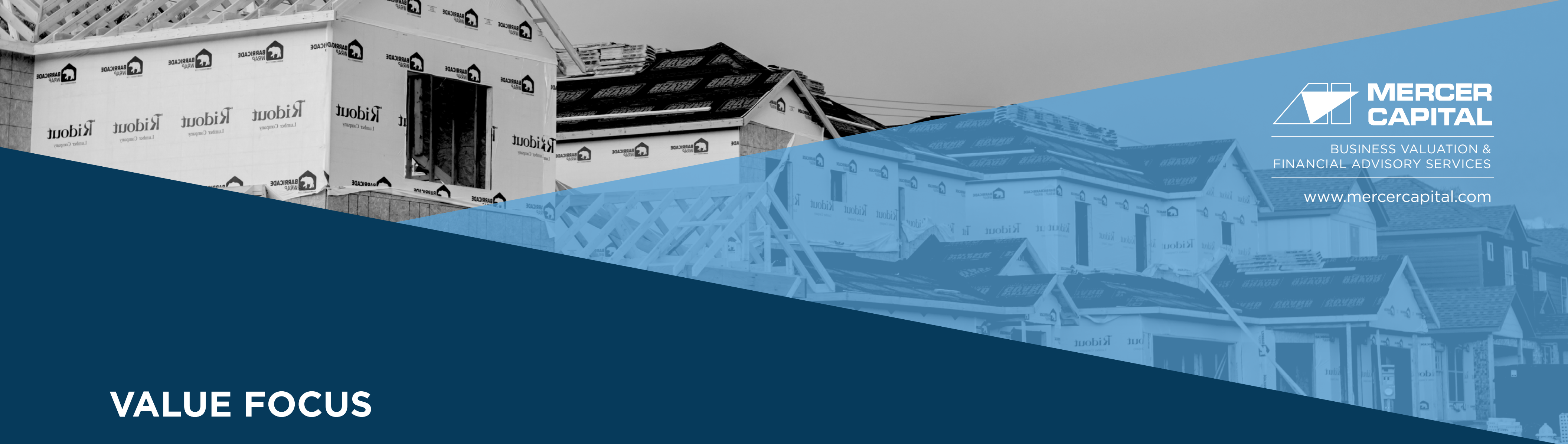

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VALUE FOCUS

Construction & Building Materials

First Quarter 2019 | Segment Focus: Residential Construction

Executive Industry Trends

- Housing market activity picks up after a tepid second half of 2018 as mortgage rates decline and ease concerns over affordability.
- 30-year mortgage rates and 10 year treasury yields declined 17 and 27 basis points respectively year-over-year. As the Fed continues its wait-and-see approach on future rate hikes, market sentiment is increasingly predicting that the next move will be to cut rates.
- The lower-priced entry-level home segment is set to drive further housing market growth as increased prices have slowed demand in the higher-priced move-up and luxury segments.

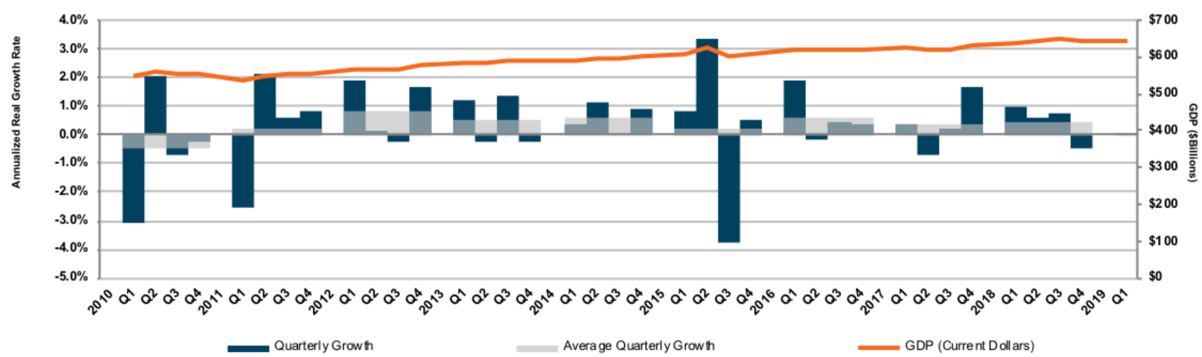
In This Issue

Construction Overview

Construction & National GDP

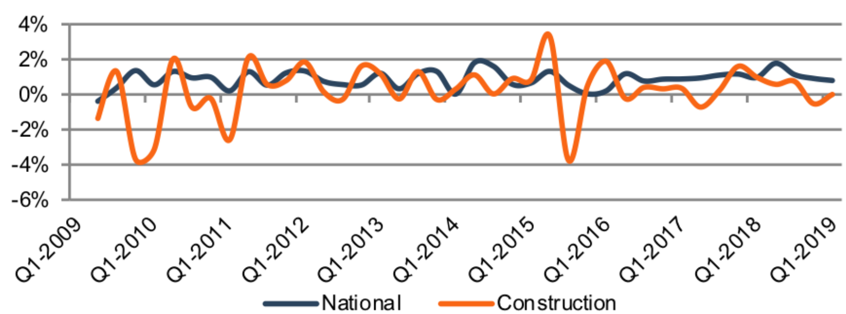
National GDP rose 5.0% over the past year through the first quarter of 2019, decelerating slightly from period highs. Since 2009, construction has averaged 3.5% of national GDP, and it accounted for 3.1% of GDP during 1Q 2019. Construction has steadily recovered since the decline precipitated by the 2008 financial crisis, experiencing growth consistent with that of the 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 0.9%. The deceleration in construction GDP growth in the fourth quarter of 2018 was primarily due to slowing residential construction activity. Despite improved corporate profitability, political and trade tensions are weighing on the outlook for industry growth as well as concerns over the length of the current credit cycle.

Construction Gross Domestic Product



Source: Bureau of Economic Analysis

% Change in GDP



Construction GDP	
Period	**% Change**
Q-o-Q	0.0%
Y-o-Y	0.9%

National GDP	
Period	**% Change**
Q-o-Q	0.9%
Y-o-Y	5.0%

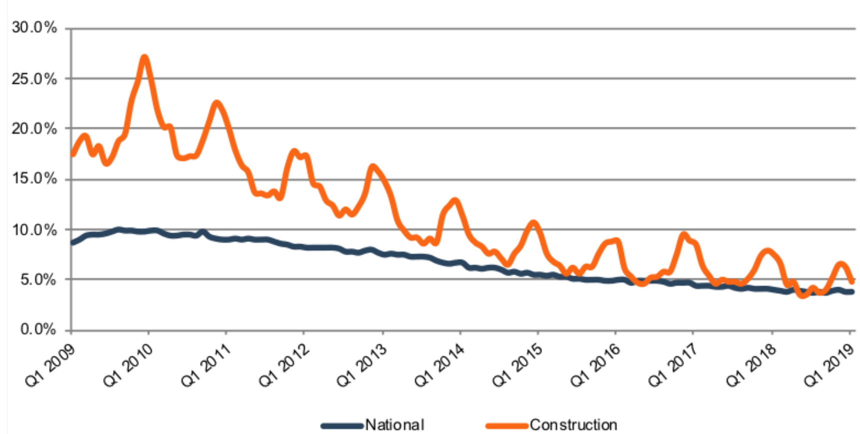
Construction Overview

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 3.8% falls below this range, indicative of a tight labor market. The unemployment rate in September and November fell to the lowest rate of the ten year period.

The unemployment rate in the construction industry is typically more volatile because it is a cyclical and seasonal industry. The major contributing factor to the seasonal nature of the industry is the weather. Production of materials and projects generally decrease during the colder, winter months. Construction unemployment is currently at 4.7%, below the level of 7.4% at the same time last year. The construction unemployment rate fell to a period low of 3.7% in September and November 2018. A lack of skilled laborers has become an industry wide issue and has contributed to wage growth and increased costs for builders.

Unemployment Rate



Source: U.S. Bureau of Labor Statistics

Note: The national unemployment rate is seasonally adjusted, but the construction unemployment rate is not to show seasonality and recent trends.

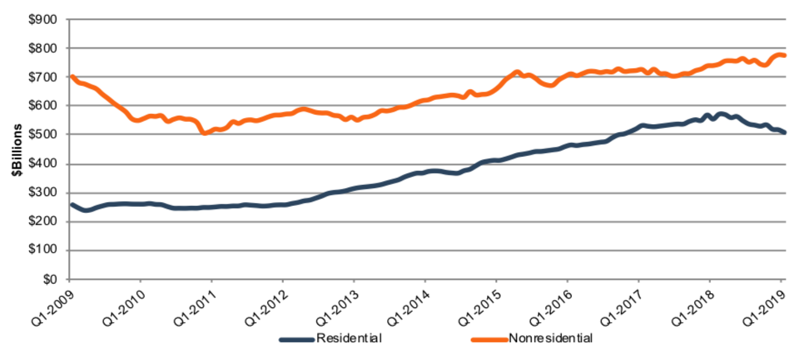
Construction Overview

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, engineering costs, interest, and taxes.

Year-over-year put-in-place construction has decreased by 8.4% for residential and increased by 4.8% for nonresidential. Residential construction declined by 4.9% quarter-over-quarter through March 2019. After declining in late 2018, put-in-place nonresidential construction increased 4.4% over the first quarter of 2019. Construction loans increased in the first quarter to a post-crisis high of $354 billion after declining slightly in the fourth quarter of 2018. The saga of the multi-trillion dollar infrastructure bill continues as any potential legislation may be pushed to 2020 as tensions between Democrats in Congress and the President have risen amidst investigations of the President.

Value of Construction Put-in-Place



Source: U.S. Census Bureau

Residential	
Period	**% Change**
Q-o-Q	-4.9%
Y-o-Y	-8.4%

Nonresidential	
Period	**% Change**
Q-o-Q	4.4%
Y-o-Y	4.8%

Sector Focus

Residential Construction

As the housing construction cycle enters its eighth year, it looks to recover from a choppy end of 2018. Housing market activity slowed in the second half of 2018 as rising interest rates and multiple years of price appreciation softened demand and buyers took a wait-and-see approach. The stock market decline in late 2018 may have also negatively impacted consumer sentiment. As rates have retreated in the first quarter of 2019 (the monthly 30-year rate decreased from 4.87% in Nov. '18 to 4.27% in Mar. '19) and price appreciation decelerated, new home demand has recovered as sales for new homes, rose. The total months' supply of housing declined in the first quarter after building up through the end of 2018 which contributed to the deceleration in pricing. The lower-priced entry level new home segment is currently placed well to drive relative growth going forward. The focus remains on affordability as prices are still high albeit increasing at a less rapid pace. According to Bloomberg Intelligence, the premium of new-home sales stands at more than 30% over resales versus 19% historically. However, if rates continue to decline, the move-up and luxury housing segments may improve.

Rising input costs in land and labor continue to be a concern for homebuilders. Land, labor, and material costs currently make up 80% of the average selling price on a new single family home, and increases in these costs could present a 100 bps headwind to gross margins in 2019 which is still lower than 2018. Currently, aggregate cost of materials is down 1% in 2019 due to a significant decline in lumber costs. Lumber costs are down 25% in comparison to the average over the same period a year ago. The labor shortage has pushed the cost of labor up by an average of about 5% annually. Immigration remains a key release valve for a tighter labor supply. Any fallout from ongoing trade tensions may negatively impact the supply of immigrant labor. Increased use of sales incentives to stoke ailing demand will also cut into companies' margins. As mortgage rates have declined in the first quarter, home builders may have more negotiating power in setting prices.

While higher materials and energy costs do not vary significantly by region, labor costs can vary markedly by region and city. A tight labor market has also increased the competition for employees in the construction industry and driven up wage costs. Labor shortages are affecting contractors' capacity for work and may be limiting potential levels of activity. According to data from BuildZoom, the most expensive cities for construction are predominantly located in expensive coastal cities (New York, San Francisco, Boston, Philadelphia, and Los Angeles) where labor costs have outpaced the rise in materials costs. The least expensive cities for construction are located in the south including Austin, Jacksonville, Little Rock, and Knoxville.

Sector Focus

Residential Construction (cont.)

Millennials will be influential in determining future housing demand as the average age of a first-time homebuyer is 33 years old (according to Zillow). Despite lackluster wage growth, strong job growth and employment amongst the millennial generation entering their early 30s should drive demand for entry level homes. A potential headwind for this age group is student debt. More than 20% of Americans are currently paying off student loans. As student loan delinquencies have increased, the younger population's credit scores have been disproportionately affected which may negatively impact the demand for new housing.

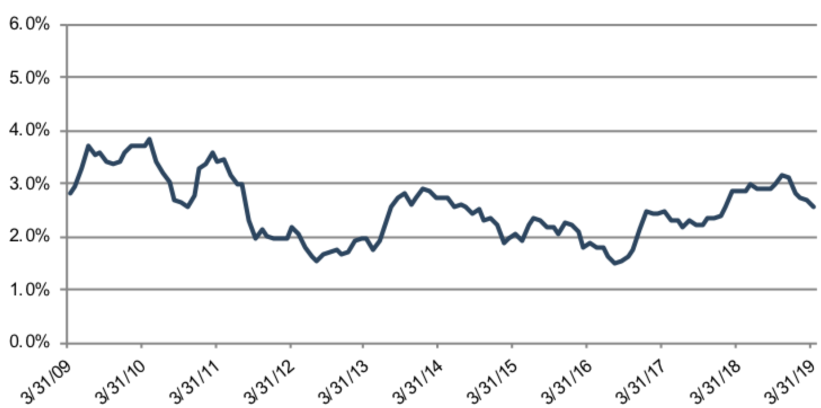
After raising the target Federal Funds rate to 2.25%-2.50% in December 2018, the Fed has maintained a "wait and see" approach regarding the future path of interest rate decisions. The currently flat yield curve as well as the Libor and Fed–funds futures markets are increasingly hinting that the next Fed decision will be an interest rate cut. If so, then mortgage rates may have reached their cycle peak in late 2018 and continue to decline.

Residential Construction

30-Year Mortgage Rate

The 30-year mortgage rate is the most common financing tool home buyers use in the U.S. Rising mortgage rates mean a higher overall cost to consumers, and therefore, a decrease in the demand for homes. Mortgage rates have decreased by 17 basis points over the past year and 37 basis points over the first quarter of 2019 after peaking in late 2018. Despite the steep decline in early 2019, mortgage rates remain above the period average. The first quarter decline prompted a renewed wave of refinancing as mortgage originations had suffered over the previous couple of years due to rising rates. The National Association of Home Builders (NAHB) economic forecast projects that mortgage rates will recover through 2019.

Yield on 10-Year Treasury



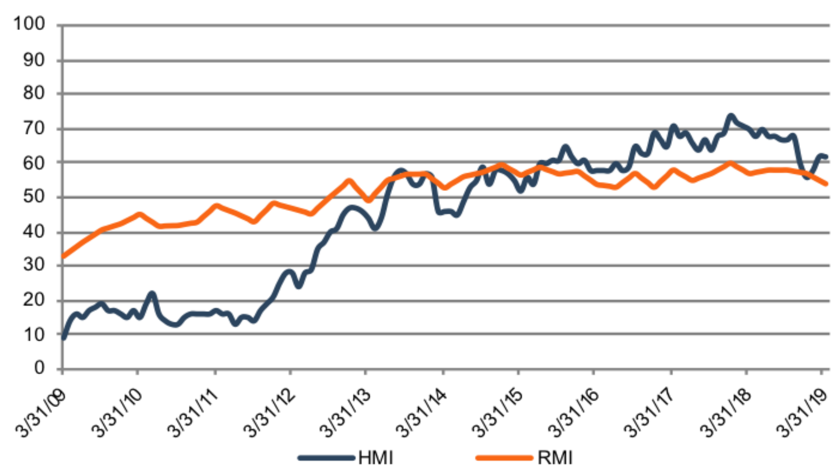
Yield on 10-Year Treasury	
Period	**% Change**
Q-o-Q	-37 BPS
Y-o-Y	-17 BPS

Residential Construction

NAHB Indicies

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 HMI recovered in the first quarter of 2019 after housing market activity had softened in late 2018. The RMI is produced quarterly and asks respondents to rate their work volume as either higher or lower than the previous quarter. The quarterly index has fluctuated between 50 and 60 since the second quarter of 2013.

National Association of Home Builders HMI and RMI



NAHB HMI	
Period	**% Change**
Q-o-Q	10.7%
Y-o-Y	-11.4%

NAHB RMI	
Period	**% Change**
Q-o-Q	-5.3%
Y-o-Y	-5.3%

Source: National Association of Home Builders

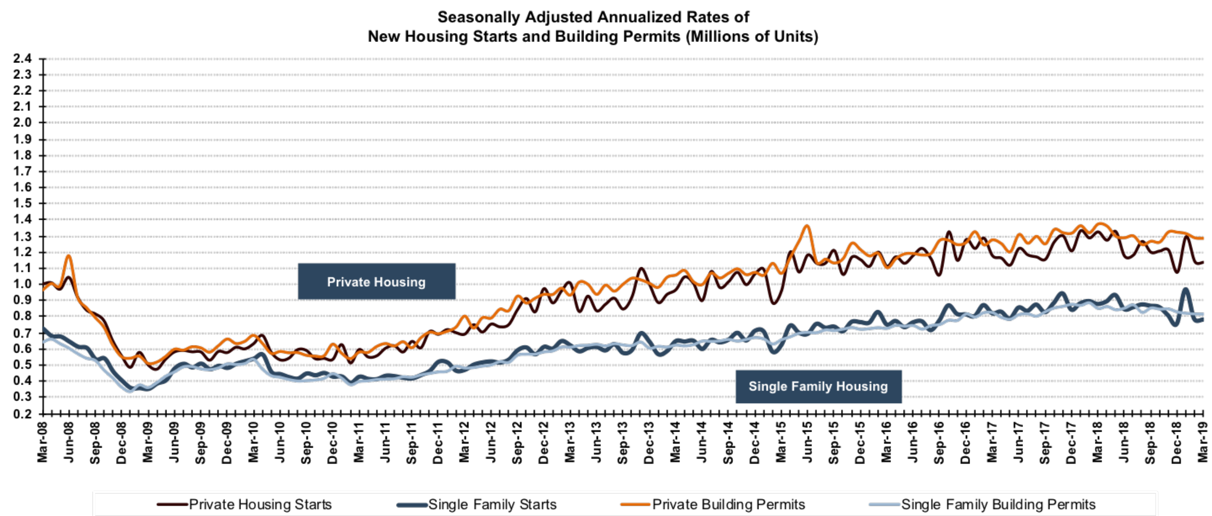
Note: RMI is measured quarterly and approximated for a monthly basis using a straight-line approach.

Residential Construction

Housing Starts & Permit

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 unwound, housing permits and starts have steadily recovered but are unlikely to reach pre-recession highs. After mixed performance throughout most of 2018, housing starts declined year-over-year as of the first quarter of 2019. Construction starts for single family homes rose in the first quarter but declined slightly for multifamily homes.

Seasonally Adjusted Annualized Rates of New Housing Starts and Building Permits (Millions of Units)



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

Private Housing Starts	
Period	**% Change**
Q-o-Q	5.7%
Y-o-Y	-14.2%

Single Family Starts	
Period	**% Change**
Q-o-Q	3.6%
Y-o-Y	-11.0%

Private Building Permits	
Period	**% Change**
Q-o-Q	-2.9%
Y-o-Y	-6.5%

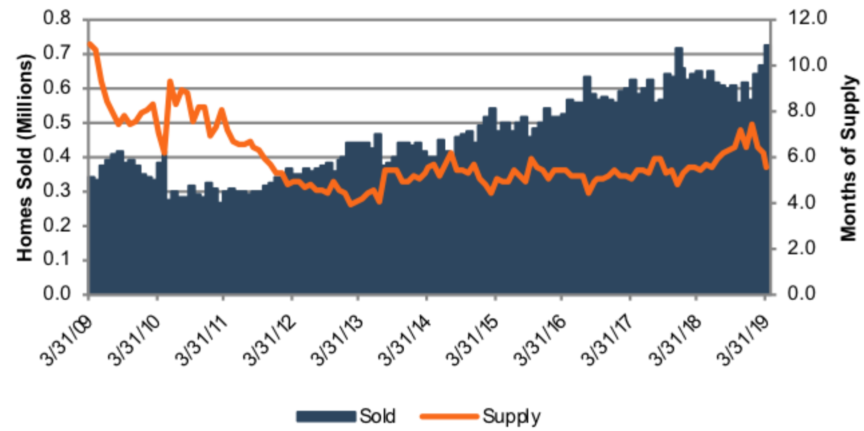
Single Family Building Permits	
Period	**% Change**
Q-o-Q	-1.6%
Y-o-Y	-4.1%

Residential Construction

New and Existing Home Sales & Months of Supply

New and existing home sales give a sense of the market demand for houses. Sales track the number of homes actually sold in a month. Months of supply is another measure of the home buying market; it shows how long it would take for all of the homes currently on the market to be purchased. It is alternatively known as the absorption rate. Six months is considered average and lower levels signify a pricing advantage for sellers and vice versa. Supply has dropped back below pre-recession levels, while new homes sold continue to increase and are up 10.6% year-over-year. More stringent bank lending standards, as well as higher interest rates and lower income growth relative to housing price appreciation, have contributed to the decline in existing homes sold.

New Homes Sold and Months of Supply

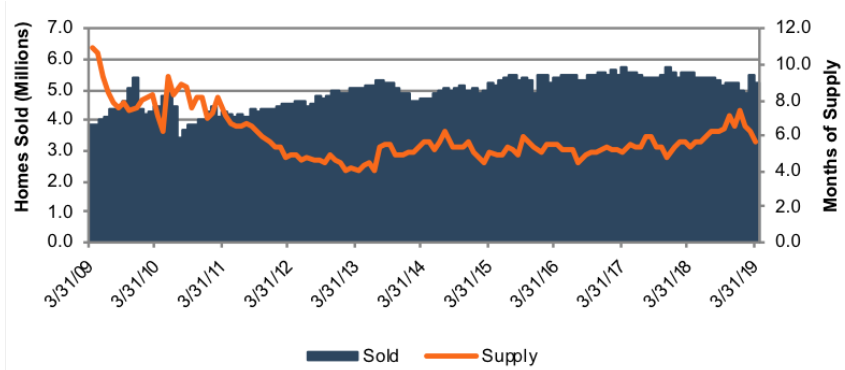


Source: St. Louis Federal Reserve

New Homes Sold	
Period	**% Change**
Y-o-Y	10.6%

Month of Supply	
Period	**% Change**
Y-o-Y	3.7%

Existing Homes Sold and Months of Supply



Source: St. Louis Federal Reserve

Existing Homes Sold	
Period	**% Change**
Y-o-Y	-7%

Month of Supply	
Period	**% Change**
Y-o-Y	3.7%

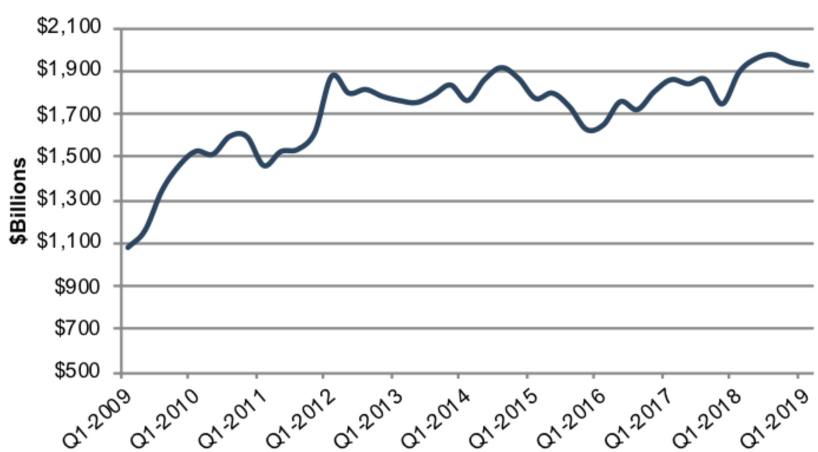
Sector Round-up

Nonresidential Construction

Corporate profit is essential for companies not only to survive, but 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.

Office rental vacancy can also be a signal for new commercial construction demand. Low vacancy rates indicate a need for more space for companies to conduct business, which is a boon for the nonresidential construction industry. Both suburban and downtown vacancy rates have remained stable at cycle lows for the previous couple of years as strong demand has absorbed supply as it has become available. New construction has been predominantly concentrated in a small number of metro markets such as Manhattan, Washington D.C., and San Francisco. Growth in office employment, another driver of construction demand, is projected to be highest in Sunbelt and tech markets.

Corporate Profit



Corporate Profit	
Period	**% Change**
Q-o-Q	-0.8%
Y-o-Y	1.6%

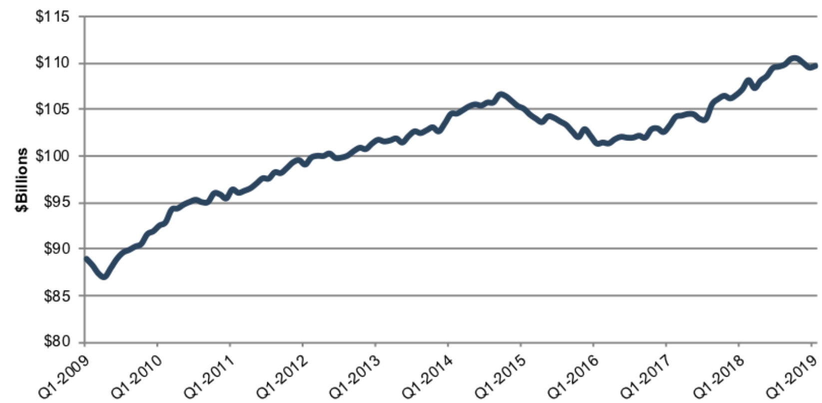
Sector Round-up

Building Materials

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 for the level 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 December 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 5.8% over the past year. Increased renovation and safety requirements have driven an increase in power construction spending as well as a focus on natural gas and renewable energy sources. Spending on water supply construction is expected to increase as most of the country's pipeline system was installed in the mid-20th century and will need to be replaced or renovated.

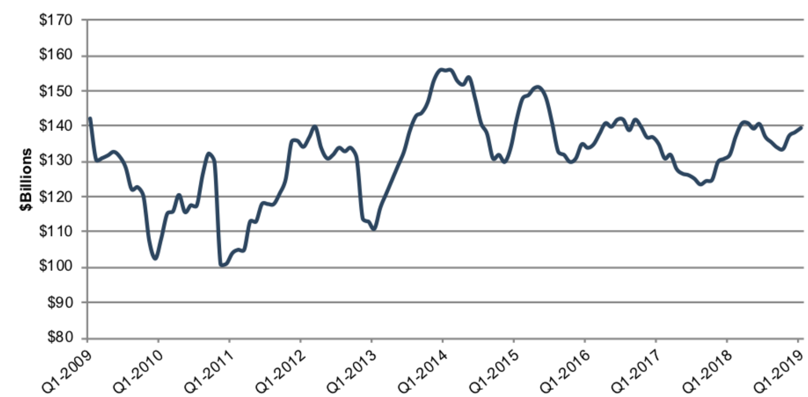
Industrial Production Index



Source: St. Louis Federal Reserve

Industrial Production Index	
Period	**% Change**
Q-o-Q	-0.7%
Y-o-Y	2.3%

Value of Utilities Construction



Source: U.S. Census Bureau

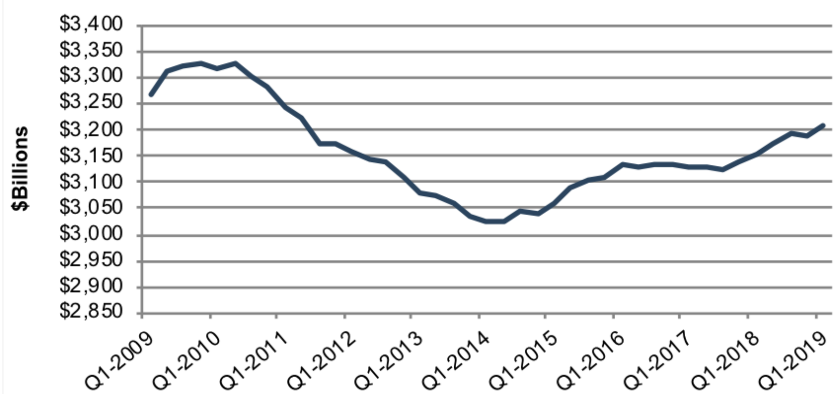
Value of Utilities Construction	
Period	**% Change**
Q-o-Q	4.5%
Y-o-Y	5.8%

Sector Round-up

Roads, Bridges, and Highways

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 grew throughout most of 2018 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. State budgets and budgets have generally grown the past couple of years. 31 states have passed legislation to increase funding since 2012.

Government Consumption and Investment



Government Consumption and Investment	
Period	**% Change**
Q-o-Q	0.6%
Y-o-Y	1.8%

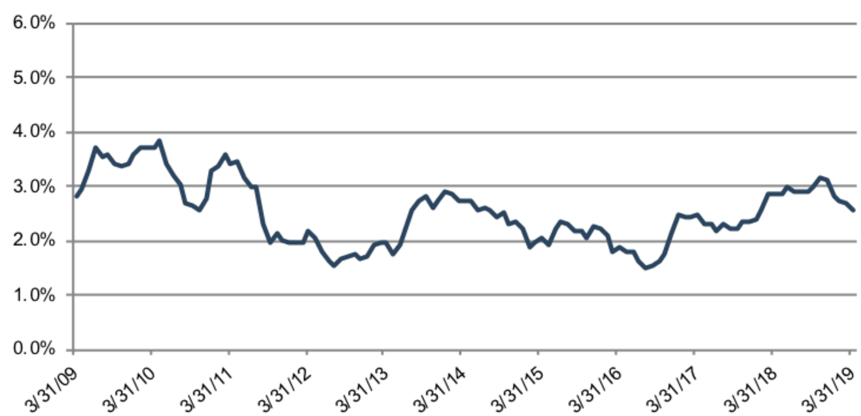
Sector Round-up

Roads, Bridges, and Highways (cont.)

The yield on 10-Year Treasury Bonds can indirectly affect the road contracting industry. 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. After a temporary interim period of increases, the 10-year yield has decreased 27 basis points over the past year.

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 0.16% in December 2018 which is the lowest monthly 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	-1 BPS
Y-o-Y	-27 BPS

Mergers and Acquisitions

Taylor Morrison Home Corp. (NYSE: TMHC) completed its acquisition of AV Homes (NASDAQ: AVHI) for nearly $1 billion in the fourth quarter of 2018. The acquisition of AV Homes increased Taylor Morrison's scale in five markets - Orlando, Phoenix, Charlotte, Raleigh, and Dallas – as well as added the new market of Jacksonville. Taylor Morrison should move from a top 10 builder to top 5 or higher in the overlapping markets. AV Homes also increases Taylor Morrison's presence in the more affordable entry-level home segment of the market. As previously discussed, the entry-level home segment is positioned well to drive further growth in the housing market due to concerns over affordability in the current climate. TMHC management indicated that the company should be able to realize $40 million in cost synergies from the acquisition which they reiterated in their 1Q19 earnings call. Total revenues in 1Q19 increased 23% to $925 million compared to the prior year first quarter and home-closing increased 25% to 1,938 as the AV acquisition boosted top line growth.

Bellwether Stocks & Industry Participants

	Ticker	Price at 3/31/19	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	11.51	-27.8%	2,103	1,524	78.7%	4.5%	16.11	8.27	NM
D.R. Horton, Inc.	NYSE: DHI	41.38	-5.6%	16,588	18,264	19.0%	12.6%	8.74	7.98	9.97
KB Home	NYSE: KBH	24.17	-15.0%	4,487	3,793	51.2%	8.6%	9.82	8.05	7.84
Lennar Corporation	NYSE: LEN	49.09	-16.7%	21,459	24,360	40.1%	12.2%	9.33	8.87	8.94
LGI Homes, Inc.	NasdaqGS: LGIH	60.24	-14.6%	1,513	1,975	33.2%	12.8%	10.19	8.58	9.34
M.D.C. Holdings, Inc.	NYSE: MDC	29.06	12.4%	3,103	2,488	38.6%	10.0%	8.02	7.11	8.35
NVR, Inc.	NYSE: NVR	2,767.00	-1.2%	7,349	9,945	6.4%	14.1%	9.57	10.99	12.20
PulteGroup, Inc.	NYSE: PHM	27.96	-5.2%	10,215	10,080	30.1%	14.5%	6.82	7.25	7.81
Taylor Morrison Home Corporation	NYSE: TMHC	17.75	-23.8%	4,400	3,833	52.7%	8.3%	10.45	9.14	9.40
Meritage Homes Corporation	NYSE: MTH	44.71	-1.2%	3,494	2,710	43.8%	8.6%	9.01	7.98	8.46
TRI Pointe Group, Inc.	NYSE: TPH	12.64	-23.1%	3,174	2,931	45.1%	11.2%	8.25	8.88	8.11
Median - Residential			**-14.6%**	**4,400**	**3,793**	**40.1%**	**11.2%**	**9.33**	**8.27**	**8.70**

All figures reported in millions, except per share data

Source: Capital IQ

Bellwether Stocks & Industry Participants

	Ticker	Price at 3/31/19	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	84.30	-18.2%	1,393	4,479	15.2%	29.6%	10.88	9.66	57.07
Martin Marietta Materials, Inc.	NYSE: MLM	201.18	-3.0%	4,105	15,638	22.6%	26.5%	14.39	12.80	25.17
Summit Materials, Inc.	NYSE: SUM	15.87	-47.6%	2,119	3,521	51.9%	17.9%	9.27	7.88	93.95
U.S. Concrete, Inc.	NasdaqCM: USCR	41.42	-31.4%	1,512	1,407	53.3%	11.6%	8.01	6.52	21.87
Vulcan Materials Company	NYSE: VMC	118.40	3.7%	4,525	18,509	17.8%	25.2%	16.23	14.32	29.63
CEMEX, S.A.B. de C.V.	BMV: CEMEX CPO	0.47	-29.3%	14,181	19,027	61.6%	16.9%	7.92	7.08	14.73
CRH plc	ISE: CRG	31.03	-8.6%	30,673	33,554	30.0%	12.5%	8.76	7.77	15.76
HeidelbergCement AG	DB: HEI	71.87	-26.8%	20,768	25,230	46.9%	14.9%	8.13	6.73	10.76
LafargeHolcim Ltd	SWX: LHN	49.41	-9.9%	27,914	46,263	35.7%	19.9%	8.32	6.88	19.30
Median - Building Materials			**-18.2%**	**4,525**	**18,509**	**35.7%**	**17.9%**	**8.76**	**7.77**	**21.87**
Roads, Bridges, and Highways										
Granite Construction Incorporated	NYSE: GVA	43.15	-23%	3,375	1,858	18.5%	6.1%	9.04	5.10	101.41
Sterling Construction Company, Inc.	NasdaqGS: STRL	12.52	9.2%	1,039	327	21.9%	4.3%	7.37	5.16	13.68
Tutor Perini Corporation	NYSE: TPC	17.12	-22.4%	4,385	1,482	52.4%	6.1%	5.56	4.79	9.00
Median - Roads, Bridges, and Highways			**-22.4%**	**3,375**	**1,482**	**21.9%**	**6.1%**	**7.37**	**5.10**	**13.68**

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 3/31/19	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	29.67	-17%	20,531	7,886	45.7%	4.1%	9.41	8.03	17.09
Dycom Industries, Inc.	NYSE: DY	45.94	-57%	3,128	2,174	37.7%	9.5%	7.34	6.51	22.82
EMCOR Group, Inc.	NYSE: EME	73.08	-6.2%	8,389	4,025	11.6%	6.1%	7.86	7.87	13.88
Fluor Corporation	NYSE: FLR	36.80	-36%	18,536	5,001	28.1%	4.0%	6.74	5.92	28.07
Jacobs Engineering Group Inc.	NYSE: JEC	75.19	27.1%	16,506	12,364	21.3%	6.3%	11.98	12.46	27.73
MasTec, Inc.	NYSE: MTZ	48.10	2%	7,031	4,978	34.0%	10.2%	6.91	6.37	13.44
Quanta Services, Inc.	NYSE: PWR	37.74	9.9%	11,561	6,365	23.9%	7.6%	7.20	6.95	15.06
Median - Nonresidential			**-6.2%**	**11,561**	**5,001**	**28.1%**	**6.3%**	**7.34**	**6.95**	**17.09**

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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