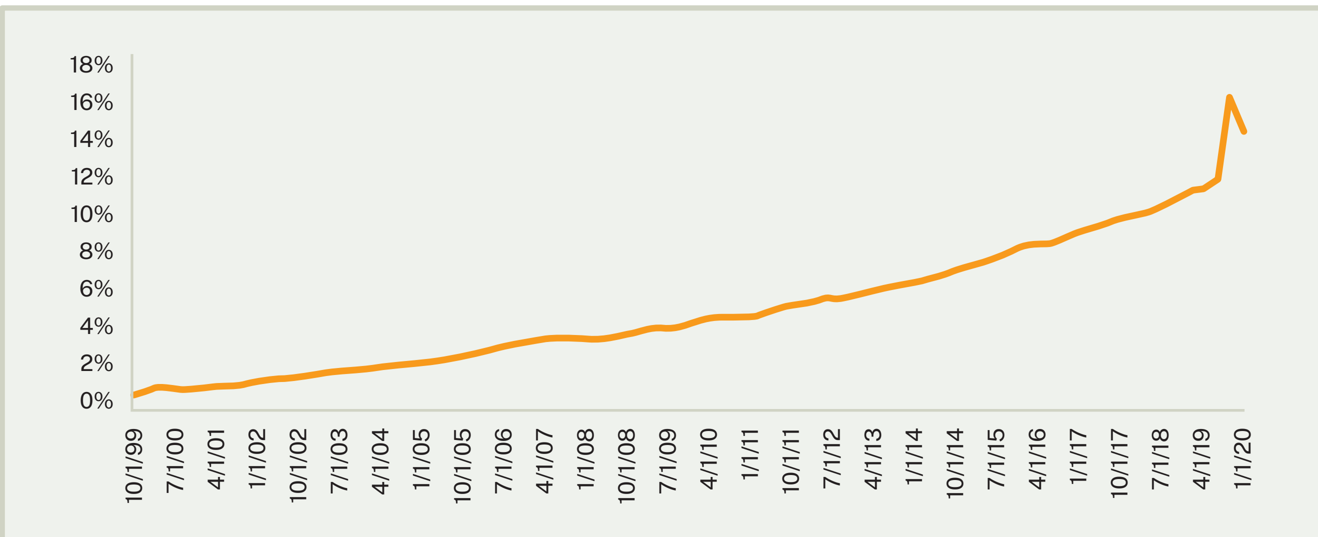
33 "Residential Eviction Protections Under the CARES ACT – What Landlords and Tenants May Need to Know About Eviction Actions", JD Supra, Sept. 4, 2020.

34 "What's in the $900 Billion Covid-19 Relief Bill", The Wall Street Journal, Dec. 27, 2020.

Nonresidential Construction

The pandemic changed human behavior and is now directly influencing the outlook for nonresidential construction. Two independent drivers affecting both industrial and commercial development are the growing preferences to buy online and corporate work-from-home policies. Stay-at-home orders and general health fears surrounding COVID-19 encouraged individuals to shop online. Companies such as Amazon have flourished in the pandemic whereas traditional brick-and-mortar stores struggled. Exhibit 10 shows how e-commerce sales as a percent of total sales have steadily grown over the last 20 years and that demand is exacerbated during the pandemic.

Exhibit 10: E-Commerce Sales as a % of Retail Sales

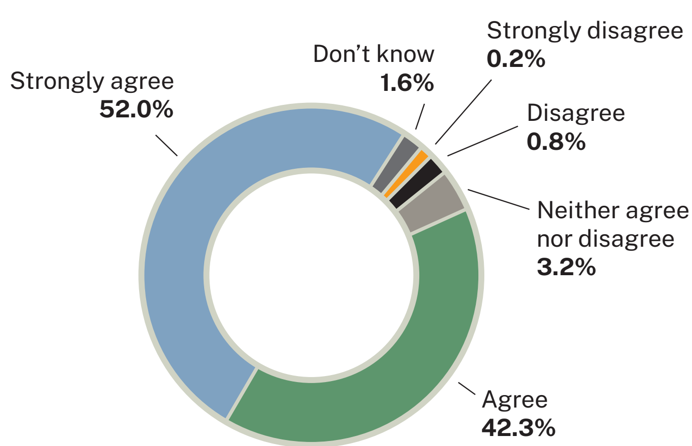


SOURCE: St. Louis FRED

Another major trend impacting nonresidential construction is work from home. Prior to the pandemic, the idea of never going to an office was almost inconceivable for many people. However, technology companies such as Slack, Zoom and Microsoft have all enabled employees to work remotely while maintaining productivity. In PwC's Emerging Trends in Real Estate 2021 survey, 94.3% of participants agree that in the future more companies will allow employees to work remotely at least part of the time (Exhibit 11).[35] The consequences of the pandemic will still be felt long after the virus has been eradicated.

Exhibit 11:

In the future, more companies will choose to allow employees to work remotely at least part time.



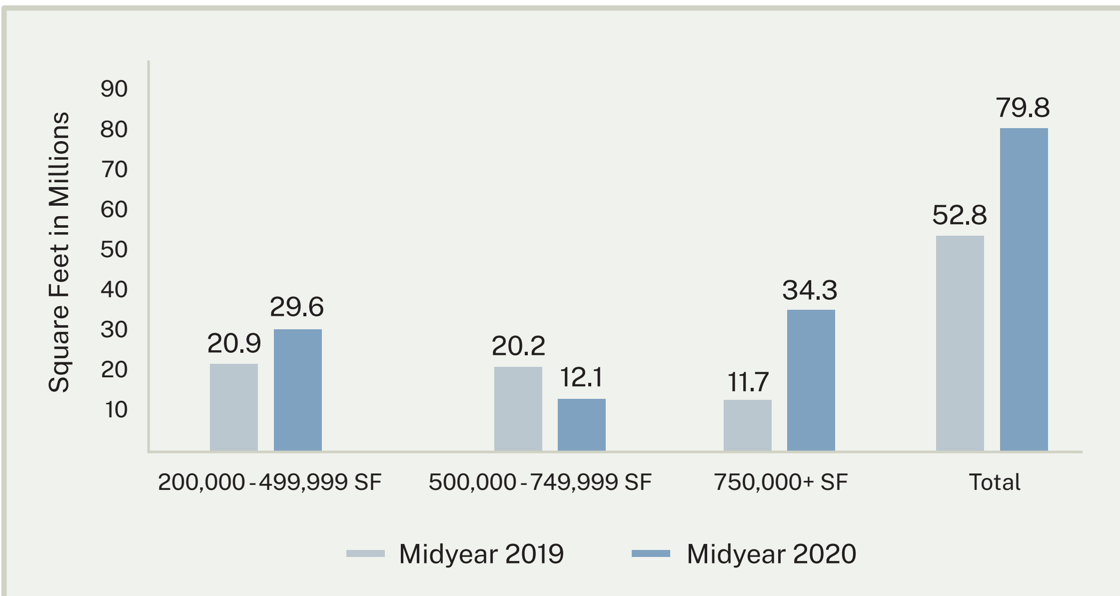
SOURCE: Emerging Trends in Real Estate 2021 survey

[35] Emerging Trends in Real Estate 2021, PwC.

Nonresidential Keys for 2021

E-commerce and Support Infrastructure. Exhibit 10 further affirms that e-commerce is a growing trend in the economy. As demand for e-commerce increases, so too does the demand for infrastructure to support online retailers (i.e., fulfillment centers, warehouses, data centers, etc.). The higher demand for industrial space was prevalent in 2020. According to Colliers International, net absorption for big-box buildings, industrial concrete compounds with 300,000 square feet or more and those with ceilings of 28 feet or higher, increased by 51% in the first half of 2020 compared to the first half of 2019 (see Exhibit 12). The momentum of e-commerce and subsequent demand for industrial space is expected to continue in 2021.

Exhibit 12: Overall Net Absorption



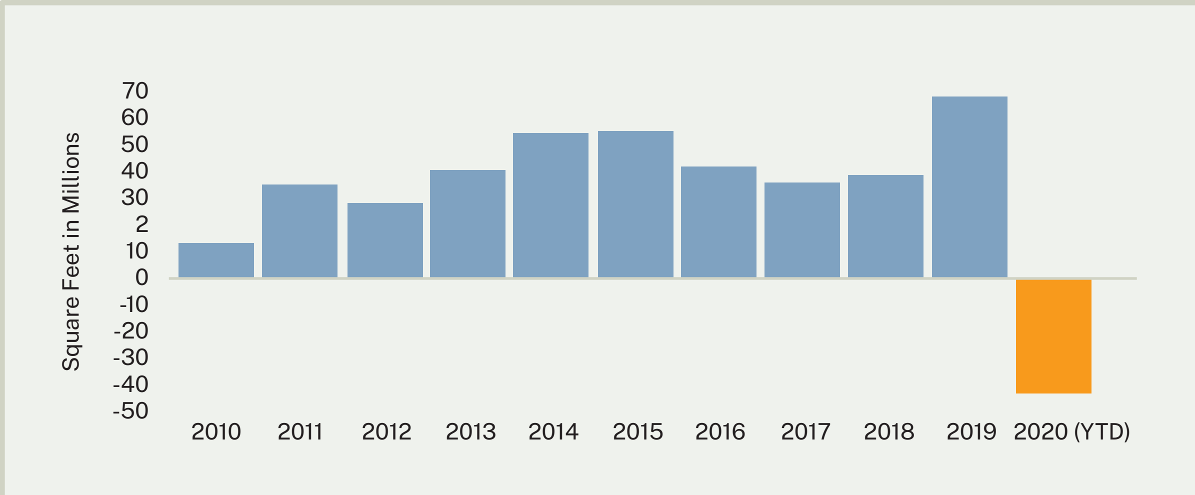
SOURCE: Colliers International

Work From Home and Office Space. The pandemic's grip was visible to commercial office markets, as governments and corporations instituted stay-at-home orders. With vaccinations only just beginning, many companies are still taking proactive measures to ensure safety by allowing employees to continue working from home.

As seen in Exhibit 13, net absorption was down significantly through the third quarter of 2020, which means that executives were shunning traditional office spaces. The sublease market, which is a key metric for the office market, is larger than it was during the dot-com bubble (as seen in Exhibit 14). As such, the demand for commercial construction has declined, and investment is not predicted to reach pre-pandemic levels for quite some time (see Exhibit 15).

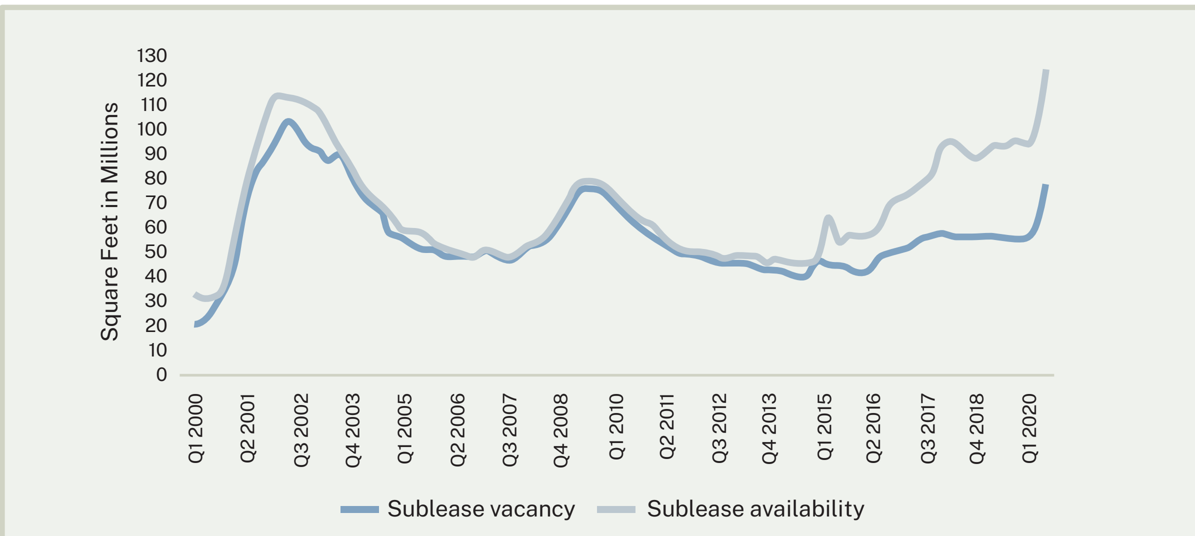
FMI expects the nonresidential market to present a "mixed bag" for the CM industry, with warehousing/ distribution providing a bright spot and commercial/office facing challenges.

Exhibit 13: Net Absorption YTD as of Q3 2020



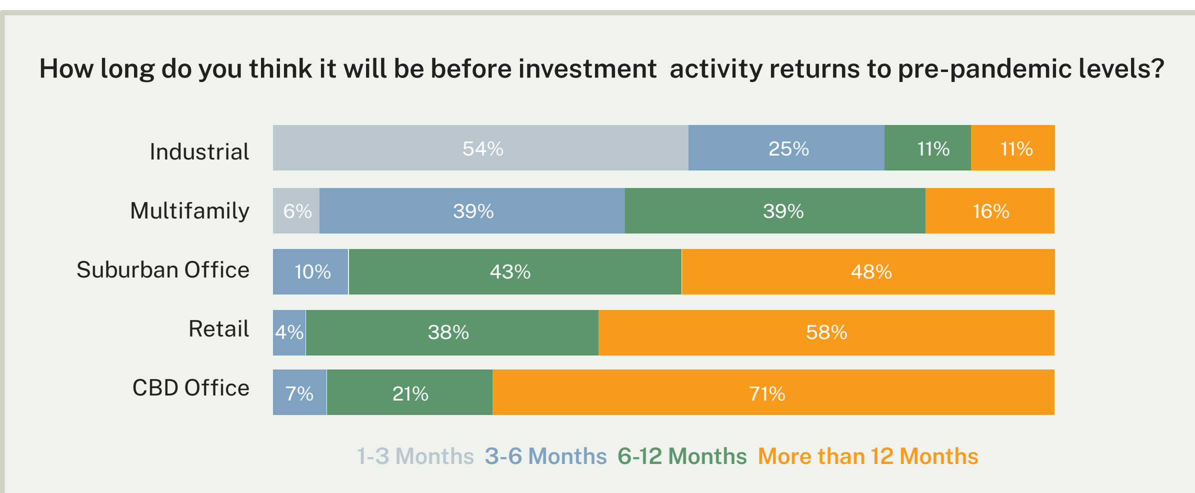
SOURCE: JLL

Exhibit 14: Sublease Vacancy and Availability



SOURCE: JLL

Exhibit 15: Investment Activity Survey



SOURCE: CBRE

Highways and Streets

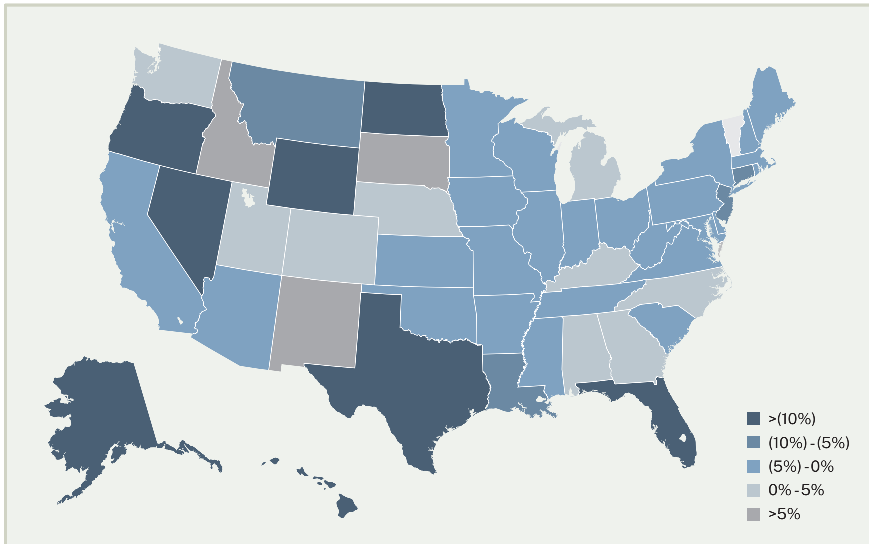
The outlook for highways and streets for 2021 could be categorized as a double-edged sword. On the one hand, the positive drivers for highways and streets include the renewal of the FAST Act, better than anticipated state tax revenue (see Exhibit 16), and bipartisan support for infrastructure spending. However, the same positive drivers also have downsides as the FAST Act is set to expire in September 2021, states have lower than normal general funds, and the increased polarization in Washington often inhibits legislation from passing.

Despite all of the moving pieces, it is undeniable that the U.S. infrastructure needs improvement. Investment remains a bipartisan issue, leading pundits to believe that Washington will act, especially now that the White House and Congress are controlled by a single party. CM industry leaders echo this belief, thinking that infrastructure will be a top priority for elected officials to jump-start the economy coming out of the pandemic.

On Vulcan Materials third quarter earnings call, CEO Tom Hill predicted that the Congress will "[pass] a new better funded highway bill in late 2021."[36] Although forecast spending for highways and streets will dip in 2021 compared to 2020 (see Exhibit 17), spending levels are expected to bounce back quickly. The passing of a new highway or federal infrastructure bill would be beneficial to the CM sector as the industry can respond quickly with shovel-ready projects.

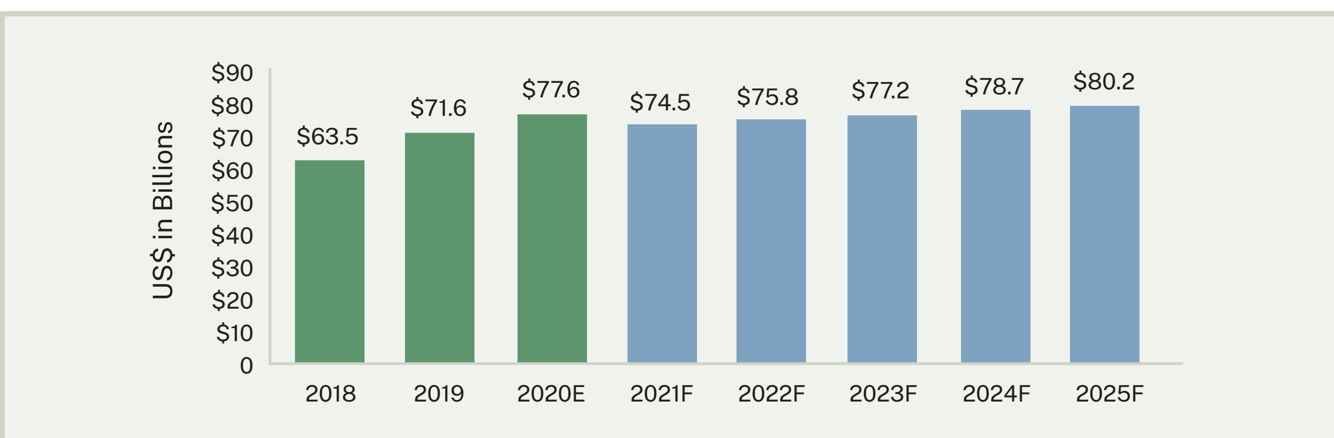
Exhibit 16: Percentage Change in Tax Revenue

(Mar.-Oct. 2019 vs. Mar.-Oct. 2020)



SOURCE: State Tax and Economic Review Project, State and Local Finance Initiative at Urban Institute

Exhibit 17: Forecast of Public Highway, Street and Related Construction Work



SOURCE: American Road and Transportation Builders Association

[36] Vulcan Materials Company (VMC) CEO Tom Hill on Q3 2020 Results-Earnings Call Transcript, Seeking Alpha, Nov. 6, 2020.

3

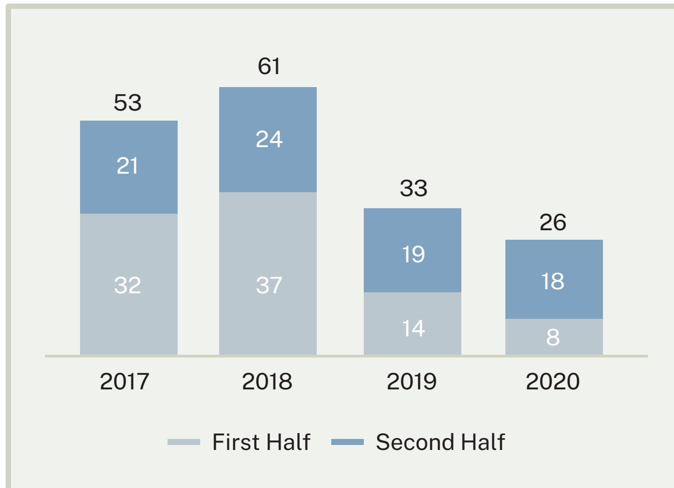
Forecasting M&A Activity and Sentiment for the Upcoming Year

M&A PROJECTIONS FOR CONSTRUCTION MATERIALS

The M&A market for Construction Materials ebbed and flowed throughout 2020 at a pace that mirrored the sentiment of the industry. There was significant activity at the start of the year. However, as noted, early turmoil forced a full stop in many processes with a "wait and see" mentality for buyers. By late summer, things began to normalize, bringing buyers and sellers back to the table.

As the year progressed, major buyers found themselves with accumulated war chests of capital and access to cheap debt financing (i.e., historically low interest rates). Exhibit 18 shows that despite an anemic first half of 2020, announced M&A activity for Construction Materials picked up dramatically in the second half of the year. While the deal count still lags previous years, there was substantial movement in the fourth quarter despite virtually no activity in the first and second quarters.

Exhibit 18: Number of Construction Materials Deals in 2020



SOURCE: FMI, Wallstreet Research

The second half increase in transactions was largely driven by CM buyers focusing on smaller, strategic, bolt-on acquisitions. Concurrently, there has been some evidence of buyers increasing their efforts to pursue platform expansions.

On his third quarter earnings call in August, Charles Owens, CEO of Construction Partners Inc. (NASDAQ: ROAD), mentioned that the company was seeing an unusually "strong pipeline" of potential M&A targets and that the company had "money available to where [they could] move quickly on acquisitions."[37]

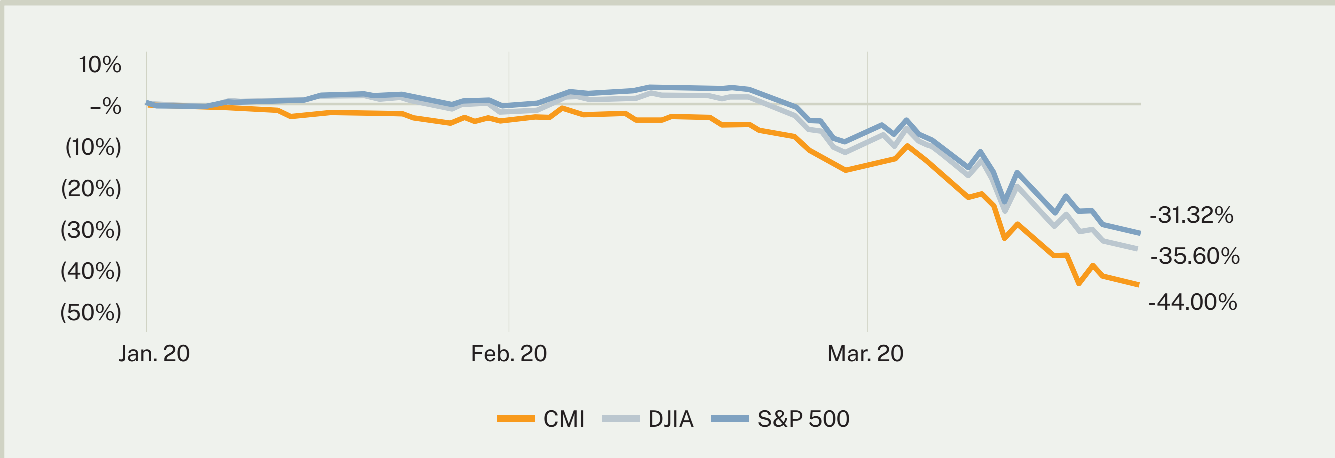
With sentiment on the upswing, large public buyers are looking to capitalize on future market potential through acquisitions. Sellers are similarly motivated to pursue transactions in 2021. With the Democratic party controlling both the House and Senate, many anticipate an increase in corporate and capital gains tax rates next year. There could now be significant advantages for sellers who close deals in 2021.

M&A Keys for 2021: Public Market Performance – Public market performance can impact a company's ability to execute deals. Executive leadership has to answer for operational performance every quarter, and M&A is often scrutinized by Wall Street analysts. Tasked with promoting shareholder value, C-suite executives can become reluctant to do deals if their company share price is declining.

As seen in Exhibit 19, the CMI declined 44% from January 2 to March 23, the day that all major indices bottomed out. However, the CMI has rallied an impressive 84% from the bottom to year-end (Exhibit 20), which has encouraged buyers to be more active with M&A in 2021. Stock price is the "currency" with which public companies operate.

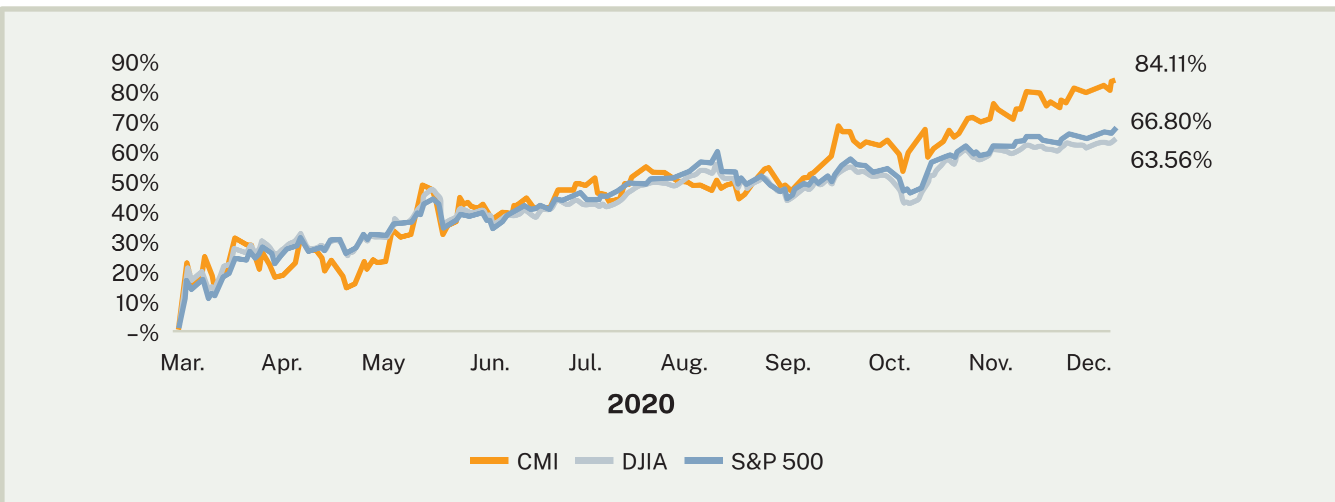
[37] Construction Partners, Inc. (ROAD) CEO Charles Owens on Q3 2020 Results - Earnings Call Transcript, Seeking Alpha, Aug. 7, 2020.

Exhibit 19: CMI and Stock Market Performance (Jan 2-March 23, 2020)



SOURCE: CapIQ

Exhibit 20: CMI and Stock Market Performance (March 23-Dec 30, 2020)



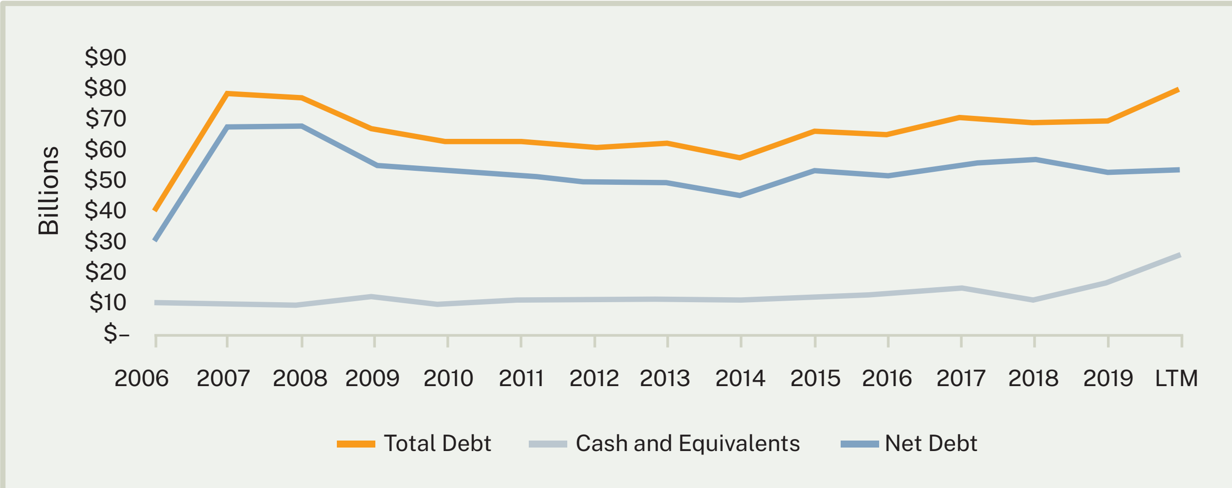
SOURCE: CapIQ

M&A Keys for 2021

Capital is a key component of all mergers and acquisitions. While preparing for the worst possible scenarios in 2020, members of the CMI increased cash positions and utilized credit facilities.

Exhibit 21 reveals that CMI member firms have dramatically increased their cash positions, with total cash on hand at its highest point in recent history and total debt at the highest point since 2007. Part of the narrative regarding debt accumulation is due to historically low interest rates. Access to cheap debt capital allows companies flexibility for both operational initiatives and M&A opportunities.

Exhibit 21: CMI Composite Cash and Debt



SOURCE: CapIQ

In regard to debt financing, Maher Al-Haffar, the CFO of Cemex (BMV: CEMEX CPO), stated, "[since] rates continue to be attractive… there may be opportunities for us."[38] On Construction Partners Inc.'s fourth quarter earnings call, CFO Alan Palmer discussed how his company's liquidity "provides financial flexibility in today's uncertain economic environment and provides capital for potential future acquisitions."[39] Bottom line: CM companies' top priority will be to maintain healthy balance sheets while simultaneously pursuing M&A opportunities.

Despite the turbulent economy, the overall atmosphere for the CM industry looks fairly stable, with the M&A market appearing optimistic. Strong industry drivers, coupled with renewed funding expectations, work together to create a strong backbone for the sector. While no one can predict the future with certainty, we expect to see more and more sellers entering the market to meet buyer demand and drive the momentum into 2021.

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[38] CEMEX, S.A.B. de C.V. (CX) CEO Fernando González on Q3 2020 Results - Earnings Call Transcript, Seeking Alpha, Oct. 28, 2020.

[39] Construction Partners, Inc. (ROAD) CEO Charles Owens on Q4 2020 Results - Earnings Call Transcript, Seeking Alpha, Dec. 11, 2020.

LOOKING AHEAD

As discussed, the CM industry is gaining momentum, and the pendulum has moved into positive territory. Sentiment is encouraged by a strong residential market and optimistic signals surrounding federal funding. The results of this momentum will likely be seen in full force later in 2021, depending on the timing of infrastructure spending and the rollout of vaccines. For M&A, the momentum began during the second half of 2020 and is expected to accelerate into 2021 as the industry buyers see long-term improvement in the construction markets, driving performance.

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George Reddin is a managing director with FMI Capital Advisors, Inc., FMI Corporation's investment banking subsidiary. George is based in Raleigh, North Carolina. He specializes in mergers and acquisitions and financial advisory services. George works regularly with companies in the construction materials industry (aggregate, hot mix asphalt, ready mixed concrete and concrete product producers) as well as contractors involved in road-building construction. George can be reached via email at *greddin@fminet.com*.

FMI Capital Advisors

FMI Capital Advisors specializes in sell-side mergers and acquisitions for the construction materials industry.

With **100+** completed transactions in the Construction Materials sector, FMI's team brings value through extensive industry relationships and deep market knowledge of the built environment.

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BARRIERE CONSTRUCTION

has been acquired by

CRH

FMI Capital Advisors

The undersigned served as the exclusive financial advisor to Barrier Construction Corporation

John S. Lane & Son, Inc.
TRAP LANE ROCK

has been acquired by

PECKHAM INDUSTRIES, INC.

FMI Capital Advisors

The undersigned served as the exclusive financial advisor to John S. Lane & Son, Inc.

McCARTNEY CONSTRUCTION CO. INC. GADSDEN, ALA.

has been acquired by

Vulcan Materials Company

FMI Capital Advisors

The undersigned served as the exclusive financial advisor to McCartney Construction

Myrl & Roy's Paving, Inc.

has been acquired by

L. G. EVERIST, INC.

FMI Capital Advisors

The undersigned served as the exclusive financial advisor to Myrl and Roy's Paving, Inc.

PALMER PAVING CORP

has been acquired by

PECKHAM INDUSTRIES, INC.

FMI Capital Advisors

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