MERCER CAPITAL

BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

VALUE FOCUS
Construction & Building Materials

Second Quarter 2018

SEGMENT FOCUS
Building Materials

EXECUTIVE
INDUSTRY TRENDS

- Favorable macroeconomic environment driving increased construction on all fronts – residential, nonresidential, public
- Tight labor market and increased fuel costs pressuring building companies' margins
- U.S. tax overhaul already boosting nonresidential construction through 2Q18
- The Fed continues on its path of raising interest rates. However, the flattening yield curve has some concerned that short-term rates are rising too quickly

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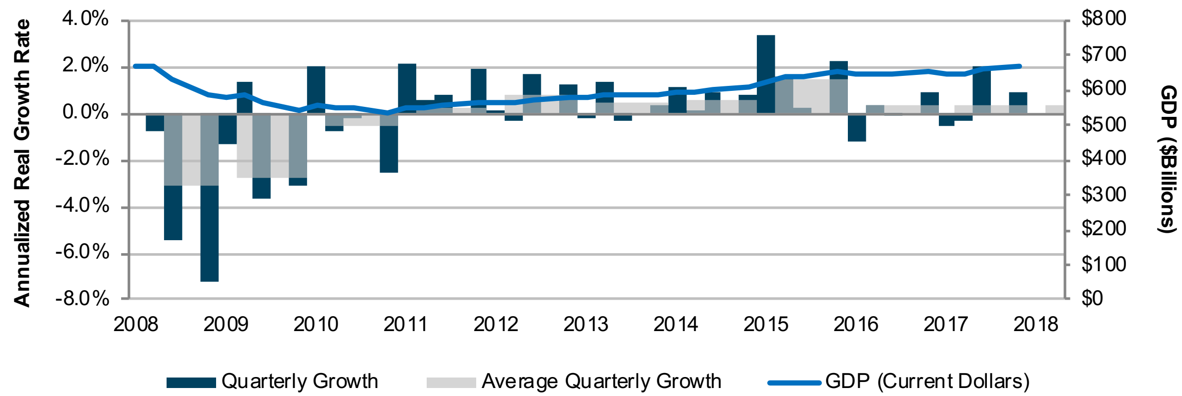
Construction Overview

Construction & National GDP

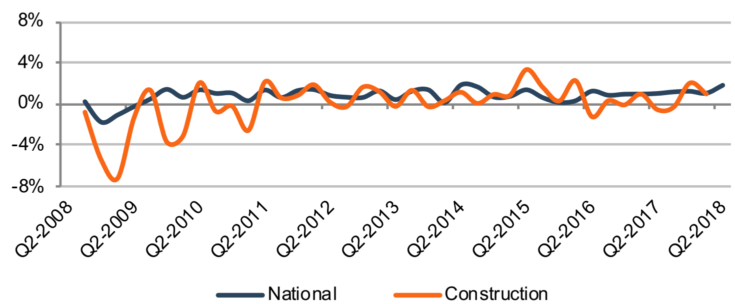
GDP rose 5.4% over the past year through the second quarter of 2018, which was the highest year-over-year rate in the examined period. Since 2008, construction has averaged 3.6% of national GDP, and it accounted for 3.3% of GDP over 1Q 2018. Construction has steadily recovered since the decline caused by the 2008 financial crisis, experiencing growth consistent with that of national GDP. Fluctuations in construction GDP have now stabilized, with most quarterly growth rates lying in the plus or minus 0-2 percent range since 2012. Year-over-year construction GDP has increased 2.1%, and plans for increased infrastructure spending, inventory constraints in the existing home market, and improved corporate profitability should facilitate continued industry growth.

Construction Gross Domestic Product



Source: Trading Economics

% Change in GDP



Source: Trading Economics, U.S. Bureau of Economic Analysis

Construction GDP	
Period	**% Change**
Q-o-Q	1.0%
Y-o-Y	2.1%

National GDP	
Period	**% Change**
Q-o-Q	1.9%
Y-o-Y	5.4%

** Construction data through Q1 2018*

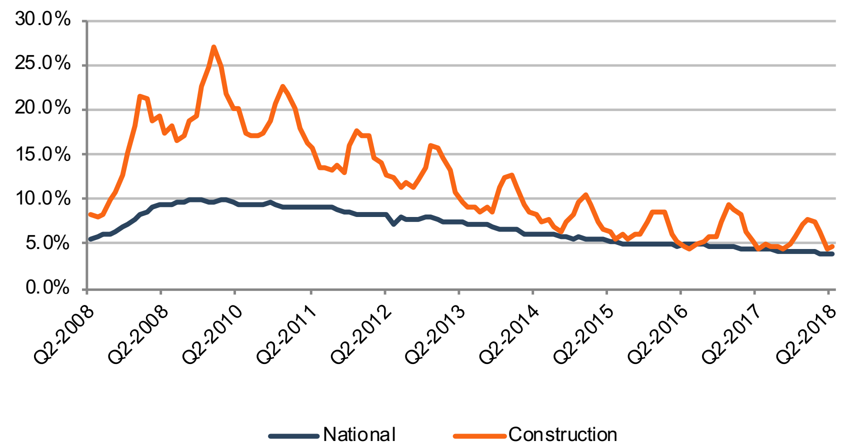
Construction Overview

Construction & National Unemployment

The Federal Reserve believes a healthy economy typically has an unemployment rate between 4.5% and 6.0%. The current level of 4.0% falls slightly below this range, indicative of a tight labor market. The unemployment rate fell to 3.8% in May which was the lowest rate of the ten year period.

The unemployment rate in the construction industry is typically more volatile due to cyclical and seasonal factors. The major contributing factor to the industry's seasonality is the weather. Production of materials and project site conditions generally decline during the colder, winter months. Construction unemployment is currently at 4.7%, comparable to 4.5% at the same time last year. A lack of skilled laborers has become an industry-wide issue and has contributed to wage growth and increased costs for builders. Lower unemployment rates suggest an increase of activity within the industry.

Unemployment Rate



Source: U.S. Bureau of Labor Statistics

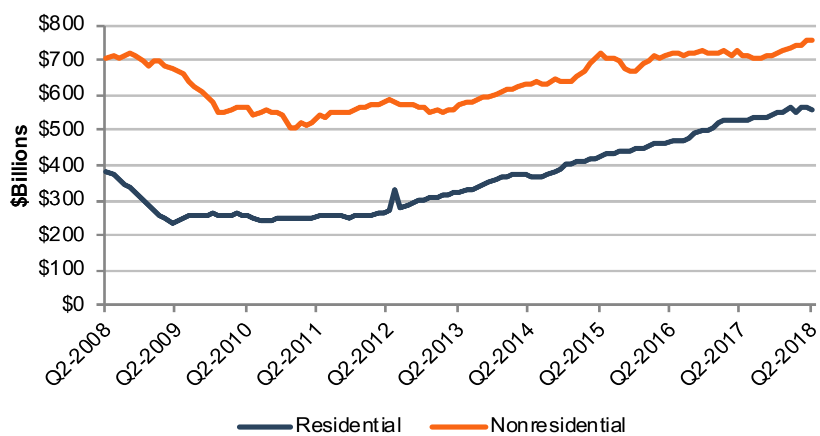
Construction Overview

Value of Construction Put-in-Place

The value of construction put-in-place is the total value of construction work done in the U.S. for a particular period. The U.S. Census Bureau tracks this data and reports the total monthly. This value includes, but is not limited to, the building materials costs, labor costs, profit, costs of engineering, interest, and taxes.

Year-over-year put-in-place construction has increased by 5.5% for residential and by 6.2% for nonresidential. Nonresidential construction grew by 2.3% quarter-over-quarter through June 2018. The increase in non-residential construction comes in the midst of delays for the President's $1.5 trillion worth of infrastructure projects due to financing issues. Progress in these plans would create significant public work projects and could continue to accelerate nonresidential growth. Growth in residential construction has been choppy in comparison to nonresidential construction but still continued to increase quarter-over-quarter.

Value of Construction Put-in-Place



Source: U.S. Census Bureau

Residential	
Period	**% Change**
Q-o-Q	0.9%
Y-o-Y	5.5%

Nonresidential	
Period	**% Change**
Q-o-Q	2.3%
Y-o-Y	6.2%

Sector Focus

Building Materials

State and local governments are typically in charge of their construction projects, but they rely on federal funding to complete many projects. Despite optimism regarding a potential $1.5 trillion infrastructure plan from the Trump administration to close the U.S. infrastructure gap, no policy has currently been implemented and the infrastructure package took a back seat to tax reform and other initiatives. According to industry executives, federal funds usually take 18 to 24 months to flow through to projects, and companies are still experiencing benefits from the 2015 FAST Act. However, overall infrastructure activity has been sluggish the past couple of years despite the pervasive need for infrastructure investment. State and local initiatives have appeared perhaps due to diminished expectations for a grand federal plan, and total government consumption and investment has increased in recent periods.

Building materials benefited from both healthy residential and nonresidential construction demand over the past year. Low home inventories and continuing improvement in employment and wages have increased demand for new home starts and subdivision development. Home prices continued to rise and rising interest rates may present headwinds due to increasing mortgage rates. In addition to increased consumer and business confidence, reduced corporate tax rates from the U.S. Tax Cuts and Jobs Act have boosted prospects for nonresidential construction.

The construction industry's strong performance and sustained economic expansion has been a boon for American aggregate producers. U.S. cement consumption has continued to increase from its low point in 2010. Cement consumption increased 2.8% in 2017 to 96.8 million metric tons, which is still 25% below the all-time peak in 2005. The U.S. was the third-largest cement producer in the world in 2017 behind China and India.

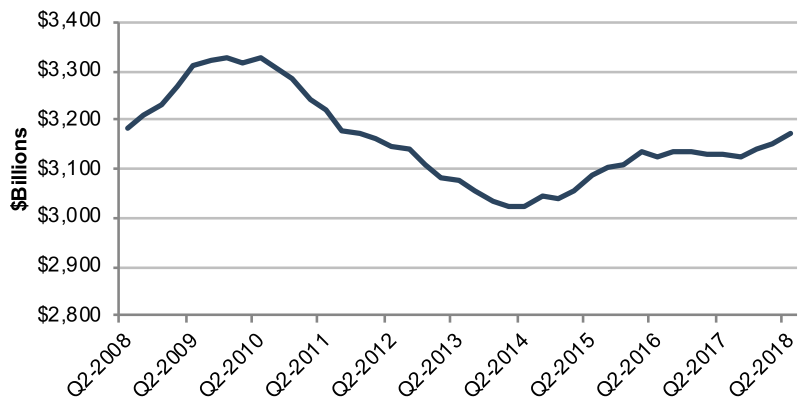
Despite a favorable macroeconomic environment and healthy revenues, the building materials industry has experienced increased cost pressures. Higher energy costs (oil, coal, petcoke) compressed industry earnings. A tight labor market has also increased the competition for employees in the building materials industry and driven up wage costs. Labor shortages are affecting contractors' capacity for work and may be limiting potential levels of activity. Since the prices for most large contracts are negotiated up front, the unexpected rise in costs has compressed margins. However, companies will have an opportunity to pass on higher prices as they negotiate new contracts. Increased demand will also boost product prices as the industry nears domestic production capacity. Concerns over increased building materials prices may dampen enthusiasm for publicly funded work as the cement producer price index hit a ten-year high in June 2018 and recently imposed tariffs on Chinese imports will increase the cost of imported materials.

Building Materials

Government Funding for Highways and Government Consumption and Investment

Building materials are a crucial input to construction projects. Without funding, however, construction projects cannot be completed. Much of this funding comes from public resources, so the industry is typically concerned with the level of government spending on construction activity. Government consumption expenditures and gross investments reached high levels during the recession to boost the economy and declined significantly in the years following. After stagnating for much of 2016 and 2017, GCI has grown consistently for the past three quarters and reached the highest levels since 2011. The growth in GCI comes despite the absence of the touted infrastructure investment bill under the new administration.

Government Consumption and Investment



Government Consumption & Investment	
Period	**% Change**
Q-o-Q	0.6%
Y-o-Y	1.3%

Source: St. Louis Fed | U.S. Bureau of Economic Analysis

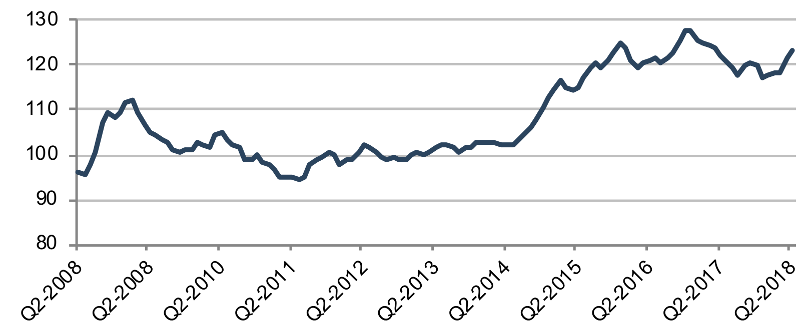
Building Materials

Trade-Weighted Index and Yield on 10-Year Treasury

The Trade-Weighted Index measures the relative strength of the U.S. dollar in comparison to foreign currencies, putting an emphasized weight on the most common trade partners and largest economies. When the dollar is strong, imports become cheaper and exports become more expensive. The dollar is near its strongest level in the last 10 years, which increases the cost for other countries to purchase U.S. building materials and decreases sales volume. The TWI has increased throughout 2018 after a decline in 2017. Divergence in monetary policy between the U.S. and the international community has boosted the dollar's appreciation as the Fed has increased rates and begun its process of shrinking its balance sheet.

The yield on 10-Year Treasury Bonds acts as a proxy for how expensive it is to finance construction projects. An increase in yields raises the cost of investment, but it can also signify increasing optimism about future economic growth, which leads to more spending in the construction industry. The 10-year yield reached its highest level since 2011 as rates have increased steadily.

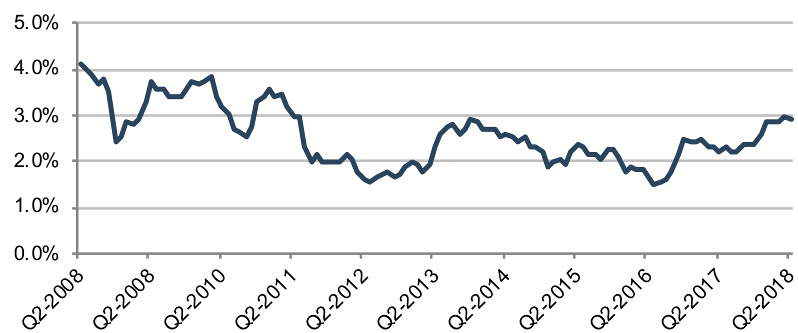
Trade-Weighted Index



Source: St. Louis Fed | Board of Governors of the Federal Reserve (US)

Trade-Weighted Index	
Period	**% Change**
Q-o-Q	4.5%
Y-o-Y	1.1%

Yield on 10-Year Treasury



Source: St. Louis Fed | Board of Governors of the Federal Reserve (US)

Yield on 10-Year Treasury	
Period	**Change**
Q-o-Q	7 BPS
Y-o-Y	72 BPS

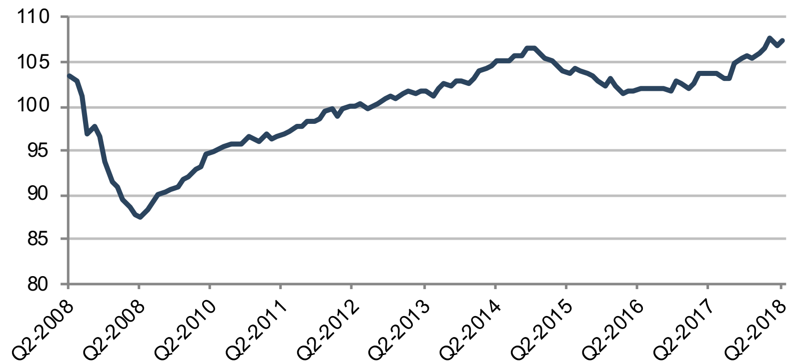
Building Materials

Industrial Production Index and Value of Utilities Construction

The Industrial Production Index is an indicator of economic activity that measures real production output of the manufacturing, mining, and utilities industries. It acts as a barometer of demand for industrial products and manufacturing activity. Building materials such as sand and gravel are important inputs of industrial production. After oscillating for a couple of years, IPI steadily increased for most of 2017 and 2018. In April 2018, IPI reached its highest level of the examined period.

Cement and ready-mix concrete are used in most construction projects involving the utilities subsector such as transportation, energy, gas, water, and sewage. There will always be a need for such infrastructure, so building materials companies can rely on this revenue stream even though the growth rate of new projects fluctuates. The value of utilities construction has increased 10.2% over the past year.

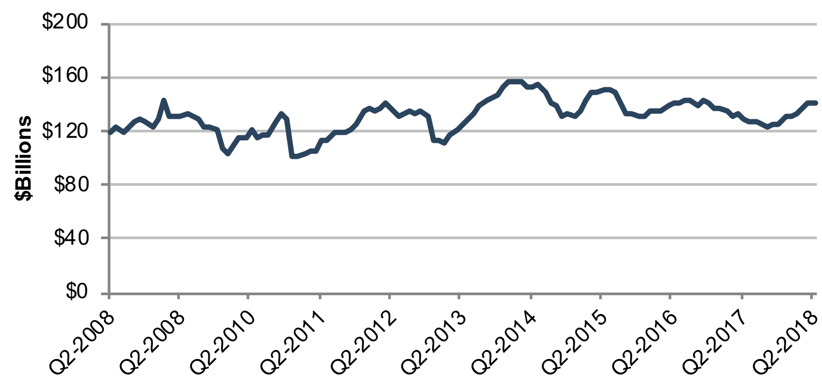
Industrial Production Index



Source: St. Louis Fed | Board of Governors of the Federal Reserve (US)

Industrial Production Index	
Period	**% Change**
Q-o-Q	0.9%
Y-o-Y	3.5%

Value of Utilities Construction



Source: U.S. Census Bureau

Value of Utilities Construction	
Period	**% Change**
Q-o-Q	6.8%
Y-o-Y	10.2%

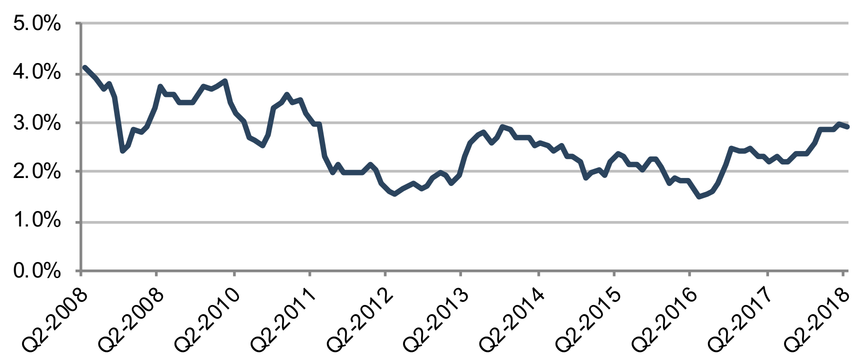
Sector Round-up

Roads, Bridges & Highways

The yield on 10-Year Treasury Bonds can indirectly affect the road contracting industry. As discussed previously, higher interest rates make construction projects more expensive to undertake, but they may also signify increased optimism about economic growth. As seen in the chart below, the 10-year yield has experienced a downward trend for much of the past ten years as the Fed attempted to aid the economic recovery by encouraging an increase in investment. The 10-year yield has increased by 72 basis points over the past year due to a shift in the Fed's stance on interest rates and expectations of stronger economic growth and higher inflation.

One interest rate measure to watch is the spread between 10-year and 2-year treasury yields. A spread approaching zero or even crossing into negative territory has historically preceded a recession and potentially signals that the Fed has tightened rates too much. The spread declined to 0.38% in June 2018 which is the lowest spread in the past ten years as the growth in 2-year yields, which the Fed has more influence over, has outpaced the growth in 10-year yields.

Yield on 10-Year Treasury



Yield on 10-Year Treasury	
Period	**Change**
Q-o-Q	7 BPS
Y-o-Y	72 BPS

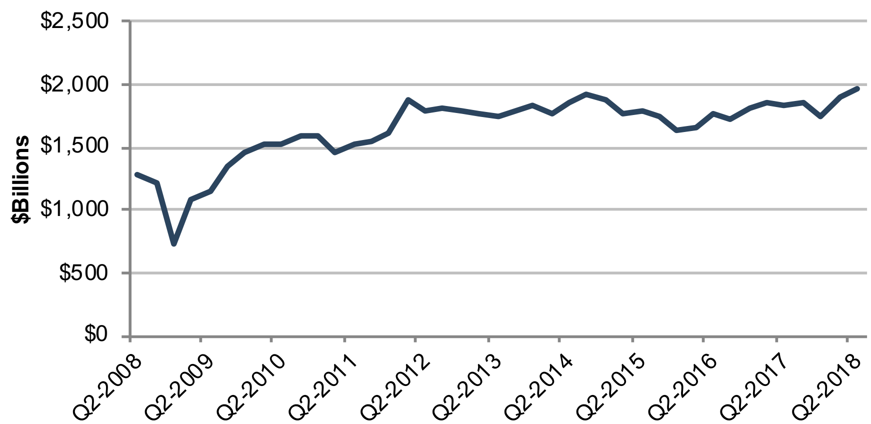
Source: St. Louis Fed | Board of Governors of the Federal Reserve (US)

Sector Round-up

Nonresidential Construction

Corporate profit is essential for companies not only to survive but also to grow and expand. When corporate profit increases, companies are more willing and able to open new branches and divisions. These additions lead to more commercial construction. As seen in the chart below, corporate profit has increased over the past year to the highest level of the past ten years. In addition to favorable macroeconomic trends discussed in other sections, the U.S. Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate from 35% to 21%. The dip in the fourth quarter of 2017 is partially due to one-time deferred tax asset write-downs incurred by companies owing to the new tax rate. A lower tax burden going forward should encourage increased investment.

Corporate Profit



Corporate Profit	
Period	**% Change**
Q-o-Q	3.3%
Y-o-Y	6.4%

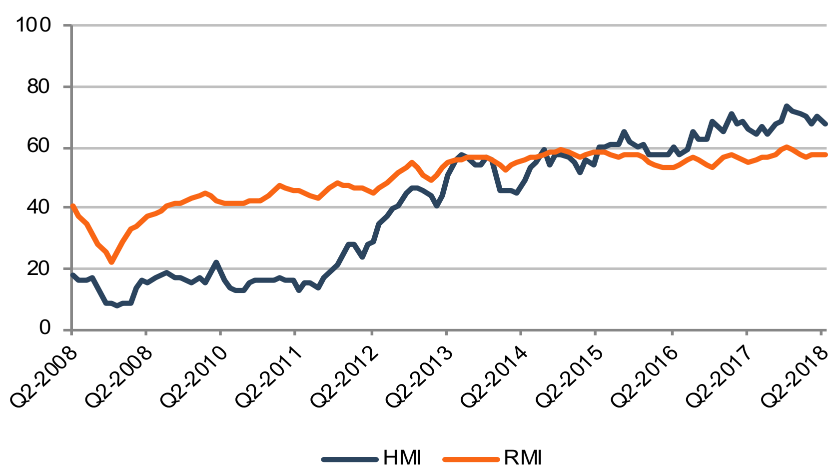
Source: St. Louis Federal Reserve

Sector Round-up

Residential Construction

The National Association of Home Builders conducts two separate surveys, the *Housing Market Index* (HMI) and the *Remodeling Market Index* (RMI), to measure confidence in the home building industry. Respondents rate their activity on a scale from 1-100 with 50 being average. The HMI is produced monthly and asks respondents to rate market conditions both at present and looking forward six months. The monthly index has remained above 50 since July 2014 and reached a ten year high of 74 in December 2017. The RMI is produced quarterly and asks respondents to rate their work volume as either higher or lower than the previous quarter. The monthly index has fluctuated between 50 and 60 since the second quarter of 2013.

NAHB HMI and RMI



NAHB HMI	
Period	**% Change**
Q-o-Q	-2.9%
Y-o-Y	3.0%

NAHB RMI	
Period	**% Change**
Q-o-Q	1.8%
Y-o-Y	5.5%

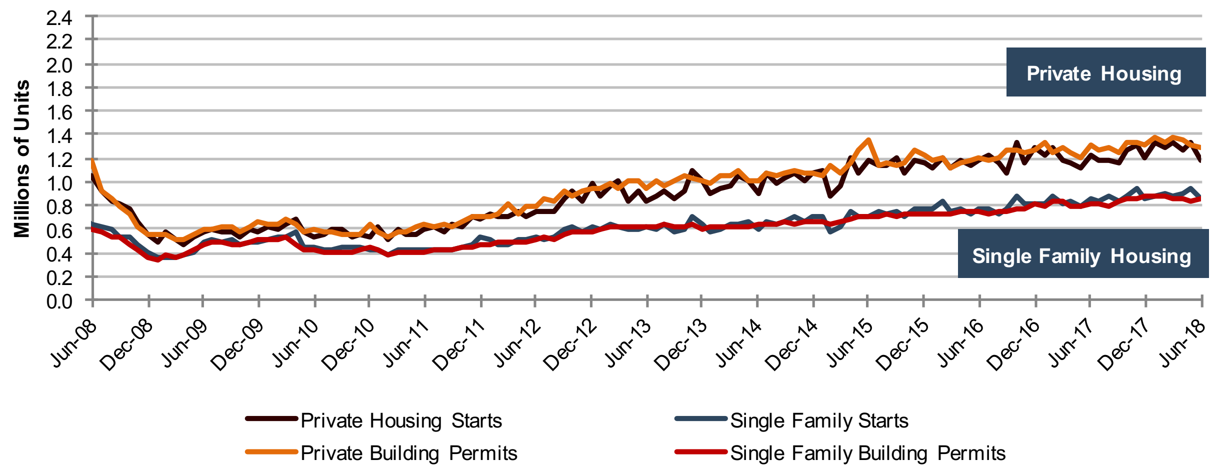
Source: National Association of Home Builders
Note: RMI is measured quarterly and approximated for a monthly basis using a straight-line approach.

Sector Round-up

Residential Construction (continued)

Building permits and housing starts are two important indicators for the home building industry. Both reflect demand, consumer confidence, and the feasibility of financing construction projects. Building permits can be issued and then shelved by builders; therefore, housing starts are a better focused measure of current activity within the industry. After declining nearly 75% during from Q1 2006 to Q1 2009 as the housing bubble deflated, housing permits and starts have steadily recovered but are unlikely to reach pre-recession highs. After strong growth in the first quarter of 2018 and low existing inventory, housing starts had a disappointing second quarter as single family starts stagnated year-over-year and private housing starts declined 4.2%.

Seasonally Adjusted Annualized Rates of New Housing Starts and Building Permits



Source: U.S. Census Bureau, Seasonally Adjusted Data
Note: Permits at a given date are generally a leading indicator of future starts.
Beginning with January 2004, building permit data reflects the change to the 20,000 place series.

Private Housing Starts		Single Family Starts		Private Building Permits		Single Family Building Permits	
Period	**% Change**	**Period**	**% Change**	**Period**	**% Change**	**Period**	**% Change**
Q-o-Q	-11.6%	Q-o-Q	-2.7%	Q-o-Q	-6.2%	Q-o-Q	0.2%
Y-o-Y	-4.2%	Y-o-Y	-0.2%	Y-o-Y	-1.5%	Y-o-Y	4.9%

Bellwether Stocks & Industry Participants

	Ticker	Price at 6/30/18	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Residential										
Beazer Homes USA, Inc.	NYSE: BZH	14.75	7.5%	2,012	1,641	73.7%	4.6%	17.87	15.13	NM
D.R. Horton, Inc.	NYSE: DHI	41.00	18.6%	15,722	17,899	16.7%	12.8%	8.91	7.66	11.80
KB Home	NYSE: KBH	27.24	13.6%	4,520	4,068	49.7%	7.9%	11.37	7.40	19.76
Lennar Corporation	NYSE: LEN	52.50	0.4%	15,487	27,767	40.0%	10.0%	17.93	9.03	13.89
LGI Homes, Inc.	NasdaqGS: LGIH	57.73	43.7%	1,470	1,825	29.8%	13.5%	9.17	7.88	8.83
M.D.C. Holdings, Inc.	NYSE: MDC	30.77	-5.9%	2,726	2,419	38.5%	8.5%	10.49	7.07	9.18
NVR, Inc.	NYSE: NVR	2,970.35	23.2%	6,819	10,942	5.3%	14.4%	11.13	9.91	16.74
PulteGroup, Inc.	NYSE: PHM	28.75	17.2%	9,461	11,382	28.5%	15.0%	8.00	7.48	11.23
Taylor Morrison Home Corporation	NYSE: TMHC	20.78	-13.5%	3,941	3,450	38.1%	9.3%	9.39	7.82	12.26
Meritage Homes Corporation	NYSE: MTH	43.95	4.1%	3,387	2,925	42.3%	8.4%	10.23	8.44	10.11
TRI Pointe Group, Inc.	NYSE: TPH	16.36	24.0%	3,201	3,635	36.9%	14.0%	8.12	7.54	9.79
Median			**14%**	**3,941**	**3,635**	**38.1%**	**10.0%**	**10.23**	**7.82**	**11.51**

All figures reported in millions, except per share data

Source: Capital IQ

Bellwether Stocks & Industry Participants

	Ticker	Price at 6/30/18	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Building Materials										
Eagle Materials Inc.	NYSE: EXP	104.97	13.6%	1,414	5,651	11.4%	29.7%	13.46	10.59	18.81
Martin Marietta Materials, Inc.	NYSE: MLM	223.33	0.3%	3,814	15,668	18.6%	27.3%	15.07	12.44	19.46
Summit Materials, Inc.	NYSE: SUM	26.25	-7.8%	2,040	4,596	38.5%	19.8%	11.37	8.99	27.34
U.S. Concrete, Inc.	NasdaqCM: USCR	52.50	-33.2%	1,428	1,624	45.9%	11.4%	9.94	6.64	25.44
Vulcan Materials Company	NYSE: VMC	129.06	1.9%	4,127	19,997	15.5%	24.3%	19.93	16.17	26.24
CEMEX, S.A.B. de C.V.	BMV: CEMEX CPO	0.66	-29.5%	13,567	21,129	51.4%	18.3%	8.50	7.68	18.03
CRH plc	ISE: CRG	35.41	0.2%	29,534	37,018	28.2%	12.4%	10.15	8.75	13.91
HeidelbergCement AG	DB: HEI	84.38	-12.7%	20,202	29,942	44.7%	15.8%	9.37	7.51	13.63
LafargeHolcim Ltd	SWX: LHN	48.70	-15.0%	26,655	46,288	39.7%	4.8%	36.04	7.39	NM
Median			**-8%**	**4,127**	**19,997**	**38.5%**	**18.3%**	**11.37**	**8.75**	**19.14**
Roads, Bridges, and Highways										
Granite Construction Incorporated	NYSE: GVA	55.66	15%	3,129	2,324	16.1%	6.3%	11.71	8.41	37.73
Sterling Construction Company, Inc.	NasdaqGS: STRL	13.03	-0.3%	1,049	389	19.7%	4.4%	8.39	6.73	16.68
Tutor Perini Corporation	NYSE: TPC	18.45	-35.8%	4,541	1,550	47.2%	4.5%	7.57	5.03	7.84
Median			**0%**	**3,129**	**1,550**	**19.7%**	**4.5%**	**8.39**	**6.73**	**16.68**

All figures reported in millions, except per share data

Source: Capital IQ

Note: CX, CRG, HEI, and LHN report in foreign currency. Margin and multiples unaffected and shown for analysis.

Bellwether Stocks & Industry Participants

	Ticker	Price at 6/30/18	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Nonresidential										
AECOM	NYSE: ACM	33.03	2%	19,706	8,601	42.3%	3.8%	11.45	8.65	37.21
Dycom Industries, Inc.	NYSE: DY	94.51	6%	2,768	3,640	20.5%	9.2%	14.23	8.20	25.25
EMCOR Group, Inc.	NYSE: EME	76.18	16.5%	7,754	4,408	6.4%	6.2%	9.21	9.45	18.28
Fluor Corporation	NYSE: FLR	48.78	7%	19,677	6,799	19.5%	3.9%	8.77	7.76	27.12
Jacobs Engineering Group Inc.	NYSE: JEC	63.49	16.7%	13,496	10,773	20.7%	7.0%	11.39	9.04	28.53
MasTec, Inc.	NYSE: MTZ	50.75	12%	6,573	5,390	28.8%	8.4%	9.77	7.48	12.32
Quanta Services, Inc.	NYSE: PWR	33.40	1.5%	10,162	5,801	14.6%	6.8%	8.41	6.63	16.56
Median - Nonresidential			**7%**	**10,162**	**5,801**	**20.5%**	**6.8%**	**9.77**	**8.20**	**25.25**

All figures reported in millions, except per share data

Source: Capital IQ

Mercer Capital

Construction & Building Materials Industry Services

Mercer Capital provides valuation and transaction advisory services to the construction and building materials industries.

Industry Segments

Mercer Capital serves construction industry segments from to commercial and civil to residential. We also serve the building materials sector from aluminum and steel to brick, glass, and lumber.

Mercer Capital Experience

- Family and management succession planning
- Buy-side and sell-side transaction advisory assistance
- Conflict resolution and litigation support
- Trust and estate planning
- Buy-sell agreement valuation, design, and funding advisory

Contact a Mercer Capital professional to discuss your needs in confidence.

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